# In our veins

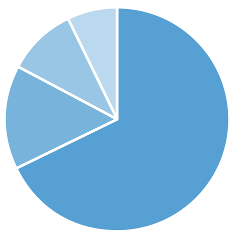
**HudBay Minerals Inc.** 2010 Annual Report




# HudBay At a Glance

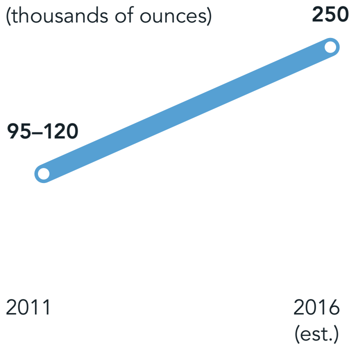
HudBay is an integrated mining company with operations, development properties and exploration activities in the Americas. Our mission is to create sustainable value through increased commodity exposure on a per share basis, in high-quality and growing long-life deposits in mining-friendly jurisdictions.

**2010 Metals Reserves**[1]

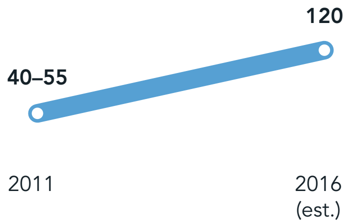


| | |
|---|---|
| Copper | **68%** |
| Precious metals[2] | **15%** |
| Zinc | **10%** |
| Molybdenum | **7%** |

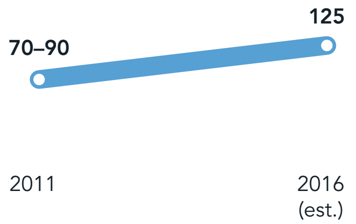
**Precious Metals**[2] **Production Volumes**
(thousands of ounces)




**Copper Production Volumes**
(thousands of tonnes)




**Zinc Production Volumes**
(thousands of tonnes)




**Copper production is projected to increase by approximately 155% between 2011 and 2016.**

[1] HudBay reserves as of January 1, 2010 plus Constancia reserves based on NI 43-101 technical report dated February 21, 2011. In-situ value calculated using commodity prices of US$900/oz Au, US$0.95/lb Zn, US$2.50/lb Cu and US$12.00/lb Mo. Silver converted to gold at ratio of 60:1. For additional information on our mineral reserve and resource disclosure, please refer to HudBay's Annual Information Form for the year ended December 31, 2010, available on SEDAR at www.sedar.com and the company's news release dated March 31, 2011.

[2] Reflects only gold and silver with silver converted to gold at a ratio of 60:1.


**Note:** We also own the Balmat zinc mine and concentrator in New York state, which are currently on care and maintenance, and the White Pine copper refinery in Michigan, which was closed in mid-2010 shortly after the closure of our Flin Flon copper smelter.

## EXPLORATION

**Back Forty, Michigan**

Back Forty is an advanced-stage exploration project that is evaluating a zinc- and gold-rich VMS deposit in Michigan's Upper Peninsula. We hold a 51% interest in the property, pursuant to a joint venture with Aquila Resources, and we can increase our interest to 65% by completing a feasibility study and making permitting applications. We are conducting an expanded drilling program, a trade-off study and engineering studies in preparation for permitting.

## OPERATIONS

### Flin Flon, Manitoba

- 777 and Trout Lake mines
- Flin Flon concentrator
- Zinc plant

Flin Flon is our main production platform. The 777 mine produces zinc, copper, gold and silver. Commercial production began in 2004, and the mine is expected to continue until 2020. The Trout Lake mine is in its final year of production. The state-of-the-art zinc plant processes zinc concentrate into finished metal. Since mid-2010, when the Flin Flon copper smelter closed, copper concentrate has been shipped to third-party copper smelters.

### Snow Lake, Manitoba

- Chisel North mine
- Snow Lake concentrator

Located 215 kilometres from Flin Flon, the Chisel North zinc mine began commercial production in 2000 and is scheduled to close in 2012 when production begins at the Lalor project. Zinc concentrate is transported to the Flin Flon zinc plant for processing.

### Zochem, Ontario

- Zinc oxide plant

Our subsidiary Zochem is located in Brampton, Ontario, and is Canada's largest zinc oxide manufacturer. Zinc oxide is used in rubber products, chemicals, ceramics, paints, pharmaceuticals and agriculture.

## DEVELOPMENT

### Lalor Project, Manitoba

The Lalor project is located three kilometres from the Chisel North mine. It will become our next major underground mine, and we expect to nearly double our company's gold output and increase zinc production by 55% once it is in full production in 2016. Construction is well advanced and initial production is expected to begin in 2012.

### Fenix Nickel Project, Guatemala

Acquired by HudBay in 2008, Fenix was a fully operational nickel laterite mining and smelting operation until it was placed on care and maintenance in 1980. We completed an updated feasibility study in 2010, and are continuing exploration, optimization and infrastructure development work on the property. A process is underway to seek potential partners and financing alternatives for the project.

### Constancia Project, Peru

We acquired the Constancia advanced-stage copper development project in March 2011 when we acquired Norsemont Mining Inc. It is a large-scale porphyry deposit with significant exploration upside in an established mining-friendly jurisdiction. We are completing feasibility optimization and exploration programs and expect to make a construction decision by early 2012.

### Reed Copper Project, Manitoba

We have a 70% interest in the copper-rich Reed project near Snow Lake, pursuant to a joint venture with VMS Ventures. In early 2011, we completed an infill drilling program and published an NI 43-101 resource estimate. We have begun an economic evaluation to assess the viability of the deposit. A construction decision is expected in late 2011, which could lead to production commencing in late 2012 or early 2013.

### Cold and Lost Properties, Manitoba

Located 110 kilometres from Flin Flon, the Cold and Lost properties are subject to an option agreement with Halo Resources. We completed an NI 43-101-compliant resource estimate in early 2011 and we intend to commence a pre-feasibility study to determine how the project fits with our long-term production plans.

### Tom and Jason, Yukon

At our 100%-owned Tom and Jason lead-zinc deposits, we are focused on upgrading resources from the inferred to indicated categories and on collecting metallurgical samples, with the intention of initiating a preliminary economic assessment in early 2012.

## OPERATIONS HIGHLIGHTS

| For the years ended December 31 | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Production** | | | |
| Copper (000 tonnes) | **52.4** | 48.4 | 50.1 |
| Zinc (000 tonnes) | **77.3** | 78.7 | 103.1 |
| Gold (000 troy ounces) | **87.2** | 92.2 | 102.8 |
| Silver (000 troy ounces) | **843.4** | 1,004.6 | 1,071.0 |

## FINANCIAL HIGHLIGHTS

| ($ millions)<br>For the years ended December 31 | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Revenue** | | | |
| Copper | **$ 380.8** | $ 354.2 | $ 553.3 |
| Zinc | **$ 178.3** | $ 172.8 | $ 176.8 |
| Gold | **$ 103.6** | $ 103.0 | $ 93.9 |
| Silver | **$ 20.8** | $ 35.5 | $ 27.6 |
| Other | **$ 108.2** | $ 60.8 | $ 149.7 |
| Less: Treatment and refining charges (TC/RC) | **$ (12.9)** | $ (5.6) | $ (19.4) |
| **Total revenue** | **$ 778.8** | $ 720.7 | $ 981.9 |
| **Earnings before tax** | **$ 158.1** | $ 141.5 | $ 168.6 |
| **Net earnings** | **$ 70.0** | $ 112.5 | $ 72.5 |
| **Total assets** | **$ 2,173.1** | $ 2,032.7 | $ 1,918.4 |
| **Shareholders' equity** | **$ 1,739.3** | $ 1,698.5 | $ 1,555.2 |
| **Cash and cash equivalents** | **$ 901.7** | $ 886.8 | $ 704.7 |
| **Dividend per share** | **$ 0.10** | | |

In 1927, our subsidiary Hudson Bay Mining and Smelting founded a mine that gave rise to a town in Manitoba, and today we are still there. We are also in Ontario, Michigan, Peru and Guatemala. After more than 85 years, we believe there is no one better when it comes to finding, building and operating a successful mine. That is our legacy and our future.

Photo above and on outside back cover courtesy of www.cityofflinflon.com

**In Our Veins –** Over the course of our history, we have built strengths in finding and exploiting mineral wealth and in consistently getting the most out of the mines we develop and operate. By now, these skills are not only a unique competitive advantage, they are part of HudBay's DNA.

## EXPLORATION

Our senior exploration team brings more than 230 years of combined experience studying volcanogenic massive sulphide (VMS) and porphyry mineral deposits. They have become specialists in applying innovative geophysical techniques to identify prospective targets as deep as 700 to 800 metres below the surface. Their mineral deposit discoveries have earned them two Bill Dennis Awards from the Prospectors and Developers Association of Canada (PDAC).
Learn more on page 16.

## MINE DEVELOPMENT

We have developed 26 mines in the Flin Flon Greenstone Belt, and have become particularly adept at driving underground ramps. While mine building is a complex process, our thorough understanding of the best ways to address the challenges associated with designing, permitting, financing and building projects equips us to bring mines into production on time and on budget.
Learn more on page 10.

Our growth strategy leverages our strengths. It is based on the belief that the greatest opportunities for creating shareholder value in the mining industry are in finding new deposits and bringing them into production, and in acquiring exploration and development properties that meet our strategic criteria.



## OPERATIONS

HudBay's operating mines and processing facilities consistently meet production targets and cost objectives. The key to this success is the 1,300 employees at our Flin Flon/Snow Lake operations, who have been with the company for an average of 19 years. We operate to the highest health, safety, quality and environmental standards, and have a strong performance-oriented culture – a key component of which is focused on continuous improvement at every stage of the process. Learn more on page 14.

## RESPONSIBILITY

Flin Flon and Snow Lake are thriving communities that have grown with HudBay as we have opened, and sometimes closed, mines and facilities. From the beginning, we have provided rewarding jobs, stimulated the local economy, helped build community infrastructure and maintained strong community relations. Engaging with our stakeholders and taking responsibility for our actions is the way we do business. Learn more on page 20.

## We aim to grow commodity exposure on a per share basis by:

Exploring and developing our existing properties and working with junior mining companies to access other opportunities

Acquiring VMS and porphyry exploration and development properties located in mining-friendly jurisdictions in the Americas and that have excellent exploration upside

Optimizing the value of our producing assets through safe and efficient operations

## INTERVIEW WITH THE CEO

**David Garofalo**
President and
Chief Executive Officer

## Q: What has impressed you most about HudBay since joining in July 2010?

HudBay is a fundamentally sound company that does the basics of finding, building and operating mines very well. The company has consistently met its production targets, even during periods of turmoil within the organization. It generates strong cash flow and has an exceptional balance sheet, enabling it to grow on a value-accretive basis. However, what impresses me most are the people – something you do not fully appreciate until you have worked with them. We have generations of families working here. Our people bring a depth of experience and expertise that few companies can match.

## Q: What are the key achievements of 2010?

One of the most important things we have done is to clarify our strategy – among ourselves and with the investment community. After 85 years of discovering and developing VMS deposits in northern Manitoba, we have recognized what we do very well, built our strategy around it, and started communicating it to the market.

By now, people who follow HudBay know that we intend to grow the company by focusing on VMS and porphyry deposits in low-risk jurisdictions in the Americas where we can add value through exploration and development. The market also appreciates that we have been able to execute on our strategy since July – by acquiring the Constancia project in Peru, by expanding our investment portfolio to a total of 14 junior exploration companies, and by making aggressive exploration commitments in the Flin Flon Greenstone Belt, Peru, Michigan, Yukon and Chile.

## Q: What was the significance of the NYSE listing and dividend introduction?

To broaden the appeal of HudBay stock, we not only needed a sound strategy for building the business, we also needed to tap into the deepest pool of capital in the world. By listing on the New York Stock Exchange and implementing a regular dividend, we are starting to appeal to a larger group of investors and helping to increase our overall trading liquidity. In fact, our representation among U.S. shareholders is already close to double what it was prior to our listing in October 2010.

## Q: What do you think investors need to know about HudBay?

Many people do not realize that we have turned the geological model in northern Manitoba on its ear, by drilling deeper than we have ever been able to go before and exploring for and discovering precious metals in what has been traditionally perceived as a base metal camp. Our innovative adaptation of electromagnetic geophysical surveys enables us to see below the limestone cover of the Flin Flon Greenstone Belt to depths of 700 and 800 metres. It is what led to the highly acclaimed 2007 discovery of the Lalor deposit, which has in turn created significant opportunity for HudBay to build a critical mass in the gold business. This expertise in geophysics is also driving our exploration strategy at properties around the world.

## Q: What is your gold strategy?

We intend to grow our gold business organically through exploration. We now have sizeable gold resources at Lalor, Back Forty, 777 and Constancia, and will continue to drill out these deposits in hopes of expanding gold production and reserves. Down the road, as we build critical mass, we may look at spinning out our gold business to capture a gold multiple for our shareholders. What we will not do is sell our precious metal streams to existing public royalty vehicles and forego the significant geological upside that we have at these deposits. We have the capital and expertise to optimize these assets ourselves.

## Q: Will you try to replace declining production before the Lalor mine comes on stream?

We are the first to acknowledge that there will be a production dip in 2012 when the Chisel North and Trout Lake mines have closed and before Lalor reaches full production. While it might be convenient to fill that gap by acquiring mature operations, it would be the wrong thing to do in the long term. In the mining business, value is created in exploration and construction.

For us, 2012 is a blip on the horizon. We are looking to perpetuate our five-year growth program. We will continue to optimize Lalor, which will be a focus in 2011. As it is, only half of the resource base of Lalor has been included in the current production profile. We plan to complete an optimized feasibility study that will incorporate more of the resource, and likely include a higher production rate.

We want to advance our Back Forty project in Michigan into permitting and construction as quickly as possible. While the Reed copper project in Manitoba is not yet in our production plans, we will be moving it along in 2011 and could start production by late 2012 or early 2013. And, of course, we now have Constancia in our portfolio, which could be in full production in 2016. What this means is that although there will be a production dip in 2012, we already have the projects in our pipeline to ramp back up as of 2014.

## Q: Where do acquisitions fit in your growth plans?

We will look to acquisitions to help build the next generation of growth – what comes next after work on Lalor and Constancia is substantially completed. While Constancia was a shovel-ready project, we will increasingly focus on smaller, early-stage projects, where we can add value by providing technical expertise and funding exploration programs. This is similar to what we have done with the Back Forty project – start small and then grow our interest into a majority stake if it makes sense to do so. This will mean more toehold investments in junior companies. Since July, we have more than doubled the number of companies we are invested in, and we consider these investments to be a farm system for future development-stage opportunities.

I should also point out that we intend to focus on transactions valued at 20% or less of our market capitalization. Generally speaking, large, transformational mergers and acquisitions are risky and value-destructive in the mining industry.

## Q: Why are you focused on per share metrics?

The most important reason is that we aim to create exceptional shareholder value. Investors today have choices. They do not need to buy mining equities to get their commodity exposure. But what they will miss is leverage to the commodity price. If a mining company is properly built and managed, it provides leverage by continually increasing its commodity exposure on a per share basis – keeping the share count low and finding more reserves and resources on a per share basis. That is how you create value and that is what will attract investors.

# We set a clear strategy in 2010. In 2011, it will be a matter of continuing to execute against that strategy.

David Garofalo, President and Chief Executive Officer

## Q: Does the Board support the new strategy?

Our Board of Directors is very supportive of our new strategy. They agree that we need to take a patient approach to building the business, and leveraging our core competencies of exploration and mine construction. This requires patient capital investment, consistent exploration budgets, stakes in a number of junior companies to diversify our exploration focus outside of our traditional areas of operation, and time – to establish a lot of opportunities that will eventually fill the pipeline.

## Q: What are your priorities for 2011?

Our two most pressing items of business are at Constancia and Lalor. With the Norsemont acquisition completed, we have outlined a US$116 million program in 2011 at Constancia for exploration, procurement, engineering and feasibility study optimization. We intend to be in a position to make a formal production decision in early 2012, which would be followed shortly afterwards by the commencement of construction.

At Lalor, we intend to finalize an optimized feasibility study by the third quarter of 2011, which incorporates more of the deeper copper-gold ore into the mine plan and increases the production rate accordingly. While the current plan contemplates a 3,500 tonne-per-day operation, we have sized the production shaft for 6,000 tonnes in anticipation of geologically-driven stage expansions of production well into the future.

We will also complete a trade-off study on whether to refurbish the Snow Lake concentrator, which is 15 kilometres away from Lalor, or construct a new concentrator at the mine site. While a new concentrator would require more capital, it would offer many advantages – enabling us to expand the production rate, bring more material into the mine plan, eliminate ore haulage costs and provide a source of paste backfill for the underground operations, which would help drive down operating costs. Additionally, with paste backfill, 15 to 20% of our tailings could go underground instead of going to an impoundment facility, so there would be some environmental benefits as well. A new concentrator would also enable us to build a gold plant and increase gold recovery rates.

In summary, we set a clear strategy in 2010. In 2011, it will be a matter of continuing to execute against that strategy.

**David Garofalo**
President and Chief Executive Officer

## STRENGTH IN MANAGEMENT











(left to right from top)

**David Garofalo**
President and Chief Executive Officer

**David S. Bryson**
Senior Vice President and Chief Financial Officer

**Alan T. C. Hair**
Senior Vice President, Business Development and Technical Services

**Tom A. Goodman**
Senior Vice President and Chief Operating Officer

**Ken Gillis**
Senior Vice President, Corporate Development

**John D. Bracale**
Country Manager, Guatemala and
President, Compañía Guatemalteca de Níquel, S.A.

**David G. C. Clarry**
Vice President, Corporate Social Responsibility

**Brad W. Lantz**
Vice President, Mining

**Cashel Meagher**
Vice President, Exploration

**John Vincic**
Vice President, Investor Relations and Corporate Communications

**Sharon Sanzo**
Vice President, Human Resources

HudBay's main operating platform is located in Flin Flon, Manitoba, where the company operates its flagship 777 mine and zinc plant.

# $902 million

**Record production from our flagship 777 mine resulted in positive results in 2010. We ended the year with $902 million in cash and are well positioned to pursue our strategic objectives for 2011 and beyond.**

MINE DEVELOPMENT

HudBay will spend more than $291 million on development projects in 2011 – at our northern Manitoba base and around the world. We are on a path to grow copper production by approximately 155% and precious metals production by 130% by 2016.

# Lalor

The Lalor project is on a fast track to become HudBay's next major underground mine, and is projected to nearly double the company's gold output and increase zinc production by 55% by 2016 once it is fully commissioned.

Located in the Chisel basin of the Flin Flon Greenstone Belt (FFGB), about three kilometres from the Chisel North mine, the Lalor deposit was discovered in 2007. Intensive exploration since then has identified separate and distinct zinc, gold and copper-gold zones. Based on current data, Lalor is estimated to hold the second-richest metal deposit ever discovered in the FFGB.

In 2010, we made a full commitment to Lalor by authorizing $560 million to advance the project to full production. The current mine plan contemplates production of 3,500 tonnes of ore per day over a 15-year projected life of mine.

Mine development began in late 2009 and continued throughout 2010 with the construction of a three-kilometre underground ramp from the Chisel North mine to the Lalor deposit. When completed, the ramp will enable early access to the zinc-rich base metals zone and establish an underground drilling platform near the gold zone. Completion of the ramp has been scheduled to coincide with the wind-down of operations at Chisel North in order to ensure a continuous source of zinc feed until Lalor reaches full production.

The Lalor project remains on schedule and on budget. In 2011, we will commence sinking a production shaft. Our plan is to use the same shaft design as at the 777 mine in order to minimize project development time and design risk.

## Plans for Lalor

While the Lalor mine plan currently contemplates a 3,500 tonne-per-day operation, we believe there is opportunity to expand well beyond this rate, and are working on an optimized feasibility study for completion in mid-2011.

Our production decision in 2010 was based on the resource identified to date and estimates of potential grades and quantities of the gold zone and copper-gold zone, along with other available information such as cost estimates and portions of the engineering design, which had been completed to a level suitable for the feasibility study. However, we recognized that there was upside at depth and that the ultimate production rate could be somewhat higher, once more information became available. The optimized feasibility study is expected to bring additional resources into the mine plan.

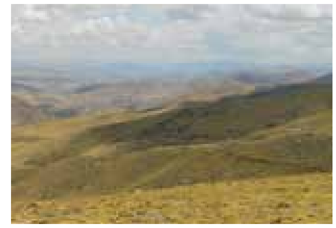
We are also conducting a trade-off study to determine whether to refurbish the existing Snow Lake concentrator, or construct a new concentrator at the mine site. The study indicates that the Lalor orebody is likely sufficient to support the construction of a new concentrator. We are continuing to evaluate options for the capacity and flowsheet of a new concentrator, and we expect to be in a position to make a decision on whether to proceed with a new concentrator in mid-2011.

## LALOR SNAPSHOT

| | |
|---|---|
| Ownership | 100% |
| Projected life of mine | 15+ years |
| Capital costs (2010–2014) | $560 million[1] |
| Annual sustaining capital expenditures | $15 million |
| Estimated mining cost/tonne | $56 |
| Estimated milling cost/tonne | $24 |

[1] Estimated costs at Lalor do not include incremental investments that may be incurred if a new concentrator is constructed.

# Constancia



In March 2011, we completed the acquisition of Norsemont Mining, owner of the Constancia advanced-stage copper development project, located in the Andes mountain range of southern Peru.

Constancia is a perfect fit with our strategy in that it is a large-scale porphyry deposit that offers significant exploration upside in an established mining-friendly jurisdiction with access to good infrastructure. We also have the financial capacity and mine development expertise to accelerate the development of Constancia.

The plan is to mine the Constancia deposit as a low-cost open pit, using large-scale bulk mining techniques. With this new asset in our portfolio, our future combined copper production is expected to grow by approximately 155% between 2011 and 2016. Constancia will also contribute to our precious metals production, which is expected to increase by 130% during the same period.

We have also announced a 2011 pre-construction program for the Constancia project of US$116 million. The program contemplates early equipment procurement for long lead items, a resource model update, a metallurgy review and pit optimization study, geotechnical and condemnation drilling and a US$9 million exploration program. The amounts budgeted for key items are as follows:

| **Constancia 2011 Program Budget** | **(US$ millions)** |
|---|---|
| Environmental, permitting, land | 12 |
| General and administrative | 12 |
| Engineering | 10 |
| Preliminary construction estimate | 27 |
| Preliminary procurement estimate | 46 |
| Exploration | 9 |
| TOTAL | 116 |

## Plans for Constancia[1]

| | |
|---|---|
| Ownership[2] | 100% |
| Projected life of mine | 15 years |
| Average annual copper production | 85,000 tonnes |
| Concentrator capacity | 70,000 tonnes per day |
| By-products | Molybdenum, gold, silver |
| Capital costs | US$920 million |
| Cash costs[3] | US$0.93/lb copper |

| **Reserves** | **Proven** | **Probable** |
|---|---|---|
| Tonnes (millions) | 195.00 | 177.00 |
| Cu (%) | 0.42 | 0.37 |
| Mo (g/t) | 117 | 92 |
| Ag (g/t) | 3.49 | 3.66 |
| Au (g/t) | 0.04 | 0.05 |

[1] Based on NI 43-101 technical report titled, "Constancia Project Technical Report", dated February 21, 2011.

[2] Subject to HudBay completing compulsory acquisition of remaining ~2% of Norsemont shares it does not currently own.

[3] Excludes sustaining CAPEX, which equates to approximately $0.09/lb Cu.

# Fenix

The Fenix nickel project in Guatemala was a fully operational nickel laterite mining and smelting operation until it was placed on care and maintenance in 1980. HudBay acquired the project with our acquisition of Skye Resources in 2008.

Fenix is one of the best undeveloped nickel projects in the world, with the potential to produce nearly 50 million pounds of nickel per year over a 26-year mine life, using conventional smelting technology. Environmental and construction permits have been received, and detailed engineering is well advanced.

In 2010, we completed an updated feasibility study, which included an increase in nickel reserve grade from 1.63% to 1.86%. There remains an opportunity to incorporate more high-grade resource into the mine plan and further improve the project's economics. For this reason, we are continuing our exploration and optimization efforts in the immediate area of Fenix.

At the same time, we are exploring financing alternatives and identifying potential strategic partners in order to reduce the risk profile for the project.

## FENIX SNAPSHOT

| | |
|---|---|
| Ownership | 98.2% |
| Projected life of mine | 27 years |

| **Reserves and Resources** | **Tonnes (millions)** | **Nickel (%)** |
|---|---|---|
| Proven and probable | 36.2 | 1.86 |
| Inferred | 9.7 | 1.80 |

## In 2010, we completed an updated feasibility study, which outlined 36 million tonnes of nickel at a grade of 1.86%.

OPERATIONS

## Consistent operating results underpin HudBay's strong overall performance. Ongoing investments in our mines, facilities, equipment and people enable us to realize the full potential of our assets and retain our skilled and dedicated workforce.

# Mining Operations

Production comes predominantly from our 777 mine, which has been a consistent, low-cost producer of zinc, copper, gold and silver since 2004. The mine operated at full capacity in 2010 with strong copper grades.

Production of contained metal in concentrate from our three operating mines (777, Trout Lake and Chisel North) met our 2010 targets. However, sales of copper concentrate lagged production due to limited rail car availability.

In 2010, we commenced the $20-million 777 North expansion, which involves driving a ramp from the surface to the 440-metre level to access gold, silver, copper and zinc zones that are connected to the underground workings of the 777 mine. Upon completion, 777 North will supply additional ore feed to the Flin Flon concentrator and zinc plant, and facilitate the development of an underground exploration platform to evaluate exploration opportunities near the mine. It will also help to sustain employment as the Trout Lake mine reaches the end of its mine life towards the end of 2011. Production is expected to begin in 2012 at a rate of 330 tonnes per day, producing approximately 5,500 tonnes of copper metal and 20,000 tonnes of zinc metal over the six-year life of the project.

The Chisel North mine was reopened in the second quarter of 2010, after having been on care and maintenance since January 2009 due to low zinc prices at the time. The mine is near the Lalor development project, and the restart enables us to share resources and infrastructure between the project and the operations for optimum efficiency. Production at Chisel North is projected to end in 2012, at which time we expect to be able to access the base metals zone at Lalor.

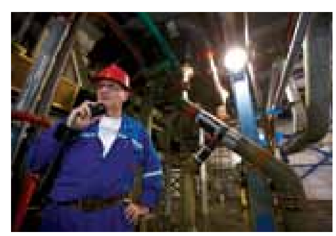
Contained metal production in concentrate in 2011 is expected to be similar to 2010, as we anticipate reduced production at Trout Lake will be offset by a full year of production at Chisel North and higher production and copper grades at the 777 mine.

## OPERATIONS SNAPSHOT

| Mine and Mill Production | 2010 | 2011 Forecast |
|---|---|---|
| Copper (tonnes) | 52,413 | 40,000–55,000 |
| Zinc (tonnes) | 77,314 | 70,000–90,000 |
| Precious metals[1] (ounces) | 101,233 | 95,000–120,000 |

[1] Precious metals production includes gold and silver production. Silver is converted to gold equivalent at a ratio of 60:1.

# Flin Flon Complex



Our integrated metallurgical complex at Flin Flon includes a concentrator, a state-of-the-art zinc plant and, until recently, a copper smelter. We closed the 80-year-old copper smelter in June 2010, and began selling our copper concentrate to third-party copper smelters.

The smelter was integral to operations at the Flin Flon complex and its closure required us to reconfigure infrastructure and processes at the site – and to invest heavily in employee training to ensure continued safe and efficient operations. We commissioned a new copper filter plant to dewater concentrate prior to shipping, and installed concentrate loading facilities. We also invested in an electric boiler to replace the steam formerly produced by the copper smelter, which is required to heat our facilities and to provide process steam for the zinc plant. It is a credit to our people that the projects were completed on time and on budget.

As a result of the smelter closure, approximately 235 jobs were eliminated. However, through attrition, early retirement and retraining, we were able to limit the number of personnel reductions to about 85, and we continue to create jobs in the area.

EXPLORATION

HudBay has a proven ability to create value through exploration. We have earmarked $68 million for exploration in 2011, one of the largest budgets in our company's history, and plan to drill approximately 190,000 metres.

## Flin Flon Greenstone Belt

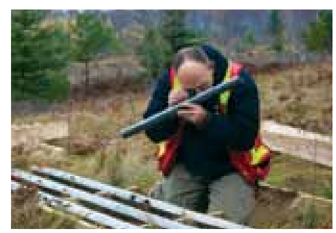
Of the total exploration budget, $33 million will be spent in the Flin Flon Greenstone Belt, where we have a land package of approximately 400,000 hectares and more than 85 years of experience. Through our innovative application of geophysics, we are now able to see deep below the limestone cover of the FFGB, and have identified several thousand untested geophysical anomalies. Our exploration focus is on systematically evaluating these targets.

We plan to spend the majority of the budget on testing anomalies within trucking distance of the Flin Flon operations, with a view to continuing to use the infrastructure in the region. We are also active at Lalor, which remains a highly prospective and underexplored area. Exploration in 2010 indicated significant potential for additional gold mineralization at Lalor and raised the possibility of discovering new gold and copper-gold zones and extending existing zones. It also confirmed the continuity of the copper-gold zone, which remains open down plunge. We will continue to drill from surface in 2011 to evaluate opportunities along strike and the periphery of the deposit.

In our search for mineral deposits near the Flin Flon operations, we have partnered with junior mining companies as a means of gaining access to new properties and encouraging the exploration of more land than we can evaluate on our own. For example, we have an option agreement with Halo Resources that allows us to earn up to a 67.5% interest in Halo's Cold and Lost properties, located about 110 kilometres from Flin Flon. We completed an NI 43-101-compliant resource estimate for the Lost property in March 2011 and are now conducting a pre-feasibility study to determine how the project fits with our long-term production plans.

We also have a joint venture with VMS Ventures, pursuant to which we have a 70% interest in the copper-rich Reed deposit near Snow Lake, Manitoba. In early 2011, we completed an infill drilling program, released an NI 43-101-compliant resource estimate and have begun an economic evaluation to confirm the viability of the Reed deposit. A production decision is expected in late 2011. Given the near-surface nature of the Reed deposit, its advantageous location adjacent to a provincial highway and its proximity to the Flin Flon complex, production could commence by late 2012 or early 2013 with a relatively small capital investment.

## Back Forty



Back Forty is an advanced-stage exploration project evaluating a zinc- and gold-rich VMS deposit in Michigan's Upper Peninsula. With its strong similarities to the FFGB, we have been able to apply our geophysical expertise to Back Forty to extend the known deposit and increase the size of the resource.

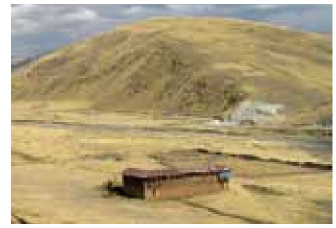
In 2010, we announced a resource increase of more than 100%, to 17.9 million tonnes of measured and indicated resources, including approximately one million ounces of contained gold and significant amounts of copper and zinc. We also discovered high-grade mineralization well outside the known resource envelope.

The Back Forty project is a prime example of how we diversify our exploration focus by taking a toehold position in a junior company conducting grassroots exploration. Since 2009, we have acquired a 15% ownership position in Aquila Resources and a 51% joint-venture interest in Back Forty, and we have the option of increasing our ownership interest to 65% by completing a feasibility study and submitting a mine permit application to the State of Michigan.

We believe Back Forty is a very promising project with potential to expand the size at depth. In 2011, we will invest $16 million on an expanded drilling program, engineering work and environmental assessments to enable us to complete and optimize the mine plan in preparation for permitting.

Recognizing Aquila's exploration expertise, we also formed a strategic exploration alliance with the firm in 2010. Under this agreement, HudBay will provide funding and seed money for Aquila to seek out new deposits in Michigan and other areas to be agreed upon.

## Peru

With the acquisition of Constancia, we have a major new exploration platform. The extensive land package is in a highly prospective area where large deposits have already been found. There is exploration upside for copper oxide, additional porphyry deposits and gold mineralization.

Although we are in the early stages of developing an exploration program for Constancia, we have identified two immediate targets in the Pampacancha and Chilloroya South prospects, which are in close proximity to the Constancia deposit. We also intend to evaluate some untested geophysical targets and apply our geophysical techniques in the area.

Our presence in Peru also provides us with the opportunity to identify and acquire interests in other prospective properties in Peru, which has the third largest exploration budget by country in the world.

## Yukon

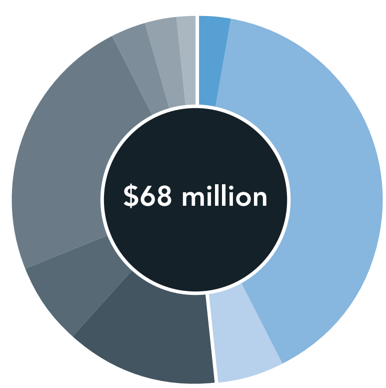
Tom and Jason are 100%-owned lead-zinc deposits with silver credits in the Yukon that have been in our portfolio for many years. We believe that with the current long-term outlook for lead and zinc prices, these deposits have very good potential, and we have budgeted $2 million for exploration in 2011. The focus will be on upgrading resources from the inferred to indicated categories, testing extensions and studying some of the regional anomalies in the area. We intend to initiate a preliminary economic assessment on the project in early 2012.

$68 million has been allocated for exploration opportunities in 2011.

## 2011 EXPLORATION EXPENDITURES ($ millions)

| Flin Flon Greenstone Belt | | |
|---|---|---|
| Reed and Cold/Lost | $ | 2 |
| Grassroots exploration (including Lalor) | | 27 |
| Other | | 4 |
| TOTAL FFGB | $ | 33 |

| Other Opportunities | | |
|---|---|---|
| Constancia | $ | 9 |
| Fenix (excluding project development) | | 5 |
| Back Forty | | 16 |
| Yukon | | 2 |
| Chile | | 2 |
| Other | | 1 |
| TOTAL OTHER OPPORTUNITIES | $ | 35 |
| **TOTAL EXPLORATION EXPENDITURES** | **$** | **68** |



RESPONSIBILITY

# Our 85 years of operating in the Flin Flon area have resulted in a strong, sustainable community and a legacy of 19 mines that have been successfully reclaimed and remediated.

## Remediation

All mines have finite lives. While some mineral deposits can sustain a mine for 50 years or more, other deposits may only produce a mine life of a few years. Mine closure is the final phase of the mining cycle. Our practice is to carry out an orderly, safe and environmentally sound process of converting an operating mine to its pre-mining condition.

Having closed 19 mines in the course of our history, sometimes in ecologically sensitive areas, we have turned mine closure and remediation into core competencies for HudBay.

We have a progressive rehabilitation program underway at our Flin Flon metallurgical complex, which has undergone numerous expansions, upgrades and closures over the years, including the 2010 closure of our copper smelter. The program aims to restore the environment in and around the complex and enhance the visual impact. Activities include removing old structures and equipment, reconfiguring and revegetating tailings sites, and greening spaces between the community and the operations. We also work with the community on green initiatives that promote rehabilitation of the region.

In addition, we are voluntarily revisiting some of the mine sites worked decades ago – both by ourselves and by other companies whose assets we inherited as legacy properties – recognizing that standards and regulations have changed over time. Our remediation specialists first render the sites safe by properly securing mine entrances and removing any abandoned structures. Next we apply leading-edge techniques that rehabilitate (where necessary) the surrounding areas and either restore them as green spaces or prepare them for redevelopment into other uses.

## Environmental Sustainability at Back Forty

As part of the planning process for the Back Forty project, we are conducting extensive environmental baseline studies with a view to integrating sustainability into the mine planning and design processes. The studies cover wildlife, plants, water resources and wetland, air quality, archeological sites and existing land use. Through this process, we are engaging with a wide variety of local stakeholders to build strong relationships and work collaboratively to identify and address their interests.

## Human Health Risk Assessment in Flin Flon/Creighton

When the Manitoba Department of Conservation conducted environmental soil sampling near certain HudBay operations in 2006, researchers encountered elevated levels of arsenic, cadmium, lead and mercury – associated with early pre-pollution abatement technology. While there was no immediate risk to human health as a result of these findings, HudBay participated in and funded the Human Health Risk Assessment (HHRA) to better understand the nature of soil conditions in the region and to determine if exposure could lead to long-term health risks. The work was conducted by an independent consultant in 2008 and 2009, and included broad community involvement.

The HHRA final report was released in June 2010. The study concluded that the likelihood of health effects among area residents from exposure to the metals evaluated is negligible to low. The full report is available on the Flin Flon Soils Study website at www.flinflonsoilsstudy.com.

## Smelter Closure

In 2010, HudBay closed the Flin Flon copper smelter and the White Pine copper refinery in Michigan. Although the 80-year-old smelter met regulatory standards, its outdated technology would have made it difficult to meet the stricter emission requirements expected in the future.

As well, the copper smelter had become uneconomic due to deteriorating terms for smelting third-party concentrate and rising energy and transportation costs.

The closure means that particulate and sulphur dioxide emissions have essentially been eliminated from the Flin Flon operations.

To replace the steam produced by the smelter, which is needed to heat our facilities and for process steam for the zinc plant, we invested in new electric boilers. Instead of fossil fuel, the new boilers are powered by clean, renewable hydroelectricity and significantly reduce HudBay's greenhouse gas emissions.

The White Pine copper refinery has been closed. Without the smelter, we no longer needed the refinery. Rather than simply demolishing it, we are exploring options for the refinery.

**For more information about HudBay's sustainability performance, please see our most recent Corporate Social Responsibility report available on our website.**

## CORPORATE GOVERNANCE

HudBay's governance practices reflect the structure and processes we believe are necessary to promote the interests of shareholders and the effective functioning of the Board and its committees. They also establish a common set of performance expectations for the Board and the senior management team.

Their primary mandate is to oversee the business of the company and provide guidance to management so as to assist in meeting corporate objectives and maximizing shareholder value. The Board discharges its responsibilities directly or through five committees – the Audit Committee, the Compensation Committee, the Corporate Governance and Nominating Committee, the Environmental, Health and Safety (EHS) Committee and the Technical Committee.

