

The following is Exhibit "E" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.



A Commissioner of Oaths
Being a Solicitor

PricewaterhouseCoopers Inc.
1250 René-Lévesque Boulevard
West
Suite 2800
Montreal Quebec
Canada H3B 2G4
Phone: +1 (514) 205 5000
Fax: +1 (514) 205 5694

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL
N°: 500-11-036722-094

SUPERIOR COURT

**IN THE MATTER OF THE PLAN OF ARRANGEMENT
OF:**

Blue Note Mining Inc., a legal person duly constituted under the Canada Business Corporation Act having its head office at 1, Place Ville-Marie, Suite 1511, Montreal, Quebec, H3B 2B5.

1.1 DEBTOR

and

PricewaterhouseCoopers Inc., a corporation having its principal place of business in Quebec at 1250 René-Lévesque Blvd. West, Suite 2800, Montreal, Quebec, H3B 2G4, acting in its capacity of monitor under proceedings pending in respect of Blue Note Mining Inc. under the Companies' Creditors Arrangement Act.

MONITOR

NOTICE OF DISALLOWANCE OF CLAIM
(Article 6.3 of the Plan of Arrangement)

Breakwater Resources Ltd
950 - 95 Wellington Street West
Toronto (Ontario) M5J 2N7

We hereby acknowledge receipt of your proof of claim dated July 9, 2009 and received • in the above mentioned matter.

We wish to advise you that in accordance with the court order on the Petition to establish a claims and meeting process by the Superior Court of Quebec rendered on June 19, 2009, we hereby disallow in part your proof of claim for the following reasons:

On August 1st, 2006, Blue Note Metals Inc. (now Blue Note Mining Inc.) issued an unsecured subordinated convertible debenture in favour of Breakwater Resources Ltd. in the principal amount of \$15 000 000 in lawful money of Canada.



On August 29, 2008, Breakwater Resources Ltd. sent the following letter to Blue Note Mining Inc.:

"In accordance with Article 3.2(a) of the Debenture, Breakwater Resources Ltd. ("Breakwater") hereby surrenders the Debenture to Blue Note Mining Inc. (formerly, Blue Note Metals Inc.) ("Blue Note") and encloses a written notice, substantially in the form set out in Exhibit A of the Debenture, stating Breakwater's election to exercise its Property Interest Conversion Option (as defined in the Debenture) (the "Notice").

By surrendering the Debenture and providing Blue Note and Blue Note Caribou Mines Inc. with the Notice, this shall constitute a contract between Breakwater and Blue Note Caribou Mines Inc. whereby Breakwater and Blue Note Caribou Mines Inc. shall enter into a joint venture agreement pursuant to Section 3.2(b) of the Debenture and Breakwater, subject to receipt of fully executed joint venture agreement, substantially in the form set out in Exhibit B of the Debenture, releases Blue Note and Blue Note Caribou Mines Inc. from all liability under the Debenture.

The conversion date shall be such date as described in Section 3.2(c) of the Debenture.

Pursuant to Section 3.2(d) of the Debenture, Blue Note and Blue Note Caribou Mines Inc. shall cause title to the Properties to be recorded in Breakwater's name in proportion to Breakwater's Interest (as defined in the Debenture) as soon as practicable after the Date of Property Interest Conversion (as defined in the Debenture). Please provide us with a copy of such title as soon as possible."

On the same date, Breakwater sent a Notice of exercise of Property Interest Conversion Option stating:

"The undersigned, the Register Holder of the Unsecured Subordinated Convertible Debenture issued by Blue Note Metals Inc. (now Blue Note Mining Inc.) on August 1, 2006 (the "Debenture") hereby irrevocably elects to convert the indebtedness outstanding under the Debenture into a 20 % interest in the Properties (as defined in the Debenture) in accordance with the terms of the Debenture."

In view of the above, Breakwater Resources Ltd. cannot claim to be a creditor of Blue Note Mining Inc. in the amount stated in its proof of claim as it can no longer claim the principal value of the Debenture, being \$15 000 000.

The amount claimed by Breakwater Resources Ltd in its proof of claim is therefore reduced to \$923,241.00.

In this regard, we are unable to accept your claim as filed.



If you wish to contest this Notice of Revision or Disallowance, you must, within ten (10) days of the this Notice, file an appeal motion with the Court and serve a copy of such appeal motion to the Petitioner and the Monitor.

Yours truly,

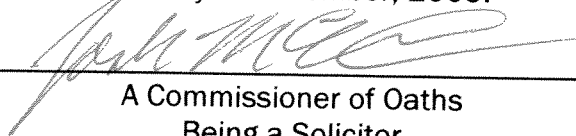
DATED AT MONTREAL, this 17th day of July, 2009

PRICEWATERHOUSECOOPERS INC.
Court Appointed Monitor.

A handwritten signature in black ink, appearing to be 'C. Bourque', written over the printed name and title.

Christian Bourque, QA, CIRP
Designated Monitor

The following is Exhibit "F" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.

A handwritten signature in dark ink, appearing to read "John M. [unclear]", is written over a horizontal line.

A Commissioner of Oaths
Being a Solicitor

District of: New Brunswick
Court No.: 03 - Bathurst
Court No.: 15411
Estate No.: 51-1228301

FORM 31 / 36
Proof of Claim / Proxy
In the matter of the Bankruptcy of
Blue Note Caribou Mines Inc.

All notices or correspondence regarding this claim must be forwarded to the following address:

Breakwater Resources Ltd.

950 - 95 Wellington Street West, Toronto, Ontario, Canada, M5J 2N7

In the matter of the bankruptcy of Blue Note Caribou Mines Inc. of the City of Montreal in the Province of Quebec and the claim of Breakwater Resources Ltd. creditor.

I, Breakwater Resources Ltd. of the city of Toronto, Ontario, a creditor in the above matter, hereby appoint ~~the trustee~~
~~identified below~~ Stephen J. Hutchison of Stewart McKelvey to be my
proxyholder in the above matter, except as to the receipt of dividends, (with or without) power to appoint another proxyholder in his
or her place.
I, Lesley Duncan (name of ~~creditor~~ representative of the creditor), of the city of Scarborough in the
province of Ontario do hereby certify:

1. That I am a ~~creditor of the above named debtor~~ corporate secretary (position/title) of Breakwater Resources Ltd. creditor).
2. That I have knowledge of all the circumstances connected with the claim referred to below.
3. That the debtor was, at the date of bankruptcy, namely the 3rd day of July 2009, and still is, indebted to the creditor in the sum of \$ 63,758.02, as specified in the statement of account (~~statement of account~~) attached and marked Schedule "A", after deducting any counterclaims to which the debtor is entitled. (The attached statement of account or affidavit must specify the vouchers or other evidence in support of the claim.)

4. (Check and complete appropriate category.)

☒ A. UNSECURED CLAIM OF \$63,758.02

(other than as a customer contemplated by Section 262 of the Act)

That in respect of this debt, I do not hold any assets of the debtor as security and
(Check appropriate description.)

☐ Regarding the amount of \$ _____, I claim a right to a priority under section 136 of the Act.

☐ Regarding the amount of \$ _____, I do not claim a right to a priority.
(Set out on an attached sheet details to support priority claim.)

☐ B. CLAIM OF LESSOR FOR DISCLAIMER OF A LEASE \$ _____

That I hereby make a claim under subsection 65.2(4) of the Act, particulars of which are as follows:
(Give full particulars of the claim, including the calculations upon which the claim is based.)

☐ C. SECURED CLAIM OF \$ _____

That in respect of this debt, I hold assets of the debtor valued at \$ _____ as security, particulars of which are as follows:
(Give full particulars of the security, including the date on which the security was given and the value at which you assess the security, and attach a copy of the security documents.)

☐ D. CLAIM BY FARMER, FISHERMAN OR AQUACULTURIST OF \$ _____

That I hereby make a claim under subsection 81.2(1) of the Act for the unpaid amount of \$ _____
(Attach a copy of sales agreement and delivery receipts.)

☐ E. CLAIM BY WAGE EARNER OF \$ _____

☐ That I hereby make a claim under subsection 81.3(8) of the Act in the amount of \$ _____

☐ That I hereby make a claim under subsection 81.4(8) of the Act in the amount of \$ _____

☐ F. CLAIM AGAINST DIRECTOR \$ _____

(To be completed when a proposal provides for the compromise of claims against directors.)

That I hereby make a claim under subsection 50(13) of the Act, particulars of which are as follows:
(Give full particulars of the claim, including the calculations upon which the claim is based.)

☐ G. CLAIM OF A CUSTOMER OF A BANKRUPT SECURITIES FIRM \$ _____

FORM 31/36 --- Concluded

That I hereby make a claim as a customer for net equity as contemplated by section 262 of the Act, particulars of which are as follows:
(Give full particulars of the claim, including the calculations upon which the claim is based.)

5. That, to the best of my knowledge, ~~XXXXXXXXXXXXXXXXXXXX~~ Breakwater Resources Ltd. the above-named creditor is (is not) related to the debtor within the meaning of section 4 of the Act, and ~~(has not)~~ (has) not dealt with the debtor in a non-arm's-length manner.

6. That the following are the payments that I have received from, and the credits that I have allowed to, and the transfers at undervalue within the meaning of subsection 2(1) of the Act that I have been privy to or a party to with the debtor within the three months (or, if the creditor and the debtor are related within the meaning of section 4 of the Act or were not dealing with each other at arm's length, within the 12 months) immediately before the date of the initial bankruptcy event within the meaning of Section 2 of the Act: (Provide details of payments and credits.) NIL

(Applicable only in the case of the bankruptcy of an individual.)

☒ I request that a copy of the report filed by the trustee regarding the bankrupt's application for discharge pursuant to subsection 170(1) of the Act be sent to the above address.

Dated at Toronto, Ontario, this 13th day of August, 2009.

Stacy
Witness
Stacy
Witness

Individual Creditor

BREAKWATER RESOURCES LTD.
Name of Corporate Creditor

Por

Name and Title of Signing Officer

Lesley Duncan, Corporate Secretary

Phone Number: 416-363-4798

Fax Number: 416-363-9470

E-mail Address: L.DUNCAN@BREAKWATER.CA

Return To:

PricewaterhouseCoopers Inc. - Trustee
PO Box 789
44 Chipman Hill, Suite 300
Saint John NB E2L 4B9
Phone: (506) 632-1810 Fax: (506) 657-4404

NOTE: If an affidavit is attached, it must have been made before a person qualified to take affidavits.

WARNINGS: A trustee may, pursuant to subsection 128(3) of the Act, redeem a security on payment to the secured creditor of the debt or the value of the security as assessed, in a pool of security, by the secured creditor.
Subsection 20(1) of the Act provides severe penalties for making any false claim, proof, declaration or statement of account.

District of: New Brunswick
Court No. 03 - Bathurst
Court No. 15411
Estate No. 51-1228301

FORM 31 / 36
Proof of Claim / Proxy
In the matter of the Bankruptcy of
Blue Note Caribou Mines Inc.

All notices or correspondence regarding this claim must be forwarded to the following address:
Breakwater Resources Ltd.

950 - 95 Wellington Street West, Toronto, Ontario, Canada, M5J 2N7

In the matter of the bankruptcy of Blue Note Caribou Mines Inc. of the City of Montreal in the Province of Quebec and the claim of Breakwater Resources Ltd., creditor.

I, Breakwater Resources Ltd., of the city of Toronto, Ontario, a creditor in the above matter, hereby appoint the trustee proxyholder in the above matter, except as to the receipt of dividends, of Stewart McKelvey, to be my or her place. Lesley Duncan (name of creditor representative of the creditor), of the city of Scarborough in the province of Ontario do hereby certify:

1. That I am a creditor of the above named debtor (or a corporate secretary (position/title) of Breakwater Resources Ltd., creditor).
2. That I have knowledge of all the circumstances connected with the claim referred to below.
3. That the debtor was, at the date of bankruptcy, namely the 3rd day of July 2009, and still is, indebted to the creditor in the sum of \$63,758.02 as specified in the statement of account (or affidavit or sworn declaration) attached and marked Schedule "A", after deducting any counterclaims to which the debtor is entitled. (The attached statement of account or affidavit must specify the vouchers or other evidence in support of the claim.)

4. (Check and complete appropriate category.)

☒ A. UNSECURED CLAIM OF \$63,758.02

(other than as a customer contemplated by Section 262 of the Act)

That in respect of this debt, I do not hold any assets of the debtor as security and
(Check appropriate description.)

☐ Regarding the amount of \$ _____, I claim a right to a priority under section 136 of the Act.

☐ Regarding the amount of \$ _____, I do not claim a right to a priority.
(Set out on an attached sheet details to support priority claim.)

☐ B. CLAIM OF LESSOR FOR DISCLAIMER OF A LEASE \$ _____

That I hereby make a claim under subsection 65.2(4) of the Act, particulars of which are as follows:

(Give full particulars of the claim, including the calculations upon which the claim is based.)

☐ C. SECURED CLAIM OF \$ _____

That in respect of this debt, I hold assets of the debtor valued at \$ _____ as security, particulars of which are as follows:
(Give full particulars of the security, including the date on which the security was given and the value at which you assess the security, and attach a copy of the security documents.)

☐ D. CLAIM BY FARMER, FISHERMAN OR AQUACULTURIST OF \$ _____

That I hereby make a claim under subsection 81.2(1) of the Act for the unpaid amount of \$ _____
(Attach a copy of sales agreement and delivery receipts.)

☐ E. CLAIM BY WAGE EARNER OF \$ _____

☐ That I hereby make a claim under subsection 81.3(8) of the Act in the amount of \$ _____

☐ That I hereby make a claim under subsection 81.4(8) of the Act in the amount of \$ _____

☐ F. CLAIM AGAINST DIRECTOR \$ _____

(To be completed when a proposal provides for the compromise of claims against directors.)

That I hereby make a claim under subsection 50(13) of the Act, particulars of which are as follows:
(Give full particulars of the claim, including the calculations upon which the claim is based.)

☐ G. CLAIM OF A CUSTOMER OF A BANKRUPT SECURITIES FIRM \$ _____

FORM 31/36 --- Concluded

That I hereby make a claim as a customer for net equity as contemplated by section 262 of the Act, particulars of which are as follows:
(Give full particulars of the claim, including the calculations upon which the claim is based.)

5. That, to the best of my knowledge, ~~XXXXXXXXXXXXXXX~~ Breakwater Resources Ltd. the above-named creditor is (is not) related to the debtor within the meaning of section 4 of the Act, and ~~(have/has not)~~ (has not) dealt with the debtor in a non-arm's-length manner.

6. That the following are the payments that I have received from, and the credits that I have allowed to, and the transfers at undervalue within the meaning of subsection 2(1) of the Act that I have been privy to or a party to with the debtor within the three months (or, if the creditor and the debtor are related within the meaning of section 4 of the Act or were not dealing with each other at arm's length, within the 12 months) immediately before the date of the initial bankruptcy event within the meaning of Section 2 of the Act: (Provide details of payments and credits.) Nil

(Applicable only in the case of the bankruptcy of an individual.)

☒ I request that a copy of the report filed by the trustee regarding the bankrupt's application for discharge pursuant to subsection 170(1) of the Act be sent to the above address.

Dated at Toronto, Ontario, this _____ day of August, 2009.

Witness

Individual Creditor

Witness

Name of Corporate Creditor

Per _____
Name and Title of Signing Officer

Return To:

Phone Number: _____
Fax Number: _____
E-mail Address: _____

PricewaterhouseCoopers Inc. - Trustee
PO Box 789
44 Chipman Hill, Suite 300
Saint John NB E2L 4B9
Phone: (506) 632-1810 Fax: (506) 657-4404

NOTE: If an affidavit is attached, it must have been made before a person qualified to take affidavits.

WARNING: A trustee may, pursuant to subsection 128(3) of the Act, redeem a security on payment to the secured creditor of the debt or the value of the security as released, or a proof of security, by the secured creditor. Subsection 20(1) of the Act provides severe penalties for making any false claim, proof, declaration or statement of account.

Schedule "A"

**STATEMENT OF OUTSTANDING FEES OWED BY BLUE NOTE CARIBOU MINES INC.
("BLUE NOTE CARIBOU") TO BREAKWATER RESOURCES LTD. ("BREAKWATER")
RELATING TO MARKETING AGENCY AGREEMENT**

INVOICES SENT TO BLUE NOTE CARIBOU BUT PAYMENT NOT RECEIVED

Code	Date	Invoiced By	Details	Amount (C\$)
001	26-Aug-08	Breakwater Debit Note No. 288002	Relating to Invoice Nos. 1178002, 1188002 and 1198002	\$18,859.04
001A	1-Aug-08	Blue Note Caribou to Falconbridge Invoice No. 1178002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 288002	N/A
001B	8-Aug-08	Blue Note Caribou to Xstrata Invoice No. 1188002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 288002	N/A
001C	13-Aug-08	Blue Note Caribou to Nyrstar Invoice No. 1198002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 288002	N/A
002	23-Sep-08	Breakwater Debit Note No. 298002	Relating to Invoice Nos. 1218002, 1228002, 1238002	\$16,920.50
002A	2-Sep-08	Blue Note Caribou to Falconbridge Invoice No. 1218002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 298002	N/A
002B	12-Sep-08	Blue Note Caribou to Boliden Invoice No. 1228002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 298002	N/A
002C	16-Sep-08	Blue Note Mining Inc. to Falconbridge Invoice No. 1238002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 298002	N/A
003	27-Oct-08	Breakwater Debit Note No. 308002	Relating to Invoice Nos. 1248002 and 1258002	\$12,674.31
003A	2-Oct-08	Blue Note Caribou to Falconbridge Invoice No. 1248002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 308002	N/A

Schedule "A"

Code	Date	Invoiced By	Details	Amount (C\$)
003B	8-Oct-08	Blue Note Caribou to Xstrata Invoice No. 1258002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 308002	N/A
004	17-Nov-08	Breakwater Debit Note No. 318002	Relating to Invoice Nos. 1268002 and 1278002	\$15,304.17
004A	3-Nov-08	Blue Note Caribou to Falconbridge Invoice No. 1268002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 318002	N/A
004B	17-Nov-08	Blue Note Caribou to MRI Trading Invoice No. 1278002	Invoice used by Breakwater to determine applicable marketing fees for the sale relating to Debit Note No. 318002	N/A
			TOTAL	\$63,758.02

RELATED DOCUMENTS

Code	Date	Document	Details
005	4-Dec-08	Letter from Breakwater to Blue Note Mining Inc. terminating Marketing Agency Agreement *Dated December 4, 2005, which was incorrect, it was December 4, 2008	
006	1-Aug-06	Marketing Agency Agreement	Between Breakwater and Blue Note Mining Inc.
007	30-Jan-09	Amended Statement of Claim on behalf of Breakwater Resources Ltd. against Blue Note Mining Inc. and Blue Note Caribou	

Section 16 of the Marketing Agency Agreement provides:

ASSIGNS

Neither party may assign this Agreement without the written consent of the other party, except to a successor corporation acquiring all or substantially all of the assignor's assets or to an affiliate [e.g. Blue Note Caribou] which latter assignment shall not release the relevant party from its obligations herein. This Agreement will bind and enure to the benefit of the parties hereto and their permitted successors and assigns.



95 WELLINGTON STREET WEST, SUITE 950
TORONTO, ONTARIO M5, 2N7

Tel: (416) 363-4790 Fax: (416) 363-1315
www.breakwater.ca

DEBIT NOTE NO. 288902

BLUE NOTE MINING INC.
1 Place Ville Marie
Suite 2125
Montreal, Quebec
H3B 2C6
Attn: Mr. John Martin

Toronto, August 26, 2008

Payment Due On or Before Prompt

ACCOUNT NAME: Breakwater Resources Ltd.
CDN ACCOUNT NUMBER: 0000216236 13
Bank of Nova Scotia
Toronto Business Support Centre
SWIFT: NOSCCATY
Bank Number: 002
Bank Transit Number: 47696

MARKETING AGENT FEE

Quality	Invoice No.	Quantity (Metric)	Price/Unit	Due	GR1	Total Due
Castro Lead Ore - July 08 Receipts	1178002	5,936,309	\$1.00	\$5,936,31	\$299.35	\$6,235.65
Castro Zinc Ore - per m/y "Orna"	1188002	4,614,077	\$1.50	\$6,921.08	\$230.70	\$7,151.78
Castro Zinc Ore - per m/y "Spitzelgracht"	1198002	7,160,000	\$1.00	\$7,160.00	\$368.00	\$7,528.00
					CAD	\$18,925.43

BREAKWATER RESOURCES LTD.

001A

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel: 506 546 6400 Fax: 506 548 5103																																																																																																																			
SOLD TO: FALCONBERG LIMITED - BRUNSWICK MINE P.O. Box 3000 Bathurst, NB B2A 3Z1 Attn: Ms. Wendy Smith			Invoice No: 1171002 PROVISIONAL INVOICE 1-Aug-08 Material: Caribou Lead Concentrate Shipment: From Caribou/Resigonie Mine Delivery: DDP Bathurst, New Brunswick Settlement: U.S. Dollars																																																																																																																
<table border="0"> <tr> <td>Month of Delivery:</td> <td>July, 2008</td> <td>Lot: 08-0448 - 08-0656</td> </tr> <tr> <td>Payment Terms / Due Dates:</td> <td colspan="2">90% due on the 5th day of the month following the month of delivery - August 5, 2008</td> </tr> <tr> <td>Q/P: 1 MAMA = Sept., 2008</td> <td>Prov. Weight:</td> <td>(unit) (H2O) (dmt)</td> </tr> <tr> <td></td> <td>6467.400</td> <td>7.43 5986.909</td> </tr> <tr> <td></td> <td>Prov. Grades:</td> <td></td> </tr> <tr> <td></td> <td>Ph (%)</td> <td>43.00 As (%) 0.60</td> </tr> <tr> <td></td> <td>Ag (g/t)</td> <td>530.00 Sb (%) 0.10</td> </tr> <tr> <td></td> <td>Am (g/t)</td> <td>1.00 S (%) 30.00</td> </tr> </table>						Month of Delivery:	July, 2008	Lot: 08-0448 - 08-0656	Payment Terms / Due Dates:	90% due on the 5th day of the month following the month of delivery - August 5, 2008		Q/P: 1 MAMA = Sept., 2008	Prov. Weight:	(unit) (H2O) (dmt)		6467.400	7.43 5986.909		Prov. Grades:			Ph (%)	43.00 As (%) 0.60		Ag (g/t)	530.00 Sb (%) 0.10		Am (g/t)	1.00 S (%) 30.00																																																																																						
Month of Delivery:	July, 2008	Lot: 08-0448 - 08-0656																																																																																																																	
Payment Terms / Due Dates:	90% due on the 5th day of the month following the month of delivery - August 5, 2008																																																																																																																		
Q/P: 1 MAMA = Sept., 2008	Prov. Weight:	(unit) (H2O) (dmt)																																																																																																																	
	6467.400	7.43 5986.909																																																																																																																	
	Prov. Grades:																																																																																																																		
	Ph (%)	43.00 As (%) 0.60																																																																																																																	
	Ag (g/t)	530.00 Sb (%) 0.10																																																																																																																	
	Am (g/t)	1.00 S (%) 30.00																																																																																																																	
<table border="0"> <tr> <td colspan="2">Provisional Prices: July, 2008</td> <td></td> <td>(US\$)</td> <td></td> </tr> <tr> <td>Metal Value</td> <td>Deductions</td> <td>Payable</td> <td>Price</td> <td>Value</td> </tr> <tr> <td>LME Cash Settlement (Ph)</td> <td>3.0</td> <td>-</td> <td>1944.163 US\$/mt</td> <td>777.67</td> </tr> <tr> <td>London Avg. of LM/PM (Am)</td> <td>1.0</td> <td>-</td> <td>939.732 US\$/oz</td> <td>-</td> </tr> <tr> <td>London Spot (Ag)</td> <td>50.0</td> <td>-</td> <td>18.03000 US\$/oz</td> <td>289.84</td> </tr> <tr> <td colspan="3"></td> <td>TOTAL PAYABLES:</td> <td>1,067.51</td> </tr> <tr> <td colspan="4">Charges/Penalties</td> <td></td> </tr> <tr> <td colspan="3">Treatment Charge: US\$180.00/dmt</td> <td></td> <td>180.00</td> </tr> <tr> <td colspan="3">Silver Refining Charge: 16.075</td> <td>9.30 US\$/oz</td> <td>4.82</td> </tr> <tr> <td colspan="3">Gold Refining Charge:</td> <td>6.08 US\$/oz</td> <td>-</td> </tr> <tr> <td colspan="3">As Penalty: US \$1.50/dmt for each 0.10% > 0.60%</td> <td></td> <td>1.00</td> </tr> <tr> <td colspan="3">Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40%</td> <td></td> <td>-</td> </tr> <tr> <td colspan="3">S Penalty: US \$8.00/dmt for each 1% > 30%</td> <td></td> <td>-</td> </tr> <tr> <td colspan="3"></td> <td>TOTAL DEDUCTIONS:</td> <td>187.82</td> </tr> <tr> <td colspan="3"></td> <td>NET VALUE:</td> <td>879.69</td> </tr> <tr> <td colspan="3">VALUE:</td> <td>5986.909 x</td> <td>879.69</td> </tr> <tr> <td colspan="3"></td> <td>Freight Allowances:</td> <td>\$20.00</td> </tr> <tr> <td colspan="3"></td> <td>TOTAL:</td> <td>5,146,826.80</td> </tr> <tr> <td colspan="3"></td> <td>Provisional Value (90%):</td> <td>4,632,197.21</td> </tr> <tr> <td colspan="3"></td> <td>GST (5%):</td> <td>231,609.86</td> </tr> <tr> <td colspan="3"></td> <td>HST (8%):</td> <td>370,375.78</td> </tr> <tr> <td colspan="3"></td> <td>TOTAL DUE:</td> <td>5,234,182.85</td> </tr> </table>						Provisional Prices: July, 2008			(US\$)		Metal Value	Deductions	Payable	Price	Value	LME Cash Settlement (Ph)	3.0	-	1944.163 US\$/mt	777.67	London Avg. of LM/PM (Am)	1.0	-	939.732 US\$/oz	-	London Spot (Ag)	50.0	-	18.03000 US\$/oz	289.84				TOTAL PAYABLES:	1,067.51	Charges/Penalties					Treatment Charge: US\$180.00/dmt				180.00	Silver Refining Charge: 16.075			9.30 US\$/oz	4.82	Gold Refining Charge:			6.08 US\$/oz	-	As Penalty: US \$1.50/dmt for each 0.10% > 0.60%				1.00	Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40%				-	S Penalty: US \$8.00/dmt for each 1% > 30%				-				TOTAL DEDUCTIONS:	187.82				NET VALUE:	879.69	VALUE:			5986.909 x	879.69				Freight Allowances:	\$20.00				TOTAL:	5,146,826.80				Provisional Value (90%):	4,632,197.21				GST (5%):	231,609.86				HST (8%):	370,375.78				TOTAL DUE:	5,234,182.85
Provisional Prices: July, 2008			(US\$)																																																																																																																
Metal Value	Deductions	Payable	Price	Value																																																																																																															
LME Cash Settlement (Ph)	3.0	-	1944.163 US\$/mt	777.67																																																																																																															
London Avg. of LM/PM (Am)	1.0	-	939.732 US\$/oz	-																																																																																																															
London Spot (Ag)	50.0	-	18.03000 US\$/oz	289.84																																																																																																															
			TOTAL PAYABLES:	1,067.51																																																																																																															
Charges/Penalties																																																																																																																			
Treatment Charge: US\$180.00/dmt				180.00																																																																																																															
Silver Refining Charge: 16.075			9.30 US\$/oz	4.82																																																																																																															
Gold Refining Charge:			6.08 US\$/oz	-																																																																																																															
As Penalty: US \$1.50/dmt for each 0.10% > 0.60%				1.00																																																																																																															
Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40%				-																																																																																																															
S Penalty: US \$8.00/dmt for each 1% > 30%				-																																																																																																															
			TOTAL DEDUCTIONS:	187.82																																																																																																															
			NET VALUE:	879.69																																																																																																															
VALUE:			5986.909 x	879.69																																																																																																															
			Freight Allowances:	\$20.00																																																																																																															
			TOTAL:	5,146,826.80																																																																																																															
			Provisional Value (90%):	4,632,197.21																																																																																																															
			GST (5%):	231,609.86																																																																																																															
			HST (8%):	370,375.78																																																																																																															
			TOTAL DUE:	5,234,182.85																																																																																																															
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS33 Address: 37 Broad Street, New York, NY 10015 ABA: 025-009-593 Account of TD Bank - Swift Code: TD0MCATYYOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transit, Financial Institution, Designation Numbers: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7325566																																																																																																																			

