



Driving Value

HudBay Minerals
Annual Report 06



We explore. We mine. We process.

HudBay Minerals Inc. is a vertically integrated mining company that operates mines, concentrators and a metal production facility in northern Manitoba and Saskatchewan where it has continuously mined for eight decades. The Company also owns a zinc oxide production facility in Ontario, the White Pine Copper Refinery in Michigan and the Balmat zinc mine operations in New York state. HudBay is Canada's third largest producer of both copper and zinc metal, and North America's third largest producer of zinc oxide.

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Driving Value

- ◆ We have organic and inorganic growth opportunities
- ◆ Our aggressive exploration program continues to deliver results
- ◆ We are generating strong cash flow and profitability
- ◆ We are focused on continued strong safety and environmental performance
- ◆ We have an experienced, proven senior management team

We bring **metals** to markets.

\$1B

Read about our record-setting year ►►►

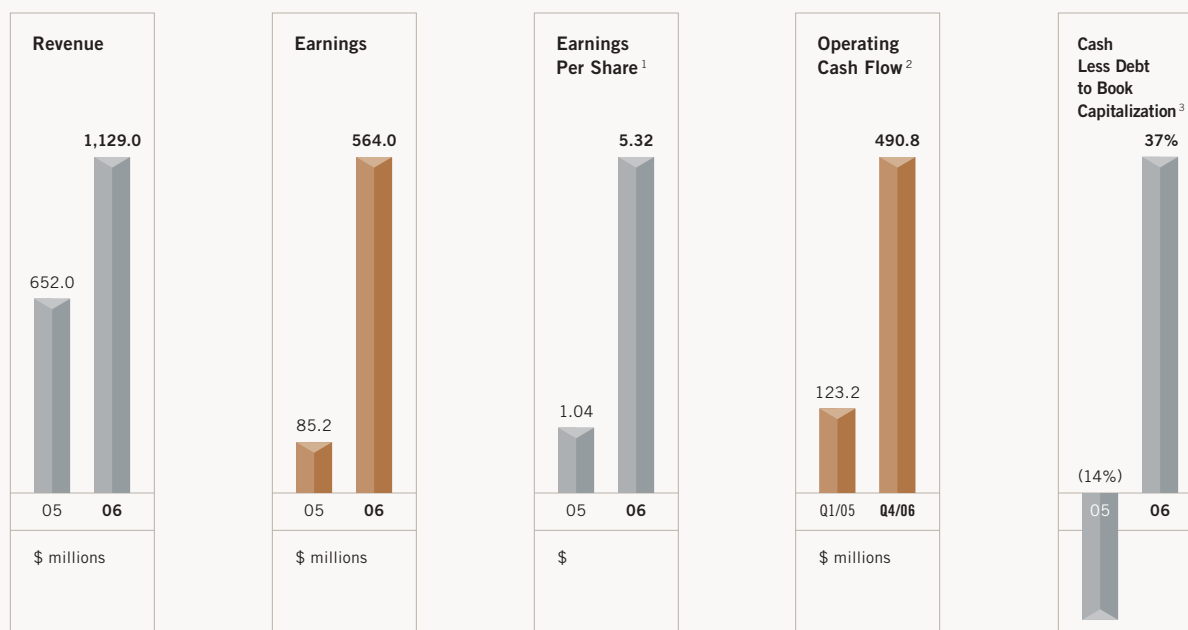
A Year of Exceptional Performance

Financial Highlights

(In thousands of Canadian dollars, except per share amounts)

	2006	2005	Change
Revenue	\$ 1,129.0	\$ 652.0	+ 73%
Earnings	\$ 564.0	\$ 85.2	+ 562%
Earnings per share¹	\$ 5.32	\$ 1.04	+ 412%
Cash flow²			
Operating cash flow	\$ 490.8	\$ 123.2	+ 298%
Operating cash flow per share	\$ 4.63	\$ 1.50	+ 209%
Shareholders' equity³	\$ 964.2	\$ 261.2	+ 269%
Cash and cash equivalents³	\$ 385.9	\$ 141.7	+ 172%

In 2006, our revenues

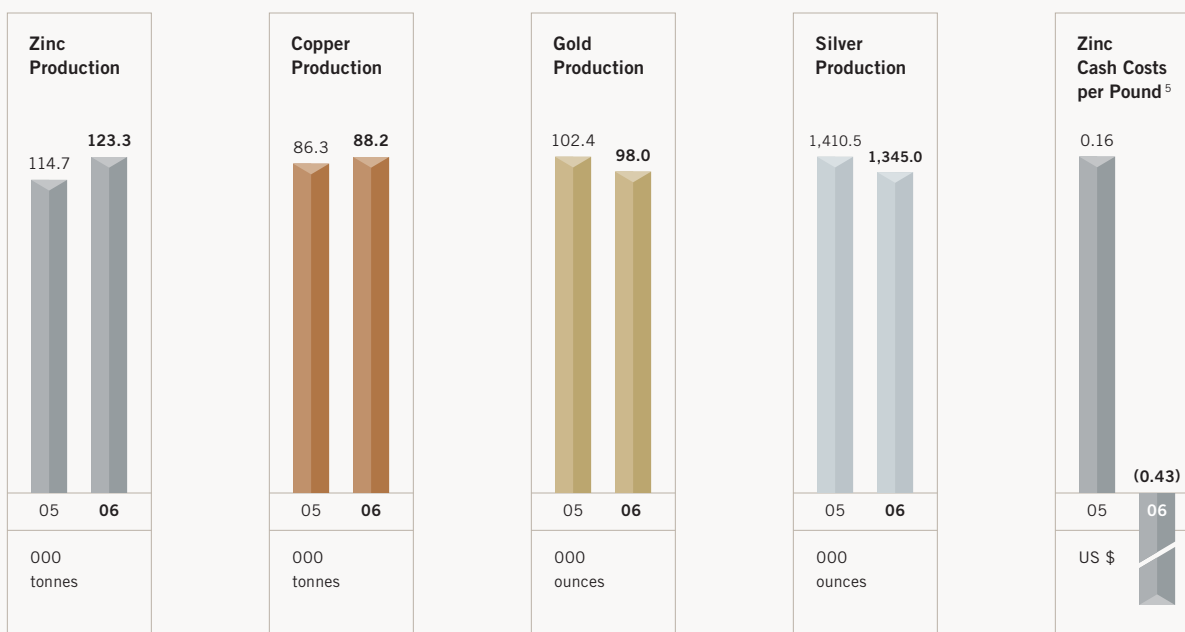


1. Basic. 2. Before changes in non-cash working capital. 3. As at December 31.

Operations Highlights

	2006	2005	Change
Production			
Zinc ⁴ (000 tonnes)	123.3	114.7	+ 7.5%
Copper (000 tonnes)	88.2	86.3	+ 2.2%
Gold (000 troy ounces)	98.0	102.4	- 4.3%
Silver (000 troy ounces)	1,345.0	1,410.5	- 4.6%
Cash costs			
Zinc ⁵ (US\$ per pound)	(0.43)	0.16	-

rose 73% to more than \$1 billion



4. Includes Balmat metal in concentrate. 5. Cost per pound of zinc sold, net of by-product credits.

HudBay at a Glance

Mines



777 Mine, Manitoba

- ◆ HudBay's principal mine
- ◆ Located in Flin Flon
- ◆ Adjacent to processing facilities
- ◆ Produces copper, zinc, gold and silver
- ◆ 2006 ore production 1.368 million tonnes
- ◆ 2006 estimated life 2020



Trout Lake Mine, Manitoba

- ◆ Located 6 km from Flin Flon
- ◆ Ore trucked to Flin Flon concentrator
- ◆ 24 years of continuous production
- ◆ Produces copper, zinc, gold and silver
- ◆ Pillar extraction program optimizes output
- ◆ 2006 ore production 838,862 tonnes
- ◆ 2006 estimated life 2011



Chisel North Mine, Manitoba

- ◆ Located 10 km from Snow Lake concentrator
- ◆ Produces zinc
- ◆ Six years of continuous production
- ◆ 2006 ore production 323,379 tonnes
- ◆ 2006 estimated life 2013



Balmat Mine, New York state

- ◆ Located 158 km from Montreal
- ◆ Produces zinc
- ◆ Commercial production January 1, 2007
- ◆ Forecast full production of 60,000 tons of zinc in concentrate by 2008
- ◆ 2007 forecast: 35,000 tons of zinc in concentrate
- ◆ 2006 estimated life 2014

Concentrators



Flin Flon, Manitoba

- ◆ Processes ore from 777 & Trout Lake mines
- ◆ Produces zinc and copper concentrate
- ◆ Produces gold and silver in copper concentrate
- ◆ Ore capacity 2.2 million tonnes / year



Snow Lake, Manitoba

- ◆ Processes ore from Chisel North mine
- ◆ Produces zinc concentrate
- ◆ Ore capacity 1.2 million tonnes / year



Balmat District, New York state

- ◆ Processes ore from Balmat mine
- ◆ Produces zinc concentrate
- ◆ Ore capacity 1.6 million tonnes / year
- ◆ Concentrate treated at CEZ refinery in Montreal

We are fully vertically integrated – from exploration, to mining, to metal production and finally, to sales of finished products including metal and zinc oxide.

Metallurgical Plants



Zinc Plant, Manitoba

- ◆ Produces special high grade zinc metal
- ◆ 2006 production 117,966 tonnes
- ◆ Treats zinc concentrate from HudBay's mines and purchased concentrate
- ◆ Leading edge pressure leaching and electrolysis technology



Zochem Plant, Ontario

- ◆ Produces zinc oxide
- ◆ 2006 production 41,378 tonnes
- ◆ Off-takes approximately 25% of HudBay's zinc production
- ◆ Supplies 20% of North American market



Copper Smelter, Manitoba

- ◆ Produces copper as anode
- ◆ 2006 copper anode production 88,225 tonnes
- ◆ Treats copper concentrate from HudBay mines and purchased concentrate
- ◆ \$11.5 million furnace rebuild during 2006



White Pine Copper Refinery, Michigan

- ◆ Produces refined copper from HudBay's anodes
- ◆ 2006 cathode copper production 69,878 tonnes
- ◆ \$5.5 million capital expansion planned for 2007, using new technology

Exploration



2007 Exploration

- ◆ \$45.2 million total budget
- ◆ \$25.6 million within Flin Flon Greenstone Belt
- ◆ Flin Flon Greenstone Belt targets include electromagnetic anomalies, known deposits and structural re-interpretations
- ◆ \$8.5 million to advance the Bur deposit near Snow Lake
- ◆ \$11.1 million at other properties
- ◆ Positive result from first hole at Lalor Lake



Reserves and Resources



At January 1, 2007

- ◆ Total mineral reserves: 22.8 million tonnes
- ◆ Total mineral resources: 3.2 million tonnes
- ◆ New reserves at 1/1/07 replaced 2006 production

Marketing



Considar Metal Marketing Toronto, Ontario

- ◆ Sells HudBay's zinc, copper, gold, silver and zinc oxide
- ◆ Purchases concentrates as required for HudBay metallurgical plants
- ◆ Owned 50% by HudBay

To Our Shareholders

2006 was a tremendous year for our company. In an environment of very strong commodity prices, we delivered on our production targets, advanced our growth plans and proactively strengthened HudBay's financial structure.

Record Financial Results

At the outset of 2006 we set ambitious performance targets for the year and I'm delighted to report that we exceeded all of them.

- ◆ Revenue increased by 73% to \$1.1 billion – surpassing the billion-dollar mark for the first time in our 80-year history
- ◆ Earnings moved up to a record \$564.0 million
- ◆ Earnings per share was \$5.32, compared to \$1.04 in 2005 – and
- ◆ Cash flow from operations climbed to \$490.8 million.

Solid production results and full leverage to strong metal prices combined to contribute to HudBay's market capitalization finishing the year at \$2.7 billion – representing a 271% increase in 2006 and translating into the second highest share price increase of any of the companies included in the S&P/TSX Index.

Strong Operating Performance from Vertically Integrated Operations

We have the distinct advantage of operations that are fully vertically integrated – from exploration, to mining, to metal production and finally, to sales of finished products including metal and zinc oxide.

Our 2006 metal production was fully in line with guidance for the year, reflecting continuing strong performance principally from our three mines in Manitoba which were in commercial production – 777, Trout Lake and Chisel North.

During 2006 we also re-opened our Balmat mine and began pre-production. Commercial production began on schedule in early 2007 and is ramping up to be at full output of 60,000 short tons of zinc metal in concentrate annually by 2008.

In 2006 we invested \$12 million in a targeted exploration program that resulted in proven and probable mineral reserves within our operating mines increasing to 22.8 million tonnes at January 1, 2007 from 21.4 million tonnes at January 1, 2006. This marks the second straight year we have effectively replaced our ore production with new reserves.

A Focus on Safety, Health & Environment

Our ability to continue to successfully operate and grow is premised on solid production results delivered with strong attention to safety and the environment. During 2006 our operations sustained a lost time accident frequency rate of 0.96 per 200,000 man-hours worked, including employees and contractors. This is only slightly higher than the 75-year low we achieved of 0.62 in 2005.



“We improved HudBay’s financial position in 2006 through a series of proactive measures that enhanced our financial flexibility and markedly expanded our balance sheet strength.”

We take our environmental responsibilities very seriously. In 2006, HudBay maintained its high credentials in environmental compliance. Our established operations continue to meet the requirements of environmental regulations as well as certification to the ISO 14001:2004 international standard for environmental management and similarly OHSAS 18001:1999 for occupational health and safety management. On March 12, 2007 we were pleased to report that our Balmat operations had also been certified to ISO 14001 and OHSAS 18001. Our White Pine Copper Refinery, acquired on January 1, 2006, is expected to be certified later in 2007, which will make HudBay certified at all of its operational facilities.

A Strengthened Financial Position

We improved HudBay’s financial position in 2006 through a series of proactive measures that enhanced our financial flexibility and markedly expanded our balance sheet strength.

- ◆ Throughout the year we actively paid down debt – in fact by year-end we had reduced our outstanding 9% notes down to approximately US\$3 million. And early in 2007 we completed a defeasement – which effectively eliminated this debt in its entirety.
- ◆ We also completed a \$20 million private placement of flow-through shares and a successful incentive program for early conversion of warrants to HudBay common shares, resulting in net proceeds of \$104.9 million to the Company.

Taken together, these actions resulted in a major de-leveraging of our balance sheet which, combined with cash on hand, translated into HudBay effectively eliminating all debt outstanding.

Driving Value

We have undertaken a \$45.2 million exploration program in 2007. This initiative – one of the most ambitious in our industry – will see extensive surface exploration, diamond drilling at all four of our mines and advancement of the Bur deposit.

I’m pleased to report that we are already seeing some positive results from our 2007 exploration program. On March 20th of this year, we announced very positive results from our first drill hole at Lalor Lake. We are looking forward to the next group of holes confirming these results and hopefully defining a new high-grade zinc deposit.

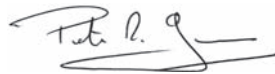
Another focus in the months ahead will be the evaluation of investment opportunities in support of growth. Our vertically integrated status means we can consider opportunities along the continuum of our business.

Going Forward

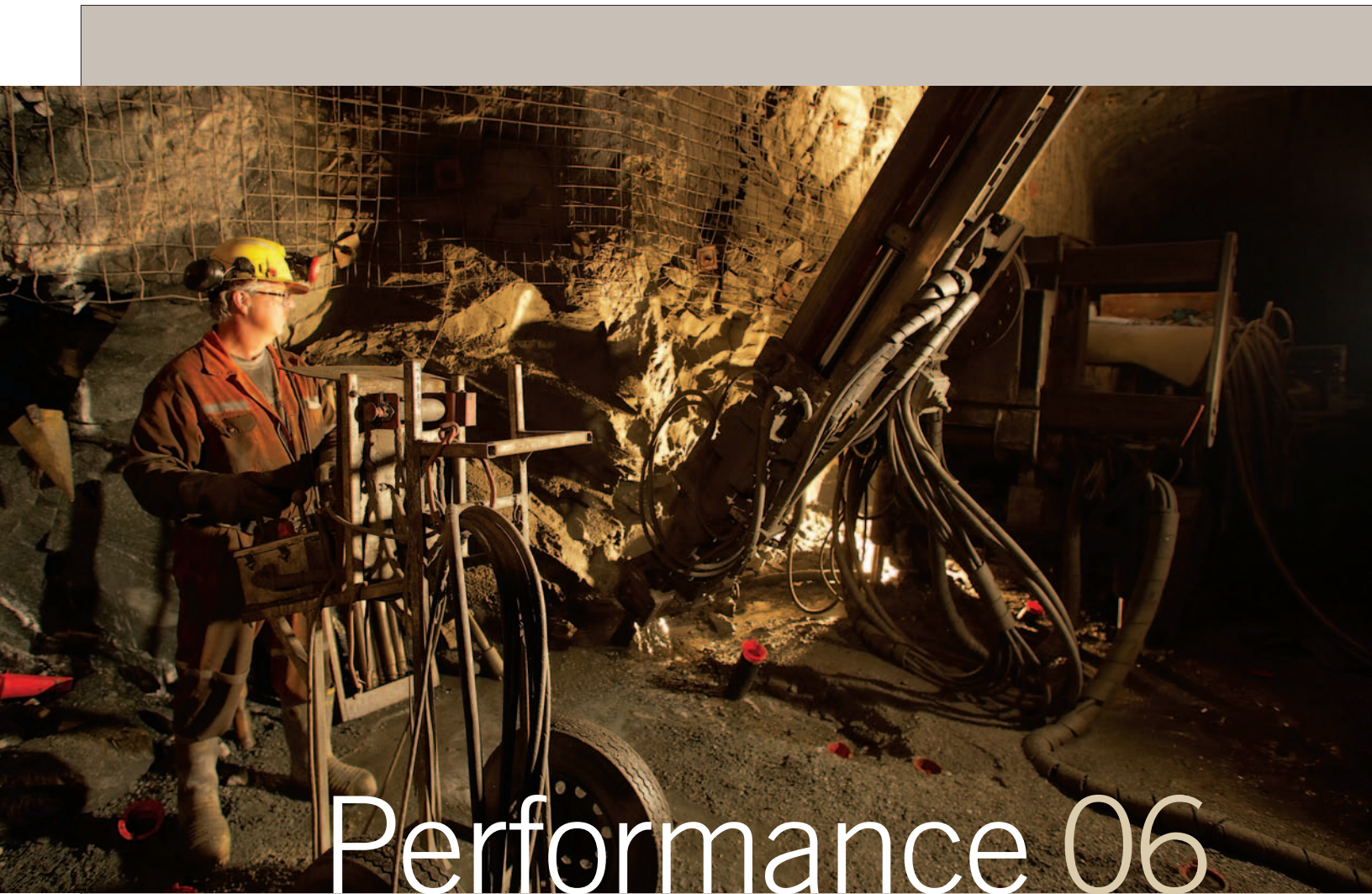
While 2006 was an extraordinarily successful and exciting year, we believe 2007 holds even greater promise:

- ◆ The outlook for metal prices remains encouraging. The fundamental demand drivers in global markets show no signs of major change and the supply of metals is expected to remain relatively tight for the foreseeable future;
- ◆ Our mining and processing operations are expected to deliver another strong year of results including an increase in our zinc production;
- ◆ Our Bur deposit will advance toward a commercial production decision;
- ◆ Our exploration activities are being ramped up;
- ◆ We have a new three-year contract with unionized employees that ensures labor stability; and
- ◆ We are in a very strong financial position.

In closing I would like to emphasize that HudBay’s achievements resulted from the guidance of our board of directors, the acumen of senior management, the skill of our staff and the business of our customers. I thank them all and express particular appreciation to our shareholders, who have placed their confidence in the people of HudBay.



Peter R. Jones
President and Chief Executive Officer



Performance 06

March 7, 2007

Unless the context otherwise suggests, references to “we”, “us”, “our” and similar terms, as well as references to “HudBay” or the “Company”, refer to HudBay Minerals Inc. and its subsidiaries.

This Management’s Discussion and Analysis (“MD&A”) dated March 7, 2007 should be read in conjunction with the Company’s consolidated financial statements for the three months and year ended December 31, 2006, and related notes which have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). Additional information regarding the Company, including its Annual Information Form for 2005, is available on SEDAR at www.sedar.com. All figures are in Canadian dollars unless otherwise noted.

HudBay’s extensive operations at Flin Flon include: longhole drilling at the 777 Mine (above); and, from left to right on page 9: analysis of exploration core samples; a furnace at our copper smelter; and zinc casting.

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We highlight our major financial and operating accomplishments in 2006.

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We report our performance and accomplishments related to these important elements of our business.

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We highlight the operating performance of the major components of our business including mines and processing facilities.

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We describe and explain our consolidated financial performance in 2006.

52 Appendix – Production

We provide a compendium of additional information to assist the reader in better understanding our business.

Management's Discussion and Analysis of Results of Operations and Financial Condition



For the Fourth Quarter and Year Ended December 31, 2006

Overview

HudBay is an integrated mining company that operates mines, concentrators and a metal production facility in northern Manitoba and Saskatchewan. The Company also owns a zinc oxide production facility in Ontario, the White Pine Copper Refinery in Michigan and the Balmat zinc mine operations in New York state.

HudBay is a member of the S&P/TSX Composite Index. Revenues were in excess of \$1 billion in 2006, and we are Canada's third largest producer of both copper and zinc metal, and North America's third largest producer of zinc oxide. We also produce approximately 100,000 ounces of gold and 1,000,000 ounces of silver annually.

Our operations include three mines in northern Manitoba operated by our significant wholly-owned subsidiary, Hudson Bay Mining and Smelting Co., Limited ("HBMS"), and a fourth in the Balmat district of New York state. Our principal processing facilities are located near our Manitoba mines and include two concentrators, a copper smelter and a zinc plant. We also refine copper at our White Pine Copper Refinery in Michigan state and produce zinc oxide at our Zochem facility in Ontario. The metals and zinc oxide we produce are marketed and sold to customers by Considar Metal Marketing Inc. ("CMM"), our agent, which is located in Toronto and 50% owned by HudBay.

As an integrated mining company we operate in a single reportable operating segment. In 2006 we earned revenues of \$1.1 billion and net income of \$564.0 million compared with revenues of \$0.7 billion and net income of \$85.2 million in 2005.

Vertically integrated, from mines to metals

Facilities and Output

■ Copper ■ Zinc ■ Gold ■ Silver

Flin Flon, Manitoba

777 Mine ■ ■ ■ ■
Trout Mine ■ ■ ■ ■
Concentrator ■ ■ ■ ■
Copper Smelter ■ ■ ■ ■
Zinc Plant ■

Snow Lake, Manitoba

Chisel North Mine ■
Concentrator ■

Toronto/Brampton, Ontario

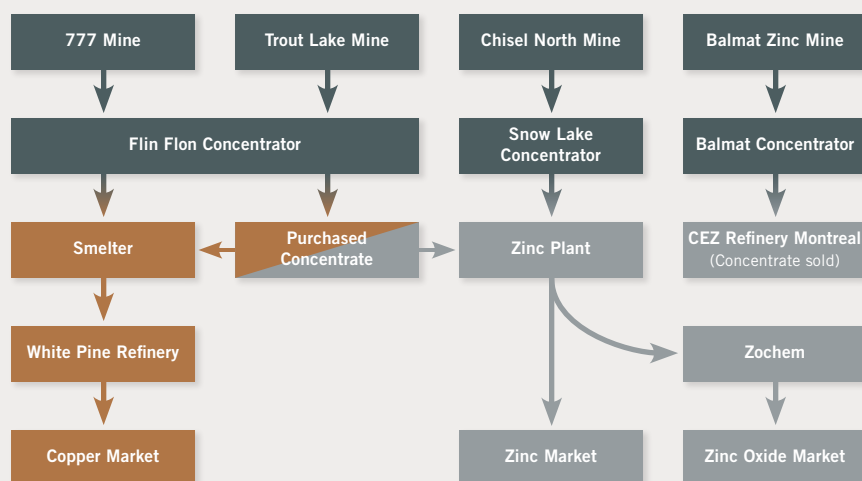
Zochem (ZnO) ■ ■ ■ ■
CMM Marketing ■ ■ ■ ■

White Pine, Michigan

White Pine Refinery ■ ■ ■ ■

Balmat, New York

Balmat Mine ■
Concentrator ■



Strategy

Our strategy is to leverage our integrated operating assets, mineral reserves and mineral resources, our large exploration lands and experienced workforce to:

1 Pursue growth through mineral exploration and mine development

Our strategy is to continue to explore our approximately 400,000 hectares of exploration land holdings in the hope of identifying additional mineral deposits and identify further mineral reserves within our operating mines. Historically we have been very successful in discovering new deposits and adding to our mineral reserves.