We have adopted a Code of Business Conduct and Ethics that sets out basic principles for directors, officers and employees on the conduct and ethical decision-making integral to their work. In conjunction with the Code, we have established a toll-free compliance hotline to allow for anonymous reporting of suspected violations. More information is posted on our website.

**G. Wesley Voorheis**
Chairman of the Board

Corporate Governance and Nominating Committee (Chair)

Mr. Voorheis is the Managing Director of VC & Co. Incorporated and a Partner of Voorheis & Co. LLP, which act as strategic advisors to institutional and other shareholders, including private equity and hedge funds. Mr. Voorheis has a number of corporate directorships. He was previously the Chief Executive Officer and a director of Hollinger Inc. He also acted as an advisor to the institutional shareholders of YBM Magnex International, Inc. and subsequently as Chairman of its Board of Directors. Mr. Voorheis was also a member of the Board of Directors of Sun-Times Media Group, Inc. and Atlas Cold Storage Holdings Inc. Prior to the establishment of Voorheis & Co. LLP in 1995, Mr. Voorheis was a partner in a major Toronto law firm.

**David Garofalo**
President and Chief Executive Officer

Environmental, Health and Safety Committee

Mr. Garofalo joined HudBay as President and Chief Executive Officer in July 2010. Previously, Mr. Garofalo served as Senior Vice President, Finance and Chief Financial Officer with Agnico-Eagle Mines Limited from 1998 to 2010 and as Treasurer and in various finance roles with Inmet Mining Corporation from 1990 to 1998. Mr. Garofalo was named Canada's CFO of the Year by Financial Executives International Canada (2009) and TopGun CFO by Brendan Wood International (2009 and 2010) and was given the IR Magazine awards for Best Investor Relations by a CFO (2009 and 2010) and Best Investor Relations by a CEO (2011). Mr. Garofalo is a graduate of the University of Toronto (B.Comm.) and a Chartered Accountant and is a certified director of the Institute of Corporate Directors (ICD.D). He also serves on the Board of Directors of York Central Hospital Foundation and Malbex Resources Inc.

**J. Bruce Barraclough**

Audit Committee (Chair), Compensation Committee, Environmental, Health and Safety Committee

Mr. Barraclough worked for Ernst & Young LLP for 37 years, 27 as a partner, until his retirement on June 30, 2008. Mr. Barraclough holds an MBA from the Schulich School of Business and a Bachelor of Applied Science from the University of Toronto. He is also a Fellow of the Institute of Chartered Accountants of Ontario (FCA) and holds the designation of Chartered Director (C.Dir.) from The Directors College (a joint venture of McMaster University and the Conference Board of Canada).

**Alan R. Hibben**

Compensation Committee (Chair)

Mr. Hibben has held several senior positions with RBC Capital Markets, including his current role as Managing Director, which he assumed on his return to RBC in March 2011. Mr. Hibben has been a director of six public companies and six substantial private companies, including Pinetree Capital Inc., Discovery Air Inc., and the Board of Governors of Havergal College, where he is Past-Chairman. Mr. Hibben received his Bachelor of Commerce Degree from the University of Toronto. He is qualified as a Canadian Chartered Accountant and also holds the CFA designation. He is a certified director of the Institute of Corporate Directors (ICD.D).

**W. Warren Holmes**

Environmental, Health and Safety Committee (Chair), Technical Committee (Chair), Corporate Governance and Nominating Committee

Mr. Holmes has over 40 years of mining industry experience notably with Noranda Inc. (1964–1986) where he was Vice President and General Manager of Pamour Porcupine Mines Limited and with Falconbridge Limited (1986–2002) where he was Senior Vice-President of Canadian Mining Operations. From November 2009 to July 2010, Mr. Holmes served as HudBay's Executive Vice Chairman and, from January 2010 to July 2010 served as our Interim Chief Executive Officer. Mr. Holmes holds a number of corporate directorships. He has been President of the Canadian Institute of Mining & Metallurgy, is a Professional Engineer and holds an engineering degree from Queen's University and a MBA from the University of Western Ontario.

**John L. Knowles**

Audit Committee, Technical Committee

Mr. Knowles is President and CEO of Wildcat Exploration Ltd., a mining exploration company, prior to which he was Executive Vice President and Chief Financial Officer of Aur Resources Inc. He was Vice President and Chief Financial Officer of HBMS from 1996 to April 2005 and, following its acquisition by HudBay, he was Vice President and Chief Financial Officer of HudBay until April 2005. Mr. Knowles has over 25 years of experience in senior roles with Canadian and international resource companies. He is a director of Tanzania Minerals Corp., a publicly listed mining exploration company, as well as private companies involved in international gold exploration, bio-pharmaceuticals and real estate development. He is a Chartered Accountant and holds a Bachelor of Commerce degree from Queen's University.

**Alan J. Lenczner**

Audit Committee , Corporate Governance and Nominating Committee, Environmental, Health and Safety Committee

Mr. Lenczner is a partner at Lenczner Slaght Royce Smith Griffin LLP. He is a Director of Leon's Furniture Ltd. and was previously a Director of Eskay Creek Ltd. Mr. Lenczner has a BA (Hon.) and an MA. He graduated from the University of Toronto with an LL.B. (Hons. Standing) in 1967 and was admitted to the Ontario Bar in 1969. He was appointed Queen's Counsel in 1982.

**Kenneth G. Stowe**

Compensation Committee, Technical Committee

Mr. Stowe has been President of Northgate Minerals Corporation since 1999 and was appointed Chief Executive Officer in 2001. He spent the first 21 years of his career with Noranda Inc. in various operational, research and development, and corporate roles. He has also held senior positions at Diamond Fields Resources Inc. and Westmin Resources Limited. Mr. Stowe is a mining engineer with a Bachelor of Science and Masters of Science from Queen's University.

## FINANCIAL REVIEW

### Management's Discussion and Analysis



### Consolidated Financial Statements



This Management's Discussion and Analysis ("MD&A") dated March 9, 2011 should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended December 31, 2010, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information regarding the Company, including its most recent Annual Information Form ("AIF"), is available on SEDAR at www.sedar.com. All figures are in Canadian dollars unless otherwise noted.

Unless the context otherwise suggests, references to "HudBay" or the "Company" or "we", "us", "our" or similar terms refer to HudBay Minerals Inc. and its subsidiaries. "HBMS" refers to Hudson Bay Mining and Smelting Co., Limited, "WPCR" refers to the White Pine Copper Refinery Inc. and "HMI Nickel" refers to HMI Nickel Inc., all wholly-owned subsidiaries of HudBay. "CGN" refers to Compañía Guatemalteca de Níquel, S.A., a 98.2%-owned subsidiary, held indirectly through HMI Nickel. "Norsemont" refers to Norsemont Mining Inc. ("Norsemont"), a 91%-owned subsidiary.

# Management's Discussion and Analysis

## Forward-Looking Information

Certain of the statements made and information contained herein may contain forward-looking information within the meaning of applicable Canadian and United States securities laws. Forward-looking information includes, but is not limited to, information concerning HudBay's intentions with respect to the exploration and development of its mineral properties. Forward-looking information is based on the views, opinions, intentions and estimates of management at the date the information is made, and is based on a number of assumptions and subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those anticipated or projected in the forward-looking information (including the actions of other parties who have agreed to do certain things and the approval of certain regulatory bodies). Many of these assumptions are based on factors and events that are not within the control of HudBay and there is no assurance they will prove to be correct. There can be no assurance that forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such information. HudBay undertakes no obligation to update forward-looking information if circumstances or management's estimates or opinions should change except as required by applicable securities laws, or to comment on analyses, expectations or statements made by third parties in respect of HudBay, its financial or operating results or its securities. The reader is cautioned not to place undue reliance on forward-looking information.

## Note to U.S. Investors

Information concerning our mineral properties has been prepared in accordance with the requirements of Canadian securities laws, which differ in material respects from the requirements of SEC Industry Guide 7. Under Securities and Exchange Commission (the "SEC") Industry Guide 7, mineralization may not be classified as a "reserve" unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time of the reserve determination, and the SEC does not recognize the reporting of mineral deposits which do not meet the United States Industry Guide 7 definition of "Reserve". In accordance with National Instrument 43-101 – Standards of Disclosure for Mineral Projects ("NI 43-101") of the Canadian Securities Administrators, the terms "mineral reserve", "proven mineral reserve", "probable mineral reserve", "mineral resource", "measured mineral resource", "indicated mineral resource" and "inferred mineral resource" are defined in the Canadian Institute of Mining, Metallurgy and Petroleum (the "CIM") Definition Standards for Mineral Resources and Mineral Reserves adopted by the CIM Council on December 11, 2005. While the terms "mineral resource", "measured mineral resource", "indicated mineral resource" and "inferred mineral resource" are recognized and required by NI 43-101, the SEC does not recognize them. You are cautioned that, except for that portion of mineral resources classified as mineral reserves, mineral resources do not have demonstrated economic value. Inferred mineral resources have a high degree of uncertainty as to their existence and as to whether they can be economically or legally mined. Under Canadian securities laws, estimates of inferred mineral resources may not form the basis of an economic analysis. It cannot be assumed that all or any part of an inferred mineral resource will ever be upgraded to a higher category. Therefore, you are cautioned not to assume that all or any part of an inferred mineral resource exists, that it can be economically or legally mined, or that it will ever be upgraded to a higher category. Likewise, you are cautioned not to assume that all or any part of measured or indicated mineral resources will ever be upgraded into mineral reserves. You are urged to consider closely the disclosure on the technical terms in Schedule A "Glossary of Mining Terms" of HudBay's annual information form for the fiscal year ended December 31, 2010, available on SEDAR at www.sedar.com and incorporated by reference as Exhibit 99.1 in the Offeror's Form 40-F filed on March 31, 2011 (File No. 001-34244).

## Documents Incorporated by Reference

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this MD&A to the extent that a statement contained herein, or in any other subsequently filed document that also is incorporated or is deemed to be incorporated by reference herein, modifies or supersedes such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement will not be deemed an admission for any purposes that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this MD&A after it has been modified or superseded.

## Our Business

HudBay Minerals Inc. (the "Company" or "HudBay") is a Canadian diversified mining company governed by the Canada Business Corporations Act with assets in North, Central and South America. Through its subsidiaries, HudBay owns copper/zinc/gold mines, ore concentrators and zinc production facilities in northern Manitoba and Saskatchewan, a zinc oxide production facility in Ontario, a nickel project in Guatemala and a copper project in Peru. HudBay produces copper concentrate (containing copper, gold and silver), zinc metal and zinc oxide. HudBay's shares are listed on the Toronto and New York stock exchanges under the symbol "HBM".

## Strategy

We believe that the greatest opportunities for shareholder value creation in the mining industry are in the discovery of new mineral deposits and the development of new facilities to profitably extract ore from those deposits. We also believe that our long history of mining in northern Manitoba and our highly experienced workforce provide HudBay with a competitive advantage relative to other mining companies of similar scale.

To capitalize on these opportunities, our mission is to create sustainable value through increased commodity exposure on a per share basis, in high quality and growing long life deposits in mining friendly jurisdictions.

We intend to grow HudBay both through the exploration and development of properties we already control, such as our Lalor project in northern Manitoba, as well as through the acquisition of exploration and development properties such as Norsemont's Constancia project in Peru (in which we recently acquired a majority interest; see Recent Developments – Acquisition of Norsemont). We also intend to optimize the value of our producing assets through efficient and safe operations.

In order to ensure that any acquisitions we undertake create sustainable shareholder value, we have established a number of criteria for evaluating mineral property acquisition opportunities against our mission:

- Potential acquisitions should be located in jurisdictions that are supportive of mining activity and have acceptable levels of political risk. Given our current scale and geographic footprint, our current geographic focus is the Americas;
- We believe we have the greatest exploration and development expertise in volcanogenic massive sulphide ("VMS") and porphyry types of mineral deposits. While these types of deposits typically contain copper, zinc and precious metals in varying quantities, we are not targeting any one type of metal; rather, we focus on properties where we see the greatest opportunities for risk-adjusted returns based on our expectations for future metal prices;
- Any properties that we acquire must have excellent exploration potential. We believe that the markets for mining assets are sophisticated and fully value the delineated resources and reserves, especially at properties that are already in production which makes it difficult to acquire properties for substantially less than their fair value. However, markets may undervalue the exploration potential of prospective properties, providing us with an opportunity to create value through exploration on acquired properties;
- We believe that large, transformational mergers or acquisitions are risky and potentially value-destructive in the mining industry, so we will focus on transactions with a value of up to approximately 20% of our market capitalization, except where exceptional opportunities present themselves;
- Before we make an acquisition, we will develop a clear understanding of how we can add value to the acquired property. We intend to add value through the application of technical exploration or development expertise, the provision of needed financial capacity, or a combination of these factors and other opportunities; and
- Acquisitions should be accretive to HudBay on a per share basis. Given that our strategic focus will be on the acquisition of non-producing assets at various stages of development, when evaluating accretion we will consider measures such as net asset value per share and the contained value of reserves and resources per share.

Our key strategic objectives for 2011 and early 2012 are to:

- Advance the Lalor project, including advancing construction on the production and ventilation shafts, additional exploration from surface to evaluate opportunities along strike and in the periphery of the deposit, completing an optimization study, and making a decision on whether to construct a new concentrator near the Lalor headframe or whether to refurbish our Snow Lake concentrator;
- Continue to advance the exploration and development of the Constancia project, including building a project team and continuing with efforts to optimize the project, so that we can make a construction decision early in 2012;
- Manage the upcoming closures of the Trout Lake and Chisel North mines;
- Expand our grassroots exploration program in the Flin Flon Greenstone Belt and continue to partner with junior mining companies to access promising exploration opportunities;
- Utilize the recently completed feasibility study to assist in evaluating options for advancing the Fenix project;
- Advance the Back Forty and Reed Lake projects towards completion of economic assessments and required permit applications; and
- Identify and carry out one or more acquisitions of projects that meet our acquisition criteria described above.

## 2010 Results Summary

Our 2010 financial results reflected a continuation of the strong recovery in metal prices that began in 2009 and continued throughout 2010. Continued growth in China and other developing economies and continuing efforts by the world's major central banks to support economic recovery in developed economies provided robust fundamentals for base and precious metal price appreciation.

Operational performance was strong again in 2010. Our 777 mine produced at full capacity with strong copper grades. We completed the closure of our copper smelter and refinery, and managed the challenges associated with late-stage mining operations at our Trout Lake and Chisel North mines. Production of contained metal in concentrate met our production targets for 2010, although our sales of copper concentrate lagged production due to limited rail car availability.

We made substantial progress on our Lalor project, with Board approval of a $560 million commitment to full development of the mine, and we significantly advanced on the underground ramp to Lalor from the Chisel North mine. We also strengthened our management team with the appointment of David Garofalo as President and Chief Executive Officer ("CEO") and several other key management appointments.

During 2010 we generated net earnings of $73.0 million and operating cash flow of $199.9 million (not including changes in working capital). We reinvested our cash flow into investments in Lalor and other growth opportunities, share repurchases and the establishment of a common share dividend. In addition, we maintained our financial strength throughout 2010 by arranging a US$300 million credit facility and ending the year with cash and cash equivalents of $901.7 million and no debt.

## Key Financial and Production Results

| Financial condition ($000s) | **Dec. 31, 2010** | Dec. 31, 2009 |
|---|---|---|
| Cash and cash equivalents | **901,693** | 886,814 |
| Working capital | **902,522** | 945,724 |
| Total assets | **2,173,086** | 2,032,686 |
| Shareholders' equity | **1,739,279** | 1,698,484 |

| ($000s except per share and cash cost per pound amounts) | | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **Financial performance** | | | | | |
| Revenue | | **183,280** | 166,673 | **778,818** | 720,722 |
| Earnings before tax and non-controlling interest | | **41,606** | 9,620 | **158,105** | 141,468 |
| Net earnings attributable to shareholders | | **24,493** | 7,171 | **72,985** | 112,440 |
| Basic and diluted net earnings per share | | **0.16** | 0.05 | **0.48** | 0.73 |
| EBITDA[1] | | **71,745** | 40,571 | **280,240** | 143,339 |
| Operating cash flow[1, 2] | | **59,927** | 33,624 | **199,850** | 124,512 |
| Operating cash flow per share[1, 2] | | **0.40** | 0.22 | **1.33** | 0.81 |
| Cash cost (on a co-product basis)[1] | | | | | |
| Copper | $/pound | **1.39** | — | **1.46** | — |
| Zinc | $/pound | **0.87** | — | **0.90** | — |
| Gold | $/troy oz | **345** | — | **383** | — |
| Cash cost per pound of zinc sold[1] | | **US (0.42)** | US 0.09 | **US (0.39)** | US (0.03) |
| **Operating highlights** | | | | | |
| Production (HBMS contained metal in concentrate)[3] | | | | | |
| Copper | tonnes | **13,660** | 11,215 | **52,413** | 48,397 |
| Zinc | tonnes | **19,120** | 21,239 | **77,314** | 78,722 |
| Gold | troy oz. | **22,375** | 22,350 | **87,176** | 92,201 |
| Silver | troy oz. | **209,788** | 248,195 | **843,401** | 1,004,624 |
| Metal sold | | | | | |
| Copper | tonnes | | | | |
| Cathode & anodes | | **50** | 8,864 | **31,795** | 59,981 |
| Payable metal in concentrate[5] | | **8,543** | — | **15,407** | — |
| Zinc – refined[4] | tonnes | **27,200** | 29,299 | **104,941** | 110,070 |
| Gold | troy oz. | | | | |
| Contained in slimes & anode | | **1,948** | 19,342 | **55,868** | 94,263 |
| Payable metal in concentrate[5] | | **13,458** | — | **25,239** | — |
| Silver | troy oz. | | | | |
| Contained in slimes & anode | | **21,082** | 474,195 | **789,305** | 2,185,407 |
| Payable metal in concentrate[5] | | **121,270** | — | **217,534** | — |

1 Refer to page 69 for non-GAAP measures. Cash costs (on a co-product basis) have not been presented for 2009 as the smelter was in operation for all of 2009 and a portion of 2010.

2 Before changes in non-cash working capital.

3 Metal reported in concentrate is prior to refining losses or deductions associated with smelter terms.

4 Zinc sales include sales to our Zochem facility of 8,914 tonnes in the fourth quarter of 2010. In the fourth quarter, Zochem had sales of 11,006 tonnes of zinc oxide.

5 Concentrate was not sold in 2009 while the smelter was in operation.

# Recent Developments

## Acquisition of Norsemont Mining Inc.

On January 10, 2011, we announced that we entered into an agreement to acquire all of the outstanding common shares of Norsemont, together with the associated rights issued under Norsemont's stockholder rights plan. Holders of Norsemont's common shares were given the ability to elect consideration per Norsemont common share, on an individual basis, of 0.2617 common shares of HudBay and $0.001 in cash, $4.50 in cash, or a combination of cash (greater than $0.001 and not to exceed $4.50) and HudBay common shares, subject to rounding and proration necessary to effect a maximum aggregate cash consideration of $130 million.

On March 1, 2011, we acquired 104,635,351 common shares of Norsemont through the issuance of approximately 20.5 million of our common shares and the payment of $119 million in cash and we extended our take-over bid to holders of Norsemont common shares until March 15, 2011. As a result, we own approximately 91% of Norsemont's issued and outstanding shares (calculated on a fully-diluted basis). We intend to proceed with a compulsory acquisition transaction to acquire the remaining common shares of Norsemont that we do not already own or subsequently acquire before the expiry of our take-over bid.

Norsemont's principal asset is the Constancia copper project located in the Cuzco district of southern Peru. Norsemont recently completed and filed an optimized technical report as of February 21, 2011 which outlined an increase in reserves utilizing new long-term metal pricing and increasing and sustaining production throughput in the processing plant in the later years of the project.

The feasibility study contemplates an open pit mine feeding a processing plant at up to 70,000 tonnes per day for the estimated 15 year mine life. The average yearly metal production in concentrate for the life of mine is expected to be 85,000 tonnes of copper, 1,400 tonnes of molybdenum and 69 tonnes of silver. The initial project capital is estimated to be US$920 million with a life of mine average copper cost of US$0.93/lb. We are currently reviewing the work required to make a construction decision to optimize and advance the Constancia project. This review process is expected to be complete and a feasibility optimization and exploration program and budget will be provided by the end of March 2011.

**Constancia Project Mineral Reserve Estimate February 21, 2010**[1]

| Category | Tonnes (millions) | Au (g/t) | Ag (g/t) | Cu (%) | Mo (g/t) |
|---|---|---|---|---|---|
| Proven | 195 | .04 | 3.5 | 0.42 | 120 |
| Probable | 177 | .05 | 3.7 | 0.40 | 92 |
| Total reserves | 372 | .05 | 3.6 | 0.43 | 105 |

[1] The Mineral Reserve for the FSO study is based on Net Smelter Return ("NSR") cut-off since project revenue is derived from copper, molybdenum, silver and gold. For NSR evaluation, metal prices assumed were Cu $2.25/lb, Mo $14.50/lb, Ag $14/oz and Au $1,000/oz while average metal recovery to concentrates was Cu 89%, Mo 40%, Ag 80% to Cu concentrate and Au 60% to Cu concentrate.

## Full Commitment to Development of Lalor Mine

On August 4, 2010, our board of directors made a full commitment to the development of our wholly owned Lalor project by authorizing the expenditures necessary to put the project into full production. Initial production from the access ramp is scheduled in the second quarter of 2012 and full production from the 985 meter production shaft is anticipated in late 2014. The project's estimated capital cost of approximately $560 million, which includes $59 million spent to December 31, 2010, is expected to fund full project development, including access to the gold and copper-gold zones. We intend to fully fund the project from our current cash resources and future cash flows.

We expect the remaining capital spending to occur over the 2011–2014 period as follows:

| (in $ millions) | |
|---|---|
| 2011 | 163 |
| 2012 | 135 |
| 2013 | 120 |
| 2014 | 83 |
| **Total** | 501 |

Our current mine plan for Lalor contemplates the following:

- Full production of 3,500 tonnes of ore per day;
- The approved expenditure is intended to fully fund project development, including the extension of power and water facilities to the site, a 300 person camp, surface and underground construction at the mine site, including the completion of the access ramp, a production shaft and a ventilation shaft; and
- We are presently conducting an optimization study to determine whether to refurbish our existing Snow Lake concentrator, as currently planned, or to construct a new concentrator at the mine site. The estimated capital cost for the project of $560 million does not include any incremental costs that may be incurred if a new concentrator is constructed.

Development and site construction have proceeded on schedule. The Lalor project has gone 440 days without a lost time accident and all safety systems are in place and working well. We continue to make significant progress on the planned 3,200 meter access ramp at the Lalor project, having advanced 1,750 meters from the Chisel North mine as at February 28, 2011. The ramp is intended to extend to the base of the ventilation shaft that is currently under development, with expected completion of the ventilation shaft in the second quarter of 2012. Ground conditions on the ramp have been good and water intersections have been minimal since the first quarter of 2010. In January 2011, we completed the temporary ventilation exhaust, a 435 meter bored raise, and we will construct the main fresh air fan and heater system this summer in preparation for the next heating season.

Surface site construction has proceeded on several fronts. The access road to the site is complete, the main surface exhaust raise site has been cleared, and construction on the 6.1 meter diameter ventilation raise has been started with civil work proceeding on the temporary hoist and head frame arrangement and development of the pre-sink for the shaft sinker.

All power poles for the site have been installed, and the line wiring is ongoing, with the temporary substation becoming operational at the end of February. Water lines for process water and discharge water are being placed and civil work on the pump stations is underway.

On the main site, construction is proceeding with the excavation of the polishing pond and water treatment plant. Temporary construction trailers have been brought in and are currently being installed. The construction camp located in the town of Snow Lake was fully commissioned in February 2011 to accept a small number of contract employees.

Procurement and tendering is ongoing. The main production hoist and man hoist have been ordered with the man hoist expected to be delivered in the first quarter of 2011.

We are continuing with the metallurgical testing of the Lalor ores, focusing on gold optimization. This includes variable testing on the primary grind, with and without a regrind circuit, as well as optimization of the reagent used and projected consumption.

Tradeoff studies that we have undertaken indicate that the Lalor orebody is likely sufficient to support the construction of a new concentrator. We are continuing to evaluate options for the capacity and flowsheet of a new concentrator, and we expect to be in a position to make a decision on whether to proceed with a new concentrator in mid-2011. The construction of a new concentrator is expected to result in a greater increase in our overall capital expenditure investment in Lalor than refurbishing the existing Snow Lake concentrator.

## Revised Lalor Resource and Reserve Estimates

On August 4, 2010, we announced an updated NI 43-101 compliant mineral resource estimate for the base metal zone at Lalor, which increases the tonnage in the indicated resource category by 8.1% from the resource announced in October 2009.

### Base Metal Zone Mineral Resource – May 1, 2010[1]

| Category | Tonnes (millions) | Au (g/t) | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| Indicated | 13.3 | 1.6 | 24.9 | 0.66 | 8.87 |
| Inferred | 4.8 | 1.3 | 26.2 | 0.58 | 9.25 |

[1] Mineral resources that are not mineral reserves do not have demonstrated economic viability.

In-fill drilling completed between late 2009 and early 2010 has allowed gold zone 21 and a portion of gold zone 25 to be classified as inferred mineral resources in accordance with NI 43-101, as shown below:

### Gold Zone Inferred Mineral Resource – May 1, 2010[1]

| Category | Tonnes (millions) | Au (g/t) | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| Inferred | 5.4 | 4.7 | 30.6 | 0.47 | 0.46 |

[1] Mineral resources that are not mineral reserves do not have demonstrated economic viability. Capping of the gold grades was employed to avoid any disproportionate influence of random anomalously high gold grades on the average grade determination.

A revised conceptual estimate of the tonnes and grade of the remaining portion of the gold zone was also completed. The Lalor gold zone potential estimate is conceptual in nature and to date there has been insufficient exploration to define a mineral resource compliant with NI 43-101 and it is uncertain if further exploration will result in the target being delineated as a mineral resource.

### Potential Gold Zone Conceptual Estimate – May 1, 2010

| | Tonnes (millions) | Au (g/t)[1] | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| Potential mineral deposit | 5.1–6.1 | 4.3–5.1 | 23–27 | 0.2–0.4 | 0.2–0.4 |

[1] Capping of the gold grades was employed to avoid any disproportionate influence of random anomalously high gold grades on the estimate of the range of average grade.

On August 4, 2010, we also announced a new conceptual estimate of the tonnes and grade of the copper-gold zone. The Lalor copper-gold zone potential estimate is conceptual in nature and to date there has been insufficient exploration to define a mineral resource compliant with NI 43-101 and it is uncertain if further exploration will result in the target being delineated as a mineral resource.

### Potential Copper-Gold Zone Conceptual Estimate – May 1, 2010

| | Tonnes (millions) | Au (g/t)[1] | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| Potential mineral deposit | 1.8–2.2 | 5.8–7.0 | 18–22 | 3.2–4.0 | 0.2–0.3 |

[1] Capping of the gold grades was employed to avoid any disproportionate influence of random anomalously high gold grades on the estimate of the range of average grade.

For details on the key assumptions, parameters and methods used to estimate the mineral resources, and the basis on which the potential quantity and grade of the gold zone and copper-gold zone was determined, refer to "Lalor Project Supplementary Information" in our press release dated August 4, 2010.

We have completed a reserve estimate following the completion of a pre-feasibility study based on the indicated mineral resources at Lalor. Refer to "Estimated Mineral Reserves" for details of the estimated mineral reserve.

The copper-gold zone remains open, and we are continuing to test the extension of this zone with one drill from surface at Lalor. Two drills are currently testing targets on the periphery of the Lalor deposit to locate possible satellite deposits. We also intend to conduct extensive underground exploration at Lalor, including definition drilling on the gold zone and copper-gold zone, starting in late 2012 when ramp access reaches the deposit and exploration platforms are developed.

### Back Forty Project

On November 29, 2010, Aquila Resources Inc. ("Aquila") filed an updated NI 43-101 compliant resource estimate including 17.9 million tonnes of measured and indicated mineral resources with nearly one million ounces of contained gold and 3.4 million tonnes of inferred mineral resources.

**Back Forty November 29, 2010 Resource Table**[1]

| Category | Tonnes (millions) | Au (g/t) | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| **Open pit** | | | | | |
| Measured | 14.1 | 1.59 | 16.97 | 0.15 | 2.54 |
| Indicated | 2.1 | 1.53 | 32.80 | 0.41 | 1.17 |
| Measured and indicated | 16.2 | 1.58 | 19.00 | 0.18 | 2.36 |
| Inferred | 1.4 | 1.40 | 32.89 | 0.62 | 1.00 |
| **Underground** | | | | | |
| Measured | 0.8 | 1.67 | 25.83 | 0.24 | 3.45 |
| Indicated | 0.9 | 1.28 | 24.72 | 0.34 | 2.85 |
| Measured and indicated | 1.7 | 1.46 | 25.23 | 0.29 | 3.13 |
| Inferred | 2.0 | 1.22 | 18.34 | 0.32 | 2.64 |
| **Combined open pit and underground** | | | | | |
| Measured and indicated | 17.9 | 1.57 | 19.60 | 0.19 | 2.44 |
| Inferred | 3.4 | 1.31 | 25.17 | 0.46 | 1.87 |

[1] Mineral resource estimate is from "Technical Report, Back Forty Deposit, Menominee County, Michigan" as filed on SEDAR by Aquila Resources Inc. on November 29, 2010.

On March 3, 2011, Aquila announced additional drill results from the Back Forty project, which included 12 meters of 15.29 g/t gold and 66.49 g/t silver in drill hole LK-484.

The high gold intercept from LK-484 occurs approximately 250 meters down dip of the previously modeled resource and is located approximately 32 meters northeast of a 6.23 meter, 6.39 g/t gold intercept in LK-479 (see the HudBay news release dated October 15, 2010 for more details). Two drills are focused on the exploration of the deep gold zone intersected in LK-484 12 referenced above. A third drill has been mobilized to test some high ranking electromagnetic targets within a kilometer east of the deposit.

### Fenix Project

On March 31, 2010, we announced a new NI 43-101 compliant mineral resource estimate for our Fenix project in eastern Guatemala. As part of the completion of an updated feasibility study at the end of 2010, we prepared a revised reserve estimate for Fenix. Refer to "Estimated Mineral Reserves" on page 61 for details of the estimated mineral reserve.

In parallel with the work that took place in 2010 updating the Fenix feasibility study and mineral reserve estimate:

- We completed 7,000 meters of diamond drilling at the Fenix project in the second quarter and we incorporated the results into the new reserve estimate;
- We are evaluating other exploration opportunities in the project vicinity that would enhance the economics of Fenix;
- We are utilizing the updated feasibility study to assist in evaluating options for advancing the Fenix project; and
- The revised feasibility study incorporates a new power strategy for Fenix based on the generation of power from coal or petroleum coke at an on-site power plant, while retaining the option to consider supplemental power supply from the Central American power grid.

### VMS Ventures Inc. ("VMS")

On July 6, 2010, HBMS entered into a joint venture agreement and four option agreements with VMS respecting our Reed Lake property and a series of adjacent mineral properties held by VMS in Manitoba's Flin Flon Greenstone Belt. Pursuant to the joint venture agreement, we have a 70% interest and VMS has a 30% interest in a joint venture respecting the Reed Lake property and the two claims immediately to the south. We are the operator of the joint venture with authority and discretion as to the exploration and potential development of the property and have exclusive rights to purchase and market the ore produced from the property. We will also provide full financing of VMS's proportionate share of the costs to develop the property, which will be repayable solely from VMS's share of cash flow generated from the project.

The option agreements grant us the right to earn a 70% interest in four adjacent claim parcels held by VMS. Upon making certain cash payments and meeting work commitments over two to three years, we will earn a 70% interest in the applicable property and a new joint venture will be formed between HudBay and VMS, which will have substantially the same terms as the Reed joint venture. Any failure to make the required cash payments and work commitments with respect to a certain property will cause that property to revert to VMS but will not affect our option over the other properties. Two drills are currently drilling at the Reed Lake deposit: one drill is collecting metallurgical samples, and the other is scheduled to step out and test near deposit extensions and geophysical anomalies as part of the VMS joint venture. We intend to complete an NI 43-101 compliant resource estimate for the Reed Lake property in the first quarter of 2011.

### Exploration

We continue to invest in exploration. In addition to the drilling activity referred to previously at the Lalor and Back Forty projects, one drill is operating in the vicinity of Flin Flon, Manitoba, testing near mine geophysical targets and trends, and we are carrying out a continual underground exploration program out at the 777 mine. Another drill is testing regional geophysical anomalies south of Flin Flon.

One drill has completed work on the Lost property, which we optioned from Halo Resources Ltd. and we are compiling and interpreting the results.

### 777 North Mine Expansion Approved

On August 4, 2010, we announced plans to expand the 777 Mine. The 777 North expansion involves driving a ramp from surface to the 440 meter level to access mineral resources of 550,000 tonnes grading 1.5 g/t gold, 22.5 g/t silver, 1.0% copper and 3.6% zinc. These zones are connected to the underground workings of the 777 Mine. We estimate total capital costs for the expansion at approximately $20 million, with production expected to begin in 2012 at a rate of 330 tonnes per day, producing approximately 5,500 tonnes of copper metal and 20,000 tonnes of zinc metal over the six year life of the project.

Upon completion, the 777 North expansion will provide an additional egress from the mine and is expected to supply additional ore feed to the Flin Flon concentrator and zinc plant. It will also help to sustain employment in Flin Flon, as the Trout Lake mine reaches the end of mine life, and it facilitates the development of an underground exploration platform to evaluate additional exploration opportunities near the 777 mine.

### Investment in Augusta Resource Corporation ("Augusta")

On August 23, 2010, we entered into a subscription agreement with Augusta providing for the purchase, on a private placement basis, of 10,905,590 units for a purchase price of $2.75 per unit for total consideration of $30 million. Each unit consists of one common share of Augusta and one-half of one common share purchase warrant of Augusta ("Warrants"). Each whole Warrant entitles us to acquire one common share of Augusta at an exercise price of $3.90.

We own and have control over 14,789,490 common shares of Augusta (approximately 11.0% of the issued and outstanding common shares) and 5,452,795 Warrants (representing approximately 13.6% of the issued and outstanding common shares of Augusta on a fully-diluted basis). Pursuant to the terms of the Warrants, the Warrants' expiry date was recently accelerated to March 21, 2011, and we currently expect to exercise the warrants prior to expiry at a cost of $21.3 million. Pursuant to the subscription agreement, Augusta has granted us the right to participate in future equity financings in the 24 months following closing of the transaction on a basis that would permit us to maintain our current percentage equity ownership in Augusta.

### Normal Course Issuer Bid

On September 29, 2009, the Toronto Stock Exchange ("TSX") accepted our application for a normal course issuer bid ("NCIB"). The NCIB permitted us to purchase up to 13,655,000 of our common shares (representing approximately 10% of the public float) during the 12 month period from October 1, 2009 to September 30, 2010. We did not renew the NCIB upon its expiry on September 30, 2010. As at December 31, 2010, we had repurchased a total of 5,646,700 of our common shares at a cost of $68.3 million.

### Management Team Strengthened with Key Appointments

On June 21, 2010, we announced the appointment of David Garofalo as President and CEO and to our Board of Directors, effective July 12, 2010. Most recently, Mr. Garofalo served as Senior Vice President, Finance and Chief Financial Officer with Agnico-Eagle Mines Limited, where he had been employed since 1998. Before joining Agnico-Eagle, Mr. Garofalo served as Treasurer and in various finance roles with Inmet Mining Corporation from 1990.

On August 4, 2010, we named Ken Gillis as Senior Vice President, Corporate Development, along with other changes to our existing senior management team intended to reflect current responsibilities and facilitate execution of our strategic plan. We have continued to build our management team with the recent hirings of vice presidents of human resources and corporate social responsibility.

### Common Share Dividend Paid

On September 30, 2010, a semi-annual dividend in the amount of $0.10 per common share was paid to shareholders of record as of September 15, 2010. On March 9, 2011, a semi-annual dividend in the amount of $0.10 per common share was declared with a record date of March 21, 2011 and a payment date of March 31, 2011.

### New York Stock Exchange ("NYSE") Listing

On October 22, 2010, our common shares commenced trading on the NYSE under the symbol "HBM". We intend to maintain our listing on the Toronto Stock Exchange.

### Copper Smelter and WPCR

On June 11, 2010, our copper smelter in Flin Flon, Manitoba, ceased operations. Operations at WPCR ceased in July due to the smelter closure.

## Outlook

This outlook includes forward-looking information about HudBay's operations and financial expectations that is subject to risks, uncertainties and assumptions. The outlook and financial targets are for 2011 only. The information provided in this section is forward-looking, based on HudBay's expectations and outlook and shall be effective only as of the date the targets were originally issued on March 9, 2011. Refer to "Forward-Looking Information" on page 25. The overall outlook, including targets, and our performance is generally subject to various risks and uncertainties which may impact future performance and our achievement of these targets.

Copper, gold and silver prices have recovered substantially over the course of 2010 and are currently significantly higher than average prices in 2009. If these prices and current exchange rates are sustained during 2011 and our production, sales and cost performance are as expected, our operating financial results are likely to improve substantially over 2010 results. HudBay may update its outlook depending on changes in metals prices and other factors.

For our sensitivity to metal prices and foreign exchange rates, refer to "Sensitivity Analysis" on page 39.

### Material Assumptions

Our 2011 operational and financial performance will be influenced by a number of factors. At the macro-level, the general performance of the North American and global economies will influence the demand for our products. The realized prices we achieve in the commodity markets significantly affect our performance. Our general expectations regarding prices for metals and foreign exchange rates are included in the "Commodity Markets" and "Sensitivity Analysis" sections of this MD&A.

**2011 Domestic Mine and Mill Production (Contained Metal in Concentrate)**

| | | **2010 actual** | 2011 forecast |
|---|---|---|---|
| Copper | (tonnes) | **52,413** | 40,000–55,000 |
| Zinc | (tonnes) | **77,314** | 70,000–90,000 |
| Gold equivalent[1] | (oz.) | **101,233** | 95,000–120,000 |

1 Gold equivalent production includes gold and silver production. Silver converted to gold equivalent at 60:1 ratio.

Contained metal production in concentrate in 2011 is expected to be similar to 2010 as we expect reduced production at Trout Lake will be offset by a full year of production at Chisel North and higher production and copper grades at the 777 mine.