001B

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel: 506 546 6100 Fax: 506 548 5103					
SOLD TO: Xstrata Canada Corporation Xstrata Zinc Canada Division 100 King Street West Suite 7050, P.O. Box 494 Toronto, Ontario, M5X 1B3 Attn: Mr. Martha Thomas			Invoice No: H88602 PROVISIONAL INVOICE Material: Caribou Zinc Concentrate Shipment: CIF PO Aviles, Spain Settlement: U.S. Dollars 8-Aug-08		
Vessel Name: m/v "Orea" Bill of Lading Date: 4-Aug-08 Payment Terms / Due Date: 90% 5 days after arrival at dispatch Q/P: 2 MAMA					
Final Weight: 4,999.00 Less 0.3% Weight Trenches: 4,984.00 Prov. Grades: Zn (%): 49.50		(H2O) 7.70 (H2O) 7.70 (dm) 4,614.077 Final Weight: 4,600.236 Fe (%): 11.00			
Provisional Price: July, 2008 Metal: Zinc LME Settlement (Zn): 8.090 Reduction: 8.090 Payable: 1852.37 US\$/mt TOTAL PAYABLES: 768.73 US\$/DMT					
Charges/Penalties Treatment Charges: 2008 Terms Based: US\$302.00/dmt @ US\$2,000.00 Recalculation: + 0.085/dmt for each \$1.00 > \$2,000.00 < \$2,500.00 + 0.07/dmt for each \$1.00 > \$2,500.00 De-calculation: - 0.075/dmt for each \$1.00 < \$2,000.00 > \$1,500.00 - 0.07/dmt for each \$1.00 < \$1,500.00 Fe Penalty: US \$1.75/dmt for each 1% > 8.5% TOTAL DEDUCTIONS: 358.31 US\$/DMT NET VALUE: 473.42 US\$/DMT 90% Provisionals: 1,560,059.93					
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS3N Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-593 Account of TD Bank - Swift Code: TDOMCATTTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2V 1S1 Transat, Financial Institution, Designation Numbers: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7328566					

001C

Blue Note - Caribou Mines 9361 Route 190, P.O. Box / C.P. 26 Bathurst, NB, Canada E2A 3Z1 Tel: 506 546 6401 Fax: 506 548 5183					
SOLD TO: NYRSTAR BELGIUM SA/NV Zinkstraat 1 B-2490 Helsen Belgium			Invoice No: 1108002 PROVISIONAL INVOICE Material: Caribou Zinc Concentrate Shipments: DISE UT Auwerw, Belgium Settlement: U.S. Dollars 13-Aug-88		
Attn: Christine Hense m/v "Ryckelghecht" 11-Aug-88 90% due 5 calendar days after the vessel's arrival at dispatch Q/P: 2 MAMA					
Prov. Weight: 8000.000 Prov. Grades: Zn (%): 49.50 Ag (g/t): 115.00		(wmt) 8.00 (t20) (dmt) 7968.000 Pb (%): 10.50 Pb (%): 2.50			
Provisional Prices: 11-Aug-88					
Metal Value LME Settlement (Zn) 8.000 London Spot Price (Ag) 3.600		Deduction Payable Price 1670.50 US\$/mt 15.34 US\$/oz TOTAL PAYABLES:		(US\$) Value 693.25 7.99 701.24 US\$/DMT	
Charges/Provisions Treatment Charges 2808 Terms Base: US\$340.00/dmt @ US\$2,000.00 Reculator: + 0.10dmt for each \$1.00 > \$2,000.00 < \$2,500.00 + 0.12dmt for each \$1.00 > \$2,500.00 De-reculator: - 0.09/dmt for each \$1.00 < \$2,000.00 < \$1,500.00 - 0.11/dmt for each \$1.00 < \$1,500.00 Pb Penalty: US \$1.50/dmt for each 1% > 9% Pb Penalty: US\$2.00/dmt for each 1% > 2.5%					
		Base: 300.00 Reculator: 29.66 Pb Penalty: 2.23 TOTAL DEDUCTIONS: 331.89 US\$/DMT			
		NET VALUE: 428.16 US\$/DMT 7360.000 x 428.16 = 3,151,257.60 Provisional Value Due (90%): 2,836,131.84 US\$			
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS33 Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-593 Account of TD Bank - Swift Codes TDOMCATTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1R1 Transit, Financial Institution, Designation Number: 41601-004-0018 Beneficiary: Blue Note Caribou Address: 9361 route 190, P.O. Box / C.P. 26 Bathurst, NB, Canada E2A 3Z1 Account No: 7325566					



95 WELLINGTON STREET WEST, SUITE 950
TORONTO, ONTARIO M5T 1N7

Tel: (416) 363-4790 Fax: (416) 363-0115
www.breakwater.ca

DEBIT NOTE NO. 228802

BLUE NOTE MINING INC.
1 Place Ville Marie
Suite 2125
Montreal, Quebec
H3M 1C6
Attn: Mr. John Martin

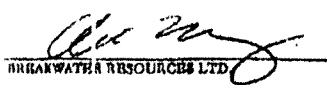
Toronto, September 25, 2008

Payment Due Date: Prompt

ACCOUNT NAME: Breakwater Resources Ltd.
CDN ACCOUNT NUMBER: 800021623613
Bank of Nova Scotia
Toronto Business Support Centre
SWIFT NO: NSCCATT
Bank Number: 003
Bank Transit Number: 47696

MARKETING AGENT FEE

Quality	Invoice No.	Quantity (tonnes)	Price/tonne	Due	GST	Total Due
Carlbus Lead Conc - August 08 Receipts	1218002	5,437.270	\$1.00	15,437.27	1281.86	16,719.13
Carlbus Zinc Conc - per m/v "Minesuriborg"	1228002	7,997.000	\$1.00	77,997.00	6399.83	84,396.83
Carlbus Lead Conc - September 1-15th Receipts	1238002	2,486.490	\$1.00	12,480.49	1124.02	13,604.51
					CAD	\$16,720.50


BREAKWATER RESOURCES LTD.

002A

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel: 506 541 6400 Fax: 506 548 5103				Invoice No: 215002 PROVISIONAL INVOICE Material: Caribou Lead Concentrate Shipments From: Caribou/Restigouche Mine Delivery: DDP Bathurst, New Brunswick Settlement: U.S. Dollars 2-Sep-08	
SOLD TO: FALCONBRIDGE LIMITED - BRUNSWICK MINZ P.O. Box 3000 Bathurst, NB B2A 3Z8 Attn: Ms. Wendy Smith					
Month of Delivery: August, 2008 082-087-02-043 Payment Terms/Due Date: 70% due on the 5th day of the month following the month of delivery - September 5, 2008 Q/P: 2 MANA = Oct., 2008		Prov. Weight: (gross) 1437.270 (net) 7.34 (dmt) 5189.166 Prov. Grades: Pb (%) 42.50 As (%) 0.60 Ag (g/tn) 500.00 Sb (%) 0.18 Au (g/tn) 1.00 S (%) 30.00			
Metal Values LME Cash Settlement (Pb) 3.0 London Avg. (AM/PM) (Au) 1.0 London Spot (Ag) 80.0		Provisional Prices August, 2008 Deduction Payable Price 1923.575 US\$/mt 839.707 US\$/oz 14.68575 US\$/oz		(US\$) Value 759.81 222.47 972.28 US\$/DMT	
Charges/Penalties Treatment Charge: US\$180.00/dmt Silver Refining Charge: 14.468 0.30 US\$/oz Gold Refining Charge: 6.00 US\$/oz As Penalty: US \$1.50/dmt for each 0.10% > 0.40% Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40% S Penalty: US \$8.00/dmt for each (%) > 30%		TOTAL DEDUCTIONS: 187.34 US\$/DMT NET VALUE: 784.94 US\$/DMT VALUE: 5189.166 x 784.94 4,073,166.26 Freight Allowance: \$20.00 (143,782.92) TOTAL: 3,969,383.34 US\$		Provisional Value (70%): 3,572,446.81 GST (5%): 178,622.34 IHT (8%): 283,798.74 TOTAL DUE: 4,034,867.89 US\$	
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS3N Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-993 Account of T/D Bank - Swift Code: TDOMCATTTOR For Further Credits to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1R1 Transit, Financial Institution, Designation Numbers: 41001-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7328566 <i>K. Prossanti</i>					

002B

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel: 506 546 6100 Fax: 506 548 5103			
SOLD TO: Dolden Commercial AB Zinc and Lead Concentrates PO Box 750 SE - 10135 Stockholm Sweden		Invoice No: 1228002 FIRST PROVISIONAL INVOICE Material: Caribou Zinc Concentrate Shipment: POB Bathurst, NB, Canada Settlement: U.S. Dollars 12-Sep-00	
Vessel Name: m/v "Missouri" Bill of Lading: Date: 8-Sep-00 Payment Terms/Due Date: 90% due 3 banking days after arrival of vessel at disposal Q/P: 2 MAM/		Attn: Ms. Andrea Orsz 8-Sep-00	
Prov. Weight (wmt) 7227.000 Prov. Grades Zn (%) 49.50 Prov. Grades Pb (%) 11.00		(H2O) 8.50 (dmt) 7317.255	
Provisional Price: 8-Sep-00 Metal Value LME Settlement (Zn) 8.000 Charges/Penals Treatment Charges 2000 Terms Basis: US\$302.00/dmt @ US\$2,000.00 Escalator: + 0.08125/dmt for each \$1.00 > \$2,000.00 < \$2,500.00 + 0.1350/dmt for each \$1.00 > \$2,500.00 De-escalator: - 0.07875/dmt for each \$1.00 < \$2,000.00 > \$1,500.00 - 0.12/dmt for each \$1.00 > \$1,500.00 Pb Penalty: 115 \$2.00/dmt for each 1% > 8.3%		Price \$1,735.00 US\$/mt TOTAL PAYABLES: 720.03 Basis Escalator: 302.00 -20.87 TOTAL DEDUCTIONS: 5.00 NET VALUE: 433.90 7317.255 x \$ 433.90 Provisional Value Due (90%): 2,857,461.25 Freight Allowance/wmt \$ 68.00 Balance: 2,313,668.25 Interest: (83,136.74) Total Balance Due: 2,310,534.51	
Kindly send funds to: Pay through Caribou's Corresponding Bank Bank of America National Trust and Savings Association Swift Code: BOPAUS33 Address: 37 Broad Street, New York, NY 10016 ABA: 026-009-593 Account of TD Bank - Swift Code: TD0MCATTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transit, Financial Institution, Designation Number: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7325566		US\$/DMT US\$/DMT US\$/DMT US\$ US\$	

002C

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada E2A 3Z1 Tel: 506 546 6100 Fax: 506 548 5103				Invoice No: 1238002 PROVISIONAL INVOICE 16-Sep-08 Material: Carbon Lead Concentrate Shipments From Caribou/Restigouche Mine Delivery: DDP Datedline, New Brunswick Settlement: U.S. Dollars	
SOLD TO: FALCONBIDGE LIMITED - BRUNSWICK MINE P.O. Box 3000 Bathurst, NB E2A 3Z8 Attn: Ms. Wendy Smith					
Month of Delivery: September, 2008 08-066-08-067 Payment Terms / Due Date: 85% due September 19, 2008 Q/P: 2 MAMA = Nov., 2008		Prov. Weight: (wmt) (H2O) (dmt) 2480.490 8.23 2276.346			
Prov. Grades: Pb (%) 12.50 Ag (g/l) 500.00 Au (g/l) 1.00		As (%) 0.60 Sb (%) 0.30 S (%) 30.00			
Provisional Prices: September 1-15, 2008					
Metal Value LME Cmt Settlement (Pb) 3.0 London Avg of LM/PM (Au) 1.0 London Spot (Ag) 50.0		Deductions Z payable Price 1860.410 US\$/mt 790.261 US\$/oz 12.05900 US\$/oz		(US\$) Value 734.86 174.47 909.33	
Charges/Rebates Treatment Charges: 118130.00/dmt Silver Refining Charges: 14.468 Gold Refining Charges: 0.30 4US/oz As Penalty: US \$1.50/dmt for each 0.10% > 0.40% Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40% S Penalty: US \$8.00/dmt for each 1% > 30%		6.08 3US/oz 3.00 - - -		US\$/DMT 180.80 4.34 3.00 - -	
		TOTAL DEDUCTIONS:		187.34 US\$/DMT	
		NET VALUE:		721.99 US\$/DMT	
VALUE:		2276.346 x 721.99 Freight Allowances: 320.00		1,643,999.85 (45,326.92) 1,597,972.13 US\$	
		TOTAL:		1,597,972.13 US\$	
		Provisional Value (85%): GST (5%): HST (8%):		1,358,276.31 67,913.82 108,662.10	
		TOTAL DUE:		1,534,852.33 US\$	
Kindly remit funds to:					
Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS33N Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-593 Account of TD Bank - Swift Code: TDOMCAT1TOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transit, Financial Institution, Designation Number: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada E2A 3Z1 Account No: 7325966					

K. P. P. P.



95 WELLINGTON STREET WEST, SUITE 950
TORONTO, ONTARIO M5J 2H7

Tel: (416) 363-4798 Fax: (416) 363-1315
www.breakwater.ca

DEBIT NOTE NO. 308002

BLUE NOTH MINING INC.
1 Place Ville Marie
Suite 2123
Montreal, Quebec
H3B 2G4
Attn: Mr. John Mazlin

Toronto, October 27, 2008

Payment Due E pay Prompt

ACCOUNT NAME: Breakwater Resources Ltd.
CDN ACCOUNT NUMBER: 8090216234 13
Bank of Nova Scotia
Toronto Business Support Centre
SWIFT: NOSCCAT
Bank Number: 002
Bank Transit Number: 47696

MARKETING AGENT FEE						
Quantity	Invoice No.	Quantity (kg)	Price/kg	Unit	GR1	Total Price
Carbon Lead Conc - Sept 16-30, 2008 Receipts	1248002	2,973.076	\$1.00	\$2,973.07	\$143.66	\$3,116.73
Carbon Zinc Conc - per m/v "Nisint Pride" (DL Oct 4/08)	1251002	7,596.000	\$1.10	\$8,355.60	\$469.80	\$8,825.40
					CAD	\$12,574.21

BREAKWATER RESOURCES LTD.

003A

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel: 506 546 6100 Fax: 506 548 5103																																	
SOLD TO: FALCONBRIDGE LIMITED - BRUNSWICK MINE P.O. Box 3000 Bathurst, NB B2A 3Z8 Attn: Ms. Wendy Smith		Invoice No: E210062 PROVISIONAL INVOICE Material: Caribou Lead Concentrate Shipment: From Caribou/Roadbouche Mine Delivery: DDP Belledune, New Brunswick Settlement: U.S. Dollars 2-Oct-08																															
Month of Delivery: September, 2008 08-068-08-078 Payment Terms / Due Date: 90% due October 8, 2008 Q/Pr 2 MAMA = Nov., 2008 Prov. Weight: (wmt) 5353.860 (H2O) 8.16 (dmt) 4916.968 Prov. Grades: Pb (%): 42.00 As (%): 0.80 Ag (g/t): 500.00 Sb (%): 0.10 Au (g/t): 1.00 S (%): 30.00																																	
Provisional Prices: September, 2008 <table border="1"> <thead> <tr> <th>Metal Value</th> <th>Deduction</th> <th>Payable</th> <th>Price</th> <th>(US\$)</th> <th>Value</th> </tr> </thead> <tbody> <tr> <td>LME Cash Settlement (Pb)</td> <td>3.0</td> <td>-</td> <td>1868.364 US\$/mt</td> <td>728.66</td> <td></td> </tr> <tr> <td>London Avg of LME/PM (Au)</td> <td>1.0</td> <td>-</td> <td>827.426 US\$/oz</td> <td>179.01</td> <td></td> </tr> <tr> <td>London Spot (Ag)</td> <td>50.0</td> <td>-</td> <td>12.57298 US\$/oz</td> <td>907.67</td> <td></td> </tr> <tr> <td colspan="4">TOTAL PAYABLE US\$:</td> <td>1815.34</td> <td>US\$/DMT</td> </tr> </tbody> </table>				Metal Value	Deduction	Payable	Price	(US\$)	Value	LME Cash Settlement (Pb)	3.0	-	1868.364 US\$/mt	728.66		London Avg of LME/PM (Au)	1.0	-	827.426 US\$/oz	179.01		London Spot (Ag)	50.0	-	12.57298 US\$/oz	907.67		TOTAL PAYABLE US\$:				1815.34	US\$/DMT
Metal Value	Deduction	Payable	Price	(US\$)	Value																												
LME Cash Settlement (Pb)	3.0	-	1868.364 US\$/mt	728.66																													
London Avg of LME/PM (Au)	1.0	-	827.426 US\$/oz	179.01																													
London Spot (Ag)	50.0	-	12.57298 US\$/oz	907.67																													
TOTAL PAYABLE US\$:				1815.34	US\$/DMT																												
Charges/Penalties Treatment Charges: US\$180.00/dmt Silver Refining Charges: 14.468 0.30 US\$/oz Gold Refining Charges: 6.00 US\$/oz As Penalty: US \$1.50/dmt for each 0.10% > 0.40% Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40% S Penalty: US \$8.00/dmt for each 1% > 30%																																	
<table border="1"> <thead> <tr> <th>Charges/Penalties</th> <th>Value</th> <th>US\$/DMT</th> </tr> </thead> <tbody> <tr> <td>Treatment Charges</td> <td>180.00</td> <td></td> </tr> <tr> <td>Silver Refining Charges</td> <td>4.34</td> <td></td> </tr> <tr> <td>Gold Refining Charges</td> <td>6.00</td> <td></td> </tr> <tr> <td>As Penalty</td> <td>-</td> <td></td> </tr> <tr> <td>Sb Penalty</td> <td>-</td> <td></td> </tr> <tr> <td>S Penalty</td> <td>-</td> <td></td> </tr> <tr> <td>TOTAL DEDUCTIONS:</td> <td>190.34</td> <td>US\$/DMT</td> </tr> </tbody> </table>				Charges/Penalties	Value	US\$/DMT	Treatment Charges	180.00		Silver Refining Charges	4.34		Gold Refining Charges	6.00		As Penalty	-		Sb Penalty	-		S Penalty	-		TOTAL DEDUCTIONS:	190.34	US\$/DMT						
Charges/Penalties	Value	US\$/DMT																															
Treatment Charges	180.00																																
Silver Refining Charges	4.34																																
Gold Refining Charges	6.00																																
As Penalty	-																																
Sb Penalty	-																																
S Penalty	-																																
TOTAL DEDUCTIONS:	190.34	US\$/DMT																															
<table border="1"> <thead> <tr> <th>NET VALUE:</th> <th>Value</th> <th>US\$/DMT</th> </tr> </thead> <tbody> <tr> <td>VALUE: 4916.968 x</td> <td>717.33</td> <td></td> </tr> <tr> <td>Freight Allowance:</td> <td>320.00</td> <td></td> </tr> <tr> <td>TOTAL:</td> <td>3,428,749.10</td> <td>US\$</td> </tr> <tr> <td>Provisional Value (90%):</td> <td>3,085,874.37</td> <td></td> </tr> <tr> <td>Mid Month Payment:</td> <td>(1,358,276.31)</td> <td></td> </tr> <tr> <td>Balance:</td> <td>1,727,598.06</td> <td></td> </tr> <tr> <td>GST (8%):</td> <td>86,379.90</td> <td></td> </tr> <tr> <td>HST (8%):</td> <td>138,207.84</td> <td></td> </tr> <tr> <td>TOTAL DUE:</td> <td>1,952,185.81</td> <td>US\$</td> </tr> </tbody> </table>				NET VALUE:	Value	US\$/DMT	VALUE: 4916.968 x	717.33		Freight Allowance:	320.00		TOTAL:	3,428,749.10	US\$	Provisional Value (90%):	3,085,874.37		Mid Month Payment:	(1,358,276.31)		Balance:	1,727,598.06		GST (8%):	86,379.90		HST (8%):	138,207.84		TOTAL DUE:	1,952,185.81	US\$
NET VALUE:	Value	US\$/DMT																															
VALUE: 4916.968 x	717.33																																
Freight Allowance:	320.00																																
TOTAL:	3,428,749.10	US\$																															
Provisional Value (90%):	3,085,874.37																																
Mid Month Payment:	(1,358,276.31)																																
Balance:	1,727,598.06																																
GST (8%):	86,379.90																																
HST (8%):	138,207.84																																
TOTAL DUE:	1,952,185.81	US\$																															
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOFAUS33 Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-593 Account of TD Bank - Swift Code: TDOMCATTTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transit, Financial Institution, Designation Number: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7325566																																	

$2480.490 = 2,873.07$
 less 1st half receipts (2,270.34 dmt)
 = 2,640.622 DMT

003B

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Tel 506 546 6100 Fax 506 548 5103					
SOLD TO: Xstrata Canada Corporation Xstrata Zinc Canada Division 100 King Street West Suite 7030, P.O. Box 494 Toronto, Ontario, M5X 1E3 Attn: Ms. Martina Thomas			Invoice No: 1258002 PROVISIONAL INVOICE Material: Caribou Zinc Concentrate Shipment: CIF PO Aviles, Spain Settlement: U.S. Dollars 8-Oct-08		
Vessel Name: m/v "Nirint Pride" Bill of Lading Date: 4-Oct-08 Payment Terms / Due Date: 90% 8 days after arrival at report Q/P: 2 MAMA			Vessel Arrival: 12-Oct-08 Final Weight: (net) Less 0.3% Weight Penalties: (net) Prov Grades: Zn (%) Fe (%)		
Metal Value LMR Settlement (Zn)			Provisional Prices: 17-Oct-08 Payable Price: 1115.50 US\$/mt TOTAL PAYABLES:		
Deduction: 8.000			(US\$) Value: 462.93 US\$/DMT		
Charges/Penalties Treatment Charges 2008 Terms Base: US\$302.00/dmt @ US\$2,600.00 Recalculation + 0.085/dmt for each \$1.00 > \$2,000.00 < \$2,500.00 + 0.12/dmt for each \$1.00 > \$2,500.00 De-recalculation - 0.078/dmt for each \$1.00 < \$2,000.00 > \$1,500.00 - 0.12/dmt for each \$1.00 < \$1,500.00 1% Penalty: US \$1.75/dmt for each 1% > 8.5%			Base: 302.00 Recalculation: -83.64 4.38 TOTAL DEDUCTIONS: 222.74 US\$/DMT		
NET VALUE: 240.19 90% Provisional Payment Due: 1,594,650.00			7376.803 240.19 1,771,834.31 1,594,650.00 US\$/DMT		
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: B0FAUS33 Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-695 Account of TD Bank - Swift Code: TD0MCATTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transat, Financial Institution, Designation Number: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada B2A 3Z1 Account No: 7325566					



95 WELLINGTON STREET WEST, SUITE 950
TORONTO, ONTARIO M5J 1A7

TEL: (416) 363-4790 FAX: (416) 363-1315
www.breakwater.ca

DEBIT NO. 13 NO. 318002

BLUE NOTCH MINING INC.
1 Place Ville Marie
Suite 2125
Montreal, Quebec
H3B 2C6
Attn: Mr. John Martin

Toronto, November 17, 2008

Payment Due 15 days in Advance

ACCOUNT NAME: Breakwater Resources Ltd.
CDN ACCOUNT NUMBER: 00001 16236 13
Bank of Nova Scotia
Toronto Business Support Centre
SWIFT: NOSCCATT
Branch Number: 002
Bank Transit Number: 47696

MARKETING AGENT FEE

Quantity	Invoice No.	Quantity (month)	Fee/Unit	Due	QST	Total Due
Caribou Lead Conc. - October, 2008 Receipts	1268082	3,824,268	\$1.15	\$4,397.90	\$219.89	\$4,617.79
Caribou Zinc Conc. - m/y "Nassauberg" - (8/1/08 to 10/31/08)	1278002	8,650,000	\$1.15	\$10,177.50	\$508.88	\$10,686.38
					CAD	\$15,304.17

J. Bruns

BREAKWATER RESOURCES LTD.

004A

Blue Note - Caribou Mines

9361 Route 180, P.O. Box / C.P. 26

Dartmouth, NB, Canada

E2A 3Z1

Tel 506 546 5400 Fax 506 548 5103

SOLD TO:

FALCONBRIDGE LIMITED - BRUNSWICK MINE

P.O. Box 3000

Dartmouth, NB

E2A 3Z1

Attn: Ms. Wendy Smith

Invoice No: 1248082

PROVISIONAL INVOICE

3-Nov-08

Material: Caribou Lead Concentrate

Shipment From Caribou/Restigouche Mine

Delivery: DDP Belledune, New Brunswick

Settlement: U.S. Dollars

Month of Delivery:

October, 2008

Payment Terms/Due Date:

90%

Q/P: 2 MAM = Dec., 2008

Final Weight:

3824.260

(H2O)

8.60

(DMT)

3495.253

Prov. Grades

Pb (%)

12.50

As (%)

0.80

Ag (g/t)

500.00

Sb (%)

0.10

Au (g/t)

1.00

S (%)

30.00

Metal Values

Provisional Prices: October, 2008

LME Cash Settlement (Pb)

3.0

1.0

London Avg of AM/PM (Au)

50.0

London Spot (Ag)

50.0

Deduction

Payable

Price

1480.109 US\$/mt

809.718 US\$/oz

10.44138 US\$/oz

(US\$)

Value

584.44

-

161.06

TOTAL PAYABLES:

735.78

US\$/DMT

Charges/Penalties

Treatment Charge: US\$180.00/dmt

Silver Refining Charge: 14.46\$

Gold Refining Charge: -

0.30 US\$/oz

6.00 US\$/oz

As Penalty: US \$1.50/dmt for each 0.10% > 0.40%

Sb Penalty: US \$1.50/dmt for each 0.10% > 0.40%

S Penalty: US \$5.00/dmt for each 1% > 30%

TOTAL DEDUCTIONS:

190.34

US\$/DMT

NET VALUE:

545.36

US\$/DMT

VALUE:

3495.253

x

545.36

Freight Allowance:

328.00

TOTAL:

1,836,266.12

US\$

Provisional Value (90%):

1,652,639.51

GST (5%):

82,631.98

HST (8%):

132,211.16

TOTAL DUE:

1,867,482.64

US\$

Kindly remit funds to:

Pay through Caribou's Corresponding Bank:

Bank of America National Trust and Savings Association

Swift Code: BOTAUS33N

Address: 37 Broad Street, New York, NY 10015

ABA: 026-009-593

Account of TD Bank - Swift Code: TDOMCATTTOR

For Further Credit to: TD CANADA TRUST

Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1

Transit, Financial Institution, Designation Num: 41601-004-0010

Beneficiary: Blue Note Caribou

Address: 9361 route 180, P.O. Box / C.P. 26

Dartmouth, NB, Canada E2A 3Z1

Account No: 7325566

K. Pearson

004B

Blue Note - Caribou Mines 9361 Route 180, P.O. Box / C.P. 26 Bathurst, NB Canada E2A 3Z1 Tel: 806 546 1400 Fax: 506 548 5183				
SOLD TO: MRI TRADING AG Bismarckstrasse 53 P.O. Box 4362 6304 Zug, Switzerland Attn: Evelynne Jod		Invoice No: 1278002 PROVISIONAL INVOICE 17-Nov-08 Material: Caribou Zinc Concentrate Shipments: POD Bathurst, New Brunswick Settlement: U.S. Dollars		
Vessel Name: m/v "Neussahorg II" Bill of Lading Date: 13-Nov-08 Payment Terms/Due Date: 90% CAD Q/P: 2 MAM/		Prov. Weight: (wmt) (1320) (dmt) 8,850.00 7.10 8186.250 Prov Grades: Zn (%): 49.59 Fe (%): 11.00 Ag (g/t): 128.800		
Metal Values LME Settlement (Zn) 8.000 London Spot Price (Ag) 3.8		Provisional Price: November 3-7, 2008 Payable Price 1112.80 US\$/mt 10.16 US\$/oz TOTAL PAYABLE \$: 469.86 US\$/DMT		
Charges/Penalties Treatment Charge: 2008 Terms Base: US\$389.00/dmt @ US\$2,500.00 (\$330.00 + Freight Allowance \$59.00/dmt or \$55.00/wmt) Escalator: + 0.12/dmt for each \$1.00 > \$2,500.00 De-escalator: - 0.06/dmt for each \$1.00 < \$2,500.00 > \$2,600.00 - 0.08/dmt for each \$1.00 < \$2,000.00 Fe Penalty: US \$1.50/dmt for each 1% > 8.0%		(US\$) Value 461.81 7.25 469.86 TOTAL DEDUCTIONS: 4.50 NET VALUE: 176.94 US\$/DMT 8186.250 x 176.94 = 1,445,200.58 90% Provisional Payment Due: 1,300,680.52		
Kindly remit funds to: Pay through Caribou's Corresponding Bank: Bank of America National Trust and Savings Association Swift Code: BOPAU33N Address: 37 Broad Street, New York, NY 10015 ABA: 026-009-693 Account of TD Bank - Swift Code: TDOMCATTOR For Further Credit to: TD CANADA TRUST Address: 500 St. Jacques West, Montreal, Quebec H2Y 1S1 Transit, Financial Institution, Designation Numbers: 41601-004-0010 Beneficiary: Blue Note Caribou Address: 9361 route 180, P.O. Box / C.P. 26 Bathurst, NB, Canada E2A 3Z1 Account No: 7328566 <i>K. Brisson</i>				



BREAKWATER RESOURCES LTD.