2 Pursue growth through selective acquisitions

We believe there is opportunity for future growth through selective acquisitions of operating assets and properties at an advanced state of exploration and development. Leveraging our expertise, we intend to pursue a selective and disciplined acquisition strategy in areas of political stability, with a particular focus on properties in North America, Europe, Australia and South America, and particularly those associated with zinc, copper and nickel.



3 Maintain strong safety and environmental performance

One of our core values is protecting the health and welfare of our employees and the environment. We have achieved an excellent safety record and we intend to continue to adhere to strict environmental compliance standards with our ongoing goal of continuously improving our performance in these critical areas. We believe that our ability to minimize lost-time injuries and environmental regulatory violations is a significant factor in maintaining and realizing opportunities to improve operational efficiency.



4 Identify further opportunities and lower our costs

Over the past decade, we have minimized our unit costs of production through infrastructure investments, a focus on workplace safety, targeted workforce reduction and an increase in production. Increasing production from our operating mines and bringing new mines into production is our most significant opportunity to further reduce our unit costs and improve our profitability.



2006 Results Summary

2006 was a year of major accomplishments for HudBay. In an environment of strong global demand and metals prices, we achieved record financial performance. Underpinning our strong financial results was our solid progress in relation to each of our key focus areas for 2006:

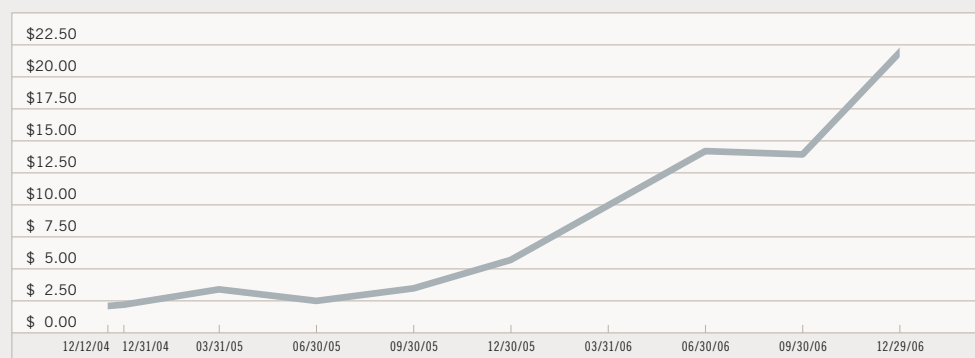
- ◆ Our **metal production** was in line with our guidance for the year
- ◆ We increased our **financial strength** by delivering strong results
- ◆ We essentially **eliminated our debt**
- ◆ We have \$386 million in **available cash**
- ◆ We **invested \$12 million** to advance our **exploration program**
- ◆ We **re-opened our Balmat zinc mine** and began pre-production
- ◆ We **acquired White Pine Copper Refinery** to complete our vertical integration
- ◆ We successfully **completed the early exercise warrant transaction** for proceeds of approximately \$104.9 million
- ◆ Our **January 1, 2007 reserves and resources replaced 2006 production**

Our 2006 financial performance was record setting. Earnings increased more than six fold to \$564.0 million, cash flow from operations increased to \$423.9 million, assets exceed \$1.3 billion and, for the first time in our Company's history, revenues exceeded \$1 billion, increasing by 73% from a year earlier.

Share Price Performance

HBM Share Price History

December 12, 2004 to December 29, 2006



+830%

From inception in December 2004 to December 29, 2006, HudBay's share price has increased by more than 830%. In 2006 alone, HudBay's shares rose by 271%.

Key Financial and Production Results

	Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Financial Highlights (\$000's except per share amounts)				
Revenue	313,110	173,051	1,129,003	652,028
Earnings before tax	134,636	23,864	442,451	74,418
Earnings	165,788	43,941	563,991	85,218
Operating cash flow ¹	148,508	32,349	490,797	123,171
Earnings per common share:				
Basic	\$ 1.32	\$ 0.52	\$ 5.32	\$ 1.04
Diluted	\$ 1.29	\$ 0.47	\$ 4.69	\$ 1.01
Operating cash flow per common share: ¹				
Basic	\$ 1.19	\$ 0.38	\$ 4.63	\$ 1.50
Diluted	\$ 1.16	\$ 0.34	\$ 4.08	\$ 1.45
Cash cost per pound of zinc sold ²	(US\$ 0.21)	US\$ 0.23	(US\$ 0.43)	US\$ 0.16

Operating Highlights

Production						
Zinc ³	tonnes	31,959	30,520	123,253	114,687	
Copper	tonnes	23,194	23,807	88,225	86,285	
Gold	troy oz.	28,143	25,877	97,952	102,371	
Silver	troy oz.	342,963	401,390	1,344,927	1,410,512	
Metal Sold ⁴						
Zinc, incl sales to Zochem ³	tonnes	32,386	29,598	114,646	114,682	
Copper	tonnes	19,901	17,644	79,395	78,070	
Gold	troy oz.	22,112	21,783	82,921	95,511	
Silver	troy oz.	295,545	358,434	1,195,142	1,321,784	

Financial Condition

				(\$000's)
Cash and cash equivalents			385,864	141,660
Working capital			647,685	209,117
Cash (less debt) ⁵			362,639	(66,669)
Total assets			1,318,515	728,753
Shareholders' equity			964,208	261,226

1. Cash flow from operations of \$423,926 excluding \$66,871 of changes in non-cash working capital. Operating cash flow per common share is considered a non-GAAP measure.
2. Non-GAAP reconciliation of cash cost per pound of zinc sold, net of by-product credits (refer to page 43).
3. Production includes Balmat metal in concentrate and sales include Balmat payable metal in concentrate shipped (including to HBMS) for which proceeds are credited to capital as pre-commercial production revenues, and therefore not included in metals sold for financial reporting purposes.
4. Excludes inventory changes prior to the contractual change with CMM.
5. Cash and cash equivalents of \$385,864 less current and long-term portion of senior secured notes, Province of Manitoba loan and capital leases (\$3,380, \$10,834, and \$9,011 respectively).

Outlook

This outlook includes forward-looking information about our operations and financial expectations that are subject to risks, uncertainties and assumptions.

Material Assumptions

Our 2007 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 impact our performance. Our general expectations regarding metals prices as well as, the prices of electricity, heavy fuel oil and foreign exchange rates are included in the "Commodity Markets" section of this MD&A.

2006 Production and 2007 Guidance

The following chart summarizes our 2006 production and 2007 guidance.

PRODUCTION AND GUIDANCE ¹	Cu (tonnes)	Zn (tonnes)	Au (oz.)	Ag (oz.)
2006				
Metal from HBMS concentrates	56,698	113,637	95,980	962,743
Metal from purchased concentrates	31,527	4,329 ²	1,972	382,184
Metal in Balmat concentrate, for sale ²	–	9,037 ³	–	–
Metal in Balmat associated purchased concentrates ^{2,3}	–	(3,750)	–	–
Total Production	88,225	123,253	97,952	1,344,927
Total Production – Guidance	(000's) 45 – 55 ⁴	120 – 140	85 – 100	1,000 – 1,300
2007				
Total Production – Guidance	(000's) 80 – 90	130 – 150	85 – 95	1,000 – 1,300

1. HBMS mines in Manitoba. Metal from HBMS 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. Includes 3,750 tonnes from metal in Balmat equivalent purchased concentrates, purchased from Xstrata. Through an arrangement to decrease costs, HudBay sells all concentrates from its Balmat zinc mine to Xstrata, and elects annually to purchase up to 50% of Balmat equivalent concentrates from Xstrata.
3. Metal in concentrate produced in 2006 prior to commercial production.
4. Copper guidance in 2006 is HBMS production only and excludes purchased concentrates, whereas 2007 guidance includes purchased concentrates.

Exploration

Exploration is a key element of our growth strategy. In 2007, we've targeted \$45.2 million for exploration, including \$8.5 million on the Bur deposit, which will be a significant increase from levels in 2006 and years prior. Our 2007 exploration preliminary expenditure plan is as follows:

2007 PRELIMINARY EXPLORATION EXPENDITURE PLAN ¹		(\$ millions)
Flin Flon Greenstone Belt		
Geophysical anomaly drilling		8.5
Known deposit/drilling		4.5
Capitalized underground mine exploration		3.2
Geophysics surveys		3.2
Structural reinterpretation drilling		3.2
Bur deposit		8.5
Administration/miscellaneous		3.0
Total		34.1
Other Locations		
Balmat mine and district exploration		4.1
Unallocated		7.0
Total		11.1
Total planned 2007 expenditure for exploration and Bur deposit		45.2

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

In the Flin Flon Greenstone Belt, anticipated drilling targets include known mineral deposits, structural re-interpretations and geophysical anomalies. We also plan to increase exploration expenditures to further expand mineral reserves and resources within our three mines in Manitoba. Our principal production facilities are located in the Flin Flon Greenstone Belt, and a discovery in this district could be significantly accretive to our operations. Outside the Flin Flon Greenstone Belt, exploration will aim to further expand mineral reserves and resources at the Balmat mine in New York state and to discover new deposits in the Balmat district. Exploration in 2007 will also include our mineral properties in Southwestern Ontario and elsewhere.

We hold large tracts of high potential exploration properties and, through our subsidiary Hudson Bay Exploration & Development ("HBED"), are actively exploring these property holdings.

Exploration properties as of December 31, 2006 are as follows:

Hectares	Area	Metal	Location
382,283	Flin Flon Greenstone Belt	Zinc/copper	Manitoba
20,750	Balmat district	Zinc	New York state
10,897	Prospect lands	Zinc	SW Ontario
5,278	Tom Valley/Jason ¹	Lead/zinc	Yukon
1,531	San Antonio prospect	Copper	Chile

1. HudBay holds an option to purchase the Jason property, which is adjacent to Tom Valley.

HBED was established in 1937 and has an exceptional record of discovering ore bodies. In 2006, we invested \$12 million in exploration for essentially diamond drilling in the Flin Flon Greenstone Belt. For 2007, a key area of focus will again be the Flin Flon Greenstone Belt, a region where we have a long track record of discovering new mineral deposits and increasing the mineral reserves in our producing mines.

Royalties and NPI

For guidance on the future impact of royalty agreements and profit sharing, see contractual obligations and commitments on page 46.

The Bur Deposit

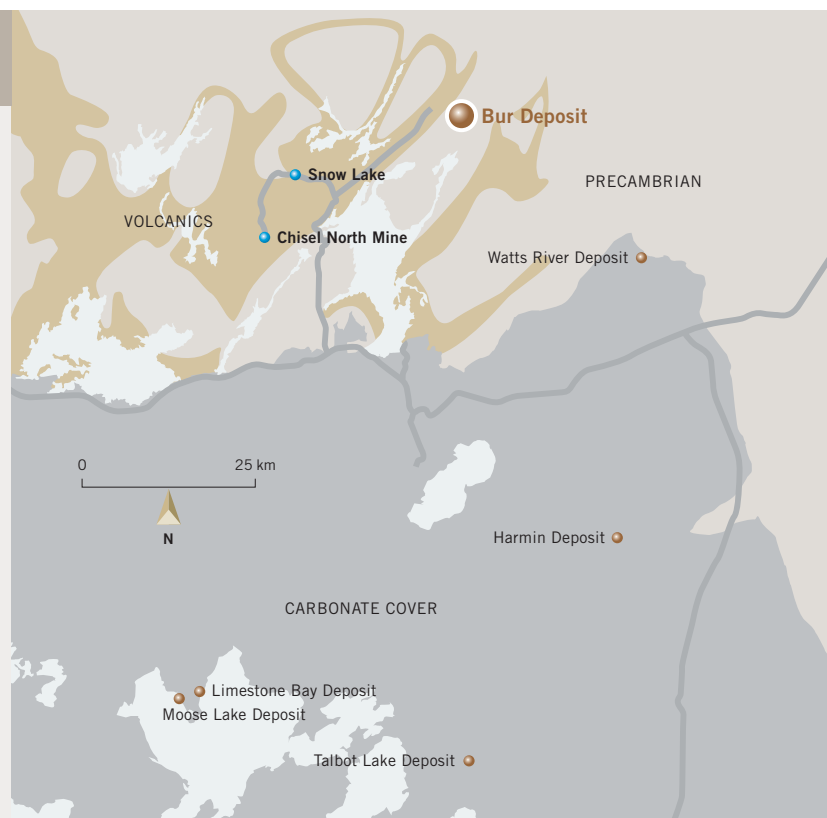
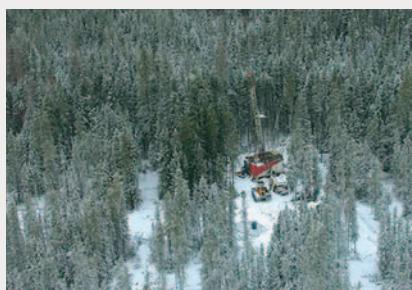
We are also advancing our Bur deposit project by investing approximately \$8.5 million in 2007 for in-fill diamond drilling, underground excavations to extract a 10,000 tonne ore sample and completing a feasibility study.

The completion of the Bur deposit project underground decline, 10,000 tonne ore sample and feasibility study is dependent on receiving permits and successfully doing the work and is expected late in 2007. Based on exploration updates from March 20, 2006 and September 27, 2006, and assuming a positive feasibility study and production decision, the Bur deposit is targeted to provide incremental feed to HudBay's Snow Lake concentrator and to the Flin Flon metallurgical plants for up to three years, producing an additional annual refined metal production of approximately 6,000 tonnes of copper, 20,000 tonnes of zinc, 2,000 oz. of gold and 45,000 oz. of silver. Assuming a decision to proceed, major project capital expenditure is expected to be approximately \$35 million (including the planned \$8.5 million expenditure).

The Company plans to complete a price protection program on the Bur deposit to secure the economic returns for this mine. The program is expected to be completed prior to the completion of the feasibility study. Details of this program will be disclosed when the program is complete.

The Bur Deposit

The Bur mineral deposit is 22 kilometres from our Snow Lake ore concentrator in Manitoba and can be easily accessed. Assuming a positive feasibility study and subsequent production decision, this potential mine, despite high costs, is financially attractive based on forward metal prices, and is similar to several other of our small mineral deposits in the Snow Lake area.



2007 Capital Spending

To support continued strong levels of production from its mines and facilities, the Company's capital expenditure program is expected to be approximately \$109 million in 2007 – lower than the \$119 million level in 2006. Our 2007 capital program includes expenditures of approximately \$60 million for mine development.

The following is our capital spending by mine and processing facility:

(\$ millions)	2007E	2006A
777 Mine	24.3	25.3
Trout Lake Mine	22.2	22.8
Chisel North Mine	9.3	5.9
Balmat Mine and Concentrator ¹	18.1	24.6
Flin Flon and Snow Lake Concentrators	4.0	3.5
Copper Smelter	4.1	12.4
White Pine Copper Refinery	5.5	2.4
Zinc Plant	6.9	4.2
Flin Flon and Snow Lake General Plant	13.9	11.1
Increase in Asset Retirement Obligations	–	2.5
Increase in Capital Spares	–	2.6
Zinc Oxide Plant	0.9	2.0
Total	109.2	119.3

1. Including pre-production and revenues.

2007 Tax Considerations

In 2007, as the Company utilizes the corporate income tax pools, the benefit of which is shown as a future tax asset, the value of this asset is expected to be drawn down during the year and reflected as a non-cash income tax expense on the Company's income statement. Similarly, the mining tax asset is expected to be drawn down and reflected as a non-cash income tax expense.

Commodity Markets

In addition to our production, our financial performance is directly affected by a number of factors including metal prices, foreign exchange rates, as well as input costs including electricity, heavy fuel oil, natural gas and transportation. In 2006, metals prices increased strongly, and we also experienced increases to many of our input costs.

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

Zinc

Of the five primary products we produce, the Company's earnings and cash flow are most sensitive to fluctuations in the price of zinc (see "Sensitivity Analysis" on page 22 for details). In 2006, the LME zinc price averaged US\$1.49 per pound, increasing over the year to a high of US\$2.10 per pound in November, before retreating to US\$1.96 per pound at year end. In early 2007, the zinc price continued to decline in line with increasing concerns over Chinese demand as well as reports of weaker US demand.

Zinc inventories on the London Metal Exchange ("LME") fell by 305,675 tonnes or almost 80% during the year as zinc consumption again exceeded production capacity. The LME inventory at year end was approximately 90,000 tonnes.

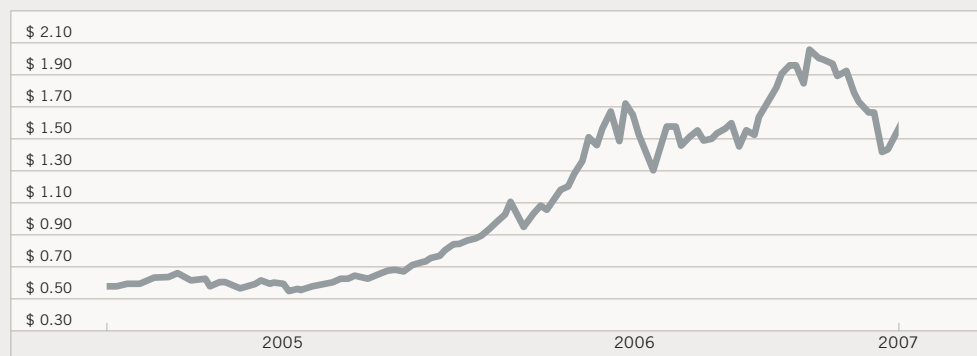
The tight supply of zinc in 2006 is evidenced by the increase in the associated premiums received for the direct sale of zinc metal. Our contractual sales for 2007 are expected to reflect higher market premiums; however, recent weakness in US demand has resulted in lower spot premiums early in 2007.

On a global basis the longer-term outlook for the zinc price remains positive as general demand for both zinc concentrate and zinc metal is expected to meet or exceed mine supply.

LME Zinc inventories declined as prices rose in 2006

LME Zinc Cash Settlement Price Weekly Average (US\$ per lb.)

January 2005 to February 2007



US\$/lb.	LME Average	Realized
2005	\$0.63	\$0.65
2006	\$1.49	\$1.53

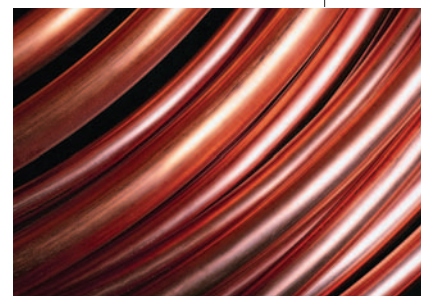
Copper

Global copper consumption increased by almost 5% in 2006, driven largely by increased demand. The LME copper price averaged US\$3.05 per pound in 2006, peaking during the second quarter at US\$4.00 per pound before declining to US\$2.85 per pound at year end. Copper prices have retreated early in 2007 from commodity fund rebalancing and reports of weaker US demand.

Copper inventories in warehouses increased by more than 100,000 tonnes in 2006 but are considered low by historical standards. The higher price encouraged the continued expansion of mine production during 2006; however, due to a series of strikes and accidents, actual mine production was relatively unchanged from 2005.

The outlook for the price of copper is neutral, based on greater expected mine supply and is vulnerable to weaker US demand.

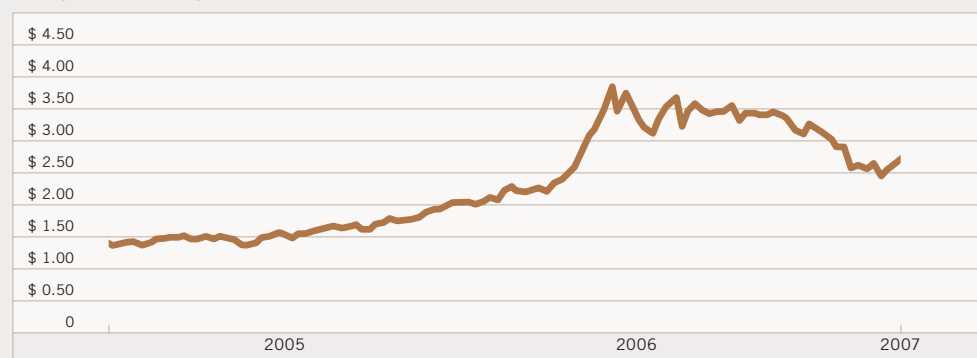
Zinc is used mainly for galvanizing to inhibit rusting of steel. Zinc is also used to create brass, bronze and zinc-based alloys. Copper is used in a wide variety of products and industries that include infrastructure construction, electronic components, industrial machinery, transportation and consumer products.



Higher copper prices were driven by global demand

LME Copper Cash Settlement Price Weekly Average (US\$ per lb.)¹

January 2005 to February 2007



US\$/lb.	LME Average	Realized
2005	\$1.67	\$1.72
2006	\$3.05	\$3.15

1. The Company's sales contracts are primarily based on Comex copper prices.

Gold

Gold prices averaged US\$604 per ounce and followed an upward trend in 2006, closing the year at US\$630 per ounce. In 2007, the trend has continued with gold exceeding US\$650 per ounce in February 2007. The prospects for the gold price remain favourable, particularly in response to any global economic/political uncertainty and potential increased investment demand to mitigate US dollar weakness.

Silver

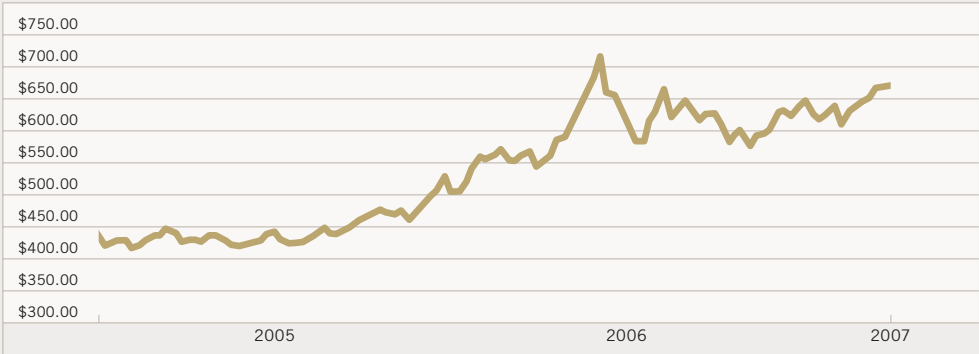
In 2006, silver prices increased primarily due to increasing investment and industrial demand, along with higher world economic growth. As a result of higher silver prices in 2006, demand from jewelry and silverware fabrication decreased. Early in 2007, silver prices have exceeded US\$13 per ounce and, for the remainder of the year, silver prices may remain at these higher levels.