2010 contained concentrate metal production was consistent with our 2010 outlook.

**2011 Exploration Plan**

| Exploration expenditures[1] ($ millions) | Capitalized | Expensed | Total |
|---|---|---|---|
| **Flin Flon Greenstone Belt** | | | |
| Near mine exploration | 4 | — | 4 |
| Reed Lake and Cold/Lost Lake | — | 2 | 2 |
| Grassroots exploration | 1 | 22 | 23 |
| Other | 1 | 3 | 4 |
| | 6 | 27 | 33 |
| **Other opportunities** | | | |
| Fenix | 3 | 2 | 5 |
| Back Forty | 1 | 15 | 16 |
| Yukon | — | 2 | 2 |
| Chile | — | 2 | 2 |
| Other areas | — | 1 | 1 |
| | 4 | 22 | 26 |
| **Total target** | 10 | 49 | 59 |

1 All values are preliminary estimates, and actual expenditures may vary and will depend on several factors and may be subject to change.

Exploration expenditures of $59 million will support ongoing exploration near our existing mines and projects and fund grassroots exploration on properties we hold in the Flin Flon Greenstone Belt, Chile and the Yukon. Expenditures on the Back Forty project will support exploration initiatives as well as project engineering and environmental permitting activities. Depending on exploration success, we may commit additional funding to exploration at Lalor and other opportunities. We expect to incur additional amounts over and above the exploration expenditures noted above at the Constancia project.

The 2011 exploration plan in the Flin Flon Greenstone Belt includes additional drilling at the Lalor project with geophysical platform holes targeting potential satellite deposits and continued tracing of known exploration targets such as the Lalor copper-gold zone. We will also continue to explore within the 777 mine with an expenditure of approximately $3 million. A concentrated effort will be focused on following up on regional targets close to Flin Flon due to the available concentrator capacity in our Flin Flon operations.

Our exploration properties include approximately 400,000 hectares in the prolific Flin Flon Greenstone Belt of Manitoba and Saskatchewan. The Company has also optioned mineral properties to several other exploration companies as a means to leverage our expenditures in the Flin Flon Greenstone Belt. Pursuant to our option agreements with Halo Resources, we have acquired an option to earn up to a 67.5% interest in Halo's Cold and Lost properties in the Sherridon district of Manitoba. We are continuing our exploration efforts at Cold and Lost, and we intend to complete an NI 43-101 compliant resource estimate in the first quarter of 2011.

Beyond the Flin Flon Greenstone Belt, we are planning additional exploration at the Fenix property in Guatemala, our San Antonio copper project in Chile and our Tom/Jason zinc-lead-silver mineral deposits in the Yukon.

**2011 Capital Expenditures**

| Capital expenditures ($ millions) | 2011 budget |
|---|---|
| **Growth** | |
| Lalor | 163 |
| 777 North | 8 |
| Fenix | 13 |
| Total growth capital | 184 |
| **Sustaining** | 105 |
| **Total capital expenditures** | 289 |

We expect to invest approximately $289 million in capital expenditures in 2011, of which approximately two-thirds is allocated toward growth initiatives. Capital expenditures at Lalor are expected to total approximately $163 million, which includes sinking of the ventilation and production shafts, continuation of the ramp from Chisel North, concentrator refurbishment costs and mine site buildings and utilities. We recently awarded the construction contract for the Lalor ventilation shaft to J.S. Redpath.

An optimization study is ongoing for the Lalor project to determine whether to refurbish the existing Snow Lake concentrator, as currently planned, or to construct a new concentrator at the mine site. The Lalor capital expenditure projections above do not incorporate any incremental costs that may arise if a new concentrator is constructed. We expect to incur additional amounts over and above the capital expenditures noted above at the Constancia project. Refer to "Capital Expenditures" on page 49 for 2010 capital expenditures by mine and processing facility.

## Commodity Markets

In addition to our production, financial performance is directly affected by a number of factors including metal prices, foreign exchange rates, and input costs including energy prices. In 2010, metal prices generally performed well, contributing to the increase in our financial performance compared to 2009.

The following market analysis has been developed from various information sources including research analyst reports and industry experts.

### Copper

In 2010, the London Metal Exchange ("LME") copper price averaged US$3.42 per pound, increasing over the second half of the year from a low of US$2.76 per pound in June to a high of US$4.42 per pound in December. Strong growth in copper demand from China and other markets, combined with the inability of copper mine supply to keep up with growing demand, were key factors in the movement of copper prices to historic highs in late 2010. After a sharp increase in LME inventories in the second half of 2009, inventories were steadily drawn down over the course of 2010, although not to the historic lows seen in the 2005–2008 period.

Copper prices will likely require a continuation of global economic growth to be sustained at current levels in the shorter term, but medium term supply-demand fundamentals for copper remain positive assuming continued strong copper demand from China and other developing countries.

### Zinc

In 2010, the LME zinc price averaged US$0.98 per pound, with the price fluctuating in a range between US$0.73 per pound and US$1.22 per pound over the course of the year. While zinc demand grew significantly in 2010, mine and refinery production also grew substantially in response to higher zinc prices, leading to continued growth in LME inventories to levels near the historical highs seen in 2003 and 2004.

Continued strong economic growth globally will likely be needed to support current zinc prices over the next two years. However, third party forecasts for global zinc production highlight the expected closure of a number of major zinc mines starting in 2012 and an absence of new zinc projects to replace the lost production, which suggests a positive medium-term outlook for zinc prices.

### Gold

Gold prices averaged US$1,225 per ounce during 2010. The gold price appreciated steadily over 2010, reaching US$1,420 per ounce by the end of the year. The price of gold has continued to benefit from concerns about the risk of rising inflation as a result of the aggressive monetary response to the global recession from the world's major central banks.

### Silver

Silver prices averaged US$20.16 per ounce during 2010. As with gold, silver prices increased to a high at the end of the year reaching US$30.90.

### Foreign Exchange

As revenues from our principal products are substantially denominated in US dollars, we are affected by fluctuations in the Canadian/US dollar exchange rate. In general, a stronger Canadian dollar causes our revenue, and therefore earnings, to decrease when our US dollar receipts are converted to Canadian dollars, because the majority of our operating costs are denominated in Canadian dollars. In addition, a stronger Canadian dollar may result in foreign exchange losses due to depreciation in the value of US dollar denominated cash balances.

The Canadian dollar traded in a relatively narrow band relative to the US dollar, reaching lows of approximately $1.07 per US dollar and highs of just above parity with the US dollar, where it ended the year.

## Sensitivity Analysis

### Net Earnings Sensitivity

The following table displays the approximate impact of changes in metal prices and exchange rates on our 2011 net earnings.

| | | Change of 10%, as represented by:[1, 2] | Would change 2011 net earnings by[1] (C$ million) | Would change 2011 net earnings per share by[3] (C$/share) |
|---|---|---|---|---|
| Copper[1] | lb. | US$ 0.40 | 23.1 | 0.15 |
| Zinc[1] | lb. | US$ 0.10 | 10.1 | 0.07 |
| Gold[1] | troy oz. | US$ 130.00 | 6.2 | 0.04 |
| Silver[1] | troy oz. | US$ 2.50 | 0.8 | 0.01 |
| Exchange rates[2] | US$1 to C$ | C$ 0.10 | 40.5 | 0.27 |

1 Based on exchange rate of US$1 to C$1.

2 Based on metal prices of US$1.00/lb. zinc, US$4.00/lb. copper, US$1,300/oz. gold and $25.00/oz silver.

3 Based on weighted average number of common shares outstanding of 149.4 million.

# Financial Review

## Earnings Increased in the Fourth Quarter of 2010

For the fourth quarter, net earnings attributable to common shareholders were $24.5 million, reflecting a $17.3 million increase from the fourth quarter of 2009. Net earnings of $73.0 million for 2010 reflected a decrease of $39.5 million from the same period in 2009. Significant variances affecting earnings compared to the same periods in 2009 are as follows:

| (in $ millions) | Three months ended Dec. 31, 2010 | Year ended Dec. 31, 2010 |
|---|---|---|
| Increase (decrease) in earnings components compared to same period in 2009: | | |
| Revenues | 16.6 | 58.1 |
| Expenses | | |
| Operating | 10.6 | 55.2 |
| Depreciation and amortization | 6.9 | (2.7) |
| General and administrative | 7.4 | 16.0 |
| Stock-based compensation | (1.2) | (1.8) |
| Accretion of asset retirement obligations | 0.5 | 0.1 |
| Foreign exchange loss | (2.7) | 9.3 |
| Exploration | (7.0) | (22.2) |
| Interest and other income | 1.1 | (99.1) |
| Gain (loss) on derivative instruments | (0.2) | 3.7 |
| Non-controlling interests | 3.0 | 3.0 |
| Future taxes | (19.6) | (19.7) |
| Current taxes | 1.9 | (39.4) |
| Increase (decrease) in net earnings attributable to common shareholders | 17.3 | (39.5) |

Earnings were higher in the fourth quarter of 2010 due to sales prices of metals sold offset by higher exploration expenses and taxes. Earnings were lower in 2010 since we had recognized a gain of $99.9 million on sale of shares of Lundin Mining Corporation ("Lundin") in 2009. However, this was offset by improvements in revenues, operating expenses and general and administrative expenses.

## Revenue Increased in the Fourth Quarter of 2010

Total revenue for the fourth quarter was $183.3 million, $16.6 million higher than the same quarter last year. 2010's total revenue was $778.8 million, $58.1 million higher than 2009. The increases were due to the following:

| (in $ millions) | Three months ended Dec. 31, 2010 | Year ended Dec. 31, 2010 |
|---|---|---|
| **Metal prices** | | |
| Higher copper prices | 28.6 | 158.0 |
| Higher zinc prices | 3.7 | 62.3 |
| Higher gold prices | 7.6 | 27.0 |
| **Sales volumes** | | |
| Lower copper sales volumes | (2.8) | (103.1) |
| Lower zinc sales volumes | (5.1) | (10.1) |
| Lower gold sales volumes | (5.8) | (16.8) |
| **Other** | | |
| Stronger Canadian dollar | (6.7) | (66.4) |
| Other volume and pricing differences | (2.9) | 7.2 |
| Change in revenues compared to same period in 2009 | 16.6 | 58.1 |

Sales of copper, gold and silver contained in copper concentrate were adversely affected in the third and fourth quarters by the inability of our rail service provider to supply sufficient railcars to transport our concentrate production, together with weather-related shipping delays at port, late in 2010.

Sales of copper concentrate in 2011 to our principal customer will be lower than previously expected following the exercise by that customer of a one-time option to reduce their 2011 purchases. While we expect to sell our remaining 2011 production and excess inventory to other customers in the spot market for concentrate, doing so will require additional railcar capacity than would be the case if our principal customer agreed to take its full allotment in 2011. We have made arrangements to lease additional rail cars, enabling us to transport current production and reduce excess inventory gradually. We expect to draw down and sell most of the excess inventory over the course of calendar 2011.

Under the terms of contracts with our concentrate suppliers and customers, our concentrate purchases and sales are "provisionally priced". For these contracts, prices are subject to final adjustment at the end of a future period after shipment, based on quoted market prices during the quotational period specified in the contract. At each reporting date, the fair value of the final purchase or sales price adjustment is re-estimated, and changes in fair value, metal weights and assays are recognized as adjustments to revenue (in the case of concentrate sales) or cost of sales (in the case of concentrate purchases). We recorded $12.7 million in net provisional revenue pricing adjustments in the fourth quarter of 2010 and $20.5 million for the 2010 year.

Our revenue by significant product types is summarized as follows:

| (in $ millions) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Copper | **87.4** | 64.2 | **380.8** | 354.2 |
| Zinc | **44.1** | 55.2 | **178.3** | 172.8 |
| Gold | **22.8** | 21.9 | **103.6** | 103.0 |
| Silver | **4.8** | 8.5 | **20.8** | 35.5 |
| Other | **29.9** | 17.8 | **108.2** | 60.8 |
| Gross revenue | **189.0** | 167.6 | **791.7** | 726.3 |
| Less: treatment & refining charges | **(5.7)** | (0.9) | **(12.9)** | (5.6) |
| Revenue | **183.3** | 166.7 | **778.8** | 720.7 |

In accordance with our accounting policy, we deduct concentrate treatment and refining charges paid to third parties from revenues for financial statement presentation.

## Realized Prices Increased in the Fourth Quarter of 2010

| | | | Realized prices[1] for three months ended | | | Realized prices[1] for year ended | |
|---|---|---|---|---|---|---|---|
| | | **LME Q4 2010[2]** | **Dec. 31, 2010** | Dec. 31, 2009 | **LME 2010[2]** | **Dec. 31, 2010** | Dec. 31, 2009 |
| **Prices in US$** | | | | | | | |
| Zinc[3] | US$/lb | **1.05** | **1.08** | 1.02 | **0.98** | **1.03** | 0.79 |
| Copper[3] | US$/lb | **3.92** | **4.56** | 3.10 | **3.42** | **3.55** | 2.34 |
| Gold | US$/troy oz. | **1,367** | **1,459** | 1,081 | **1,225** | **1,238** | 950 |
| Silver | US$/troy oz. | **26.43** | **33.25** | 16.96 | **20.16** | **20.03** | 14.19 |
| **Prices in C$** | | | | | | | |
| Zinc[3] | C$/lb | **1.06** | **1.10** | 1.08 | **1.01** | **1.06** | 0.88 |
| Copper[3] | C$/lb | **3.97** | **4.62** | 3.29 | **3.52** | **3.66** | 2.68 |
| Gold | C$/troy oz. | **1,385** | **1,479** | 1,131 | **1,262** | **1,278** | 1,093 |
| Silver | C$/troy oz. | **26.77** | **33.70** | 17.91 | **20.76** | **20.67** | 16.26 |
| Exchange rate | US$1 to C$ | | **1.01** | 1.06 | | **1.03** | 1.14 |

1 Realized prices are before refining and treatment charges and only on the sale of finished metal or metal in concentrate. Realized prices for copper in 2010 reflect an average of prices realized for copper cathode and spent anode sales and sales of contained copper in concentrate. Realized prices for gold and silver in 2010 reflect an average of prices realized for precious metal slimes and spent anode sales and sales of contained gold and silver in concentrate.

2 London Metals Exchange ("LME") average for zinc, copper and gold prices, London Spot US equivalent for silver prices. HudBay's copper sales contracts are primarily based on Comex copper prices.

3 The realized components of our metal swap cash flow hedges resulted in a gain of US$0.01/lb. for zinc during the fourth quarter of 2010 (full year gain of US$0.01/lb. for zinc). Refer to "Base Metal Price Strategic Risk Management" on page 54.

The price, quantity and mix of metals sold, along with movements in the Canadian dollar, affect our revenue, operating cash flow and earnings. Revenue from metal sales can vary from quarter to quarter due to production levels, shipping volumes, and risk and title transfer terms with customers.

## Outlook (see Forward-Looking Information – page 25)

Revenues will continue to be affected by the volume of purchased zinc concentrates and the market prices of zinc, copper, gold and silver, together with fluctuation of the US dollar exchange rate compared to the Canadian dollar. Average market prices for zinc and copper in 2011 to date have been higher than average prices in 2010. If this trend continues, it will positively impact revenues in 2011 as compared to 2010.

In addition, the sale of excess copper concentrate inventory in 2011 is expected to result in higher copper and gold sales quantities in 2011 compared to 2010, assuming that we achieve our production objectives and obtain sufficient rail car capacity.

## Operating Expenses Decreased in the Fourth Quarter of 2010

| ($000s) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| **Non-GAAP detailed operating expenses**[1] | | | | |
| **Mines** | | | | |
| 777 | **15,211** | 15,763 | **54,364** | 58,897 |
| Trout Lake | **7,978** | 10,896 | **35,788** | 36,391 |
| Chisel North[2] | **5,805** | — | **16,272** | 2,436 |
| **Concentrators** | | | | |
| Flin Flon | **6,882** | 6,026 | **24,025** | 21,642 |
| Snow Lake | **1,640** | — | **4,925** | 1,090 |
| **Metallurgical plants** | | | | |
| Zinc plant | **19,210** | 19,240 | **74,395** | 70,141 |
| Copper smelter | **—** | 12,587 | **20,896** | 47,902 |
| WPCR | **—** | 3,249 | **7,276** | 12,561 |
| **Other** | | | | |
| Purchased concentrate treated | **17,651** | 26,843 | **43,984** | 116,783 |
| Anode freight & refining | **65** | 769 | **3,336** | 6,373 |
| Services & administration | **11,125** | 11,313 | **40,921** | 39,823 |
| HBMS employee profit sharing | **5,252** | 1,766 | **15,849** | 8,124 |
| Net profits interest | **8,213** | 4,204 | **22,059** | 14,658 |
| Other[3] | **15,045** | 13,862 | **61,947** | 52,764 |
| Changes in domestic inventory[4] | **(21,529)** | (22,303) | **13,751** | 8,471 |
| HMI Nickel | **2,753** | 1,724 | **11,318** | 8,219 |
| **Total operating expenses** | **95,301** | 105,939 | **451,106** | 506,275 |

1 Refer to "Non-GAAP Measures" on page 69.

2 During the first quarter of 2010, while Chisel North was undergoing start-up, all costs were initially capitalized. During the second quarter, we transferred $1.0 million from capital to operating expenses along with the related 11,703 tonnes of pre-production ore.

3 Includes Zochem operating costs, care and maintenance costs for Balmat for 2010 and 2009 and Chisel North for 2009.

4 A reduction of inventories requires recognition of additional operating expenses to reflect the cost of sales during the period. Conversely, an increase in inventories requires a negative adjustment to operating expenses.

For the fourth quarter of 2010, our operating expenses were $95.3 million, $10.6 million lower than the same quarter last year. In addition, 2010's full year of operating expenses was $451.1 million, $55.2 million lower than 2009. The decreases were due to the following:

| (in $ millions) | **Three months ended Dec. 31, 2010** | **Year ended Dec. 31, 2010** |
|---|---|---|
| Decreased volumes of purchased copper concentrate | **(7.3)** | **(65.8)** |
| Decreased volumes of purchased zinc concentrate | **(1.9)** | **(7.0)** |
| Smelter and refinery costs | **(15.8)** | **(32.3)** |
| Chisel North operating costs | **7.4** | **17.7** |
| Zochem zinc purchases | **3.0** | **17.6** |
| Other provisions, primarily related to smelter closure | **(0.8)** | **(3.8)** |
| Changes in domestic inventory | **0.8** | **5.3** |
| Higher profit sharing | **3.5** | **7.7** |
| Other operating expenses | **0.5** | **5.4** |
| Decrease in operating expenses compared to same period in 2009 | **(10.6)** | **(55.2)** |

Purchased copper concentrate volumes and direct smelter and refinery costs decreased due to the closure of the smelter. Some of these cost reductions were offset by concentrate treatment and refining charges payable to third parties, which are reduced from revenue in accordance with our accounting policies. Lower zinc concentrate purchases were more than offset by the addition of Chisel North operating costs and production in 2010.

We acquired our Balmat mine from a third party in 2003 for consideration that included a commitment to pay 30% of future net free cash flow from the Balmat operations to the vendor, up to a cap of US$25 million. The acquisition terms placed limitations on our ability to freely dispose of the Balmat assets pending full satisfaction of the purchase price. The vendor also remained responsible for certain environmental liabilities associated with Balmat. In the second quarter of 2010, we agreed with the vendor to settle the satisfaction of the purchase price and all other rights, claims, liabilities and causes of action between the parties with a payment of US$2.5 million from us and completed this transaction in the third quarter of 2010. We determined that it was appropriate to recognize an asset retirement obligation of $3.1 million associated with liabilities at Balmat in the second quarter. We expensed the full amount related to this obligation in operating expenses in the second quarter. Upon completing the settlement described above with the vendor in the third quarter, we recognized the US$2.5 million payment as property, plant and equipment based on the estimated salvage value of the assets. In the fourth quarter, we expensed an additional $1.5 million in operating expenses due to a revision in estimate.

| | | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **Unit operating costs** | | | | | |
| **Mines** | | | | | |
| 777 | $/tonne | **41.77** | 42.85 | **36.53** | 38.24 |
| Trout Lake | $/tonne | **67.09** | 67.24 | **66.20** | 53.57 |
| Chisel North[1] | $/tonne | **85.97** | — | **71.52** | — |
| Total mines[1] | $/tonne | **52.66** | 50.31 | **47.02** | 40.88 |
| **Concentrators** | | | | | |
| Flin Flon | $/tonne | **13.88** | 11.04 | **11.77** | 9.63 |
| Chisel North[1] | $/tonne | **27.23** | — | **24.35** | — |
| **Metallurgical plants** | | | | | |
| Zinc plant | $/lb. Zn | **0.343** | 0.304 | **0.337** | 0.298 |
| Copper smelter[2] | $/lb. Cu | **—** | 0.457 | **0.478** | 0.371 |
| WPCR[3] | US$/lb. Cu | **—** | 0.129 | **0.112** | 0.098 |

1 Production at our Chisel North mine was suspended in early 2009, thus 2009 costs are not shown here. However, mining costs are reflected within the weighted average unit costs presented for total mines.

2 The copper smelter was shut down in June 2010.

3 Production at WPCR ceased in July 2010. The above figures reflect costs incurred from January to June as production in July was minimal.

For the fourth quarter, significant variances for 2010 versus 2009 were:

- **Depreciation and amortization** decreased by $6.9 million, totaling $20.8 million for the fourth quarter of 2010, primarily as the smelter and copper refinery had been shut down earlier in the year.
- **General and administrative** expenses decreased by $7.4 million, totaling $9.0 million for the fourth quarter of 2010. In 2009, general and administrative expense was higher mainly due to $6.9 million of severance costs for key management employees.
- **Stock-based compensation** increased by $1.2 million to $2.4 million in the fourth quarter of 2010 primarily related to expense of restricted share units ("RSUs") issued during the 2010 year.
- **Foreign exchange** decreased by $2.7 million to a loss of $4.2 million in the fourth quarter of 2010. Foreign exchange represents changes in the Canadian dollar value of our foreign currency denominated operating accounts (including certain cash and cash equivalents, accounts receivable, accounts payable and derivatives) in response to changes in the value of the Canadian dollar relative to foreign currencies over the period. Our foreign currency denominated operating accounts are held primarily in US dollars and small amounts are held in Guatemalan quetzals. The value of the Canadian dollar relative to the US dollar increased over the fourth quarter of 2010, with exchange rates moving from $1.03 as at September 30, 2010 to $0.99 as at December 31, 2010, resulting in a foreign exchange loss of $4.2 million in the fourth quarter of 2010. Over the same period in the prior year, the value of the Canadian dollar increased, with exchange rates moving from $1.07 as at September 30, 2009 to $1.05 as at December 31, 2009, which resulted in a foreign exchange loss of $1.4 million in the fourth quarter of 2009.
- **Exploration expenses** increased by $7.0 million to $11.0 million for the fourth quarter of 2010, reflecting higher levels of exploration activity in line with our 2010 exploration plan and our commitment to the Back Forty project. Refer to "Capital Expenditures" on page 49 for information on capitalized exploration expenditures.

For the year, significant variances for 2010 versus 2009 were:

- **Depreciation and amortization** increased by $2.7 million, totaling $103.4 million for the 2010 year, primarily as a result of increases in depreciation rates for operating assets, including accelerated depreciation for the smelter and copper refinery, which were shut down late in the second quarter and early in the third quarter, respectively.
- **General and administrative** expenses decreased by $16.0 million, totaling $28.1 million for the 2010 year. The decrease resulted mainly from costs in 2009 related to the Lundin transaction, shareholder litigation, proxy solicitation and severance.
- **Stock-based compensation** increased by $1.8 million to $6.5 million for the 2010 year primarily due to the issuance of deferred share units ("DSUs"), RSUs and stock options during 2010.
- **Foreign exchange** improved by $9.3 million, to a loss of $8.5 million in 2010. The loss represents changes in the Canadian dollar value of our foreign currency denominated operating accounts (including certain cash and cash equivalents, accounts receivable, accounts payable and derivatives) in response to changes in the value of the Canadian dollar relative to foreign currencies over the period. Our foreign currency denominated operating accounts are held primarily in US dollars and small amounts are held in Guatemalan quetzals. The value of the Canadian dollar relative to the US dollar increased over the 2010 year, with exchange rates moving from $1.05 as at December 31, 2009 to $0.99 as at December 31, 2010, resulting in a foreign exchange loss of $8.5 million for the 2010 year. Over the same period in the prior year, the value of the Canadian dollar increased, with exchange rates moving from $1.22 as at December 31, 2008 to $1.05 as at December 31, 2009, which resulted in a foreign exchange loss of $17.8 million for the 2009 year.
- **Exploration expenses** increased by $22.2 million to $29.8 million for the 2010 year. The increase reflected higher levels of exploration activity in line with our 2010 exploration plan and our commitment to the Back Forty project. Refer to "Capital Expenditures" on page 49 for information on capitalized exploration expenditures.
- **Interest and other income** decreased by $99.1 million, mainly due to the gain of $99.9 million on the sale of Lundin shares recognized in the second quarter of 2009.
- **Gain (loss) on derivative instruments** increased by $3.7 million to a gain of $2.8 million in 2010 as we recognized gains on warrants of listed common shares.

### Outlook

Operating expenses will continue to be affected by the volume of purchased zinc concentrates as well as production volumes. The sale of excess copper concentrate inventory will also be reflected in 2011 operating costs. Depreciation expense is expected to decline compared to the previous twelve months, as the accelerated depreciation from the closure of the smelter and refinery was largely completed by the end of the second quarter of 2010. General and administrative costs are expected to increase modestly over the remainder of 2011 from 2010 levels due to increased corporate and business development activities.

#### Tax Expense

Tax expense for the 2010 year decreased earnings by $59.1 million (fourth quarter – $17.7 million), compared to the same period in 2009.

| ($000s) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Non-cash – income tax expense[1] | **5,546** | (4,747) | **14,029** | (887) |
| Non-cash – mining tax expense[1] | **2,589** | (6,714) | **7,852** | 3,105 |
| Total non-cash tax expense | **8,135** | (11,461) | **21,881** | 2,218 |
| Estimated current taxes payable – income tax | **6,493** | 10,895 | **39,759** | 24,102 |
| Estimated current taxes payable – mining tax | **5,321** | 2,821 | **26,427** | 2,668 |
| Total estimated current taxes payable | **11,814** | 13,716 | **66,186** | 26,770 |
| Tax | **19,949** | 2,255 | **88,067** | 28,988 |

1 Non-cash tax expenses represent our draw-down/increase of non-cash future income and mining tax assets/liabilities.

#### Income Tax Expense

Our effective income tax rate for the 2010 year was approximately 34.0% (fourth quarter – 28.9%). As a result, we recorded income tax expense of $53.8 million (fourth quarter – $12.0 million) for the full year.

Significant items causing our 2010 effective income tax rate to be higher than the 30% statutory income tax rate include:

- Our US operations recorded losses of $31.9 million (fourth quarter – $5.1 million). These losses cause temporary differences, which result in a future tax asset. However, we have determined that we are not more likely than not to realize the benefit related to these future tax assets; accordingly, we have increased our valuation allowance, which offsets the future tax asset. The net effect is an increase to our effective tax rate because we have recorded a loss for accounting purposes but not recorded a corresponding tax benefit.

- Our Guatemalan operations realized a loss of approximately $7.0 million (fourth quarter – loss of $0.9 million). In Guatemala, there are two tax regimes for income tax purposes; the "general tax regime" applies tax at a rate of 5% of gross revenue, and the "alternative tax regime" subjects the net taxable income of CGN to a tax at a rate of 31%. Guatemalan companies have the option of electing on an annual basis to be taxed under the "alternative tax regime" for the following year. It is our view that CGN will pay tax under the "general tax regime" when temporary differences reverse. As the "general tax regime" applies tax on gross revenue, the reversal of temporary differences will not result in future cash outflows. Consequently, no future taxes have been recognized with respect to our Guatemalan operations. The net effect is an increase to our effective tax rate because we have recorded an expense for accounting purposes but not recorded a corresponding tax benefit.

- We increased our valuation allowance by approximately $5.0 million with respect to increases in temporary differences realized in the 2010 year (fourth quarter – increase of $3.8 million) that relate to obligations associated with mine closure.

- In the fourth quarter, the Company resolved a dispute with the taxation authorities related to the 1994 taxation year. As part of the settlement agreement, the Company was permitted to amend a number of its historical tax returns. The net impact of the settlement and related tax return amendments was a recovery of tax of $5.5 million.

**Mining Tax Expense**

The Province of Manitoba imposes mining tax on net earnings related to the sale of mineral products mined in Manitoba (mining taxable profit) at the following rates:

- 10% of total mining taxable profit if mining profit is $50 million or less;
- 15% of total mining taxable profit if mining profits are between $55 million and $100 million; and
- 17% of total mining taxable profit if mining profits exceed $105 million.

We have accumulated mining tax pools over the years and recorded the related benefits as future mining tax assets. We estimate that the tax rate that will be applicable when temporary differences reverse will be 17%.

For the 2010 year, our effective rate for mining taxes was approximately 21.7% (fourth quarter – 19.0%). For the 2009 year, mining taxes were approximately 4.1% on earnings before tax. Effective mining tax rates can vary significantly based on the composition of our earnings and the expected amount of mining taxable profits. The effective mining tax rate for 2009 was significantly lower than 2010 as a result of lower estimated mining taxable profit in 2009 which resulted in mining taxable profit being taxed at the 10% rate rather than the 17% rate which is applicable in 2010. In addition, the exclusion of certain amounts, including the gain on the disposition of the Lundin shares, from the calculation of mining taxable profit also reduced mining taxable profit in 2009. The fourth quarter tax rate was lower than the tax rate for the 2010 year as a result of revisions to our estimates of 2010 mining taxable profits.

## Trend Analysis and Quarterly Review

The following table sets forth selected consolidated financial information for each of our eight most recently completed quarters.

| | | | | **2010** | | | | 2009 |
|---|---|---|---|---|---|---|---|---|
| ($000s) | **Q4** | **Q3** | **Q2** | **Q1** | Q4 | Q3 | Q2 | Q1 |
| Revenue | **183,280** | **163,367** | **191,851** | **240,320** | 166,673 | 194,608 | 197,657 | 161,784 |
| EBITDA[1] | **71,745** | **55,465** | **69,596** | **83,434** | 40,571 | 58,769 | 28,397 | 15,602 |
| Operating cash flow[1, 2] | **59,927** | **39,825** | **41,027** | **59,071** | 33,624 | 48,102 | 28,820 | 13,966 |
| Earnings before tax | **41,606** | **29,572** | **34,572** | **52,355** | 9,620 | 32,515 | 104,504 | (5,171) |
| Net earnings | **21,657** | **11,670** | **13,162** | **23,549** | 7,365 | 19,727 | 89,234 | (3,846) |
| Earnings per share: | | | | | | | | |
| Basic | **0.16** | **0.08** | **0.09** | **0.15** | 0.05 | 0.13 | 0.58 | (0.03) |
| Diluted | **0.16** | **0.08** | **0.09** | **0.15** | 0.05 | 0.13 | 0.58 | (0.03) |

1 Refer to "Non-GAAP Measures" on page 69.

2 Before changes in non-cash working capital.

The price, quantity and mix of metals sold, along with movements in the Canadian dollar, affect our revenue, operating cash flow and earnings. Revenue from metal sales can vary from quarter to quarter due to production levels, shipping volumes, and risk and title transfer terms with customers.

In 2010, we reported higher EBITDA and operating cash flow due to increased prices for zinc and copper, offset by a decline in volumes and a stronger Canadian dollar. In comparison, our 2009 EBITDA and operating cash flow was lower as the global economy recovered from late 2008. A significant weakening of the Canadian dollar, which occurred at the same time as the decline in metals prices, partially offset this trend.

In the second quarter of 2009, we realized a gain of $99.9 million on the disposition of our interest in Lundin.

The following table sets forth selected consolidated financial information for each of the three most recently completed years.

| ($000s) | 2010 | 2009 | 2008 |
|---|---|---|---|
| Revenue | **778,818** | 720,722 | 981,894 |
| Earnings before tax and non-controlling interests | **158,105** | 141,468 | 168,603 |
| Operating cash flow[1] | **199,850** | 124,512 | 234,255 |
| Net earnings attributable to common shareholders | **72,985** | 112,440 | 72,947 |
| Earnings per share: | | | |
| Basic | **0.48** | 0.73 | 0.54 |
| Diluted | **0.48** | 0.73 | 0.54 |
| Total assets | **2,173,086** | 2,032,686 | 1,918,353 |
| Total long-term financial liabilities[2] | **94,676** | 90,176 | 102,361 |
| Cash dividends declared per common share | **$ 0.10** | $ — | $ — |

1 Before changes in non-cash working capital. Refer to "Non-GAAP Measures" on page 69.

2 Total long-term financial liabilities consist of non-current portions of pension obligations, other employee future benefits, obligations under capital leases, and fair value of derivative liabilities.

In 2010, our revenue, operating cash flow and earnings before tax were significantly higher primarily due to higher metal prices and a better economic climate compared to 2009.

## Financial Condition, Cash Flows, Liquidity and Capital Resources

### Financial Condition at December 31, 2010 Compared to December 31, 2009

Cash and cash equivalents of $901.7 million as at December 31, 2010 reflected a $14.9 million increase from December 31, 2009. We have not invested in asset-backed commercial paper, and our cash equivalents are held in low-risk, liquid investments and deposit accounts with major Canadian banks. The increase in our cash and cash equivalents during 2010 resulted from positive operating cash flow, release of restricted cash and changes in non-cash working capital offset by capital expenditures, strategic investments, repurchase of shares and dividend payments.

Working capital decreased by $43.2 million to $902.5 million from December 31, 2009 to December 31, 2010. In addition to the higher cash and cash equivalents position, inventory decreased by $9.4 million as the build-up in copper concentrate inventory was more than offset by the reduction in copper and gold metals and the sale of anode inventories from 2009. Receivables increased by $38.0 million over the same period, primarily due to increased metal prices and the change of payment terms as we transitioned from sales of copper and gold to sales of concentrates. Zinc prices and increased zinc oxide sales also contributed to the increase. Payables increased due to Callinan NPI accruals and prior year adjustment, increased Lalor capital expenditures and higher profit sharing. We also recognized deferred revenue of $24.4 million related to two copper concentrate lots initiated in December 2010 that did not meet criteria for revenue recognition. Taxes payable increased by $33.1 million due to timing of payments and increased taxes in 2010 due to higher estimated taxable income.

During 2010, we repurchased 5,047,100 of our own shares at a cost of $63.3 million and reduced our share capital by $21.1 million, contributed surplus by $3.4 million and retained earnings by $35.8 million. In total, we repurchased 5,646,700 shares for approximately $68.3 million since the inception of the NCIB in 2009. We did not renew the NCIB upon its expiry on September 30, 2010.

The following table summarizes our cash flows for the three months and year ended December 31, 2010 and December 31, 2009.

| ($000s) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Net earnings for the period | **21,657** | 7,365 | **70,038** | 112,480 |
| Items not affecting cash | **38,270** | 26,259 | **129,812** | 12,032 |
| Net change in non-cash working capital items | **4,937** | 6,008 | **55,740** | (18,318) |
| Cash provided by operating activities | **64,864** | 39,632 | **255,590** | 106,194 |
| Cash used in investing activities | **(11,103)** | (33,347) | **(162,275)** | 564,209 |
| Cash (used in) provided by financing activities | **(2,751)** | 1,619 | **(75,610)** | 118 |
| Effect of exchange rate changes on cash and cash equivalents | **(1,056)** | (1,382) | **(2,826)** | (9,434) |
| Increase in cash and cash equivalents | **49,954** | 6,522 | **14,879** | 661,087 |

### Cash Flow from Operating Activities

Operating activities provided $64.9 million of cash flows in the fourth quarter of 2010, representing an increase of $25.2 million compared to the same period in 2009. This increase in 2010 compared to 2009 was due to various factors such as changes in non-cash working capital and higher copper prices.

In 2010, cash provided by operations was $255.6 million, reflecting an increase of $149.4 million from the same period in 2009. The overall increase is mainly due to higher copper and zinc prices in 2010 and changes in non-cash working capital. Significant changes in 2010 working capital included increases in accounts receivables of $38.0 million, inventories which decreased by $9.4 million, accounts payables which increased by $14.8 million and taxes payable which increased by $31.8 million.

### Cash Flow from Investing and Financing Activities

During the fourth quarter of 2010, our investing and financing activities used cash of $13.9 million, primarily driven by capital expenditures of $53.8 million and the purchase of strategic investments of $12.3 million, significantly offset by the release of restricted cash of $57.1 million. In the same quarter of 2009, our investing and financing activities used cash of $31.7 million, as we invested in capital expenditures of $36.2 million.

We used $237.9 million in investing and financing activities in 2010, due to capital asset additions of $167.6 million, repurchases of common shares of $63.3 million, strategic investments of $52.6 million and dividend payments of $14.9 million, partially offset by the release of restricted cash of $54.6 million. In 2009, our investing and financing activities provided cash of $564.3 million, as we disposed certain of our short term investments of $478.9 million and our interest in Lundin for proceeds of $235 million and invested in capital expenditures of $99.9 million and additions to restricted cash of $48.5 million.