December 04, 2008⁶

Mr. John Martin, Chief Operating Officer
Blue Note Mining Inc.
1 Place Ville Marie
Suite 2125
Montreal, Quebec
H3B 2C6

Dear John:

RE: Notice of Termination of Marketing Agency Agreement

We are writing further to our recent discussions and the e-mail that was sent to you on November 20, 2008.

As you are aware, Blue Note Mining Inc. ("Blue Note") is in default of payment of marketing fees due and owing to Breakwater Resources Ltd. under the Marketing Agency Agreement made as of August 01, 2006. In particular, our invoices dated August 26, 2008, September 23, 2008 and October 27, 2008 in the total amount of \$48,483.85 remain outstanding. As a result, Blue Note is in default of the Marketing Agency Agreement which default has not been cured within ninety (90) days.

Accordingly, please be advised that Breakwater hereby exercises its right to terminate the Marketing Agency Agreement, effective immediately, pursuant to Article 6.4 of the Marketing Agency Agreement.

Please acknowledge receipt of this correspondence.

Yours truly,

BREAKWATER RESOURCES LTD.

Steve Harris
Chief Commercial Officer

cc: Bill Heath

95 Wellington Street West, Suite 950, Toronto, Ontario M5J 2N7
Tel: (416) 363-4798 Fax: (416) 363-1315
www.breakwater.ca

MARKETING AGENCY AGREEMENT

This Agreement made as of August 1, 2006.

BETWEEN

BREAKWATER RESOURCES LTD.

(hereinafter called "Breakwater")

- and -

BLUE NOTE METALS INC.

(hereinafter called "Blue Note")

WHEREAS Blue Note mines and produces lead, copper and zinc concentrate (the "Concentrates") at its Caribou and Restigouche Mines in New Brunswick (as further described on Schedule A hereto, the "Mines"); and

WHEREAS Blue Note desires to appoint Breakwater as marketing agent for the sale of the Concentrates produced from the mine and Breakwater has agreed to accept such appointment.

NOW THEREFORE this Agreement witnesses that in consideration of the covenants and agreements contained herein, it is agreed by and between the parties hereto as follows:

1. **APPOINTMENT**

- 1.1 Blue Note appoints Breakwater and Breakwater agrees to act as exclusive agent for the marketing of all the Concentrates produced by Blue Note provided that if Breakwater is unable to market the Concentrates, Blue Note may otherwise market the Concentrates.

2. **MARKETING PROGRAM**

- 2.1 Breakwater shall discuss with Blue Note and agree to a comprehensive marketing program for the Concentrates. This program will include strategy related to targeted sales profiles, commercial term objectives and risks management strategies related to concentrate and freight markets. (the "Marketing Program")
- 2.2 The Marketing Program will also set out the merits of combinations and swaps of the Concentrates by time, geography and quality that may bring extra returns to the Mine.

The Marketing Program shall be regularly reviewed to take account of changing market conditions and Blue Note's changing needs.

- 2.3 It is understood and agreed that the Marketing Program in relation to the sale of the Concentrates shall at all times be subject to the approval of Blue Note.

3. **BREAKWATER'S DUTIES**

- 3.1 Breakwater agrees to provide Blue Note with Breakwater's understanding of the metal, concentrate and freight markets, and to render the following services to and on behalf of Blue Note at Breakwater's cost:

- (a) solicit terms and negotiate sales contracts with buyers (the "Contracts"), copies of all such Contracts are to be promptly forwarded to Blue Note by Breakwater; provided however that any commercial terms contained therein beyond the pre-agreed parameters agreed to by the parties from time to time, are to be subject to the written approval of Blue Note. It is further understood that Blue Note will be fully informed and involved during the negotiation process;
- (b) ... administer the Contracts, including but not limited to umpire assaying, settlements and issuing invoices;
- (c) assist in the collection of sales proceeds and provide credit management recommendations;
- (d) provide logistics management services;
- (e) provide cash flow and marketing forecasting;
- (f) provide market intelligence and strategic analysis as requested by Blue Note from time to time;
- (g) comply with the Marketing Program; and
- (h) provide a contact person to act as the liaison person for all issues arising out of this Agreement

4. **BLUE NOTE'S DUTIES**

- 4.1 Blue Note shall:

- (a) regularly advise Breakwater of the qualities and quantities of Concentrates available for shipment;
- (b) promptly notify Breakwater of any circumstances affecting the production and/or shipment of the Concentrates;

- (c) refer to Breakwater all inquiries received from prospective or actual buyers for concentrates from the mine;
- (d) promptly pay (i) all fees due to Breakwater and (ii) other fees negotiated by Breakwater on Blue Note's behalf, such as freight invoices, umpire invoices, etc.
- (e) make available a contact at the mine to act as a liaison and facilitate the day to day execution of this agreement.

5. **FEES**

- 5.1 Blue Note shall pay to Breakwater CDN. \$1.00 (one dollar) per wet metric tonne of all sales of Concentrate produced at the Mine (the "Rate"), up to a maximum aggregate annual (based on 365 day periods commencing on the date of this Agreement) amount of CDN. \$150,000 (one hundred and fifty thousand dollars) (the "Maximum Fee").
- 5.2 Notwithstanding the foregoing, once during the second and once during the third years (based on 365 day periods commencing on the date of initial shipment of the Concentrate) following the date of initial shipment of the Concentrate, Breakwater shall have the right on 15 days notice by Breakwater to Blue Note to increase each of the Rate and the Maximum Fee by up to a maximum of 15% (fifteen per cent) (an "Increase") in aggregate over the term of the contract.
- 5.3 An Increase shall only be permitted in the event that the costs incurred by Breakwater in its performance of its obligations under this Agreement justify such Increase, which shall be determined by Breakwater. Breakwater will fully disclose and justify to Blue Note the reasons for the Increase provided however that Blue Note will not be permitted to refuse the Increase.
- 5.4 Subject to section 5.5, the fees based on the Rate payable pursuant to Section 5.1, shall be fully earned and due and payable by Blue Note to Breakwater upon Blue Note's receipt of first provisional payment basis loaded weights.
- 5.5 Upon the execution of this Agreement by the parties, Blue Note shall pay Breakwater \$7,500 per month (the "Monthly Fee") payable on the 15th day of the month following the month in which the services were performed. The payment of this Monthly Fee shall terminate on the date of the initial shipment of the Concentrate.

6. **DURATION**

- 6.1 This Agreement shall commence on the date hereof and shall continue in force and effect for 3 years following the date of the initial shipment of Concentrate (the "Term").

6.2 Notwithstanding the foregoing, Blue Note may terminate this Agreement at any time by paying to Breakwater 33% of the Fees (including any increase, if applicable) owing under this Agreement.

6.3 The Term may be extended by mutual and written consent of the parties.

6.4 Breakwater shall have the right to terminate this Agreement if Blue Note is in default of this Agreement and the default has not been cured within 90 days or upon providing six months notice.

7. QUALITY

7.1 Blue Note undertakes and agrees that its production of the concentrates for committed sales agreements will meet the specifications of the Concentrates agreed to be delivered under contracts (the "Specifications").

7.2 In the event Blue Note recognizes any deviation from the Specifications, Blue Note will promptly advise Breakwater of such deviation in order that Breakwater may so advise purchasers of the products.

8. RISK

8.1 Breakwater shall take every reasonable precaution on behalf of Blue Note to guard against bad debts and late payments for Concentrates, but the risk of non-payment or late payment by buyers shall be that of Blue Note. Blue Note hereby agrees to indemnify and defend and save harmless Breakwater from all liabilities, judgments, orders or claims which may be made or purported to be made against Breakwater as a result of the performance of its duties hereunder and the actions, inactions, negligence, omission or other conduct of Blue Note in respect of any contract, the performance thereof, or any production of Concentrate (including failure to meet Specifications) or business activity in connection with the Mine. However, Breakwater will make every reasonable effort to assist Blue Note in defending against any such actions or in resolving customer concerns and disputes.

9. EXPENSES OF THE PARTIES

9.1 Breakwater shall be responsible for paying on its own account all costs relating to the preparation of Contracts and transportation contracts and for communication and travel costs related to selling, shipping, market research and market intelligence. This will not include any travel or other costs which Blue Note elects to incur related to this contract.

9.2 All costs related to the production and shipment of concentrates shall be for Blue Note's account.

10. **MULTIPLE AGENCY**

- 10.1 It is recognized by Blue Note that Breakwater could be acting for itself, its affiliates or other third parties in connection with the sale of base metal concentrates. Blue Note expressly acknowledges and agrees that Breakwater shall be free to so act for itself, its affiliates and other third parties, and to continue to so act as agent for such companies and to continue to conduct its business in the ordinary course and notwithstanding this to act as marketing agent for Blue Note as contemplated by this Agreement. Notwithstanding the above, Breakwater will represent Blue Note in a fair and equitable manner.

11. **FORCE MAJEURE**

- 11.1 It is understood and agreed that the obligations of the parties herein are subject to force majeure.
- 11.2 Breakwater will include in all Contracts a force majeure clause.

12. **CONFIDENTIALITY**

Each of the parties covenant and agree to endeavour to restrict the distribution of commercial and marketing information to those employees of each such party who in the opinion of such party have a "need to know" such information. Except as required during commercial discussions and negotiations, all business process or production related matters disclosed by Blue Note to Breakwater as a result of this agreement will be treated as confidential information and will not be disclosed without Blue Note's prior written consent.

13. **NOTICES**

- 13.1 Any notice or other communication required to be given hereunder by either party shall be in writing and will be deemed to have been well and sufficiently given to the other party.

BREAKWATER RESOURCES LTD.
95 Wellington Street West, Suite 950
Toronto, Ontario M5J 2N7
Canada

Telephone: 416-363-4798
Fax: 416-363-1290

BLUE NOTE METALS INC.
2 Place Alexis Nihon, Suite 1110
3500 de Maisonnouve Blvd. West
Westmont, Quebec H3Z 3C1

Telephone: 514-486-3095
Fax: 514-486-1317

Or at such substitute address as such party may from time to time direct in writing, and any such notice or other communication will be deemed to have been received, if delivered or faxed, on the next business day after the time of delivering or faxing, and if mailed, on receipt thereof.

14. **NATURE OF RELATIONSHIP**

This Agreement shall not constitute the parties hereto as "partners" or as a "joint venture". Each party shall have the right independently to engage in and receive full benefits from business activities (and each party acknowledges that the other is or may be engaged in business activities which are directly competitive with the business activities of the other party) whether or not competitive with the production of Concentrate or the business of the other party. The doctrines of "corporate opportunity" or "business opportunity" shall not be applied to any other activity, venture or operation of any party and no party shall have any obligation to the other party with respect to any opportunity to engage in any business activity or transaction.

15. **NON-SOLICITATION**

- 15.1 Without Breakwater's prior written consent, for a period commencing on the date hereof and ending one year from the date upon which this agreement is terminated neither Blue Note nor any of its representatives will directly or indirectly knowingly solicit for employment or any other engagement, the services of any person who is now directly employed in a marketing function by Breakwater.

16. **ASSIGNS**

Neither party may assign this Agreement without the written consent of the other party, except to a successor corporation acquiring all or substantially all of the assignor's assets or to an affiliate which latter assignment shall not release the relevant party from its obligations herein. This Agreement will bind and enure to the benefit of the parties hereto and their permitted successors and assigns.

17. **GOVERNING LAW**

This Agreement shall be governed by and construed in accordance with the law of the Province of Ontario and the laws of Canada applicable therein.

18. COUNTERPARTS

In witness whereof the parties hereto have executed this Agreement.

BREAKWATER RESOURCES LTD.

Per _____
Name: _____
Title: _____
I have the authority to bind the Corporation.

Per _____
Name: _____
Title: _____
I have the authority to bind the Corporation.

Date: _____

BLUE NOTE METALS INC.

Per: *[Signature]*
Name: Richard J. Brown
Title: President and Chief Executive Officer
I have the authority to bind the Corporation.

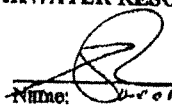
Date: _____

18. COUNTERPARTS

In witness whereof the parties hereto have executed this Agreement.

BREAKWATER RESOURCES LTD.

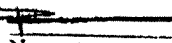
Per


Name: George E. Airlie

Title: President and CEO

I have the authority to bind the Corporation.

Per


Name: William M. Heath

Title: Executive Vice President

I have the authority to bind the Corporation.

Date: _____

BLUE NOTE METALS INC.

Per: _____

Name: _____

Title: _____

I have the authority to bind the Corporation.

Date: _____

Cause No.: S/C/684/08
 Numéro de Cause:

IN THE COURT OF QUEEN'S BENCH OF
 NEW BRUNSWICK

TRIAL DIVISION

JUDICIAL DISTRICT OF SAINT JOHN

BETWEEN:

BREAKWATER RESOURCES LTD.

Plaintiff

- and -

BLUE NOTE MINING INC. and BLUE
 NOTE CARIBOU MINES INC.

Defendants

COUR DU BANC DE LA REINE DU
 NOUVEAU-BRUNSWICK

DIVISION DE PREMIERE INSTANCE

CIRCONSCRIPTION JUDICIAIRE DE

ENTRE:

demandeur(s)

- et -

défendeur(s)

AMENDED NOTICE OF ACTION
WITH STATEMENT OF CLAIM
ATTACHED
(FORM 16A)

TO: Blue Note Mining Inc.
 1 Place Ville Marie, Suite 2125
 Montreal, PQ H3B 2C6

TO: Blue Note Caribou Mines Inc.
 9361 Route 180, P.O. Box/C.P. 26
 Bathurst, NB E2A 3Z1

LEGAL PROCEEDINGS HAVE BEEN
 COMMENCED AGAINST YOU BY
 FILING THIS NOTICE OF ACTION WITH
 STATEMENT OF CLAIM ATTACHED

If you wish to defend these
 proceedings, either you or a New Brunswick
 lawyer acting on your behalf must prepare
 your Statement of Defence in the form

AVIS DE POURSUITE
ACCOMPAGNE D'UN EXPOSÉ DE
LA DEMANDE
(FORMULE 16A)

À:

PAR LE DÉPÔT DU PRÉSENT AVIS DE
 POURSUITE ACCOMPAGNÉ D'UN
 EXPOSÉ DE LA DEMANDE, UNE
 POURSUITE JUDICIAIRE A ÉTÉ
 ENGAGÉE CONTRE VOUS.

Si vous désirez présenter une
 défense dans cette instance, vous-même ou
 un avocat du Nouveau-Brunswick chargé
 de vous représenter devrez rédiger un

prescribed by the Rules of Court and serve it on the plaintiff or the plaintiff's lawyer at the address shown below and, with proof of such service, file it in this Court Office together with the filing fee of \$50,

- (a) if you are served in New Brunswick, WITHIN 20 DAYS after service on you of this Notice of Action With Statement of Claim Attached, or
- (b) if you are served elsewhere in Canada or in the United States of America, WITHIN 40 DAYS after such service, or
- (c) if you are served anywhere else, WITHIN 60 DAYS after such service.

If you fail to do so, you may be deemed to have admitted any claim made against you, and without further notice to you, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE.

You are advised that:

- (a) you are entitled to issue documents and present evidence in the proceeding in English or French or both;
- (b) the Plaintiff intends to proceed in the English language; and

exposé de votre défense en la forme prescrite par les Règles de procédure, le signifier au demandeur ou à son avocat à l'adresse indiquée ci-dessous et le déposer au greffe de cette Cour avec un droit de dépôt de \$50 et une preuve de sa signification:

- (a) DANS LES 20 JOURS de la signification qui vous sera faite du présent avis de poursuite accompagné d'un exposé de la demande, si elle vous est faite au Nouveau-Brunswick ou
- (b) DANS LES 40 JOURS de la signification, si elle vous est faite dans une autre région du Canada ou dans les États-Unis d'Amérique ou
- (c) DANS LES 60 JOURS de la signification, si elle vous est faite ailleurs.

Si vous omettez de le faire, vous pourrez être réputé avoir admis toute demande formulée contre vous et, sans autre avis, JUGEMENT POURRA ÊTRE RENDU CONTRE VOUS EN VOTRE ABSENCE.

Sachez que:

- (a) vous avez le droit dans la présente instance, d'émettre des documents et de présenter votre preuve en français, en anglais ou dans les deux langues;
- (b) le demandeur a l'intention d'utiliser la langue et

- (c) your Statement of Defence must indicate the language in which you intend to proceed.

- (c) l'exposé de votre défense doit indiquer la langue que vous avez l'intention d'utiliser.

If you pay to the plaintiff or the plaintiff's lawyer the amount of the plaintiff's claim, together with the sum of \$100 for the plaintiff's costs, within the time you are required to serve and file your Statement of Defence, further proceedings will be stayed or you may apply to the court to have the action dismissed.

Si, dans le délai accordé pour la signification et le dépôt de l'exposé de votre défense, vous payez au demandeur ou à son avocat le montant qu'il réclame, plus \$100 pour couvrir ses frais, il y aura suspension de l'instance ou vous pourrez demander à la cour de rejeter l'action.

THIS NOTICE is signed and sealed for the Court of Queen's Bench by George Theriault, Clerk of the Court at Saint John, New Brunswick the 30th day of ~~December~~, 2008: January, 2009

CET AVIS est signé et scellé au nom de la Cour au Banc de la Reine par _____, greffier de la Cour à _____, ce _____ de _____, 200_____.



George A. Theriault
CLERK

Clerk of the Court of
Queen's Bench
Provincial Building
110 Charlotte Street, P.O. Box 5001
Saint John, NB E2L 4Y9

GREFFIER

STATEMENT OF CLAIM

1. The Plaintiff, Breakwater Resources Ltd., ("Breakwater") is a corporation incorporated pursuant to the laws of Canada, having its executive offices in the city of Toronto, Province of Ontario. Breakwater is a publicly traded company whose shares trade on the TSX. Breakwater carries on business in mineral exploration, development and mining.
2. The Defendant, Blue Note Mining Inc. ("Blue Note") (formerly known as Blue Note Metals Inc.) is a corporation incorporated pursuant to the laws of Canada, having its head office in the city of Montreal, Province of Quebec. Blue Note is a publicly traded company whose shares trade on the TSX. Blue Note carries on business in mineral exploration, development and mining.
3. The Defendant, Blue Note Caribou Mines Inc. ("Blue Note Caribou") is a wholly-owned subsidiary of Blue Note. It is a corporation incorporated pursuant to the laws of Canada, having its head office in the town of Bathurst, Province of New Brunswick. Blue Note Caribou carries on business in mineral exploration, development and mining.
4. CanZinco Ltd. ("CanZinco") is a wholly owned subsidiary of Breakwater. CanZinco is the previous owner of the Caribou Mine, an underground mining and mineral processing property located fifty kilometres west of Bathurst, New Brunswick, and the Restigouche Mine, an open-pit mining property located in the county of Restigouche (collectively, the "Mines"), as more particularly described in Schedule "A" (land titles property) and Schedules "B" and "C" (registry properties) attached hereto. Can Zinco carries on business in mineral exploration, development and mining.
5. In 2004, CanZinco entered into negotiations for the sale of the Mines to Forest Gate Resources Inc., a predecessor company of Blue Note. On July 26, 2006, Blue Note entered into an asset purchase agreement with CanZinco to acquire the Mines (the "Asset Purchase Agreement"). Part of the consideration given by Blue Note for the Mines was the issuance to Breakwater (at CanZinco's direction) of an Unsecured Subordinated Convertible Debenture dated August 1, 2006, in the amount of \$15,000,000.00 CDN, (the "Debenture").
6. A further part of the consideration given by Blue Note for the Mines was Blue Note's entering into the following agreements with Breakwater:
 - (a) a Net Smelter Royalty Agreement dated August 1, 2006 between Blue Note and Breakwater (the "NSR Agreement"); and;
 - (b) a Marketing Agency Agreement dated August 1, 2006 between Blue Note and Breakwater (the "Marketing Agreement").
7. Following the acquisition of the Mines, and after a period of rehabilitation and commissioning, Blue Note began producing zinc and lead concentrates at the Mines.

The Debenture

8. Breakwater pleads and relies on the terms and conditions of the Debenture as if the same were set out herein in its entirety. Within the terms and conditions of the Debenture, Breakwater is referred to as the "Holder", and Blue Note is referred to as the "Corporation".
9. Pursuant to Article 3 of the Debenture, Breakwater may, at its option, convert the Debenture in exchange for a twenty percent (20%) interest in the Mines by, *inter alia*, providing Notice of Exercise of Property Conversion Option (the "Notice of Conversion") to Blue Note. As promptly as practicable following receipt of the Notice of Conversion, Blue Note is to cause title to the Mines to be recorded in Breakwater's name in proportion to Breakwater's interest. Further, the surrender of the Debenture accompanied by the Notice of Conversion is deemed to constitute a contract between Breakwater and Blue Note whereby they shall enter into a joint venture agreement, substantially in the form attached to the Debenture as Exhibit B (the "Joint Venture Agreement"). Accordingly, Blue Note is bound by and obliged to act in accordance with the terms of the Joint Venture Agreement, upon receipt of the Notice of Conversion and surrendered Debenture.
10. Article 3 of the Debenture provides as follows:

ARTICLE 3

RIGHT OF CONVERSION INTO PROPERTY INTEREST

3.1 Conversion Privilege into Property Interest

(a) *Conversion Privilege into Property Interest.* Subject to and upon compliance with the provisions of this Article, the Holder may, at its option (the "Property Interest Conversion Option"), at any time up to the Redemption Date, convert this Debenture in exchange for a twenty percent (20%) interest in the Properties (the "Holder's Interest").

(b) *Extension.* If, by the Redemption Date, the Corporation has not met the Exploration Cost Minimum in connection with the Properties, the Holder shall be granted an extension on its Property Interest Conversion Option until such time that the Corporation has met the Exploration Cost Minimum.

3.2 Exercise of Conversion Privilege into Property Interest

(a) *Notice.* In order to exercise the Property Interest Conversion Option set out in this Article 3, the Holder shall surrender this Debenture to the Corporation at its office set out on the face page hereof, accompanied by written notice substantially in the form of Exhibit A attached hereto signed by the Holder

stating that it elects to exercise its Property Interest Conversion Option.

(b) *Contract between the Holder and the Corporation.* The surrender of this Debenture accompanied by notice given pursuant to Subsection 3.2(a) shall be deemed to constitute a contract between the Holder and the Corporation whereby: (I) the Holder and the Corporation shall enter into a joint venture agreement, substantially in the form of the joint venture agreement attached hereto at Exhibit B (the "Joint Venture Agreement"), which joint venture agreement shall govern the parties' common interests in the Properties; and (II) the Holder releases the Corporation from all liability under this Debenture.

(c) *Date of Conversion.* The date of receipt by the Corporation of this Debenture and the notice referred to in Subsection 3.2(a) is herein referred to as the "Date of Property Interest Conversion" of this Debenture. Such conversion shall be deemed to have been effected immediately prior to the close of business of the Date of Property Interest Conversion and at such time the rights of the Holder under this Debenture as a holder shall cease and the Holder shall be deemed to have become on such date the holder of the Holder's Interest.

(d) *Title.* As promptly as practicable after the Date of Property Interest Conversion, the Corporation shall cause title to the Properties to be recorded in the Holder's name in proportion to the Holder's Interest.

11. On August 29, 2008, Breakwater exercised its Property Interest Conversion Option pursuant to Article 3.2 (a) of the Debenture. August 29, 2008, is the Date of Property Interest Conversion, as stipulated in Article 3.2 (c) of the Debenture.
12. Article 8.3 of the Debenture provides as follows:

8.3 Restrictive Covenants

The Corporation hereby covenants and agrees with the Holder that, until all obligations under this Debenture have been terminated and unless the Holder has otherwise consented to in writing:

(a) *Encumbrances.* The Corporation shall not enter into or grant, create, assume or suffer to exist any Lien affecting any of its property, assets or undertaking, save and except only for the Permitted Liens.

(b) *Indebtedness.* The Corporation shall not incur or permit or suffer to exist any indebtedness other than the Permitted Indebtedness.

The Transfer Agreement

13. On February 28, 2008, Breakwater received written notice that Blue Note had transferred the Mines to Blue Note Caribou via an Agreement For Transfer of Caribou and Restigouche Mines dated June 29, 2007 (the "Transfer Agreement").
14. Under Article 3 of the Transfer Agreement, Blue Note purported to unilaterally transfer or release its obligations under the Joint Venture Agreement. Article 3 of the Transfer Agreement provides as follows:

3. *JV Agreement.* BN Caribou and Blue Note hereby agree that in the event that Breakwater exercises its Property Interest Conversion Option, the JV Agreement will be entered into between BN Caribou and Breakwater and all references in the JV Agreement to Blue Note shall be references to BN Caribou.

Article 11 of the Debenture provides as follows:

ARTICLE 11

TRANSFER OF PROPERTY INTEREST

11.1 Transfer of Property Interest

Notwithstanding anything herein contained, the Corporation may sell, assign or otherwise dispose of all of its interest in the Properties, or part thereof (the "Corporation's Interest"), to an Affiliate of the Corporation (the "Corporation Affiliate") without the consent of the Holder provided that, in any such event, the Corporation Affiliate shall deliver to the Holder an agreement between the Corporation Affiliate and the Holder under which such Corporation Affiliate:

- (a) acknowledges the Holder's Property Interest Conversion option rights under this Debenture;
- (b) covenants to provide the Holder with the Holder's Interest in the Properties in the event the Holder exercises its Property Interest Conversion Option pursuant to Subsection 3.1(a) hereof; and
- (c) agrees to retransfer the Corporation's Interest to the Corporation in the event that the Corporation Affiliate ceases to be an Affiliate of the Corporation.