Gold has a number of applications. Most consumption is in the domain of jewellery, but other applications are found in light commercial equipment, dental work, coins and investment bullion. Silver is used in film, silverware, transparent coating on double pane thermal windows, solar panels, mirrors, water purification, electronic products, jewellery and batteries.

The prospects for gold prices remain favourable

London Gold PM Fix Weekly Average (US\$ per troy oz.)
January 2005 to February 2007



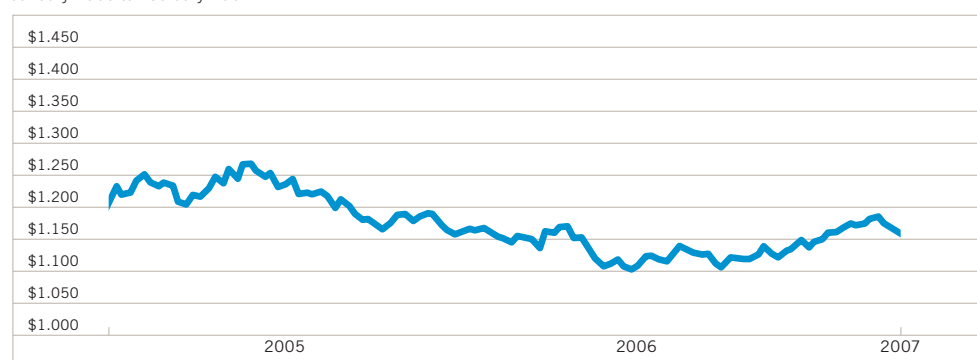
US\$/oz.	LME Average	Realized
2005	\$445	\$445
2006	\$604	\$603

Foreign Exchange

Since the revenue from our five principal products is substantially in US dollars, HudBay is affected by the fluctuations in the Cdn/US dollar exchange rate. In 2006, the Company's exposure increased with the reduction of its US dollar debt, partially offset by US dollar purchased copper concentrate and US dollar put options (see "Risk Management" on page 22 for details). In general, a weaker US dollar would cause the Company's revenue and therefore earnings to decrease. The Canadian dollar has out-performed most major currencies in 2006, including the US dollar. In 2007, we expect the Canadian dollar to remain strong relative to an anticipated weaker US dollar.

Foreign Exchange (C\$/US\$)

January 2005 to February 2007



C\$/US\$	Exchange Average
2005	\$1.21
2006	\$1.13

2005	\$1.21
2006	\$1.13

Silver prices increased due to demand

London Silver Bullion Price Weekly Average (US\$ per troy oz.)

January 2005 to February 2007



US\$/oz.	LME Average	Realized
2005	\$7.31	\$7.28
2006	\$11.57	\$11.13

Sensitivity Analysis

The following table shows the approximate impact of metal prices and exchange rates on the Company's 2007 cash flow.

A change of			Would change our 2007 cash flow by (C\$/million)	Would change our 2007 cash flow per share by ¹ (C\$/share)
Zinc	lb.	US\$ 0.10	\$ 27.00	\$ 0.21
Copper	lb.	US\$ 0.10	\$ 11.00	\$ 0.09
Gold	troy oz.	US\$ 10.00	\$ 0.90	\$ 0.01
Silver	troy oz.	US\$ 1.00	\$ 0.80	\$ 0.01
Exchange Rates	US\$1 to C\$1	C\$ 0.01	\$ 8.00	\$ 0.06

1. Based on undiluted common shares outstanding of 126 million.

Electricity and Heavy Fuel Oil

In 2006, the Company consumed almost one billion kWh's of electricity, with our zinc plant being the largest consumer of electricity in HudBay's operations. Additionally, we consume almost 250,000 barrels of heavy fuel oil and almost 25 million litres of propane at our mines and plants annually. Changes in the cost of these commodities affect our costs to produce our products. Consumption levels in 2007 are expected to increase due to the re-opening of the Balmat mine.

Rail Costs

The Company expects the average rail rate per short ton will increase from \$54 in 2006 to \$58 in 2007 representing an increase of approximately \$1 million.

Purchase Concentrate/Treatment Charges

Early in 2006, we negotiated terms for our two long-term copper concentrate purchase contracts (Highland Valley Copper and Montana Resources), covering one half of the 2006 tonnage and one half of the 2007 tonnage. These were settled at levels similar to contract settlements achieved by major Japanese and Korean smelters.

Risk Management

The Company uses forward exchange contracts to limit the effects of movements in exchange rates on foreign currency denominated assets and liabilities and future anticipated transactions. At December 31, 2006, the Company held US dollar put options giving it the right, but not the obligation, to sell up to US\$39 million in equal quarterly amounts at \$1.20482 per US dollar, continuing to January 2009. In 2006, the Company has elected not to adopt hedge accounting on these forward exchange contracts.

From time to time, the Company maintains price protection programs and conducts commodity price risk management to reduce risk through the use of financial instruments. The Company utilizes forward physical sales where it receives a fixed price for zinc and zinc oxide and then enters into offsetting forward contracts to purchase zinc. These contracts effectively offset the Company's forward sales to ensure the Company receives a floating or unhedged realized zinc price. In the current environment of strong base metal market prices, the Company benefits from full exposure to metal price movements; however, in the future the Company may consider implementing protection to mitigate the effects of future price changes from time to time.

Mineral Reserves and Mineral Resources

Estimated Mineral Reserves (January 1, 2007)

Mine	Tonnes	Au (g/t)	Ag (g/t)	Cu (%)	Zn (%)
777					
Proven	5,041,000	2.3	27.5	2.8	4.5
Probable	11,813,000	2.1	26.9	2.3	4.5
Trout Lake					
Proven	1,301,000	1.6	18.1	2.2	4.7
Probable	896,000	1.8	19.1	3.0	4.1
Chisel North					
Proven	605,000	–	–	–	8.2
Probable	1,054,000	–	–	–	8.0
Balmat					
Proven	912,000	–	–	–	10.1
Probable	1,163,000	–	–	–	11.4
Total Proven	7,859,000				
Total Probable	14,926,000				
Total Reserves	22,785,000				

To estimate mineral reserves, measured and indicated mineral resources were first estimated by a 12-step process, which includes determination of the integrity and validation of the data collected, including confirmation of specific gravity, assay results and methods of data recording. The process also includes determining the appropriate geological model, selection of data and the application of statistical models including probability plots and restrictive kriging to establish continuity and model validation. The resultant estimates of measured and indicated mineral resources are then converted to proven and probable mineral reserves by the application of mining dilution and recovery, as well as the determination of economic viability using historical operating costs. Other factors, such as depletion from production, are applied as appropriate. Long-term metal prices, including premiums, used to determine economic viability of the 2007 mineral reserves were US\$450/oz. gold, US\$7.00/oz. silver, US\$1.10/lb. copper and US\$0.60/lb. zinc.

Aggregate ore reserves at our mines increased from 21,357,000 tonnes calculated as of January 1, 2006 to 22,785,000 tonnes calculated as of January 1, 2007, after mining during 2006.

Estimated Inferred Mineral Resources¹ (January 1, 2007)

Mine	Tonnes	Au (g/t)	Ag (g/t)	Cu (%)	Zn (%)
777	1,145,000	2.0	26.5	1.4	4.3
Trout Lake	403,000	1.3	22.7	1.4	5.1
Chisel North	248,000	–	–	–	7.9
Balmat	1,448,000	–	–	–	12.8
Total Resources	3,244,000				

1. Diluted, recovered and economically tested.

Estimated inferred mineral resources within HudBay mines were estimated by a similar 12-step process, used to estimate measured and indicated resources. The inferred mineral resources tabulated on the previous page and contained in HudBay mines are compliant with the requirements of National Instrument 43-101 and have had dilution and recovery applied and have been economically tested using the same historical costs and long-term metal prices as those used for the estimation of mineral reserves.

HudBay's estimated mineral reserves and estimated inferred mineral resources are contained within HudBay's operating mines.

The 2007 estimated measured and indicated mineral resource and the estimated inferred mineral resource were prepared under the supervision of Kimberley Lau, B.Sc., P.Geo, who is employed by Hudson Bay Mining and Smelting Co., Limited ("HBMS"), a wholly-owned subsidiary of HudBay, as Superintendent, Mining Technical Services and who is a Qualified Person under NI 43-101. The 2007 estimated mineral reserve and the estimated diluted, recovered and economically tested inferred mineral resources have been prepared under the supervision of Gerald Beauchamp, B.Sc, P.Eng., who is employed by HBMS as Senior Mines Analyst and who is a Qualified Person under NI 43-101.

Exploration

In 2006 we invested \$12 million to advance our surface exploration program, contributing to reserves at January 1, 2007, increasing to 22.8 million tonnes, even after 2006 production.



Health, Safety, Environment and Product Quality

HudBay's lost time accident frequency rate per 200,000 hours worked increased from 0.62 in 2005 to 0.96 in 2006. Days lost per 200,000 hours worked produced a severity of 21 in 2005 compared to 30 in 2006. Total accident frequency rate per 200,000 hours worked was, however, reduced from 42.5 in 2005 to 37.4 in 2006. Safety statistics include HudBay employees and contractors at all locations.

HudBay operations, excluding St. Lawrence Zinc Company LLC ("SLZ") and the White Pine Copper Refinery, maintained certification to both OHSAS 18001:1996 occupational health and safety assessment series and ISO 14001:2004 environmental management systems standard in 2006. Plans for certification to ISO 14001:2004 and OHSAS 18001:1996 are on schedule for both SLZ early in 2007 and the White Pine Copper Refinery before the end of 2007.

The production and supply of the Company's final products, excluding the White Pine Copper Refinery, continued to be certified to ISO 9001:1996 quality management systems standard. Certification of White Pine Copper Refinery is planned for late 2007.

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

Work commenced in 2006 on the expansion to the Flin Flon Tailings Impoundment System. This project will install final mitigation measures to minimize the possibility of wind blown tailings at this location while providing additional tailings storage capacity. Work to decommission and remediate the Konuto Lake mine, which closed at the end of 2005, is essentially complete, with the exception of revegetation activities scheduled for 2007.

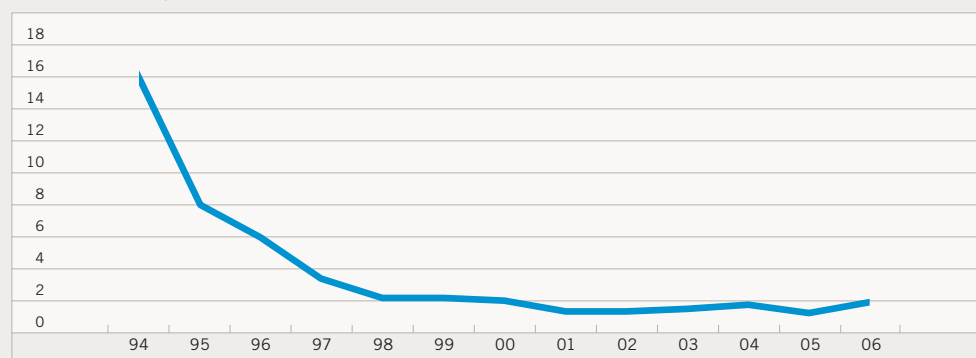
In April 2006, a notice was gazetted by the Federal Government requiring HudBay's operating subsidiary, HBMS, to prepare and commence implementation of a pollution prevention plan in respect of specified toxic substances released from its Flin Flon metallurgical complex. This requirement was met, and HBMS will now provide annual interim progress reports to government until the plan is fully implemented, no later than December 31, 2015.

HudBay publishes an annual sustainability report that specifies the Company's Environmental, Health and Safety performance.

Strong attention to safety

HudBay Safety Performance

Lost Time Accidents per 200,000 Hours Worked



Note: Zochem included after 2001. White Pine Copper Refinery and St. Lawrence Zinc included after 2005.

ISO 14001

Environmental Management

OHSAS 18001

Health & Safety Management

ISO 9001

Quality Management

Operations Overview



Solid & efficient

In 2006, our operations consisted of four mines, three concentrators, a copper smelter, a copper refinery, a zinc plant, and a zinc oxide facility.

Above, a Jumbo drill advances a heading at the 777 Mine. Opposite page, the mine's hoist control room.

777 Mine

The 777 mine is located immediately adjacent to the Company's principal concentrator and metallurgical complex in Flin Flon, Manitoba. In 1999, HBMS commenced development of the 777 mine as part of the \$435 million "777 Project", and commercial production commenced in January 2004 at an initial capacity of 1.0 million tonnes of ore per annum.

Ore production at the 777 mine, for the quarter ended December 31, 2006, increased by 18% compared to the same period in 2005, consistent with plans to increase production to the design of 1.35 million tonnes per annum. Copper grades were higher by 31%, and zinc grades were lower by 20% due to planned changes in mining areas. Operating costs per ore tonne in the last quarter were lower by 11% primarily as a result of increased ore production.

Ore production for all of 2006 increased by 25% compared to 2005. Zinc grades increased by 8% and copper grades increased by 25%, largely due to the mining of ore blocks with favourable grades. Gold and silver grades increased by 16% and 7% respectively. Operating costs decreased by 4.6% related to greater mined ore volumes.

A total of \$24 million of capital expenditures is planned for 2007, compared to \$25 million in expenditures for 2006. For 2007, the 777 mine ore tonnage is expected to increase slightly compared to 2006, with a small decrease in zinc content due to planned changes in mining areas and copper content remaining similar to 2006.



777 Mine Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Production	tonnes	362,042	308,099	1,367,548	1,093,683
Copper grade	%	2.99	2.28	2.81	2.24
Zinc grade	%	4.07	5.10	4.81	4.47
Gold grade	g/tonne	2.91	2.06	2.43	2.09
Silver grade	g/tonne	26.13	24.56	25.61	23.83
Operating costs	\$/tonne	36.14	40.46	35.85	37.60

2006 Highlights

+25%

Increase in production for all of 2006 compared to 2005

-4.6%

Decrease in \$/tonne operating costs due to greater mined volumes

\$25M

Capital expenditures; another \$24 million planned for 2007

2020

Current expected mine life

Trout Lake Mine



The Trout Lake mine is located approximately six kilometres from the Company's principal ore concentrator and metallurgical complex in Flin Flon, Manitoba. Commercial production commenced at the Trout Lake mine in 1982. The mine is accessed from surface by a shaft and ramp and ore from the mine is truck hauled to the Flin Flon concentrator.

Trout Lake mine ore production tonnage for the quarter ended December 31, 2006 increased by 6% compared to the same quarter in 2005. Copper grade increased by 29%, and zinc grade decreased by 26%, consistent with the mining plan. The lower gold and silver grades were also consistent with the mining plan. Operating costs increased by 24% in the fourth quarter due to the costs associated with higher mining cost ore pillar extraction project. The Trout Lake Project was initiated in 2006 to extract additional ore during a period of high metal prices. The Trout Lake

Project extracted a total of 40,000 tonnes at grades of 1.8% copper and 4.1% zinc were mined successfully in 2006. As planned, the unit cost of this additional ore of \$74.40 per ore tonne mined was significantly higher than conventionally mined Trout Lake ore, related to more challenging mining and the use of contractors.

Production tonnage in 2006 was 2% less than in 2005 due to the planned reduction in the mining areas available. In 2006, copper grades increased by 57% and zinc grades decreased by 35%. Gold and silver grades were lower by 13% and 7% respectively. Production grades were consistent with the mine plan. Operating costs for 2006 increased by 18% due largely to the costs associated with the Trout Lake ore pillar extraction project, where the cost of extraction was higher than conventional mining.

A total of \$22 million in capital expenditures is planned for 2007 compared to \$23 million in capital expenditures in 2006. Ore production tonnage, ore grade and unit costs for 2007, within normal fluctuations, are expected to be similar to 2006.

Trout Lake Mine Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Production	tonnes	228,539	214,981	838,862	858,751
Copper grade	%	2.31	1.79	2.18	1.39
Zinc grade	%	2.86	3.86	3.65	5.61
Gold grade	g/tonne	1.28	1.32	1.28	1.47
Silver grade	g/tonne	11.19	13.35	13.53	14.61
Operating costs	\$/tonne	48.51	39.11	41.74	35.43

2006 Highlights

-2%

Decrease in production for all of 2006 compared to 2005

+18%

Increase in \$/tonne operating costs due to higher extraction costs

\$23M

Capital expenditures; another \$22 million planned for 2007

2011

Current expected mine life

Chisel North Mine

The Chisel North mine is located approximately 10 kilometres west of the Company's Snow Lake ore concentrator, which is approximately 215 kilometres from Flin Flon. Commercial production commenced at the mine in June 2000. The mine is accessed by a ramp, and ore from the mine is trucked to the Snow Lake concentrator. Concentrate produced is trucked to HudBay's zinc plant in Flin Flon.

Ore production at the Chisel North mine for the quarter ended December 31, 2006 increased by 1% compared to the same quarter in 2005. Zinc grade decreased by 2%, consistent with the mine plan. Operating costs increased by 11% due to a greater amount of operating development and the need for increased ground support.

Ore production for the year ended December 31, 2006 decreased by 4% compared to the prior year due to less ore availability from long hole stopes. The zinc grade of ore mined was lower by 5%, consistent with the mine plan. Ore unit costs for 2006 compared to 2005 increased by 21% due to greater amounts of operating development and lower volumes of ore from long hole mining.

A total of \$9 million in capital expenditures is planned for 2007, compared to \$6 million in 2006, with 2007 capital including \$2 million for an upgrade of the water treatment plant. Ore production, grades and unit costs for 2007, within normal fluctuations, are expected to be similar to 2006.



Chisel North Mine Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Production	tonnes	82,148	80,996	323,379	336,731
Zinc grade	%	8.83	8.97	8.56	9.00
Operating costs	\$/tonne	53.57	48.23	51.37	42.40

2006 Highlights

-4%

Decrease in production for all of 2006 compared to 2005

+21%

Increase in \$/tonne operating costs due to higher cost mining

\$6M

Capital expenditures; another \$9 million planned for 2007

2013

Current expected mine life

Balmat Mine and Concentrator (Under Development¹)

From October 2001 the Balmat zinc mine ("Balmat") was maintained to a high standard while on care and maintenance. The mine includes a 3,200 foot deep shaft, underground excavations to access the ore zones, extensive mining equipment and a 5,000 ton per day ore concentrator.

After completion of a feasibility study, HudBay started production in May 2006 from its re-opened, Balmat mine and concentrator. Production of zinc concentrate commenced in May 2006 according to plan. Pre-production has ramped up slower than anticipated due to lower availability and recruitment of skilled mining labour. At the end of the fourth quarter 2006, 181 employees had been hired, with 44 contractors also doing mine development and production. Training of employees and the use of contractors continues. Production of zinc contained in zinc concentrates for the fourth quarter 2006 was 4,407 tons and 10,123 tons for the full year 2006. Recovery of zinc to concentrate during 2006 has been approximately 96%, producing a concentrate containing approximately 55% zinc. Production outlook for 2007 is approximately 35,000 tons of zinc in concentrate. At full production in 2008, the mine is expected to produce approximately 60,000 tons of zinc in concentrate.



Balmat achieved commercial production as of January 1, 2007.

Zinc concentrate produced at Balmat is sold to Xstrata and treated at its Canadian Electrolytic Zinc ("CEZ") refinery near Montreal, approximately 158 kilometres from the mine. The agreement with Xstrata provides for an annual election by HudBay for up to 50% of Balmat's zinc concentrate production sold to Xstrata to be purchased by HudBay, from a closer location, as equivalent zinc concentrate, for treatment at HudBay's zinc plant in Manitoba.

In 2006, capital project costs of US\$25 million were incurred. The final capital cost of the project is US\$26 million before deduction of capitalized pre-production operating costs, net of revenues.

1. Tons in this section of the MD&A are reported in short tons (tons) compared to other sections of this report which state metric tonnes (tonnes).

Balmat Mine and Concentrator Data

Pre-Production, Year Ended Dec. 31, 2006

Zinc metal in concentrates sold (tons)	10,123
Recovery of zinc to concentrate	96%
Zinc concentrate grade	55%

2007 Outlook

Zinc metal in concentrate (tons)	35,000
----------------------------------	--------

2006 Highlights

10,123

Tons of zinc in concentrate produced during 2006

181

Employees hired by the end of 2006

US\$25M

Capital expenditures for 2006

2014

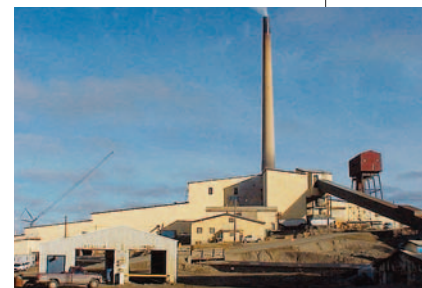
Current expected mine life

Flin Flon Concentrator

The Flin Flon concentrator produces zinc and copper concentrates from ore mined at the 777 and Trout Lake mines. As part of the \$435 million "777 Project" that was completed in 2004, the ore capacity of the Flin Flon concentrator was increased to 2.18 million tonnes per annum. The concentrator receives ore from each mine separately and blends the ore prior to grinding.

For the fourth quarter of 2006, the Flin Flon concentrator throughput increased slightly, compared to the same period in 2005. Copper head grade increased by 23% while zinc head grade decreased 14% as a result of changes in the Trout Lake mine ore grades. Recoveries of copper and zinc fluctuated marginally with a 2% increase in zinc recovery and a 1% decrease in copper recovery. Gold and silver recoveries were affected by the reduced recovery of copper during the quarter. Unit cost of ore throughput increased by 11% due to increases in reagent and grinding media costs, associated with price increases for these commodities.

In 2006, processed ore tonnage was similar to tonnage processed in 2005. Copper head grade increased by 21% and zinc head grade decreased by 4% compared to 2005. Operating costs increased 9% year-on-year due principally to increases in commodity prices as noted above. Both copper and zinc recovery increased in 2006 compared to 2005 while gold and silver recovery reduced to historical levels of 70.7% and 63.5% respectively. A total of \$4 million in capital expenditures are planned for 2007, similar to 2006.



Flin Flon Concentrator Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Ore processed	tonnes	569,516	566,445	2,258,146	2,262,555
Copper grade	%	2.75	2.23	2.58	2.14
Zinc grade	%	3.70	4.32	4.36	4.53
Gold grade	g/tonne	2.28	1.75	1.99	1.78
Silver grade	g/tonne	20.56	19.01	20.99	18.14
Copper concentrate	tonnes	59,187	49,465	218,177	188,851
Concentrate grade	Cu %	24.58	23.99	24.90	23.82
Zinc concentrate	tonnes	33,375	38,115	161,554	164,417
Concentrate grade	Zn %	52.42	52.15	51.92	51.51
Copper recovery	%	92.9	93.7	93.4	92.8
Gold recovery	%	68.4	72.5	70.7	74.9
Silver recovery	%	63.4	66.1	63.5	66.3
Zinc recovery	%	83.1	81.2	85.1	82.6
Operating costs	\$/tonne	8.80	7.95	8.61	7.93

2006 Highlights

-0.2%

Decrease in production for all of 2006 compared to 2005

9%

Increase in \$/tonne operating costs due to rising commodity prices

\$3.1M

Capital expenditures for 2006

2.2M

Ore capacity in millions of tonnes

Snow Lake Concentrator



The Snow Lake concentrator is approximately 215 kilometres from the Flin Flon metallurgical complex. The facility processes the Chisel North mine zinc ore and produces zinc concentrate that is trucked to the Flin Flon zinc plant for treatment. The concentrator has an ore capacity of approximately 1.2 million tonnes per annum.