### Capital Expenditures

The following tables summarize additions to capital assets, which include $7.4 million (2009: $4.1 million) of non-cash additions.

| (in $ millions) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Plant and equipment | **10.5** | 8.7 | **54.0** | 26.4 |
| Capital development | **8.2** | 11.0 | **37.4** | 38.9 |
| Capitalized exploration | **38.1** | 10.9 | **81.5** | 24.5 |
| Capitalized Fenix project | **0.4** | 0.1 | **2.2** | 14.3 |
| Total | **57.2** | 30.7 | **175.1** | 104.1 |

Our capital expenditures in the fourth quarter of 2010 were $26.5 million higher than the same period in 2009, mainly due to capital expenditures associated with Lalor.

| (in $ millions) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| 777 mine | **7.2** | 5.2 | **22.0** | 21.5 |
| Trout Lake mine | **5.5** | 4.7 | **16.9** | 21.9 |
| Chisel North mine | **1.5** | 2.0 | **10.1** | 1.9 |
| Balmat mine and concentrator | **—** | — | **2.6** | — |
| Flin Flon and Snow Lake concentrators | **0.2** | 0.6 | **2.0** | 2.1 |
| Flin Flon and Snow Lake other | **1.8** | 1.7 | **5.4** | 3.9 |
| Zinc plant | **2.1** | 1.7 | **9.8** | 5.4 |
| Copper Smelter & WPCR[1] | **4.2** | 5.1 | **24.4** | 10.8 |
| Other | **—** | 1.7 | **3.7** | 2.7 |
| Sustaining capital expenditures | **22.5** | 22.7 | **96.9** | 70.2 |
| Lalor project | **28.7** | 7.9 | **68.6** | 19.6 |
| Fenix project | **0.4** | 0.1 | **2.2** | 14.3 |
| VMS | **2.6** | — | **2.6** | — |
| 777 North | **3.0** | — | **4.8** | — |
| Growth capital expenditures | **34.7** | 8.0 | **78.2** | 33.9 |
| Total | **57.2** | 30.7 | **175.1** | 104.1 |

1 These amounts relate primarily to capital expenditures associated with the preparations for sales of concentrates.

### Liquidity

On November 3, 2010, we entered into a credit agreement with a syndicate of banks for a new US$300 million revolving credit facility. The facility has an initial term of four years and is secured by a pledge of assets of the parent company and unconditionally guaranteed by our material subsidiaries. The facility contains customary limitations on our ability to make dividend and other payments to shareholders, none of which are expected to affect our ability to continue with the dividend policy currently in place. The facility also contains customary financial maintenance covenants, including minimum tangible net worth, debt to EBITDA and interest coverage, which we were in compliance with at December 31, 2010. At December 31, 2010, we had $56.9 million in letters of credit outstanding which would have had to be secured with cash and cash equivalents if the credit facility was unavailable.

Our cash and cash equivalents balance of $901.7 million and revolving credit facility provide a substantial cushion against unanticipated demands on liquidity.

## Contractual Obligations and Commitments

The following table summarizes, as at December 31, 2010, certain of HudBay's contractual obligations for the period specified.

| Payment schedule ($000s) | Total | Less than 1 year | 2–3 years | 4-5 years | After 5 years |
|---|---|---|---|---|---|
| Operating lease obligations | 24,652 | 2,210 | 5,520 | 5,410 | 11,512 |
| Purchase obligations | 20,074 | 19,924 | 100 | 50 | — |
| Pension and other employee future benefits obligations | 107,645 | 19,440 | 9,968 | 8,982 | 69,255 |
| Asset retirement obligations[1] | 138,836 | 6,467 | 6,206 | 2,386 | 123,777 |
| Total | 291,207 | 48,041 | 21,794 | 16,828 | 204,544 |

[1] Before inflation and market risk.

In addition to the contractual obligations included in the above payment schedule, HudBay also has the following commitments:

- Commitments to purchase zinc concentrates, with payments related to market prices over a quotational period;
- A profit-sharing plan with most HBMS employees;
- A royalty agreement and net profit interest agreements related to the 777 mine;
- Collective Bargaining Agreements in place with unionized Flin Flon/Snow Lake workforce that prohibit strikes and lockouts and provide for binding arbitration;
- A contingent commitment to make payments based on tonnages of ore mined at areas of the Fenix project and to pay a sales agency fee and net smelter return if a ferro-nickel plant is operated; and
- A requirement to provide security to the Government of Guatemala for commitments related to the Fenix project under an approved Environmental Impact Assessments program.

Additional details on the above commitments are available in notes 19b and 19c to our December 31, 2010 annual consolidated financial statements.

## Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas where management's judgment is applied include ore reserve determinations used in amortization of certain property, plant and equipment, in-process inventory quantities and provision for inventory obsolescence, cost allocations for inventory, plant and equipment estimated economic lives and salvage values, assessment of impairment, ultimate realization of capitalized exploration costs, cost allocations for mine development, fair value of certain assets and liabilities, purchase price allocations, contingent liabilities, future income and mining tax assets and valuation reserves, interpretation of tax legislation, allocation of revenue and costs to non-Manitoba sourced ore for the purpose of computing Manitoba mining taxes payable, asset retirement obligations, stock-based compensation, pension obligations and other employee future benefits. Actual results could differ from those estimates by material amounts. These estimates are reviewed at least annually, and changes in estimates are reported in earnings in the period in which they became known.

### Mineral Reserves and Resources

HudBay estimates mineral reserves and resources to determine future recoverable mine production based on assessment of geological, engineering and metallurgical analyses, estimates of future production costs, capital costs and reclamation costs, as well as long-term commodity prices and foreign exchange rates. Capitalized costs of mineral properties and mine development are amortized on a unit-of-production basis, based on related proven and probable mineral reserves.

### Impairment

We review the carrying value of operating mines and plant and equipment for impairment when events or changes in circumstances indicate that the carrying amounts of related assets may not be recoverable. If total estimated future cash flows on an undiscounted basis are less than the carrying amount of the asset, we measure and record an impairment loss to write down the assets to fair value, which is normally the discounted value of future cash flows. Cash flows include the production of both mineral reserves and a portion of mineral resources based on management's best estimate of the most probable production profile. Cash flows are also dependent on estimates of future production costs, capital expenditures, salvage values, closure costs, reclamation costs as well as long term commodity prices and foreign exchange rates.

### In-Process Inventories

In-process copper concentrates and zinc metal inventory quantities comprise a large part of our inventories by value and represent materials that are in the process of being converted into saleable product. HudBay measures in-process inventories based on assays of material received at metallurgical plants and estimates of recoveries in the production processes. We estimate the realizable value of in-process inventories at financial statement dates and carry inventories at the lower of cost and estimated net realizable value. Where the net realizable value is less than the accumulated costs that have been allocated to that inventory, an impairment charge is reported as part of current period operating costs to reduce the carrying value of the inventory.

### Future Tax Assets and Liabilities

We use the asset and liability method of tax allocation for accounting for income taxes. Future income and mining tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities. Future tax assets and liabilities are measured using substantively enacted tax rates expected to be in effect in the years that differences reverse. These determinations rely on management's estimate of when temporary differences will reverse, as well as management's interpretation of tax legislation. Future tax assets are reduced by a valuation allowance if it is more likely than not that some or all of the future tax assets will not be realized. We evaluate the carrying value of future tax assets on a quarterly basis and adjust the amount of the valuation allowance as necessary. Factors used to assess the likelihood of realization include forecasts of future taxable income and available tax planning strategies that could be implemented to realize future tax assets.

### Asset Retirement Obligations

Asset retirement obligations are estimated based on environmental plans, in compliance with current environmental and regulatory requirements. We estimate and provide for decommissioning costs, and record a corresponding decommissioning asset, when a new mine or plant is placed into commercial production. Accretion expenses are accrued over the life of each associated operating mine or plant, such that at the end of the asset life the provision is equal to the balance estimated to be paid at that date. The decommissioning asset is amortized over the life of the related asset. Judgment is required to determine assumptions including credit adjusted risk-free rates, expected timing of decommissioning costs, inflationary factors and market risks. Changes in cost estimates result in offsetting changes to the asset and liability and corresponding changes to the associated amortization and accretion rates. In view of the uncertainties concerning these future obligations, the ultimate timing and cost of reclamation and mine closure may differ materially from these estimates.

### Pensions and Other Employee Future Benefits

Our post-retirement obligations relate mainly to ongoing health care benefit plans. Obligations relating to these plans and pension plans are estimated based on actuarial determinations, which incorporate assumptions using management's best estimates of factors including plan performance, salary escalation, retirement dates of employees and drug cost escalation rates.

### Estimates in Determining Fair Value of Assets and Liabilities

We record various financial assets, financial liabilities and derivatives at fair value. Fair values are based on quoted market prices, where available. If market quotes are not available, we use internal valuation models with market-based or independent information as inputs. These models could produce a fair value that may not be reflective of future fair value.

We separate and record at fair value embedded derivatives related to provisional pricing in concentrate purchase, concentrate sale and certain other sale contracts. Under the terms of these contracts, prices are subject to final adjustment at the end of a future period after title transfers based on quoted market prices during the quotational period specified in the contract. The period between provisional pricing and final pricing is typically up to three months. At each reporting date, provisionally priced metals are marked-to-market based on the forward market price for the quotational period stipulated in the contract, with changes in fair value recognized in revenues for sales contracts and in operating expenses for purchase concentrate contracts.

Where financial assets, other than those classified as fair value through earnings, show evidence of impairment, judgment is also required to conclude whether a decline in fair value is other than temporary. In making this assessment for available-for-sale investments, management considers the length and extent of a decline in fair value below its cost, the financial condition and environment of the issuer, and our ability and intention to hold the investment until its anticipated recovery.

### Stock-Based Compensation

We use the fair value based method to account for the grant of stock options. Under this method, compensation cost attributable to options granted is measured at fair value at the grant date. To determine the fair value of options, we use a Black-Scholes option pricing model, which relies on estimates of the future risk-free interest rate, future dividend payments, future stock price volatility and the expected average life of the options.

## Risk Management

From time to time we maintain price protection programs and conduct commodity price risk management to reduce risk through the use of financial instruments.

### Base Metal Price Strategic Risk Management

Our strategic objective is to provide our investors with exposure to base metal prices, unless a reason exists to implement a hedging arrangement. We may hedge base metal prices from time to time to ensure we will have sufficient cash flow to meet our growth objectives, or to maximize debt capacity (and correspondingly minimize equity dilution) to the extent that third party financing may be needed to fund growth initiatives. However, we will generally prefer to raise financing for attractive growth opportunities through equity issuance if the alternative is to engage in a substantial amount of strategic metal price hedging. We may also hedge base metal prices to manage the risk of putting higher cost operations into production or the risk associated with provisional pricing terms in concentrate purchase and sales agreements.

In October 2009, we implemented a price protection program for the restart of our Chisel North mine. We entered into zinc commodity swap contracts with an average volume of approximately 2.0 million pounds of zinc per month for the period of May 2010 through July 2012, at an average price of approximately $1.01 per pound. This volume represents approximately 50% of the anticipated production from Chisel North. Hedge accounting was applied to these transactions.

### Foreign Exchange Risk Management

In October 2009, we entered into foreign exchange forwards to hedge anticipated US dollar revenues. We agreed to sell US dollars and purchase C$1.45 million per month for the same period as the zinc swap contracts described above, at an average rate of approximately C$1.07 per US dollar. Hedge accounting was applied to these transactions.

For the 2010 year, we recorded pre-tax net gains of $7,524 (2009 – losses of $9,038) to other comprehensive income ("OCI") for the effective portion of the cash flow hedges and recorded pre-tax net gains of $366 (2009 – losses of $876) in earnings for the ineffective portion. Ineffective gains and losses are included in gain (loss) on derivative instruments. We also reclassified pre-tax net gains of $3,266 from OCI to earnings as hedges were realized (2009 – gains of $8,012).

### Zinc and Zinc Oxide Customer Risk Management

To provide a service to customers who purchase zinc and zinc oxide from our plants and require known future prices, we enter into fixed price sales contracts. To ensure that we continue to receive a floating or unhedged realized zinc price, we enter into forward zinc purchase contracts that effectively offset the fixed price sales contracts with our customers.

## Environment, Health and Safety

### The Environment

There were no significant environmental non-compliances during the year.

All producing operations have management systems certified to both OHSAS 18001 for occupational health and safety and ISO 14001 for the environment. In addition, the production and supply of HBMS' finished products are registered to the ISO 9001 quality standard.

In the third quarter of 2007, Manitoba Conservation issued a report on its study of surface soils in Flin Flon, Manitoba and Creighton, Saskatchewan. The report identified some sample levels of metal in soils that exceeded Canadian Council of Ministers of the Environment guidelines. The Flin Flon Soils Study was then initiated to assess the potential for any ongoing human health risk. The Flin Flon Soils Study was released in June 2010 and concluded that the likelihood of adverse health effects among Flin Flon area residents from exposure to the metals evaluated is negligible to low. The full study results are available on-line at www.flinflonsoilsstudy.com.

### Addressing Evolving Environmental Regulations

In April 2006, the Canadian federal government issued a notice requiring the preparation and implementation of pollution prevention plans in respect of specified toxic substances released from base metal smelters and refineries. These plans were to be fully implemented no later than December 31, 2015. The required plan was prepared for the Flin Flon metallurgical complex.

The notice set annual air release targets for the specified substances to be reached by 2015 that in the absence of economically viable technological alternatives, together with other economic challenges, resulted in the determination that the copper smelter was no longer economically viable. Our copper smelter operations ceased in June 2010, essentially eliminating atmospheric emissions from the Flin Flon metallurgical complex and thereby completing our implementation of the pollution prevention plan.

### Health and Safety

For the fourth quarter, we recorded a lost time accident frequency of 1.8 per 200,000 hours worked, including contractors, compared to 0.2 for the same quarter in 2009. For the full year, we recorded a lost time accident frequency of 1.2, compared to 0.5 for the same period in 2009.

We publish an annual sustainability report that specifies our environmental, health and safety performance. The 2009 report is available on our website at www.hudbayminerals.com.

# Operations Overview

## Mines

| | | Three months ended Dec. 31, 2010 | Three months ended Dec. 31, 2009 | Year ended Dec. 31, 2010 | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **777** | | | | | |
| Ore | tonnes | **364,181** | 367,826 | **1,488,014** | 1,540,348 |
| Zinc | % | **3.89** | 4.95 | **4.01** | 4.35 |
| Copper | % | **3.24** | 2.40 | **2.86** | 2.49 |
| Gold | g/tonne | **2.25** | 2.17 | **2.09** | 2.12 |
| Silver | g/tonne | **25.42** | 27.68 | **25.89** | 26.39 |
| **Trout Lake** | | | | | |
| Ore | tonnes | **118,918** | 162,045 | **540,636** | 679,331 |
| Zinc | % | **2.23** | 4.07 | **2.67** | 3.10 |
| Copper | % | **2.05** | 1.86 | **2.35** | 1.96 |
| Gold | g/tonne | **0.95** | 1.47 | **1.30** | 1.30 |
| Silver | g/tonne | **10.12** | 19.22 | **12.03** | 15.73 |
| **Chisel North zinc ore** | | | | | |
| Ore | tonnes | **61,536** | — | **207,642** | 48,695 |
| Zinc | % | **8.38** | — | **7.49** | 9.18 |
| **Chisel North copper ore** | | | | | |
| Ore | tonnes | **5,996** | — | **5,996** | — |
| Zinc | % | **0.77** | — | **0.77** | — |
| Copper | % | **1.76** | — | **1.76** | — |
| Gold | g/tonne | **1.71** | — | **1.71** | — |
| Silver | g/tonne | **18.38** | — | **18.38** | — |
| **Total mines**[1] | | | | | |
| Ore | tonnes | **550,631** | 529,871 | **2,242,288** | 2,268,374 |
| Zinc | % | **3.40** | 4.68 | **4.00** | 4.08 |
| Copper | % | **2.63** | 2.23 | **2.51** | 2.28 |
| Gold | g/tonne | **1.79** | 1.96 | **1.78** | 1.84 |
| Silver | g/tonne | **21.87** | 25.09 | **22.63** | 23.17 |

[1] For unit operating costs, refer to page 44.

### 777 Mine

Ore production tonnage for the fourth quarter of 2010 was 1% lower compared to the same period in 2009. The zinc grade was lower by 21%, and the copper grade was higher by 35%, primarily due to the zinc rich areas being delayed in mining and increased tonnage from the copper rich zones. The gold grade was 4% higher, and the silver grade was 8% lower, due to the areas mined. Operating costs per tonne of ore in the fourth quarter of 2010 were 3% lower as compared to the same period in 2009.

For the 2010 year, ore production tonnage decreased by 3% compared to 2009. The hoisted tonnage in 2009 represented a production record for the mine. In addition, the hoisted tonnage was affected somewhat by the increase in waste hoisting of the access decline development below the 1412 metre level. Compared with grades in 2009, the zinc grade was 8% lower, copper grade was 15% higher, gold grade was 1% lower, and silver grade was 2% lower. The higher copper grades are attributed to increased tonnage coming from copper rich areas. Operating costs at $36.53 per tonne of ore were 4% lower as compared to 2009 due primarily to lower propane consumption as a result of a milder spring weather, lower direct mining costs particularly backfilling, cable bolting and hoisting, and decreased use of contractors.

### Trout Lake Mine

Ore production tonnage for the fourth quarter of 2010 was 27% lower as compared to the same quarter in 2009. The decrease in production followed the mine plan for the quarter. Production levels are expected to remain relatively constant throughout 2011 at 1,360 tonnes per day ("tpd") as the mine reserves are depleted to closure by the end of 2011. Zinc grade was 45% lower and copper grade was 10% higher. The zinc grades were lower, while the copper grades were higher than mine reserve grade primarily due to the increased percentage in production from the Deep West mining zone. Also reflecting the areas mined, gold grades were 35% lower and silver grades were 47% lower, respectively. Operating unit costs per tonne of ore were similar as compared to the fourth quarter of 2009.

Ore production tonnage decreased by 20% for the 2010 year compared to 2009 year in line with the mining plan. Zinc grade was lower by 14%, copper grade was 20% higher, gold grade was unchanged and silver grade was 24% lower. Improved copper grades were expected as we extracted more ore from the Deep West mining zone, which is also lower in zinc. Operating unit costs per tonne of ore mined were 24% higher, due to reduced tonnage hoisted, an increase in ground support and rehabilitation of some of the mining areas of the Deep West.

### Chisel North Mine

On October 9, 2009, we announced that we would restart operations at our Chisel North mine in Snow Lake, and commenced full production in the second quarter of 2010. The copper ore is trucked to Flin Flon to be processed in the Flin Flon concentrator. During the fourth quarter of 2010, 61,536 tonnes of zinc ore were mined at a grade of 8.38% and 5,996 tonnes of copper ore at a grade of 1.76% copper, 0.77% zinc, 1.74 g/t gold and 18.38 g/t silver. Production reported during the period is up 2% over the third quarter and the zinc grade is down by 28%. Operating costs were $85.97 per tonne mined for the quarter and $71.52 per tonne for the year.

## Concentrators

| | | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **Flin Flon concentrator**[1] | | | | | |
| Ore | tonnes | **495,752** | 545,925 | **2,041,618** | 2,248,143 |
| Zinc | % | **3.49** | 4.61 | **3.67** | 3.95 |
| Copper | % | **2.95** | 2.22 | **2.74** | 2.31 |
| Gold | g/tonne | **1.92** | 1.92 | **1.89** | 1.86 |
| Silver | g/tonne | **21.51** | 24.55 | **22.25** | 22.99 |
| Zinc concentrate | tonnes | **27,936** | 40,952 | **120,769** | 142,647 |
| Concentrate grade | % Zn | **50.94** | 51.86 | **51.91** | 52.22 |
| Copper concentrate | tonnes | **55,373** | 47,219 | **210,893** | 197,739 |
| Concentrate grade | % Cu | **24.67** | 23.75 | **24.85** | 24.47 |
| Zinc recovery | % | **82.2** | 84.4 | **83.8** | 83.9 |
| Copper recovery | % | **93.6** | 92.4 | **93.8** | 93.2 |
| Gold recovery | % | **72.6** | 66.3 | **70.5** | 68.7 |
| Silver recovery | % | **61.2** | 57.6 | **57.8** | 60.4 |
| **Chisel North concentrator**[1] | | | | | |
| Ore | tonnes | **60,200** | — | **202,197** | 49,006 |
| Zinc | % | **8.32** | — | **7.48** | 8.96 |
| Zinc concentrate | tonnes | **9,597** | — | **29,072** | 8,646 |
| Concentrate grade | % Zn | **50.96** | — | **50.28** | 48.95 |
| Zinc recovery | % | **97.6** | — | **96.7** | 96.4 |

[1] For unit operating costs, refer to page 44.

| | | Three months ended Dec. 31, 2010 | Three months ended Dec. 31, 2009 | Year ended Dec. 31, 2010 | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **HBMS contained metal in concentrate** | | | | | |
| Zinc | tonnes | **19,120** | 21,239 | **77,314** | 78,722 |
| Copper | tonnes | **13,660** | 11,215 | **52,413** | 48,397 |
| Gold | troy oz. | **22,375** | 22,350 | **87,176** | 92,201 |
| Silver | troy oz. | **209,788** | 248,195 | **843,401** | 1,004,624 |

### Flin Flon Concentrator

For the fourth quarter of 2010, ore processed decreased by 9% compared to the same period in 2009. The reduction in throughput was related to the reduced feed from the Flin Flon mines, primarily lower production from the Trout Lake mine, and the higher copper head grades resulting in curtailed production to manage the higher levels of copper concentrate. Zinc head grade was 24% lower, and copper head grade was 33% higher than the fourth quarter of 2009. The gold head grade was unchanged, and the silver head grade was 12% lower. Recovery of zinc to concentrate was lower by 3% due to the lower head grades while copper recovery was 1% higher. Concentrate grades were in line with expectations. Operating cost per tonne of ore processed increased by 26% compared to 2009, primarily related to higher maintenance costs, increased contractor costs and 9% reduced throughput.

Ore processed for the 2010 year was 9% lower compared to 2009 levels. Zinc head grade in 2010 was 7% lower than last year, while copper head grade was 19% higher, consistent with the ore received from the 777 and Trout Lake mines. Recovery of zinc to concentrate was unchanged and copper recovery was 1% higher than the same period in 2009. Operating costs per tonne of ore processed were 22% higher, primarily related to higher maintenance costs, lower throughput and higher prices and consumption of copper sulphate.

### Chisel North Concentrator

On October 30, 2009, we announced the restart of the Chisel North mine and concentrator. Full production was reached in the second quarter of 2010.

During the fourth quarter of 2010 the concentrator treated 60,200 tonnes of zinc ore at a grade of 8.32% with a recovery of 97.6% and a concentrate grade of 51.0% zinc. Operating costs for the fourth quarter were $27.23 per tonne milled and costs for the 2010 year were $24.35 per tonne. During the quarter, the effective milling days were reduced to 3.5 days from 5 days to match the zinc ore production from the Chisel North mine.

## Metallurgical Plants

### Metal Produced and Sold

| | | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **Refined metal produced**[1] | | | | | |
| Metal from HBMS concentrates | | | | | |
| Zinc | tonnes | **15,262** | 17,702 | **74,083** | 70,577 |
| Copper[2] | tonnes | **—** | 11,836 | **19,770** | 49,091 |
| Gold[2] | troy oz. | **—** | 22,757 | **35,649** | 91,010 |
| Silver[2] | troy oz. | **—** | 281,758 | **372,372** | 989,715 |
| Metal from HBMS purchased concentrates | | | | | |
| Zinc | tonnes | **10,162** | 11,013 | **25,964** | 36,205 |
| Copper[2] | tonnes | **—** | 665 | **48** | 9,460 |
| Gold[2] | troy oz. | **—** | 17 | **—** | 347 |
| Silver[2] | troy oz. | **—** | 191,270 | **—** | 1,016,923 |
| Total HBMS metal produced | | | | | |
| Zinc | tonnes | **25,424** | 28,715 | **100,047** | 106,782 |
| Copper[2] | tonnes | **—** | 12,501 | **19,818** | 58,551 |
| Gold[2] | troy oz. | **—** | 22,774 | **35,649** | 91,357 |
| Silver[2] | troy oz. | **—** | 473,028 | **372,372** | 2,006,638 |
| **Metal sold** | | | | | |
| Zinc – refined | tonnes | **27,200** | 29,299 | **104,941** | 110,070 |
| Copper | tonnes | | | | |
| Cathode & anodes | | **50** | 8,864 | **31,795** | 59,981 |
| Payable metal in concentrate[3] | | **8,543** | — | **15,407** | — |
| Gold | troy oz. | | | | |
| Contained in slimes & anode | | **1,948** | 19,342 | **55,868** | 94,263 |
| Payable metal in concentrate[3] | | **13,458** | — | **25,239** | — |
| Silver | troy oz. | | | | |
| Contained in slimes & anode | | **21,082** | 474,195 | **789,305** | 2,185,407 |
| Payable metal in concentrate[3] | | **121,270** | — | **217,534** | — |

1 Metal from concentrates and purchased concentrates include copper, gold and silver returned to the copper smelter for re-processing as part of the normal production process. Metal reported in concentrate is prior to refining losses or deductions associated with smelter terms.

2 Production excludes recycled spent anode and represents non-recycled anode production only.

3 Copper concentrate was not sold in 2009 while the smelter was in operation.

### Metallurgical Plant Production

| | | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|
| **Zinc plant** | | | | | |
| Zinc concentrate treated | | | | | |
| Domestic | tonnes | **28,480** | 34,214 | **153,742** | 139,312 |
| Purchased | tonnes | **17,083** | 20,523 | **47,990** | 68,911 |
| Total | tonnes | **45,563** | 54,737 | **201,732** | 208,223 |
| **Zinc oxide** | | | | | |
| Zinc from HBMS | tonnes | **8,914** | 6,168 | **29,204** | 20,549 |
| Zinc from others | tonnes | **16** | — | **4,108** | 6 |
| Total zinc consumption | tonnes | **8,930** | 6,168 | **33,312** | 20,555 |
| Zinc oxide produced | tonnes | **11,056** | 7,532 | **40,991** | 25,107 |
| Zinc oxide sold | tonnes | **11,006** | 7,275 | **40,470** | 25,930 |
| **Smelter** | | | | | |
| Copper concentrate treated | | | | | |
| Domestic | tonnes | **—** | 52,508 | **86,528** | 197,022 |
| Purchased | tonnes | **—** | 1,680 | **—** | 27,630 |
| Total | tonnes | **—** | 54,188 | **86,528** | 224,652 |
| **WPCR** | | | | | |
| Anodes received | tonnes | **—** | 12,076 | **23,487** | 60,396 |
| Cathode produced | tonnes | **—** | 9,262 | **20,933** | 48,200 |
| Spent anode produced | tonnes | **—** | 2,924 | **4,008** | 11,358 |
| Liberator anode produced | tonnes | **—** | 341 | **819** | 1,091 |
| Slimes produced | tonnes | **—** | 47 | **80** | 197 |

For unit operating costs, refer to page 44.

#### Zinc Plant

Our Flin Flon, Manitoba zinc plant uses leading-edge technology to produce special high grade zinc and includes an oxygen plant, a two-stage pressure leaching plant, a four-step solution purification, an electrolysis plant and a casting plant.

Production of cast zinc in the fourth quarter of 2010 was 11% lower than the same quarter in 2009. Operating costs per pound of zinc metal produced were 13% higher due to the lower production. Cast production was lower in the fourth quarter as a result of concentrate impurities that limited plant throughput.

For the 2010 year, production was 100,047 tonnes of cast metal, 6% lower than in 2009 due to insufficient concentrate availability in the earlier part of the year and the impact of concentrate impurities in the fourth quarter of 2010. Operating costs per pound were up 13% due to lower production and increased maintenance costs as we prepared and completed the biennial maintenance shutdown.

#### Zinc Oxide Facility – Zochem

During the fourth quarter of 2010, Zochem consumed 8,914 tonnes of HBMS zinc and 16 tonnes of third party zinc, resulting in a production of 11,056 tonnes of zinc oxide. In comparison to the fourth quarter of 2009, sales volumes increased by 50%. Production levels increased by 47% in response to production interruptions at a competitor, which caused a sudden temporary market shortage.

For the full year, Zochem consumed 29,204 tonnes of HBMS zinc and 4,108 tonnes of third party zinc, resulting in a production of 40,991 tonnes of zinc oxide. In comparison to the fourth quarter of 2009, sales volumes increased by 56%, while production levels increased by 63% in response to stronger customer demand.

### Copper Smelter

The copper smelter ceased operations with the last cast of anodes on June 11, 2010. Cleanup and decommissioning of the plant is proceeding.

### White Pine Copper Refinery

Operations at the refinery ceased in July following the smelter closure. Copper cathode production for 2010 was 20,933 tonnes. The last anode was loaded on July 6th and the last cathode produced on July 27th.

## Estimated Mineral Reserves (January 1, 2011)[1]

| | Tonnes | Au (g/t) | Ag (g/t) | Cu (%) | Zn (%) |
|---|---|---|---|---|---|
| **HBMS** | | | | | |
| 777 | | | | | |
| Proven | 4,516,000 | 2.27 | 29.38 | 2.87 | 4.44 |
| Probable | 8,307,000 | 1.79 | 27.31 | 1.78 | 4.24 |
| 777 North | | | | | |
| Proven | 81,000 | 1.61 | 26.52 | 0.68 | 4.89 |
| Probable | 449,000 | 1.44 | 21.48 | 1.09 | 3.31 |
| Trout Lake | | | | | |
| Proven | 409,000 | 2.06 | 9.66 | 2.10 | 3.53 |
| Probable | 36,000 | 1.17 | 1.01 | 2.18 | 1.43 |
| Chisel North – Zinc | | | | | |
| Proven | 164,000 | — | — | — | 8.77 |
| Probable | 56,000 | — | — | — | 10.60 |
| Chisel North – Copper | | | | | |
| Probable | 92,000 | 2.41 | 31.56 | 1.72 | 3.67 |
| Lalor Project | | | | | |
| Probable | 10,525,000 | 1.55 | 21.00 | 0.64 | 8.31 |
| Total proven | 5,170,000 | 2.17 | 26.84 | 2.68 | 4.51 |
| Total probable | 19,465,000 | 1.65 | 23.66 | 1.14 | 6.43 |
| Total reserves | 24,635,000 | 1.76 | 24.33 | 1.46 | 6.03 |

1 Diluted, recovered and economically tested.

The mineral reserve and mineral resource estimates contained in this MD&A respecting Lalor (along with the estimate of tonnes and grade of the gold and copper-gold zones) and HBMS' operating mines were prepared by or under the supervision of Robert Carter, Superintendent, Mines Technical Services with HBMS. The mineral resource estimate for the Back Forty project and the mineral reserve estimate for the Fenix project were prepared under the supervision of Cashel Meagher, Vice President, Exploration of HudBay. Both Mr. Carter and Mr. Meagher are "qualified persons" for the purposes of NI 43-101.

| | Tonnes | Ni (%) |
|---|---|---|
| **Fenix** | | |
| Proven | 7,800,000 | 2.03 |
| Probable | 28,400,000 | 1.81 |
| Total reserves | 36,200,000 | 1.86 |

The above mineral reserve estimate has been prepared under the supervision of Cashel Meagher P.Geo., Vice President, Exploration, who is employed by HudBay Minerals Inc. and is a Qualified Person under NI 43-101.

Long term metal prices, including premiums used to determine economic viability of the 2011 mineral reserves were US$1 to C$1.10, US$900/oz. gold, US$15.00/oz. silver, US$2.50/lb. copper, US$1.00/lb. zinc and $7.25/lb nickel. In addition to the reserves in the above table, there are inferred mineral resources.

## Outstanding Share Data

As of March 8, 2011, there were 169,933,875 common shares issued and outstanding. In addition, options for a maximum aggregate of 4,362,284 common shares were outstanding.

## Adoption of New Accounting Standards

For information on our adoption of new accounting standards, refer to notes 3a and 3b of our December 31, 2010 annual consolidated financial statements. Refer to note 3c for information regarding new accounting standards that will be applicable to HudBay in future years.

### International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board has set January 1, 2011 as the date that IFRS will replace existing Canadian GAAP for public companies with fiscal years beginning on or after that date, with comparative figures presented in these financial statements also required to comply with IFRS. Accordingly, our adoption date for IFRS is January 1, 2011, but our effective transition date is January 1, 2010 in order to accommodate IFRS comparative figures in our 2011 financial statements.

We have engaged external consultants to assist us through this complex transition project, which involves individuals from many aspects of the business, including accounting and finance, tax, information technology, legal, investor relations, logistics and operations. We have conducted workshops and training. We have established a project structure, including a charter and a detailed project plan that includes phases for planning and assessment, design and implementation. The project plan includes activities related to subsidiaries in all jurisdictions. Our project team provides regular status and informational updates to our IFRS Steering Committee and the Audit Committee of the board of directors.

Based on the detailed project plan, our project team has substantially completed the design phase and is in the implementation phase. The design phase included preparing accounting technical papers and analyses, selecting accounting policies, drafting financial statement templates, calculating transition adjustments, designing changes to information technology ("IT") systems and considering any impact on business activities. The implementation phase includes preparing the opening balance sheet as at January 1, 2010, implementing and testing changes identified in the design phase, making updates as needed to reflect changing standards, making any changes required for internal control over financial reporting ("ICFR") and disclosure controls and procedures ("DC&P") and preparing quarterly and annual IFRS financial statements for 2010 and reconciling them to our Canadian GAAP financial statements. Throughout the implementation phase, we are delivering training and knowledge transfer at appropriate points. The implementation phase will be substantially complete upon the issue of our March 31, 2011 interim IFRS financial statements and will culminate with the issue of our annual 2011 IFRS financial statements. Our project team has substantially completed accounting analyses and transition adjustment calculations related to our opening IFRS balance sheet. We have also prepared preliminary calculations of IFRS adjustments required for the nine months ended September 30, 2010. Over the next quarter, our project team will finalize these IFRS adjustments and quantify adjustments required for the fourth quarter of 2010.

To date, our IFRS Steering Committee and Audit Committee have reviewed our detailed assessment, which included identifying and prioritizing areas of differences between Canadian GAAP and IFRS, our mock-up of IFRS financial statement presentation and disclosure, including our draft first-time adoption footnote, as well as our status updates on project work findings and conclusions, including accounting policy choices and expected IFRS adjustments.

We implemented a dual reporting solution to maintain accounting records in accordance with each of Canadian GAAP and IFRS for our 2010 transition year with minimal changes to existing systems and processes. We are also continuing with the implementation of a new fixed asset subledger in conjunction with the implementation of a new Enterprise Resource Planning information system.

We completed an impact assessment related to key controls and determined that the majority of our key controls are not expected to change during and after our transition to IFRS. As we make changes to systems and processes, we are addressing in detail related internal controls. We continue to evaluate the processes and controls that are being used to develop the IFRS transition adjustments to ensure that the controls are effective.

We also completed impact assessments related to business activities such as key performance indicators, compensation plans and contracts. We determined that the main business impact of changeover to IFRS relates to HBMS' employee profit-sharing plan. Under this plan, 10% of HBMS' after-tax earnings (excluding provisions or recoveries for future income and mining tax) for any given fiscal year, currently calculated in accordance with Canadian GAAP, will be distributed to eligible employees. We have also identified operating cash flow before changes in non-cash working capital and co-product costing as key performance indicators. We are in the process of determining the effect of changeover to IFRS on the profit-sharing plan and these indicators.

Building on workshops held in the assessment phase, our project team receives additional training as we work through detailed analyses and adjustments with external consultants and our auditors. In turn, members of our project team provide specific training to others in the Company as we include them in our analyses and decision-making.

Areas that will result in significant changes to our financial reporting or that require significant efforts include the following:

- **IFRS 1, First-time Adoption of International Financial Reporting Standards**

  IFRS 1 applies when an entity adopts IFRS for the first time and generally requires that we retrospectively apply each standard in effect as at December 31, 2011, the date of our first annual IFRS financial statements, as if we had always applied those standards. However, IFRS 1 provides certain optional exemptions and mandatory exceptions to the principle of retrospective application.

  We will elect the optional exemption for business combinations. This allows us to avoid retrospectively applying IFRS 3 (2008), Business Combinations, to business combinations prior to January 1, 2010, which would otherwise be a very significant undertaking. This exemption also applies to purchases accounted for as asset acquisitions under Canadian GAAP that would qualify as business combinations under IFRS 3 (2008), which contains a broader definition of a business. We have determined that our 2008 acquisition of HMI Nickel would qualify as a business combination under IFRS 3 (2008). Accordingly, we will carry forward our Canadian GAAP accounting treatment for such acquisitions. Other significant IFRS 1 exemptions that apply to us are described below.

  In accordance with the requirements of IFRS 1, we will record transition adjustments where applicable against retained earnings as at January 1, 2010 for differences between our Canadian GAAP and IFRS accounting.

- **Exploration for and Evaluation of Mineral Resources**

  IFRS 6, Exploration for and Evaluation of Mineral Resources, applies to expenditures incurred on properties in the exploration and evaluation ("E&E") phase, which begins when an entity obtains the legal rights to explore a specific area and ends when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. IFRS 6 requires entities to select and consistently apply an accounting policy specifying which E&E expenditures are capitalized and which are expensed.

  We have selected an IFRS policy to expense the cost of our E&E activities and capitalize the cost of acquiring interests in mineral rights, licenses and properties in business combinations, asset acquisitions or option agreements. Under Canadian GAAP, certain expenditures are capitalized on specified properties identified through pre-feasibility or other assessments as having mineral reserves and/or resources with the potential of being developed into a mine. Application of our IFRS policy results in a transition adjustment to reverse the Lalor project assets previously capitalized under Canadian GAAP, as the amounts arose from E&E activities rather than acquisitions. Under IFRS, we will begin capitalizing Lalor project expenditures when it reaches the end of the E&E phase. We interpret the end of the E&E phase to be the point at which we have completed a preliminary feasibility study, some of the resources have been converted to reserves, and management has determined it is probable the property will be developed into a mine.

  Under IFRS, we will capitalize option payments made and record option payments received as a reduction to the cost of the related E&E asset, with any excess over cost recognized as a gain in the income statement. As a result, IFRS transition adjustments are required to reduce the cost of E&E assets for option payments received prior to our transition date that we recorded in earnings under Canadian GAAP and to increase the cost of E&E assets for option payments we previously expensed under Canadian GAAP.

As a result of these differences, we expect transition adjustments related to E&E phase mineral properties to decrease retained earnings as at January 1, 2010 by approximately $21 million. IFRS adjustments to reverse capitalized expenditures on the Lalor project will continue during our 2010 transition year. For the nine months ended September 30, 2010, we expect adjustments related to E&E phase mineral properties to decrease comprehensive income by approximately $20 million. We have determined that the Lalor project reached the end of the E&E phase as at December 31, 2010 and entered the development phase at that time; accordingly, in 2011, we will capitalize Lalor project expenditures and present them within capital works in progress in property, plant and equipment.