15. Article 11.1 of the Debenture does not provide for a transfer of Blue Note's obligations pursuant to the Joint Venture Agreement. Article 3 of the Transfer Agreement is not

authorized by the Debenture. Breakwater was not a party to the Transfer Agreement and did not agree to the purported unilateral transfer of obligations under the Joint Venture Agreement from Blue Note to Blue Note Caribou. Accordingly, to the extent that Article 3 of the Transfer Agreement purports to affect Breakwater's rights and Blue Note's obligations under the Joint Venture Agreement, it is of no force and effect.

16. Pursuant to Article 3 of the Debenture, Blue Note is bound by and obligated to act in accordance with the terms of the Joint Venture Agreement, including, without limiting the generality of the foregoing, the Rights, Duties and Status of the Operator as set out therein.

The Joint Venture Agreement

17. Article 5 of the Joint Venture Agreement provides that, following the Operative Date, being the date upon which Breakwater exercises its Property Interest Conversion Option, Blue Note shall continue to Act as Operator of the Mines under the Joint Venture Agreement until, *inter alia*, it resigns pursuant to Article 5.2. The selection of a replacement Operator is within the discretion of the Management Committee to be appointed pursuant to the Joint Venture Agreement.
18. "Operative Date" is defined at Article 1.1 (y) of the Joint Venture Agreement as follows:

(y) "Operative Date" means the date upon which Breakwater exercises its Property Interest Conversion Option in accordance with the Blue Note Debenture.
19. As previously stated, the Date of Property Interest Conversion pursuant to Article 3.2(a) and 3.2 (c) of the Debenture is August 29, 2008. Therefore, the Operative Date pursuant to the Joint Venture Agreement is August 29, 2008.
20. Articles 5.1 and 5.2 of the Joint Venture Agreement provide as follows:

5.1 Following the Operative Date, but subject to paragraph 5.2, Blue Note shall continue to act as the Operator under this Agreement and as such, subject to the discretion and control of the Management Committee, shall have full right, power and authority to do everything necessary or desirable to carry out the purposes of the parties in connection with this Agreement.

5.2 The party acting as Operator may resign as Operator on at least ninety (90) days' notice to all the parties and the parties shall, within ninety (90) days after receipt of such notice, convene a meeting of the Management Committee which shall appoint a party who consents to act as Operator, and determine its terms of engagement.

21. Article 6 of the Joint Venture Agreement sets out the Rights, Duties and Status of Blue Note, as Operator. Articles 6.4 and 6.4(b) and (c) of the Joint Venture Agreement provide as follows:

6.4 The Operator shall have the sole and exclusive right and authority to manage and carry out all Mining Operations and to incur the Costs required for that purpose, including but not limited to the cost of retaining such subcontractors as it deems fit. In doing so the Operator shall:

(b) pay all Costs properly incurred promptly as and when due;

(c) keep the Property and Assets free of all liens and encumbrances (other than those, if any, in effect on the Operative Date, those the creation of which are permitted pursuant to this Agreement, or builder's or mechanic's liens) arising out of the Mining Operations and, in the event of any lien being filed as aforesaid, proceed with diligence to contest or discharge same;

22. Costs is defined in paragraph 2.1(k) of the Joint Venture Agreement as:

(k) "Costs" means, except as to Prior Production Costs, all items of outlay and expense whatsoever, direct or indirect, with respect to Mining Operations, recorded by the Operator in accordance with this Agreement. Without limiting the generality of the foregoing, the following categories of Costs shall have the following meanings:

(i) "Production Program Costs" means, for any period prior to the Completion Date, all Costs incurred directly or indirectly in connection with Production Program for purposes of bringing into Commercial Production any Mineral deposit on the Property, including, without limitation:

(I) all monies expended to develop or construct the Mine, as contemplated in the Production Program, including all costs related to banking and financing charges;

(II) working capital required for the initial four (4) months of operation of the Property or part thereof as a Mine or for such longer period as may be reasonably justified in the circumstances.

- (ii) "Operating Costs" means, for any period after the Completion Date, all Costs incurred or chargeable, directly or indirectly, by the Operator in connection with the Operating Plan, which Costs include, without limiting the generality of the foregoing, the following:
- (I) all costs of or related to operating employee facilities, including housing;
 - (II) all duties, charges, levies, royalties, taxes (excluding taxes levied on the income of the parties) and other payments imposed by any government or municipality or department or agency thereof upon or in connection with operating the Property as a Mine;
 - (III) all costs of maintaining the Property in good standing, including any required vendor's or royalty payments;
 - (IV) all reasonable costs of the Operator for providing technical, management and/or supervisory services;
 - (V) all reasonable costs of consulting, legal, accounting, insurance and other services;
 - (VI) all exploration expenditures incurred after the Completion Date;
 - (VII) all capital costs of operating the Property as a Mine including all costs of construction, equipment and mine development and including maintenance, repairs and replacements, and any capital expenditures relating to an improvement, expansion, modernization or replacement of the facilities located at the Mine;
 - (VIII) a reasonable amount of funds set aside to cover reclamation costs and other costs associated with a permanent shut-down of the Mine;
 - (IX) any costs or expenses incurred or to be incurred relating to a temporary or permanent shut-down of the Mine;
 - (X) all reasonable costs of supplies and services purchased for the day to day operation of the Property as a Mine;

- (XI) all costs relating to banking and financing charges; and
- (XII) all costs relating to the shipping of Minerals to the point of sale,

and, except where specific provision is made otherwise, all Operating costs shall be determined in accordance with generally accepted accounting principles applied consistently from year to year provided however that such costs shall not include any amount in respect of amortization of expenditures or Production Program Costs, depletion or depreciation. For greater certainty, Operating Costs shall not include any Costs or expenses incurred by the Operator which are solely related to general overhead and administrative expenses of the Operator including bonuses, salaries, auditor's fees, legal fees, consulting fees, insurance and rent; and

- (iii) "Prior Production Costs" means all exploration, production and operating Costs incurred by Blue Note prior to the Operative Date and as deemed by the parties under paragraph 3.4, and for greater certainty, shall not include the Reclamation Deposit, the Environmental Protection Deposit, any Additional Reclamation Deposits and any Additional Environmental Protection Deposits made by Blue Note prior to the Operative Date.

23. Article 3 of the Joint Venture Agreement provides that the respective interests of Blue Note and Breakwater in the Mines shall be eighty percent (80%) to Blue Note and twenty percent (20%) to Breakwater, so long as both parties continue to contribute their respective proportionate share of production costs as set out in the Joint Venture Agreement. Article 3.3 of the Joint Venture Agreement provides as follows:

3.3 The respective Interests of the parties shall be as set out in paragraph 3.1 so long as they contribute their respective Proportionate Share of Production Program Costs and Operating Costs, as applicable, as set out in this Agreement. At any time and from time to time if a party fails to contribute to such Costs, its respective Interest shall be reduced in accordance with the formula set out in paragraph 3.2. If, as a result of such calculation, the Interest of any party is reduced to or below 5% its Interest shall be deemed to be converted (the "Deemed Conversion") to a 2% Net Smelter Royalty as more particularly described in Appendix III and thereafter such party shall have no further rights, interests, obligation, or liabilities in respect of the Assets or under this Agreement, save and except (a) such Net Smelter Royalty and (b) any liabilities or obligations incurred

hereunder from the Operative Date to the date of the Deemed Conversion.

The NSR Agreement

24. Breakwater pleads and relies on the terms and conditions of the NSR Agreement as if the same were set out herein in its entirety.
25. Breakwater is entitled to a Net Smelter Return Royalty, pursuant to Article 2 of the NSR Agreement, which provides as follows:

Net Smelter Return Royalty: Breakwater, shall be entitled to, and is hereby granted by Blue Note, the Net Smelter Return Royalty.

26. The Net Smelter Return Royalty is to be calculated pursuant to the formula provided in Article 1 of the NSR Agreement, as follows:

"Net Smelter Return Royalty" means

(i) one percent (1%) of the Net Smelter Return when the average price for zinc on the London Metal Exchange ("LME") for a quarter for which the calculation is made under section 3 is US \$0.65 to US \$0.70 inclusive per pound; and

(ii) two percent (2%) of the Net Smelter Return when the average price for zinc on the LME is greater than US \$0.70 per pound for a quarter for which the calculation is made under section 3. No royalty shall be paid when the average price for zinc on the LME is less than US \$0.65 per pound for a quarter for which the calculation is made under section 3. If the LME ceases to publish a price for zinc, the price quoted by an equivalent market shall be use.

Net Smelter Return is also defined in Article 1 of the NSR Agreement, as follows:

Net Smelter Return shall mean the actual market value received, from time to time, for lead, zinc and copper concentrates or other Products recovered from the ore extracted from the Caribou Mine and the Restigouche Mine by Blue Note from any independent smelter, or other purchaser or user, less:

- (a) all actual charges and costs, including insurance premiums, for transportation of Products from the processing facilities on or near the Caribou Mine and the Restigouche Mine to the place of sale, or other disposition, whether transported by Blue Note or a third party;*
- (b) all actual charges and costs for marketing the Products;*

(c) all actual charges, costs, deductions, and penalties for the treatment, tolling, or smelting of the Products and all costs and charges associated therewith, such as costs and charges with respect to handling, weighing, sampling, assaying and marketing, as well as presentation charges, referee's fees and expenses, after said Products leave the processing facility on or near the Caribou Mine and the Restigouche Mine; and

(d) severance, production, ad valorem, excise, sales, and any other similar taxes or fees (excluding income taxes) paid to any lawful taxing authority on Products mined from the Property.

If Products are transported, processed or smelted by Blue Note or an affiliate thereof, all charges, costs, penalties and deductions referred to above and used for calculating Net Smelter Return shall be equivalent to the prevailing competitive rates charged by a person who is not an affiliate in an arm's length transaction for transportation or smelting of a like quantity and quality of such Product.

27. Products is defined at Article 1 of the NSR Agreement as follows:

"Products" means all ores, minerals, metals and concentrates and any other mineral resources produced from the Caribou Mine and the Restigouche Mine during the term of this Agreement.

28. At all material times, throughout the second and third quarters of 2008 and up to and including the Date of Property Interest Conversion, the price of zinc was greater than \$0.70 per pound.
29. Blue Note is to calculate the amount of the Net Smelter Return Royalty at the conclusion of each quarter and transmit payment to Breakwater. Article 3 of the NSR Agreement provides as follows:

Calculation of Net Smelter Return Royalty: An estimate of the quarterly Net Smelter Return Royalty shall be calculated by Blue Note at the end of each calendar quarter, and the Net Smelter Return Royalty shall be calculated by Blue Note at the end of each calendar year. The estimate of the quarterly Net Smelter Return Royalty and a statement containing Blue Note's calculation of the annual Net Smelter Return Royalty shall be transmitted to Breakwater together with payments of Net Smelter Return Royalty, if any, within 60 days of the end of the first three quarters of each calendar year and within ninety (90) days of the end of each calendar year, respectively.

30. Article 5 of the NSR Agreement provides as follows:

5. *Assignment: The Net Smelter Return Royalty is a right running with the Caribou Mine and the Restigouche Mine. Breakwater shall have no right, title or interest in the Caribou Mine or the Restigouche Mine other than the rights granted in this Agreement. Breakwater may file or register notice of this Agreement or notice thereof as it deems fit, including with the Mining Recorder in New Brunswick. This Agreement shall be binding on any successor to Blue Note and on any assignee or purchaser of the Caribou Mine or the Restigouche Mine. Breakwater may not assign its rights under this Agreement to any person without the prior written approval of Blue Note, which approval shall not be unreasonably withheld.*

31. Pursuant to Article 5 of the NSR Agreement, the Net Smelter Return Royalty is a right running with the Mines, and the NSR Agreement is binding on any successor to Blue Note and on any assignee or purchaser of the Mines, including Blue Note Caribou.
32. The NSR Agreement does not provide that Blue Note is released from its obligations under the NSR Agreement, including payment of the NSR Royalty, upon any sale or transfer of the Mines.
33. Blue Note and Blue Note Caribou are liable, jointly and severally to Breakwater with respect to payment of the NSR Royalty under the NSR Agreement.
34. According to Blue Note and Blue Note Caribou, the Mines began commercial production, as contemplated by the NSR Agreement, on September 1, 2007.
35. On May 15, 2008, Breakwater received payment from Blue Note Caribou in the amount of \$452,730.05, representing the amount of the Net Smelter Return Royalty for September 1, 2007 until December 31, 2007 (i.e., a portion of the third quarter, and the entire fourth quarter of 2007).
36. On June 6, 2008, Breakwater received payment from Blue Note Caribou in the amount of \$404,005.31, representing the amount of the Net Smelter Return Royalty for the first quarter of 2008 (i.e., January 1, 2008 until March 31, 2008).
37. Breakwater is entitled to continue to receive payments under the NSR Agreement up to and including the Date of Property Interest Conversion (August 29, 2008).

The Marketing Agreement

38. Breakwater pleads and relies on the terms and conditions of the Marketing Agreement as if the same were set out herein in its entirety.
39. Breakwater is entitled to fees, pursuant to Article 5.1, 5.4 and 5.5 of the Marketing Agreement (the "Marketing Fees"), which provided as follows:

5. FEES

5.1 Blue Note shall pay to Breakwater CDN. \$1.00 (one dollar) per wet metric tonne of all sales of Concentrate produced at the Mine (the "Rate"), up to a maximum aggregate annual (based on 365 day periods commencing on the date of this Agreement) amount of CDN. \$150,000 (one hundred and fifty thousand dollars) (the "Maximum Fee").

5.4 Subject to section 5.5, the fees based on the Rate payable pursuant to Section 5.1, shall be fully earned and due and payable by Blue Note to Breakwater upon Blue Note's receipt of first provisional payment basis loaded weights.

5.5 Upon the execution of this Agreement by the parties, Blue Note shall pay Breakwater \$7,500 per month (the "Monthly Fee") payable on the 15th day of the month following the month in which the services were performed. The payment of this Monthly Fee shall terminate on the date of the initial shipment of the Concentrate.

40. The Marketing Agreement defines concentrates as the lead, copper and zinc concentrates mined and produced by Blue Note at the Mines.

41. Article 6.1 of the Marketing Agreement provides for a term of 3 years following the date of the initial shipment of Concentrate (the "Term"), subject to early termination by Blue Note (Article 6.2), extension of the Term by mutual and written consent (Article 6.3) and termination by Breakwater in the event of default by Blue Notes (Article 6.1);

42. Following the execution of the Marketing Agreement, Breakwater began submitting invoices to Blue Note with respect to the Monthly Fee owing under Article 5.5 of the Marketing Agreement. On December 12, 2006 Blue Note instructed Breakwater to change its billing address to:

Blue Note Caribou Mines Inc.
P.O. Box 26
Bathurst, NB E2A 3Z1

(the "Change in Billing Address Notice").

43. Notwithstanding the Change of Billing Address Notice, Blue Note has not advised Breakwater of any assignment of the Marketing Agreement by Blue Note to its affiliate, Blue Note Caribou.
44. Pursuant to Article 16 of the Marketing Agreement, the assignment of the Marketing Agreement by Blue Note to its affiliate, Blue Note Caribou, would not release Blue Note from its obligations under the Marketing Agreement. In the event of any assignment to Blue Note Caribou, Blue Note and Blue Note Caribou would be jointly and severally liable to Breakwater with respect to payment of the Fees under the Marketing Agreement.

45. Following receipt of the Change of Billing Address Notice, Breakwater submitted invoices for Fees owing pursuant to Article 5.1 and 5.4 of the Marketing Agreement pursuant to the instruction contained in the Change of Billing Address Notice. As of November 5, 2008, Breakwater re-issued all outstanding invoices and sent them to Blue Note.

Blue Note's Breach of Its Contractual Obligations to Breakwater

46. The combined effect of the Debenture and the Joint Venture Agreement is that Blue Note was obliged to pay all Costs (pursuant to the Joint Venture Agreement) incurred promptly as and when due, and keep the Mines free of all liens and indebtedness (except Permitted Liens and Permitted Indebtedness, pursuant to the Debenture), up to and including the recording of Breakwater as an owner on the title to the Mines and the execution of the Joint Venture Agreement by Blue Note and Breakwater. Further, prior to the execution of the Joint Venture Agreement, Blue Note is not released from its obligations under the Debenture.
47. The records of the New Brunswick Land Titles Office reveal that, as of the present date, Breakwater has not been recorded as an owner on the title to the Mines.
48. The records of the New Brunswick Land Titles Office reveal that, as of the present date, the following mechanic's lien claims have been registered in respect of the Mines (the "Mechanics Liens") (PID No. 50072032, PID No. 50237924, and PID No. 50252766, except where otherwise indicated):
- (a) \$442,571.73 plus interest filed by Sunny Corner Enterprises Inc. on September 16, 2008 against PID 50072032 as document no. 26168741 and against PIDs 50237924 and 50252766 as document no. 26168717;
 - (b) \$90,609.05 plus interest filed by Eastern Reinforcing Ltd. on September 17, 2008 against PID 50072032 as document no. 26174293 and against PID 50237924 as document no. 2174418;
 - (c) \$970,528.58 plus interest filed by Hachey Construction & Fabrication Ltd. on September 19, 2008 against PID 50072032 as document no. 26186099 and against PIDs 50237924 and 50252766 as document no. 26186081;
 - (d) \$3,088,178.18 plus interest filed by Rockwood Transportation Co. Ltd. on September 19, 2008 against PID 50072032 as document no. 2686412 and against PIDs 50237924 and 50252766 as document no. 26186446;
 - (e) \$234,046.02 plus interest filed by Guillevin International Co. on September 22, 2008 against PID 50072032 as document no. 26194808;
 - (f) \$195,493.00 plus interest filed by Jacques Whitford Limited on September 23, 2008 against PID 50072032 as document no. 262025524 and against PIDs 50237924 and 50252766 as document no. 26202557;

- (g) \$98,082.26 plus interest filed by K & M Utility Lines Ltd. on September 26, 2008 against PID 50072032 as document no. 26221375 and against PIDs 50237924 and 50252766 as document no. 26221300;
- (h) \$175,141.75 plus interest filed by Godin Electrique Ltee – Godin's Electric Ltd. on September 26, 2008 against PID 50072032 as document no. 26222175 and against PIDs 50237924 and 50252766 as document no. 26222217;
- (i) \$120,407.41 plus interest filed by Hewitt Rentals Inc. on September 30, 2008 against PID 50072032 as document no. 26235953 and against PIDs 50237924 and 50252766 as document no. 26236274;
- (j) \$76,321.14 plus interest filed by Atlantic Tractors & Equipment Limited on September 30, 2008 against PID 50072032 as document no. 26236324 and against PIDs 50237924 and 50252766 as document no. 26236373;
- (k) \$680,431.03 plus interest filed by Longyear Canada, ULC and Boart Longyear Alberta Limited on October 1, 2008 against PID 50072032 as document no. 26244864 and against PIDs 50237924 and 50252766 as document no. 26244948;
- (l) \$2,558,081.66 plus interest filed by J.S. Redpath Limited on October 1, 2008 against PID 50072032 as document no. 26245077 and against PIDs 50237924 and 50252766 as document no. 26245127;
- (m) \$328,236.56 plus interest filed by Corepro Drilling Inc. on October 2, 2008 against PID 50072032 as document no. 26253105 and against PIDs 50237924 and 50252766 as document no. 26253139;
- (n) \$134,921.94 plus interest filed by Eddy Group Limited on October 7, 2008 against PID 50072032 as document no. 26280520 and against PIDs 50237924 and 50252766 as document no. 26280421;
- (o) \$30,326.65 plus interest filed by United Rentals of Canada, Inc. on October 14, 2008 against PID 50072032 as document no. 26303538 and against PID 50237924 as document no. 26303587;
- (p) \$61,984.49 plus interest filed by ADI Limited on October 15, 2008 against PID 50072032 as document no. and against PIDs 50237924 and 50252766 as document no. 26310004;
- (q) \$1,170,494.71 plus interest filed by Bradley Jenks Excavation Ltd. on October 17, 2008 against PID 50072032 as document no. 26323650 and against PIDs 50237924 and 50252766 as document no. 26323742;
- (r) \$609,709.76 plus interest filed by Consbec Inc. on October 20, 2008 against PID 50072032 as document no. 26332164 and against PIDs 50237924 and 50252766 as document no. 26332172;

- (s) \$16,907.99 plus interest filed by Source Atlantic, A Division of Universal Sales Limited on October 20, 2008 against PID 50072032 as document no. 26332180 and against PID 50237924 as document no. 26332255;
- (l) \$79,593.66 plus interest filed by Modern Pump & Metal Ltd. on October 30, 2008 against PID 50072032 as document no. 26387838 and against PIDs 50237924 and 50252766 as document no. 26387903;
- (u) \$38,727.69 plus interest filed by Atlantic Reproduction Co. Ltd. on October 30, 2008 against PID 50072032 as document no. 26388273 and against PIDs 50237924 and 50252766 as document no. 26388224; and
- (v) \$292,015.70 plus interest filed by Dyno Nobel Canada Inc. on November 3, 2008 against PID 50072032 as document no. 26406125 and against PIDs 50237924 and 50252766 as document no. 26406463.
- (w) \$89,160.88 plus interest filed by OME Engineering Inc. on November 12, 2008 against PID 50072032 as document no. 26452210 and against PIDs 50237924 and 50252766 as document no. 26452277.
- (x) \$28,279.38 plus interest filed by Power Precision Inc. on November 12, 2008 against PID 50072032 as document no. 26452293 and against PIDs 50237924 and 50252766 as document no. 26452335.
- (y) \$292,015.70 plus interest filed by Dyno Nobel Canada Inc. on November 1, 2008 against PID 50072032 as document no. 26406125 and against PIDs 50237924 and 50252766 as document no. 26406463.
- (z) \$569,921.16 plus interest filed by Chaleur Shotcrete Inc. on November 12, 2008 against PID 50072032 as document no. 26452368 and against PIDs 50237924 and 50252766 as document no. 26452376.

The total amount of the Mechanics Liens is \$11,984,679.40

- 49. The Mechanics Liens are not Permitted Liens under Article 8.3 of the Debenture. The Mechanics Liens will encumber Breakwater's interest in the Mines (if and when Breakwater's interest is registered and or recorded) if they are not discharged and/or vacated. Blue Note has not taken steps to contest or discharge the Mechanics Liens as required by Article 6.4 of the Joint Venture Agreement.
- 50. Blue Note, in breach of its obligations under the Debenture:
 - (a) failed to cause title to the Mines to be recorded in Breakwater's name in proportion to Breakwater's interest as promptly as practicable after the Date of the Property Interest Conversion, constituting a violation of Article 3.2(d) of the Debenture; and
 - (b) delayed entering into the Joint Venture Agreement until October 17, 2008, notwithstanding that the effective date of Breakwater's exercise of the Property

Interest Conversion was August 29, 2008, constituting a violation of Article 3.2(b) of the Debenture.

51. Blue Note, in breach of its obligations to Breakwater under the Debenture and the Joint Venture Agreement:
- (a) suffered to exist the Mechanics Liens, constituting a violation of Article 8.3(a) of the Debenture;
 - (b) suffered to exist extensive Indebtedness, other than the Permitted Indebtedness, constituting a violation of Article 8.3(b) of the Debenture;
 - (c) failed to proceed with diligence to contest or discharge the Mechanics Liens contrary to Article 6.4(c) of the Joint Venture Agreement; and
 - (d) failed to pay all Costs, promptly as and when due contrary to Article 6.4(b) of the Joint Venture Agreement.
52. As a result of Blue Note's breach of its obligations under the Debenture:
- (a) Breakwater's twenty percent (20%) interest in the Mines was not recorded and/or registered as promptly as practicable and remains unrecorded and/or unregistered as of the date hereof;
 - (b) the Mechanics Liens have been registered and remain on record against the Mines and are encumbering the title to the Mines;
 - (c) until such time as the Mechanics Liens are discharged and/or vacated, if Breakwater's interest is registered and/or recorded subsequent to the Mechanics Liens, Breakwater's interest in the Mines will be encumbered by the Mechanics Liens and Breakwater will not have received the 20% interest in the Mines as contemplated by the Debenture; and
 - (d) there is extensive indebtedness and/or outstanding Costs in relation to the Mines.
53. On September 10, 2008, Bill Heath, Executive Vice-President of Breakwater and President of CanZinco ("Mr. Heath"), met with representatives of Blue Note (the "September 10th Meeting"), including; *inter alia*, Mike Judson, President and Chief Executive Officer of Blue Note ("Mr. Judson"), John Martin, Chief Operating Officer of Blue Note and President of Blue Note Caribou ("Mr. Martin") and Jean Mayer, Vice President, Legal and Corporate Affairs of Blue Note ("Mr. Mayer"). The September 10th Meeting was convened to discuss the terms of the Joint Venture Agreement. However, on commencement of the September 10th Meeting, Mr. Judson advised Breakwater of the following:
- (a) that the completion of the Joint Venture Agreement was unlikely to be necessary as it was unlikely that Blue Note would continue to have an interest in, or be involved at, the Mines much longer;

- (b) that Blue Note would no longer be sending any funding to Blue Note Caribou for the operation of the Mines and that the operation was going to have to be completely self-sustaining; and
 - (c) that Blue Note Caribou had entered into a "voluntary reorganization" and had commenced discussions with its creditors.
- 54. At the September 10th Meeting, Mr. Mayer advised Breakwater that Blue Note and Blue Note Caribou denied liability for any further payments under the NSR Agreement beyond the first quarter of 2007, and that Blue Note and Blue Note Caribou would not be making any further payments of the Net Smelter Return Royalty under the NSR Agreement.
- 55. On September 12, 2008, Breakwater demanded, in writing, payment of the Net Smelter Return Royalty for the second quarter of 2008 on or before September 19, 2008. Payment of the Net Smelter Return Royalty was not received.
- 56. On September 24, 2008, Blue Note advised Breakwater, in writing, that it was under no obligation to make payment of Net Smelter Return Royalty because, in exercising its Property Conversion Option, effective August 29, 2008, Breakwater had:
 - (a) waived payment of the Net Smelter Return Royalty for the second quarter of 2008, and
 - (b) thereby had caused the NSR Agreement to terminate, ending any obligation on the part of Blue Note to make such payment.
- 57. At no time did Breakwater waive payment of the Net Smelter Return Royalty for the second quarter of 2008 or the portion of the third quarter of 2008, up to and including the Date of Property Interest Conversion, nor did it cause the NSR Agreement to terminate prior to the Date of Property Interest Conversion.
- 58. Blue Note and/or Blue Note Caribou have calculated the amount of the Net Smelter Return Royalty due and owing for the second quarter of 2008 (i.e., from April 1, 2008 until June 30, 2008) as being \$442,865.74, but they have not paid this, or any, amount.
- 59. Breakwater estimates the amount of the Net Smelter Return Royalty due and owing to Breakwater for the portion of the third quarter of 2008, ending on the Date of Property Interest Conversion, (i.e., from July 1, 2008 until August 28, 2008) is approximately \$300,000.00.
- 60. The exact amounts due and owing to Breakwater under the terms of the NSR Agreement, for the period of April 1, 2008 until August 28, 2008 are presently unascertained but will be proven at trial.
- 61. On October 10, 2008, Breakwater provided Blue Note with written notice of its failure to comply with the convertible Debenture and the Joint Venture Agreement and its default in payment of Royalty Payments owing under the NSR Agreement.