In the fourth quarter of 2006, ore processed by the Snow Lake concentrator decreased by 2% compared to the same quarter in 2005, while zinc recovery increased 1%. Unit cost per tonne of ore processed, which includes the cost of transportation to Flin Flon, increased by approximately 15% due to cost increases for reagents and grinding media consistent with general commodity price increases during 2006.

For 2006, ore throughput decreased by 2%, consistent with ore supply from the Chisel North mine. Zinc ore head grade was lower by 5%, while zinc metal recovery to concentrate was similar to 2005. Operating costs per tonne of ore were 14% higher due to increases in commodity prices.

A total of \$0.3 million in capital expenditures is planned for 2007, compared to an expenditure of \$0.4 million in 2006.

Snow Lake Concentrator Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Ore processed	tonnes	81,305	82,729	325,114	331,427
Zinc grade	%	8.84	9.00	8.59	9.00
Zinc concentrate	tonnes	13,583	14,118	53,001	56,646
Concentrate grade	Zn %	51.65	51.21	51.40	51.25
Zinc recovery	%	97.60	97.10	97.60	97.30
Operating costs ¹	\$/tonne	22.78	19.80	19.69	17.35

1. Operating costs include the cost of trucking concentrates to the Flin Flon metallurgical plant.

2006 Highlights

-2%

Decrease in production for all of 2006 compared to 2005

+14%

Increase in \$/tonne operating costs due to rising commodity prices

\$0.4M

Capital expenditures; another \$0.3 million planned for 2007

1.2m

Ore capacity, in millions of tonnes

Copper Smelter

The copper smelter treats copper concentrate and produces copper anodes, which are railed to the White Pine Copper Refinery, where they are electro-refined into market standard cathode copper.

Both copper concentrate from HudBay-owned mines ("domestic") and copper concentrate purchased from others ("purchased") are treated at the smelter. Purchased concentrate represented approximately 28% of the concentrate treated during 2006. HudBay has long-term contracts with both Highland Valley Copper Mines and Montana Resources for the supply of purchased copper concentrate.

For the fourth quarter of 2006, copper anode production decreased by 3% compared to the same quarter in 2005, due to changes in internal smelter inventories. Operating costs per pound of copper as anode were 18% higher due to higher maintenance costs.

For 2006, concentrate treated was 5% lower compared to 2005, due to the planned smelter maintenance shutdown. Improved copper concentrate grades and smelter recoveries resulted in copper anode production in 2006 being 2% higher than 2005. Copper anode production in 2006 was a record. Gold and silver production decreased by 4% and 5% respectively compared to 2005, due to lower precious metals in concentrate feed.

A planned maintenance shutdown of the smelter was successfully executed during the second quarter of 2006. The shutdown to rebuild the reverberatory furnace was the first since 2000, reflecting a record furnace campaign period.

A total of \$4 million in capital expenditures is planned for 2007 compared to \$12 million for 2006, which included the planned smelter shutdown to rebuild the furnace.



Copper Smelter Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Domestic conc. treated	tonnes	58,455	55,172	218,267	206,342
Purchased conc. treated	tonnes	20,835	28,828	85,305	111,936
Total	tonnes	79,290	84,000	303,572	318,278
Operating costs ¹	\$/tonne	189.12	154.87	169.33	147.59
Copper produced	tonnes	23,194	23,807	88,225	86,285
Gold	troy oz.	28,143	25,860	97,952	102,374
Silver	troy oz.	342,963	401,385	1,344,927	1,410,512
Operating costs	¢/lb. Cu	29.30	24.80	26.40	24.70

1. Per tonne of concentrate treated.

2006 Highlights

+2%

Increase in copper produced for all of 2006

+7%

Increase in ¢/lb. Cu operating costs

\$12M

Capital expenditures; another \$4 million planned for 2007

6 yrs

Record operating campaign for reverberatory furnace, 2000–2006

White Pine Copper Refinery

The White Pine Copper Refinery is located in the Upper Peninsula of Michigan, USA and was purchased by HudBay January 1, 2006. Comparative data has been provided for 2005, when the plant was operated by previous owners.

Copper anode tonnage received at the White Pine Copper Refinery from HudBay's copper smelter was 3% lower compared to the fourth quarter of 2005 while copper cathode copper tonnage produced was 3% greater. Typically during the last quarter of the year, planned maintenance is undertaken, resulting in higher unit costs.

For 2006, copper cathode production tonnage set a record of 69,878 tonnes, which was 4% higher than 2005. Operating costs for 2006 per pound of copper cathode produced were similar to 2005.

For 2007, a capital expenditure of \$5.5 million is planned, including the installation of new technology to replace the conventional liberator process currently employed, compared to \$2.4 million in 2006. The liberator process change is expected to increase cathode copper production by 5,500 tonnes annually and eliminate the possibility of emitting arsine gas within the refinery.

We expect the refinery to achieve the HudBay standards of ISO 14001:2004 certification for environmental management, OHSAS 18001:1996 for health and safety management and ISO 9001:2000 for quality management in 2007.



White Pine Copper Refinery Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Anodes received	tonnes	21,759	22,316	85,567	84,314
Cathode produced	tonnes	17,719	17,230	69,878	67,180
Spent anode produced	tonnes	3,254	3,146	12,875	12,680
Liberator anode produced	tonnes	601	630	2,439	2,638
Slimes produced	tonnes	51	54	201	198
Operating costs	US\$/lb				
	Cu cathode	7.30	7.80	6.60	6.40

2006 Highlights

+4%

Increase in production for all of 2006 compared to 2005

+3%

Increase in US\$/lb. Cu cathode operating costs

\$2.4M

Capital expenditures; another \$5.5 million planned for 2007

2007

Target for achieving ISO and OHSAS standards

Zinc Plant

The Flin Flon zinc plant utilizes leading edge technology that includes a two-stage pressure leaching plant, four steps of solution purification, a new electrolysis plant and a casting plant. An oxygen plant also supplies the pressure leaching process. The facility produces special high grade zinc.

Through an arrangement to decrease transportation costs for zinc concentrate, we sell all of the concentrates from our Balmat mine to Xstrata for processing at their CEZ refinery in Montreal. Annually, we elect to purchase from Xstrata equivalent zinc concentrate, from a location closer to our zinc plant, representing up to 50% of the Balmat concentrate sold to Xstrata. Receipt of this concentrate commenced towards the end of the third quarter 2006 and represented some 11% of the total concentrate treated in the fourth quarter 2006.

For the fourth quarter 2006, zinc production was similar to the production in the fourth quarter of 2005. Operating costs per pound of zinc metal increased by 5% compared to the fourth quarter in 2005.

For 2006, zinc production increased by 3% compared to 2005. The 2006 production established a production record. Operating costs per pound of zinc metal increased by 3% compared to 2005 due to higher commodity and maintenance costs.

Planned capital expenditure in 2007 is approximately \$7 million, compared to 2006 expenditure of \$4 million.



Zinc Plant Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Domestic conc. treated	tonnes	54,234	59,856	222,705	228,109
Purchased conc. treated	tonnes	7,035	–	8,461	–
Total conc. treated	tonnes	61,269	59,856	231,166	228,109
Operating costs ¹	\$/tonne	304.84	290.98	298.40	285.31
Zinc produced	tonnes	30,988	30,520	117,966	114,687
Operating costs	¢/lb. Zn	27.30	25.90	26.50	25.70

1. Per tonne of concentrate treated.

2006 Highlights

+3%

Increase in zinc production for 2006, reaching a new record

+3%

Increase in ¢/lb. Zn operating costs due to maintenance costs

\$4M

Capital expenditures; another \$7 million planned for 2007

1st

World's first two-stage pressure leaching facility

Zochem Zinc Oxide



Zochem is our zinc oxide production facility in Brampton, Ontario and is the third largest producer of zinc oxide in North America, accounting for approximately 20% of the North American market. Zochem has an annual production capacity of 45,000 tonnes of zinc oxide, made from approximately 37,000 tonnes of zinc metal.

For the fourth quarter 2006, 6,834 tonnes of our zinc and 1,255 tonnes of zinc purchased from others were processed to produce 9,861 tonnes of zinc oxide. Operating costs per pound of zinc oxide for the quarter were 10% higher than for the fourth quarter 2005 due primarily to lower production volumes.

For 2006, Zochem processed 33,917 tonnes of zinc, of which 32,469 tonnes were from our zinc plant and 1,448 tonnes were purchased from others. Zinc oxide production was 41,378 tonnes.

Operating costs per pound of zinc oxide produced increased by 2% for 2006 compared to 2005.

Planned capital expenditures for 2007 are \$0.9 million compared to \$2 million in 2006.

Zochem Zinc Oxide Facility Data

Production		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Zinc from HudBay	tonnes	6,834	9,224	32,469	31,758
Zinc from others	tonnes	1,255	–	1,448	3,293
Total zinc consumption	tonnes	8,089	9,224	33,917	35,051
Zinc oxide produced	tonnes	9,861	11,340	41,378	42,849
Operating costs	¢/lb. oxide	12.70	11.50	11.80	11.60

2006 Highlights

-3%

Decrease in production for all of 2006 compared to 2005

+2.0%

Increase in operating costs due to lower production rate

\$2M

Capital expenditures; another \$0.9 million planned for 2007

~20%

Zochem's share of the North American market for ZnO

Financial Review

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

(\$000's, except per share data)	2006				2005			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	313,110	346,203	261,727	207,963	173,051	169,264	158,188	151,525
Earnings before taxes	134,636	151,582	94,590	61,643	23,864	27,156	11,412	11,986
Net Earnings	165,788	169,381	152,836	75,986	43,941	23,405	8,691	9,181
Per Common Share								
Basic	1.32	1.37	1.71	0.89	0.52	0.28	0.11	0.12
Diluted ¹	1.29	1.33	1.30	0.70	0.47	0.28	0.11	0.12

1. Based on the treasury method of calculating diluted shares outstanding.

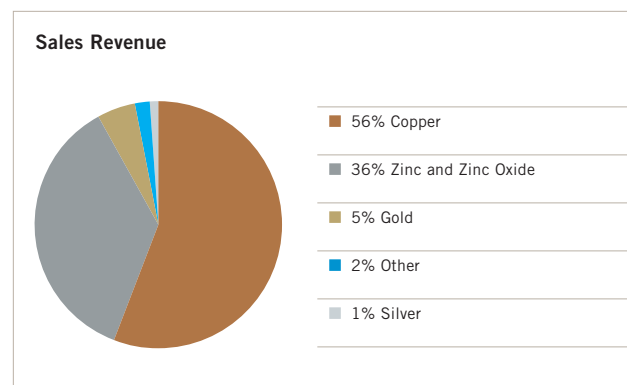
The quantity and mix of metals sold affects our gross sales revenue. The recognition of revenue from metal sales can vary from quarter to quarter due to production levels, shipping volumes and schedules, price determination terms, and risk and title transfer terms with the Company's various customers. As metal sales are primarily based in US dollars, the US dollar weakening against the Canadian dollar over the past eight quarters has reduced the realized Canadian dollar gross sales revenue. As metal prices have increased, revenues and earnings correspondingly increased.

Revenue

Total sales revenue for the quarter ended December 31, 2006 was \$313.1 million from sales of approximately 19,901 tonnes of copper and 29,047 tonnes of zinc (which includes 6,834 tonnes sold to Zochem). In the fourth quarter of 2006, Zochem had sales of approximately 8,861 tonnes of zinc oxide.

During the quarter, realized prices averaged US\$1.93/lb. zinc, US\$3.16/lb. copper, US\$603/oz. gold and US\$11.59/oz. silver before refining costs. The Canadian to US dollar exchange rate averaged C\$1.14 per US\$1.00 for the quarter.

Revenues are affected by production and sales volumes, commodity prices and currency exchange rates. For 2006, total revenue was \$1,129.0 million, resulting from the sale of 108,581 tonnes of zinc (which includes 32,468 tonnes to our Zochem division for use in the production of zinc oxide); 79,395 tonnes of copper; 82,921 ounces of gold and 1,195,142 ounces of silver. For the year, Zochem had sales of approximately 40,501 tonnes of zinc oxide.



During 2006, realized prices averaged US\$1.53/lb. zinc, US\$3.15/lb. copper, US\$603/troy oz. gold and US\$11.13/troy oz. silver before refining costs. The Canadian to US dollar exchange rate averaged C\$1.13 per US\$1.00. These prices were substantially higher than in 2005, as shown in the table below.

Metal Prices

		Three Months Average Prices ¹	Realized Three Months Ended Dec. 31, 2006	Realized Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006 Average Prices ¹	Realized Year Ended Dec. 31, 2006	Realized Year Ended Dec. 31, 2005
Zinc ²	US\$/lb.	1.90	1.93	0.79	1.49	1.53	0.65
Copper	US\$/lb.	3.20	3.16	2.04	3.05	3.15	1.72
Gold	US\$/troy oz.	614	603	465	604	603	445
Silver	US\$/troy oz.	12.61	11.59	7.66	11.57	11.13	7.28

1. LME average for zinc, copper and gold prices, London Spot US equivalent for silver prices.

2. Zinc realized price includes derivative gains effective June 1, 2006 onwards.

Finished metals inventories at the end of 2006 contained approximately 13,800 tonnes of zinc and 4,200 tonnes of copper, which have increased from the 2005 levels of 7,900 for zinc and 1,600 for copper. Approximately 3,600 of the 5,900 zinc increase relates to the agency changeover (see "Agency Arrangement with CMM") whereby title remains with the Company until receipt by the final customer whereas for 2005, 50% of this would have been sold (see below). The balance of the increase was due to a build up in on hand inventory. The increases in copper inventory were primarily due to changes in title transfer terms with customers beginning in 2006, which resulted in a delay in recognition of a sale, as well as a build up in on hand inventory.

Agency Arrangement with CMM

Finished metals and zinc oxide are sold through an agency agreement with CMM, which is based in Toronto and is 50% owned by HudBay. CMM also arranges the purchase of concentrates that are required to ensure our metallurgical plants operate at full capacity. Under the agency contractual arrangement, HudBay retains title to these metals until they are sold to third party customers.

Previous to this agency agreement, HudBay recognized 100% of its sales when its product was shipped from the Flin Flon operations and sold to CMM. In order to enhance the Company's credit capacity under its credit facility, by increasing account receivable and inventory, the Company re-negotiated its contractual relationship with CMM in two phases described below:

- Phase one, as at January 1, 2006, the Company changed its relationship with CMM from a sales to an agency arrangement, whereby copper and precious metal inventory are owned by the Company until sold to customers. The associated one-time change in sales at HBMS' Flin Flon location to the third party customer arrangement reflected in the three months ended December 31, 2005 was approximately 7 weeks, or a reduction to sales of \$36 million and costs of \$27 million.
- Phase two, as at June 1, 2006, the agency agreement was expanded to include zinc, zinc oxide and other miscellaneous products. The associated one-time change in sales during the second quarter of 2006 for the zinc products was approximately \$13 million on sales with a net earnings impact of \$4 million.

Expenses

Operating Expenses

Operating expenses of \$163.7 million in the fourth quarter of 2006 reflected an increase of approximately 34% from operating expenses of \$122.0 million in the fourth quarter of 2005. This increase resulted from higher concentrate purchase costs of \$5.4 million, higher HBMS employee profit sharing expenses (10% of HBMS profit after adjustments) of \$10.2 million, increased pension and retiree health costs of \$3.3 million and other cost increases in the mines and plants of \$5.4 million, including additional maintenance costs and higher costs of consumables (steel, heavy fuel oil, grinding media, etc.). Other unfavourable variances were related to changes in volumes of sales, particularly as the relationship change with CMM resulted in reduced sales due to the timing of revenue recognition. For the quarter, operating costs in the mines and concentrators increased by approximately 7% related to increased operating development, and the zinc plant and copper smelter operating costs increased by approximately 11% compared to the same quarter in 2005.

Total operating costs in 2006 were \$598.1 million, approximately 25% higher than the \$479.2 million for 2005. As noted above, the increased costs related to higher costs of purchased concentrates and profit sharing costs due to higher metal prices, increased pension costs and additional maintenance costs and higher costs of consumables.

For 2007, operating costs are expected to increase as a result of the addition of the Balmat mine (in commercial production) and from additional purchased zinc concentrates associated with the arrangement with Xstrata.

General and Administration ("G&A")

G&A expense for the quarter ended December 31, 2006 was \$7.2 million, compared to \$5.6 million for the same quarter last year. This increase is primarily due to higher consulting costs resulting from additional compliance programs.

Total G&A expenses for 2006 were \$19.8 million compared to \$16.9 million for the previous year, for similar reasons as described in the quarter. For 2007, we expect a slight increase in these expenses related to the Balmat mine operation offset by moderating compliance costs.

Foreign Exchange Gain

For the quarter ended December 31, 2006, the US dollar appreciation increased the value of the Company's US dollar denominated cash resulting in a gain of \$12.9 million compared to a loss of \$0.2 million in the fourth quarter of 2005.

For the full year of 2006, the Company realized a foreign exchange gain of \$11.1 million. This relates primarily to the change in the value of the Company's cash balance, which is held largely in US dollar deposits, and was converted to Canadian dollars at a year end exchange rate of C\$1.17 per US\$1.00, compared to higher rates earlier in the year.

Operating Earnings

For the quarter ended December 31, 2006, operating earnings were \$136.4 million, compared to \$30.3 million for the three months ended December 31, 2005. The increase of \$106.1 million is mainly attributable to higher metal prices, partially offset by increased costs for concentrates, profit sharing accruals, general and administration and other operating expenses. Production volumes for copper were lower and for zinc were higher than in 2005. Sales volumes for copper were higher (mainly due to the change in relationship with CMM in 2005) and for zinc were similar to last year. Exploration expenses have been reclassified and excluded from operating earnings for 2006 and 2005 reporting.

Operating earnings for the year were \$448.5 million, approximately 372% higher than the \$95.1 million for 2005. The higher earnings were primarily due to significantly higher metal prices, higher copper sales volumes, partially offset by lower zinc and gold sales volumes and increased costs as indicated earlier of purchased concentrates and profit sharing expenses.

Exploration Expenses

Surface exploration expenditures of \$3.3 million during the fourth quarter of 2006 were funded primarily by the flow-through share program. The exploration costs for the comparable period in 2005 were \$3.6 million.

For the year ended December 31, 2006, the majority of the \$12.3 million exploration expenditure was funded by flow-through shares. For the year ended December 31, 2005, exploration expenditures of \$11.3 million included \$5.9 million relating to flow-through activity, \$4.1 million for Balmat feasibility costs (including exploration), and \$1.3 million of other costs (primarily non flow-through related expenses).

As indicated above, of the \$45.2 million expenditures planned for 2007, including the Bur deposit of \$8.5 million, the amount expected to be expensed would be \$42 million with the remainder planned to be capitalized mine development.

Foreign Exchange – Long-Term Debt

For the quarter ended December 31, 2006, the Company recorded a foreign exchange loss on long-term debt of \$1.4 million, compared to a loss of \$0.1 million in the previous year. This loss reflects the change in US dollar denominated debt valued at month end exchange rates.

For the year, the Company recorded a foreign exchange gain on long-term debt of \$4.9 million, compared to \$6.8 million in 2005, related to the general appreciation of the Canadian dollar on the US dollar denominated debt.

Gain on Derivative Instruments

In the quarter ended December 31, 2006, the Company recorded a \$4.3 million gain on derivative instruments, compared to a \$3.2 million gain for the comparable quarter in 2005. The derivatives are forward contracts for zinc related to fixed price sales contracts for zinc and to a lesser extent zinc oxide to convert the fixed price zinc sales contract to floating prices. Since the Company elected not to utilize hedge accounting, this gain also includes the mark-to-market improvement on currency option contracts.

For the full year 2006, the Company recorded a \$22.6 million gain on derivatives compared to \$5.3 million in 2005. The gain includes \$1.5 million for the currency option contracts and the remainder represents the gain on the zinc forward contracts.

Interest Expense

Interest expense for the quarter was \$1.3 million, lower than the \$5.2 million expensed in the same quarter in 2005 as a result of long-term debt repurchases and the lower US exchange rate.

For the full year, interest expense was \$11.0 million compared to \$21.9 million for 2005. These costs are due to the repurchase of debt that the Company undertook during the year.

Debt Repurchase

During the quarter, the Company successfully completed a tender offer to repurchase US\$42.2 million of outstanding debt at an average premium of 1.13 resulting in additional costs of US\$5.6 million. Deferred financing fees associated with the debt were expensed in the quarter in the amount of \$1.9 million for a total of \$7.6 million for the year. Since the acquisition of HBMS in 2004, the Company has reduced its US debt notes from US\$175 million to US\$2.9 million as at December 31, 2006, with US\$153.1 million of repurchases occurring in 2006.

Future Income and Mining Tax Assets

In the fourth quarter of 2006, the Company fully recognized the future income tax asset, with the exception of timing differences for long-term obligations that relate primarily to closure and assets that are more unlikely than not to be realized. In 2007, as the Company utilizes the remaining tax pools, the benefit of which is shown as the future income tax asset, the value of this asset is expected to be drawn down and reflected as an income tax expense on the Company's income statement.

In the fourth quarter of 2006, the Company also recognized a future mining tax asset based on the next three future years of expected earnings. Three years are considered appropriate due to the uncertainties of future longer-term metal prices, exchange rates, the magnitude of prior losses, net operating earnings from non-Manitoba sources of ore and the restricted rate of deductions for mining tax purposes. Factors to recognize a future mining tax asset will continue to be reviewed as circumstances change. Similar to the above, the future mining tax asset is expected to be drawn down during 2007, and this reduction will be reflected as a mining tax expense.

For the year, the Company recorded a net benefit of taxes of \$121.5 million, primarily related to the further increase in the income tax asset of \$118.7 million, a recognition of a \$28.1 million mining tax asset, and a \$3.6 million benefit from the renunciation of flow-through shares, offset by a current mining tax expense of \$28.9 million. In 2006, the mining tax pools sheltered approximately \$51 million of mining tax, and the corporate income tax pools, after giving consideration to the deduction for additional mining taxes, sheltered approximately \$167 million of income tax.

Gain on Divestiture of ScoZinc

In December 2005, the Company entered into a letter of intent to sell ScoZinc (Gays River lead and zinc mineral property) to Acadian Gold Corporation for \$7.5 million plus adjustments. The agreement was executed on April 7, 2006, and the sale successfully closed on July 6, 2006, with a net gain of \$1.7 million recognized.

Earnings Analysis of December 31, 2005 to December 31, 2006

(\$ millions)	Three Months Ended Dec. 31, 2006	Twelve Months Ended Dec. 31, 2006
Earnings for the period ended Dec. 31, 2005	43.9	85.2
Changes in earnings components		
Revenues	140.1	477.0
Costs and expenses		
Operating	(41.6)	(118.8)
General and administrative	(1.6)	(2.8)
Stock-based compensation	(0.2)	(3.5)
Depreciation, depletion and amortization	(3.7)	(11.8)
Foreign exchange gain operating	13.1	13.5
Interest expense	3.9	11.0
Exploration	0.2	(1.0)
Foreign exchange gain of long-term debt	(1.4)	(1.9)
Gain on derivative instruments	1.0	17.2
Premium on debenture prepayment	(5.2)	(18.8)
Interest and other income	6.8	13.5
Amortization of deferred financing costs	(0.6)	(5.3)
Taxes		
Future taxes	17.8	124.8
Flow-through share renunciation	–	3.7
Mining taxes	(10.3)	(28.9)
Other taxes	3.5	11.1
Other	0.1	(0.2)
Earnings for the period ended Dec. 31, 2006	165.8	564.0

Cash Cost¹ per Pound of Zinc Sold

HudBay's cash cost of zinc sold, net of by-product credits, for 2006 was negative US\$0.43 per pound.