- **Decommissioning and Restoration**

  Under Canadian GAAP, we apply a credit-adjusted risk-free rate to measure our decommissioning and restoration liabilities and we do not re-measure them as a result of changes in the discount rate. Under IFRS, we will reflect applicable risks (excluding, in particular, credit risk) in estimated future cash flows and apply a risk-free rate when measuring our decommissioning and restoration liabilities, and in subsequent periods we will re-measure the liabilities to reflect changes in the discount rate. Differences between historical Canadian GAAP discount rates and current IFRS discount rates will result in IFRS transition adjustments.

  To simplify our transition calculations, we will apply the IFRS 1 optional exemption for determining the amount of the decommissioning and restoration liabilities to be included in the cost and accumulated depreciation of property, plant and equipment as at January 1, 2010.

  Differences between historical Canadian GAAP discount rates and current IFRS discount rates result in IFRS transition adjustments to increase decommissioning and restoration liabilities and increase the carrying amount of related property, plant and equipment. We expect net transition adjustments related to these items to decrease retained earnings by approximately $15 million as at January 1, 2010. We have revised this estimate by $3 million from the figure previously disclosed in our September 30, 2010 MD&A as result of refining the assumptions used in the measurement of our decommissioning and restoration liabilities.

  Differences related to decommissioning and restoration liabilities will also result in ongoing IFRS adjustments during our 2010 transition year. Re-measurement of the liability to reflect movements in discount rates will require adjustments to decommissioning liabilities, with offsetting adjustments to property, plant and equipment, except for decommissioning and restoration liabilities related to properties that have no remaining useful life, for which we will adjust other operating expense. Such changes to liability and asset balances will also affect accretion expense and depreciation expense during our 2010 transition year. For the nine months ended September 30, 2010, we expect adjustments related to decommissioning and restoration to decrease comprehensive income by approximately $9 million.

- **Property, Plant and Equipment**

  IFRS requires capitalized costs to be directly attributable to bringing assets to a working condition for their intended use and requires depreciation to be calculated separately for individual components of an item of property, plant and equipment that have costs significant in relation to the total cost of the item. Requirements under Canadian GAAP, while similar, are less specific. Accordingly, in practice, IFRS may require more detailed component accounting. Under IFRS, components may be physical or non-physical. Costs of major inspections and overhauls are capitalized as separate components and depreciated over the useful lives of the major inspections or overhauls.

  Working with staff from operations to analyze components of our property, plant and equipment at a more detailed level, we identified additional components from those currently recorded under Canadian GAAP, resulting in IFRS transition adjustments to increase accumulated depreciation. For certain equipment, the increase in accumulated depreciation also reflects a change in depreciation method from unit-of-production to straight-line because the expected pattern of future economic benefits is different at the lower level of componentization. Transition adjustments are also required to increase the carrying value of property, plant and equipment for major inspections and overhauls of mobile equipment that require capitalization as separate components under IFRS but were expensed under Canadian GAAP. We expect net transition adjustments related to these items to decrease retained earnings by approximately $5 million as at January 1, 2010.

Ongoing IFRS adjustments will also be required to depreciation expense during our 2010 transition year. For the nine months ended September 30, 2010, we expect adjustments related to property, plant and equipment to decrease comprehensive income by approximately $4 million. We are also implementing a new fixed asset subledger, which accommodates IFRS requirements for property, plant and equipment.

We will elect the optional IFRS 1 deemed cost exemption for our Balmat property, plant and equipment. Under Canadian GAAP, in 2008, we determined these assets were impaired and wrote off their carrying values. Accordingly, we do not expect to record a transition adjustment for these assets.

We will also elect the optional IFRS 1 borrowing cost exemption.

- **Mine Development**

  Our project team is reviewing our Canadian GAAP policies for capitalizing and amortizing mine development costs against IFRS requirements. As part of this analysis, we are determining whether all types of capitalized costs are directly attributable to bringing the asset to a working condition for its intended use, in accordance with IAS 16, Property, Plant and Equipment. We do not anticipate a significant transition adjustment for these assets. We are also assessing whether differences exist with respect to depreciation of equipment used in construction projects. IFRS requires depreciation of equipment used in construction projects to be capitalized. Canadian GAAP requirements, while similar, are less specific. As a result, transition adjustments may be required.

- **Functional Currency**

  IFRS requirements for determining the functional currency of an entity are more specific than those in Canadian GAAP. Although indicators considered in the determination of functional currency are similar, IFRS also provides a hierarchy for analyzing indicators in which primary factors are based on the currency that mainly influences sales prices for goods and services and labour, material and other costs of providing goods or services. In addition, IFRS requires functional currency to be determined for every entity, whereas Canadian GAAP does not specifically require such determinations to be made for domestic operations. This area requires significant judgment. Our project team has assessed the functional currency for each of HudBay's entities under IFRS. We will record a transition adjustment for our Guatemalan operations, which we have determined have a Canadian dollar functional currency under Canadian GAAP and a US dollar functional currency under IFRS. We gained control of the Back Forty project in Michigan during the third quarter of 2010 and identified a similar difference in functional currency between Canadian GAAP and IFRS. These changes will also result in IFRS adjustments during our 2010 transition year. To simplify our calculation of the transition adjustments, we will elect the optional IFRS 1 exemption to deem cumulative translation differences to be zero as at January 1, 2010 (with an offsetting adjustment to retained earnings). Under Canadian GAAP, we do not currently have a currency translation adjustment, as the measurement currency of all HudBay entities is Canadian dollars.

  We expect transition adjustments related to the change in functional currency to decrease retained earnings by approximately $5 million as at January 1, 2010. For the nine months ended September 30, 2010, we expect adjustments related to changes in functional currency to decrease comprehensive income by approximately $8 million.

- **Employee Benefits**

  Under IFRS, past service costs are recognized over the vesting period, whereas Canadian GAAP allows recognition of past service costs over the expected average remaining service period. As a result, we will record a transition adjustment to charge unamortized, vested past service costs to retained earnings. Further, we will elect the IFRS 1 optional exemption to reset unamortized actuarial gains and losses to zero as at January 1, 2010 with an adjustment against retained earnings. We expect transition adjustments related to employee benefits to decrease retained earnings by approximately $4 million as at January 1, 2010.

IFRS provides a policy choice for ongoing recognition of actuarial gains and losses. Entities may opt to recognize actuarial gains and losses in profit or loss, applying either the corridor method or an approach that results in faster recognition; alternately, entities may recognize actuarial gains and losses immediately in other comprehensive income. We will continue to apply the corridor method to recognize actuarial gains and losses in profit or loss under IFRS.

The transition adjustments described above and our policy choice for ongoing recognition of actuarial gains and losses under the corridor method will also cause ongoing IFRS adjustments during our 2010 transition year. For the nine months ended September 30, 2010, we expect adjustments related to employee benefits to increase comprehensive income by approximately $1 million.

- **Provisions**

  IFRS requires recognition of provisions that are constructive obligations, which arise when an entity's past practice or sufficiently detailed public statements have created a valid expectation in other parties that it will carry out an action. As a result, additional liabilities may require recognition under IFRS. Upon transition to IFRS, we will record provisions for donation commitments previously made that we have concluded require recognition under IFRS as constructive obligations but under Canadian GAAP are expensed as payments are made. We expect these transition adjustments to decrease retained earnings by approximately $1 million as at January 1, 2010. For the nine months ended September 30, 2010, we do not expect adjustments related to provisions.

- **Non-Controlling Interest**

  IFRS requires presentation of non-controlling interests within equity on the balance sheet, separate from the equity of the owners of the parent entity. We will record a transition adjustment to reclassify non-controlling interests of $1 million to equity from other long-term liabilities. We reflected the same reclassification as at January 1, 2010 in our Canadian GAAP financial statements upon early adoption of a new Canadian GAAP standard for non-controlling interests. This transition adjustment has no impact on retained earnings. The effect on comprehensive income for the nine months ended September 30, 2010 is not significant.

- **Impairment of Long Lived Assets**

  Canadian GAAP applies a two-step process for impairment analyses. When indicators of impairment exist for an asset group, we first test the asset group's recoverability by comparing its carrying value to its undiscounted estimated future cash flows. If we determine the carrying value is not recoverable, we then measure an impairment loss by comparing the carrying value to fair value. In contrast, IFRS applies a one-step process for impairment analyses. Under IFRS, when indicators of impairment exist for an asset or cash-generating unit, we test for impairment by comparing the carrying value to the recoverable amount, which is the greater of fair value less costs to sell and value in use (discounted cash flows). As a result, impairments may be recorded more often or earlier under IFRS than under Canadian GAAP. Our project team has identified our cash-generating units and is finalizing our assessment of indicators of impairment as at our IFRS transition date. We do not anticipate a significant IFRS adjustment as at January 1, 2010 or during our 2010 transition year.

- **Income Taxes**

  Accounting for income tax under IFRS is addressed under IAS 12, *Income Taxes*, and differs significantly in many respects from Canadian GAAP. Our project team has determined that differences pertaining to HudBay relate to reclassifications within equity and differences in financial statement presentation and note disclosure. The tax effect of accounting adjustments upon transition to IFRS has been reflected in the figures disclosed above. In addition to tax effecting accounting adjustments, during our 2010 transition year, we expect adjustments related to changes in tax rate assumptions on transition adjustments.

- **Cash Flow Statement Classification**

  Under IFRS, cash flows from interest received may be classified as either operating or investing activities, and cash flows for interest paid may be classified as either operating or financing activities. Under Canadian GAAP, we classify cash flows from interest income and interest expense as operating activities. Upon transition to IFRS, we will classify cash flows from interest received as investing activities, cash flows for interest paid on borrowings as financing activities, and cash flows for other operating interest paid as operating activities. These classification changes will not require IFRS transition adjustments; however, the changes may result in differences in reported cash flow from operations, which we have identified as a key performance indicator. Currently, we have interest income but no borrowings. In this circumstance, reported cash flow from operations will be lower under IFRS, as cash flows from interest received will be reflected in investing activities instead of in operating activities. During our 2010 transition year, cash flow from operations will also be lower as a result of expensing exploration and evaluation expenditures for the Lalor project under IFRS (and classifying them in cash flow from operations) that we capitalized for CGAAP purposes (and classified in cash flow from investing activities).

In addition to the accounting policy changes described above, extensive changes to financial statement presentation and disclosure will be required upon adoption of IFRS. Our project team has prepared mock-up IFRS financial statements to reflect these changes and is continuing to implement processes to accumulate the necessary data in 2011 and future years for such changes.

The accounting policy changes described above are based on the IFRSs expected to be in effect at the end of our first IFRS reporting period, which is the year ended December 31, 2011. We will continue to monitor changing standards to enable us to assess their effect on our IFRS financial statements.

Accounting, reporting and procedural changes in areas affected by IFRS, including those described above, have also resulted in changes that affect ICFR and DC&P. As noted above, our IFRS project plan has identified those areas where changes are required to accounting policies, procedures and controls. Certain of these changes result in new or changed controls, and we are evaluating these controls to confirm that the new or revised controls are operating effectively. This evaluation will include ongoing testing of the effectiveness of the operation of the controls.

The IFRS project plan includes DC&P relating to IFRS disclosures in the MD&A as well as the preparation of regular updates to management, the Steering Committee, the Audit Committee and other stakeholders on the project plan progress and on the expected impact that transition to IFRS has on our financial reporting and disclosure responsibilities. HudBay has a Disclosure Committee whose responsibilities include the designing, establishing and monitoring of controls and other procedures so that information that we are required to disclose is done so on a timely basis and in accordance with regulatory requirements. Our Chief Financial Officer (“CFO”) is a member of both the IFRS Steering Committee and the Disclosure Committee.

We currently expect the IFRS transition adjustments described above to result in a decrease to equity attributable to owners of HudBay Minerals Inc. of approximately $50 million or approximately $0.32 per common share outstanding as at December 31, 2009, as compared to equity presented in our Canadian GAAP financial statements for the year ended December 31, 2009.

## Disclosure Controls and Procedures

The Canadian Securities Administrators have issued National Instrument 52-109 ("NI 52-109"), "Certification of Disclosure in Issuers' Annual and Interim Filings" which requires Canadian public companies to submit annual and interim certificates relating to the design and operation of the disclosure controls and procedures that we use. Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported on a timely basis to senior management, including the CEO and the CFO, to enable this information to be reviewed and discussed so that appropriate decisions can be made regarding the timely public disclosure of the information.

As of December 31, 2010, management has evaluated the design and the operation of the disclosure controls and procedures as defined by NI 52-109. This evaluation was performed under the supervision of and with the participation of our CEO and CFO. Based on this evaluation, the CEO and CFO concluded that the design and operation of the disclosure controls and procedures were effective as of December 31, 2010.

### Internal Control over Financial Reporting

NI 52-109 also requires Canadian public companies to submit an annual certificate relating to the design and effectiveness of internal control over financial reporting ("ICFR"). ICFR is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management is responsible for establishing and maintaining ICFR and management, including the CEO and the CFO, has evaluated the design and effectiveness of ICFR at December 31, 2010. Based on this evaluation, management, with the participation of the CEO and CFO, has concluded that the design and operation of ICFR was effective as of December 31, 2010. We have used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") internal control framework to evaluate the design and operation of ICFR.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis as such systems can only be designed to provide reasonable as opposed to absolute assurance. Also projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### Changes in Internal Control over Financial Reporting

NI 52-109 also requires Canadian public companies to disclose in their MD&A any change in ICFR during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting. There were no changes to ICFR during the quarter ended December 31, 2010 that materially affected or are reasonably likely to materially affect the Company's ICFR. During 2011, we intend to implement a new Enterprise Resource Planning ("ERP") information system. The ERP implementation includes replacing our key financial systems, which could materially affect our internal control over financial reporting. As part of the ERP implementation project we intend to implement processes to ensure that our ICFR remains effective both during and after implementation of the new ERP system.

## Non-GAAP Measures

Detailed operating expenses, EBITDA, operating cash flow before changes in non-cash working capital, operating cash flow per share, cash cost per pound of zinc sold and co-product cash costs per unit sold are included in this MD&A because these measures are performance indicators that we use internally to monitor performance. We use these measures to assess how well we are performing compared to plan and to assess the overall effectiveness and efficiency of mining, processing and refining operations. We believe that the inclusion of these measures in the MD&A helps an investor to assess performance "through the eyes of management" and that certain investors use these measures to assess our performance. These measures do not have a meaning presented by GAAP and should not be considered in isolation or as a substitute for measures prepared in accordance with GAAP. These measures are not necessarily indicative of operating profit or cash flow from operations as determined under GAAP. Other companies may calculate these measures differently.

### EBITDA

The following table presents our calculation of EBITDA for the three months and year ended December 31, 2010 and December 31, 2009.

| ($000s) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Earnings before tax and non-controlling interests | **41,606** | 9,620 | **158,105** | 141,468 |
| Adjustments: | | | | |
| Depreciation and amortization | **20,781** | 27,653 | **103,399** | 100,731 |
| Exploration | **10,954** | 3,994 | **29,822** | 7,609 |
| Interest and other income | **(2,206)** | (1,151) | **(8,323)** | (107,386) |
| Loss (gain) on derivative instruments | **610** | 455 | **(2,763)** | 917 |
| EBITDA | **71,745** | 40,571 | **280,240** | 143,339 |

### Operating Cash Flow Before Changes in Non-Cash Working Capital and Operating Cash Flow per Share

The following table presents our calculations of operating cash flow before changes in non-cash working capital and operating cash flow per share for the three months and year ended December 31, 2010 and December 31, 2009.

| ($000s except share and per share amounts) | **Three months ended Dec. 31, 2010** | Three months ended Dec. 31, 2009 | **Year ended Dec. 31, 2010** | Year ended Dec. 31, 2009 |
|---|---|---|---|---|
| Cash provided by operating activities, per financial statements | **64,864** | 39,632 | **255,590** | 106,194 |
| Adjustments: | | | | |
| Changes in non-cash working capital | **(4,937)** | (6,008) | **(55,740)** | 18,318 |
| Operating cash flow before changes in non-cash working capital | **59,927** | 33,624 | **199,850** | 124,512 |
| Weighted average shares outstanding | **149,219,230** | 153,973,547 | **150,636,835** | 153,460,823 |
| Operating cash flow per share | **$0.40** | $0.22 | **$1.33** | $0.81 |

## Cash Cost per Pound of Zinc Sold

Our cash cost per pound of zinc sold, net of by-product credits, for the fourth quarter of 2010 was negative US$0.42 per pound, excluding costs and sales related to Balmat, HMI Nickel and corporate activities, as calculated in the following table.

| ($000s except as noted) | | **Three months ended Dec. 31, 2010** | | Three months ended Dec. 31, 2009 | | **Year ended Dec. 31, 2010** | | Year ended Dec. 31, 2009 |
|---|---|---|---|---|---|---|---|---|
| Operating expenses | | **95,301** | | 105,939 | | **451,106** | | 506,275 |
| General and administrative expenses[1] | | **2,019** | | 1,914 | | **8,139** | | 6,501 |
| | | **97,320** | | 107,853 | | **459,245** | | 512,776 |
| Exclude amounts related to Balmat and HMI Nickel | | **(4,772)** | | (5,071) | | **(18,592)** | | (15,318) |
| | | **92,548** | | 102,782 | | **440,653** | | 497,458 |
| Less by-product credits[2] | | **(117,767)** | | (96,398) | | **(533,398)** | | (505,938) |
| Cash cost net of by-products | | **(25,219)** | | 6,384 | | **(92,745)** | | (8,480) |
| Exchange rate (US $1 to C$)[3] | | **1.013** | | 1.056 | | **1.030** | | 1.142 |
| Cash cost net of by-products | **US** | **(24,895)** | US | 6,045 | **US** | **(90,044)** | US | (7,426) |
| Zinc sales (000's lbs.) | | **59,966** | | 64,593 | | **231,355** | | 240,897 |
| Cash cost per pound of zinc sold, net of by-product credits in US $/lb. | **US** | **(0.42)** | US | 0.09 | **US** | **(0.39)** | US | (0.03) |

1 General and administrative expenses relate to HBMS entity only.

2 By-product credits include revenues from sale of copper, gold, silver, the value added by converting zinc to zinc oxide, and by-product sales.

3 Weighted average exchange rate for sales during the period.

Cash costs net of by-product credits have been restated to exclude corporate activities in order to be better comparable with costs disclosed by comparable mining companies. For the fourth quarter of 2010, our cash cost per pound of zinc sold was negative US$0.42, a net decrease of US$0.51 from the same period in 2009, and for the 2010 year was negative US$0.39, a net decrease of US$0.36 from 2009. The decrease in cost per pound was due primarily to higher by-product copper, gold and silver credits arising from higher prices.

Our calculation of cash cost per pound of zinc sold is significantly influenced by by-product metal prices, which may fluctuate going forward.

## Co-Product Cash Costs per Unit Sold

Commencing in the third quarter of 2010, we introduced co-product cash costs as a new non-GAAP measure. We believe that these costs serve as meaningful indicators for investors to evaluate our operations. Costs for 2009 have not been included for comparability because they included substantial purchased copper concentrate volumes together with the cost of the smelter and refinery, which were shut down in 2010.

Whereas cash costs net of by-product credits present the cash costs of a single metal, assuming that all other metals are by-products of the given metal, co-product cash costs present a cost of producing each of our primary metals, copper, zinc and gold, based on an allocation of costs among the metals. Costs that can be readily associated with a specific metal are allocated to that metal. Mining and milling costs for our Trout Lake and 777 mines are allocated proportionately based on the value of the contained metals at prevailing metals prices. Operating overhead expenses and general and administrative expenses (in both cases, excluding costs not related to our HBMS operations) are generally allocated equally between zinc and copper with some further cost allocation to gold. In order to present a cost per finished unit sold, we also add to these costs third party treatment and refining costs, which are deducted from revenue in our financial statements.

Zinc oxide production is treated as a by-product of zinc production, so the costs of our Zochem operation are allocated to zinc operating expenses and zinc oxide revenues are deducted from total zinc cash costs. Similarly, silver production is treated as a by-product of gold production. Other miscellaneous revenues are allocated among zinc, copper and gold in the same manner as general and administrative costs.

While the impact of fluctuating metals prices is expected to be less significant on co-product cash costs than it is on by-product cash costs, changes in relative metals prices may cause our reported cash costs to vary substantially over time, irrespective of our operational results. Significant management judgement is also required in determining how costs should be allocated among metals. Caution should also be exercised in using co-product cash costs to evaluate the profitability of a particular metal, as the profitability of our polymetallic mines is dependent on the production of all of our principal metals. Our future co-product cash costs may change significantly from those reported for the three months and year ended December 31, 2010 as we complete the transition from copper smelting and refining to copper concentrate sales.

| Three months ended December 31, 2010<br>($000s except as noted) | Copper | Zinc | Gold | Non-allocated costs | Total |
|---|---|---|---|---|---|
| Operating expenses | 21,776 | 59,308 | 9,402 | 4,815 | 95,301 |
| General and administrative[1] | 807 | 807 | 404 | 7,000 | 9,018 |
| Treatment and refining costs[2] | 4,549 | — | 1,121 | — | 5,670 |
| | 27,132 | 60,115 | 10,927 | 11,815 | |
| Zinc oxide and by-product revenues | (756) | (7,655) | (4,796) | | |
| **Co-product costs** | 26,376 | 52,460 | 6,131 | | |
| Sales volume[3] | 18,943 | 59,965 | 17,779 | | |
| **Co-product cash costs per unit[3] sold** | $ 1.39 | $ 0.87 | $ 345 | | |

[1] Allocation of general and administrative costs to copper, zinc and gold production exclude corporate and other non-production related costs.

[2] Treatment and refining costs are deducted from revenue.

[3] Copper and zinc sales volumes denoted in 000's pounds, and gold sales volumes denoted in troy oz.

| Year ended December 31, 2010<br>($000s except as noted) | Copper | Zinc | Gold | Non-allocated costs | Total |
|---|---|---|---|---|---|
| Operating expenses | 141,458 | 240,605 | 50,409 | 18,634 | 451,106 |
| General and administrative[1] | 3,255 | 3,255 | 1,628 | 19,994 | 28,132 |
| Treatment and refining costs[2] | 10,854 | — | 2,041 | — | 12,895 |
| | 155,567 | 243,860 | 54,078 | 38,628 | |
| Zinc oxide and by-product revenues | (3,403) | (36,282) | (22,130) | | |
| **Co-product costs** | 152,164 | 207,578 | 31,948 | | |
| Sales volume[3] | 104,062 | 231,356 | 83,481 | | |
| **Co-product cash costs per unit[3] sold** | $ 1.46 | $ 0.90 | $ 383 | | |

[1] Allocation of general and administrative costs to copper, zinc and gold production exclude corporate and other non-production related costs.

[2] Treatment and refining costs are deducted from revenue.

[3] Copper and zinc sales volumes denoted in 000's pounds, and gold sales volumes denoted in troy oz.

# Report of Independent Registered Chartered Accountants

## To the Shareholders of HudBay Minerals Inc.

We have audited the accompanying consolidated financial statements of HudBay Minerals Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as at December 31, 2010 and December 31, 2009, and the consolidated statements of earnings, retained earnings, comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2010, and the notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of HudBay Minerals Inc. and subsidiaries as at December 31, 2010 and December 31, 2009 and the results of their operations and cash flows for each of the years in the three-year period ended December 31, 2010 in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Independent Registered Chartered Accountants
Licensed Public Accountants

March 9, 2011
Toronto, Canada

# Consolidated Balance Sheets

As at December 31

| (in thousands of Canadian dollars) | 2010 | 2009 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents (note 4) | **$ 901,693** | $ 886,814 |
| Accounts receivable | **78,168** | 40,187 |
| Income taxes receivable | **99** | 15,313 |
| Inventories (note 5) | **121,694** | 131,128 |
| Prepaid expenses and other current assets | **9,992** | 7,990 |
| Future income and mining tax assets (note 13b) | **15,431** | 23,152 |
| Current portion of fair value of derivatives (note 18c) | **3,813** | 1,106 |
| | **1,130,890** | 1,105,690 |
| Property, plant and equipment (note 7) | **906,906** | 818,634 |
| Available-for-sale investments | **104,990** | 27,249 |
| Other assets (note 8) | **30,300** | 81,113 |
| | **$ 2,173,086** | $ 2,032,686 |
| **Liabilities and equity** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | **$ 139,480** | $ 119,738 |
| Taxes payable | **33,088** | — |
| Current portion of other liabilities (note 9) | **55,800** | 40,228 |
| | **228,368** | 159,966 |
| Pension obligations (note 10) | **2,604** | 516 |
| Other employee future benefits and stock-based compensation (note 11) | **90,439** | 81,287 |
| Asset retirement obligations (note 12) | **58,915** | 49,133 |
| Future income tax liabilities (note 13b) | **42,146** | 34,927 |
| Fair value of derivatives (note 18c) | **1,633** | 7,068 |
| | **424,105** | 332,897 |
| Equity | | |
| Share capital (note 14b) | **629,861** | 644,127 |
| Contributed surplus (note 14f) | **24,205** | 26,717 |
| Retained earnings (note 2b) | **1,043,516** | 1,021,195 |
| Accumulated other comprehensive income (note 15) | **41,697** | 6,445 |
| | **1,739,279** | 1,698,484 |
| Non-controlling interests (note 16) | **9,702** | 1,305 |
| | **1,748,981** | 1,699,789 |
| | **$ 2,173,086** | $ 2,032,686 |

Commitments, Contingencies and Subsequent Event (note 19, 20 and 24)

On behalf of the Board:

J. Bruce Barraclough, Director

Alan R. Hibben, Director

# Consolidated Statements of Earnings

Years ended December 31, 2010, 2009 and 2008

| (in thousands of Canadian dollars, except share and per share amounts) | **2010** | 2009 | 2008 |
|---|---|---|---|
| Revenue (note 22) | **$ 778,818** | $ 720,722 | $ 981,894 |
| Expenses | | | |
| Operating | **451,106** | 506,275 | 686,664 |
| Depreciation and amortization | **103,399** | 100,731 | 88,295 |
| General and administrative | **28,132** | 44,176 | 30,578 |
| Stock-based compensation (note 14e) | **6,511** | 4,692 | 11,952 |
| Accretion of asset retirement obligations (note 12) | **4,352** | 4,488 | 3,847 |
| Foreign exchange loss (gain) | **8,477** | 17,752 | (42,348) |
| | **601,977** | 678,114 | 778,988 |
| Earnings before the following: | **176,841** | 42,608 | 202,906 |
| Exploration | **(29,822)** | (7,609) | (25,583) |
| Interest and other income (note 23) | **8,323** | 107,386 | 26,217 |
| Gain (loss) on derivative instruments | **2,763** | (917) | (589) |
| Asset impairment losses (note 6) | **—** | — | (30,433) |
| Share of income of equity investee | **—** | — | (3,915) |
| Earnings before tax | **158,105** | 141,468 | 168,603 |
| Tax expense (note 13a) | **88,067** | 28,988 | 96,123 |
| Net earnings | **$ 70,038** | $ 112,480 | $ 72,480 |
| Net earnings attributable to: | | | |
| Shareholders of the Company | **$ 72,985** | $ 112,440 | $ 72,947 |
| Non-controlling interests | **(2,947)** | 40 | (467) |
| Net earnings | **$ 70,038** | $ 112,480 | $ 72,480 |
| Earnings per share: | | | |
| Basic | **$ 0.48** | $ 0.73 | $ 0.53 |
| Diluted | **$ 0.48** | $ 0.73 | $ 0.53 |
| Weighted average number of common shares outstanding (note 14g): | | | |
| Basic | **150,636,835** | 153,460,823 | 135,902,627 |
| Diluted | **151,336,399** | 154,067,282 | 136,713,080 |

# Consolidated Statements of Cash Flows

Years ended December 31, 2010, 2009 and 2008
(in thousands of Canadian dollars)

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Cash provided by (used in): | | | |
| Operating activities | | | |
| Net earnings | **$ 70,038** | $ 112,480 | $ 72,480 |
| Reclamation payments | **(2,764)** | (1,685) | (1,133) |
| Items not affecting cash: | | | |
| Depreciation and amortization | **103,399** | 100,731 | 88,295 |
| Stock-based compensation (note 14e) | **6,336** | 4,692 | 11,952 |
| Accretion on asset retirement obligations (note 12) | **4,352** | 4,488 | 3,847 |
| Foreign exchange loss | **2,826** | 9,868 | (19,298) |
| Change in fair value of derivatives | **(1,421)** | 74 | (2,553) |
| Asset impairment losses (note 6) | **—** | — | 30,433 |
| Future tax expense (note 13a) | **21,881** | 2,218 | 49,365 |
| Net gains reclassified from OCI (note 15) | **(5,429)** | (107,956) | (843) |
| Share of income of equity investee | **—** | — | 3,915 |
| Other | **632** | (398) | (2,205) |
| Change in non-cash working capital (note 21a) | **55,740** | (18,318) | 12,451 |
| | **255,590** | 106,194 | 246,706 |
| Investing activities | | | |
| Additions to property, plant and equipment | **(167,642)** | (99,948) | (144,717) |
| Additions to computer software | **(4,691)** | (1,966) | — |
| Purchase of short-term investments | **—** | — | (602,824) |
| Sale of short-term investments | **—** | 478,941 | 123,883 |
| Proceeds from sale of investments | **8,051** | 235,704 | — |
| Purchase of other non-current investments | **(52,619)** | (3,945) | (240,414) |
| Release of cash held in trust | **—** | 3,885 | — |
| Release of (additions to) restricted cash | **54,626** | (48,462) | — |
| Cash acquired with acquisition of HMI Nickel | **—** | — | 130,747 |
| | **(162,275)** | 564,209 | (733,325) |
| Financing activities | | | |
| Repayment of loans payable and senior secured notes | **—** | (3,764) | (7,500) |
| Repayment of obligations under capital leases | **—** | (511) | (4,470) |
| Repurchase of common shares (note 14b) | **(63,294)** | (5,000) | (53,291) |
| Prepaid financing costs | **(2,668)** | — | — |
| Dividends paid (note 14b) | **(14,901)** | — | — |
| Proceeds on exercise of stock options | **5,253** | 9,393 | 622 |
| | **(75,610)** | 118 | (64,639) |
| Effect of exchange rate changes on cash and cash equivalents | **(2,826)** | (9,434) | 19,411 |
| Change in cash and cash equivalents | **14,879** | 661,087 | (531,847) |
| Cash and cash equivalents, beginning of year | **886,814** | 225,727 | 757,574 |
| Cash and cash equivalents, end of year (note 4) | **$ 901,693** | $ 886,814 | $ 225,727 |

For supplemental information, see note 21.

# Consolidated Statements of Retained Earnings

Years ended December 31, 2010, 2009 and 2008

| (in thousands of Canadian dollars) | **2010** | 2009 | 2008 |
|---|---|---|---|
| Retained earnings as reported, beginning of year | **$ 1,025,060** | $ 912,289 | $ 868,857 |
| Accounting adjustments for error (note 2b) | **(3,865)** | (3,534) | (3,128) |
| Balance, beginning of year, after adjustments | **1,021,195** | 908,755 | 865,729 |
| Net earnings attributable to shareholders | **72,985** | 112,440 | 72,947 |
| Share repurchases (note 14b) | **(35,763)** | — | (29,921) |
| Dividends paid (note 14b) | **(14,901)** | — | — |
| Retained earnings, end of year | **$ 1,043,516** | $ 1,021,195 | $ 908,755 |

# Consolidated Statements of Comprehensive Income

Years ended December 31, 2010, 2009 and 2008

| (in thousands of Canadian dollars) | **2010** | 2009 | 2008 |
|---|---|---|---|
| Net earnings for the year | **$ 70,038** | $ 112,480 | $ 72,480 |
| Other comprehensive income (loss), net of tax (note 15): | | | |
| Cash flow hedges | **5,271** | (6,212) | 13,029 |
| Amounts reclassified to earnings on realization of cash flow hedges | **(2,252)** | (5,715) | (657) |
| Net gains (losses) on available-for-sale investments | **33,700** | 116,699 | (28,680) |
| Amounts reclassified to earnings on impairment of available-for-sale investments | **—** | — | 3,189 |
| Amounts reclassified to earnings on disposal of available-for-sale investments | **(1,467)** | (79,970) | — |
| Currency translation adjustments | **—** | (23) | 186 |
| Other comprehensive income (loss) | **35,252** | 24,779 | (12,933) |
| Comprehensive income | **$ 105,290** | $ 137,259 | $ 59,547 |
| Comprehensive income (loss) attributable to: | | | |
| Shareholders of the Company | **$ 108,237** | $ 137,219 | $ 60,014 |
| Non-controlling interests | **(2,947)** | 40 | (467) |
| Comprehensive income | **$ 105,290** | $ 137,259 | $ 59,547 |

# Notes to Consolidated Financial Statements

Years ended December 31, 2010, 2009 and 2008
(in thousands of Canadian dollars, except where otherwise noted)

## 1. Nature of Business

HudBay Minerals Inc. (the "Company" or "HudBay") is a Canadian diversified mining company governed by the Canada Business Corporations Act with assets in North and Central America. Through its subsidiaries, HudBay owns copper/zinc/gold mines, ore concentrators and zinc production facilities in northern Manitoba and Saskatchewan, a zinc oxide production facility in Ontario and a nickel project in Guatemala. HudBay produces copper concentrate (containing copper, gold and silver), zinc metal and zinc oxide. HudBay's shares are listed on the Toronto and New York stock exchanges under the symbol "HBM".

## 2. Significant Accounting Policies

### (a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and are presented in Canadian dollars (unless otherwise specified).

These 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 in which the Company shares joint control and any variable interest entities in which the Company is the primary beneficiary. The Company's significant subsidiaries include Hudson Bay Mining and Smelting Co., Limited ("HBMS"), Hudson Bay Exploration and Development Company Limited, White Pine Copper Refinery Inc., HudBay Marketing & Sales Inc., HMI Nickel Inc. ("HMI Nickel"), St. Lawrence Zinc Company LLC ("St. Lawrence"), Zochem Inc., HudBay Michigan Inc. and HudBay Metal Marketing Inc. Compañía Guatemalteca de Níquel, S.A. ("CGN") is a 98.2%-owned subsidiary of HMI Nickel.

### (b) Accounting adjustments:

In 2010, the Company adjusted the following errors pertaining to prior periods: an under-accrual of $4,479 of certain royalty obligations that arose prior to 2008 and related under-accruals of $581 and $474 in 2008 and 2009, respectively. A tax recovery related to the royalty obligation of $1,351, $175 and $143 was recorded for the 2007, 2008 and 2009 years, respectively. These errors were corrected by decreasing opening retained earnings in the Company's fiscal 2008 financial statements, and increasing operating expenses and reducing tax expense in the 2008 and 2009 financial statements. These errors were not material to the periods to which they relate, either individually or in the aggregate.

### (c) Use of estimates:

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas where management's judgment is applied include ore reserve determinations used in amortization of certain property, plant and equipment, in-process inventory quantities and provision for inventory obsolescence, cost allocations for inventory, plant and equipment estimated economic lives and salvage values, assessment of impairment, ultimate realization of capitalized exploration costs, cost allocations for mine development, fair value of certain assets and liabilities, purchase price allocations, contingent liabilities, future income and mining tax assets and valuation reserves, interpretation of tax legislation, allocation of revenue and costs to non-Manitoba sourced ore for the purpose of computing Manitoba mining taxes payable, asset retirement obligations, stock-based compensation, pension obligations and other employee future benefits. Actual results could differ from those estimates by material amounts. These estimates are reviewed at least annually, and changes in estimates are reported in earnings in the period in which they became known.

### (d) Translation of foreign currencies:

The Company's reporting currency is the Canadian dollar.

Monetary assets and liabilities are translated at year-end exchange rates, and non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at monthly average exchange rates approximating those in effect at the transaction dates. Gains and losses on translation of monetary assets and monetary liabilities are reflected in earnings. Foreign currency gains and losses on available-for-sale financial assets and hedging items in effective cash flow or net investment hedges of foreign exchange risk are recorded in other comprehensive income ("OCI").

The assets and liabilities of self-sustaining foreign operations are translated at year-end exchange rates, and revenue and expenses are translated at monthly average exchange rates. Differences arising from these foreign currency translations are recorded in accumulated other comprehensive income ("AOCI") until they are realized by a reduction in the investment.

The monetary assets and liabilities of integrated foreign operations are translated at year-end exchange rates, whereas non-monetary items are translated at historical rates. Revenues and expenses are translated at monthly exchange rates, with the exception of accretion, depreciation and amortization, which are translated at historical rates. Differences arising from these foreign currency translations are recorded in foreign exchange loss (gain).

### (e) Revenue recognition:

Sales are recognized and revenue is recorded at market prices when title and the rights and obligations of ownership pass to the customer, collection is reasonably assured and the price is reasonably determinable.

Under the terms of contracts with independent companies, the Company's concentrate and certain other sales are "provisionally priced". For these contracts, sales prices are subject to final adjustment at the end of a future period after shipment, based on quoted market prices during the quotational period specified in the contract. Revenues are recognized when title passes to the customers, using forward prices to estimate the fair value of the total consideration receivable. At each reporting date, the fair value of the final sales price adjustment is re-estimated, and changes in fair value, metal weights and assays are recognized as adjustments to revenue.

The Company recognizes deferred revenue in the event it receives payments from customers before a sale meets criteria for revenue recognition. Deferred revenue is presented within current liabilities.

### (f) Cash and cash equivalents:

Cash and cash equivalents are classified as fair value through earnings and include cash and highly liquid investments with an original maturity of three months or less at the date of acquisition. Interest earned is included in interest and other income on the statements of earnings and in operating activities on the statements of cash flows.

### (g) Inventories:

Inventories consist substantially of in-process inventory (concentrates and metals), metal products and supplies. Concentrates, metals and all other saleable products are valued at the lower of cost and estimated net realizable value. Cost includes material, labour and amortization of all property, plant and equipment involved with the mining and production process. Costs are allocated based on estimations of net realizable value of the metal content of the inventories. In-process inventories represent materials that are currently in the process of being converted to a saleable product. Conversion processes vary depending on the nature of the concentrate or metal. In-process inventory is measured based on assays of the material fed to the processing plants and the projected recoveries of the respective plants, and is valued at the lower of cost and net realizable value. Cost of finished metal and concentrate inventory represents the average cost of the in-process inventory incurred prior to the external refining processes. Supplies are valued at the lower of cost and net realizable value. Cost is determined on an average basis.