62. On November 5, 2008 Breakwater provided Blue Note with written Notice of its default in payment of Marketing Fees owing under the Marketing Agreement.
63. As of November 5, 2008, the following invoices, which had been issued by Breakwater and sent to Blue Note Caribou pursuant to the Change of Billing Address Notice, remained outstanding with respect to Marketing Fees due and owing to Breakwater under the Marketing Agreement (the "Outstanding Marketing Fee Invoices"):

<u>INVOICE NUMBER</u>	<u>DATE OF INVOICE</u>	<u>FEE DUE AND PAYABLE</u>
Debit Note No. 288002	August 26, 2008	\$18,859.04
Debit Note No. 298002	September 23, 2008	\$16,920.50
Debit Note No. 308002	October 27, 2008	<u>\$12,674.31</u>
Total Outstanding Marketing Fee Invoices		<u>\$48,453.85</u>

64. On November 5, 2008 Breakwater sent re-issued copies of the Outstanding Marketing Fee Invoices to Blue Note and demanded payment of same forthwith.
65. As of the date hereof, the Marketing Fees in the amount of \$48,453.85 are due and owing to Breakwater by Blue Note and Blue Note Caribou, together with interest accruing thereon (the "Outstanding Marketing Fees").
66. In addition to the Outstanding Marketing Fees, Blue Note and Blue Note Caribou remain responsible to make payment to Breakwater with respect to Marketing Fees relating to sales of concentrate which have not yet been invoiced by Breakwater, as delivery of the concentrate with respect to such sales to purchasers is not yet complete (the "Marketing Fees Accruing Due"). Breakwater estimates that the total amount of Marketing Fees Accruing Due is approximately \$22,000.00.

Blue Note's Invoices For Joint Venture Costs

67. On October 9, 2008 Blue Note Caribou forwarded an invoice to Breakwater by email which purported to invoice Breakwater for the first 2 months joint venture costs (the "Joint Venture Funding Invoice"). At that time, Blue Note had not complied with its obligations pursuant to Article 3 of the Debenture, and in particular, had not caused title to the mines to be recorded in Breakwater's name in accordance with Breakwater's interest and had not entered into the Joint Venture Agreement.
68. Until such time as Blue Note has complied with its obligations under Articles 3 and 8.3 of the Debenture (as alleged in paragraphs 10 and 12 hereof), Breakwater states that it is not obligated to make payments to Blue Note under the Joint Venture Agreement.

Breakwater claims a right of set-off against any funds payable to Blue Note under the Joint Venture Agreement equal to all amounts outstanding and owing to Breakwater by Blue Note under the Joint Venture Agreement, the NSR Agreement and the Marketing Agreement.

69. The Joint Venture Funding Invoice was also contrary to the terms of the Joint Venture Agreement as it:
- (a) did not provide the required detail of all charges and credit (as contemplated by section 2.2 of the Appendix 1 of the Joint Venture Agreement); and
 - (b) purported to invoice for the estimated cash flow deficit for October, when the Joint Venture Agreement does not contemplate invoicing for estimates, but rather, provides for invoicing by the 15th of each month based on the calculation of the Net Cash Flow Deficit or Surplus for the prior month.

Blue Note's Suspension of Mining Operations

70. On October 17, 2008, Blue Note issued a press release announcing that it would be initiating a temporary care and maintenance program at the Mines (the "Press Release"). The effect of initiating a care and maintenance program would be to suspend or terminate mining operations at the Mines. The Press Release did not identify the effective date of its suspension or termination of mining operations at the Mines. Blue Note did not provide Breakwater with the required notice of its intention to suspend or terminate mining operations at the Mines and did not consult with Breakwater prior to the issuance of the Press Release.
71. On October 17, 2008, subsequent to the issuance of the Press Release, Blue Note forwarded a package of documents to Breakwater by telecopy and courier. The package of documents included correspondence attaching the Press Release and a copy of the Joint Venture Agreement that had been executed by Blue Note. The correspondence notified Breakwater that the suspension or termination of mining operations at the Mines would take effect November 28, 2008. Blue Note did not consult with Breakwater with respect to the effective date of the suspension or termination of mining operations at the Mines.
72. On October 22, 2008, Mr. Heath of Breakwater contacted Mr. Martin of Blue Note to request a meeting with representatives of Blue Note to discuss the many issues that had arisen. At that time, Mr. Martin advised Mr. Heath of the following:
- (i) notwithstanding the Press Release and its previously stated intention to suspend or terminate mining operations at the Mines effective November 28, 2008, Blue Note would in fact be shutting down mining operations later that same day or the following day;
 - (ii) Blue Note would be providing notice of lay-off/termination to employees pursuant to the Employment Standards Act; and

- (iii) Blue Note was looking to sell assets and return leased assets, including underground equipment used at the Mines.

73. On October 22, 2008, following Mr. Heath's discussion with Mr. Martin, Blue Note provided Breakwater with a letter delivered by telecopy and courier which stated Blue Note's intention to "shut down operations" at the Mines on Friday, October 24, 2008. The letter also stated that following:

Provided you are inclined to keep operations going at the Mines and that you are willing to provide the funds necessary to maintain such operations, you may contact us prior to the close of business this Friday, October 24, 2008 and we shall provide you with the financial requirements to keep operations going.

74. Blue Note's unilateral initiation of a care and maintenance program at the Mines constitutes the suspension or termination of Mining Operations under the Joint Venture Agreement. In acting unilaterally to initiate the care and maintenance program and the suspension or termination of mining operations at the Mines, Blue Note breached its obligations as operator of the Mines pursuant to the Joint Venture Agreement. Pursuant to Article 16 of the Joint Venture Agreement, Blue Note was not permitted to act unilaterally to suspend or terminate mining operations at the Mines without notice to and consultation with Breakwater.

75. Article 16 of the Joint Venture Agreement provides as follows:

16. TERMINATION OF MINING OPERATIONS

16.1 The Operator may, at any time subsequent to the Completion Date, on at least thirty (30) days notice to all Participants, recommend that the Management Committee approve that the Mining Operations be suspended. The Operator's recommendation shall include a plan and budget (in this article 16 called the "Mine Maintenance Plan"). In reasonable detail, of the activities to be performed to maintain the Assets and Property during the period of suspension and the Costs to be incurred. The Management Committee may, at any time subsequent to the Completion Date, cause the Operator to suspend Mining Operations in accordance with the Operator's recommendation with such changes to the Mine Maintenance Plan as the Management Committee deems necessary. The Participants shall be committed to contribute their Proportionate Share of the Costs incurred in connection with the Mine Maintenance Plan. The Management Committee may cause Mining Operations to be resumed at any time.

16.2 The Operator may, at any time following a period of at least ninety (90) days during which Mining Operations have been suspended, upon at least thirty (30) days notice to all Participants, or in the events described in paragraph 16.1, recommend that the

Management Committee approve the permanent termination of Mining Operations. The Operator's recommendation shall include a plan and budget (in this article 16 called the "Mine Closure Plan"), in reasonable detail, of the activities to be performed to close the Mine and reclaim the Property. The Management Committee may approve the Operator's recommendation with such changes to the Mine Closure Plan as the Management Committee deems necessary.

16.3 If the Management Committee approves the Operator's recommendation as aforesaid, it shall cause the Operator to:

- (a) implement the Mine Closure Plan, whereupon the Participants shall be committed to pay, in proportion to their respective Interest, such Costs as may be required to implement the Mine Closure Plan;
- (b) remove, sell and dispose of such Assets as may reasonably be removed and disposed of profitably and such other Assets as the Operator may be required to remove pursuant to applicable environmental and mining laws; and
- (c) sell, abandon or otherwise dispose of the Property.

The disposal price for the Assets and the Property shall be the best price obtainable and the net revenues, if any, from the removal and sale shall be credited to the Participants in proportion to their respective Interests.

16.4 If the Management Committee does not approve the Operator's recommendation contemplated in paragraph 16.2, the Operator shall maintain Mining Operations in accordance with the Mine Maintenance Plan.

76. On October 28, 2008, representatives of Breakwater (Mr. Heath and Torben Jensen, Vice-President Engineering of Breakwater) met with representatives of Blue Note (Mr. Judson and Mr. Martin). At the meeting, Blue Note advised Breakwater of *inter alia*, the following:
- (a) there was no need for a joint venture agreement;
 - (b) Blue Note wanted to sell Blue Note Caribou;
 - (c) Blue Note would proceed without delay with the registration of Breakwater's interest in the Mines; and
 - (d) Blue Note was not in a position to do anything with the Mechanics Liens that had been registered against the Mines as it did not have the funds to deal with its creditors.

77. Blue Note has recently offered to arrange for the registration and/or recording of Breakwater's interest in the Mines, but has refused to vacate and/or discharge the Mechanics Liens. As such, Blue Note intends to register and/or record Breakwater's interest in the Mines subsequent to the Mechanics Liens and such interest would be encumbered by the Mechanics Liens and would not constitute the 20% interest in the Mines as required by the Debenture.
78. Breakwater states that any registration of its interest in the Mines subsequent to the registration of the Mechanics Liens and while the Mechanics Liens have not been vacated and/or discharged would be contrary to Blue Note's obligations under the Debenture.

Relief Sought

79. Breakwater seeks the following relief, jointly and severally, against Blue Note and Blue Note Caribou:
- (a) Certificates of Pending Litigation pursuant to Rule 42.01 of the New Brunswick Rules of Court with respect to the Mines, as more particularly described in Schedules "A", "B" and "C" attached hereto;
 - (b) an injunction or mandatory order that Blue Note and Blue Note Caribou proceed with diligence to contest and discharge or vacate the Mechanics Liens and all other liens, (other than Permitted Liens) against the Mines;
 - (c) a mandatory order that Blue Note and Blue Note Caribou shall take all steps necessary and proceed with diligence to cause title to the Mines to be recorded in the name of Breakwater or its nominee, in proportion to Breakwater's interest, free and clear of the Mechanics Liens and all other liens (other than Permitted Liens) and thereafter, that Blue Note comply with Article 6.4 (b) and (c) of the Joint Venture Agreement;
 - (d) a declaration that Breakwater is not required to make any payments to Blue Note under the Joint Venture Agreement until Blue Note has fully complied with subparagraph (b) hereof;
 - (e) a declaration that Breakwater may set-off all amounts outstanding and owing to Breakwater under the Joint Venture Agreement, the NSR Agreement and the Marketing Agreement against any amounts that may now or in the future be owing by Breakwater to Blue Note under the Joint Venture Agreement;
 - (f) damages in the full amount that Blue Note and/or Blue Note Caribou are obligated to pay to Breakwater for outstanding NSR Royalty due and owing under the terms of the NSR Agreement, for the period of April 1, 2008 until August 31, 2008, plus pre-judgment interest;
 - (g) damages in the full amount that Blue Note and/or Blue Note Caribou are obligated to pay to Breakwater for Outstanding Marketing Fees and Marketing Fees

Accruing Due under the terms of the Marketing Agreement, as of the date of trial, plus pre-trial judgment interest;

(h) the costs of this action on a solicitor and client basis, plus harmonized sales tax; and

(i) such further and other relief as to this Honourable Court may deem just.

80. The within claims against Blue Note and Blue Note Caribou fall within the provisions of Rule 19.01(a), (c), (f), and (j) of the New Brunswick *Rules of Court*, permitting service outside of New Brunswick without leave, in that the claims are:

(a) in respect of real property situate in New Brunswick;

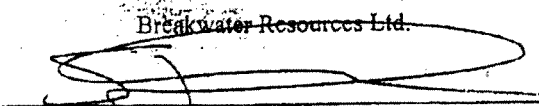
(b) for the construction of a contract or obligation affecting real property situate in New Brunswick;

(c) in respect of a mortgage, charge or lien on real property situate in New Brunswick; and

(d) for an injunction ordering such party to do, or refrain from doing, anything in New Brunswick, or affecting real property situate in New Brunswick.

Dated at Saint John, New Brunswick this 30th day of January, 2009.

STEWART McKELVEY
Solicitors for the Plaintiff,
Breakwater Resources Ltd.


Stephen J. Hutchison

Stewart McKelvey
Barristers and Solicitors
44 Chipman Hill
Saint John, New Brunswick E2L 4S6

Telephone No. 506.632.1970
Facsimile No. 506.652.1989

SCHEDULE "A"

Property identified by PID 50072032

SCHEDULE "B"

PID: 50237924

All that certain lot, piece or parcel of land situate, lying and being in the Parish of Colborne, County of Restigouche, Province of New Brunswick, lying East of Caribou Lake and being more particularly described as follows:

NOTE:

Azimuths stated are referenced to the New Brunswick Provincial Co-ordinate System, with control derived from scaled map points from Map 210/09S.

Beginning at a standard survey marker set in concrete and shown as point 270 on a subdivision Plan titled "Department of Natural Resources and Energy Subdivision 93-7" as prepared by David Green, N.B.L.S. dated September 10th, 1990 and filed in the Restigouche County Registry Office on November 24th, 1993 under Number 3255, said marker located near the southerly end of the dam creating Caribou Lake;

thence, in a northerly direction following along the upstream face of said dam and its prolongation to intersect with a yellow painted blazed line extended on an azimuth of 238° 40' 31" from a Survey Marker shown as point 321 on said filed plan;

thence, 58° 40' 31" to said Survey Marker (321);

thence, 341° 23' 23" a distance of 345.701 metres to a Survey Marker;

thence, 67° 41' 15" a distance of 102.271 metres to a Survey Marker set in concrete (332);

thence, 65° 37' 41" a distance of 863.048 metres to a Survey Marker set in concrete (360);

thence, 68° 45' 50" a distance of 133.715 metres to a Survey Marker;

thence, 142° 35' 16" a distance of 132.526 metres to a Survey Marker;

thence, 120° 26' 44" a distance of 328.463 metres to a Survey Marker;

thence, 143° 46' 20" a distance of 208.736 metres to a Survey Marker;

thence, 136° 09' 20" a distance of 64.873 metres to a Survey Marker;

thence, 117° 29' 02" a distance of 39.667 metres to a Survey Marker (80);

thence, 98° 32' 12" a distance of 42.634 metres to a Survey Marker;

thence, 86° 31' 42" a distance of 88.264 metres to a Survey Marker;

thence, 104° 21' 14" a distance of 250.151 metres to a Survey Marker;

thence, 131° 22' 35" a distance of 450.830 metres to a Survey Marker;

thence, 177° 34' 42" a distance of 172.762 metres to a Survey Marker;

thence, 176° 42' 48" a distance of 222.553 metres to a Survey Marker;

thence, 162° 18' 46" a distance of 248.426 metres to a Survey Marker (150);

thence, 161° 57' 28" a distance of 151.984 metres to a Survey Marker;

thence, 235° 13' 59" a distance of 359.964 metres to a Survey Marker;

thence, 254° 56' 19" a distance of 280.232 metres to a Survey Marker;

thence, 349° 17' 27" a distance of 261.035 metres to a Survey Marker;

thence, 329° 37' 30" a distance of 121.666 metres to a Survey Marker (200);

thence, 309° 55' 57" a distance of 90.787 metres to a Survey Marker;

thence, 80° 2' 41" a distance of 162.094 metres to a Survey Marker;

thence, 294° 02' 46" a distance of 194.630 metres to a Survey Marker;

thence, 266° 54' 49" a distance of 55.734 metres to a Survey Marker;

thence, 259° 48' 41" a distance of 500.044 metres to a Survey Marker (250);

thence, 245° 15' 29" a distance of 683.676 metres to a Survey Marker;
thence, 341° 23' 45" a distance of 229.739 metres to the Place of Beginning.

The hereinbefore described parcel of land is estimated to contain an area of 254.260 hectares,
more or less. The said plan also filed in the records of the Minister of Natural Resources and
Energy on October 28, 1993 as Number 293-1.

SCHEDULE "C"

PID: 50252766

All that certain lot, piece or parcel of land situate, lying and being in the Parish of Balmoral, Restigouche County and Province of New Brunswick, and being a portion of Crown Land situate at Portage Lakes, said lot being more particularly described as follows:

being all that lot as shown on a Return of Survey prepared by David G. Green, N.B.L.S., dated September 18, 1996, said Return of Survey accepted and filed in the records of the Minister of Natural Resources and Energy on May 20, 1997 under number 347-1;

the above described lot containing 128 ha. in area, be it slightly more or less; and
saving and excepting any timber roads with the above described lands.

The following is Exhibit "G" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.



A Commissioner of Oaths
Being a Solicitor

Court File No: S/C/684/08

IN THE COURT OF QUEEN'S BENCH OF NEW BRUNSWICK
TRIAL DIVISION
JUDICIAL DISTRICT OF SAINT JOHN

BETWEEN:

BREAKWATER RESOURCES LTD.

COURT OF QUEEN'S BENCH
CLERK / SAINT JOHN

- and -

PLAINTIFF,

REC'D
JAN 19 2009

JAN 19 2009

FILED
DEPOSE

**BLUE NOTE MINING INC. and BLUE NOTE
CARIBOU MINES INC.,**

COUR DU BANC DE LA REINE
GREFFIER / SAINT-JEAN

DEFENDANTS

STATEMENT OF DEFENCE AND COUNTERCLAIM (FORM 27C-1)

STATEMENT OF DEFENCE

1. The Defendants, Blue Note Mining Inc. ("Blue Note") and Blue Note Caribou Mines Inc. ("Blue Note Caribou"), admit the allegations contained in paragraphs 1 to 7 and 10 to 12 of the Statement of Claim.
2. The Defendants deny the allegations contained in paragraphs 9 to 78 of the Statement of Claim and put the Plaintiff, Breakwater Resources Ltd. ("Breakwater"), to the strict proof thereof.
3. The Defendants deny that Breakwater is entitled to the relief sought in paragraph 79 of the Statement of Claim.
4. Blue Note acquired the mines known as the Restigouche and Caribou Mines (the "Mines") from Canzinc Ltd., a wholly owned subsidiary of Breakwater, as of August 1, 2006. Pursuant to the Asset Purchase Agreement executed as of August 1, 2006, (the "APA") Blue Note issued to Breakwater an Unsecured Subordinated Convertible Debenture (the "Debenture") in the amount of \$15,000,000.00 to Breakwater. Blue Note and Breakwater also entered into, as of August 1, 2006, a Net Smelter Royalty Agreement (the "NSR Agreement") and a Marketing Agreement (the "Marketing Agreement"). As of June, 2007,

the Mines were transferred from Blue Note to Blue Note Caribou. As is set out in more detail below, the obligations of Blue Note under the Debenture, the NSR Agreement and the Marketing Agreement were transferred to Blue Note Caribou. The Defendants plead and rely on the terms of the APA, the Debenture, the NSR Agreement and the Marketing Agreement.

5. With respect to the allegations contained in paragraph 9 of the Statement of Claim, the Defendants admit that the Debenture provided that Breakwater could, at its option, convert the Debenture into a 20% interest in Mines.
6. Further with respect to paragraph 9 of the Statement of Claim, the Defendants admit that, pursuant to the Debenture, upon conversion by Breakwater, Breakwater and Blue Note Caribou were obliged to enter into a joint venture agreement, in substantially the form attached as Exhibit "B" to the Debenture (the "Joint Venture Agreement"). The Defendants plead and rely upon the terms of the Joint Venture Agreement.
7. Upon conversion, Breakwater became bound by the terms of the Joint Venture Agreement, including terms relating to payments under the Joint Venture Agreement. Among other things, Breakwater is obliged to assume 20% of the costs of operating and developing the Mines.
8. With respect to the allegations contained in paragraphs 14 and 15 of the Statement of Claim, the Defendants deny that Blue Note attempted to unilaterally transfer its obligations under the Joint Venture Agreement to Blue Note Caribou. In fact, such obligations were transferred with the consent of Breakwater (either impliedly or explicitly). The transfer was effected with the knowledge and concurrence of Breakwater and had been contemplated by the parties from and after August, 2006.
9. In the alternative, if Breakwater did not consent to the transfer, including transfer of the Joint Venture Agreement (which is not admitted but expressly denied), then Breakwater acquiesced in and ratified the transfer and is now estopped from denying such acquiescence and ratification.
10. With respect to the allegations contained in paragraph 16 of the Statement of Claim, Blue Note Caribou admits that both Blue Note and Breakwater are obliged to act in accordance with the terms of the Joint Venture Agreement.
11. With respect to the allegations contained in paragraphs 17 to 23 of the Statement of Claim, the Defendants deny that either of them has failed to abide by any obligations upon them pursuant to the Joint Venture Agreement. The obligations under the Joint Venture Agreement have been complied with, in

full, by Blue Note Caribou. In fact, as soon as was practicable following conversion, Blue Note Caribou caused transfer documentation to be delivered, in draft form, for approval by Breakwater. While Breakwater provided, through counsel, comments upon the draft documentation, Breakwater has failed or refused to execute the transfer documentation, alleging that the presence of mechanics' liens registered against certain of the assets relating to the Mines permits Breakwater to refuse to execute the transfer documentation. The liens relate to allegations by suppliers of labour and materials that they are unpaid by Blue Note Caribou.

12. Further with respect to the allegations contained in paragraph 17 to 23 of the Statement of Claim, the presence of mechanics' liens in no way entitles Breakwater to fail or refuse to execute the transfer documentation and the Joint Venture Agreement. Blue Note Caribou is actively contesting the validity of all mechanics' liens registered against the assets associated with the Mines. All mechanics' liens were filed following the date of conversion by Breakwater.
13. By the terms of the Debenture, Blue Note Caribou is obliged to actively contest all mechanics' liens. It has done so. None of the liens had been filed prior to the date of conversion by Breakwater. Having converted its interest from that of a debenture holder to an equity owner, Breakwater knowingly and voluntarily assumed the risk that its ownership interest might be impaired by the claims of suppliers of labour and materials. Blue Note Caribou and Breakwater, as joint venturers, share the burden of the costs of operation and development, according to the terms of the Joint Venture Agreement and their respective interests in the joint venture. While the claims of suppliers of labour and materials, if valid and eligible to claim the rights of a lien holder (which is not admitted but expressly denied), burdens the equity of the owners of the Mines, such burden does not fall to a greater degree upon Breakwater. In the event that the liens are valid, Breakwater, as an equity owner, shares the burden of the claims in accordance with its interest in the Mines. The same is true regardless of whether the ownership interest of Breakwater was registered before or after the registration of the mechanics' liens.
14. With respect to the allegations contained in paragraphs 24 to 37 of the Statement of Claim, the Defendants state that all amounts owing pursuant to the NSR Agreement have been paid, in full, to Breakwater. In the alternative, if any amounts are owing to Breakwater, the Defendants plead set-off in respect of all amounts owing by Breakwater to Blue Note Caribou with respect to the Joint Venture Agreement.

15. With respect to the allegations contained in paragraphs 46 to 52 of the Statement of Claim, the Defendants state that Blue Note Caribou has actively contested all mechanics' liens and repeats and relies upon the allegations set forth in paragraphs 11 to 13 of the within Statement of Defence.
16. With respect to the allegations contained in paragraphs 53 and 54 of the Statement of Claim, the Defendants deny the position attributed to them with respect to the meetings referred to therein. Further, the Defendants state that the meetings referred to were held on a without prejudice basis with a view to settling or compromising contemplated litigation and are as such privileged and confidential.
17. With respect to the allegations contained in paragraphs 55 to 66 of the Statement of Claim, the Defendants deny that there is any balance owing with respect to the NSR Agreement or any other agreement. In the alternative, the Defendants plead set-off against amounts owing by Breakwater to Blue Note Caribou in respect of the Joint Venture Agreement.
18. With respect to the allegations contained in paragraphs 67 to 69 of the Statement of Claim, Breakwater has consistently refused to meet its financial obligations pursuant to the Joint Venture Agreement. Such obligations arise upon conversion under the Debenture and are governed by the Joint Venture Agreement. Breakwater's refusal to honour its payment obligations under the Joint Venture Agreement, together with its refusal to execute the transfer documentation in order to register its interest in and to the Mines, amounts to repudiation by Breakwater of the Joint Venture Agreement.
19. With respect to the allegations contained in paragraphs 70 to 78 of the Statement of Claim, the Defendants admit that, as of October, 2008, Blue Note Caribou scaled back operations at the Mines and placed the Mines on a care and maintenance program. Breakwater has consistently failed and refused to meet its financial obligations with respect to the care and maintenance program, pursuant to the Joint Venture Agreement.
20. The Defendants respectfully submit that the within action should be dismissed as against them with costs.
21. The Defendants intend to proceed in the English language.

COUNTERCLAIM

22. The Defendants repeat and rely upon the allegations set forth in their Statement of Defence herein.
23. Blue Note Caribou claims as against Breakwater damages in an amount to be specified prior to trial for breach of the Joint Venture Agreement.
24. In the alternative, Blue Note Caribou claims as against Breakwater damages in an amount to be specified prior to trial for repudiation of the Joint Venture Agreement.
25. Blue Note Caribou further claims as against Breakwater the following:
 - a. interest until payment;
 - b. costs of this action, together with applicable Harmonized Sales Tax; and
 - c. such further and other relief as this Honourable Court deems just and expedient.

Dated at Moncton, New Brunswick, this 15th day of January, 2009

COX & PALMER



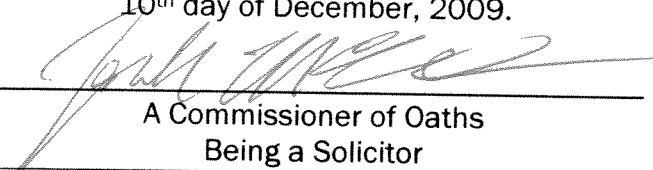
GEORGE L. COOPER
Solicitor for the Defendants

COX & PALMER
644 Main Street, Suite 500
Moncton, NB E1C 1E2

Tel: (506) 856-9800
Fax: (506) 856-8150

Email: gcooper@coxandpalmer.com

The following is Exhibit "H" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.



A Commissioner of Oaths
Being a Solicitor

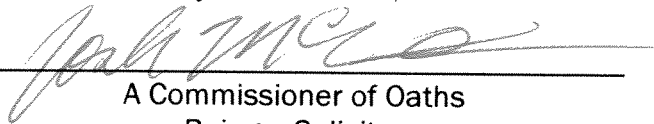
Blue Note Caribou Mines Inc.
Non-controlling interest - 20% Breakwater
As of March 31, 2009

Portion of loss from August 29 to September 30, 2008	1,401,678.00	
Portion of loss relative to asset impairment	22,200,000.00	
BW's portion of loss as per Financial State- ment disclosed as at September 30, 2008	23,601,678.00	Agree to F/S disclose on Sedar - non audited
Portion of loss from October 1 to Decem- ber 31, 2008	1,789,162.32	
BW's portion of loss as per Audited Financial State- ment disclosed as of December 31, 2008	25,390,840.32	Agree to F/S audited by E&Y
Portion of loss from January 1 to March 31, 2009	655,955.25	
Total Breakwater portion as of March 31, 2009	26,046,795.57	
<u>Compose of:</u>		
Cash operating loss	3,846,795.57	
Impairment loss on mining assets	22,200,000.00	
	26,046,795.57	

An impairment of \$111,000,000 , as of September 31, 2009, was taken on mining assets, in accordance with the Corporation's stated accounting policy on long-lived assets. Breakwater portion is \$22,200,000 (20% of \$111M).

[Handwritten signature]

The following is Exhibit "I" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.

A handwritten signature in cursive script, appearing to read "John McLeod", is written over a horizontal line.

A Commissioner of Oaths
Being a Solicitor



BREAKWATER

R E S O U R C E S L T D

2008 Financial Report

P



Message to Shareholders

2008 was an unprecedented year for commodities and financial markets as the global credit markets seized, banks hemorrhaged and capital and jobs disappeared. What made it unprecedented was the violence and psychology of the decline causing markets to evaporate literally overnight. In the context of our share price, the stock market and the prices of the metals we produce, 2008 can only be described as devastating. For the past several years Breakwater's management has worked diligently to execute its business plan. While the medium to long-term plan, which is to invest in capital and exploration as required to secure a long-term future for the assets that warrant that investment and grow our production profile is still in place, we are deeply disappointed that the current economic environment requires that we layer on top of this what we hope will be a short term austerity plan.