Non-GAAP Reconciliation of Cash Cost per Pound of Zinc Sold, Net of By-Product Credits

(\$000's except as noted)	Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005 ⁴	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005 ⁴
Expenses	C\$ 176,737	C\$ 143,988	C\$ 680,503	C\$ 558,188
Non-cash operating costs:				
Depreciation and amortization	(17,185)	(13,530)	(64,928)	(53,100)
Stock-based compensation	(906)	(729)	(6,201)	(2,674)
Accretion and other non-cash	(737)	(656)	(2,692)	(2,612)
Foreign exchange gain (loss)	12,935	(162)	11,127	(2,338)
	170,844	128,911	617,809	497,464
Less: By-product credits ²	(185,812)	(111,615)	(734,827)	(450,097)
Cash cost net of by-products	(C\$ 14,968)	C\$ 17,296	(C\$ 117,018)	C\$ 47,367
Exchange rate (C\$/US\$) ³	1.139	1.176	1.134	1.211
Cash cost net of by-products	(US\$ 13,141)	US\$ 14,707	(US\$ 103,190)	US\$ 39,114
Zinc sales (000 lbs.)	64,038	65,252	239,380	252,760
Cash cost per pound of zinc, net of by-product credits in US\$/lb.	(US\$ 0.21)	US\$ 0.23	(US\$ 0.43)	US\$ 0.16

1. Cash cost per pound of zinc sold, net of by-product credits, is furnished to provide additional information. It is a non-GAAP measure that does not have a standardized meaning and is therefore unlikely to be comparable to similar measures presented by other issuers. This measure should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles and is not necessarily indicative of operating expenses as determined under generally accepted accounting principles. This measure is intended to provide investors with information about the cash generating capabilities of the Company's operations. The Company uses this information for the same purpose. This analysis excludes capital expenditures.
2. By-product credits include revenues from sale of copper, gold, silver, the premium on zinc oxide sales and the Company's proportionate share of by-product sales by CMM.
3. Weighted average exchange rate for sales during the period.
4. As reported in the 2005 Consolidated Financial Statements, before reclassification change of \$1,284 from operating costs.

The table above shows a US\$0.44 per pound net decrease in the cash cost per pound of zinc for the quarter ended December 31, 2006 compared to the quarter ended December 31, 2005. The US\$0.44 decrease per pound of zinc consists of a favourable by-product credit increase of approximately US\$1.10 per pound of zinc sold, offset by an increase of US\$0.62 for higher costs (largely due to higher prices for purchased concentrates and profit sharing) and US\$0.04 for the impact of the changes in foreign exchange rates.

For the full year 2006, there was an US\$0.59 per pound net decrease in the cash cost per pound of zinc compared to 2005. The US\$0.59 decrease per pound of zinc consists of a favourable by-product credit variance of approximately US\$1.17 per pound of zinc sold, offset by unfavourable variances of US\$0.48 for higher costs (largely due to higher prices for purchased concentrates and profit sharing), US\$0.09 for the impact of the changes in foreign exchange rates, and US\$0.01 for decreased zinc sales volumes.

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

Operating Costs

		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Mines					
777	\$/tonne	36.14	40.46	35.85	37.60
Trout Lake	\$/tonne	48.51	39.11	41.74	35.43
Chisel North	\$/tonne	53.57	48.23	51.37	42.40
Konuto ¹	\$/tonne	–	39.80	–	36.42
Total mines	\$/tonne	42.47	40.92	39.78	37.36
Concentrators					
Flin Flon	\$/tonne	8.80	7.95	8.61	7.93
Snow Lake	\$/tonne	22.78	19.80	19.69	17.35
Metallurgical Plants					
Copper Smelter	\$/lb. Cu	0.293	0.248	0.264	0.25
White Pine Copper Refinery	US\$/lb. Cu	0.073	0.078	0.066	0.064
Zinc Plant	\$/lb. Zn	0.273	0.259	0.265	0.26
Zochem	\$/lb. ZnO	0.127	0.115	0.118	0.116
Non-GAAP Reconciliation of Operating Expenses (C \$000's)					
Mines					
777		13,084	12,466	49,022	41,119
Trout Lake		11,087	8,407	35,013	30,425
Chisel North		4,401	3,906	16,611	14,278
Konuto		(14)	2,090	51	11,380
Concentrators					
Flin Flon		5,011	4,501	19,431	17,934
Snow Lake		1,852	1,638	6,402	5,749
Metallurgical Plants					
Copper Smelter		14,995	13,009	51,405	46,975
White Pine Copper Refinery		3,281	–	11,590	–
Zinc Plant		18,678	17,416	68,981	65,082
Other					
Purchased Concentrate Treated		56,438	50,998	235,926	161,906
Anode Freight & Refining ²		(850)	4,936	7,060	22,893
Services & Administration		10,660	7,084	32,908	26,353
Care & Maintenance		(161)	620	787	3,440
HBMS Employee Profit Sharing		14,447	4,223	47,295	10,442
Other ³		10,782	(9,249)	15,571	21,258
Total Operating Expenses, per financials		163,691	122,045	598,053	479,234

1. Konuto was depleted of ore and closed in November 2005. Stockpiled ore continued to be processed until August 2006.

2. During the quarter, refining costs deducted from metal sales invoices have been reclassified to sales deductions.

3. Includes changes in domestic inventory, share of CMM costs and miscellaneous provisions.

Cash Flows, Liquidity and Capital Resources

The following table summarizes our cash flows for the three and twelve-month periods ended December 31, 2006 and 2005.

Operating Activities

(\$000's)	Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Net earnings for the period	165,788	43,941	563,991	85,218
Items not affecting cash	(17,280)	(11,592)	(73,194)	37,953
Net change in non-cash items	(4,083)	24,805	(66,871)	21,691
Cash required for operating activities	144,425	57,154	423,926	144,862
Cash required for financing activities	(44,218)	(22,736)	(44,522)	(7,368)
Cash required for investing activities	(33,236)	(19,478)	(135,686)	(57,430)
Effect of exchange rate changes on cash and equivalents	7,882	840	486	(2,957)
Increase in cash and cash equivalents	74,853	15,780	244,204	77,107

As of December 31, 2006, HudBay had cash and cash equivalents of \$385.9 million, compared to \$141.7 million as at December 31, 2005. As at December 31, 2006, there were outstanding letters of credit in the amount of \$34.3 million.

Cash flow from operating activities totaled \$144.4 million for the quarter ended December 31, 2006, compared to \$57.2 million for the quarter ended December 31, 2005, primarily due to significantly higher realized metal prices. Significant changes in non-cash working capital affecting the quarterly cash flow were increases in accounts receivable of \$12.4 million, due to higher metal prices, offset by increased taxes payable of \$19.9 million.

For the full year of 2006, cash flow from operating activities totaled \$423.9 million, approximately 193% higher than the \$144.9 million for 2005. This increase reflects the significant increase in earnings due to higher realized metal prices, offset by changes to non-cash working capital due to the increase in receivables, inventory and payables.

Financing Activities

Financing activities in the quarter resulted in cash outflows of \$44.2 million, with \$48.5 million used to retire long-term debt. Net proceeds of \$5.3 million were generated from the exercise of warrants and stock options.

For the year ended December 31, 2006, cash outflows required for financing activities were \$44.5 million. This included \$173.1 million used to retire long-term debt with an offset of \$136.4 million generated from the exercise of warrants and stock options. By July 2006, our early exercise warrant incentive transaction resulted in 97.2% of the Company's formerly publicly traded warrants being exercised early and converted to common shares. The warrants were delisted from the Toronto Stock Exchange at the conclusion of the early exercise warrant transaction. As at December 31, 2006, only a small number of warrants remained outstanding.

Investing Activities

In the fourth quarter, \$26.4 million was invested in property, plant and equipment additions, at levels similar to the same period last year. The Company also invested \$6.8 million in marketable securities.

For the twelve months ended December 31, 2006, additions to property, plant and equipment were higher than in the same period in 2005, with increases in improvement expenditures in the smelter and zinc plant associated with the planned shutdown activities, along with \$28.1 million in expenditures at the Balmat mine.

As at December 31, 2006, HudBay had long-term debt (excluding the current portion) of \$10.2 million, significantly reduced from December 31, 2005 due primarily to the repurchases of US debt.

Cash inflow for the fourth quarter was \$74.9 million, significantly higher than the cash inflow of \$15.8 million for the same quarter in 2005. For the twelve months ended December 31, 2006, cash inflow was \$244.2 million compared to cash inflow of \$77.1 million for the twelve months ended December 31, 2005. The significant improvements in both periods were due to higher cash earnings and net proceeds from exercise of warrants offset by repayment of debt.

Financial Condition

Financial Condition at December 31, 2006 Compared to Financial Condition as at December 31, 2005

Cash and cash equivalents increased to \$385.9 million as at December 31, 2006 from \$141.7 million as at December 31, 2005. Cash generated from operations was \$423.9 million, with \$119.3 million used for additions to property, plant and equipment and project capital expenditures for the Balmat mine and \$17.0 million used for the purchase of White Pine Copper Refinery. Cash of \$136.4 million was generated from the exercise of warrants and options and the issuance of flow through shares. Cash was used to pay down debt in the amount of \$177.1 million and capital leases in the amount of \$3.8 million.

Working capital improved by \$438.6 million. This includes the \$244.2 million increase in cash and cash equivalents and the \$127.9 million increase in the Company's current portion of future tax assets. In addition, accounts receivable increased due to copper cathode being sold directly to end users, increased metal prices for all receivables and the contractual change with CMM. Inventory increased due to higher copper cathode on hand, reflecting the increased transit time to deliver product to direct customers, and higher zinc and zinc oxide inventory, resulting from the contractual change with CMM as well as an increase in inventory on hand. Interest payable decreased as a result of debt reductions. Accounts payable increases were principally due to higher mining tax and profit sharing accruals.

Share capital increased by \$135.9 million primarily from the early exercise of the warrants, flow-through share issuance and exercise of stock options during 2006.

During the year ended December 31, 2006, the Company increased HBMS's revolving credit facility from \$25 million to \$50 million and extended the maturity date to January 30, 2007, after successfully repurchasing debt and changing its contract with CMM in 2006. In January 2007, the Company increased its revolving credit facility to \$80 million and extended the maturity date to April 30, 2007.

As a result of the reduction in long-term debt in 2006, the estimated future interest expenditures will be minimal as compared to the previously stated \$17.5 million per year.

Closure and Environmental Reclamation Provisions

HudBay has completed an evaluation of the closure and reclamation plans for its Manitoba and Saskatchewan operations to a feasibility level of accuracy together with a review of other potential environmental costs, utilizing major Canadian environmental engineering firms.

Based on the results of the evaluations to date, HudBay is satisfied that current financial statement provisions for closure and environmental reclamation obligations in Manitoba, Saskatchewan and elsewhere, are adequate and appropriate. The HudBay financial statement provision for closure and environmental reclamation has been adjusted to reflect the estimates of \$60.3 million, which has been recorded as a net present value of \$33.5 million. These provisions may be modified based on further review by HudBay and requirements of the Provincial and Federal Governments.

Contractual Obligations and Commitments

Contractual Obligations

The following table summarizes, as at December 31, 2006, certain of our contractual obligations for the period specified.

PAYMENT SCHEDULE

(\$000's)	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	After 5 Years
Interest on long-term debt obligations	1,787	325	650	650	162
Long-term debt obligations	14,880	4,000	7,500	–	3,380
Capital lease obligations	9,607	4,429	5,077	101	–
Operating lease obligations	1,928	800	791	337	–
Purchase obligations	9,607	9,607	–	–	–
Pension and other employee future benefits obligations	125,594	18,836	34,000	25,500	47,258
Asset retirement obligations ¹	60,300	1,300	1,300	1,600	56,100
Total	223,703	39,297	48,527	28,642	107,237

1. Before inflation and market risk.

Commitments

(a) Buy-sell commitments:

The Company has a commitment to purchase copper concentrate based on a schedule of payments rather than actual physical delivery. The contract requires delivery of 72,000 dry metric tonnes annually for 2007 and 2008.

The Company also has a long-term agreement for the purchase of 10% of another mine's concentrate, or approximately 13,000 dry metric tonnes in 2006, and 20% of annual production or approximately 26,000 dry metric tonnes each year thereafter. The term of this agreement is from 2007 to 2015 and is subject to certain termination rights effective after December 31, 2008.

The Company has an agreement to sell all the concentrate produced from the Balmat Mine for the life of the mine, anticipated to be from June 2006 to 2014.

The Company has another agreement with the same party as indicated above to buy suitable concentrates to be delivered to Flin Flon in quantities up to 40% of the Balmat life of mine concentrate production.

Payment for the above-mentioned purchased concentrates is based on the market price of contained metal during a quotational period following delivery of the concentrate, less a fixed treatment and refining credit. If the Company cannot process the deemed 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.

(b) Other commitments and agreements:

- (i) On the majority of the 777 mine, 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. Although the cumulative cash flow has been negative to date, it may be positive in the future.
- (ii) HBMS has a profit-sharing plan, whereby 10% of HBMS's after-tax net earnings (excluding provisions or recoveries for future income and mining tax) calculated in accordance with Canadian generally accepted accounting principles for any given fiscal year will be distributed to all employees in the Flin Flon/Snow Lake operations, with the exception of executive officers and key management personnel. This expense has been accrued in the consolidated financial statements.
- (iii) HBMS entered into a security agreement dated March 31, 1999 in favour of the Province of Saskatchewan in respect of its reclamation undertakings in Saskatchewan. As security for the implementation of decommissioning plans in respect of its undertakings in Saskatchewan, HBMS has granted to the Province of Saskatchewan a first priority security interest in its mining equipment, buildings and fixtures and a first charge on all proceeds derived from any dealings with such mining equipment, buildings and fixtures. In addition, HBMS has a security agreement dated May 7, 2004 in favour of the Province of Manitoba in respect of its reclamation undertakings in Manitoba. As security for the implementation of a decommissioning plan in respect of its undertakings in Manitoba, HBMS has granted to the Province of Manitoba a first priority security interest in its mining equipment, buildings and fixtures owned by HBMS and located on the lands and a first charge on all proceeds derived from any dealings with such mining equipment, buildings and fixtures relating to the Flin Flon metallurgical complex and 777 mine. The salvage value of these assets is estimated at between \$45.3 and \$65.3 million and is adjusted annually and re-estimated at least every five years. The security interests granted to the Provinces of Saskatchewan and Manitoba rank *pari passu*.

The Company has completed a study of reclamation costs (see note 11 to the consolidated financial statements). The Company believes the existing security provided is adequate and sufficient. However, the Company has provided additional security to the Provinces of Saskatchewan and Manitoba in the form of letters of credit in the amount of \$13 million.

- (iv) 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.

- (v) The Company has outstanding letters of credit in the amount of \$34.3 million (including the \$13 million for extra security to the provinces for the environmental reclamations).
- (vi) In 2003, the Company established a wholly-owned subsidiary, St. Lawrence Zinc Company LLC ("St. Lawrence"). St. Lawrence was incorporated in the State of New York for the purposes of acquiring the Balmat zinc mine.

On September 24, 2003, St. Lawrence purchased the Balmat zinc mine and related assets located in upper New York state. Total consideration paid consisted of a cash deposit of US\$1 million required to assume an environmental bond. In addition, the asset purchase agreement requires the Company to pay a cash purchase price out of 30% of future net free cash flow from Balmat mine operations, after allowing for reasonable capital and exploration expenditures. The cash purchase price is subject to a "Cap" of US\$20 million subject to an increase to US\$25 million if the monthly average special high grade settlement price of zinc, as quoted by the LME, averages US\$0.70 or greater during any consecutive 24-month period after the closing date and prior to the fifth anniversary of the date on which the seller receives payment of the US\$20 million. During 2006, those requirements were met, and the Cap was increased to US\$25 million.

The Balmat mine operations have not commenced commercial production as at December 31, 2006 and, based on the purchase agreement calculation (which includes deduction of reasonable capital and exploration expenditures), the mine did not generate positive cash flow for the year ended December 31, 2006. Accordingly, no cash purchase price has been accrued in the financial statement relating to the 2006 fiscal year.

As at December 31, 2006, due to variability of future zinc prices and zinc grades, a reasonable estimate cannot be made of the amount of any cash purchase price to be paid with respect to net free cash flow in future years, and consequently no accrual has been recorded in the financial statements. The cash purchase price will be accrued as additional property, plant and equipment cost when management is able to quantify the amounts to be paid at the year end date.

- (vii) On a portion of the Balmat mine, the Company is subject to royalty payments of up to 4% of the net smelter return of ore removed from these properties.
- (viii) 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.
- (ix) 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 2012 in the event that negotiated CBA settlements are not achieved.

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 judgement is applied include ore reserve determinations used in amortization of capitalized mine development, in-process inventory quantities, plant and equipment estimated economic lives and salvage values, contingent liabilities, future income and mining tax, assets and valuation reserves, 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, as the adjustments become necessary, they are reported in earnings in the period in which they became known.

Mineral Reserves and Mineral Resources

Mineral reserves and mineral resources are estimated 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 metal prices. The costs of mineral properties and mine development are capitalized and amortized by the unit-of-production basis, based on related proven and probable mineral reserves.

Impairment

The carrying value of our operating mines and plant and equipment is periodically reviewed for impairment when events or changes in circumstances indicate that the carrying amounts of related assets or groups of assets may not be recoverable. If total estimated future cash flows on an undiscounted basis are less than the carrying amount of the asset, an impairment loss is measured and recorded to write down the asset to its fair value which is normally the discounted value of future cash flows.

In-Process Inventories

In-process concentrates and metal inventory quantities comprise the majority of our inventories by value, and represent materials that are in the process of being converted into saleable product. Measurement of in-process inventories is based on assays of material received at our metallurgical plants and estimates of recoveries in the production processes. Realizable value of in-process inventories is estimated at financial statement dates and inventories are carried at the lower of cost and estimated net realizable value.

Future Tax Assets and Liabilities

We use the asset and liability method of tax allocation for accounting for income taxes. Under the liability method, 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 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 our future tax assets quarterly by assessing its valuation allowance and by adjusting the amount of such valuation allowance, if necessary. The factors used to assess the likelihood of realization are 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. Decommissioning costs are estimated and provided for, along with an identical decommissioning asset, when a new mine or plant is placed into commercial production. Accretion costs are over the life of each associated operating mine or plant. The accrued liability amounts are increased by an annual interest component such that at the end of the asset life the provision is equal to the balance estimated to be paid at that date.

In view of the uncertainties concerning these future obligations, the ultimate timing and cost of reclamation and mine closure may differ materially from our estimates.

Pensions and other Employee Future Benefits

Our on-going health care benefit plans comprise the majority of post-retirement obligations. The obligations relating to these plans, together with pension plans maintained by us, 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.

Outstanding Share Data

As of March 7, 2007, there were 126,181,252 common shares of the Company issued and outstanding, as well as 90,521 warrants (pre-consolidated) exercisable for a maximum aggregate of 3,017 common shares. In addition, options for an aggregate maximum of 3,012,437 common shares were outstanding.

Disclosure Controls

Disclosure Controls and Procedures

The Canadian Securities Administrators have issued Multilateral Instrument 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 effectiveness of the disclosure controls and procedures that are in use at the Company. 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 Chief Executive Officer and the Chief Financial Officer, 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, 2006, management has evaluated the effectiveness of the design and operation of the disclosure controls and procedures as defined by Multilateral Instrument 52-109. This evaluation was performed under the supervision of and with the participation of the Chief Executive Officer and the Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of the disclosure controls and procedures were effective as of December 31, 2006.

Internal Control Over Financial Reporting

Multilateral Instrument 52-109 also requires Canadian public companies to submit an annual certificate relating to the design of internal control over financial reporting. Internal control over financial reporting 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 internal control over financial reporting and management, including the CEO and the CFO, has evaluated the design of the internal control over financial reporting at December 31, 2006 and based on this evaluation, management has concluded that the design of internal control over financial reporting was effective as of December 31, 2006.

Changes in Internal Control over Financial Reporting

Multilateral Instrument 52-109 also requires Canadian public companies to disclose in their MD&A any change in internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect internal control over financial reporting.

Management has determined that there have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

Risks, Uncertainties and Other Information

Readers are encouraged to read and consider the risk factors, and additional information regarding the Company, included in its most recent Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com.

Forward-looking Statements

This document contains “forward-looking information”, within the meaning of applicable Canadian securities legislation, concerning the business, operations and financial performance and condition of HudBay. Forward-looking information involves a number of risks and uncertainties. Forward-looking information includes, but is not limited to, statements with respect to the future price of commodities, the estimation of mineral reserves and resources, the realization of mineral estimates, the timing and amount of estimated future production, costs of production, capital and committed expenditures, costs and timing of the development of new deposits, timing and success of exploration activities, acquisitions, currency fluctuations and its impact, the planned price protection program for the Bur deposit, requirements for additional capital, government regulation of mining operations, taxation policies, reserves and pools, and environmental remediation plans. 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”, “anticipates” or “does not anticipate”, or “believes”, or variations of such words and phrases or state 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 they are 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 but not limited to risks related to: the mining industry such as the integration of acquisitions, international operations, exploration, government regulation, environmental and reclamation risks, title disputes or claims, success of exploration activities, future commodity prices, costs of production, possible variations in ore reserves, resources, grade or recovery rates, failure of plant, equipment or processes to operate as anticipated, accidents, labour disputes and the availability of skilled labour, delays in the completion of development or construction activities, the timing and amount of estimated future production, capital expenditures, financial market fluctuations, requirements for additional capital, conclusions of economic evaluations, limitations on insurance coverage, inflation and risks associated with acquisitions as well as those factors discussed in the section entitled “Risk Factors” in HudBay’s Annual Information Form for the year ended December 31, 2005, available under the profile of HudBay at www.sedar.com. 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 such 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 in accordance with applicable securities laws.

Certain items of financial information in this MD&A, including operating cash flow per common share, unit operating expenses, and cash cost per pound of zinc, net of by-product credits, are non-GAAP measures and are furnished to provide additional information. As non-GAAP measures, they neither have standardized meanings nor are they necessarily comparable with similar measures presented by other companies. These measures are not necessarily indicative of operating expenses as determined under GAAP, and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. These measures are intended to provide investors with information about the cash generating capabilities of the Company’s operations. Management uses this information for the same purpose. Mining operations are capital intensive. These measures exclude capital expenditures. Capital expenditures are discussed throughout the MD&A and the consolidated financial statements.

Appendix – Production

A summary of production statistics for the fourth quarter of 2006, as well as year-to-date data, together with comparative information for 2005 is shown in the following table.