### (h) Property, plant and equipment:

**(i) Mineral properties:**

(a) Mineral property and exploration expenditures, including expenditures incurred to earn an interest in a joint venture, are expensed as incurred except for certain expenditures determined by the Company on specified properties identified through pre-feasibility or other assessments as having mineral reserves and/or resources with the potential of being developed into a mine.

(b) Mineral exploration properties capitalized as part of acquisitions are carried at initial fair value and are subject to an impairment review and evaluation, if indicators for potential impairment exist.

**(ii) Mine development expenditures:**

Development costs for properties deemed capable of economical commercial production are capitalized and amortized using the unit-of-production method after commencement of commercial production. Unit-of-production amortization is based on the related proven and probable tonnes of ore reserves and associated future development costs. The cost of underground development to provide access to a reserve at an operating mine is capitalized where that portion of the development is necessary to access more than one workplace or stope. Capital development includes shafts, ramps, track haulage drifts, ancillary drifts, sumps, refuge stations, ventilation raises, permanent manways, and ore and waste pass raises.

Ongoing repairs, maintenance and development expenditures are charged to operations as incurred. These include ore stope access drifts, footwall and hangingwall drifts in stopes, drawpoints, drill drifts, sublevels, slots, drill raises, stope manway access raises and definition diamond drilling.

**(iii) Commercial production:**

The decision on when commercial production is reached is based on a range of criteria that is considered relevant to the specific situation, including: a pre-determined percentage of design capacity for the mine and mill; achievement of continuous production, ramp-ups, or other output; and expected net margin during the pre-production period. In a phased mining approach, consideration is given to milestones achieved at each phase of completion. Management assesses the operation's ability to sustain production over a period of approximately one to three months, depending on the complexity related to the stability of continuous operation. Commercial production is considered to have commenced at the beginning of the month in which the criteria are met.

No amortization is provided in respect of mine development expenditures until commencement of economical commercial production. Any production revenue earned prior to commercial production, net of related costs, is offset against the development costs.

**(iv) Plant and equipment:**

Expenditures for plant and equipment additions, major replacements and improvements are capitalized at cost, net of applied investment tax credits. Plant and equipment, including assets under capital lease, are depreciated on either a unit-of-production or a straight-line basis. The unit-of-production method is based on proven and probable tonnes of ore reserves. The assets using the straight-line method are depreciated over the estimated useful economic lives of the assets, which extend up to approximately 10 years. The Company also considers salvage values in its determination of depreciation.

**(v) Capitalized interest:**

Interest on borrowings related to the financing of major capital projects under construction is capitalized during the construction phase as part of the cost of the project.

**(vi) Impairment of long-lived assets:**

The Company reviews and evaluates the carrying value of its operating mines and exploration and development properties for impairment when events or circumstances indicate that the carrying amounts of related assets or groups of assets may not be recoverable. If the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the asset, an impairment loss is measured and assets are written down to fair value, which is normally the discounted value of future cash flows. Future cash flows are estimated based on estimated future recoverable mine production, expected sales prices (considering current and historical commodity prices, price trends and related factors), production levels, cash costs of production, and capital and reclamation costs, all based on detailed engineering life-of-mine plans. Future recoverable mine production is determined from reserves and resources after taking into account estimated dilution and recoveries during mining, and estimated losses during ore processing and treatment. Estimates of recoverable production from measured, indicated and inferred mineral resources are considered economically mineable and are based on management's confidence in converting such resources to proven and probable reserves. Long-lived assets are grouped for purposes of estimating future cash flows at the lowest level of assets and liabilities for which identifiable cash flows are largely independent of the cash flows of other assets. Assumptions underlying future cash flow estimates are subject to risks and uncertainties. It is possible that changes in estimates could occur which may affect the expected recoverability of the Company's investments in mineral properties.

### (i) Pension and other employee future benefits:

The Company has non-contributory and contributory defined benefit pension plans for the majority of its Canadian employees. The benefits are based on years of service and final average salary for the salaried plans, and a flat dollar amount combined with years of service for the hourly plans. The Company provides long-term disability income, health benefits and other post-employment benefits to hourly employees and long-term disability health benefits to salaried employees. The Company also provides non-pension, post-retirement (other retirement) benefits to certain active employees and pensioners.

The Company accrues its obligations under the defined benefit plans as the employees render the services necessary to earn the pension and other retirement benefits. The actuarial determination of the accrued benefit obligations for pensions and other retirement benefits uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors). The measurement date of the plan assets and accrued benefit obligation coincides with the Company's fiscal year. The most recent actuarial valuation for funding purposes for the two largest pension plans was performed in 2010 using data as of December 31, 2009.

Actuarial gains (losses) on plan assets arise from the difference between the actual return on plan assets for a period and the expected return on plan assets for that period. For the purpose of calculating the expected return on plan assets, those assets are valued at fair value. Actuarial gains (losses) on the accrued benefit obligation arise from differences between actual and expected experience and from changes in the actuarial assumptions used to determine the accrued benefit obligation. The average remaining service period of the active employees covered by the pension plans is 9.9 years. Any actuarial gains or losses over 10 per cent of the greater of the obligation and the fair value of assets are amortized over the expected service life of the plan population. The average remaining service period of the active employees covered by the other retirement benefits plan is 12.6 years.

The Company also has defined contribution plans providing pension benefits for certain of its salaried employees. The cost of the defined contribution plans is recognized based on the contributions required to be made during each period.

The Company also has defined contribution plans providing pension benefits for certain of its US employees utilizing 401K plans. The cost of the defined contribution plans is recognized based on the contributions required to be made during each period.

### (j) Financial instruments:

Financial assets, financial liabilities, and non-financial derivative contracts are initially recognized at fair value on the balance sheet when the Company becomes a party to their contractual provisions. Measurement in subsequent periods depends on the financial instrument's classification. The Company uses trade date accounting for regular-way purchases or sales of financial assets. Transaction costs are added to the initial carrying value of financial instruments other than those classified as fair value through earnings.

#### (i) Non-derivative financial instruments – classification:

Financial assets held-to-maturity, loans and receivables, and other financial liabilities are accounted for 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. However, available-for-sale investments in equity securities that are not traded in an active market are measured at cost. The Company has designated investments in common shares as available-for-sale.

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." This category includes financial instruments acquired or incurred principally for the purpose of selling or repurchasing in the near term; however, other financial instruments may also be designated irrevocably as fair value through earnings on initial recognition.

#### (ii) Derivatives:

Derivative instruments, including those derivatives that are embedded in financial or non-financial contracts and are not closely related to the host contracts, are measured at fair value on the balance sheet. All derivatives are classified as fair value through earnings unless they are accounted for as hedging items. The Company elected to identify embedded derivatives only in contracts entered into or amended on or after January 1, 2003 in accordance with the provisions of Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855.

#### (iii) Hedge accounting:

The Company may use derivatives and non-derivative financial instruments to manage exposures to interest, currency, credit and other market risks. Where hedge accounting can be applied, a hedging relationship is designated as a fair value hedge, a cash flow hedge or a hedge 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.

At the inception of a hedge, the Company formally documents the hedging relationship and the risk management objective and strategy for undertaking the hedge. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows. The Company tests effectiveness each 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.

During the year ended December 31, 2010, the Company had 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 a hedged anticipated transaction subsequently occurs, 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. When hedge accounting is discontinued, 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. However, when a hedged item ceases to exist or when it is probable that an anticipated transaction will not occur, gains and losses previously recognized in AOCI are reclassified immediately to earnings. For contracts accounted for as a hedge of an identifiable current or anticipated position, the Company classifies the cash flows of the contract in the same manner as the cash flows of the position being hedged.

**(iv) 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 models 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 Company applies a hierarchy to classify valuation methods used to measure financial instruments carried at fair value. Level 1 represents quoted (unadjusted) prices in active markets for identical assets and liabilities. Level 2 valuation techniques use significant observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). Level 3 valuation techniques use significant inputs that are not based on observable market data.

**(v) Impairment:**

Each balance sheet date, the Company reviews its financial assets, other than those classified as fair value through earnings, for objective evidence of impairment. In assessing available-for-sale investments, the Company considers the length and extent of a decline in fair value below its cost, the financial condition and environment of the issuer, and the Company's ability and intention to hold the investment until its anticipated recovery. When objective evidence of impairment exists and a decline in value is other than temporary, the Company removes cumulative losses from AOCI and recognizes impairment losses in the statements of earnings.

### (k) Stock-based compensation plans:

The Company's stock-based compensation plans are described in note 14c and d. The Company offers a deferred share unit ("DSU") plan for non-employee members of the Board of Directors and a restricted share unit ("RSU") plan for employees. Share units under these plans are notional shares; the value of one share unit represents the value of one HudBay common share. The Company also offers a stock option plan and an employee share purchase plan ("ESPP") for employees.

Cash-settled transactions, consisting of DSUs and RSUs, are recognized as an obligation at the grant date. Each reporting date, up to and including the settlement date, the Company measures the liabilities at fair value based on the closing price of HudBay's common shares, adjusted to reflect estimated forfeitures and to reflect the portion of the service period that had been performed by the financial statement reporting date. DSU and RSU liabilities are presented on the balance sheet in other employee future benefits and stock-based compensation, and changes in the fair value of the liabilities are recognized in the income statement and presented within stock-based compensation expense.

The Company accounts for stock options using the fair value based method. Under this method, compensation cost attributable to options granted is measured at fair value at the grant date and expensed over the vesting period, with a corresponding increase to contributed surplus. Any consideration received on exercise of stock options or purchase of stock is credited to share capital.

HudBay accounts for its portion of contributions to the ESPP by recording compensation expense as incurred on a payroll cycle basis.

### (l) Income and mining taxes:

The Company accounts for income and mining taxes under the asset and liability method. Under this method of tax allocation, future income and mining tax assets and liabilities are determined based on loss carryforwards and differences between the financial statement carrying values and their respective tax bases (temporary differences). Future tax assets and liabilities are measured using the substantively enacted tax rates expected to apply when the asset is realized or the liability settled. A valuation allowance is recorded as a reduction against any future tax asset to the extent that the benefit of the future tax asset is not more likely than not to be realized. The effect on future tax assets and liabilities from a change in tax rates is included in income in the year in which the change is enacted or substantively enacted.

### (m) Earnings per share:

Basic earnings per share is computed by dividing net earnings for the year by the weighted average number of common shares outstanding for the year. Diluted earnings per share is similar to basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued using the treasury stock method. In applying this method, the Company determines the number of common shares that would be issued upon exercise of in-the-money options and warrants and assumes that the proceeds received upon exercise would be used to purchase additional common shares at the average market price during the year.

### (n) Asset retirement obligations:

The Company's accounting for asset retirement obligations applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of a long-lived asset.

The fair value of a liability for an asset retirement obligation is recorded in the period in which it is identified and a reasonable estimate of fair value can be made. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. Costs that relate to existing conditions caused by past operations and that do not contribute to current or future revenue generation are expensed. Upon settlement of the liability, a gain or loss is recorded. The Company records asset retirement obligations primarily associated with decommissioning and restoration costs. The Company assesses the reasonableness of its asset retirement obligation estimates when conditions change and revises those estimates accordingly. Changes in the respective asset and liability balances are expensed in future periods.

The long-term asset retirement obligation is based on environmental plans, in compliance with the current environmental and regulatory requirements. Accretion expense is charged to the statements of earnings based on application of an interest component to the existing liability.

### (o) Exploration costs:

The Company accounts for exploration expenditures by expensing such costs until management's evaluation indicates, through pre-feasibility or other assessments, that the property has mineral reserves and/or resources with the potential of being developed into a mine.

### (p) Non-controlling interests:

Effective January 1, 2010, the Company adopted CICA Handbook Section 1602, Non-controlling interests. Accordingly, the Company has presented, on a retrospective basis, non-controlling interests as a component of total equity and the net earnings on the consolidated statements of earnings and comprehensive income has been adjusted to include the net earnings (loss) and OCI attributable to non-controlling interests.

## 3. Adoption of New Accounting Standards

### (a) Adopted in 2010:

Effective January 1, 2010, the Company early adopted the following CICA recommendations:

***Business Combinations, Consolidated Financial Statements and Non-Controlling Interests***

In January 2009, the CICA issued Handbook Section 1582, *Business Combinations*, replacing Section 1581 of the same name. Section 1582 establishes standards for the accounting for business combinations that are equivalent to the business combination accounting standards under International Financial Reporting Standards ("IFRS"). Prospective application of Section 1582 is required for the Company's business combinations with acquisition dates on or after the adoption date. Section 1582 requires business acquisitions to be measured at the acquisition-date fair value, generally requires acquisition-related costs to be expensed, requires gains from bargain purchases to be recorded in earnings (loss), and expands the definition of a business to include certain development-stage entities. It also requires the acquirer to measure any non-controlling interest either at fair value or at the non-controlling interest's proportionate share of the acquirer's identifiable net assets. Adoption of Section 1582 did not have an effect on the Company's consolidated financial statements.

The CICA concurrently issued Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-controlling Interests*, which together replace the previous Section 1600, *Consolidated Financial Statements*. Sections 1601 and 1602 establish standards equivalent to those under IFRS for the preparation of consolidated financial statements and the accounting for non-controlling interests in consolidated financial statements, including accounting for non-controlling interests upon a change in ownership interest or loss of control of a subsidiary. Section 1602 requires attribution of comprehensive income to owners of the parent entity and to non-controlling interests, even if it results in the non-controlling interests having a deficit balance. The Company applied these sections prospectively, except for presentation and disclosure requirements, which were applied retrospectively. As a result of adopting these sections, the Company has presented non-controlling interests as a separate component of equity on the balance sheet.

### (b) Adopted in 2009:

As required by the CICA, effective January 1, 2009, the Company adopted four new accounting standards addressing disclosure requirements:

***Goodwill and Intangible Assets***

On January 1, 2009, the Company adopted CICA Handbook Section 3064, *Goodwill and Intangible Assets*, which replaced Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*. The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. The Company's adoption of this standard had no effect on the consolidated financial statements.

***Credit Risk and the Fair Value of Financial Assets and Financial Liabilities***

Effective January 1, 2009, the Company adopted Emerging Issues Committee ("EIC") abstract 173 ("EIC-173"), *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*. The abstract clarifies that an entity should take into account its own credit risk and counterparty credit risk in determining the fair value of financial assets and financial liabilities, including derivative instruments.

***Mining Exploration Costs***

Effective January 1, 2009, the Company adopted EIC-174, *Mining Exploration Costs*, which clarifies guidance related to capitalization of exploration costs and impairment of capitalized costs. The Company's adoption of this abstract had no effect on the consolidated financial statements.

***Financial Instruments Disclosures***

The Company has adopted the amendments to CICA Handbook Section 3862, *Financial Instruments – Disclosures*. The amendments set out new standards for disclosures about the fair value measurements of financial instruments and the nature and extent of liquidity risk. The amendments require an entity to classify fair value measurements using a fair value hierarchy in levels ranging from 1 to 3 that reflect the significance of the inputs used in making these measurements. These amendments are consistent with recent amendments to financial instrument disclosure standards under IFRS.

### (c) Future accounting changes:

**International Financial Reporting Standards**

The Canadian Accounting Standards Board ("AcSB") has confirmed that Canadian publicly accountable entities will be required to prepare their financial statements in accordance with IFRS for fiscal years beginning on or after January 1, 2011. As a result, the Company will adopt IFRS on January 1, 2011, and its first interim IFRS-compliant financial statements will be for the quarter ending March 31, 2011, with comparative information for 2010 also presented on an IFRS basis. The Company is currently assessing the impact the adoption of IFRS will have on its consolidated financial statements.

## 4. Cash and Cash Equivalents

| | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents: | | |
| Cash on hand and demand deposits | **$ 149,543** | $ 76,297 |
| Short-term money market instruments with original maturities of three months or less | **752,150** | 810,517 |
| | **$ 901,693** | $ 886,814 |

## 5. Inventories

| | 2010 | 2009 |
|---|---|---|
| Work-in-process | **$ 18,775** | $ 51,250 |
| Finished goods | **81,277** | 59,595 |
| Materials and supplies | **21,642** | 20,283 |
| | **$ 121,694** | $ 131,128 |

The cost of inventories included in operating expenses during the year ended December 31, 2010 was $381,871 (2009 – $430,837, 2008 – $627,997).

## 6. Balmat Asset Impairment Losses

During 2008, the Company recorded an asset impairment loss of $30,433 on its Balmat zinc mine. In its second year of commercial production, the performance of the Balmat mine continued to fall short of the Company's expectations, which had been revised as part of the previous asset impairment taken in the fourth quarter of 2007. Due to this operating shortfall and 2008's zinc prices, the Balmat mine operations were suspended on August 22, 2008.

Based on the anticipated expenses and deferral of operating cash flow associated with a period of care and maintenance, the Company completed a review of the discounted value of future cash flows and determined that the carrying value of Balmat's assets was not likely to be recoverable. Therefore, the carrying value of the Balmat property, plant and equipment was written off. The carrying value of Balmat's materials and supplies inventory was also written down to its net realizable value. The Company is currently continuing exploration on the Balmat property.

## 7. Property, Plant and Equipment

| 2010 | **Cost** | **Accumulated depreciation and amortization** | **Net book value** |
|---|---|---|---|
| Buildings and equipment | **$ 534,834** | **$ 213,801** | **$ 321,033** |
| Mine development | **369,731** | **270,118** | **99,613** |
| Mineral properties | **486,260** | **—** | **486,260** |
| | **$ 1,390,825** | **$ 483,919** | **$ 906,906** |

| 2009 | Cost | Accumulated depreciation and amortization | Net book value |
|---|---|---|---|
| Buildings and equipment | $ 470,350 | $ 161,622 | $ 308,728 |
| Mine development | 326,011 | 219,427 | 106,584 |
| Mineral properties | 403,322 | — | 403,322 |
| | $ 1,199,683 | $ 381,049 | $ 818,634 |

The carrying value of property, plant and equipment under construction or development that is not being amortized is $504,494 (2009 – $419,272).

## 8. Other Assets

| | **2010** | 2009 |
|---|---|---|
| Restricted cash | **$ 4,405** | $ 59,031 |
| Long-term portion of prepaid financing fees | **1,884** | — |
| Computer software | **7,083** | 1,966 |
| Long-term portion of future tax asset (note 13b) | **8,636** | 19,720 |
| Long-term portion of fair value of derivatives (note 18c) | **604** | 258 |
| Investments, at fair value through earnings | **7,688** | 138 |
| | **$ 30,300** | $ 81,113 |

On November 3, 2010, the Company arranged a new US$300 million revolving credit facility with a syndicate of lenders. The facility has an initial term of four years and is secured by a pledge of assets of the parent company and is unconditionally guaranteed by the Company's material subsidiaries. Upon closing, restricted cash on deposit to support letters of credit was reclassified to cash and cash equivalents.

## 9. Current Portion of Other Liabilities

| | 2010 | 2009 |
|---|---|---|
| Current portion of: | | |
| Pension obligation (note 10) | $ 16,283 | $ 28,447 |
| Asset retirement obligation (note 12) | 6,510 | 5,327 |
| Other employee future benefits (note 11) | 3,157 | 2,876 |
| Fair value of derivatives (note 18c) | 5,445 | 3,503 |
| Future tax liabilities (note 13b) | — | 75 |
| Deferred revenue | 24,405 | — |
| | $ 55,800 | $ 40,228 |

Deferred revenue relates to the receipt of payment on the sale of copper concentrate, the terms of which did not meet the Company's criteria for revenue recognition as at December 31, 2010.

## 10. Pension Obligation

The Company maintains several non-contributory and contributory defined benefit pension plans for certain of its employees.

The Company uses a December 31 measurement date for all of its plans. For the Company's significant plans, the most recent actuarial valuations filed for funding purposes were performed during 2010 using data as at December 31, 2009. For these plans, the next actuarial valuation required for funding purposes will be performed as at December 31, 2010.

The defined benefit pension plans were amended in 2009 to grant benefit improvements for past service. The Company is amortizing these past service costs over three years.

Information about the Company's pension plans is as follows:

| | 2010 | 2009 |
|---|---|---|
| Obligations and funded status: | | |
| Change in pension obligation: | | |
| Obligation, beginning of year | $ 264,350 | $ 213,849 |
| Service cost | 6,603 | 6,021 |
| Interest cost | 17,075 | 16,782 |
| Employee contributions | 157 | 143 |
| Actuarial loss | 35,570 | 33,658 |
| Plan amendments | — | 7,854 |
| Special termination benefits | 510 | 3,050 |
| Benefits paid | (24,345) | (17,007) |
| Obligation, end of year | 299,920 | 264,350 |
| Change in pension plan assets: | | |
| Fair value of plan assets, beginning of year | 234,527 | 195,791 |
| Actual return on plan assets | 27,920 | 26,648 |
| Employer contributions | 21,484 | 28,952 |
| Employee contributions | 157 | 143 |
| Benefits paid | (24,345) | (17,007) |
| Fair value of plan assets, end of year | 259,743 | 234,527 |
| Unfunded status of plans, end of year | (40,177) | (29,823) |
| Unamortized past service costs | 2,617 | 5,236 |
| Unamortized net actuarial loss (gain) | 18,673 | (4,376) |
| Net liability recognized, end of year | (18,887) | (28,963) |
| Less current portion (note 9) | 16,283 | 28,447 |
| | $ (2,604) | $ (516) |

Early retirement windows were opened in 2009 to certain members who will be eligible to retire with an unreduced pension and supplemental benefit. Special termination benefits offered to employees on voluntary termination of employment are recognized as a liability and an expense when employees accept the offer and the amount of the special termination benefits can be reasonably estimated. Special termination benefits in the amount of $510 have been recognized for elections made in 2010 (2009 – $3,050, 2008 – $0).

Pension expense includes the following components:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Costs arising in the year: | | | |
| Service cost | **$ 6,603** | $ 6,021 | $ 8,310 |
| Interest cost | **17,075** | 16,782 | 14,505 |
| Actual asset return | **(27,920)** | (26,648) | 27,034 |
| Actuarial loss (gain) | **35,570** | 33,658 | (59,107) |
| Special termination benefits | **510** | 3,050 | — |
| | **31,838** | 32,863 | (9,258) |
| Difference in costs arising and recognized in the year: | | | |
| Actual loss (gain) on plan assets | **12,507** | 11,332 | (42,693) |
| Actuarial (gain) loss | **(35,554)** | (34,713) | 58,765 |
| Plan amendments | **2,619** | 2,618 | 4,107 |
| Defined benefit pension expense | **11,410** | 12,100 | 10,921 |
| Defined contribution pension expense | **637** | 666 | 1,247 |
| | **$ 12,047** | $ 12,766 | $ 12,168 |

Additional information:

The weighted average assumptions used in the determination of the accrued benefit expense and obligations were as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| To determine the net benefit expense for the year: | | | |
| Discount rate – defined benefit | **6.50%** | 7.50% | 5.50% |
| Interest rate – defined contribution | **3.92%** | 3.74% | 4.17% |
| Expected return on plan assets | **6.50%** | 7.50% | 7.00% |
| Rate of compensation increase* | **2.25%** | 1.75% | 2.35% |
| To determine the accrued benefit obligations at the end of the year: | | | |
| Discount rate – defined benefit | **5.50%** | 6.50% | 7.50% |
| Interest rate – defined contribution | **3.92%** | 3.74% | 4.17% |
| Rate of compensation increase* | **2.50%** | 2.25% | 1.75% |

* plus a merit and promotion scale

The Company's pension cost is significantly affected by the discount rate used to measure obligations, the level of plan assets available to fund those obligations and the expected long-term rate of return on plan assets.

The Company reviews the assumptions used to measure pension costs (including the discount rate) on an annual basis. Economic and market conditions at the measurement date impact these assumptions from year to year.

In determining the discount rate, the Company considers the duration of the pension plan liabilities.

In determining the expected future rate of return on pension assets, the Company considers the types of investment classes in which the plan assets are invested and the expected compound returns on those investment classes.

The pension plan asset allocations, by asset category, are as follows:

| | 2010 Weighted average | 2010 Target | 2009 Weighted average | 2009 Target |
|---|---|---|---|---|
| Equity securities | **50%** | **50%** | 47% | 50% |
| Debt securities | **50%** | **50%** | 53% | 50% |
| | **100%** | **100%** | 100% | 100% |

The Company's primary quantitative investment objectives are maximization of the long-term real rate of return, subject to an acceptable degree of investment risk, and preservation of principal. Risk tolerance is established through consideration of several factors, including past performance, current market conditions and the funded status of the plan.

With the exception of fixed income investments, the plan assets are actively managed by investment managers, with the goal of attaining returns that potentially outperform passively managed investments. Within appropriate limits, the actual composition of the invested funds may vary from the prescribed investment mix.

## 11. Other Employee Future Benefits

The Company sponsors several post-employment benefit plans and uses a December 31 measurement date. Information about the Company's post-retirement and other post-employment benefits is as follows:

| | **2010** | 2009 |
|---|---|---|
| Obligations and funded status: | | |
| Change in other employee future benefits obligation: | | |
| Obligation, beginning of year | **$ 86,961** | $ 77,550 |
| Service cost | **2,610** | 3,163 |
| Interest cost | **5,753** | 5,326 |
| Actuarial loss | **15,269** | 3,234 |
| Benefits paid | **(2,548)** | (2,312) |
| Obligation, end of year | **108,045** | 86,961 |
| Change in plan assets: | | |
| Fair value of plan assets, beginning of year | **—** | — |
| Employer contributions | **2,548** | 2,312 |
| Benefits paid | **(2,548)** | (2,312) |
| Fair value of plan assets, end of year | **—** | — |
| Unfunded status of plans, end of year | **(108,045)** | (86,961) |
| Unamortized net actuarial loss | **19,257** | 3,988 |
| Net liability recognized, end of year | **(88,788)** | (82,973) |
| Less current portion (note 9) | **3,157** | 2,876 |
| Other employee future benefits | **(85,631)** | (80,097) |
| Liability for deferred share units (note 14d) | **(3,167)** | (1,190) |
| Liability for restricted share units (note 14d) | **(1,641)** | — |
| Other employee future benefits and stock-based compensation | **$ (90,439)** | $ (81,287) |

Other employee future benefits expense includes the following components:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Costs arising in the year: | | | |
| Service cost | **$ 2,610** | $ 3,163 | $ 2,282 |
| Interest cost | **5,753** | 5,326 | 4,352 |
| Actuarial loss (gain) | **15,269** | 3,234 | (6,696) |
| | **23,632** | 11,723 | (62) |
| Difference in costs arising and recognized in the year: | | | |
| Actuarial (gain) loss | **(15,269)** | (3,234) | 6,696 |
| Other employee future benefits expense | **$ 8,363** | $ 8,489 | $ 6,634 |

Additional information:

The weighted average assumptions used in the determination of other employee future benefits expense and obligations were as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| To determine the net benefit expense for the year: | | | |
| Discount rate | **6.75%** | 7.50% | 5.50% |
| Initial weighted average health care trend rate | **8.16%** | 8.30% | 7.80% |
| Ultimate weighted average health care trend rate | **4.50%** | 4.60% | 4.60% |
| Year ultimate rate reached | **2029** | 2029 | 2015 |
| To determine the benefit obligations at the end of the year: | | | |
| Discount rate | **5.75%** | 6.75% | 7.50% |
| Initial weighted average health care trend rate | **8.01%** | 8.16% | 8.30% |
| Ultimate weighted average health care trend rate | **4.50%** | 4.50% | 4.60% |
| Weighted average health care trend rate | **2029** | 2029 | 2029 |

The weighted average health care cost trend rate used in measuring other employee future benefits was assumed to begin at 8.16% in 2010, gradually declining to 4.5% by 2029 and remaining at those levels thereafter.

If the health care cost trend rate was increased by one percentage point, the accumulated post-retirement benefit obligation and the aggregate service and interest cost would have increased as follows:

| | 2010 | 2009 |
|---|---|---|
| Accumulated post-retirement benefit obligation | **$ 21,208** | $ 15,250 |
| Aggregate of service and interest cost | **1,627** | 1,796 |

If the health care cost trend rate was decreased by one percentage point, the accumulated post-retirement benefit obligation and the aggregate service and interest cost would have decreased as follows:

| | 2010 | 2009 |
|---|---|---|
| Accumulated post-retirement benefit obligation | **$ 16,767** | $ 12,196 |
| Aggregate of service and interest cost | **1,277** | 1,388 |

The Company's post-retirement and other post-employment benefit cost is materially affected by the discount rate and health care cost trend rates used to measure obligations.

The Company reviews the assumptions used to measure post-retirement and other post-employment benefit costs (including the discount rate) on an annual basis.

Any unamortized actuarial gains or losses over 10 per cent of the obligation are amortized over the expected service life of the plan population.

## 12. Asset Retirement Obligations

The Company's asset retirement obligations relate to the reclamation and closure of currently operating mines and metallurgical plants and closed properties.

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of year | $ 54,460 | $ 46,632 |
| Obligations recognized during the year | 3,820 | 6,804 |
| Revisions in estimated cash flows | 5,557 | (1,779) |
| Obligations settled during the year | (2,764) | (1,685) |
| Accretion expense | 4,352 | 4,488 |
| Balance, end of year | 65,425 | 54,460 |
| Less current portion (note 9) | 6,510 | 5,327 |
| | $ 58,915 | $ 49,133 |

Total undiscounted future cash flows required to settle the decommissioning and restoration asset retirement obligations are estimated to be $138,836 (2009 – $109,726) before adjusting for inflation, market, and credit risk. Credit adjusted risk-free rates ranging from 1.8% to 6.3% (2009 – 2.4% to 10.0%) have been used to determine the additional obligations recognized during the year. The Company's asset retirement obligations were revised in 2010 to reflect changes in amounts and timing of estimated cash flows. Management anticipates that the asset retirement obligations relating to the Flin Flon operations will be substantially settled at or near the closure of the mining and processing facilities, anticipated to occur from 2011 to 2024.

The Company's exploration and exploitation licences require that it reclaim any land covered by those licences which it disturbs during exploration and exploitation activities for the Fenix Project. Although the timing and the amount of the actual expenditures can be uncertain, and given that the Company chose to delay construction of the Fenix project due to low nickel prices at the time, the Company has estimated the present value of the future reclamation obligation arising from its activities relating to the Fenix Project as at December 31, 2010 to be $3,478 (2009 – $8,052).

In view of the uncertainties concerning environmental remediation, the ultimate cost of asset retirement obligations could differ materially from the estimated amounts provided. The estimate of the total liability for asset retirement obligation costs is subject to change based on amendments to laws and regulations and as new information concerning the Company's operations becomes available. Future changes, if any, to the estimated total liability as a result of amended requirements, laws, regulations and operating assumptions may be significant and would be recognized prospectively as a change in accounting estimate, when applicable. Environmental laws and regulations are continually evolving in all regions in which the Company operates. The Company is not able to determine the impact, if any, of environmental laws and regulations that may be enacted in the future on its results of operations or financial position due to the uncertainty surrounding the ultimate form that such future laws and regulations may take.

## 13. Income and Mining Taxes

### (a) Tax expense:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Current – income taxes | $ 39,759 | $ 24,102 | $ 24,517 |
| – mining taxes | 26,427 | 2,668 | 22,241 |
| | 66,186 | 26,770 | 46,758 |
| Future – income taxes | 14,029 | (887) | 42,819 |
| – mining taxes | 7,852 | 3,105 | 6,546 |
| | 21,881 | 2,218 | 49,365 |
| Tax expense | $ 88,067 | $ 28,988 | $ 96,123 |

### (b) Future tax assets and liabilities as represented on the balance sheet:

| | 2010 | 2009 |
|---|---|---|
| Future tax assets | | |
| Current portion | $ 15,431 | $ 23,152 |
| Long-term portion (note 8) | 8,636 | 19,720 |
| | 24,067 | 42,872 |
| Future tax liabilities | | |
| Current portion (note 9) | — | 75 |
| Long-term portion | 42,146 | 34,927 |
| | 42,146 | 35,002 |
| | $ (18,079) | $ 7,870 |

Future tax assets and liabilities are composed of:

| | 2010 | 2009 |
|---|---|---|
| Future income tax asset (note 13e) | $ 15,543 | $ 26,497 |
| Future income tax liability (note 13e) | (42,146) | (35,002) |
| Future mining tax asset (note 13f) | 8,524 | 16,375 |
| | $ (18,079) | $ 7,870 |

### (c) Changes in future tax assets and liabilities:

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of year | $ 7,870 | $ 12,359 |
| Future tax expense (note 13a) | (21,881) | (2,218) |
| OCI (loss) transactions | (4,068) | (2,366) |
| Other | — | 95 |
| Balance, end of year | $ (18,079) | $ 7,870 |

### (d) Reconciliation to statutory tax rate:

As a result of Canadian mining operations, the Company is subject to both income and mining taxes. Generally, most expenditures incurred are deductible in computing income tax, whereas mining tax legislation, although based on a measure of profitability from carrying on mining operations, is more restrictive in respect of the deductions permitted in computing income subject to mining tax. These restrictions include deductions for financing expenses, such as interest and royalties. In addition, income unrelated to carrying on mining operations is not subject to mining tax.

Income tax expense differs from the amount that would be computed by applying the statutory income tax rates to income before income taxes. A reconciliation of income taxes calculated at the statutory rates to the actual tax provision is as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Statutory tax rate | **30.15%** | 31.29% | 32.54% |
| Tax expense at statutory rate | **$ 47,669** | $ 44,265 | $ 54,863 |
| Effect of: | | | |
| Non-controlling interests | **888** | (12) | 152 |
| Resource and depletion allowance, net of resource tax recovery | **(8,322)** | (1,449) | (9,571) |
| Adjusted income taxes | **40,235** | 42,804 | 45,444 |
| Mining taxes | **34,279** | 5,773 | 28,787 |
| | **74,514** | 48,577 | 74,231 |
| Temporary income tax differences not recognized | **17,528** | 7,274 | 17,387 |
| Tax benefit not recognized | **—** | — | 10,739 |
| Permanent differences related to: | | | |
| – capital items | **(436)** | (13,448) | (5,475) |
| – stock-based compensation | **772** | 1,548 | 3,985 |
| Other income tax permanent differences | **734** | (422) | 1,414 |
| Recognition of prior years' income tax temporary differences | **—** | (14,224) | (2,760) |
| Impact related to reduction of tax rates | **457** | (317) | (3,398) |
| Benefit related to tax settlement and tax return amendments | **(5,502)** | — | — |
| Tax expense | **$ 88,067** | $ 28,988 | $ 96,123 |
| Tax expense applicable to: | | | |
| Current taxes | **$ 66,186** | $ 26,770 | $ 46,758 |
| Future taxes | **21,881** | 2,218 | 49,365 |
| Tax expense | **$ 88,067** | $ 28,988 | $ 96,123 |

### (e) Future income tax assets and liabilities:

The tax effects of temporary differences and loss carryforwards that give rise to significant portions of the future tax assets or future tax liabilities at December 31, 2010, 2009 and 2008 are as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Future income tax assets (liabilities): | | | |
| Property, plant and equipment | **$ 18,301** | $ 17,838 | $ 22,713 |
| Pension obligation | **4,946** | 8,515 | 9,137 |
| Other employee future benefits | **3,220** | 3,841 | 1,355 |
| Asset retirement obligations | **4,308** | 2,737 | 1,547 |
| Non-capital losses (note 13g) | **41,730** | 35,399 | 28,630 |
| Share issue and debt costs | **2,595** | 3,424 | 4,444 |
| Capital losses | **152** | 172 | — |
| Other | **(1,876)** | 5,059 | 3,360 |
| | **73,376** | 76,985 | 71,186 |
| Less valuation allowance | **(57,833)** | (50,488) | (56,253) |
| Net future income tax asset (note 13b) | **15,543** | 26,497 | 14,933 |
| Less current portion | **(11,741)** | (18,307) | (13,163) |
| | **$ 3,802** | $ 8,190 | $ 1,770 |
| Future income tax liabilities (assets): | | | |
| Property, plant and equipment | **$ 46,755** | $ 43,192 | $ 39,075 |
| Pension obligation | **(366)** | (152) | (4,941) |
| Other employee future benefits | **(22,415)** | (19,785) | (19,776) |
| Asset retirement obligations | **(9,787)** | (9,723) | (9,382) |
| Share issue and debt costs | **128** | (1,294) | (2,553) |
| Other | **(288)** | (134) | (318) |
| | **14,027** | 12,104 | 2,105 |
| Add: valuation allowance | **28,119** | 22,898 | 19,950 |
| Net future income tax liability (note 13b) | **42,146** | 35,002 | 22,055 |
| Less current portion | **—** | 75 | 42 |
| | **$ 42,146** | $ 34,927 | $ 22,013 |

The income tax valuation allowance represents management's best estimate of the allowance necessary to reflect the future income tax assets at an amount that the Company considers is more likely than not to be realized. The Company's valuation allowance provides for long-term obligations that are deductible expenses for tax purposes related to asset retirement obligations and other assets that are more unlikely than not to be realized.

### (f) Mining tax effect of temporary differences:

The tax effects of temporary differences that give rise to significant portions of the future mining tax assets at December 31, 2010, 2009 and 2008 are as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Future mining tax assets: | | | |
| Property, plant and equipment | **$ 8,524** | $ 16,375 | $ 27,121 |
| Less valuation allowance | **—** | — | (7,640) |
| Net future mining tax asset (note 13b) | **8,524** | 16,375 | 19,481 |
| Less current portion | **(3,690)** | (4,844) | (8,054) |
| | **$ 4,834** | $ 11,531 | $ 11,427 |

The Company has not recorded a valuation allowance against future mining tax assets in 2010 and 2009 as the Company considers it more likely than not that the asset will be realized.

### (g) Non-capital losses:

At December 31, 2010, the Company had cumulative non-capital losses of $74.7 million in Canada and net operating losses of US$66.0 million in the US. The benefit related to approximately $30 million of the Canadian non-capital losses has been recognized on the balance sheet. The benefit of the US net operating losses has not been recognized.

The Canadian non-capital losses were incurred between 2004 and 2010 and expire between 2012 and 2030. The utilization of approximately $42.3 million of non-capital losses is restricted as a result of a change in control. The US net operating losses were incurred between 2004 and 2010 and have a 20 year carry-forward period.