As everyone is now well aware, the Company announced that it would temporarily suspend operations at both Langlois in Québec, Canada and Myra Falls in British Columbia, Canada. This decision was precipitated by the decline in commodity prices and the deterioration of the economic outlook globally, which mitigated the overall operational improvements in production and costs at both mines. At Langlois, the temporary cessation of operations took full effect by November 2, 2008. At Myra Falls, results of exploration activities caused the Company to extend the notice period and accordingly the operation continues to produce albeit on a reduced scale with a smaller workforce. The plan for 2009 includes mining higher grade and fewer tonnes with the goal of producing positive cash flow at forecast metal prices and exchange rates. The South Flank lens has the potential to add additional higher grade material to the 2009 mine plan.

“Notwithstanding the bad news, 2008 was not without its successes.”

Notwithstanding the bad news, 2008 was not without its successes. Breakwater's production profile grew this year with 13% higher aggregate production of zinc in concentrate. The increase in zinc production was due to higher production from Myra Falls and Langlois partially offset by lower production from Mochito and Toqui. Production of copper in concentrate decreased 5% in 2008 from 2007 due to fewer tonnes milled at Myra Falls partially offset by increased production from Langlois. Production of lead in concentrate increased 50% in 2008 due to more tonnes milled at higher grades at Mochito and milling of the Concordia deposit at Toqui which is a zinc/lead/silver deposit. Gold in concentrate decreased 34% year-over-year due to lower production from Myra Falls and the planned reduction in milling of gold material at Toqui during the first nine months of 2008. Silver in concentrate increased 12% year-over-year primarily due to more tonnes milled at Mochito, higher silver grades at Toqui, again due to the Concordia deposit, and more tonnes milled at Langlois with higher silver grades.

At Mochito in late 2007 and early 2008 ground control issues affected the mine necessitating the move to mining mineralized material in areas unaffected by these issues. This change in the mine plan resulted in the extraction of certain lower grade mantos with the final production figures below those originally predicted in early 2008. Additionally, in the category of “It never rains but it pours!”, Honduras experienced significantly higher than normal levels of rainfall to the extent that the President declared a National Emergency in October. Mochito did not go unscathed and the wetter conditions gave rise for the need for additional manpower on projects related to dewatering.

road repair and ground rehabilitation. The Company is focusing all its efforts on those activities necessary to maintain a safe, environmentally compliant and productive mine while maximizing cash flows. The mine rehabilitation program, to address the ground control problems, is expected to be complete in the first quarter of 2009.

At Toqui, the operational results were on target for zinc, below target for lead and well above target for gold and silver. The 2009 mine plan at Toqui is focused on mining the gold bearing deposits, Mina Profunda and Aserradero, to the exclusion of other production ready deposits such as the zinc/lead/silver bearing Concordia deposit or the zinc bearing Estatuas deposit. It is anticipated that the throughput will be approximately half that of 2008's throughput with a reduction in manpower and/or the implementation of job sharing initiatives. A recovery in the price of zinc would support the restart of mining these other deposits.

“However, as always from adversity springs opportunity.”

So where does that leave us now? There are obviously questions regarding going concern. We have been addressing the question of survivability since the second quarter last year and I can assure our readers that we will continue to do the things we have been doing, sell non-core assets, continue to actively pursue further Red Mile type transactions, explore long-term off-take agreements, and explore all alternatives to extract value from our assets. Obviously all options have to be explored and considered. We are not alone in the mining sector in taking these actions.

However, as always from adversity springs opportunity. Supply side destruction has been unprecedented and the recovery in zinc prices was not long enough to ensure continued supply from existing operations. New projects are stalled and exploration non-existent. As such, supply recovery will be difficult and will not be in any position to match demand recovery.

Our first instincts are always to survive, but not just survive—survive and prosper. We are at a hinge in history. What we are observing now, caused by the financial meltdown in the West is a rapid increase in what to-date has already been a rather swift shift from Western predominance globally to Asia, principally China and India. Our future will rest in these markets and they will continue to grow, albeit slower, but still grow and prosper. China continues to be a net importer of zinc concentrate and in January of this year, more automobiles were sold in China than the United States for the first time. This will continue. We are endeavouring with all our will to be in a position to capitalize on all the opportunities this market will deliver.

We wish to thank our directors for their guidance, our employees for their efforts and our shareholders for their patience. It is through these three groups that we continue to build a company which will continue to do the right things right.



George E. Pirie

President and Chief Executive Officer

February 26, 2009

Reserves and Resources

On February 26, 2009, the Company released its 2008 mineral reserve and mineral resource estimates to the public and this excerpt should be read in conjunction with that news release.

Proven and Probable Mineral Reserves

	December 31, 2008						December 31, 2007					
	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)
Mochito	2,464	5.2	2.3	—	66	—	2,535	6.0	2.2	—	72	—
Toqui	3,343	7.1	0.4	0.1	11	2.6	4,715	7.3	0.5	0.1	11	1.1
Myra Falls	6,298	5.2	0.5	0.9	44	1.3	5,835	5.4	0.5	1.0	45	1.3
Langlois	5,095	9.7	—	0.6	45	0.1	7,879	8.1	—	0.5	37	0.1
Total	17,200	6.9	—	—	—	—	20,964	6.9	—	—	—	—

Measured and Indicated Mineral Resources*

	December 31, 2008						December 31, 2007					
	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)
Mochito	2,535	6.2	2.8	—	76	—	3,009	6.4	2.4	—	79	—
Toqui	4,925	8.1	0.4	0.1	12	2.1	5,346	8.1	0.5	0.1	13	1.3
Myra Falls	6,799	6.9	0.6	1.2	57	1.7	6,323	7.3	0.6	1.3	58	1.6
Langlois	6,659	10.0	—	0.7	47	0.1	9,374	8.7	—	0.6	41	0.1
Total	20,918	8.1	—	—	—	—	24,052	7.9	—	—	—	—

* Includes proven and probable reserves but excludes inferred resources

Inferred Mineral Resources

	December 31, 2008						December 31, 2007					
	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)	Tonnes (000's)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)
Mochito	2,372	4.3	2.3	—	55	—	1,821	5.8	2.2	—	67	—
Toqui	3,994	7.3	0.5	0.1	16	1.0	4,761	7.1	0.5	0.1	15	0.6
Myra Falls	3,196	8.2	0.9	1.1	110	2.3	3,777	7.8	0.9	1.0	90	2.2
Langlois	1,543	8.0	—	0.5	44	0.1	2,290	6.4	—	0.5	39	0.1
Total	11,105	7.0	—	—	—	—	12,649	7.0	—	—	—	—

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

This management's discussion and analysis of financial condition and results of operations ("MD&A") of Breakwater Resources Ltd. (the "Company") should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2008, and related notes thereto which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Unless otherwise indicated, this MD&A has been prepared as of February 26, 2009. The reporting currency is Canadian dollars ("C\$" or "\$") and all amounts disclosed are in Canadian dollars unless otherwise indicated. Unless the context indicates otherwise, a reference to the "Company" in this MD&A means Breakwater Resources Ltd. and its subsidiaries and other entities owned or controlled, directly or indirectly, by the Company.

The audited consolidated financial statements of the Company for the years ended December 31, 2008 and 2007 were prepared in accordance with GAAP applicable to a going concern which assume that the Company will realize its assets, discharge its liabilities and meet its future obligations in the normal course of business. Accordingly, the audited consolidated financial statements for the years ended December 31, 2008 and 2007 do not include any adjustments to the recoverability and reclassification of recorded assets, or the amounts or classification of liabilities, that might be necessary should the Company be unable to continue as a going concern.

While the audited consolidated financial statements for the years ended December 31, 2008 and 2007 were prepared on the basis of accounting principles applicable to a going concern, certain market conditions, including falling metal prices and higher operating costs, cast significant doubt upon the validity of this assumption. For the year ended December 31, 2008, the Company incurred a loss of \$88.3 million, had a net decrease in cash of \$42.6 million and, used net cash in operating activities of \$3.7 million.

The Company's ability to continue its operations in the normal course of business is dependent upon its ability to achieve and sustain profitable operations. Alternatively, the Company is dependent on continued support from shareholders and creditors. In 2009, metal prices remain low and the Company continues to experience operating losses and the Company's cash has been significantly reduced. Management is exploring all available options to secure additional funding including equity and debt financing, sale of non-core assets and strategic partnerships. It is not possible to determine with any certainty the success and adequacy of these initiatives.

The audited consolidated financial statements for the years ended December 31, 2008 and 2007 do not give effect to adjustments to the carrying values of assets and liabilities and the reported revenues and expenses and balance sheet classifications that would be necessary should the Company be unable to continue as a going concern. These adjustments could be material.

The Company is a mining, exploration and development company which produces zinc, copper, lead and gold concentrates. During 2008, the Company's concentrate production was derived from mines located in Canada, Chile and Honduras. The Company also owns base metal and gold exploration properties in Canada, Honduras, Chile and Tunisia. The Langlois mine, located in Canada, began production in November 2006 and commenced commercial production for accounting purposes on July 1, 2007. On November 2, 2008, the Company temporarily suspended operations at Langlois due to the decline in commodity prices and the general deterioration of the economic outlook globally. The start-up and subsequent temporary suspension of the Langlois mine affects all aspects of the Company's financial results which makes comparisons between years difficult.

CURRENT MARKET CONDITIONS

Current global financial conditions have negatively impacted the economic environment and numerous financial institutions have either gone into bankruptcy or have had to be rescued by governmental authorities. Access to public financing has significantly diminished for companies like Breakwater as a direct result of both sub-prime mortgages and the liquidity crisis affecting the asset-backed commercial paper market. If the current negative economic environment and market turmoil continue, the Company's ability to operate could be adversely impacted and the trading price of the shares could continue to be under downward pressure. Also see Financial Capability section of this MD&A.

HIGHLIGHTS

The Company realized a net loss of \$88.3 million or \$0.20 per share in 2008 compared with net earnings of \$23.4 million or \$0.06 per share in 2007. The main items affecting the movement to a loss were:

- \$30.5 million higher write-down of mineral properties and fixed assets primarily due to \$25.3 million and \$8.3 million write-downs at Myra Falls and Mochito respectively combined with an \$11.0 million write-down of the carrying value of a 20% interest (defined below) in the mineral properties and mine facilities which comprise the Caribou and Restigouche mines in 2008 partially offset by a \$16.0 million write-down of Myra Falls in 2007
- \$6.2 million (US\$7.5 million) lower gross sales revenue due to 42% higher concentrate sales being more than offset by decreases of 39%, 13% and 23% in the realized prices of zinc, copper and lead respectively
- \$35.5 million increase in treatment and marketing costs primarily due to higher production volumes and significantly higher freight rates
- \$68.2 million increase in direct operating costs primarily due to the impact of higher sales volumes principally at Langlois (\$44.6 million) and higher costs at the other mines
- \$24.9 million increase in depreciation and depletion expense due to Langlois and increases in the depreciation charges at Toqui and Mochito due to higher fixed asset bases
- \$8.1 million decrease in the income tax provision due primarily to write-downs of future tax assets at Myra Falls and Langlois and lower earnings before tax at Mochito and Toqui
- \$21.1 million increase in investment and other income primarily due to gains on sales of investments and the Lapa Royalty disposal (as more fully described below) and lower unrealized losses on investments held for trading
- \$15.0 million improvement in foreign exchange and other is primarily due to the impact of the weakening of the C\$ against the US\$ in 2008 compared with a strengthening C\$ in 2007

Concentrate produced in 2008 increased by 10% to 315,837 tonnes largely due to increased production at all operations and particularly Langlois.

On April 10, 2008, the Company purchased a 3% net smelter royalty ("NSR") at Myra Falls established in December 2007 in conjunction with the creation of a qualifying environmental trust for 13,518,739 Common Shares.

On April 15, 2008, the Company issued 7.0 million Common Shares to acquire Metco Resources Inc. ("Metco") to consolidate its land position in Lebel-sur-Quévillon and acquire a large under-explored land package in the prolific Matagami camp.

On August 29, 2008, the Company gave notice it would exercise its right to convert an unsecured subordinated convertible debenture from Blue Note Mining Inc. (formerly, Blue Note Metals Inc.) (together with its affiliates, "Blue Note") to a 20% interest in the mineral properties and mine facilities which comprise the Caribou and Restigouche mines (the "20% interest"). The Company claims that Blue Note is not in compliance with its obligations under the debenture and related documents and accordingly the 20% interest has not been conveyed to the Company. At September 30, 2008, based on the estimated and undiscounted cash flow for the fair value of the 20% interest and the prevailing market conditions, the investment was deemed to be impaired and was written off. There is currently litigation between the Company, CanZinco Ltd. and Blue Note which in part relates to this conveyance and joint venture obligation. The Company claims that Blue Note has an obligation prior to conveying an interest to the Company to discharge or vacate liens and claims against the properties, other than claims specifically permitted under the agreements to which the Company is a party.

On October 28, 2008, the Company announced that it would temporarily suspend operations at both Langlois in Québec, Canada and Myra Falls in British Columbia, Canada. This decision was precipitated by the decline in commodity prices and the general deterioration of the short-term economic outlook globally, which mitigated the overall operational improvements in production and costs at both mines. At Langlois the temporary cessation of operations took full effect by November 2, 2008. At Myra Falls, results of exploration activities caused the Company to extend the notice period and accordingly the operation continues to produce albeit on a reduced scale with a smaller workforce. The Company continues to closely monitor economic and market conditions and will take appropriate actions in the best interest of the Company, its employees and its shareholders.

In December 2008, the Company sold its 50% interest in the Coulon joint venture property to Virginia Mines Inc. ("Virginia"). Virginia purchased the interest by issuing 1,666,666 common shares of Virginia. At closing, all of the shares of Virginia issued to the Company in respect of the transaction were resold at a price of \$2.85 per share (\$4.75 million) in favour of third-party buyers.

Additionally, the Company sold its 1.0 percent NSR on all gold production from the Tonawanda property and its 0.5 percent NSR on all gold production from the Zulapa property (the "Lapa Royalty") to Agnico-Eagle Mines Limited ("Agnico-Eagle") for \$6.25 million.

In December 2008, the Company entered into a Royalty Agreement ("Agreement") with Red Mile Resources No. 5 Limited Partnership ("Red Mile") whereby the Company sold a "Basic Royalty" on a portion of the payable zinc production, over the life of the Myra Falls mine. The Company received \$18.2 million which included royalty income of \$16.0 million and indemnity fees and interest of \$2.2 million. The royalty income is shown as Royalty Obligation on the balance sheet and will attract a royalty payment over the life of the obligation that will be recorded as interest expense. The fees and interest received will be brought into income over the life of the Agreement. Of the funds received, \$16.0 million were placed with a financial institution, for which the Company took back a restricted promissory note. Interest earned from the promissory note and a portion of the principal must be used to fund the expected Basic Royalty payments. The remaining funds of \$2.2 million will be used for working capital purposes (*see note 13 of the 2008 audited consolidated financial statements for details*).

The collective bargaining agreement at Myra Falls was renewed during 2008 for eighteen months and has an expiry date of September 30, 2009.

The carrying values of the Company's wholly-owned mines are tested for impairment when conditions warrant. In view of the current market conditions, at December 31, 2008 the Company has reviewed all of its wholly-owned mines for impairment and concluded that impairments existed¹. The Company will continue to monitor these assets for impairment (please see the Accounting Policies and Critical Accounting Estimates section of this MD&A for a description of the impairment tests) and readers are cautioned that further write-downs may be required should circumstances change.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2008.

OUTLOOK

In 2009, the Company's objectives are to maximize cash flow in this uncertain economic environment while maintaining safe, environmentally compliant and productive mines. Where necessary and appropriate the Company will invest in capital projects to increase the productivity and efficiency of operations and continue to advance mine exploration and development.

Sales

The Company's Canadian dollar gross sales revenues are affected by the United States dollar ("US\$") denominated metals prices received and the exchange rate between the US\$ and C\$. With the current volatility in the markets it is extremely difficult to forecast metal prices or exchange rates. The effect of various government planned stimulus packages and interest rate cuts will have on the worldwide economy is unknown.

Processing Charges and Freight

Base zinc treatment charges, while currently under negotiation, are expected to decline from 2008 levels. Unsustainably low metal prices are reducing mine production globally. It is anticipated that copper treatment and refining charges will increase in 2009 following recently announced benchmark settlements between major mining companies and smelters. Ocean freight rates are expected to fall significantly from the levels prevailing in 2008, reflecting the current slowdown in global economic activity.

¹ - The fixed assets at Myra Falls and Mochito were written-down by \$25.3 million and \$8.3 million respectively.

Production

The Company's projected metals production for 2009 is set forth in the following table:

Metal in Concentrate	Contained	Payable
Zinc (tonnes)		
Mochito	33,300	28,200
Toqui	8,200	6,800
Myra Falls	36,200	30,800
	77,700	65,800
Copper (tonnes)		
Myra Falls	4,800	4,600
Lead (tonnes)		
Mochito	17,600	16,700
Gold (ounces)		
Toqui	44,000	36,000
Myra Falls	14,200	11,300
	58,200	47,300
Silver (ounces)		
Mochito	2,235,000	1,807,000
Toqui	37,000	7,000
Myra Falls	698,000	409,000
	2,970,000	2,223,000

These projections are based on the following throughput at each mine:

	Tonnes Milled	Zinc (%)	Copper (%)	Lead (%)	Gold (g/t)	Silver (g/t)
Mochito	698,000	5.4	n.a.	3.0	n.a.	114.6
Toqui	259,000	3.7	n.a.	n.a.	6.2	7.6
Myra Falls	482,000	8.3	1.3	n.a.	1.3	55.8
All Operations	1,439,000	6.1	n.a.	n.a.	n.a.	n.a.

Estimates of production are subject to change and actual production may vary materially from such estimates

There are numerous uncertainties inherent in estimating anticipated production including many factors beyond the control of the Company. The estimation of anticipated production is a subjective process and the accuracy of any such estimates is a function of the quality of available data, reliability of production history, variability in grade encountered, mechanical or other problems encountered, engineering and geological interpretation and operator judgment. Rates of production may be less than anticipated. Results of drilling, metallurgical testing and production, and the evaluation of mine plans subsequent to the date of any estimate may cause actual production to vary materially from such estimates.

Exploration

Based on current market conditions, the Company expects to spend \$2.5 million on exploration expenditures in 2009 with the objective of increasing the mineral resources (both measured and indicated and inferred) at Mochito in Honduras and at Toqui in Chile as well as meeting the Company's obligations under various joint venture agreements in Québec, Canada. In the event of a further deterioration in market conditions, the Company may curtail or eliminate projected exploration expenses. The breakdown of exploration expenses is set forth in the following table.

Exploration Expenses

<i>(\$ millions)</i>	2009 Projection
Mochito	0.5
Toqui	0.6
Québec	1.4
	2.5

Capital Expenditures

In 2009, based on current market conditions, the Company plans to spend \$17.3 million on capital with the bulk of the funds related to Mochito and Toqui. Of the capital expenditure budget at Mochito, \$6.2 million of the total has been allocated to the mine and mine development with \$2.4 million allocated to complete the work at Soledad and Pozo Azul. At Toqui, \$2.7 million of the capital expenditures will be directed to the development of Mina Profunda and certain other deposits and to underground delineation drilling. A portion of the construction of a new tailings impoundment area will account for \$1.8 million. The mill and the Company's initiative of increasing hydro-electric generating capacity have been allotted \$1.0 million. The balance of the funds will be spent on a number of other projects including several environmental and safety initiatives. In the event of a further deterioration in market conditions, the Company may curtail or eliminate projected capital expenditures.

Capital Expenditures

<i>(\$ millions)</i>	2009 Projection
Mochito	9.9
Toqui	6.2
Myra Falls	1.1
Other	0.1
Total Capital	17.3

Costs

The operating costs on a production basis at each mine are estimated to fall in the ranges set forth below:

	Production Costs <i>(per tonne milled)</i>
Mochito	US\$45 – US\$55
Toqui	US\$56 – US\$69
Myra Falls	C\$93 – C\$113

Key Assumptions**CORPORATE**

The Company's ability to continue its operations in the normal course of business is dependent upon its ability to achieve and sustain profitable operations. Alternatively, the Company is dependent on continued support from shareholders and creditors. In 2009, metal prices remain low and the Company continues to experience operating losses and the Company's cash has been significantly reduced. Management is exploring all available options to secure additional funding including equity and debt financing, sale of non-core assets and strategic partnerships. It is not possible to determine with any certainty the success and adequacy of these initiatives.

There are numerous uncertainties inherent in estimating anticipated production including many factors beyond the control of the Company. The estimation of anticipated production is a subjective process and the accuracy of any such estimates is a function of the quality of available data, reliability of production history, variability of grade encountered, mechanical or other problems encountered, engineering and geological interpretation and operator judgment. Rates of production may be higher or lower than anticipated. Results of drilling, metallurgical testing and production, and the evaluation of mine plans subsequent to the date of any estimate may cause actual production to vary materially from such estimates.

MOCHITO

As noted in previous interim reports, in late 2007 and early 2008 certain ground control issues affected the mine necessitating the move to mining mineralized material in areas unaffected by these issues. This change in the mine plan resulted in the extraction of certain lower grade mantos and the final production figures being below those originally predicted in early 2008. While these issues are thought to be largely resolved, a recurrence could result in the 2009 production being lower than anticipated.

TOQUI

The 2009 mine plan at Toqui is focused on mining the gold bearing deposits, Mina Profunda and Aserradero, to the exclusion of other production ready deposits such as the zinc/lead/silver bearing Concordia deposit or the zinc bearing Estatuas deposit. It is anticipated that the throughput will be approximately half that of 2008's throughput with a reduction in manpower and/or the implementation of job sharing initiatives. A recovery in the price of zinc would support the restart of mining these other deposits and the Company will continue to monitor the markets closely to assess the need to modify the mine plan.

MYRA FALLS

Myra Falls is assumed to operate throughout 2009 with high grade feed in the latter half of the year coming from the South Flank, a lens discovered late in 2008. The current labour agreement with Myra Falls employees, represented by the Canadian Auto Workers union, expires September 30, 2009. In addition to the known and unknown challenges in these markets, in the event the Company is unable to negotiate a new labour contract at Myra Falls, the Myra Falls production forecast may be unattainable.

LANGLOIS

The suspension of operations at Langlois is considered temporary. The Company will continue to closely monitor the markets to determine when it is economically feasible to restart the mine.

SENSITIVITY TO METAL PRICES AND EXCHANGE RATES

The Company's cash flow and net earnings are sensitive to movements in the price of zinc, lead, copper, silver and the US\$/C\$ exchange rate. The following table provides the Company's estimates of the sensitivity of cash flow to changes in the various metal prices and US\$/C\$ exchange rate movements based on the projections for 2009 (also see the Outlook section of this MD&A for additional details). The Company's projections for 2009 are based on prices for zinc, copper, lead, gold and silver of US\$0.50 per pound, US\$1.45 per pound, US\$0.60 per pound, US\$825 per ounce and US\$11 per ounce respectively and a US\$/C\$ exchange rate of \$0.8333. The sensitivity table assumes that all other prices and/or the exchange rate are held constant.

Variable	Change	Sensitivity (\$ millions)
Zinc	+/-US10¢ per pound	+\$14.3/- \$13.6
Copper	+/-US20¢ per pound	+\$2.0/- \$2.0
Lead	+/-US10¢ per pound	+\$4.3/- \$3.8
Gold	+/-US\$20 per ounce	+\$1.2/- \$1.2
Silver	+/-US\$1 per ounce	+\$2.6/- \$2.4
Exchange rate	+/-US\$/C\$ 10¢	-\$6.5/+ \$8.1

SELECTED ANNUAL INFORMATION

Statement of Operations and Statement of Cash Flow Data

(\$ millions except for share and per share numbers)

Years ended December 31,

	2008	2007
Gross sales revenue	398.1	404.3
Treatment and marketing costs	135.8	100.3
Net revenue	262.3	304.0
Total operating costs	280.9	191.3
(Loss) contribution from mining activities	(18.6)	112.7
Write-down of mineral properties and fixed assets	46.5	16.0
Net (loss) earnings	(88.3)	23.4
Basic (loss) earnings per Common Share	(0.20)	0.06
Diluted (loss) earnings per Common Share	(0.20)	0.05
Net cash (used in) provided by operating activities	(3.7)	79.1
Capital expenditures	76.8	113.8
Basic weighted-average number of Common Shares outstanding (000's)	441,378	413,681
Number of Common Shares outstanding (000's)	446,843	425,700

Balance Sheet Data		As at December 31,	
(\$ millions)	2008		2007
Cash and cash equivalents	20.3		62.9
Working capital	29.2		82.6
Total assets	495.2		609.6
Total debt	6.8		2.3
Total long-term liabilities	113.5		134.3
Shareholders' equity	309.7		364.4

STATEMENT OF OPERATIONS REVIEW – 2008 AND 2007

Gross Sales Revenue

Sales of concentrate fluctuate period-to-period due to production levels, shipping volumes, ship schedules, price determination terms, and risk and title transfer terms with the Company's various customers. The Company has a relatively conservative revenue recognition policy (see below) and the recognition of sales can be as much as six months after the date of concentrate production. The Company's sales are primarily denominated in US\$.

Concentrate Sold (tonnes)	2008	2007
Zinc:		
Mochito	55,316	58,426
Toqui	73,488	67,825
Myra Falls	68,361	50,243
Langlois ⁽¹⁾	81,730	17,817
	278,895	194,311
Copper		
Myra Falls	23,500	26,523
Langlois ⁽¹⁾	11,818	2,846
	35,318	29,369
Lead		
Mochito	20,669	16,054
Toqui	6,828	-
	27,497	16,054
Gold		
Toqui	4,894	4,313
Myra Falls	1	3
	4,895	4,316
All Metals	346,605	244,050

⁽¹⁾ Langlois entered commercial production on July 1, 2007. Net cash flow from concentrate produced prior to July 1, 2007 reduced preproduction capital expenditures. On November 2, 2008, Langlois operations were temporarily suspended.

	2008				2007			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)
Zinc	278,895	122,047	1,882	229,724	194,311	82,661	3,075	254,154
Copper	35,318	7,440	6,042	44,950	29,369	6,207	6,959	43,193
Lead	27,497	16,235	1,930	31,331	16,054	10,162	2,508	25,481
Gold ⁽²⁾	4,895	37,209	873	32,486	4,316	44,508	702	31,225
Silver	n.a.	2,646,450	14.69	38,884	n.a.	2,127,277	13.36	28,429
Other ⁽³⁾	n.a.			(2,231)	n.a.			165
	346,605				244,050			
Gross sales revenue in US\$				375,144				382,647
Exchange rate				1.0612				1.0567
Gross sales revenue in C\$				398,110				404,335

(1) Payable metal and realized prices for zinc, copper and lead are per tonne and for gold and silver are per ounce.

(2) Gold concentrate sales are principally from Toqui while payable gold is from all operations except Mochito.

(3) Other gross sales revenue represents revaluations of prior period concentrate receivables.

Concentrate sold in 2008 increased 42% to 346,605 tonnes. The 102,555 tonne increase was due to increases of 2% at Mochito, 18% at Toqui, 20% at Myra Falls and 353% at Langlois. In payable metal terms, zinc, copper, lead and silver sales in 2008 were 48%, 20%, 60% and 24% higher respectively while gold sales were 16% lower than in 2007.

Zinc, copper and lead prices, denominated in US\$, decreased by 39%, 13% and 23% respectively in 2008 compared with 2007 while realized prices for gold and silver increased by 24% and 10% respectively. The Company periodically hedges against fluctuations in metal prices and foreign exchange rates using forward sales or options. The Company has not applied hedge accounting historically; therefore, mark-to-market gains or losses have been included in gross sales revenue at the end of each year. There were no hedges in place in 2008 and 2007 and accordingly no hedging gains or losses.

Gross sales revenues decreased US\$7.5 million or 2% in 2008 compared with 2007. In C\$ terms, gross sales revenue decreased \$6.2 million in 2008 compared with 2007.

The Company's revenue recognition policy requires that, among other things, final pricing of concentrate inventories be known prior to the recognition of revenue. Using commodity prices and exchanges rates prevailing at December 31, 2008, the following schedule provides details regarding inventories shipped but not recognized for revenue purposes and the related provisional payments.