Fourth Quarter Results

		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Mines					
777					
Ore	tonnes	362,042	308,099	1,367,548	1,093,683
Copper	%	2.99	2.28	2.81	2.24
Zinc	%	4.07	5.10	4.81	4.47
Gold	g/tonne	2.91	2.06	2.43	2.09
Silver	g/tonne	26.13	24.56	25.61	23.83
Trout Lake					
Ore	tonnes	228,539	214,981	838,862	858,751
Copper	%	2.31	1.79	2.18	1.39
Zinc	%	2.86	3.86	3.65	5.61
Gold	g/tonne	1.28	1.32	1.28	1.47
Silver	g/tonne	11.19	13.35	13.53	14.61
Chisel North					
Ore	tonnes	82,148	80,996	323,379	336,731
Zinc	%	8.83	8.97	8.56	9.00
Konuto ¹					
Ore	tonnes	nil	52,522	nil	312,465
Copper	%	nil	3.30	nil	3.90
Zinc	%	nil	2.36	nil	1.81
Gold	g/tonne	nil	1.73	nil	1.65
Silver	g/tonne	nil	11.46	nil	9.17
Total Mines					
Ore	tonnes	672,729	656,598	2,529,789	2,601,630
Copper	%	2.41	1.94	2.26	1.89
Zinc	%	4.24	4.95	4.91	5.11
Gold	g/tonne	2.06	1.59	1.84	1.64
Silver	g/tonne	20.51	19.95	20.99	19.40

1. Konuto mine closed in the fourth quarter of 2005.

Fourth Quarter Results

		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Concentrators					
Flin Flon Concentrator					
Ore	tonnes	569,516	566,445	2,258,146	2,262,555
Copper	%	2.75	2.23	2.58	2.14
Zinc	%	3.70	4.32	4.36	4.53
Gold	g/tonne	2.28	1.75	1.99	1.78
Silver	g/tonne	20.56	19.01	20.99	18.14
Copper concentrate					
Concentrate grade	Cu %	24.58	23.99	24.90	23.82
Zinc concentrate					
Concentrate grade	Zn %	52.42	52.15	51.92	51.51
Copper recovery	%	92.9	93.7	93.4	92.8
Gold recovery	%	68.4	72.5	70.7	74.9
Silver recovery	%	63.4	66.1	63.5	66.3
Zinc recovery	%	83.1	81.2	85.1	82.6
Snow Lake Concentrator					
Ore	tonnes	81,305	82,729	325,114	331,427
Zinc	%	8.84	9.00	8.59	9.00
Zinc concentrate					
Concentrate grade	Zn %	51.65	51.21	51.40	51.25
Zinc recovery	%	97.6	97.1	97.6	97.3

Fourth Quarter Results

		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Smelter					
Copper Concentrate Treated					
Domestic	tonnes	58,455	55,172	218,267	206,342
Purchased	tonnes	20,835	28,828	85,305	111,936
Total	tonnes	79,290	84,000	303,572	318,278
White Pine					
Anodes received	tonnes	21,759	22,316	85,567	84,314
Cathode produced	tonnes	17,719	17,230	69,878	67,180
Spent anode produced	tonnes	3,254	3,146	12,875	12,680
Liberator anode produced	tonnes	601	630	2,439	2,638
Slimes produced	tonnes	51	54	201	198
Zinc Plant					
Zinc Concentrate Treated					
Domestic	tonnes	54,234	59,856	222,705	228,107
Purchased	tonnes	7,035	–	8,461	–
Total	tonnes	61,269	59,856	231,166	228,107
Zinc Oxide					
Zinc from HudBay	tonnes	6,834	9,224	32,469	31,758
Zinc from others	tonnes	1,255	–	1,448	3,293
Total zinc consumption	tonnes	8,089	9,224	33,917	35,051
Zinc oxide produced	tonnes	9,861	11,340	41,378	42,849

Fourth Quarter Results

		Three Months Ended Dec. 31, 2006	Three Months Ended Dec. 31, 2005	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Metal Produced¹					
Metal from HudBay Concentrates					
Copper	tonnes	15,317	13,822	56,698	49,179
Zinc	tonnes	27,419	30,485	113,637	114,557
Gold	troy oz.	27,563	25,311	95,980	100,144
Silver	troy oz.	245,328	264,259	962,743	916,810
Metal from HudBay Purchased Concentrates					
Copper	tonnes	7,877	9,985	31,527	37,106
Zinc ²	tonnes	3,569	35	4,329	131
Gold	troy oz.	580	546	1,972	1,927
Silver	troy oz.	97,635	137,131	382,184	493,702
Total Produced Metal					
Copper	tonnes	23,194	23,807	88,225	86,285
Zinc	tonnes	30,988	30,520	117,966	114,688
Gold	troy oz.	28,143	25,877	97,952	102,371
Silver	troy oz.	342,963	401,390	1,344,927	1,410,512
Balmat					
Zinc metal in concentrate for sale ³	tonnes	4,003	—	9,037	—
Metal in equivalent concentrate purchased by HudBay ^{2,3}	tonnes	(3,032)	—	(3,750)	—
Total Produced ⁴					
Copper	tonnes	23,194	23,807	88,225	86,285
Zinc	tonnes	31,959	30,520	123,253	114,687
Gold	troy oz.	28,143	25,877	97,952	102,371
Silver	troy oz.	342,963	401,390	1,344,927	1,410,512
Metal Sold⁵					
Copper	tonnes	19,901	17,644	79,395	78,070
Zinc, incl. sales to Zochem ⁶	tonnes	32,386	29,598	114,646	114,682
Gold	troy oz.	22,112	21,783	82,921	95,511
Silver	troy oz.	295,545	358,434	1,195,142	1,321,784

1. Metal from HudBay 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. Includes 3,750 tonnes from metal in Balmat equivalent purchased concentrates, purchased from Xstrata. Through an arrangement to decrease costs, HudBay sells all concentrates from its Balmat zinc mine to Xstrata, and elects annually to purchase up to 50% of Balmat equivalent concentrates from Xstrata.
3. Metal in concentrate produced in 2006 prior to commercial production.
4. Includes production of metal and metal in concentrate.
5. Excludes inventory changes at CMM.
6. Production includes Balmat metal in concentrate and sales include Balmat payable metal in concentrate shipped (including to HBMS) for which proceeds are credited to capital as pre-commercial production revenues, and therefore not included in metals sold for financial reporting purposes.

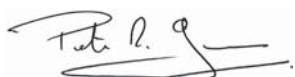
Management's Responsibility for Financial Reporting

All information in the Annual Report, including the accompanying financial statements and management's discussion and analysis of the consolidated financial position and results of operations ("MD&A") of the Company, is the responsibility of the management of the Company. The consolidated financial statements and the MD&A were prepared by management in accordance with accounting principles and MD&A disclosure requirements generally accepted in Canada, and the financial information contained elsewhere in the Annual Report conforms to the consolidated financial statements and MD&A.

The preparation of financial statements and MD&A requires the selection of appropriate generally accepted accounting principles and the use of estimates and judgment by management to present fairly and consistently the consolidated financial position and results of operations of the Company. Estimates are necessary when transactions affecting the current accounting period cannot be finalized with certainty until future periods. In management's opinion, such estimates have been properly reflected in the consolidated financial statements and MD&A. Systems of internal accounting controls are designed and maintained by management in order to provide reasonable assurance, on a cost-effective basis, of the reliability of this financial information.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements and MD&A. The Board carries out this responsibility principally through its Audit Committee ("Committee") composed of three directors, none of whom are members of management. The Committee meets periodically with management and the Company's independent auditors to discuss internal controls over the financial reporting issues and to review the consolidated financial statements, the MD&A and the independent auditors' report to shareholders. The Committee reports its findings to the Board for consideration when approving the consolidated financial statements and MD&A for issuance to shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the engagement or re-appointment of the Company's independent auditors.

The consolidated financial statements have been audited on behalf of the shareholders by the Company's independent auditors, Deloitte & Touche LLP, Chartered Accountants, in accordance with Canadian generally accepted auditing standards. The auditors' report, dated March 7, 2007, outlines the scope of their examination and their opinion on the consolidated financial statements.



Peter R. Jones, P.Eng.
President & Chief Executive Officer



Jeff A. Swinoga, CA, MBA
Vice-President & Chief Financial Officer

Auditors' Report

To the Shareholders,
HudBay Minerals Inc.

We have audited the consolidated balance sheets of HudBay Minerals Inc. as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte + Touche LLP.

Chartered Accountants
Winnipeg, Manitoba

March 7, 2007

Consolidated Statements of Earnings

(In thousands of Canadian dollars, except share and per share amounts) Years ended December 31, 2006 and 2005

	2006	2005
Revenue	\$ 1,129,003	\$ 652,028
Expenses:		
Operating	598,053	479,234
Depreciation and amortization	64,928	53,100
General and administrative	19,756	16,946
Stock-based compensation (Note 14d)	6,201	2,674
Accretion of asset retirement obligation (Note 11)	2,692	2,612
Foreign exchange (gain) loss	(11,127)	2,338
	680,503	556,904
Operating earnings	448,500	95,124
Gain on derivative instruments (Note 16a,b)	22,558	5,319
Other income (Note 22)	17,450	3,996
Foreign exchange gain on long term debt	4,907	6,825
Amortization of deferred financing fees	(7,610)	(2,342)
Interest expense	(10,971)	(21,939)
Exploration	(12,311)	(11,281)
Premium on long-term debt prepayment (Note 8a)	(20,072)	(1,284)
Earnings before income taxes	442,451	74,418
Tax benefit (Note 13a)	121,540	10,800
Net earnings for the year	\$ 563,991	\$ 85,218
Earnings per share:		
Basic	\$ 5.32	\$ 1.04
Diluted	4.69	1.01
Weighted average number of common shares outstanding (Note 14f):		
Basic	105,979,721	82,008,190
Diluted	120,334,201	84,767,082

See accompanying notes to consolidated financial statements.

Consolidated Statements of Retained Earnings

(In thousands of Canadian dollars) Years ended December 31, 2006 and 2005

	2006	2005
Retained earnings (deficit), beginning of year	\$ 78,732	\$ (6,486)
Net earnings for the year	563,991	85,218
Retained earnings, end of year	\$ 642,723	\$ 78,732

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

(In thousands of Canadian dollars) December 31, 2006 and 2005

	2006	2005
Assets:		
Current assets:		
Cash and cash equivalents	\$ 385,864	\$ 141,660
Accounts receivable	132,275	44,698
Inventories (Note 4)	163,842	116,596
Prepaid expenses	7,288	3,625
Current portion of fair value of derivatives (Note 16a,b)	2,579	4,483
Future income and mining tax assets (Note 13b,c)	154,063	26,200
	845,911	337,262
Property, plant and equipment (Note 5)	444,044	378,207
Other assets (Note 6)	28,560	13,284
	\$ 1,318,515	\$ 728,753
Liabilities and Shareholders' Equity:		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 140,449	\$ 91,930
Interest payable on long-term debt	149	8,004
Taxes payable	30,217	—
Future income taxes payable (Note 13a)	543	—
Current portion of other liabilities (Note 7)	26,868	28,211
	198,226	128,145
Long-term debt (Note 8)	10,214	191,493
Pension obligation (Note 9)	41,675	46,743
Other employee future benefits (Note 10)	65,083	61,250
Asset retirement obligations (Note 11)	33,548	29,219
Obligations under capital leases (Note 12)	4,979	9,011
Future income tax liabilities (Note 13b)	582	1,666
	\$ 354,307	\$ 467,527
Shareholders' equity:		
Share capital:		
Common shares (Note 14b)	308,441	143,611
Warrants (Note 14c)	3	28,931
Contributed surplus (Note 14e)	13,098	10,015
Cumulative translation adjustment	(57)	(63)
Retained earnings	642,723	78,732
	964,208	261,226
	\$ 1,318,515	\$ 728,753

Contingencies (Note 15), Commitments (Note 19), Subsequent events (Note 23).

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Allen J. Palmiere
Director



Ronald P. Gagel
Director

Consolidated Statements of Cash Flows

(In thousands of Canadian dollars) Years ended December 31, 2006 and 2005

	2006	2005
Cash provided by (used in):		
Operating activities:		
Net earnings for the year	\$ 563,991	\$ 85,218
Items not affecting cash:		
Depreciation and amortization	64,928	53,100
Future tax benefit	(151,588)	(11,858)
Unrealized foreign exchange gain	(5,393)	(4,012)
Amortization of deferred financing costs	7,610	2,342
Accretion expense on asset retirement obligation	2,692	2,612
Stock-based compensation (Note 14d)	6,201	2,674
Unrealized portion of change in fair value of derivative	3,114	(562)
Gain on divestiture of ScoZinc (Note 22)	(1,655)	–
Other	897	(6,343)
	490,797	123,171
Change in non-cash working capital (Note 20a)	(66,871)	21,691
	423,926	144,862
Financing activities:		
Repayment of senior secured notes (Note 8a)	(173,142)	(21,953)
Repayment of obligations under capital leases (Note 12)	(3,825)	(3,672)
Repayment of loans payable (Note 8b)	(4,000)	(2,000)
Deferred financing cost	–	(350)
Issuance of common shares, net of costs (Note 14b)	16,771	20,607
Proceeds of exercise of stock options (Note 14d)	8,306	–
Proceeds on exercise of warrants (Note 14b,c)	111,368	–
	(44,522)	(7,368)
Investing activities:		
Additions to property, plant and equipment	(119,250)	(70,924)
Acquisition of White Pine Copper Refinery, Inc., net of cash acquired (Note 3)	(17,041)	–
Decrease in restricted cash	–	13,000
Additions to environmental deposits	16	31
Divestiture of ScoZinc (Note 22)	7,412	–
Sale of investments	–	463
Purchase of investments	(6,823)	–
	(135,686)	(57,430)
Effect of exchange rate changes on cash and cash equivalents	486	(2,957)
Change in cash and cash equivalents	244,204	77,107
Cash and cash equivalents, beginning of year	141,660	64,553
Cash and cash equivalents, end of year	\$ 385,864	\$ 141,660
Cash and cash equivalents is comprised of:		
Cash on hand and demand deposits	\$ 157,655	\$ 55,272
Short term money market instruments	228,209	86,388
	\$ 385,864	\$ 141,660

For supplemental information, see Note 20.

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Amounts in thousands of Canadian dollars, except share and per share data) Years ended December 31, 2006 and 2005

Note 1 Nature of Business

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

Note 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 and its wholly-owned subsidiaries. The significant subsidiaries include Hudson Bay Mining and Smelting Co., Limited (“HBMS”), Hudson Bay Exploration and Development Company Limited (“HBED”), White Pine Copper Refinery Inc. (“WPCR”), HudBay Marketing and Sales Inc. (“HMS”) and a 50% ownership of Considar Metal Marketing SA Inc. (“CMMSA”). Inter-company accounts and transactions have been eliminated on consolidation. The proportionate share of the assets and liabilities of any joint ventures in which the Company shares joint control has also been included.

(b) 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 judgement is applied include ore reserve determinations used in amortization of capitalized mine development, in-process inventory quantities, plant and equipment estimated economic lives and salvage values, contingent liabilities, future income and mining tax, assets and valuation reserves, 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, as the adjustments become necessary, they are reported in earnings in the period in which they became known.

(c) Translation of Foreign Currencies

The Company’s functional 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. Gains and losses on translation of monetary assets and monetary liabilities are charged to earnings.

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 shareholders’ equity as a cumulative translation adjustment until they are realized by a reduction in the investment.

(d) 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 certain contracts with independent companies, sale prices may be based on quoted market prices on a specified future date or period. Revenues are recorded when title passes to the customers. Until prices are final, the sale is recorded using the quoted market prices on the last day of the reporting period. Subsequent variations in the final determination of metal weight, assay and price are recognized as revenue adjustments as they occur until finalized.

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments with an original maturity of three months or less at the date of acquisition.

(f) 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 directly involved with the mining and production process. Costs are allocated based on estimations of net realized 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 cost. Cost of finished metal inventory represent the average cost of the in-process inventory incurred prior to the refining and casting process, plus applicable refining and casting costs.

Supplies are valued at the lower of cost, replacement and value in use. Cost is determined on an average basis.

(g) Investments

Investments include marketable securities recorded at the lower of cost and market.

(h) Property, Plant and Equipment

— (i) Mineral properties:

- (a) Mineral exploration costs are expensed as incurred. When management's evaluation, based on a feasibility study, indicates that the property is capable of economical commercial production, as a result of establishing proven and probable resources, future costs are capitalized as mine development expenditures.
- (b) Mineral exploration properties acquired as part of the purchase of HBMS will be carried at initial fair value and be subject to an annual impairment review and evaluation.

— (ii) Mine development expenditures:

Development costs for properties deemed capable of economical commercial production are capitalized and amortized using the unit-of-production method. The 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, electrical substations, 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, generally between 50% to 80%; achievement of continuous production, ramp-ups, or other output; and expected net margin during the pre-production period. In a phased mining approach, consideration would be given to milestones achieved at each phase of completion. Management usually assesses the operation's ability to sustain production over a period of one to three months, depending on the complexity related to the stability of continuous operation. Commercial production will be 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 unit-of-production or 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 range from 5 to 13 years. The Company also considers future estimated residual 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 prices, price trends and related factors), production levels, cash costs of production, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Future recoverable mine production is determined from proven and probable reserves and measured, indicated and inferred mineral 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. All long-lived assets are considered together for purposes of estimating future cash flows. 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.

— (vii) Pension and other employee future benefits:

The Company has non-contributory and contributory defined benefit pension plans for its employees. The benefits are based on years of service and final average salary for the salary plan, and flat dollar amount combined with years of service for the hourly plan. 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 ongoing health care benefits to certain 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 of the pension plans for funding purposes was performed in 2006 using data as of December 31, 2005.

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 plan is 12 years. The average remaining service period of the active employees covered by the other retirement benefits plan is 13.7 years.

The Company also has defined contribution plans providing pension benefits for 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.

(i) Financial Instruments and Commodity Contracts

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, taxes payable, current portion of long-term debt and current portion of obligations under capital leases approximate their fair value due to their short-term nature. The fair value of long-term debt has been determined using discounted cash flows at current market rates. Derivative financial instruments have been valued at current fair values using quoted market prices or accepted valuation methodologies.

The Company from time to time employs derivative financial instruments, including forwards and option contracts, to manage risk originating from actual exposures to commodity price risk, foreign exchange risk and interest rate risk. The Company's objective in using derivative financial instruments is to reduce the volatility of future earnings and cash flow within the economic goals of the Company.

In management's opinion, although the contracts continue to be effective in mitigating the Company's exposure to risk, the Company's management elected not to designate its risk management activities as accounting hedges under The Canadian Institute of Chartered Accountants' ("CICA") Accounting Guideline 13 ("AcG-13"), Hedging Relationships. Accordingly, such contracts are carried at fair value as assets or liabilities as appropriate, with changes in fair value recognized in earnings. Management may evaluate, from time to time, its hedge accounting policies and practices and may elect to designate and document contracts as accounting hedges.

The estimated fair value of all derivative financial instruments is based on quoted market prices or, in their absence, third party market indications and forecasts. Unrealized gains or losses and realized gains or losses are recorded in the statement of earnings.

(j) Stock-based Compensation Plans

The Company's stock-based compensation plan is described in note 14d. The Company accounts for all stock-based payments using the fair value-based method. Under this method, compensation cost attributable to options granted is measured at fair value at the grant date. Any consideration paid on exercise of stock options or purchase of stock is credited to share capital.

(k) 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 differences between the financial statement carrying values and their respective tax basis (temporary differences). Future tax assets and liabilities are measured using the substantively enacted tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future tax assets and liabilities of a change in tax rates is included in income in the year in which the change is enacted or substantively enacted. The amount of future tax assets recognized is limited to the amount that is more likely than not to be realized.

(l) Flow-through Shares

The Company financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of these share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced and future income tax liabilities and/or tax recoveries are increased by the estimated income tax benefits renounced by the Company to the subscribers.

(m) Earnings per Share

Basic earnings per share is computed by dividing 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.

(n) Asset Retirement Obligations

The Company accounts for asset retirement obligations in accordance with Section 3110 of the CICA Handbook. Section 3110 requires a legal obligation associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of a long-lived asset.

This policy requires that the fair value of a liability for an asset retirement obligation be recorded in the period in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. 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 will make periodic assessments as to the reasonableness of its asset retirement obligation estimates and revise those estimates accordingly. The respective asset and liability balances are adjusted with the corresponding increase or decrease 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 consolidated statements of earnings based on application of an interest component to the existing liability.

(o) Exploration Costs

The Company accounts for exploration expenditures by capitalizing the costs when management's evaluation indicates that the property is capable of economical commercial production.

(p) Future Accounting Changes – Financial Instruments

In January 2005, the CICA issued new accounting standards: CICA 1530, Comprehensive Income, CICA 3251, Equity, CICA 3855, Financial Instruments – Recognition and Measurement and CICA 3865, Hedges. These standards become effective for fiscal years beginning on or after October 1, 2006 and are applicable to the Company as of January 1, 2007.

The new standards increase harmonization with US GAAP and will require the following:

- ◆ Financial assets will be classified as held-to-maturity, loans and receivables, held-for-trading or available-for-sale. The held-to-maturity classification will be restricted to fixed maturity instruments that the Company intends and is able to hold to maturity. Assets classified as held-to-maturity or loans and receivables will be accounted for at amortized cost. Held-for-trading assets will be recorded at fair value with realized and unrealized gains and losses reported in net income. The remaining financial assets will be classified as available-for-sale and will be recorded at fair value with unrealized gains and losses reported in a new category of the consolidated balance sheet under shareholders equity called other comprehensive income (“OCI”).
- ◆ Financial liabilities will be classified as either held-for-trading or other liabilities. Held-for-trading liabilities will be recorded at fair value with realized and unrealized gains and losses reported in net income, and the remaining financial liabilities will be classified as other liabilities and will be accounted for at amortized cost.
- ◆ Derivatives will be classified as held-for-trading unless designated as hedging instruments. All derivatives, including embedded derivatives that must be separately accounted for, will be recorded at fair value on the consolidated balance sheet. For derivatives that hedge the changes in fair value of an asset or liability, changes in the derivatives’ fair value will be reported in net income and will be substantially offset by changes in the fair value of the hedged asset or liability attributable to the risk being hedged. For derivatives that hedge variability in cash flows, the effective portion of the changes in the derivatives’ fair value will be initially recognized in OCI, and the ineffective portion will be recorded in net income. The amounts temporarily recorded in OCI will subsequently be reclassified to net income in the periods when net income is affected by the variability in the cash flows of the hedged item.

The standards do not permit restatement of prior years’ financial statements; however, they provide detailed transitional provisions. Management is in the process of evaluating the effect of the adoption of the new standards on the Company’s financial statements.

Note 3 Acquisitions

Acquisition of White Pine Copper Refinery Inc.

On January 1, 2006, the Company, through HBMS, acquired all of the outstanding common shares of White Pine Copper Refinery Inc. (“WPCR”) for total purchase consideration of \$17.9 million. The acquisition is accounted for by the purchase method and the result of operations and cash flows has been included within these consolidated financial statements from January 1, 2006.