### (h) Other disclosure:

The tax rules and regulations applicable to mining companies are highly complex and subject to interpretation. The Company may be subject in the future to a review of its historic income and other tax filings, and in connection with such reviews, disputes can arise with the taxing authorities over the interpretation or application of certain tax rules and regulations to the Company's business. These audits may alter the timing or amount of taxable income or deductions. The amount ultimately reassessed upon resolution of issues raised may differ from the amount accrued.

## 14. Share Capital

### (a) Preference shares:

Authorized: Unlimited preference shares

Issued: none

### (b) Common shares:

Authorized: Unlimited common shares

Issued:

| | Common shares | Amount |
|---|---|---|
| Balance, December 31, 2007 | 127,032,612 | $ 311,143 |
| Exercise of options | 111,827 | 976 |
| Shares repurchased | (5,420,000) | (21,175) |
| Shares issued for acquisition | 31,295,685 | 341,436 |
| Balance, December 31, 2008 | 153,020,124 | 632,380 |
| Exercise of options | 1,434,131 | 14,241 |
| Shares repurchased | (599,600) | (2,494) |
| Balance, December 31, 2009 | 153,854,655 | 644,127 |
| Exercise of options | 623,784 | 6,881 |
| Shares repurchased | (5,047,100) | (21,147) |
| Balance, December 31, 2010 | 149,431,339 | $ 629,861 |

On September 29, 2009, the Company announced a share repurchase program, through the facilities of the Toronto Stock Exchange, for cancellation of up to 13,655,000 common shares (approximately 10% of the Company's public float) by way of a normal course issuer bid. Purchases of common shares were made from time to time at market prices and in accordance with the rules of the Toronto Stock Exchange. This repurchase program was authorized to be in effect until September 30, 2010.

During 2010, the Company repurchased for cancellation 5,047,100 common shares (2009 – 599,600, 2008 – 5,420,000) at a net cost of $60,309 (2009 – $7,985; 2008 – $53,291). The Company recorded a reduction in share capital of $21,147 (2009 – $2,494). The excess net cost over the average book value of the shares was recorded as a reduction to contributed surplus of $3,399 (2009 – $5,491, 2008 – $2,195) and a reduction to retained earnings of $35,763 (2009 – $0, 2008 – $29,921).

The Company paid dividends of $0.10 per share on September 30, 2010 to shareholders of record as of September 15, 2010.

### (c) Stock option plan:

During the year ended December 31, 2010, the Company granted additional options to an employee, consistent with the Company's stock option plan approved in June 2005 and amended in May 2008 (the "Plan").

Under the amended Plan, the Company may grant to employees, officers, directors or consultants of the Company or its affiliates options to purchase up to a maximum of 13 million common shares of the Company. The maximum number of common shares issuable to insiders pursuant to the Plan is limited to 10% of the then issued and outstanding common shares of the Company. The maximum number of common shares issuable to each non-employee director under the Plan shall not exceed the lesser of $100,000 in value per year and 1% in number of the then issued and outstanding common shares of the Company per year. Options granted under the amended Plan have a maximum term of five years and become exercisable as follows: the first 33 1/3% are exercisable after one year, the next 33 1/3% are exercisable after two years, and the last 33 1/3% are exercisable after three years. Except in specified circumstances, options are not assignable and terminate upon, or within a specified time following the optionee ceasing to be employed by or associated with the Company. The Plan further provides that the price at which common shares may be issued under the Plan cannot be less than the market price of the common shares on the last trading date before the relevant options are approved by the Board.

Prior to the May 2008 amendment, the Plan approved in June 2005 allowed the Company to grant options up to 10% (to a maximum of 8 million issued outstanding options) of the issued and outstanding common shares of the Company to employees, officers, and directors of the Company for a maximum term of ten years. Of the common shares covered by the stock option plan, the first 33 1/3% were exercisable immediately, the next 33 1/3% were exercisable after one year, and the last 33 1/3% were exercisable after two years.

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Number of shares subject to option** | **Weighted average exercise price** | Number of shares subject to option | Weighted average exercise price |
| Balance, beginning of year | **4,637,113** | **$ 14.25** | 7,159,944 | $ 13.07 |
| Granted | **900,000** | **12.17** | 350,000 | 7.96 |
| Exercised | **(623,784)** | **8.42** | (1,434,131) | 6.55 |
| Forfeited | **(145,557)** | **10.42** | (1,438,700) | 14.54 |
| Expired | **(398,988)** | **17.31** | — | — |
| Balance, end of year | **4,368,784** | **$ 14.50** | 4,637,113 | $ 14.25 |

The weighted average fair value of options granted during 2010 was $4.53 (2009 – $3.82) per option at the grant date. The fair value of the options has been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 1.8% (2009 – 2.9%); dividend yield of 0% (2009 – 0%); volatility factor of 67% (2009 – 51%); and expected life of 3 years (2009 – 3 years). The terms of the options granted during 2010 were amended resulting in the first 33 1/3% being exercisable immediately at the date of grant, the next 33 1/3% exercisable after one year and the last 33 1/3% exercisable after two years.

The grant of stock options in 2010 took place prior to the Company's dividend declaration in September 2010.

The following table summarizes the options outstanding at December 31, 2010:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Number of options outstanding | Weighted-average remaining contractual life (years) | Weighted-average exercise price | Number of options exercisable | Weighted-average exercise price |
| $ 2.59 – 10.20 | 1,017,942 | 4.6 | $ 6.85 | 857,940 | $ 6.65 |
| 10.21 – 14.02 | 1,008,000 | 3.4 | 12.01 | 354,667 | 11.94 |
| 14.03 – 16.00 | 756,703 | 7.2 | 15.86 | 756,703 | 15.86 |
| 16.01 – 20.78 | 355,200 | 3.7 | 17.53 | 351,867 | 17.53 |
| 20.79 – 23.74 | 1,230,939 | 6.3 | 21.16 | 1,230,939 | 21.16 |
| $ 2.59 – 23.74 | 4,368,784 | 5.2 | $ 14.50 | 3,552,116 | $ 15.24 |

### (d) Other stock-based compensation plans:

#### DSU Plan

DSUs vest on the grant date and are redeemable with a cash payment when a participant is no longer a member of the Board of Directors. Issue and redemption prices of DSUs are based on the average closing price of the Company's common shares for the five trading days prior to issuance or redemption. During the year ended December 31, 2010, the Company granted 100,831 DSUs at a weighted average issue price of $12.92 (2009 – 87,724 granted at $9.90). As at December 31, 2010, 176,229 DSUs at a weighted average price of $17.97 were outstanding, 1,111 of which related to additional units issued to DSU holders to reflect dividends paid on September 30, 2010.

At December 31, 2010, the Company's DSU liability was $3,167 (2009 – $1,190). During the year ended December 31, 2010, the Company recognized stock-based compensation expense related to the DSU plan of $2,177 (2009 – $1,190).

#### RSU Plan

RSUs, which are granted under the Company's long-term equity plan, vest on the third anniversary of the grant date, subject to the Board's discretion to set other terms. For RSUs granted prior to July 2010, the Company has the option on the vest date to settle RSUs either in common shares of the Company or with a cash payment based on the closing price of the Company's common shares for the last trading date before the vest date. Under the long-term equity plan, a maximum of one million common shares of the Company may be issued from treasury. Effective July 2010, RSUs are issued under the Company's Share Unit Plan, which has similar terms but requires settlement in cash. Management expects all RSUs will be settled in cash. Except in specified circumstances, RSUs terminate when an employee ceases to be employed by the Company.

During the year ended December 31, 2010, the Company granted 433,927 RSUs at a weighted average price of $12.95 at the grant date (2009 – 0 RSUs), including additional units issued to holders to reflect dividends paid on September 30, 2010. No RSUs were granted or outstanding in 2009.

At December 31, 2010, the Company's RSU liability was $1,641 (2009 – $0). During the year ended December 31, 2010, the Company recognized stock-based compensation expense related to the RSU plan of $1,641 (2009 – $0).

#### ESPP

Effective August 2010, certain employees of the Company have the opportunity to contribute up to a maximum of 10% of their annual base salary to purchase common shares of the Company in the open market at current fair market value. The Company contributes 75 cents for each dollar contributed by employees. Shares acquired for the ESPP by the Company are restricted for one year.

During the year ended December 31, 2010, the Company recognized compensation expense of $175 (2009 – $0; 2008 – $0) related to the employer portion of ESPP contributions.

### (e) Stock-based compensation expense:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Stock option expense | $ 2,518 | $ 3,502 | $ 11,952 |
| DSU expense (note 13d) | 2,177 | 1,190 | — |
| RSU expense (note 13d) | 1,641 | — | — |
| | 6,336 | 4,692 | 11,952 |
| ESPP expense | 175 | — | — |
| | $ 6,511 | $ 4,692 | $ 11,952 |

### (f) Contributed surplus:

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of year | $ 26,717 | $ 32,345 |
| Stock-based compensation expense | 2,518 | 4,692 |
| Transfer to common shares on exercise of stock options | (1,631) | (4,849) |
| Share repurchases (note 14b) | (3,399) | (5,491) |
| Warrants forfeited | — | 20 |
| Balance, end of year | $ 24,205 | $ 26,717 |

### (g) Earnings per share data:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Net earnings attributable to common shareholders | $ 72,985 | $ 112,440 | $ 72,947 |
| Basic weighted average common shares outstanding | 150,636,835 | 153,460,823 | 135,902,627 |
| Add: net incremental shares from assumed conversions of | | | |
| – Stock options | 699,564 | 606,459 | 809,957 |
| – Warrants | — | — | 496 |
| Diluted weighted average common shares outstanding | 151,336,399 | 154,067,282 | 136,713,080 |

## 15. Accumulated Other Comprehensive Income (Loss) ("OCI")

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Accumulated OCI (loss), beginning of year: | | | |
| Cash flow hedge (losses) gains (net of tax of $2,169, $2,954, $3,145) | **$ (4,782)** | $ 7,145 | $ (5,227) |
| Gains (losses) on investments (net of tax of $2,379, $0, $7) | **11,227** | (25,502) | (11) |
| Currency translation adjustments (net of tax of $0, $13, $92) | **—** | 23 | (163) |
| Accumulated OCI (loss), beginning of year | **6,445** | (18,334) | (5,401) |
| OCI (loss) for the year: | | | |
| Effective portion of changes in fair value of cash flow hedges | **7,524** | (9,038) | 19,314 |
| Less: income tax (expense) benefit | **(2,253)** | 2,826 | (6,285) |
| Effective portion of changes in fair value reclassified to earnings: | **(3,266)** | (8,012) | (843) |
| Less: income tax expense | **1,014** | 2,297 | 186 |
| Changes in fair value of investments | **38,464** | 139,016 | (28,680) |
| Less: income tax expense | **(4,764)** | (22,317) | — |
| Changes in fair value of investments reclassified to earnings | **(2,163)** | (99,908) | — |
| Less: income tax expense | **696** | 19,938 | — |
| Changes in fair value of investments reclassified to earnings as impairment | **—** | — | 3,196 |
| Less: income tax expense | **—** | — | (7) |
| Currency translation adjustments | | | 291 |
| Less: income tax expense | | | (105) |
| Currency translation adjustments reclassified to earnings | **—** | (36) | — |
| Less: income tax expense | **—** | 13 | — |
| OCI (loss), net of tax for the year | **35,252** | 24,779 | (12,933) |
| Accumulated OCI (loss), end of year: | | | |
| Cash flow hedge (losses) gains (net of tax of $930, $2,169, $2,954) | **(1,763)** | (4,782) | 7,145 |
| Gains (losses) on investments (net of tax of $6,447, $2,379, $0) | **43,460** | 11,227 | (25,502) |
| Currency translation adjustments (net of tax of $0, $0, $13) | **—** | — | 23 |
| Accumulated OCI (loss), end of year | **41,697** | 6,445 | (18,334) |
| Retained earnings | **1,043,516** | 1,021,195 | 908,755 |
| | **$ 1,085,213** | $ 1,027,640 | $ 890,421 |

## 16. Non-Controlling Interests

On August 31, 2010, pursuant to the terms of a Subscription, Option and Joint Venture Agreement with Aquila Resources Inc. ("Aquila"), the Company earned a 51% ownership interest in Aquila's Back Forty Project.

On July 5, 2010, pursuant to the terms of a joint venture agreement with VMS Ventures Inc. ("VMS"), the Company acquired a 70% ownership interest in the Reed Lake property and the two claims immediately to the south.

The Company accounted for its acquisition of control over the Back Forty and Reed Lake projects as asset acquisitions and has consolidated the projects in its consolidated financial statements.

| | CGN | Aquila | VMS | Total |
|---|---|---|---|---|
| Balance, January 1, 2008 | $ — | $ — | $ — | $ — |
| Share of assets acquired | 1,732 | — | — | 1,732 |
| Share of net loss | (467) | — | — | (467) |
| Balance, December 31, 2008 | 1,265 | — | — | 1,265 |
| Share of net earnings | 40 | — | — | 40 |
| Balance, December 31, 2009 | 1,305 | — | — | 1,305 |
| Share of assets acquired | — | 10,222 | 1,122 | 11,344 |
| Share of net loss | (224) | (1,865) | (858) | (2,947) |
| Balance, December 31, 2010 | $ 1,081 | $ 8,357 | $ 264 | $ 9,702 |

## 17. Capital Disclosures

The Company's objectives when managing capital are to maintain a strong capital base in order to:

- Advance the Company's corporate strategies to create long-term value for its stakeholders; and
- Sustain the Company's operations and growth throughout metals and materials cycles.

| | **2010** | 2009 |
|---|---|---|
| Shareholders' equity | **$ 1,739,279** | $ 1,698,484 |
| Cash and cash equivalents | **901,693** | 886,814 |

HudBay monitors its capital and capital structure on an ongoing basis to ensure they are sufficient to achieve the Company's short-term and long-term strategic objectives. The Company does not currently have significant debt outstanding. The Company's credit facility requires that sufficient cash, cash equivalents and undrawn credit facility be available to fund three years of capital expenditures on the Lalor project. Interest coverage ratios, debt to book capitalization ratios and debt to cash flow ratios are metrics that would also be evaluated during periods when financial leverage was employed as an element of the Company's capital structure.

## 18. Financial Instruments

### (a) Fair value and carrying value of financial instruments:

The following presents the fair value and carrying value of the Company's financial instruments and non-financial derivatives:

| | Classification | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash and cash equivalents[1] | FV through earnings | **$ 901,693** | $ 886,814 |
| Accounts receivable | | | |
| Trade and other receivables[1] | Loans & receivables | **72,327** | 39,978 |
| Embedded derivatives[2] | FV through earnings | **5,841** | 209 |
| Derivative assets | | | |
| Hedging derivatives[2] | Hedging derivatives | **1,676** | 390 |
| Non-hedge derivative assets[2] | FV through earnings | **2,741** | 974 |
| Available-for-sale investments[3] | Available-for-sale | **104,990** | 27,249 |
| Investments at fair value through earnings[3] | FV through earnings | **7,688** | 138 |
| Restricted cash[1] | FV through earnings | **4,405** | 59,031 |
| | | **$ 1,101,361** | $ 1,014,783 |
| **Financial liabilities** | | | |
| Accounts payable | | | |
| Trade payables & accrued liabilities[1] | Other financial liabilities | **$ 138,539** | $ 119,181 |
| Embedded derivatives[2] | FV through earnings | **941** | 557 |
| Derivative liabilities | | | |
| Hedging derivatives[2] | Hedging derivatives | **4,384** | 9,823 |
| Non-hedge derivative liabilities[2] | FV through earnings | **2,694** | 748 |
| | | **$ 146,558** | $ 130,309 |
| Net financial assets | | **$ 954,803** | $ 884,474 |

1 Carrying values of cash and cash equivalents and restricted cash are classified as held-for-trading and measured at fair value. The carrying values of accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short-term nature and thus have not been classified within the fair value hierarchy.

2 Derivatives and embedded provisional pricing derivatives are carried at their fair value and determined based on internal valuation models that reflect observable forward commodity prices and exchange rates, currency exchange rates and discount factors based on market US dollar interest rates.

3 Available-for-sale investments consist mainly of listed common shares carried at their fair values, which are determined using quoted market bid prices in active markets. Investments at fair value through earnings consist of warrants to purchase listed shares, which are carried at their fair value as determined using a Black-Scholes model. In December 2010, the Company invested $2,000 in common shares of a private company. As the shares are not actively traded, the Company carries them at cost. Due to the short time period since the initial purchase, management determined that their cost approximated fair value as at December 31, 2010.

The table below provides an analysis by valuation method of financial instruments that are measured at fair value subsequent to initial recognition. Refer to note 2j(iv) for an explanation of the fair value hierarchy.

| December 31, 2010 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets measured at fair value** | | | | |
| Financial assets at fair value through earnings | | | | |
| Cash and cash equivalents | **$ 901,693** | **$ —** | **$ —** | **$ 901,693** |
| Embedded derivatives | **—** | **5,841** | **—** | **5,841** |
| Cash flow hedging derivatives | **—** | **1,676** | **—** | **1,676** |
| Non-hedge derivative assets | **—** | **2,741** | **—** | **2,741** |
| Restricted cash | **4,405** | **—** | **—** | **4,405** |
| Investments at fair value through earnings | **—** | **7,688** | **—** | **7,688** |
| Financial assets available-for-sale | | | | |
| Available-for-sale investments | **102,990** | **—** | **—** | **102,990** |
| | **$ 1,009,088** | **$ 17,946** | **$ —** | **$ 1,027,034** |
| **Financial liabilities measured at fair value** | | | | |
| Financial liabilities at fair value through earnings | | | | |
| Embedded derivatives | **$ —** | **$ 941** | **$ —** | **$ 941** |
| Cash flow hedging derivatives | **—** | **4,384** | **—** | **4,384** |
| Non-hedge derivative liabilities | **—** | **2,694** | **—** | **2,694** |
| | **$ —** | **$ 8,019** | **$ —** | **$ 8,019** |

| December 31, 2009 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets measured at fair value** | | | | |
| Financial assets at fair value through earnings | | | | |
| Cash and cash equivalents | $ 886,814 | $ — | $ — | $ 886,814 |
| Embedded derivatives | — | 209 | — | 209 |
| Cash flow hedging derivatives | — | 390 | — | 390 |
| Non-hedge derivatives | — | 974 | — | 974 |
| Restricted cash | 59,031 | — | — | 59,031 |
| Investments at fair value through earnings | — | 138 | — | 138 |
| Financial assets available-for-sale | | | | |
| Available-for-sale investments | 27,249 | — | — | 27,249 |
| | $ 973,094 | $ 1,711 | $ — | $ 974,805 |
| **Financial liabilities measured at fair value** | | | | |
| Financial liabilities at fair value through earnings | | | | |
| Embedded derivatives | $ — | $ 557 | $ — | $ 557 |
| Cash flow hedging derivatives | — | 9,823 | — | 9,823 |
| Non-hedge derivatives | — | 748 | — | 748 |
| | $ — | $ 11,128 | $ — | $ 11,128 |

### (b) Financial risk management:

The Company's financial risk management activities are governed by Board-approved policies addressing risk identification, hedging authorization procedures and limits, and reporting. HudBay's policy objective, when hedging activities are undertaken, is to reduce the volatility of future earnings and cash flow within the strategic and economic goals of the Company. The Company from time to time employs derivative financial instruments, including forward and option contracts, to manage risk originating from exposures to commodity price risk, foreign exchange risk and interest rate risk. Significant derivative transactions are approved by the Board of Directors, and hedge accounting is applied when certain criteria have been met. The Company does not use derivative financial instruments for trading or speculative purposes.

The following is a discussion of the Company's risk exposures. Information on derivatives held by the Company as at December 31, 2010 is presented in note 18c.

**(i) Market risk**

Market risk is the risk that changes in market prices, including foreign exchange rates, commodity prices and interest rates, will cause fluctuations in the fair value or future cash flows of a financial instrument.

*Foreign Currency Risk*

The Company's primary exposure to foreign currency risk arises from:

- Translation of US dollar denominated revenues and expenses and, to a lesser extent, Guatemalan quetzal expenses into Canadian dollars. Substantially all of the Company's revenues are denominated in US dollars, while a small portion of its expenses are denominated in US dollars. As a result, appreciation of the Canadian dollar relative to the US dollar will reduce the Company's earnings, and a weakening of the Canadian dollar will increase the Company's earnings.
- Translation of US dollar and Guatemalan quetzal denominated operating accounts, consisting mainly of certain cash and cash equivalents, accounts receivable, accounts payable and derivatives. Cash balances in quetzals are restricted to amounts required to fund near-term operating requirements. Appreciation of the Canadian dollar relative to the US dollar or quetzal will reduce the net asset value of these operating accounts once they have been translated to Canadian dollars, resulting in foreign currency translation losses on foreign currency denominated assets and gains on foreign currency denominated liabilities.

Based on HudBay's financial instruments and non-financial derivatives outstanding as at December 31, 2010, the Company had significant market risk sensitivity to reasonably possible changes in the US$/C$ exchange rate. At December 31, 2010, US$1 was worth $0.9946. If the US$/C$ exchange rate had been higher by C$0.10 with all other variables held constant, net earnings would have been $10.7 million higher due to translation of operating accounts denominated in US dollars, and after-tax gains accumulated in OCI would have been decreased by C$1.8 million due to the revaluation of the foreign currency hedge. An equal change in the opposite direction would have decreased the Company's net earnings by $10.7 million and increased the after-tax gains accumulated in OCI by C$1.9 million.

At December 31, 2009, US$1 was worth $1.0510. If the USD/CAD exchange rate had been higher by C$0.40 with all other variables held constant, 2009 net earnings would have been $15.5 million higher due to translation of operating accounts denominated in US dollars and OCI would have been lower by C$8.9 million due to the revaluation of the foreign currency hedge. An equal change in the opposite direction would have decreased the Company's 2009 net earnings by $15.5 million and increased the Company's OCI by C$9.5 million.

The above sensitivity analyses relate solely to the financial instruments and non-financial derivatives that were outstanding as at December 31, 2010 and December 31, 2009; these analyses do not reflect the overall effect that changes in the US$/C$ exchange rate would have on the Company's results of operations.

*Commodity Price Risk*

HudBay is exposed to market risk from prices for the commodities the Company produces and sells, such as zinc, copper, gold and silver. From time to time, the Company maintains price protection programs and conducts commodity price risk management through the use of derivative contracts.

Based on HudBay's financial instruments and non-financial derivatives outstanding as at December 31, 2010, the Company's net earnings and OCI had significant market risk sensitivity to reasonably possible changes in base metal prices. If copper prices at December 31, 2010 had been higher by US$0.30/lb. with all other variables held constant, net earnings would have been $2.1 million higher due to the mark-to-market effect on the Company's embedded provisional pricing derivatives. A downward change of US$0.30/lb. would have decreased the Company's net earnings by $2.1 million.

If zinc prices at December 31, 2010 had been higher by US$0.10/lb. with all other variables held constant, after-tax OCI would have been $2.7 million lower due to the mark-to-market effect on the Company's commodity swap hedges. A downward change of US$0.10/lb. would have increased the Company's after-tax OCI by $2.3 million.

If copper prices at December 31, 2009 had been higher by US$1.50/lb. with all other variables held constant, 2009 net earnings would have been $2.3 million higher due to the mark-to-market effect on the Company's embedded provisional pricing derivatives. A downward change of US$1.50/lb. would have increased the Company's 2009 net earnings by $2.3 million.

If zinc prices at December 31, 2009 had been higher by US$0.50/lb. with all other variables held constant, 2009 after-tax OCI would have been $2.3 million lower due to the mark-to-market effect on the Company's commodity swap hedges. A downward change of US$0.50/lb. would have decreased the Company's 2009 net earnings by $18.7 million.

The above sensitivity analyses relate solely to financial instruments and non-financial derivatives that were outstanding as at December 31, 2010 and as at December 31, 2009; these analyses do not reflect the overall effect that changes in copper and zinc prices would have on the Company's results of operations.

*Share Price Risk*

HudBay is exposed to market risk from share prices as the Company holds investments in Canadian listed mineral resource companies. These investments are made to foster strategic relationships in connection with joint venture agreements and for investment purposes. Management monitors the value of these investments for the purposes of determining whether to add to or reduce the Company's positions.

Based on HudBay's investments held as at December 31, 2010, the Company had significant market risk sensitivity to reasonably possible changes in share prices. If share prices at December 31, 2010 had been higher by 25% with all other variables held constant, after-tax OCI would have been $26.8 million higher. An equal change in the opposite direction would have decreased the Company's after-tax OCI by $26.8 million.

If share prices at December 31, 2009 had been higher by 50% with all other variables held constant, 2009 after-tax OCI would have been $11.7 million higher. An equal change in the opposite direction would have decreased the Company's 2009 after-tax OCI by $11.7 million.

The above sensitivity analyses relates solely to the investments that were held as at December 31, 2010 and as at December 31, 2009.

*Interest Rate Risk*

The Company is not exposed to significant interest rate risk other than cash flow interest rate risk on its cash and cash equivalents. The Company invests its cash and cash equivalents primarily in Canadian bankers' acceptances, deposits at major Canadian banks, or treasury bills issued by the federal or provincial governments. These investments are liquid, interest-bearing investments with original maturities of six months or less.

Based on HudBay's financial instruments outstanding as at December 31, 2010, the Company's net earnings had significant sensitivity to reasonably possible changes in interest rates. If interest rates at December 31, 2010 had been higher by 2% with all other variables held constant, net earnings would have been $10.5 million higher related mainly to the Company's cash and cash equivalents. A downward change to interest rates of 0.25% would have decreased the Company's net earnings by $1.3 million.

If interest rates at December 31, 2009 had been higher by 3.00% with all other variables held constant, 2009 net earnings would have been $16.7 million higher related mainly to the Company's cash, cash equivalents and short-term investments. A downward change to interest rates of 0.25% would have decreased the Company's 2009 net earnings by $1.4 million.

The above sensitivity analyses relate solely to financial instruments that were outstanding as at December 31, 2010 and December 31, 2009.

**(ii) Credit risk:**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The Company has taken into account its own credit risk in determining the fair value of its financial assets and liabilities. The Company's maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative assets, on the balance sheet. Refer to note 18a.

The Company holds its cash and cash equivalents in low-risk, liquid investments and deposit accounts with major Canadian banks. The Company's short-term investment policy establishes minimum acceptable counterparty credit ratings for short-term investments. Management has a credit policy in place that requires the Company to obtain credit insurance from an investment grade credit insurance provider to mitigate exposure to credit risk in its receivables. The deductible and any additional exposure to credit risk is monitored and approved on an ongoing basis. Transactions involving derivatives are with counterparties the Company believes to be creditworthy. A deterioration of economic conditions could cause an increase in the rate of customer bad debts relative to historical experience, which may be mitigated by the credit insurance described above. The Company uses an allowance to provide for doubtful accounts receivable. During the year ended December 31, 2010, the allowance decreased by $35. As at December 31, 2010, less than 1% of the Company's trade accounts receivable were past due.

Three customers accounted for approximately 22%, 8% and 6%, respectively, of total revenue during the year ended December 31, 2010 (2009 – approximately 14%, 5% and 5%, respectively, of total revenue). One customer accounted for approximately 62% of total accounts receivable as at December 31, 2010 (2009 – 14%).

**(iii) Liquidity risk:**

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. HudBay's objective is to maintain sufficient liquid resources to meet operational and investing requirements. The Company's investment policy requires it to comply with a list of approved investments, concentration and maturity limits, as well as credit quality. The Company has not invested in asset-backed commercial paper. As at December 31, 2010, the Company had cash and cash equivalents of $901,693 (2009 – $886,814). Substantially all of the Company's financial liabilities and non-financial derivative liabilities mature within one year.

### (c) Derivatives:

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

| December 31, 2010 | Non-hedge derivative zinc contracts | Cash flow hedging derivatives | Total |
|---|---|---|---|
| Derivative assets: | | | |
| Current portion | $ 2,741 | $ 1,072 | $ 3,813 |
| Long-term portion (note 8) | — | 604 | 604 |
| | 2,741 | 1,676 | 4,417 |
| Derivative liabilities: | | | |
| Current portion (note 9) | 2,694 | 2,751 | 5,445 |
| Long-term portion | — | 1,633 | 1,633 |
| | 2,694 | 4,384 | 7,078 |
| Net derivative asset (liability) | $ 47 | $ (2,708) | $ (2,661) |

| December 31, 2009 | Non-hedge derivative zinc contracts | Cash flow hedging derivatives | Total |
|---|---|---|---|
| Derivative assets: | | | |
| Current portion | $ 974 | $ 132 | $ 1,106 |
| Long-term portion (note 8) | — | 258 | 258 |
| | 974 | 390 | 1,364 |
| Derivative liabilities: | | | |
| Current portion (note 9) | 748 | 2,755 | 3,503 |
| Long-term portion | — | 7,068 | 7,068 |
| | 748 | 9,823 | 10,571 |
| Net derivative asset (liability) | $ 226 | $ (9,433) | $ (9,207) |

*Non-Hedge Derivative Zinc Contracts*

HudBay enters into fixed price sales contracts with zinc and zinc oxide customers and, to ensure the Company continues to receive a floating or unhedged realized zinc price, enters into forward zinc purchase contracts that effectively offset the fixed price sales contracts. Forward purchases and forward customer sales of zinc are recorded as derivatives. Gains and losses on these contracts are recorded in revenues, and cash flows are classified in operating activities. However, forward customer sales of zinc oxide do not qualify as derivatives.

At December 31, 2010, the Company held contracts for forward zinc purchases of 891 tonnes that related to non-derivative forward customer sales of zinc oxide. Prices ranged from US$1,722 to US$2,340 per tonne, and settlement dates extended out to one year in the future. In addition, the Company held contracts for forward zinc purchases of 6,198 tonnes that substantially offset forward customer zinc sales of 6,198 tonnes, which have been recorded as derivatives.

*Embedded Provisional Pricing Derivatives*

The Company records embedded derivatives (presented in accounts receivable and accounts payable) related to provisional pricing in concentrate purchase, concentrate sale, anode sale, and certain other sale contracts. Under the terms of these contracts, prices are subject to final adjustment at the end of a future period based on quoted market prices during the quotational period specified in the contract. The period between provisional pricing and final pricing is typically up to three months. At each reporting date, provisionally priced metal sales and purchases are marked to market based on the forward market price for the quotational period stipulated in the contract, with changes in fair value recognized in revenues for sales contracts and in operating expenses for purchase concentrate contracts. Cash flows are classified in operating activities. At December 31, 2010, the Company's net position consisted of contracts awaiting final pricing for purchases of 5,178 tonnes of zinc, sales of 6,236 tonnes of copper, sales of 10,740 ounces of gold and sales of 99,071 ounces of silver.

*Cash Flow Hedges*

During 2009, the Company entered into a foreign exchange swap contract to hedge foreign exchange risk for future receipts of US dollars and commodity swap contracts to hedge prices for a portion of future sales of zinc. These contracts will expire in mid-2012. The risk management objective for these hedging relationships is to mitigate the impact on the Company of fluctuating zinc prices and exchange rates. Cash flow hedge accounting has been applied to the hedging relationships. As at December 31, 2010, the zinc swap contracts have been recorded as hedging net derivative liabilities at their fair value of $4,384 (2009 – liability of $9,823) and the foreign exchange swap contract has been recorded as a hedging net derivative asset at its fair value of $1,676 (2009 – asset of $390).

For the year ended December 31, 2010, the Company recorded pre-tax net gains of $7,524 (2009 – losses of $9,038) to OCI for the effective portion of these cash flow hedges and recorded pre-tax net gains of $366 (2009 – losses of $876) in earnings for the ineffective portion. Ineffective gains and losses are included in gain (loss) on derivative instruments. The Company also reclassified pre-tax net gains of $1,179 from OCI to earnings as hedged anticipated zinc sales occurred (2009 – $0).

In 2007, the Company applied hedge accounting to commodity swap contracts used to hedge prices for a portion of future sales of zinc and copper. During 2008, the Company terminated its remaining zinc and copper commodity swap contracts. The related hedging relationships were discontinued prospectively, and related gains and losses in AOCI were reclassified to earnings as the remaining hedged anticipated future sales occurred. For the year ended December 31, 2010, the Company reclassified pre-tax net gains of $2,087 from OCI to earnings (presented in revenue) as hedged anticipated zinc sales occurred (2009 – gains of $8,012).

Of the $2,693 pre-tax losses in AOCI at December 31, 2010, pre-tax losses of $1,438 will be reclassified to earnings in the next twelve months. The remaining pre-tax losses of $1,255 will be reclassified to earnings in 2012.

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

| Zinc swaps – US$ denominated contracts maturing in: | Volume (metric tonnes) | Weighted average price US$/MT | Fair value of derivative liability |
|---|---|---|---|
| 2011 | 10,980 | 2,220 | $ 2,750 |
| 2012 | 6,405 | 2,220 | 1,634 |
| | | | $ 4,384 |

## (d) Financial instruments at fair value through earnings – changes in value:

Financial instruments and non-financial derivatives classified as fair value through earnings include non-hedge derivative zinc contracts, embedded derivatives relating to provisional pricing, and investments at fair value through earnings. For the year ended December 31, 2010, the total amount of change in fair value that has been recognized in earnings for these items was a net gain of $25,233 (2009 – net loss of $403).

## 19. Commitments

### (a) Operating lease commitments:

The Company has entered into various lease commitments for facilities and equipment. The leases expire in periods ranging from one to six years. The aggregate remaining minimum annual lease payments required for the next five years are as follows:

| | |
|---|---|
| 2011 | $ 2,210 |
| 2012 | 2,618 |
| 2013 | 2,902 |
| 2014 | 2,924 |
| 2015 | 2,486 |
| Thereafter | 11,512 |

### (b) Buy-sell commitments:

The Company has an agreement to sell copper concentrates representing the majority of the Company's expected copper concentrate production through 2015. Payment for the concentrates is based on the market price of contained copper and precious metals following delivery of the concentrate, less fixed treatment and refining credits.

The Company also has an agreement to purchase zinc concentrates to be delivered to Flin Flon in amount sufficient to meet the majority of the Company's requirements in 2011 for third party purchased zinc concentrates.

Payment for these zinc concentrates is based on the market price of contained metal during a quotational period following delivery of the concentrate, less a fixed treatment credit. If the Company cannot process the contracted tonnage in a timely manner, management believes the Company will be able to negotiate alternate arrangements for the sale or diversion of the tonnage.

The Company relies partly on processing purchased concentrates to contribute to operating earnings by covering a portion of fixed costs. The continued availability of such concentrates at economic terms beyond the expiry of current existing contracts cannot be determined at this time.

### (c) Other commitments and agreements:

(i) With respect to the Callinan Mines Limited claims, the Company is subject to a royalty payment of $0.25 per ton of ore milled and, if aggregate cash flow for the year and cumulative cash flow are positive, a net profits interest of 6 $^2/_3$% of the net proceeds of production. During 2007, cumulative cash flow became positive. Payments are made according to the terms of the agreement.

(ii) HBMS has a profit-sharing plan whereby 10% of HBMS's after-tax earnings (excluding provisions or recoveries for future income and mining tax) calculated in accordance with Canadian GAAP for any given fiscal year will be distributed to all eligible employees in the Flin Flon/Snow Lake operations, with the exception of executive officers and key management personnel. An expense of $15,849 (2009 – $8,124) has been included in these financial statements.

(iii) In the normal course of operations, the Company provides indemnifications that are often standard contractual terms to counterparties in transactions, such as purchase and sale contracts, service agreements and leasing transactions. These indemnification provisions may require the Company to compensate the counterparties for costs incurred as a result of various events, including environmental liabilities, changes in (or in the interpretation of) laws and regulations, or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification provisions will vary based upon the contract, the nature of which prevents the Company from making a reasonable estimate of the maximum potential amount that could be required to pay to counterparties. Historically, the Company has not made any significant payments under such indemnification provisions. Management estimates that there are no significant liabilities with respect to these indemnification provisions.

(iv) The Company has outstanding letters of credit in the amount of $59,335, of which $56,931 is supported by the revolving credit facility as described in note 8. $2,404 represents letters of credit provided by HMI Nickel, as described in note 19(c)(vii).

(v) In the normal course of operations, the Company negotiates exploration option agreements with other companies whereby the Company and its subsidiaries may either grant options or obtain options on exploration properties.

(vi) The Company's subsidiary, HBMS, has Collective Bargaining Agreements ("CBA") in place with its unionized Flin Flon/ Snow Lake workforce. In 1998, HBMS entered into an Amending Agreement that prohibits strikes and lockouts and provides for binding arbitration through the negotiations of 2012 in the event that negotiated CBA settlements are not achieved.

(vii) As a result of the Company's acquisition of HMI Nickel on August 26, 2008, the Company became subject to additional commitments which are still in effect, as follows.

- CGN and Skye Resources (B.V.I.) Inc. entered into long-term agreements with subsidiaries of Duke Energy International LLC for the supply of electrical power and construction of a new power transmission line for the Fenix project and its interconnection with the Guatemalan transmission grid. Under the terms of the agreements, the Company provided a letter of credit of US$5,000 supported by a restricted bank deposit. On February 27, 2009, these agreements were cancelled. The agreements included cancellation costs of approximately US$2,000 which were paid in 2009 and the letter of credit was cancelled. These agreements also specified a contingent obligation to purchase certain transmission line development assets upon contract cancellation and these assets were purchased in 2009 at a cost of US$5,000.
- The Company has a contingent commitment to make payments to Vale Inco based on tonnages of ore mined from the mining licence areas at the Fenix project and, if a ferro-nickel plant is operated, to pay a sales agency fee and make certain payments on any ferro-nickel produced based on a net smelter return formula.
- The Company is required to provide bonds to the Government of Guatemala in respect of security for CGN's commitments under an approved Environmental Impact Assessments program. As at December 31, 2010, these bonds are supported by a letter of credit of US$2,404, which in turn is supported by a restricted bank deposit.

## 20. Contingencies

The Company and its subsidiaries are involved in various claims and litigation arising in the ordinary course and conduct of business. As the outcomes are uncertain, no amounts have been recorded in these consolidated financial statements. The significant claims and litigation matters are as follows:

(a) Statements of claim were filed against Saskatchewan Power Corporation ("SaskPower"), HBMS and Churchill River Power Company Limited ("CRP") on February 10, 1995, seeking an aggregate of $1 billion in compensatory damages and in excess of $100 million in punitive damages. These claims were filed in connection with the use and operation of the Whitesand Dam and the Island Falls Hydro Electric Station in Saskatchewan, which were transferred by CRP, formerly a wholly-owned subsidiary of HBMS, to SaskPower in 1981. Based on the current knowledge of management, the ultimate resolution of the claims will not be material to the Company's financial position.