	Concentrate (DMT)	Net smelter return (\$'000's)	Inventory value (\$'000's)	Earnings before taxes (\$'000's)	Provisional payments (\$'000's)	Weighted-average months to settlement
Zinc	19,449	4,234	3,729	505	4,897	1.5
Copper	4,085	4,990	4,708	282	5,615	2.8
Lead	1,873	1,674	1,674	-	-	1.0
	25,407	10,898	10,111	787	10,512	

As at December 31, 2007, the Company estimated that inventories shipped but not recognized for revenue purposes had earnings before tax of \$8.4 million consisting of \$47.8 million of net smelter return less \$39.4 million of inventory value on 51,100 tonnes of concentrate.

The following table provides the average base and precious metal prices and exchange rates for the periods indicated.

Average Metal Prices & Exchange Rate	2008	2007
Zinc (US\$/tonne)	1,875	3,242
Copper (US\$/tonne)	6,956	7,114
Lead (US\$/tonne)	2,091	2,578
Gold (US\$/ounce)	872	697
Silver (US\$/ounce)	15.02	13.40
C\$/US\$ exchange rate	1.0675	1.0736

Treatment and Marketing Costs

Treatment and marketing costs increased 35% to \$135.8 million in 2008 from \$100.3 million in 2007 while 42% more tonnes of concentrate were sold. Treatment and marketing costs as a percentage of gross sales revenue in 2008 were 34% compared with 25% in 2007. The increase in treatment and marketing costs as a percentage of revenue was primarily due to the significantly higher freight rates as well as higher base treatment charges.

Direct Operating Costs

Direct operating costs were 42% higher in 2008 at \$229.8 million compared with \$161.6 million in 2007, as 42% more tonnes of concentrate were sold. The average cost stayed constant at \$663 per tonne of concentrate sold in 2008 compared with \$662 in 2007. Also see details of direct operating costs under each mine's Expenses in the Production Results section of this MD&A.

Depreciation and Depletion

Depreciation and depletion increased \$24.9 million in 2008 compared with 2007. Langlois, which commenced commercial production effective July 1, 2007 and which suspended operation on November 2, 2008, was primarily responsible for the increase with depreciation and depletion of \$21.1 million in 2008 compared with \$5.0 million in 2007. The balance of the increase was due to the impact of higher fixed asset bases and lower mineral reserves at both Mochito and Toqui.

Reclamation and Closure Costs

Reclamation and closure costs decreased by \$3.6 million in 2008 compared with 2007. The decrease was primarily due to a \$3.2 million provision for completion of modifications of the tailings facility at Myra Falls in 2007 and a \$1.2 million reduction in 2008 at Toqui and Langlois partially offset by a \$1.0 million increase in estimated closure costs at Bouchard-Hébert in 2008. The reductions at Toqui and Langlois were due to a revised estimate of reclamation and closure cost obligations which resulted from a change in the timing of cash flows for reclamation due to increased reserves which extended the lives of both of these operations.

General and Administrative

General and administrative expenses decreased by \$3.3 million in 2008 compared with 2007. The decrease was primarily due to decreased bonus accruals, consulting fees, stock-based compensation expense, travel expenses and capital taxes partially offset by costs associated with the acquisition of Metco and increased salaries, legal expenses and a refund of a deposit to purchase shares of Jascan Resources Inc. in 2007 which did not recur in 2008.

Interest and Financing

Interest and financing costs decreased by \$2.4 million in 2008 compared with 2007 primarily due to \$1.4 million lower royalty costs associated with the Myra Falls royalty transactions and \$1.0 million of fees paid in relation to the qualifying environmental trust at Myra Falls in 2007.

Investment and Other Income

For 2008, investment and other income was \$21.1 million higher than 2007 at \$24.2 million. The increase was primarily due to an \$8.7 million gain on sale of investments, a \$6.4 million gain on sale of the Lapa Royalty and \$5.7 million lower unrealized losses on marking-to-market of investments held for trading in 2008 compared with 2007 partially offset by \$2.7 million lower interest income due to lower cash balances.

Foreign Exchange and Other

For 2008, foreign exchange and other was \$15.0 million higher with an income of \$5.2 million compared with an expense of \$9.8 million in 2007. The change in foreign exchange and other was primarily due to the weakening of the C\$ versus the US\$ in 2008 compared with a strengthening C\$ in 2007.

Exploration

In 2008, exploration expenses were similar to 2007 primarily due to decreases at all operations being offset by increased expenses at the Company's joint venture properties.

Please refer to the exploration section of each mine and the project sections for details of the exploration activities in 2008. Refer to Note 2 of the Company's 2008 audited consolidated financial statements for the accounting treatment of exploration expenditures.

Exploration (\$ millions)	2008	2007
Mochito	2.6	2.9
Toqui	1.0	2.7
Myra Falls	1.0	3.3
Langlois	3.9	4.3
Non-operating	0.5	0.8
Corporate	8.2	3.0
Total	17.2	17.0

Other Non-Producing Property Costs

Other non-producing property costs decreased by \$0.3 million for 2008 compared with the equivalent period in 2007 due to reduced expenditures as non-producing properties proceed towards closure partially offset by inventory write-downs.

Write-down of Mineral Properties and Fixed Assets

At December 31, 2008, the carrying value of the mineral properties and fixed assets at Myra Falls and Mochito were written-down by \$25.3 million and \$8.3 million respectively as the net book values exceeded the fair values. The \$16.0 million write-down of mineral properties and fixed assets in 2007 related to an impairment charge for Myra Falls. Fair value was determined by using estimated future cash flow using the process outlined in the Asset Impairment section of Critical Accounting Estimates of this MD&A. The write-downs were allocated against the fixed assets of the respective mine on a prorata basis, based on the net book value before the write-down. At December 31, 2008, the carrying values of fixed assets at Bougrine and Nanisivik were also determined to exceed their fair values and were written-down by \$0.9 million and \$0.4 million respectively.

At September 30, 2008, based on estimated and undiscounted cash flow for the fair value of the 20% interest in the Caribou and Restigouche mines and the prevailing market conditions, the investment was deemed to be impaired and \$11.0 million was written-off.

The carrying values of the Company's wholly-owned mines are tested for impairment when conditions warrant. The Company will continue to monitor these assets for impairment (please see the Accounting Policies and Critical Accounting Estimates section of this MD&A for a description of the impairment tests) and readers are cautioned that further write-downs may be required should circumstances change.

Income and Mining Tax Provision

The income and mining tax provision decreased to \$18.5 million from \$26.6 million in 2007, an \$8.1 million change. The decrease was primarily due to a \$19.0 million write-down of the Myra Falls future tax asset in 2007 related to an impairment review, the establishment of a \$15.5 million future tax asset for Langlois in 2007 and the impact of lower earnings before tax at Mochito and Toqui in 2008 partially offset by write-offs of \$13.4 million and \$8.0 million of future tax assets at Langlois and Myra Falls respectively in 2008 and a renunciation of the tax benefit of flow-through shares in 2008 of \$2.2 million. Please refer to the income and mining tax provision sections for each mine in the Production section of this MD&A for additional details.

LIQUIDITY AND FINANCIAL POSITION REVIEW

Working Capital

Working capital at the end of 2008 was \$29.2 million compared with \$82.6 million at the end of 2007, a decrease of \$53.4 million.

Current Assets

Total current assets decreased by \$92.2 million to \$101.3 million at December 31, 2008 compared with December 31, 2007. The main components of current asset changes were:

- Cash and cash equivalents decreased by \$42.6 million reflecting lower cash flow from operating activities, expenditures on mineral properties and fixed assets net of proceeds from investment sales
- Short-term investments decreased by \$6.4 million primarily due to the sale of certain equity investments and unrealized losses on equity investments held
- Concentrate inventory decreased by \$43.0 million primarily due to the tonnes of concentrate in inventory decreasing by 31,732 tonnes to 49,085 tonnes at December 31, 2008 and the value of those tonnes decreasing to \$444 per tonne at December 31, 2008 from \$801 per tonne at December 31, 2007
- Materials and supplies inventory increased by \$8.3 million primarily due to higher quantities of inventory at Mochito and the impact of a stronger US\$ on translation of inventories at Mochito and Toqui partially offset by \$1.4 million of additional provisions for obsolescence

Current Liabilities

Current liabilities decreased by \$38.8 million to \$72.1 million at December 31, 2008 compared with December 31, 2007. The main components of the current liabilities changes were:

- Accounts payable and accrued liabilities decreased by \$11.1 million primarily due to a \$10.1 million decrease in accounts payable and accrued liabilities at Myra Falls due to lower production levels and reduced capital spending and a \$5.6 million decrease at Langlois related to the temporary suspension of operations partially offset by an increase of \$4.9 million of provisional payments refundable to customers related to a fall in metal prices from the time the initial provisional payment was received to December 31, 2008
- Short-term debt increased by \$4.7 million primarily due to US\$4.0 million of borrowings by Toqui
- Provisional payments for concentrate inventory shipped and not priced, which represent payments received for concentrate shipments that were not recognized as revenue, decreased by \$21.7 million. The balance at December 31, 2008 was \$10.5 million compared with \$32.2 million at December 31, 2007. Refer to the table in Gross Sales Revenue section of this MD&A for additional details
- Income and mining taxes payable decreased by \$9.8 million due principally to reduced profits at Mochito and Toqui

Provisional payments for concentrate inventory shipped and not priced are based on prices prevailing on the date of payment. Recognition of sales can be as much as six months after the date of concentrate production based on contract terms. In the event that prices deteriorate significantly, a portion of the provisional payment may have to be repaid to the customer.

Future Income Tax Asset, Long-Term

At December 31, 2008, future income tax assets, long-term were nil down from \$19.9 million at December 31, 2007. The decrease was due to write-offs of future tax assets at Langlois and Myra Falls.

Restricted Reclamation Investments

At December 31, 2008, the Company had restricted reclamation investments of \$35.0 million compared with \$33.5 million at December 31, 2007. Reclamation deposits of \$13.5 million and \$21.5 million are held under a safe keeping agreement and a trust indenture respectively to fund future reclamation requirements at Myra Falls.

Long-term Investments

At December 31, 2008, long-term investments were nil down from \$32.9 million at December 31, 2007. The decrease was primarily due to sales of certain equities and the conversion and sale of certain convertible debentures.

Restricted Promissory Notes

The Company held three restricted promissory notes at December 31, 2008 totalling \$80.9 million compared with two restricted promissory notes totalling \$62.3 million at December 31, 2007. All promissory notes are related to Myra Falls royalty transactions² completed in 2004, 2005 and 2008. The interest earned and a portion of the principal of these restricted promissory notes will be used to meet the Company's royalty obligations.

Deferred Income

Deferred income of \$5.9 million at December 31, 2008 consisted of deferred indemnity agreement fees and prepaid interest income received in relation to the Myra Falls royalty transactions in 2004, 2005 and 2008 which will be taken into income over the lives of the three agreements (see note 13 to the Company's 2008 audited consolidated financial statements). During 2008, the Company entered into an additional Red Mile transaction which increased deferred income by \$2.2 million and sold a royalty interest it held on Agnico-Eagle's Lapa properties which reduced deferred income by \$1.3 million.

Royalty Obligations

The royalty obligations of \$78.4 million at December 31, 2008 relate to the royalty amounts received from the 2004, 2005 and 2008 Myra Falls royalty transactions. The 2008 Red Mile transaction increased royalty obligations by \$16.0 million while shares issued to acquire a 3% net smelter royalty interest in Myra Falls related to a qualifying environmental trust reduced royalty obligations by \$20.0 million. See reclamation deposits and restricted promissory notes above.

Reclamation, Closure Cost Accruals and Other Environmental Obligations

Reclamation, closure cost accruals and other environmental obligations represent the Company's obligation for reclamation and severance costs accrued for its mine sites. At December 31, 2008, total reclamation, closure cost accruals and other environmental obligations were \$28.5 million compared with \$39.7 million at December 31, 2007. During 2008, the provision at Myra Falls was decreased by \$9.8 million due to a change in mine life while the provision at Bouchard-Hébert was increased by \$1.1 million and was included in reclamation and closure costs.

Of the \$28.5 million, \$5.6 million is classified as current and is expected to be spent over the next 12 months at Nanisivik, Bouchard-Hébert, Bougrine and Myra Falls. The Company incurred expenditures of \$5.4 million in reclamation and closure costs in 2008 compared with \$6.8 million in 2007. As there is currently no law, regulation or contract in Honduras related to reclamation and closure costs, GAAP does not permit the Company to set up a liability for reclamation at the Mochito mine. Closure and reclamation costs for Mochito are estimated to be \$4.6 million.

Reclamation and Closure Cost Accruals and Other Environmental Obligations at December 31, 2008

(\$ millions)	Current	Long-term	Total
Myra Falls	0.7	16.7	17.4
Mochito ⁽¹⁾	0.0	1.1	1.1
Toqui	0.0	3.1	3.1
Langlois	0.0	1.1	1.1
Bouchard-Hébert	2.2	0.1	2.3
Nanisivik	2.2	0.4	2.6
Bougrine	0.5	0.4	0.9
Total	5.6	22.9	28.5

⁽¹⁾ Reclamation and closure cost accruals for Mochito relate to accrued severances.

² For further information on the Myra Falls royalty please see the Company's most recent audited consolidated financial statement filed on SEDAR at www.seadar.com or available at the Company's website at www.breakwater.ca.

Employee Future Benefits

Employee future benefits payable relate to Myra Falls and decreased \$1.8 million in 2008 to \$0.9 million at December 31, 2008. The decrease was primarily due to an \$8.1 million increase in unamortized actuarial loss and a \$0.2 million increase in unamortized past service costs partially offset by a \$4.7 million decrease in the fair value of plan assets and a \$1.7 million increase in accrued benefit obligations. The \$4.7 million or 14% decrease in the fair value of plan assets was primarily due to the impact of the significant volatility in the financial markets experienced in 2008 on plan asset values. Continued deterioration of the financial markets in the future could increase the \$10.6 million defined benefit pension plan deficit resulting in the requirement for greater contributions after the next required actuarial valuation on December 31, 2010. The \$8.1 million increase in unamortized actuarial loss was primarily due to a change in the actuarial assumption that the mine closure date would be December 31, 2020.

Included in employee future benefits is a defined benefit pension plan for the Myra Falls unionized employees. Actuarial reports valuing this defined benefit pension plan are prepared every three years with December 31, 2007 being the most recent valuation. The Company's minimum contribution, until the next required valuation on December 31, 2010, for the defined benefit pension plan is approximately \$2.9 million per annum consisting of \$1.2 million for current service costs and \$1.7 million for annual special payments. Please also refer to Contractual Obligations and Critical Accounting Estimates in this MD&A as well as to note 15 of the 2008 audited consolidated financial statements for additional information.

Future Income Tax Liabilities

Future income tax liabilities decreased \$4.7 million to \$3.2 million at December 31, 2008. The decrease was primarily due to a \$4.9 million reduction of Québec mining duties at Langlois and a \$2.3 million reduction associated with gains on investments which were sold in 2008 partially offset by a \$2.4 million increase at Toqui related to timing differences.

Shareholders' Equity

Shareholders' equity at December 31, 2008 was \$309.7 million compared with \$364.4 million at December 31, 2007. The decrease of \$54.7 million was primarily due to a net loss of \$88.3 million and the renunciation of \$2.2 million related to the flow-through shares issued in late 2007 partially offset by the issuance of 7.0 million Common Shares on the acquisition of Metco, the issuance of approximately 13.5 million Common Shares on the acquisition of a 3% royalty at Myra Falls and \$7.1 million of other comprehensive income.

Shareholders' Equity (\$000's)	Capital stock	Warrants	Contributed surplus	Retained earnings	Other comprehensive income	Total shareholders' equity
As at December 31, 2007	188,726	8,540	2,029	168,908	(3,817)	364,386
Shares issued on acquisition of Metco, net of expenses	7,264	-	-	-	-	7,264
Shares issued on acquisition of the Myra Falls royalty, net of expenses	18,146	-	1,820	-	-	19,966
Value ascribed to options exercised under stock-based compensation	15	-	(15)	-	-	-
Adjustment to flow-through share costs	(26)	-	-	-	-	(26)
Renunciation related to flow-through shares	(2,160)	-	-	-	-	(2,160)
Exercise of warrants	8	(2)	-	-	-	6
Employee share option plan - proceeds of options exercised	26	-	-	-	-	26
Employee share purchase plan	375	-	-	-	-	375
Stock-based compensation	-	-	1,091	-	-	1,091
Other comprehensive income	-	-	-	-	7,074	7,074
Loss	-	-	-	(88,340)	-	(88,340)
As at December 31, 2008	212,374	8,538	4,925	80,568	3,257	309,662

In 2008, the Company issued the following Common Shares: 7,000,000 on the acquisition of Metco; 13,518,739 on the acquisition of the Myra Falls royalty; 6,480 on exercise of warrants; 46,667 following the exercise of employee share options and 570,626 pursuant to the Company's employee share purchase plan. The 33,481,849 outstanding warrants at December 31, 2008 expired on January 28, 2009.

Capital Expenditures

The Company invested \$76.8 million in mineral properties and fixed assets in 2008. At mining operations, \$28.1 million, \$20.9 million, \$3.7 million and \$25.0 million were spent at Mochito, Toqui, Myra Falls and Langlois respectively. For details of these expenditures, please refer to the financial results discussion for each mine. Corporate capital expenditures of negative \$0.8 million were primarily related to tax credits of \$1.3 million partially offset by fixed asset additions and earn-in payments made on certain joint venture properties including Coulon in Québec.

Financial Capability

The audited consolidated financial statements of the Company for the twelve month period ended December 31, 2008 and 2007 were prepared in accordance with GAAP applicable to a going concern which assume that the Company will realize its assets, discharge its liabilities and meet its future obligations in the normal course of business. Accordingly, the audited consolidated financial statements for the twelve months ended December 31, 2008 and 2007 do not include any adjustments to the recoverability and reclassification of recorded assets, or the amounts or classification of liabilities, that might be necessary should the Company be unable to continue as a going concern.

While the audited consolidated financial statements for the twelve months ended December 31, 2008 and 2007 were prepared on the basis of accounting principles applicable to a going concern, certain market conditions including falling metal prices and higher operating costs cast significant doubt upon the validity of this assumption. For the twelve month period ended December 31, 2008, the Company incurred a loss of \$88.3 million, had a net decrease in cash of \$42.6 million and used net cash in operating activities of \$3.7 million.

The Company's ability to continue its operations in the normal course of business is dependent upon its ability to achieve and sustain profitable operations. Alternatively, the Company is dependent on continued support from shareholders and creditors. In 2009, metal prices remain low and the Company continues to experience operating losses and the Company's cash has been significantly reduced. Management is exploring all available options to secure additional funding including equity and debt financing, sale of non-core assets and strategic partnerships. It is not possible to determine with any certainty the success and adequacy of these initiatives.

Recent market events and conditions, including disruptions in the Canadian, American and international credit markets and other financial systems and the deterioration of the Canadian, American and global economic conditions have had a significant material adverse impact on a number of financial institutions forcing them into bankruptcy or requiring government authorities to rescue them. These events and a general flight from risk have limited access to capital and credit for many companies. These unprecedented disruptions in the current credit and financial markets, could, among other things, impede access to capital or increase the cost of capital, which would have an adverse effect on the Company's ability to obtain, or increase its cost of obtaining, capital and financing, if required, for its operations. The Company's access to additional capital may not be available on terms acceptable to the Company or at all.

In recent months, worldwide securities markets, particularly those in the United States and Canada, have experienced a high level of price and volume volatility, and the market price of securities of many companies have experienced unprecedented declines in price which have not necessarily been related to the operating performance, underlying asset values or prospects of such companies. In addition, significantly higher redemptions by holders of mutual and hedge funds has forced many of such funds (including those holding the Company's securities) to sell such securities at any price. Therefore, there can be no assurance that significant fluctuations in the trading price of the Company's Common Shares will not occur, or that such fluctuations will not materially adversely affect the Company's ability to raise equity funding without significant dilution to its existing shareholders, or at all.

The audited consolidated financial statements for the twelve months ended December 31, 2008 and 2007 do not give effect to adjustments to the carrying values of assets and liabilities and the reported revenues and expenses and balance sheet classifications that would be necessary should the Company be unable to continue as a going concern. These adjustments could be material.

PRODUCTION RESULTS

The table below contains the Company's production for the periods presented. Production results include the production from Langlois since January 2007. For accounting purposes, production from Langlois was not recognized on the income statement until the commencement of commercial production – July 1, 2007. On November 2, 2008, the Company temporarily suspended operations at Langlois due to the decline in commodity prices and the general deterioration of the economic outlook globally.

	2008	2007
Tonnes Milled	2,272,740	2,294,000
Zinc (%)	6.7	5.9
Concentrate Production (tonnes)		
Zinc:		
Mochito	53,757	56,205
Toqui	64,776	65,322
Myra Falls	66,051	56,978
Langlois ⁽¹⁾	71,868	54,184
	256,452	232,689
Copper:		
Myra Falls	21,569	27,181
Langlois ⁽¹⁾	10,661	6,492
	32,230	33,673
Lead:		
Mochito	18,865	15,470
Toqui	5,395	1,564
	24,260	17,034
Gold:		
Toqui	2,895	4,687
Myra Falls	—	—
	2,895	4,687
Total	315,837	288,083
C\$ operating costs, production basis (\$000's)	192,553	178,397
C\$ operating cost per tonne milled (production basis)	85	85

⁽¹⁾ First concentrate shipped November 2006 and considered to be at commercial production levels effective July 1, 2007. On November 2, 2008, Langlois operations were temporarily suspended.

Concentrate produced in 2008 increased by 10% to 315,837 tonnes largely due to increased zinc concentrate production at Myra Falls and Langlois; increased copper concentrate production at Langlois; and, increased lead concentrate production at Mochito and Toqui.

The table below summarizes the Company's metal contained in concentrate, before smelting deductions, for the periods presented.

Metal in Concentrate	2008	2007	%
Zinc (tonnes)			
Mochito	28,462	29,211	-2.6%
Toqui	31,992	32,191	-0.6%
Myra Falls	35,762	29,845	19.8%
Langlois ⁽¹⁾	38,620	28,327	36.3%
	134,836	119,574	12.8%
Copper (tonnes)			
Myra Falls	5,024	6,086	-17.4%
Langlois ⁽¹⁾	1,994	1,315	51.6%
	7,018	7,401	-5.2%
Lead (tonnes)			
Mochito	12,545	10,215	22.8%
Toqui	2,796		n.a.
	15,341	10,215	50.2%
Gold (ounces)			
Toqui	23,085	37,021	-37.6%
Myra Falls	13,994	18,880	-25.9%
	37,079	55,901	-33.7%
Silver (ounces)			
Mochito	1,894,835	1,732,755	9.4%
Toqui	343,457	155,890	120.3%
Myra Falls	661,228	811,353	-18.5%
Langlois ⁽¹⁾	298,863	159,672	87.2%
	3,198,383	2,859,670	11.8%

⁽¹⁾ First concentrate shipped November 2006 and considered to be at commercial production levels effective July 1, 2007. On November 2, 2008, Langlois operations were temporarily suspended.

Aggregate production of zinc in concentrate in 2008 was 13% higher at 134,836 tonnes. The increased zinc was primarily due to higher production from Myra Falls and Langlois partially offset by lower production from Mochito and Toqui. Production of copper in concentrate decreased 5% in 2008 from 2007 due to lower tonnes milled at Myra Falls. Production of lead in concentrate increased 50% in 2008 due to more tonnes milled at higher lead grades at Mochito and milling of higher lead grade material from Concordia at Toqui. Gold in concentrate decreased 34% year-over-year due to lower production from Myra Falls and the planned reduction in milling of gold material at Toqui during the first nine months of 2008. Silver in concentrate increased 12% year-over-year primarily due to more tonnes milled at Mochito, higher silver grades at Toqui and more tonnes milled at Langlois at higher silver grades.

Mochito

(I) MOCHITO FINANCIAL RESULTS

	2008	2007
Gross sales revenue	98,596	130,005
Treatment and marketing costs	(28,978)	(23,252)
Net revenue	69,618	106,753
Direct operating costs	(42,463)	(32,540)
Depreciation and depletion	(10,033)	(4,374)
Reclamation and closure costs	(1,314)	(1,099)
Contribution from mining activities	15,808	68,740
Exploration	(2,609)	(2,919)
Write-down of mineral properties and fixed assets	(8,327)	-
	4,872	65,821
Income and mining tax provision	(3,270)	(19,132)
Net earnings	1,602	46,689
Capital expenditures	28,091	23,130

Revenue:

The following tables and discussion provide details of Mochito's gross sales revenue for the periods indicated:

	2008				2007			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)
Zinc	55,316	24,422	1,771	43,244	58,426	25,307	3,079	77,926
Lead	20,669	12,856	2,023	26,006	16,054	10,162	2,507	25,481
Silver	n.a.	1,736,421	14.61	25,377	n.a.	1,395,766	13.29	18,546
Other ⁽²⁾	n.a.			(1,168)	n.a.			453
	<u>75,985</u>				<u>74,480</u>			
Gross sales revenue in US\$				93,459				122,406
Exchange rate				1.0550				1.0621
Gross sales revenue in C\$				<u>98,596</u>				<u>130,005</u>

⁽¹⁾ Payable metal and realized price(s) for zinc and lead are per tonne and for silver is per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Concentrate sales in 2008 were 2% higher than in 2007 primarily due to 29% more lead sold partially offset by less zinc sold. 27% more payable lead and 24% more payable silver were partially offset by 3% less payable zinc. Despite these factors, the 42% decline in realized zinc prices resulted in gross sales revenue falling by US\$28.9 million or \$31.4 million in C\$ terms.

Expenses:

For the full year, treatment and marketing costs were higher than in 2007 both in aggregate terms and per tonne sold primarily due to an increase in the global availability of zinc concentrates which increased treatment charge terms and because of higher freight rates.

Direct operating costs for 2008 increased primarily due to increased power consumption and fuel surcharges, a switch to an improved, more expensive method of ground control and support and to the wetter than normal rainy season. Upgrades to the electrical system and other major initiatives also increased direct operating costs.

Depreciation and depletion for 2008 increased \$5.7 million or 129% when compared with 2007. The increase was primarily due to decreased proven and probable mineral reserves compared with 2007, higher capital assets due to acquisitions in prior years and lower mineral reserves.

Exploration expenses in 2008 were broadly comparable with the respective period in 2007. Please refer to the exploration section below for additional details.

At December 31, 2008, the carrying value of the mineral properties and fixed assets at Mochito were written-down by \$8.3 million as the net book value exceeded the fair value. Fair value was determined by using estimated future cash flow using the process outlined in the Asset Impairment section of Critical Accounting Estimates of this MD&A.

Income and mining tax provision for 2008 decreased by \$15.9 million primarily due to significantly lower earnings before tax in 2008 compared with 2007.

Capital Expenditures:

At Mochito, \$28.1 million was spent in 2008 primarily as follows: \$6.0 million for mobile equipment; \$4.8 million for tailings facilities; \$0.5 million for electrical upgrades; \$9.8 million for mine development; \$2.1 million for various infrastructure projects; and \$2.7 million for capital spares.

(II) MOCHITO PRODUCTION

Mochito's production is set out in the following table:

	2008	2007
Tonnes Milled	646,845	607,583
Zinc (%)	5.0	5.4
Lead (%)	2.4	2.1
Silver (g/t)	103	102
Concentrate Production		
Zinc (tonnes)	53,757	56,205
Recovery (%)	88.6	88.9
Grade (%)	53.0	52.0
Lead (tonnes)	18,865	15,470
Recovery (%)	82.4	78.6
Grade (%)	66.5	66.0
Metal in Concentrates		
Zinc (tonnes)	28,462	29,211
Lead (tonnes)	12,545	10,215
Silver (ounces)	1,894,835	1,732,755
US\$ operating costs, production basis (\$000's)	35,761	31,655
US\$ operating cost per tonne milled (production basis)	55	52

Production of zinc in concentrate in 2008 was 3% lower than 2007 due to lower zinc grades despite more tonnes milled. Production of lead in concentrate in 2008 was 23% higher than 2007 due to higher lead grades and more tonnes milled.