The following table summarizes the allocation of the purchase consideration based on management’s estimate of the fair value of the assets and liabilities acquired on the date of acquisition:

Current assets (including cash of \$872)	\$	2,817
Property, plant and equipment		16,694
Current liabilities		(1,210)
Asset retirement obligation		(388)
	\$	17,913

Acquisition of Hudson Bay Mining and Smelting Co., Limited

On December 21, 2004, the Company acquired all of the outstanding common shares of HBMS for total purchase consideration of \$315,790, plus \$4,324 of corporate transaction costs. The total purchase consideration of \$315,790 was satisfied by cash of \$302,790 and by the issuance to Anglo American plc of 5,777,777 common shares and 86,666,667 share purchase warrants, where every 30 share purchase warrants are exercisable for one common share at an exercise price of \$3.15 per common share. The acquisition has been accounted for by the purchase method and the result of operations and cash flows have been included within these consolidated financial statements from December 21, 2004. The following table summarizes the allocation of the purchase consideration of the fair value of the assets and liabilities acquired on the date of acquisition:

Current assets (including cash of \$51,504)	\$ 229,601
Investments	463
Property, plant and equipment	349,629
Intangible assets	1,452
Current liabilities	(73,886)
Debt obligations	(15,179)
Pensions and post-retirement benefit obligations	(130,353)
Asset retirement obligations	(26,163)
Obligations under capital leases	(15,074)
Other non-current liabilities	(376)
	\$ 320,114

During the fourth quarter of 2005, after receiving the final independent asset and obligation valuations from third parties, the Company finalised its accounting for the HBMS acquisition. The excess of amounts assigned to net assets over the purchase price ("negative goodwill") in the amount of \$299.6 million was allocated as a pro rata reduction as follows:

	Fair market value	Negative goodwill allocation	Carrying value
Property, plant and equipment	\$ 647,976	\$ 298,347	\$ 349,629
Intangible assets	2,691	1,239	1,452
	\$ 650,667	\$ 299,586	\$ 351,081

Note 4 Inventories

	2006	2005
Work-in-process	\$ 93,941	\$ 76,121
Finished goods	54,849	24,970
Material and supplies	15,052	15,505
	\$ 163,842	\$ 116,596

Note 5 Property, Plant and Equipment

2006	Cost	Accumulated depreciation and amortization	Net book value
Property, plant and equipment	\$ 339,164	\$ 46,325	\$ 292,839
Mines under development – Balmat zinc mine	26,534	–	26,534
Mine development	180,121	72,442	107,679
Mineral exploration properties	16,992	–	16,992
	\$ 562,811	\$ 118,767	\$ 444,044
2005			
Property, plant and equipment	\$ 279,711	\$ 19,924	\$ 259,787
Mines under development – Balmat zinc mine	1,899	–	1,899
Mine development	133,927	34,398	99,529
Mineral exploration properties	16,992	–	16,992
	\$ 432,529	\$ 54,322	\$ 378,207

Included in property, plant and equipment are the following:

	2006	2005
Property, plant and equipment under construction or development	\$ 13,776	\$ 6,107
Equipment under capital leases:		
Cost	\$ 18,109	\$ 18,109
Less accumulated depreciation	3,693	1,822
	\$ 14,416	\$ 16,287
Amortization expense related to equipment under capital leases	\$ 1,871	\$ 1,783

Note 6 Other Assets

	2006	2005
Future tax asset (Note 13b,c)	\$ 18,941	\$ –
Investments, at cost	6,823	–
Fair value of derivatives (Note 16a,b)	1,631	269
Environmental deposits	1,165	1,758
Deferred option premiums (Note 16a,b)	–	3,647
Deferred financing costs	–	7,610
	\$ 28,560	\$ 13,284

Note 7 Current Portion of Other Liabilities

	2006	2005
Current portion of long-term debt (Note 8)	\$ 4,000	\$ 4,000
Current portion of pension obligation (Note 9)	16,554	18,355
Current portion of other employee future benefits (Note 10)	2,282	2,031
Current portion of obligations under capital leases (Note 12)	4,032	3,825
	\$ 26,868	\$ 28,211

Note 8 Long-Term Debt

	2006	2005
Senior secured Notes (a)	\$ 3,380	\$ 181,428
Province of Manitoba (b)	10,834	14,065
	14,214	195,493
Less current portion of long-term debt	4,000	4,000
	\$ 10,214	\$ 191,493

(a) Senior Secured Notes

On December 21, 2004, a subsidiary of the Company issued US\$175 million Senior Secured Notes ("Notes") bearing interest at 9.625% per annum with interest payable semi-annually in arrears on January 15 and July 15 of each year, commencing on July 15, 2005. The Notes were scheduled to mature on January 15, 2012. Subsequent to the issuance of the Notes, the subsidiary which issued the Notes amalgamated with HBMS.

During the year, the Company used operating cash flow to repurchase US\$110.9 million (2005 – US\$19.0 million) of the Notes in the open market. In addition, on November 22, 2006, HBMS commenced a cash tender offer for the remaining US\$45.1 million aggregate outstanding principal amount of the Notes at that time, of which approximately US\$42.2 million aggregate principal amount of the Notes were purchased in December, 2006, reducing the outstanding notional amount of the Notes to US\$2.9 million. The Company paid a premium for these purchases in the amount of \$20,072 (2005 – \$1,284) that was recorded as an expense.

As of December 31, 2006, the Notes were HBMS' senior indebtedness obligations and ranked equally in right of payment with all of its existing and future senior indebtedness and senior to all of its existing and future subordinated indebtedness, subject to the security for decommissioning and credit facility noted below. The Notes were guaranteed on a senior basis by the Company's subsidiaries, HBED and HMS.

On February 21, 2007, HBMS completed the covenant defeasance of the Notes. The covenant defeasance involved the irrevocable deposit in trust by HBMS with The Bank of New York, as trustee, of approximately US\$3.3 million of US Government securities, such amount being sufficient to pay the principal of US\$2.9 million, and interest and premium on, the outstanding Notes to the redemption date of January 15, 2009. Pursuant to the terms of the indenture governing the Notes, the collateral securing the Notes was released upon completion of the covenant defeasance.

The Company's interest expense on the Notes and weighted average interest rate was as follows:

	2006	2005
Interest expense	\$ 9,546	\$ 20,237
Weighted average interest rate	9.625%	9.625%

(b) Loan Payable

The interest-free loan from the Province of Manitoba is secured by an irrevocable standby letter of credit issued by a Canadian chartered bank and the balance is due in instalments of \$4 million on June 14, 2007 and \$7.5 million on June 14, 2008. As at December 21, 2006 the fair value of the loan was determined using the net present value of the interest-free component of the loan, assuming a discount rate of 6%. The discounted loan amount is being accreted to the principal amount through annual accretions with an offsetting charge to interest expense. Non-cash interest expense for the year was \$770 (2005 – \$886). The Province can declare all indebtedness to be due and payable in full if the Company fails to maintain, among other things, agreed levels of exploration expenditures and employment, or if it ceases to maintain a corporate presence in Manitoba. The Company is in compliance with these conditions.

(c) Credit Facility

On January 31, 2006, HBMS concluded a \$25 million revolving credit facility that was scheduled to mature on January 30, 2007. During the third quarter, the facility was increased to \$50 million. On January 17, 2007 it was further increased to \$80 million with the maturity date extended to April 30, 2007.

The borrowings under this facility may be made in either Canadian dollars in the form of (a) Prime Rate Advances or (b) Bankers' Acceptances or in United States dollars in the form of (i) United States Base Rate Advances or (ii) London Interbank Offered Rate (LIBOR) loans. Borrowings under these facilities bear interest, when drawn, at a rate that varies based on the type of borrowing. Canadian or US dollar denominated letters of credit or guarantees may also be used against this facility. The credit facility is secured by a first charge on the issued shares, inventory, inventory related receivables and certain cash of HBMS, HBED and HMS. As of December 31, 2006 there were no amounts drawn under the facility. The Company is in compliance with covenants under this credit facility.

Note 9 Pension Obligation

HBMS maintains several non-contributory and contributory defined benefit pension plans for its employees. Included in the defined contribution pension expense are 401K plans for the US subsidiaries in the amount of \$238.

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 2006 using data as at December 31, 2005. For these plans, the next actuarial valuation required for funding purposes will be performed as at December 31, 2006. 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 defined benefit pension plans have been amended to grant benefit improvements for past service. The Company has elected to amortize these past service costs over three years.

Information about the Company's non-contributory and contributory defined benefit plan is as follows:

	2006	2005
Obligations and funded status:		
Change in pension obligation:		
Obligation, as at January 1	\$ 244,772	\$ 217,812
Service cost	8,671	7,426
Interest cost	12,955	12,754
Employee contributions	157	156
Actuarial loss (gain)	(8,761)	15,823
Plan amendments	12,323	–
Flex account balance at end of year	–	1,544
Benefits paid	(11,977)	(10,743)
Obligation, at December 31	258,140	244,772
Change in pension plan assets:		
Fair value of plan assets, at January 1	174,028	147,725
Actual return on plan assets	18,522	20,712
Employer contributions	20,144	14,634
Employee contributions	157	156
Flex account balance at end of year*	–	1,544
Benefits paid	(11,977)	(10,743)
Fair value of plan assets, at December 31	200,874	174,028
Unfunded status of plans at end of year	(57,266)	(70,744)
Unamortized past service costs	8,215	–
Unamortized net actuarial loss (gain)	(9,178)	5,646
Net amount recognized at December 31	\$ (58,229)	\$ (65,098)
Less current portion	(16,554)	(18,355)
	\$ (41,675)	\$ (46,743)

* Included in the ending balance as at December 31, 2006.

As a result of the closure of the Ruttan mine, the Company plans to settle its obligations under the pension plans for the former employees of the Ruttan mine through the purchase of insurance contracts by which the insurer assumes all of the Company's risks and obligations under the plans.

Pension expense includes the following components:

	2006	2005
Service cost	\$ 8,671	\$ 7,426
Interest cost	12,955	12,754
Actual asset return (gain)	(18,522)	(20,712)
Actuarial loss (gain)	(8,761)	15,823
Plan amendments	12,323	–
Costs arising in the period	6,666	15,291
Difference in costs arising and recognized in period:		
Return on plan assets	6,054	10,176
Actuarial loss (gain)	8,770	(15,823)
Plan amendments	(8,215)	–
Defined benefit pension expense	13,275	9,644
Defined contribution pension expense	474	227
	\$ 13,749	\$ 9,871

Additional Information

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

	2006	2005
To determine the net benefit expense for the year:		
Discount rate (defined benefit)	5.00%	5.80%
Discount rate (defined contribution)	4.04%	4.69%
Expected return on plan assets	7.00%	7.00%
Rate of compensation increase	3.35%	4.70%
To determine the accrued benefit obligations at the end of the year:		
Discount rate (defined benefit)	5.25%	5.00%
Discount rate (defined contribution)	4.11%	4.04%
Rate of compensation increase	2.35%*	3.35%

* 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.

Determining the expected future rate of return on pension assets is a judgmental matter. The Company considers the following factors in determining this assumption:

- (i) Duration of pension plan liabilities; and
- (ii) Types of investment classes in which the plan assets are invested and the expected compound returns on those investment classes.

Plan Assets

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

	2006		2005	
	Weighted average	Target	Weighted average	Target
Equity securities	51%	52%	58%	57%
Debt securities	49%	48%	42%	43%
	100%	100%	100%	100%

The Company's primary quantitative investment objective is to maximize the long-term real rate of return, subject to an acceptable degree of investment risk, and the 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 and non-North American equities, the plan assets are actively managed by investment managers, with the goal of attaining returns that are in excess of that which could be realized with passively managed investments. Although the actual composition of the invested funds will vary from the prescribed investment mix, the investment managers have a responsibility to bring items back to the appropriate mix.

Note 10 Other Employee Future Benefits

HBMS 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:

	2006	2005
Obligations and funded status:		
Change in other employee future benefits:		
Obligation, at January 1	\$ 74,781	\$ 59,941
Service cost	1,781	1,593
Interest cost	3,914	3,506
Actuarial losses	698	11,500
Benefits paid	(2,161)	(1,759)
Obligation, at December 31	\$ 79,013	\$ 74,781
Change in plan assets:		
Fair value of plan, at January 1	\$ –	\$ –
Employer contributions	2,161	1,759
Benefits paid	(2,161)	(1,759)
Fair value of plan assets at December 31	\$ –	\$ –
Unfunded status of plans at end of year	\$ (79,013)	\$ (74,781)
Unamortized net actuarial loss	11,648	11,500
Net amount recognized at December 31	\$ (67,365)	\$ (63,281)
Less current portion	(2,282)	(2,031)
	\$ (65,083)	\$ (61,250)

Other employee future benefits expense includes the following components:

	2006	2005
Service cost	\$ 1,781	\$ 1,593
Interest cost	3,914	3,506
Actuarial loss	698	11,500
Costs arising in the period	6,393	16,599
Difference in costs arising and recognized in period:		
Actuarial loss (gain)	(148)	(11,500)
Other employee future benefits expense	\$ 6,245	\$ 5,099

Additional Information

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

	2006	2005
To determine net benefit expense for the year:		
Discount rate	5.1%	6.0%
Weighted average health care trend rate	8.7%	9.2%
To determine benefit obligation at end of year:		
Discount rate	5.25%	5.1%
Weighted average health care trend rate	8.2%	8.7%

The weighted average health care cost trend rate used in measuring other employee future benefits was assumed to begin at 8.2% in 2007, gradually declining to 4.6% by 2015 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:

	2006	2005
Accumulated post-retirement benefit obligation	\$ 16,486	\$ 15,761
Aggregate of service and interest cost	1,439	1,267

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:

	2006	2005
Accumulated post-retirement benefit obligation	\$ 12,839	\$ 12,129
Aggregate of service and interest cost	1,103	961

The Company's post-retirement and other post-employment benefit cost is materially affected by the discount rate and health care cost trend rates 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 actuarial gains or losses over 10 per cent of the obligation are amortized over the expected service life of the plan population.

Note 11 Asset Retirement Obligations

The Company's asset retirement obligations relate to the final reclamation and closure of currently operating mines and refinery, mines under care and maintenance, and closed properties.

	2006	2005
Balance, beginning of year	\$ 29,219	\$ 27,120
Additional obligations recognized during the year	3,031	–
Obligations settled during the year	(1,456)	(463)
Obligations assumed through acquisition of HBMS	–	(50)
Obligations assumed through acquisition of WPCR	388	–
Obligations removed through sale of ScoZinc	(326)	–
Accretion expense	2,692	2,612
Balance, end of year	\$ 33,548	\$ 29,219

Total undiscounted future cash flows required to settle the decommissioning and restoration asset retirement obligations are estimated to be \$60.3 million (2005 – \$55.1 million) before adjusting for inflation, market, and credit risk. A credit adjusted risk-free rate of 7.5% (2005 – 9.625%) has been used to determine the additional obligations recognized during the year. Management anticipates that such obligations will substantially be settled at or near the closure of the mining and processing facilities, anticipated to occur from 2012 to 2019.

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.

Note 12 Obligations Under Capital Leases

The Company has entered into capital lease obligations for equipment.

	2006	2005
Lease obligations	\$ 9,011	\$ 12,836
Less current portion of obligations	4,032	3,825
	\$ 4,979	\$ 9,011

The following represents the minimum lease payments for equipment used in operations for the next four years:

2007	\$ 4,429
2008	3,554
2009	1,523
2010	101
	9,607
Less imputed interest	596
	\$ 9,011

The capital lease average interest rate was 5.2% and is fixed for the term of the leases that expire 2007 to 2010. Interest expense on capital leases in 2006 was \$611 (2005 – \$772).

Note 13 Income and Mining Taxes

(a) Income Tax Expense (Benefit)

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 (benefit) 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:

	2006	2005
Statutory tax rate	39%	42%
Tax expense (benefit) at statutory rate	\$ 171,411	\$ 31,557
Effect of:		
Resource and depletion allowance, net of resource tax recovery	(30,279)	(20,569)
Adjusted income taxes	141,132	10,988
Mining taxes	28,860	–
	169,992	10,988
Temporary income tax differences (recognized) not recognized	(45,491)	28,946
Tax benefit not recognized	(105,986)	(40,674)
Other income tax permanent differences	6,749	1,798
Recognition of prior years' income tax temporary differences	(118,700)	(11,858)
Recognition of prior years' mining tax temporary differences	(28,104)	–
Income tax expense (benefit)	\$ (121,540)	\$ (10,800)
Income tax provision (benefit) applicable to:		
Current taxes	30,048	678
Future taxes	(151,588)	(11,478)
Income tax expense (benefit)	\$ (121,540)	\$ (10,800)

(b) Income Tax Effect of Temporary Differences

The tax effects of temporary differences that give rise to significant portions of the future tax assets or future tax liabilities at December 31, 2006 and 2005 are presented below:

	2006	2005
Future income tax assets:		
Property, plant and equipment	\$ 31,454	\$ 218,394
Pension obligation	21,032	23,839
Other employee future benefits	24,332	23,238
Asset retirement obligations	10,554	10,689
Non-capital losses (see (d) on page 72)	121,506	73,560
Share issue costs	9,795	3,140
Other	453	440
	219,126	353,300
Less valuation allowance	74,226	327,100
Net future tax asset	\$ 144,900	\$ 26,200
Less current portion	137,842	26,200
	\$ 7,058	\$ –
Future income tax liability:		
Derivatives and other timing differences	\$ 1,125	\$ 1,666
Less current portion	543	–
	\$ 582	\$ 1,666

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. In consideration of the Company's increasing earnings over the last three years, the Company has reduced its valuation allowance related to the future income tax asset to provide only for long term obligations that are deductible expenses for tax purposes near or at closure and other assets that are more unlikely than not to be realized.

(c) Mining Tax Effect of Temporary Differences

The tax effects of temporary differences that give rise to significant portions of the future tax assets at December 31, 2006 and 2005 are presented below:

	2006	2005
Future mining tax assets:		
Property, plant and equipment	\$ 53,705	\$ 76,404
Less valuation allowance	25,601	76,404
Net future tax asset	\$ 28,104	\$ –
Less current portion	16,221	
	\$ 11,883	\$ –

The mining tax valuation allowance represents management's best estimate of the allowance necessary to reflect the future tax assets at an amount that the Company considers is more likely than not to be realized. As mining tax deductions are more restrictive in the rate of deduction, a net mining tax asset has been based on a projected three years of earnings. This period to recognize a net mining tax asset is deemed appropriate due to uncertainties of future longer-term metal prices, exchange rates and the magnitude of prior operating losses, but this position will continue to be reviewed as circumstances change.

(d) Non-capital Losses

At December 31, 2006, the Company has cumulative non-capital losses of \$313,286 in Canada and net operating losses of \$23,849 in the US, the benefit of which has been recognized on the balance sheet as it relates to HBMS non-capital losses.

The non-capital losses expire as follows:

2007	\$ 253
2008	44,922
2009	94,033
2010	2,066
2013	146,134
2014	8,197
2015	8,016
2016	1,042
2024	3,491
2025	8,021
2026	20,960
	\$ 337,135

(e) Other Disclosure

In the normal course of business, the Company is subject to audit by taxation authorities. For major entities, audits by the Canadian income taxation authorities on years after 2001 are not yet completed, while mining taxation authorities have the opportunity to audit beyond this period. 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.

Note 14 Share Capital

(a) Preference Shares

Authorized: Unlimited preference shares

(b) Common Shares

Authorized: Unlimited common shares

Issued:

	2006		2005	
	Common shares	Amount	Common shares	Amount
Balance, beginning of year	84,807,452	\$ 143,611	77,450,628	\$ 120,138
Exercise of warrants	37,061,332	168,028	4,047,032	12,941
Automatic exchange of warrants	643,294	628	–	–
Exercise of options	2,033,923	11,433	310,340	1,130
Issued flow-through shares	1,460,000	20,075	2,999,452	10,000
Tax effect of flow-through shares	–	(3,662)	–	–
Share issue costs	–	(31,672)	–	(598)
Balance, end of year	126,006,001	\$ 308,441	84,807,452	\$ 143,611

Pursuant to a short form prospectus dated May 30, 2006, the Company offered from treasury common shares as an incentive for holders of its publicly-traded warrants to exercise early such warrants during a 30-day early exercise period commencing June 5, 2006. A total of 998,948,693 warrants were exercised, resulting in the issuance of 35,296,171 shares including the incentive early exercise shares of 1,997,882 (0.002 per warrant) for cash proceeds of \$104,889. Share issue costs of approximately \$2,268 were incurred. Eligible warrants of 24,166,512, not exercised as of July 5, 2006, were subject to an automatic exchange of 0.02662 common shares per warrant for a total of 643,294 common shares.

Proceeds from the exercise of warrants of \$168,028 represents cash proceeds from the exercised warrants of \$111,368, the incentive shares estimated value of \$28,371 and the estimated fair value of the warrants of \$28,289.

On April 25, 2006, the company issued 1,460,000 flow-through common shares at a price of \$13.75 per share for gross proceeds of \$20,075 less share issue costs of \$1,033. Proceeds from the private placement will be used for exploration on the Company's Canadian properties.

On June 22, 2005, the Company completed a private placement of 2,193,000 flow-through common shares at a price of \$3.42 per share for aggregate gross proceeds of approximately \$7,500. Commission and fees related to the offering were paid to the underwriters resulting in net proceeds of \$7,078. The gross proceeds are being used to incur Canadian exploration expenses that will be renounced in favour of the holders for the 2006 taxation year.

On February 22, 2005, the Company completed a private placement of 806,452 flow-through common shares at a price of \$3.10 per share for aggregate gross proceeds of approximately \$2,500. Commission and fees related to the offering were paid to the underwriters resulting in net proceeds of \$2,323. The proceeds are being used to incur Canadian exploration expenses that will be renounced in favour of the holders for the 2006 taxation year.

(c) Warrants

	2006		2005	
	Number of Warrants	Amount	Number of Warrants	Amount
Balance, beginning of year	1,076,082,458	\$ 28,931	1,269,478,323	\$ 35,850
Underlying warrants issued	257,641	–	–	–
Automatic exchange of warrants	(24,166,512)	(628)	–	–
Issued on private placements	–	–	1,727,258	44
Exercised	(1,051,899,961)	(28,300)	(121,411,064)	(2,590)
Cancelled	(150,525)	–	(73,712,059)	(4,373)
Balance, end of year	123,101	\$ 3	1,076,082,458	\$ 28,931

Warrants outstanding to acquire common shares (30 warrants required to acquire one common share) of the Company at December 31, 2006 are as follows:

Warrants outstanding	Pre-consolidated exercise price	Expiry date
123,101	\$ 0.105	December 21, 2009

(d) Stock Option Plan

Under the Company's stock option plan (the "Plan") approved in June 2005, the Company may grant options up to 10% (to a maximum of 8 million) 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% are exercisable immediately, the next 33 1/3% are exercisable after one year, and the last 33 1/3% exercisable after two years. Shares in respect of which options are not exercised as well as shares in respect of which options are exercised, shall become available for the grant of subsequent options. Except in specified circumstances, options are not assignable and terminate upon the optionee ceasing to be employed by or associated with the Company. The terms of the Plan further provide that the price at which shares may be issued under the Plan cannot be less than the market price of the shares when the relevant options are granted. Certain restrictions apply on the issuance of options pursuant to the Plan.

The fair value of the options granted during 2006 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 3.38%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of 43.5%; and a weighted average expected life of these options of 4 years.

The fair value of the options granted during 2005 was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.2%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of 42%; and a weighted average expected life of these options of 4 years.