(b) On December 20, 2004, a Statement of Claim was filed by the Peter Ballantyne Cree Nation against SaskPower, the Government of Canada and the Province of Saskatchewan. The action claims damages alleged as a result of the operation and use of the Whitesand Dam and Island Falls Hydro-Electric Station. HBMS and CRP have both been named as third parties in the action by SaskPower. It has come to HudBay's attention that CRP, a former subsidiary of HBMS that was dissolved, has been revived by SaskPower for the purpose of taking legal action against CRP for alleged breaches by CRP of its obligations under a certain Purchase and Sale Agreement made in 1981. At present, the resolution of the claims against CRP and HBMS is not reasonably determinable.

(c) On March 2, 2007, a Statement of Claim was issued in the Manitoba Court of Queen's Bench by Callinan Mines Limited against HBMS seeking declaratory relief, an accounting and an undisclosed amount of damages in connection with a Net Profits Interest and Royalty Agreement between HBMS and Callinan Mines Limited dated January 1, 1988. HBMS has retained legal counsel and the likelihood of success and materiality of this claim is not reasonably determinable. See note 19(c)(i) for more information.

## 21. Supplementary Cash Flow Information

### (a) Change in non-cash working capital:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Accounts receivable | **$ (37,981)** | $ 16,049 | $ 3,467 |
| Income taxes receivable | **15,214** | — | — |
| Inventories | **9,434** | 15,759 | 34,784 |
| Accounts payable and accrued liabilities | **14,821** | (31,734) | (35,142) |
| Taxes payable | **31,849** | (18,465) | 9,614 |
| Prepaid expenses and other current assets | **(2,002)** | 229 | (301) |
| Interest payable | **—** | (156) | 29 |
| Deferred revenue | **24,405** | — | — |
| | **$ 55,740** | $ (18,318) | $ 12,451 |

### (b) Non-cash investing activities:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Non-cash additions: | | | |
| Property, plant and equipment | **$ 7,469** | $ 4,101 | $ 3,063 |
| Computer software | **434** | — | — |

### (c) Interest and taxes paid:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Supplementary cash flow information: | | | |
| Interest paid | **$ 306** | $ 285 | $ 506 |
| Taxes paid | **15,736** | 39,158 | 42,811 |

## 22. Segmented Information

HudBay is a Canadian diversified mining company. When making decisions on expansions, opening or closing mines, as well as day-to-day operations, management evaluates profitability by operating segment described below. Included in "HBMS" are the Company's mines and metallurgical facilities in Manitoba, Saskatchewan, Michigan and Ontario. The HMI Nickel segment relates mainly to the Fenix nickel project. The "Other" segment consists of the Company's Balmat operations, now on care and maintenance, and the HudBay Michigan subsidiary. Accounting policies for all segments are the same as those described in note 2.

| **2010** | **HBMS** | **HMI Nickel** | **Other** | **Corporate activities** | **Total** |
|---|---|---|---|---|---|
| Revenue from external customers | **$ 778,818** | **$ —** | **$ —** | **$ —** | **$ 778,818** |
| Operating | **432,414** | **11,271** | **7,321** | **100** | **451,106** |
| Depreciation and amortization | **103,018** | **129** | **—** | **252** | **103,399** |
| Other expense[1] | **20,383** | **661** | **558** | **25,870** | **47,472** |
| Earnings (loss) before the following: | **223,003** | **(12,061)** | **(7,879)** | **(26,222)** | **176,841** |
| Exploration | **(16,076)** | **(1,683)** | **(11,731)** | **(332)** | **(29,822)** |
| Other income (expense) | **1,192** | **(9)** | **—** | **4,748** | **5,931** |
| Earnings (loss) before interest and taxes | **208,119** | **(13,753)** | **(19,610)** | **(21,806)** | **152,950** |
| Interest income | | | | | **5,155** |
| Tax expense | | | | | **(88,067)** |
| Net earnings | | | | | **70,038** |
| Total assets[2] | **710,319** | **379,774** | **9,056** | **1,073,937** | **2,173,086** |
| Property, plant and equipment[2] | **515,953** | **373,839** | **16,489** | **625** | **906,906** |
| Additions to property, plant and equipment[3] | **160,107** | **2,421** | **4,985** | **129** | **167,642** |

| **2009** | HBMS | HMI Nickel | Other | Corporate activities | Total |
|---|---|---|---|---|---|
| Revenue from external customers | $ 719,253 | $ 236 | $ 1,233 | $ — | $ 720,722 |
| Operating | 490,903 | 8,329 | 7,043 | — | 506,275 |
| Depreciation and amortization | 100,354 | 175 | — | 202 | 100,731 |
| Other expenses[1] | 23,690 | 2,234 | 825 | 44,359 | 71,108 |
| Earnings (loss) before the following: | 104,306 | (10,502) | (6,635) | (44,561) | 42,608 |
| Exploration | (4,341) | (205) | (2,833) | (230) | (7,609) |
| Other income (expenses) | (309) | — | 2,206 | 99,981 | 101,878 |
| Earnings (loss) before interest and tax | 99,656 | (10,707) | (7,262) | 55,190 | 136,877 |
| Interest income | | | | | 4,591 |
| Tax expense | | | | | (28,988) |
| Net earnings | | | | | 112,480 |
| Total assets[2] | 504,584 | 388,450 | 5,446 | 1,134,206 | 2,032,686 |
| Property, plant and equipment[2] | 440,585 | 376,028 | 1,328 | 693 | 818,634 |
| Additions to property, plant and equipment[3] | 85,267 | 11,341 | 3,211 | 267 | 99,948 |

1 Includes foreign exchange gains and losses, which fluctuate from period to period.

2 Total assets do not reflect intercompany balances, which have been eliminated on consolidation.

3 Represents cash additions to property, plant and equipment. For non-cash additions, see note 21.

The Company's revenue by significant product types:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Copper | **$ 380,847** | $ 354,196 | $ 553,304 |
| Zinc | **178,275** | 172,846 | 176,785 |
| Gold | **103,631** | 103,034 | 93,872 |
| Silver | **20,807** | 35,538 | 27,595 |
| Other | **108,153** | 60,750 | 149,769 |
| Less: treatment and refining charges | **(12,895)** | (5,642) | (19,431) |
| | **$ 778,818** | $ 720,722 | $ 981,894 |

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Copper | **$ 305** | $ 56,755 | $ 143,032 |
| Zinc | **46,266** | 58,604 | 15,770 |
| Gold | **—** | 389 | 777 |
| Silver | **—** | 17,497 | 13,664 |

## 23. Interest and Other Income

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Interest income | **$ 6,120** | $ 4,745 | $ 27,174 |
| Interest and financing expense | **(965)** | (154) | (957) |
| Gain on disposal of AFS investments | **2,124** | 100,217 | — |
| Other income | **1,044** | 2,578 | — |
| | **$ 8,323** | $ 107,386 | $ 26,217 |

## 24. Subsequent Event

On January 10, 2011, the Company announced that it had entered into an agreement to acquire all of the outstanding common shares of Norsemont Mining Inc. ("Norsemont"). Norsemont is a Canadian mineral exploration and development company focused on its wholly-owned Constancia copper project in southern Peru. Holders of Norsemont shares were given the ability to elect, on an individual basis, to receive 0.2617 shares of HudBay and $0.001 in cash, $4.50 in cash, or a combination of cash and HudBay shares, subject to proration necessary to effect maximum aggregate cash consideration of $130 million.

On March 1, 2011, the Company acquired 104,635,351 common shares of Norsemont through the issuance of approximately 20.5 million of HudBay's common shares, valued at approximately $347,000 using the Company's closing share price on the Toronto Stock Exchange of $16.94 on March 1, 2011, and the payment of $118,524 in cash. As a result, the Company owns approximately 91% of Norsemont's issued and outstanding shares (calculated on a fully-diluted basis). The Company intends to proceed with a compulsory acquisition transaction to acquire the remaining shares of Norsemont that it does not already own or subsequently acquire before the expiry of HudBay's take-over bid. The Company is determining the effect of this acquisition on its consolidated financial statements.

## 25. Reconciliation to United States Generally Accepted Accounting Principles

HudBay prepares its consolidated financial statements in accordance with Canadian GAAP, which differ in certain material respects from accounting principles generally accepted in the United States of America ("US GAAP").

The following is the reconciliation for balance sheet items:

| Consolidated Summarized Balance Sheets | 2010 | 2009 |
|---|---|---|
| Total assets under Canadian GAAP | **$ 2,173,086** | $ 2,032,686 |
| Adjustments for: | | |
| Capitalization of exploration costs (net of investment tax credits (j)) (a) | **(88,413)** | (32,779) |
| Depreciation and amortization (b) | **4,219** | (7,509) |
| Capitalization of start-up costs (c) | **(7,568)** | (1,924) |
| Pension (d) | **310** | 353 |
| Tax effect of US GAAP adjustments (g) | **11,405** | 4,629 |
| Total assets under US GAAP | **$ 2,093,039** | $ 1,995,456 |
| Total liabilities under Canadian GAAP | **$ 424,105** | $ 332,897 |
| Adjustments for: | | |
| Pension (d) | **21,601** | 1,214 |
| Other employee future benefits (d) | **19,257** | 3,988 |
| Tax effect of US GAAP adjustments (g) | **(30,380)** | (11,596) |
| Total liabilities under US GAAP | **$ 434,583** | $ 326,503 |
| Total equity under Canadian GAAP | **$ 1,748,981** | $ 1,699,789 |
| Adjustments for: | | |
| Capitalization of exploration costs (a) | **(91,311)** | (35,555) |
| Depreciation and amortization (b) | **4,219** | (7,509) |
| Capitalization of start-up costs (c) | **(7,568)** | (1,924) |
| Pension (d) | **(21,291)** | (861) |
| Other employee future benefits (d) | **(19,257)** | (3,988) |
| Investment tax credits (j) | **2,898** | 2,776 |
| Tax effect of US GAAP adjustments (g) | **41,785** | 16,225 |
| Total equity under US GAAP | **$ 1,658,456** | $ 1,668,953 |

Balances in the equity section under US GAAP are as follows:

| | 2010 | 2009 |
|---|---|---|
| Common shares | **$ 665,960** | $ 680,588 |
| Additional paid in capital | **22,348** | 24,736 |
| Retained earnings | **953,326** | 960,218 |
| Accumulated other comprehensive income | **7,120** | 2,106 |
| | **1,648,754** | 1,667,648 |
| Non-controlling interests | **9,702** | 1,305 |
| Total equity under US GAAP | **$ 1,658,456** | $ 1,668,953 |

The following is the reconciliation for statement of earnings items:

| Consolidated Summarized Statements of Earnings | 2010 | 2009 | 2008 |
|---|---|---|---|
| Net earnings, under Canadian GAAP | **$ 70,038** | $ 112,480 | $ 72,480 |
| Adjustments for: | | | |
| Capitalization of exploration costs (a) | **(55,756)** | (20,810) | (14,745) |
| Depreciation and amortization (b) | **11,728** | 4,106 | (4,163) |
| Capitalization of start-up costs (c) | **(5,644)** | (1,924) | — |
| Investment tax credits (j) | **122** | 1,250 | 1,526 |
| Stock-based compensation (f) | **(124)** | 172 | (534) |
| Tax on share issue costs (e) | **362** | (2,141) | 34 |
| Tax effect of US GAAP adjustments (g) | **20,098** | 9,288 | 4,637 |
| Net earnings | **$ 40,824** | $ 102,421 | $ 59,235 |
| Net earnings attributable to: | | | |
| Shareholders of the Company | **$ 43,771** | $ 102,381 | $ 59,702 |
| Non-controlling interests | **(2,947)** | 40 | (467) |
| Net earnings | **$ 40,824** | $ 102,421 | $ 59,235 |
| Earnings per share under US GAAP | | | |
| Basic | **$ 0.29** | $ 0.66 | $ 0.44 |
| Diluted | **$ 0.29** | $ 0.66 | $ 0.44 |
| Weighted average number of common shares outstanding: | | | |
| Basic | **150,636,835** | 153,460,823 | 135,902,627 |
| Diluted | **151,336,399** | 154,067,282 | 136,713,080 |

The statements of comprehensive income for the years ended December 31, 2010, 2009 and 2008 under US GAAP are as follows:

| Consolidated Summarized Statements of Comprehensive Income | 2010 | 2009 | 2008 |
|---|---|---|---|
| Net earnings under US GAAP | **$ 40,824** | $ 102,421 | $ 59,235 |
| Other comprehensive income (loss), net of tax: | | | |
| Cash flow hedges: | | | |
| Effective portion of gains/losses | **7,524** | (9,038) | 19,314 |
| Reclassed to earnings | **(3,266)** | (8,012) | (843) |
| Tax effect | **(1,239)** | 5,123 | (6,099) |
| Available-for-sale investments: | | | |
| Gains/losses | **38,464** | 139,016 | (28,680) |
| Reclassed to earnings | **(2,163)** | (99,908) | 3,196 |
| Tax effect | **(4,068)** | (2,379) | (7) |
| Currency translation adjustments | | | |
| Gains/losses | **—** | (36) | 291 |
| Tax effect | **—** | 13 | (105) |
| Other employee future benefits | **(15,269)** | (3,234) | 6,696 |
| Pension | **(20,430)** | (28,618) | 20,178 |
| Tax effect | **5,461** | 8,671 | (6,336) |
| | **5,014** | 1,598 | 7,605 |
| Comprehensive income | **$ 45,838** | $ 104,019 | $ 66,840 |
| Comprehensive income attributable to: | | | |
| Shareholders of the Company | **$ 48,785** | $ 103,979 | $ 67,307 |
| Non-controlling interests | **(2,947)** | 40 | (467) |
| Comprehensive income | **$ 45,838** | $ 104,019 | $ 66,840 |

Cash flows from operating activities, investing activities and financing activities for the years ended December 31, 2010 and 2009 under US GAAP are as follows:

| **Consolidated Statements of Cash Flows** | **2010** | 2009 | 2008 |
|---|---|---|---|
| Operating activities under Canadian GAAP | **$ 255,590** | $ 106,194 | $ 246,706 |
| Adjustments for: | | | |
| Capitalization of exploration costs (a) | **(55,756)** | (20,810) | (14,745) |
| Capitalization of start-up costs (c) | **(5,644)** | (1,924) | — |
| Investment tax credits (j) | **122** | 1,250 | 1,526 |
| Operating activities under US GAAP | **$ 194,312** | $ 84,710 | $ 233,487 |
| Investing activities under Canadian GAAP | **(162,275)** | 564,209 | (733,325) |
| Adjustments for: | | | |
| Capitalization of exploration costs (a) | **55,756** | 20,810 | 14,745 |
| Capitalization of start-up costs (c) | **5,644** | 1,924 | — |
| Investment tax credits (j) | **(122)** | (1,250) | (1,526) |
| Investing activities under US GAAP | **$ (100,997)** | $ 585,693 | $ (720,106) |
| Financing activities under Canadian GAAP | **(75,610)** | 118 | (64,639) |
| Financing activities under US GAAP | **$ (75,610)** | $ 118 | $ (64,639) |

### (a) Capitalization of exploration costs:

Under U.S. GAAP, the Company is required to expense all costs prior to the completion of a definitive feasibility study which establishes proven and probable reserves. Under Canadian GAAP, costs subsequent to establishing that a property has mineral resources which have the potential of being economically recoverable, are capitalized. Under Canadian GAAP, the Company capitalized costs relating to the Lalor project prior to completion of a definitive feasibility study.

### (b) Depreciation and amortization:

Under Canadian GAAP, the Company's amortization of capitalized mine development costs using the unit-of-production method is calculated using historical costs plus estimated future development costs required to access proven and probable reserves, amortized over the related proven and probable tonnes of ore reserves. For US GAAP purposes, amortization of capitalized mine development costs is calculated using historical capitalized costs incurred. Mine development costs that benefit the entire mine life are amortized over proven and probable reserves; however, the remainder of the mine development costs are amortized over the currently accessible proven and probable reserves to which these costs relate.

### (c) Capitalization of start-up costs:

Under US GAAP, deferral and amortization of start-up costs is prohibited and therefore such costs are expensed as incurred. Under Canadian GAAP, the Company deferred certain costs related to the re-start of the Chisel North mine.

### (d) Pension and other employee future benefits plans:

HudBay has adopted Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans: an amendment of FASB Statements No. 87, 88, 106, and 132(R)", effective in 2006 for US GAAP purposes, as identified in Accounting Standard Codification ("ASC") Topic 715 "Compensation – Retirement Benefits". This standard requires recognition of the funded status of each defined benefit and other post-retirement benefit plan on the balance sheet. To achieve this, the Standard first required a one-time adjustment to accumulated other comprehensive income ("AOCI") as at December 31, 2006 such that all amounts not yet recognized in net periodic pension cost were recognized in AOCI.

It also requires other comprehensive income ("OCI") in subsequent periods to include prior service (costs) credits and gains (losses) arising in subsequent periods, net of amounts amortized from accumulated other comprehensive income into net periodic pension cost. Under Canadian GAAP, prior service (costs) credits and actuarial gains (losses) are not recognized in OCI and are amortized to earnings. Expense amounts for HudBay's pension and other employee benefits plans continue to be identical under Canadian and US GAAP.

The Company's US GAAP adjustments for pension included one-time adjustments to AOCI upon adoption of this standard, consisting of an increase of $1,609 related to its pension plans and a decrease of $11,648 related to other employee future benefits plans, as well as adjustments to recognize prior service (costs) credits and actuarial gains (losses) arising during the year in OCI for pension and other employee future benefit plans.

The following summarizes the additional disclosures required and different pension-related amounts recognized or disclosed in the Company's accounts under United States GAAP:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Costs arising in the year: | | | |
| Service cost | **$ 6,603** | $ 6,021 | $ 8,310 |
| Interest cost | **17,075** | 16,782 | 14,505 |
| Expected return on plan assets | **(15,413)** | (15,316) | (15,659) |
| Plan amendments/prior service cost | **2,619** | 2,618 | 4,107 |
| Actuarial loss (gain) | **16** | (1,055) | (342) |
| Net periodic pension cost before termination benefits | **10,900** | 9,050 | 10,921 |
| Special termination benefits | **510** | 3,050 | — |
| Defined benefit net periodic pension cost | **11,410** | 12,100 | 10,921 |
| Defined contribution net periodic pension cost | **637** | 666 | 1,247 |
| Net periodic pension cost under United States GAAP | **12,047** | 12,766 | 12,168 |
| Net periodic pension cost under Canadian GAAP | **12,047** | 12,766 | 12,168 |
| Net periodic pension cost difference | **$ —** | $ — | $ — |
| Accrued benefit liability under Canadian GAAP | **(18,887)** | (28,963) | (45,816) |
| Accrued other comprehensive loss under United States GAAP, on a pre-tax basis | **(21,291)** | (861) | 27,758 |
| Net amount recognized in the consolidated balance sheets under United States GAAP | **(40,177)** | (29,823) | (18,058) |

The following summarizes the additional disclosures required and different other employee future benefit-related amounts recognized or disclosed in the Company's accounts under United States GAAP:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Costs arising in the year: | | | |
| Service cost | **$ 2,610** | $ 3,163 | $ 2,282 |
| Interest cost | **5,753** | 5,326 | 4,352 |
| Actuarial loss (gain) | **—** | — | — |
| Net periodic other employee future benefit cost under United States GAAP | **8,363** | 8,489 | 6,634 |
| Net periodic other employee future benefit cost under CICA 3461 | **8,363** | 8,489 | 6,634 |
| Net periodic other employee future benefit cost difference | **$ —** | $ — | $ — |
| Accrued benefit liability under Canadian GAAP | **(88,788)** | (82,973) | (76,797) |
| Accumulated other comprehensive loss under United States GAAP, on a pre-tax basis | **(19,257)** | (3,988) | (754) |
| Net amount recognized in the consolidated balance sheets under United States GAAP | **(108,045)** | (86,961) | (77,551) |

### (e) Tax on share issue costs:

Under US GAAP, tax benefits associated with share issue costs are recorded as a capital transaction when recognized in subsequent periods. Under Canadian GAAP, the Company recognizes in similar circumstances the tax benefit related to future tax deductions associated with share issue costs in earnings. The Company has recorded a US GAAP adjustment to reclassify such tax benefits from earnings to share capital.

### (f) Stock-based compensation:

The Company adopted ASC Topic 718 "Compensation – Stock Compensation" effective January 1, 2006. The adoption of ASC Topic 718 did not result in a material change in the Company's accounting for share based payments.

Under ASC Topic 718, entities are required to estimate the number of instruments for which requisite service is expected to be rendered and adjust the fair value to reflect estimated forfeitures at the date an option is granted. Under Canadian GAAP, the Company's policy is to accrue stock-based compensation expense as if all instruments granted were expected to vest and recognize the effect of actual forfeitures as they occur. The Company has recorded US GAAP adjustments to reflect the effect of estimating forfeitures.

### (g) Tax effect of US GAAP adjustments:

Accounting for income taxes under Canadian and US GAAP is similar, except that income tax rates of enacted or substantively enacted tax law must be used to calculate future income tax assets and liabilities under Canadian GAAP, whereas only income tax rates of enacted tax law can be used under US GAAP. In the periods presented there was no difference in tax rates. The Company has recorded tax effects of all US GAAP adjustments as appropriate.

### (h) Stated capital reduction:

Canadian GAAP allows for the reduction of the stated capital of outstanding common shares with a corresponding offset to deficit. This reclassification, which the Company made in 2004, is not permitted by US GAAP and would result in an increase in share capital and a decrease in retained earnings of $21,979. This US GAAP adjustment did not result in an overall change to equity.

### (i) Accounting for uncertainty in income taxes:

Under US GAAP, effective January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109", as identified in ASC 740. This interpretation provides guidance on the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also prescribes a recognition threshold and a measurement methodology for a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

The adoption of ASC 740 did not affect the Company's consolidated financial position, results from operations or cash flows. In the event that the Company recognizes interest accrued related to unrecognized tax benefits, it will be recorded in interest expense. Any penalties will be recorded in general and administrative expense.

### (j) Investment tax credits:

Under US GAAP, investment tax credits are recorded as a reduction of income tax expense. Under Canadian GAAP, the Company records investment tax credits as a reduction of capitalized exploration expenses or exploration costs in the statement of earnings. The Company has recorded a US GAAP adjustment to reclassify the investment tax credits from capitalized exploration expenses or exploration costs to income tax expense.

### (k) Exploration expenses:

Under US GAAP, exploration expenses would have been included in "earnings before the following" in the consolidated statement of earnings.

### (l) United States accounting pronouncements adopted effective January 1, 2009:

**(i) Financial instruments**

In the second quarter of 2009, the Company adopted the provisions of ASC paragraph 820-10-65-4 (formerly FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly") and ASC paragraph 320-10-65-1 (formerly FSP FAS 115-2, "Recognition and Presentation of Other-Than-Temporary Impairments"). The adoption of these standards did not have a material impact on the Company's consolidated financial statements.

**(ii) Subsequent events**

The Company adopted the provisions of ASC Section 855-10-25 (formerly SFAS No. 165 "Subsequent Events") effective for the quarter ended June 30, 2009. The adoption did not have a material impact on the Company's consolidated financial statements.

**(iii) Fair value measurements**

Effective January 1, 2009, the Company adopted ASC Subtopic 820-20 (formerly FSP FAS157-2 "Effective Date of FASB Statement No. 157"), which delayed the effective date of ASC 820 for non-financial assets or liabilities that are not required or permitted to be measured at fair value on a recurring basis to fiscal 2009. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

**(iv) Business combinations and non-controlling interests**

The Company adopted prospectively the provisions outlined in ASC 805 "Business Combinations" and ASC Subtopic 810-10 "Non-controlling Interests in Consolidated Financial Statements" for all business combinations with an acquisition date on or after January 1, 2009. The adoption of this standard did not have an impact on the Company as there were no business combinations completed since January 1, 2009.

**(v) Disclosures about derivative instruments and hedging activities**

Effective January 1, 2009, the Company prospectively adopted the provisions of ASC Subtopic 815-10 (formerly SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133"). There were no additional disclosures required upon adoption of ASC Subtopic 815-10 that were not already incorporated into the Company's Canadian GAAP financial statement disclosures for the year ended December 31, 2009. The adoption of ASC Subtopic 815-10 did not affect the Company's accounting for derivative financial instruments.

**(vi) Determination of the useful life of intangible assets**

Effective January 1, 2009, the Company prospectively adopted ASC Subtopic 350-30 (formerly FSP 142-3, "Determination of the Useful Life of Intangible Assets"), which did not have an impact on the consolidated financial statements.

**(vii) Determining whether an instrument (or embedded feature) is indexed to an entity's common stock**

Effective January 1, 2009, the Company adopted ASC Subtopic 815-40 (formerly EITF 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock"), which did not have an impact on its consolidated financial statements.

**(viii) Accounting for convertible debt instruments that may be settled in cash upon conversion**

Effective January 1, 2009, the Company applied, on a retrospective basis, the provisions outlined in ASC Subtopic 470-20 (formerly FSP No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Settlement)"). The adoption of this FSP did not have an impact on the Company's financial reporting.

**(ix) Non-controlling interests in consolidated financial statements**

Effective January 1, 2009, the Company adopted ASC Subtopic 810-10 (formerly SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements – an amendment of ARB No. 51). ASC Subtopic 810-10 requires an entity to clearly identify and present ownership interests in subsidiaries held by parties other than the entity in the consolidated financial statements within the equity section but separate from the entity's equity. It also requires the amount of consolidated net income attributable to the parent and to the non-controlling interest be clearly identified and presented on the face of the consolidated statement of income; changes in ownership interest be accounted for similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained non-controlling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. The presentation and disclosure requirements of ASC Subtopic 810-10 were applied retrospectively. The adoption of ASC Subtopic 810-10 had no impact on the consolidated financial statements other than the change in presentation of previously reported line items of non-controlling interests.

## (m) Recently issued accounting pronouncements:

**(i) ASC**

In July 2009, FASB's ASC became the single official source of authoritative, non-governmental GAAP in the United States. The historical GAAP hierarchy was eliminated and the ASC became the only level of authoritative GAAP, other than guidance issued by the Securities and Exchange Commission (the "SEC"). This guidance is effective for interim and annual periods ending after September 15, 2009. The Company's accounting policies are not affected by the conversion to the ASC. However, references to specific standards have been changed to refer to the appropriate sections of the ASC.

**(ii) Variable interest entities**

In June 2009, the FASB issued Accounting Standards Update 2009-17 "Amendments to FASB Interpretation No. 46(R)" ("ASU 2009-17") (subsequently codified in ASC Topic 810). ASU 2009-17 is intended to address: the effects on certain provisions of ASC Subtopic 810-10 (formerly FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities"), as a result of the elimination of the qualifying special-purpose entity concept in Accounting Standards Update 2009-16 "Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140" ("ASU 2009-16"); and concerns about the application of certain key provisions of ASC Subtopic 810-10, including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. ASU 2009-17 was effective at the start of a Company's first fiscal year beginning after November 15, 2009, or January 1, 2010 for companies reporting earnings on a calendar year basis.

The adoption of ASU 2009-17 did not have an impact on the Company's financial reporting.

**(iii) Accounting for transfers of financial assets**

In June 2009, the FASB issued ASU 2009-16. ASU 2009-16 amends ASC Topic 860 (formerly SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"), by: eliminating the concept of a qualifying special purpose entity; clarifying and amending the derecognition criteria for a transfer to be accounted for as a sale; amending and clarifying the unit of accounting for sale accounting; and requiring that a transferor initially measure at fair value and recognize all assets obtained and liabilities incurred as a result of a transfer of an entire financial asset or group of financial assets accounted for as a sale. ASU 2009-16 was effective at the start of a company's first fiscal years beginning after November 15, 2009, or January 1, 2010 for companies reporting earnings on a calendar year basis.
The adoption of ASU 2009-16 did not have an impact on the Company's financial reporting.

# Strong Management

## David Garofalo

### President and Chief Executive Officer

Mr. Garofalo joined HudBay as President and Chief Executive Officer in July 2010. Previously, Mr. Garofalo served as Senior Vice President, Finance and Chief Financial Officer with Agnico-Eagle Mines Limited from 1998 and as Treasurer and in various finance roles with Inmet Mining Corporation from 1990. Mr. Garofalo was named Canada's CFO of the Year by Financial Executives International Canada (2009) and TopGun CFO by Brendan Wood International (2009 & 2010) and was given the award for Best Investor Relations by a CFO by IR Magazine (2009 & 2010). Mr. Garofalo is a graduate of the University of Toronto (B.Comm.) and a Chartered Accountant, and serves on the Board of Directors of York Central Hospital Foundation, Stornoway Diamond Corporation and Malbex Resources Inc.

## David S. Bryson

### Senior Vice President and Chief Financial Officer

Mr. Bryson joined HudBay in 2008 from Skye Resources Inc. where he held the position of Chief Financial Officer. He has an extensive background in corporate treasury and development having had a lengthy career at Terasen Inc. where he served as its Treasurer. Mr. Bryson holds a Bachelor of Commerce (Finance) from the University of British Columbia and is a Chartered Financial Analyst.

## Alan T. C. Hair

### Senior Vice President, Business Development and Technical Services

Since joining HudBay in 1996, Mr. Hair has held several management roles in the metallurgical plants and was appointed Vice-President, Metallurgy in 2004. Prior to joining HudBay, he was Smelting Manager at MIM's zinc smelter in Avonmouth, England. He graduated from the University of Leeds, England in 1983 with a Bachelor of Science Honours degree in Mineral Engineering.

## Tom A. Goodman

### Senior Vice President and Chief Operating Officer

Mr. Goodman is a graduate in Chemical and Metallurgical Technology from the British Columbia Institute of Technology. He has worked for HudBay for over 26 years in a wide variety of operational, technical, and management positions. He recently returned to HudBay after managing a copper smelting and refining company for the Anglo American group in Zambia. Mr. Goodman is a member of the Canadian Institute of Mining, Metallurgy and Petroleum, and the Minerals, Metals & Materials Society.

## Ken Gillis

### Senior Vice President, Corporate Development

Mr. Gillis joined HudBay as Senior Vice President, Corporate Development. Previously, Mr. Gillis served as Executive Director of Macquarie Canada's North American Mining Investment Banking practice. He has a 20 year history of corporate development and related activities in mining, both with mining companies and financial and investment firms. Mr. Gillis has a background in geology, with a degree in Geological Science (B.Sc.) from Saint Francis Xavier University and a Masters of Applied Science in Mineral Exploration from McGill University. He also obtained a Masters of Business Administration (M.B.A.) in Finance, from McGill.

## John D. Bracale

### Country Manager, Guatemala and President, Compañìa Guatemalteca de Nìquel, S.A.

Mr. Bracale is an experienced mining executive with over 30 years' experience in the mining industry in Latin America and the Pacific Rim. He was most recently a director and vice president of Latin America for Gold Hawk Resources Inc., as well as executive president of their Peruvian subsidiary Compania Minera San Juan. He has also served as vice president of Latin America for Breakwater Resources, Ltd.; senior vice president of Latin American Operations for Arimetco International, Inc.; and vice president of American Pacific Mining Company, Inc. in Honduras.

## David Clarry

### Vice President, Corporate Social Responsibility

Mr. Clarry joined HudBay in 2011, bringing over 20 years' experience as a consultant in the international mining and metals industry. His work has spanned environmental management and policy, mining project development, business strategy, and operations improvement. He holds Bachelor of Science and Master of Science degrees in engineering from Queen's University, a Master of Business Administration degree (MBA) from INSEAD, and is a registered Professional Engineer in the province of Ontario.

## Brad W. Lantz

### Vice President, Mining

Mr. Lantz joined HudBay in 1987 and was appointed Vice President, Mining in September 2007. During his career, Mr. Lantz has held positions of progressively greater responsibility at the Ruttan, Trout Lake, Callinan and 777 mines. Prior to joining the Company, Mr. Lantz worked with Sherritt Gordon Mines Limited. Mr. Lantz graduated from the University of Waterloo in 1982, with a B.Sc. Honours in Earth Sciences.

## Cashel Meagher

### Vice President, Exploration

Mr. Meagher joined Hudbay in November 2008 and was promoted to the role of Vice President, Exploration in March 2010. He has an extensive background in precious metal and base metal exploration, resource and reserve estimation, engineering studies and open pit and underground operations. Prior to joining Hudbay, Mr. Meagher held management positions with Vale Inco in exploration, technical services, business analysis and mine operations. He graduated in 1994 with a Bachelor of Science Joint Advanced Major degree in Geology and Chemistry from Saint Francis Xavier University, and he is a member in good standing with the Association of Professional Geoscientists of Ontario.

## John Vincic

### Vice President, Investor Relations and Corporate Communications

Mr. Vincic joined HudBay in August 2009 and he brings more than 15 years of combined experience in investor relations and corporate communications to this role. In this position he is also responsible for overseeing government relations, corporate social responsibility reporting and brand management. Most recently, he worked at one of Canada's leading investor relations consulting firms where he advised a cross-section of clients on various issues including ongoing investor engagement strategies, IPO communications, mergers and acquisitions, and special situations.

## Sharon Sanzo

### Vice President, Human Resources

Ms. Sanzo is a Human Resources professional with over 20 years of experience in the mining, pharmaceutical and packaged goods industries. Prior to joining Hudbay, Ms. Sanzo held leadership roles in Barrick Gold, GlaxoSmithKline, Kraft, and Unilever Canada. She is a graduate of the University of Toronto, with a Bachelor of Arts specializing in Labour Relations, and is a professionally accredited Adler-Trained Coach (ATC). She is also a member in good standing of the Human Resources Professionals Association.

# Corporate and Shareholders' Information

### HudBay Minerals

As of June 6, 2011, HudBay's head office will be relocated to:
25 York Street, Suite 800
Toronto, Ontario
M5J 2V5

Telephone: 416 362-8181
Facsimile: 416 362-7844

### Listing

Toronto Stock Exchange
New York Stock Exchange
Trading Symbol: HBM

### Investor and General Public Inquiries

John Vincic
Vice President,
Investor Relations and Corporate Communications

Telephone: 416 362-0615
Facsimile: 416 362-7844

Email: info@hudbayminerals.com

### Transfer Agent

Equity Transfer & Trust Company
200 University Avenue
Suite 400
Toronto, Ontario
M5H 4H1

Telephone: 416 361-0930
Toll Free: 1 866 393-4891
Facsimile: 416 361-0470

### Auditors

Deloitte & Touche LLP
181 Bay Street
Suite 1400
Toronto, Ontario
M5J 2V1

### Annual Meeting of Shareholders

June 16, 2011
10:00 a.m. ET
Toronto, Ontario

**Cautionary Note Regarding Forward-Looking Information**

This annual report contains "forward-looking information", within the meaning of applicable Canadian securities legislation. Forward-looking information includes, but is not limited to, information with respect to HudBay's ability to execute its strategic plan, exploration expenditures and activities and the possible success of such exploration activities, including at its Lalor deposit, the estimation of mineral reserves and resources, the realization of mineral estimates, the timing and amount of estimated future production, costs of production, capital expenditures, costs and timing of the development of new deposits and the ability to recommence suspended operations, mineral pricing, reclamation costs, the economic outlook, currency fluctuations, government regulation of mining operations, environmental risks, mine life projections, plans to close HudBay's copper smelter, the availability of third party concentrate, business and acquisition strategies, and the ability to meet safety and environmental targets. Often, but not always, forward-looking information can be identified by the use of forward-looking words like "plans", "expects", or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "understands", "anticipates", or "does not anticipate", or "believes" or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might", or "will be taken", "occur", or "be achieved". Forward-looking information is based on the opinions and estimates of management as of the date such information is provided and is subject to known and unknown risks, uncertainties and other factors that may cause the actual results, level of activity, performance or achievements of HudBay to be materially different from those expressed or implied by such forward-looking information, including risks associated with the mining industry such as economic factors (including future commodity prices, currency fluctuations and energy prices), failure of plant, equipment, processes and transportation services to operate as anticipated, dependence on key personnel and employee relations, environmental risks, government regulation, actual results of current exploration activities, possible variations in ore grade or recovery rates, permitting timelines, capital expenditures, reclamation activities, land titles, and social and political developments and other risks of the mining industry as well as those risk factors discussed or referred to in HudBay's Annual Information Form for the year ended December 31, 2010 under the heading "Risk Factors". Although HudBay has attempted to identify important factors that could cause actual results to differ materially from those contained in forward-looking information, there may be other factors that cause results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such information. Accordingly, readers should not place undue reliance on forward-looking information. HudBay does not undertake to update any forward-looking information, except as required by applicable securities laws, or to comment on analyses, expectations or statements made by third parties in respect of HudBay, its financial or operating results or its securities.

**Cautionary Note to United States Investors Concerning Estimates of Measured, Indicated and Inferred Resources**

This annual report uses the terms "measured", "indicated" and "inferred" resources. United States investors are advised that while such terms are recognized and required by Canadian regulations, the United States Securities and Exchange Commission does not recognize them. "Inferred mineral resources" have a great amount of uncertainty as to their existence, and as to their economic and legal feasibility. It cannot be assumed that all or any part of an inferred mineral resource will ever be upgraded to a higher category. Under Canadian rules, estimates of Inferred Mineral Resources may not form the basis of feasibility or other economic studies. United States investors are cautioned not to assume that all or any part of measured or indicated mineral resources will ever be converted into Mineral Reserves. United States investors are also cautioned not to assume that all or any part of an Inferred Mineral Resource exists, or is economically or legally mineable.

Concept and Design: THE WORKS www.worksdesign.com

**HUDBAY**
**MINERALS**

The fabric of our company was forged 85 years ago. The values upon which this company were built are now being exported to mining camps across the Americas. As we grow, we will stay true to the guiding principles that have built HudBay into the great company it is today.

HudBay Minerals Inc.
25 York Street, Suite 800, Toronto, Ontario M5J 2V5
Tel: 416 362-8181 Fax: 416 362-7844

hudbayminerals.com

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