	2006		2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	3,498,828	\$ 2.66	663,167	\$ 3.60
Granted	1,971,698	10.57	3,865,000	2.63
Exercised	(2,033,923)	3.89	(310,340)	2.61
Cancelled	(253,334)	6.67	(718,999)	3.71
Outstanding, end of year	3,183,269	\$ 6.46	3,498,828	\$ 2.66
Weighted average fair value of options granted during the year:		\$ 4.05		

The following table summarizes the options outstanding at December 31, 2006:

Number of options outstanding	Exercise price	Weighted average remaining contractual life (years)	Number of options exercisable	Weighted average remaining contractual life (years)
1,567,187	\$ 2.59	8.4	527,157	8.4
16,667	3.00	1.9	16,667	1.9
100,000	3.35	8.8	25,000	8.8
1,189,415	9.70	9.2	208,294	9.2
250,000	14.06	9.4	50,000	9.4
60,000	17.77	9.9	20,000	9.9
3,183,269	\$ 6.46		847,118	

(e) Contributed Surplus

	2006	2005
Balance, beginning of year	\$ 10,015	\$ 3,288
Stock-based compensation expense	6,201	2,674
Transfer to common share on exercise of stock options	(3,128)	(321)
Warrants cancelled/expired	10	4,363
Warrants exercised	–	11
Balance, end of year	\$ 13,098	\$ 10,015

(f) Earnings Per Share Data

	2006	2005
Net earnings available to common shareholders	\$ 563,991	\$ 85,218
Weighted average common shares outstanding	105,979,721	82,008,190
Plus net incremental shares from assumed conversions:		
Warrants	12,038,968	2,448,186
Stock options	2,315,512	310,706
Diluted weighted average common shares	120,334,201	84,767,082

Note 15 Contingencies

The Company and its subsidiaries are involved in various claims and litigation arising in the ordinary course and conduct of their business. Since the outcome is uncertain, no amount has 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"), the Company 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 the Company, to SaskPower in 1981. Based on the current knowledge of management, the ultimate resolution of the claims will not be material to the consolidated 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 not been named as parties in the action. It has come to our attention that CRP, a former subsidiary of HBMS, which 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 any claim that will be advanced against CRP or HBMS is not reasonably determinable.
- (c) In May 2004, a number of plaintiffs initiated an action, in the State of North Carolina, against Zochem, Considar Metal Marketing Inc. ("CMM") and a number of other defendants seeking damages in an unspecified amount and alleging that they had been injured as a result of an explosion that occurred at a pharmaceutical plant. The plaintiffs have alleged that Zochem and/or CMM designed, manufactured, sold and supplied chemicals used in the manufacture of a rubber compound that were dangerous, defective and susceptible to causing explosions. HBMS has retained legal counsel in North Carolina and cannot currently assess its potential liability in relation to this claim.

Note 16 Risk Management Using Financial Instruments

(a) Foreign Currency Risk Management

The Company uses forward or currency collar contracts to limit the effects of movements in exchange rates on foreign currency-denominated assets and liabilities and future anticipated transactions.

The Company holds put options securing the right, but not the obligation, to sell US\$4.375 million per quarter at \$1.20482, continuing to January 2009. Prior to January 1, 2006, management had designated these put options as a hedge against forecasted US dollar sales and had applied hedge accounting guidelines as appropriate. However, at January 1, 2006, the hedging relationship ceased to meet requirements for critical terms match as a result of changes in payment terms for the sales contract. The relationship then became ineligible for hedge accounting. The unrealized gain on the option was deferred at January 1, 2006, with \$438 to be taken into income over the remaining term of the option (\$36 per quarter). The changes in fair value after January 1, 2006 have been recognized in income as a loss of \$1,513. The fair value at December 31, 2006 is estimated to be \$2,572. The realized gain on the foreign currency derivative was \$1,049 (2005 – \$0).

(b) Commodity Price Risk Management

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

The Company manages the risk associated with forward physical sales where it receives a fixed price from its customers regarding zinc and zinc oxide and, accordingly, enters into zinc forward contracts with counterparties to convert the fixed price received by the customer to a net realized floating price for the Company. At December 31, 2006, the company had outstanding forward contracts to purchase 3,728 tonnes of zinc at prices ranging from US\$1,043 to US\$4,555 per tonne with contract settlements extending out up to 1.1 years. The fair value at December 31, 2006 and 2005 approximates its carrying value. Realized and unrealized gains on the zinc forward contracts were \$23,022 (\$5,319 – 2005). Prior to June 1, 2006, the physical sales and associated zinc forward contracts were managed through the Company's joint venture interest in CMM.

(c) Credit Risk

The Company provides credit to its customers in the normal course of its operations. It carries out, on a continuing basis, credit checks on its customers and maintains provisions for contingent credit losses. In order to mitigate the credit risk on accounts receivables with its customers, the Company has a commercial credit insurance policy.

The Company is exposed to credit risk in the event of non-performance by counterparties in connection with its derivative contracts. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but mitigates this risk by transacting with credit worthy counterparties in accordance with its risk management policies. The Company does not anticipate a loss for non-performance with its counterparties.

Note 17 Fair Value of Financial Instruments

As at December 31, 2006, approximately 2,600 tonnes of copper and 600 ounces of gold were outstanding under sales contracts where final pricing will be determined at specified future dates based on quoted market prices. Revenues have been provisionally recorded on these sales contracts based on quoted market prices on the last day of the reporting period, according to the Company's revenue recognition policy.

Under the terms of contracts with independent companies for the purchase of concentrates, prices are set on a specified future date after shipment based on quoted market prices. Costs are recorded under these contracts when title passes to the Company. Until prices are final, the cost is recorded using quoted market prices on the last day of the reporting period. Variations between the cost recorded at the date of title transfer and the actual final price set under the contracts are caused by changes in quoted market prices, with changes in fair value classified as a component of cost when finalized. The notional amount outstanding as at December 31, 2006 was approximately 3,000 tonnes of zinc, 8,700 tonnes of copper and 500 ounces of gold.

With the exception of the above, the carrying value for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, current portion of long-term debt and current portion of obligations under capital lease approximate their fair value due to their short-term nature.

The fair value of the senior secured debt using discounted cash flows at current market rates is approximately \$3,944 (2005 – \$202,940).

Derivative financial instruments have been valued at current fair values using quoted market prices or accepted valuation methodologies.

Note 18 Investment in Joint Ventures

Considar Metal Marketing SA ("CMMSA"), an entity incorporated under the laws of the Grand Duchy of Luxembourg, is a joint venture in which the Company holds a 50% interest. The joint venture, together with its wholly owned subsidiary, CMM, carries on the business of providing metal marketing to customers in various metal-related industries.

The following is a summary of the Company's 50% pro rata share of the book value of the assets, liabilities, revenue and expenses of the CMMSA joint venture. Previous to the end of 2005, substantially all of the Company's sales were transacted with the joint venture. The Company changed its sales agreement with CMM to an agency agreement for copper and precious metal products effective January 1, 2006 and for the zinc and zinc oxide products effective June 1, 2006. As a result of this agreement, the Company retains title to the copper and precious metals until the ultimate sale to customers. In order to facilitate this agreement, the Company, in effect, on December 31, 2005 acquired the inventory of CMM. This purchase resulted in a reversal of the originating sales transactions associated with these products. Therefore the net result was the removal of any associated profit margin and inclusion of the associated inventories in the financial statements of the Company.

This information is presented prior to inter-company eliminations.

	2006	2005
Assets		
Current assets	\$ 8,447	\$ 33,783
Unrealized fair value derivative	–	269
Property, plant and equipment	72	93
Liabilities		
Current liabilities	\$ 6,962	\$ 29,177
Future income taxes payable	28	1,665
Sales	\$ 88,534	\$ 352,394
Costs and expenses:		
Operating, general and administrative	92,788	356,841
Depreciation and amortization	29	31
Gain on derivative instruments	(1,426)	(5,319)
	91,391	351,553
Other income	113	133
Interest expense	(16)	(25)
Earnings (loss) before income taxes	\$ (2,760)	\$ 949
Cash flows:		
Operating activities	\$ (1,691)	\$ (1,207)
Investing activities	(8)	(12)

Note 19 Commitments

Operating Lease Commitments

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

2007	\$	686
2008		372
2009		168
2010		106
2011		71

Through its joint venture interest in CMMSA, as at December 31, 2006, the Company has various lease commitments for facilities and equipment which expire in periods ranging from one to five years. The aggregate remaining minimum annual lease payments, representing 100% of CMMSA's commitment, required for the next five years are as follows:

2007	\$	228
2008		255
2009		248
2010		247
2011		71

The Company has recorded operating lease expense of \$2,228 (2005 – \$3,746), including \$114 (2005 – \$106) for the 50% share of the CMM leases.

Buy-Sell Commitments

The Company has a commitment to purchase copper concentrate based on a schedule of payments rather than actual physical delivery. The contract requires delivery of 72,000 dry metric tonnes annually from 2007 to 2008.

The Company also has a long-term agreement for the purchase of 10% of another mine's concentrate, or approximately 13,000 dry metric tonnes in 2006, and 20% of annual production or approximately 26,000 dry metric tonnes each year thereafter. The term of this agreement is from 2007 to 2015 and is subject to certain termination rights effective after December 31, 2008.

The Company has an agreement to sell all the concentrate produced from the Balmat Mine for the life of the mine, anticipated to be from June 2006 to 2014.

The Company has another agreement with the same party as indicated above to buy suitable concentrates to be delivered to Flin Flon in quantities up to 40% of the Balmat life of mine concentrate production.

Payment for the above-mentioned purchased concentrates is based on the market price of contained metal during a quotational period following delivery of the concentrate, less a fixed treatment and refining credit. If the Company cannot process the deemed 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.

Other Commitments and Agreements

- (i) On the majority of the 777 mine, the Company is subject to a royalty payment of \$0.25 per tonnes 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. Although the cumulative cash flow has been negative to date, it may be positive in the future.
- (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 generally accepted accounting principles for any given fiscal year will be distributed to all employees in the Flin Flon/Snow Lake operations, with the exception of executive officers and key management personnel. This expense has been accrued in these financial statements (2006 – \$47,295; 2005 – \$10,442).
- (iii) HBMS entered into a security agreement dated March 31, 1999 in favour of the Province of Saskatchewan in respect of its reclamation undertakings in Saskatchewan. As security for the implementation of decommissioning plans in respect of its undertakings in Saskatchewan, HBMS has granted to the Province of Saskatchewan a first priority security interest in its mining equipment, buildings and fixtures and a first charge on all proceeds derived from any dealings with such mining equipment, buildings and fixtures. In addition, HBMS has a security agreement dated May 7, 2004 in favour of the Province of Manitoba in respect of its reclamation undertakings in Manitoba. As security for the implementation of a decommissioning plan in respect of its undertakings in Manitoba, HBMS has granted to the Province of Manitoba a first priority security interest in its mining equipment, buildings and fixtures owned by the Company and located on the lands and a first charge on all proceeds derived from any dealings with such mining equipment, buildings and fixtures relating to the Flin Flon metallurgical complex and the 777 mine. The salvage value of these assets is estimated at between \$45,300 and \$65,300 and is adjusted annually and re-estimated at least every five years. The security interests granted to the provinces of Saskatchewan and Manitoba rank *pari passu*.

The Company has completed a study of reclamation costs (see note 11). The Company believes the existing security provided is adequate and sufficient. However, HBMS has provided additional security to the Provinces of Manitoba and Saskatchewan in the form of letters of credit in the amount of \$13,000.

- (iv) 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.

- (v) The Company has outstanding letters of credit in the amount of \$34,257 (including the \$13,000 for extra security to the provinces for the environmental reclamations).
- (vi) In 2003, the Company established a wholly-owned subsidiary, St. Lawrence Zinc Company LLC ("St. Lawrence"). St. Lawrence was incorporated in the State of New York for the purposes of acquiring the Balmat zinc mine ("Balmat").

On September 24, 2003, St. Lawrence purchased the Balmat zinc mine and related assets located in upper New York state. Total consideration paid consisted of a cash deposit of US\$1 million required to assume an environmental bond. In addition, the asset purchase agreement requires the Company to pay a cash purchase price out of 30% of future net free cash flow from Balmat mine operations, after allowing for reasonable capital and exploration expenditures. The cash purchase price is subject to a "Cap" of US\$20 million subject to an increase to US\$25 million if the monthly average special high grade settlement price of zinc, as quoted by The London Metal Exchange, averages US\$0.70 or greater during any consecutive 24-month period after the closing date and prior to the fifth anniversary of the date on which the seller receives payment of the US\$20 million. During 2006, those requirements were met, and the Cap was increased to US\$25 million.

The Balmat mine operations have not commenced commercial production as at December 31, 2006 and, based on the purchase agreement calculation (which includes deduction of reasonable capital and exploration expenditures), the mine did not generate positive cash flow for the year ended December 31, 2006. Accordingly, no cash purchase price has been accrued in the financial statement relating to the 2006 fiscal year.

As at December 31, 2006, due to variability of future zinc prices and zinc grades, a reasonable estimate cannot be made of the amount of any cash purchase price to be paid with respect to net free cash flow in future years, and consequently no accrual has been recorded in the financial statements. The cash purchase price will be accrued as additional property, plant and equipment cost when management is able to quantify the amounts to be paid at the year end date.

- (vii) On a portion of the Balmat mine, the Company is subject to royalty payments of up to 4% of the net smelter return of ore removed from these properties.
- (viii) 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.
- (ix) 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 2012 in the event that negotiated CBA settlements are not achieved.

Note 20 Supplementary Cash Flow Information

(a) Change in Non-Cash Working Capital

	2006	2005
Accounts receivable	\$ (87,071)	\$ 28,512
Inventories	(45,996)	(16,314)
Accounts payable and accrued liabilities	47,309	1,421
Taxes payable	30,217	760
Prepaid expenses	(3,475)	(129)
Interest payable	(7,855)	7,441
	\$ (66,871)	\$ 21,691

(b) Other

	2006	2005
Supplementary cash flow information:		
Interest paid	\$ 18,056	\$ 13,613
Taxes paid	1,030	1,375
Additions to obligations under capital leases	–	1,451

Note 21 Segmented Information

The Company is an integrated base metals producer and operates in a single reportable operating segment. When making decisions on expansions, opening or closing mines as well as day-to-day operations, management evaluates the profitability of the overall operation of the company.

The Company's revenue by significant product types:

	2006	2005
Revenues		
Copper ¹	\$ 624,033	\$ 351,756
Zinc	277,400	142,690
Zinc oxide	132,444	75,032
Gold	56,269	50,354
Silver	14,551	11,208
Other	24,306	20,988
	\$ 1,129,003	\$ 652,028

1. Includes purchased copper of approximately \$223,000 (2005 – \$144,000).

Note 22 Other Income

	2006	2005
Interest and other income	\$ 12,006	\$ 3,996
Gain on divestiture of ScoZinc Limited	1,655	–
Investment income	3,789	–
	\$ 17,450	\$ 3,996

On July 6, 2006, the Company, through its wholly-owned subsidiary Pan American Resources Corp., completed the sale of 100% of its outstanding shares in ScoZinc Limited to Acadian Gold Corporation for \$7.5 million plus adjustments, resulting in a gain on sale of \$1,655. Pan American Resources Corp. was dissolved during this transaction.

During the year, the Company received income from a previously negotiated exploration option agreement of \$3,789.

Note 23 Subsequent Events

On February 23, 2007, the Company renounced to subscribers \$20,075 of tax attributes as referenced in Note 2(l) pursuant to the April 25, 2006 flow-through share agreement.

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 (i) for more information.

Note 24 Comparative Figures

Certain figures, previously reported for 2005, have been reclassified to conform with the basis of presentation adopted in the current year.

Message from the Chairman of the Board

On behalf of the Board of Directors,
I am pleased to report that 2006 was another
outstanding year for HudBay Minerals.

The Company surpassed expectations in all areas, with revenue growth and earnings generation particularly strong. While these gains were due to the sound design and determined execution of our corporate strategy; buoyant metal markets also played an important role.

As the year progressed and HudBay reported quarterly results, the company's attributes and strengths became increasingly apparent to the market. As a result, market capitalization climbed from approximately \$500 million at the end of 2005 to \$2.7 billion at year end 2006.

Throughout 2006 we continued to pay close attention to health and safety. HudBay has worked hard to achieve the Company's ISO safety ratings and make our operations secure places to work. This is an area of considerable importance and it is addressed on an ongoing basis by the board's environment, health and safety committee.

The board and its committees also worked closely with management in the areas of audit, compensation, corporate governance and disclosure. We believe good governance practice and a high level of interaction are key to the achievement of HudBay's corporate objectives. Our adherence to best practices supports HudBay's conformity with the standards of good governance established by Canadian Securities Regulators.

**"As the year progressed
and HudBay reported quarterly
results, the Company's
attributes and strengths became
increasingly apparent."**

During 2006 we welcomed two new directors. Dr. Lloyd Axworthy is a former Member of Parliament who served in the House of Commons for 21 years, including five years as Minister of Foreign Affairs. A native of Manitoba, Dr. Axworthy is currently President and Vice-Chancellor of the University of Winnipeg. John Bowles is a chartered accountant who retired in mid-2006 as partner with PricewaterhouseCoopers LLP and leader of their British Columbia mining practice. They replace James Ashcroft and Richard Brissenden, who chose not to stand for re-election. HudBay is indebted to them for their contributions.

Our Company's quality assets, proven production capabilities, vertical integration, strong markets, dedicated staff and knowledgeable board, position HudBay for continued achievement of our goals. We look forward to working closely with management as we pursue the creation of shareholder value during 2007.



Allen J. Palmiere
Chairman of the Board



Corporate Governance

Board Mandate

The board of directors has a broad mandate for the stewardship of the company. It does so in a number of ways, among them by:

- ◆ Ensuring the board and its committees are properly constituted and well functioning;
- ◆ Satisfying itself that senior management is well structured and succession planning is provided for;
- ◆ Adopting a strategic planning process, with annual review of a strategic plan that takes into account opportunities and risks;
- ◆ Approving corporate objectives and goals as they apply to senior management;
- ◆ Ensuring proper internal control systems are in place to maintain the financial integrity of the enterprise;
- ◆ Managing applicable risks and monitoring systems in place to assess them;
- ◆ Reviewing with senior management major corporate decisions as they relate to capital expenditures.

Board Committees

The board of directors has established four committees:

AUDIT COMMITTEE

The audit committee has a statutory legal responsibility for review of the company's quarterly and annual financial statements. As such, the committee members are financially literate. The committee's mandate also includes recommending the appointment of independent auditors, reviewing the company's audit program and overseeing the proper functioning of the company's financial systems. In a broader sense, the committee encourages continuous improvement of company policies, procedures and practices at all levels.

Members: John H. Bowles (Chairman), Ronald P. Gagel, Allen J. Palmiere

CORPORATE GOVERNANCE AND NOMINATING COMMITTEE

The corporate governance and nominating committee is tasked with assessing the effectiveness of the board of directors as a whole and weighing the contribution of individual members. The committee also proposes new nominees and provides orientation for newly elected directors. Good governance is ensured by reviewing applicable procedures relating to transparency and disclosure.

Members: Allen J. Palmiere (Chairman), M. Norman Anderson, John H. Bowles

COMPENSATION COMMITTEE

The compensation committee reviews and recommends to the board the salaries, bonuses, benefits and change of control packages for the Chair of the board of directors and members of the senior management team. The committee also administers the company's compensation and benefit programs to ensure they remain current, competitive with other employers and in conformity with current trends in compensation.

Members: Allen J. Palmiere (Chairman), M. Norman Anderson, Ronald P. Gagel

ENVIRONMENTAL, HEALTH AND SAFETY COMMITTEE

The environmental, health and safety committee has a mandate to oversee the development and implementation of policies and management systems relating to the environment and the health and safety of employees and contractors. The committee fulfils its responsibilities by ensuring the company complies with applicable legislation and regulations governing workplaces, plus internal best practices and provisions under collective agreements the company has entered into.

Members: M. Norman Anderson (Chairman), Lloyd Axworthy, Peter R. Jones

Board of Directors



Allen J. Palmiere



M. Norman Anderson



Dr. Lloyd Axworthy



John H. Bowles



Ronald P. Gagel



Peter R. Jones

Allen J. Palmiere, CA

Chairman and Independent Director

Mr. Palmiere is a chartered accountant, and for most of his career has served in senior management financial supervisory capacities in the mining industry. In the past, Mr. Palmiere has been Treasurer of Northgate Exploration Ltd.; Chief Executive Officer and Chief Financial Officer of Breakwater Resources Ltd.; Chief Financial Officer of Zemex Corporation and Executive Chairman of Barplats Investments Limited. He is a member of the board of directors of Constellation Copper Corporation and the Chair of its audit committee. He is currently the President, Chief Executive Officer and a director of Silk Road Resources Ltd.

M. Norman Anderson, P. Eng.

Independent Director

Mr. Anderson has been involved in the mining industry for over 50 years and is the former Chairman and Chief Executive Officer of Cominco Ltd. Currently, Mr. Anderson is President of the management consulting firm of Anderson & Associates. Since 1987, he has been active in consulting, particularly due diligence consulting and evaluations for financial institutions and mining companies. He holds a Bachelor of Science in Geological Engineering from the University of Manitoba in Winnipeg, Manitoba.

Dr. Lloyd Axworthy

Independent Director

Dr. Axworthy was a member of the Manitoba Legislature for six years and a member of the House of Commons of Canada for 21 years, where he held a number of cabinet positions including Foreign Affairs, Employment and Immigration, and Transport and Human Resources. In 2003, he was made an Officer of the Order of Canada and is currently the President and Vice-Chancellor of the University of Winnipeg. Dr. Axworthy was elected to the board on June 1, 2006.

John H. Bowles, FCA, FCIM

Independent Director

Mr. Bowles is a chartered accountant and was a partner with PricewaterhouseCoopers LLP in Vancouver where he was the leader of their British Columbia mining practice. He was awarded a Fellowship in 1997 by the British Columbia Institute of Chartered Accountants. Mr. Bowles is also a Fellow of the Canadian Institute of Mining, Metallurgy and Petroleum, and is a director of Hecla Mining Company. He retired from PricewaterhouseCoopers on June 30, 2006. Mr. Bowles was elected to the board on June 1, 2006.

Ronald P. Gagel, CA

Independent Director

Mr. Gagel is Senior Vice President and Chief Financial Officer of FNX Mining Company Inc. and since 2006 has also served as Vice-President and Chief Financial Officer of International Nickel Ventures Corporation. Mr. Gagel is a chartered accountant with more than 27 years of professional experience, predominantly in the natural resources sector. From 1988 to 2004, Mr. Gagel was at Aur Resources Inc., and from 1999 to 2004, he served as Vice-President and CFO at Aur. He is a director of Glencairn Gold Corporation and the Prospectors and Developers Association of Canada.

Peter R. Jones, P. Eng.

President, Chief Executive Officer and Director

Mr. Jones has been the President and Chief Executive Officer of HBMS/HudBay since 2002. He joined the Company in 1995 as Vice President, Mining and has subsequently held the positions of Senior Vice President, Projects and President, Metallurgical Division. Prior to joining the Company, he held senior positions in operations and projects with Cominco Limited, Cape Breton Development Corporation and Cominco Engineering Services. He has an extensive operational and project background in potash, coal, lead, zinc and gold and has directed feasibility studies throughout the world. Mr. Jones graduated from the Camborne School of Mines, United Kingdom in 1969 and the Banff School of Advanced Management in 1984. Mr. Jones is chairman of the Mining Association of Canada and is the past President of the Mining Association of Manitoba. In 2006, Mr. Jones was recognized by Ernst & Young as the Prairie Region Turnaround Entrepreneur of the Year.

Corporate Officers



Peter R. Jones



H. Russell Rood



Tom A. Goodman



Brian D. Gordon



Alan T. C. Hair



Jeff A. Swinoga

Peter R. Jones, P.Eng.

President, Chief Executive Officer and Director

**H. Russell Rood, B.Sc. (Civil Engineering),
B.Sc. (Mining Engineering)**

President, Mining Division

Tom A. Goodman

Vice President, Technical Services and Human Resources

Brian D. Gordon, LLB

Vice President and General Counsel

Alan T. C. Hair, B.Sc. (Hons)

Vice President, Metallurgy, Safety, Health & Environment

Jeff A. Swinoga, CA, MBA

Vice President and Chief Financial Officer

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Annual General Meeting

May 31, 2007
2:00 pm ET
Gallery Room
TSX Conference Centre
130 King Street West
Toronto, Ontario



"2006 was a tremendous year for our company. In an environment of very strong commodity prices, we delivered on our production targets, advanced our growth plans and proactively strengthened the financial structure of HudBay."

www.hudbayminerals.com