(III) MOCHITO EXPLORATION

There are three principal mineral trends that remain open at Mochito as well as numerous secondary mineral trends that remain prospective. Exploration results during 2008 were favourable on the extension of all three of the main mineral trends and exploration efforts will continue to focus on these trends in 2009 (the northeast extension of the Porvenir trend; the northeast extension of the Salva Vida trend; and, the northern extension of the Barbasco-Imperial trend).

Drill hole #8571, drilled furthest to the northeast on the Deep North target, intersected 11.9 metres (true thickness) of mineable grade zinc. The intersection is situated well away from any other holes and lies on the north-eastern projection of the prolific Porvenir trend, which is known to host the largest deposits on the property. There are no drill holes to the northeast of drill hole #8571 and the area is open to further exploration. Drilling continues to test this area.

The Salva Vida trend continues to produce encouraging results that confirm that the mineralizing system continues to the northeast. The extension of this trend has been tested by relatively few drill holes and there remains good potential for other major deposits along this trend.

Extensional drilling of the Imperial zone has almost doubled the size of the known deposit and the zone appears to be strengthening to the north. The grades, as well as the intensity of alteration, improve to the north where the chimney is expected to intersect the manto. The discovery of more reserves is anticipated in this area. The Barbasco and Imperial zones lie on the same mineralizing structure. The extension of this structure to the north has never been tested and there is good potential for more major deposits along this trend.

The first drill hole to the west from within the Leona stope encountered skarn mineralization at least 50 metres further west than the current limits of the stope. La Leona was a major producing mining area in 2008. Grades in this area tend to be modest but production costs are low due to its proximity to the orepass. More drilling is required to confirm that the deposit continues along this trend.

The majority of the results from the surface soil sampling program have been received, with a few more remaining. A strong anomaly has been identified over the Santo Niño trend which indicates that this trend remains prospective. A new multi-element geochemical anomaly has been identified on the Palmar fault approximately 3-1/2 kilometres east of Mochito. There are a series of small anomalies along the fault with the largest being open ended at the edge of the sample grid. Additional sampling could enlarge this anomaly. Much of the area between the Mochito mine and the anomaly on the Palmar fault is covered by younger Red Bed formations that will mask geochemical anomalies. Advanced analytical techniques will be applied to this area in order to filter out the effects of geological and topographical variables.

(IV) MOCHITO OUTLOOK

Based on current market conditions, the Company is focusing all its efforts on those activities necessary to maintain a safe, environmentally compliant and productive mine while maximizing cash flows. The mine rehabilitation program, commenced to address ground control problems experienced late in 2007 and in the first few months of 2008, continued with the installation of improved ground support media throughout the mine. This initiative is expected to be complete in the first quarter of 2009.

Construction work to increase the capacity of the Pozo Azul tailings facility is largely complete. Pozo Azul is expected to provide ample capacity while the Soledad facility is repaired with completion anticipated late in 2009.

The collective bargaining agreement at Mochito, renewed in 2007, has an expiry date of October 1, 2010.

Toqui

(I) TOQUI FINANCIAL RESULTS

	2008	2007
Gross sales revenue	96,056	114,785
Treatment and marketing costs	(40,187)	(40,245)
Net revenue	55,869	74,540
Direct operating costs	(37,385)	(28,262)
Depreciation and depletion	(9,372)	(4,311)
Reclamation and closure recovery (costs)	955	(276)
Contribution from mining activities	10,067	41,691
Exploration	(943)	(2,734)
	9,124	38,957
Income and mining tax provision	(2,051)	(5,919)
Net earnings	7,073	33,038
Capital expenditures	20,890	26,738

Revenue:

The following tables and discussion provide details of Toqui's gross sales revenue for the periods indicated:

	2008				2007			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)
Zinc	73,488	29,926	2,020	60,460	67,825	27,642	3,143	86,879
Lead	6,828	3,379	1,576	5,325	n.a.	n.a.	n.a.	n.a.
Gold	4,894	25,780	876	22,591	4,313	28,209	703	19,831
Silver	n.a.	218,054	14.54	3,171	n.a.	5,770	13.60	78
Other ⁽²⁾	n.a.			(127)				(195)
	85,210				72,138			
Gross sales revenue in US\$				91,420				106,593
Exchange rate				1.0507				1.0769
Gross sales revenue in C\$				96,056				114,785

⁽¹⁾ Payable metal and realized prices for zinc and lead are per tonne and for gold and silver are per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Tonnes of concentrate sold increased by 18% in 2008 compared with 2007 due to increased sales of all types of concentrate. A 36% decrease in the realized price for zinc and a 9% decrease in payable gold were partially offset by increased payable metals for zinc, lead and silver resulting in a 14% decrease in US\$ gross sales revenue.

Expenses:

Despite an 18% increase in tonnes of concentrate sold in 2008 compared with 2007, aggregate treatment and marketing costs were comparable. Lower treatment costs offset the increased tonnage sold and resulted in the cost per tonne sold decreasing to \$472 from \$558 in 2007. As a percentage of gross revenue, treatment and marketing costs increased to 42% in 2008 compared with 35% in 2007 primarily due to lower realized prices for zinc sold.

Direct operating costs increased 32% in 2008 compared with 2007 primarily due to 18% higher concentrate sales, an unfavourable exchange rate movement between the Chilean peso and the US\$ and higher labour and fuel costs. On a cost per tonne sold basis, 2008 costs increased to \$439 from \$392 in 2007 primarily due to the factors noted above. As a percentage of gross revenue, treatment and marketing costs increased to 39% from 25% primarily due to the 36% lower realized zinc price.

Depreciation and depletion for 2008 increased \$5.1 million or 117% when compared with 2007. The increase was primarily due to decreased proven and probable mineral reserves compared with 2007 and higher capital assets due to acquisitions in prior years.

Exploration expenses decreased in 2008 primarily due to reduced expenses related to Concordia and Porvenir. Please refer to the exploration section below for additional details.

Income and mining tax provision for 2008 decreased by \$3.9 million primarily due to significantly lower earnings before tax compared with 2007.

Capital Expenditures:

Toqui capital expenditures of \$20.9 million in 2008 consisted primarily of: \$9.3 million for development of Porvenir, Mina Profunda, Concordia, Concordia East, Estatuas and Aserradero; \$5.0 million for mine equipment and buildings; \$3.2 million for mill improvements including a lead flotation circuit and a thickened tailings plant study; \$0.9 million for the mill pre-feasibility study and gold gravity circuit; and, \$0.8 million for a new sedimentation pond and a tailings facility management study.

(II) TOQUI PRODUCTION

Toqui's production is set out in the following table:

	2008	2007
Tonnes Milled	519,379	522,082
Zinc (%)	7.0	6.9
Lead (%)	0.9	0.3
Silver (g/t)	28	14
Gold (g/t)	1.9	2.7
Concentrate Production		
Zinc (tonnes)	64,779	65,322
Recovery (%)	88.8	90.0
Grade (%)	49.1	49.9
Lead (tonnes)	5,395	1,564
Recovery (%)	61.2	61.0
Grade (%)	51.8	52.6
Gold (tonnes)	2,895	4,687
Recovery (%)	55.5	59.8
Grade (g/t)	142.3	150.9
Metal in Concentrates		
Zinc (tonnes)	31,992	32,191
Lead (tonnes)	2,796	823
Gold (ounces)	23,085	37,021
Silver (ounces)	343,457	155,890
US\$ operating costs, production basis (\$000's)	24,744	24,172
US\$ operating cost per tonne milled (production basis)	48	46

Production of zinc in concentrate in 2008 was 1% lower than 2007 due to lower recoveries and fewer tonnes milled. Production of gold in concentrate was 38% lower than 2007 due to lower gold grades, lower recovery and fewer tonnes milled.

Silver and lead grades increased in 2008 due to the addition of Concordia material. The new lead flotation circuit expansion became operational in the third quarter of 2008 and, as expected, improved lead concentrate production. Production from the Concordia and Estatuas deposits was curtailed during the fourth quarter in order to concentrate on the development of the gold-rich Mina Profunda deposit. Development of the access for the Mina Profunda deposit is now complete and mining has commenced.

(III) TOQUI EXPLORATION

Exploration potential in the Toqui district is considered excellent for identifying additional resources and reserves. Since acquiring the Toqui mine in 1997, the Company has systematically explored the region and has identified several areas which have expanded the mineral reserves and mineral resources in the area of the mine. Despite this, the Toqui region generally remains under-explored.

During 2008, some 24,763 metres were drilled in 215 holes, with 14,600 metres drilled from surface in 71 holes and 10,163 metres drilled from underground in 144 holes.

On surface, the drilling program encompassed 7,226 metres in 33 holes to determine the northern and southern extensions of the Mina Profunda deposit (a gold deposit which occurs in a lower horizon of calcareous sandstones located some 60 metres below the Doña Rosa deposit), while 7,374 metres in 38 holes were drilled on new targets such as Catedral or on exploration of known mineralization, mainly Concordia, Concordia east and Porvenir northwest.

The bulk of the underground campaign was targeted on the Mina Profunda deposit initially as preliminary resource definition and later in the year as infill drilling. Some 7,518 metres were drilled in 91 holes from underground in Mina Profunda. The drilling confirmed the continuity of the gold skarn system as well as the mineralization and alteration characteristics.

At Estatuas, 2,645 metres of underground drilling in 53 holes has extended the zinc mineralization toward the south and west, with limited definition drilling remaining. To the east, two drill holes intercepted sub-mineralized manto some 60 metres below the level of current workings and to the east of the Marlin fault. To the northwest, drill hole DES69 intercepted 4.5 metres of mineralization (main manto) with economic grades as well as a lower mineralized horizon (calcareous sandstone) approximately 30 metres below the main manto, with a thickness of 8.2 metres with economic grades. When market conditions permit, further drilling will be required to investigate the significance of these intersections.

(IV) TOQUI OUTLOOK

Based on current market conditions, the Company is focusing all its efforts on those activities necessary to maintain a safe, environmentally compliant and productive mine and to maximize cash flows. Capital expenditures not required for safety and environmental initiatives have been curtailed. Mining in Concordia and Estatuas will recommence once metal prices improve. In the interim, mining will focus mainly on the higher NSR Aserradero and Mina Profunda deposits.

The Company is in the process of purchasing a used thickened tails backfill plant that it plans to relocate to Toqui during 2009. It is expected this plant will be operational by the middle of 2010 and will enable Toqui to deposit thickened tails in a yet-to-be constructed tailings impoundment facility.

Myra Falls

(I) MYRA FALLS FINANCIAL RESULTS

	2008	2007
Gross sales revenue	109,404	134,666
Treatment and marketing costs	(32,886)	(31,347)
Net revenue	76,518	103,319
Direct operating costs	(88,247)	(83,667)
Depreciation and depletion	(7,031)	(8,839)
Reclamation and closure costs	(1,466)	(4,840)
(Loss) contribution from mining activities	(20,226)	5,973
Exploration	(1,033)	(3,328)
Write-down of mineral properties and fixed assets	(25,300)	(16,000)
	(46,559)	(13,355)
Income and mining tax provision	(7,873)	(18,890)
Net loss	(54,432)	(32,245)
Capital expenditures	3,670	21,362

Revenue:

The following tables and discussion provide details of Myra Falls' gross sales revenue for the periods indicated:

	2008				2007			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)
Zinc	68,361	31,061	1,851	57,483	50,243	21,890	3,156	69,096
Copper	23,500	5,401	5,873	31,718	26,523	5,654	6,928	39,171
Gold	1	10,144	867	8,791	3	15,967	698	11,148
Silver	n.a.	359,767	15.58	5,605	n.a.	663,245	13.52	8,967
Other ⁽²⁾	n.a.			(1,341)	n.a.			(93)
	<u>91,862</u>				<u>76,769</u>			
Gross sales revenue in US\$				102,256				128,289
Exchange rate				1.0699				1.0497
Gross sales revenue in C\$				<u>109,404</u>				<u>134,666</u>

⁽¹⁾ Payable metal and realized prices for zinc and copper are per tonne and for gold and silver are per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Tonnes of concentrate sold in 2008 were 20% higher than in 2007 with 36% more zinc sold partially offset by 11% fewer tonnes of copper sold. Despite the significant increase in tonnes of concentrate sold, 41% and 15% decreases in the realized prices for zinc and copper respectively resulted in a 20% decrease in gross sales revenue in US\$ terms. A 2% increase in the exchange rate resulted in a 19% decrease in gross sales revenue in C\$ terms.

Expenses:

In 2008, aggregate treatment and marketing costs increased by 5% compared with 2007 primarily due to higher concentrate sales and higher freight costs partially offset by the mix of concentrates sold and lower treatment charges. Treatment and marketing costs per tonne sold decreased by 12% due to lower treatment charges and 11% fewer tonnes of copper concentrate sold partially offset by 36% more tonnes of zinc concentrate sold. As a percentage of gross revenue, treatment and marketing costs increased to 30% in 2008 compared with 23% in 2007 primarily due to the significant decreases in the zinc price realized.

In 2008, aggregate direct operating costs increased 5% compared with 2007 primarily due to the 20% increase in concentrate sold, write-downs related to marking inventory to the lower of cost and net realizable value and restructuring expenses partially offset by cost cutting measures and the mix of concentrate sold.

Reclamation and closure costs in 2008 decreased from 2007 primarily due to a \$3.2 million expense in 2007 related to a revised estimate of the cost to complete upgrades to the existing tailings facility which did not recur in 2008.

Exploration expense decreased in 2008 compared with 2007 due to a reduced exploration program in 2008 given the existing metal's price environment. Please refer to the exploration section below for additional details.

At December 31, 2008, the carrying value of the mineral properties and fixed assets at Myra Falls were written-down by \$25.3 million as the net book value exceeded the fair value. Fair value was determined by using estimated future cash flow using the process outlined in the Asset Impairment section of Critical Accounting Estimates of this MD&A.

The \$11.0 million decrease in income and mining tax provision in 2008 compared with 2007 was primarily due to a future tax asset write-down of \$19.0 million in 2007 which was larger than the \$8.0 million write-down in 2008.

Capital Expenditures:

Myra Falls' capital expenditures in 2008 of \$3.7 million consisted primarily of \$1.1 million for development at Price, \$2.0 million for a new tailings disposal area, \$0.2 million in ramp development and \$0.3 million for mining equipment.

(II) MYRA FALLS PRODUCTION

The following table sets forth Myra Falls' production for the periods presented:

	2008	2007
Tonnes Milled	592,072	726,460
Zinc (%)	6.9	4.8
Copper (%)	1.1	1.1
Gold (g/t)	1.2	1.2
Silver (g/t)	45	42
Concentrate Production		
Zinc (tonnes)	66,051	56,978
Zinc Recovery (%)	87.1	85.3
Zinc Grade (%)	54.1	52.4
Gold Recovery (%)	24.8	22.5
Gold Grade (g/t)	2.7	3.5
Copper (tonnes)	21,569	27,181
Copper Recovery (%)	74.1	77.9
Copper Grade (%)	23.3	22.4
Gold Recovery (%)	35.9	41.9
Gold Grade (g/t)	12.0	13.9
Gold (tonnes)	—	0.5
Recovery (%)	—	3.2
Grade (g/t)	—	9,400
Metal in Concentrates		
Zinc (tonnes)	35,762	29,845
Copper (tonnes)	5,024	6,086
Gold (ounces)	13,994	18,880
Silver (ounces)	661,228	811,353
C\$ operating costs, production basis (\$000's)	75,724	91,736
C\$ operating cost per tonne milled (production basis)	128	126

Production of zinc in concentrate in 2008 was 20% higher than 2007 due to higher zinc grades and recoveries despite fewer tonnes milled. Production of copper in concentrate was lower in 2008 compared with the same period in 2007 due to fewer tonnes milled.

On December 24, 2008, the Company announced that it had entered into a royalty agreement with Red Mile whereby the Company sold a basic royalty on a portion of the payable zinc production over the life of the Myra Falls mine. The Company received \$18.2 million, which included royalty income of \$16.0 million and fees and interest of \$2.2 million.

Under the terms of the royalty agreement, the Company is required to make basic royalty payments at fixed amounts per pound of payable zinc produced, which escalates from \$0.003 per pound to \$0.075 per pound over the first twelve years of the royalty agreement. In addition, the Company granted Red Mile a net profit interest of 1.0%, 1.25% or 1.5% in years 2014 through 2018 if the price of zinc in a given calendar year averages US\$4,250, US\$4,500 or US\$4,750 per tonne respectively. Of the cash received, \$16.0 million was placed with a financial institution, for which the Company took back a promissory note. Interest earned from the promissory note will be used to fund the expected basic royalty payments during the initial years of the royalty agreement. Over the remaining years of the royalty agreement, interest and principal from the promissory note will be used to fund the basic royalty payments.

The balance of the funds received of \$2.2 million will be used for general corporate purposes. Under certain circumstances the Company has the right, by way of a call option, to acquire the partnership units of Red Mile for the lower of market value or for the outstanding amount of the promissory note.

(III) MYRA FALLS EXPLORATION

In 2008, the focus of the diamond drilling programs switched from the Marshall deposit and other longer range initiatives to those not yet evaluated targets closer to mine infrastructure. This has been called the peripheral drill program and has been directed towards the extension and bordering areas of the Battle and HW deposits. In addition to new lens definition, infill drilling was also conducted to augment resources. The program totalled 17,638 metres of diamond drilling, carried out by company drillers using medium range drills, with the majority of the drill holes less than 200 metres in length. This program is being continued in 2009.

Specifically, the discovery of new zones, or extensions of zones into new areas include:

- The HW East lens
- The South Flank lens
- The North Gap lens
- The Bornite and Gnu West extensions
- The Gopher West down drop zone

While the Marshall drill program, which was terminated in early 2008, did not provide a sufficient density of drilling to permit a re-interpretation of the zone for a resource update, it did confirm and further define known boundaries. The next phase of evaluation will include drifting west from 24 level to provide closer diamond drill platforms for definition drilling. This program is currently on hold.

A more extensive program of exploration and property evaluation is evolving from the results of the current work.

(IV) MYRA FALLS OUTLOOK

On October 28, 2008, the Company announced that it would temporarily suspend operations at Myra Falls. Temporary layoffs and the reduction in the workforce occurred; however, mining and milling activities continued throughout the fourth quarter and into the first quarter of 2009. The Company continues to closely monitor economic and market conditions as they relate to any decision to temporarily suspend the mine. Myra Falls personnel have completed and are executing a mine plan which includes a higher grade, lower tonnage scenario with the goal of producing positive cash flow at forecast metal prices and exchange rates. The South Flank lens has the potential to add additional higher grade material to the 2009 mine plan.

The collective bargaining agreement at Myra Falls was renewed during 2008 for eighteen months and has an expiry date of September 30, 2009.

Langlois

Langlois was considered to be in commercial production effective July 1, 2007. For accounting purposes, revenue from concentrate produced and sold after commencement of commercial production is included in the income statement. Net cash flow from concentrate produced prior to July 1, 2007 reduced preproduction capital expenditures when sold. On November 2, 2008, operations at Langlois were temporarily suspended due to the decline in commodity prices and the general deterioration of the economic outlook globally. The above factors make comparisons between years difficult.

(I) LANGLOIS FINANCIAL RESULTS

Financial information:

	2008	2007
Gross sales revenue	94,054	24,879
Treatment and marketing costs	(33,745)	(5,444)
Net revenue	60,309	19,435
Direct operating costs	(61,734)	(17,145)
Depreciation and depletion	(21,075)	(5,032)
Reclamation and closure costs	(80)	(101)
Loss from mining activities	(22,580)	(2,843)
Exploration	(3,905)	(4,313)
	(26,485)	(7,156)
Income and mining tax (provision) recovery	(6,302)	15,470
Net (loss) earnings	(32,787)	8,314
Capital expenditures	24,992	35,105

Revenue:

The following tables and discussion provide details of Langlois' gross sales revenue for the periods indicated:

	2008				2007			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$000's)
Zinc	81,730	36,638	1.871	68,537	17,817	7,822	2,589	20,251
Copper	11,818	2,039	6.489	13,232	2,846	552	7,283	4,022
Silver	n.a.	332,209	14.24	4,731	n.a.	62,496	13.38	837
Gold	n.a.	1,285	860	1,104	n.a.	332	741	246
Other ⁽²⁾	n.a.			404	n.a.			n.a.
	<u>93,548</u>				<u>20,663</u>			
Gross sales revenue in US\$				88,008				25,356
Exchange rate				1.0687				0.9812
Gross sales revenue in C\$				<u>94,054</u>				<u>24,879</u>

⁽¹⁾ Payable metal and realized prices for zinc and copper are per tonne and for gold and silver are per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Year-over-year comparisons for Langlois are of limited usefulness given the commencement of commercial production in the third quarter of 2007 and the temporary closure in the fourth quarter of 2008. The 278% increase in revenues did not keep pace with the 353% increase in concentrate sold primarily due to the 28% decrease in zinc price realized.

Expenses:

Treatment and marketing costs in aggregate, on a cost per tonne concentrate sold and as a percentage of gross revenue were all dramatically higher in 2008 compared with 2007. The increases were primarily due to the sale of significantly more tonnes of concentrate, higher freight costs and a lower Canadian dollar and, as a percentage of revenue basis, the impact of lower zinc prices realized.

As noted above, year-over-year comparisons are of limited usefulness. Direct operating costs increased dramatically in 2008 compared with 2007 primarily due to higher tonnage of concentrate sold. On a per tonne of concentrate sold and as a percentage of gross revenue basis, 2008 direct operating costs decreased by 20% and 3% respectively.

Depreciation and depletion increased \$16.0 million in 2008 compared with 2007 primarily due to the higher production in 2008 and accelerated depreciation of the Grevet B deposit related to a change in the mine plan for this deposit.

Prior to the commencement of commercial production, exploration expenditures were capitalized. Exploration expenses in 2008 were modestly lower compared with 2007. Please refer to the exploration section below for additional details.

Income and mining tax provision changed by \$21.8 million to a provision of \$6.3 million in 2008 compared with a recovery of \$15.5 million in 2007. The change was primarily due to the write-off of \$13.4 million of a future tax asset in 2008 which was set-up in 2007 partially offset by a \$2.9 million lower Québec mining duties provision in 2008 and a \$2.2 million tax recovery in 2008 due to flow-through shares issued.

Capital Expenditures:

At Langlois, \$25.0 million was spent in 2008 consisting primarily of: \$12.1 million for lateral development of Zones 97, 4 and 3; \$1.8 million for horizontal and other development at Zone 4, \$1.8 million for ramp and horizontal development at Grevet B; \$6.0 million for underground mobile and stationary equipment; \$0.6 million for housing; and, \$1.3 million for an underground paste backfill system.

(II) LANGLOIS PRODUCTION

The following table sets forth Langlois' production for the periods presented:

	2008	2007
Tonnes Milled	514,444	437,875
Zinc (%)	8.1	7.1
Copper (%)	0.5	0.4
Silver (g/t)	35	29
Concentrate Production		
Zinc (tonnes)	71,868	54,184
Recovery (%)	92.5	90.9
Grade (%)	53.7	52.3
Copper (tonnes)	10,661	6,492
Recovery (%)	77.3	72.1
Grade (%)	18.7	20.3
Metal in Concentrates		
Zinc (tonnes)	38,620	28,327
Copper (tonnes)	1,994	1,315
Silver (ounces)	298,863	159,672
C\$ operating costs, production basis (\$000's)	53,001	26,725
C\$ operating cost per tonne milled (production basis)	103	106

Production of zinc in concentrate in 2008 was 36% higher than 2007 due to higher zinc grades and recoveries as well as more tonnes milled. Production of copper in concentrate in 2008 was 52% higher than 2007 due to higher copper grades and recoveries as well as more tonnes milled. The collective bargaining agreement at Langlois has an expiry date of January 17, 2012.

(III) LANGLOIS EXPLORATION

During 2008, an 11,974 metre surface and underground diamond drilling program was carried out with the goal of completing infill, definition and valuation drilling.

More than half of the program was completed in Zone 97 in order to better define the relationship between the Main and North zones. This drilling was done to evaluate the potential of mining Zone 97 Main and Zone 97 North, a parallel vein structure, at one time within one stope. All drilling was done from the 13 level targeting the area between 12 and 14 levels. Results show two veins with massive to semi-massive sulphides (mainly sphalerite). The veins range from less than a metre to four metres width with the waste between the veins ranging from virtually zero to five to six metres in some places. Zone 97 North and West extensions were delineated from level 13. The main goal was to optimize stope design and mining. A final interpretation shows areas where two veins are mineable together which is accounted for in the December 31, 2008 reserve estimate. Additional drilling may be required in the future in order to identify other similar areas.

Diamond drilling was carried out in Zones 3 and 4 and at Grevet B as well. For Zone 3, the continuity of economic mineralization was confirmed in the central west part between levels 6 and 8. Zone 1 was investigated from surface by shallow drilling.

On the Orphée lens, 525 metres were drilled in two drill holes in 2008. The drill holes were focused on delineating the western part of the lens. A resource estimate is scheduled for delivery the first half of 2009.

(IV) LANGLOIS OUTLOOK

On November 2, 2008, the Company temporarily suspended operations at the Langlois mine. The operation is being maintained on a care and maintenance basis. Langlois personnel have developed a re-opening plan which anticipates a minimum of six months of pre-production development in order to enable increased production rates. The Company will continue to closely monitor economic and market conditions as they relate to any decision to continue the temporary suspension or to restart the mine.

Coulon Project

In December 2008, the Company sold its 50% interest in the Coulon joint venture property to Virginia for 1,666,666 common shares of Virginia. At closing, all of the shares of Virginia issued to the Company in respect of the transaction were resold at a price of \$2.85 per share (\$4.75 million) in favour of third-party buyers.

Trieste Project

In 2007, the Company signed an agreement with Virginia on the Trieste property, which is located in the James Bay area of Québec. Under the terms of the agreement, the Company has the option to acquire a 50% interest in the property, in exchange for \$1.0 million of exploration work before May 8, 2011 and payments totalling \$50,000. Virginia is the operator.

During the first half of 2008, Virginia carried out ground geophysical surveys on the Trieste property in order to pinpoint past airborne electromagnetic ("EM") anomalies. Interpretation of the survey was undertaken in the second half of 2008.

The Trieste property is located within the La Grande Archean volcano-sedimentary belt and covers an assemblage of mafic to felsic volcanics, iron formations, and a synvolcanic intrusion. Many EM conductors remain unexplained and VMS type, mineralized showings returned values of up to 2.6% zinc within the volcanic sequence. An arsenopyrite-rich boulder also returned 20 g/t gold.

Gayot Project

Under an agreement reached in 2007, the Company signed an option agreement with Virginia on the Gayot property which is located in the James Bay region of Québec. Under the terms of the agreement, the Company has the option to earn a 50% interest in the property in exchange for \$10.0 million in exploration work over a nine-year period and payments totalling \$170,000 on or before the fourth anniversary of the agreement. Virginia is the operator until the completion of a positive pre-feasibility study. This agreement is subject to a 1% NSR in favour of Billiton Resources Canada.

A new camp was constructed in 2008 to permit field operations for a long duration. Reconnaissance and geological mapping as well as re-logging of some of the old core were completed during 2008.

The Gayot property consists of 116 claims covering 4,947 hectares and three mining exploration permits covering a surface area of 15,437 hectares. The property entirely covers the Venus Archean greenstone belt which consists dominantly of ultramafic magnesium-oxide rich sills and flows. This ultramafic sequence is the host to twelve nickel-platinum-palladium mineralized zones distributed over a strike length of 25 kilometres.

Kaminak Project

In April 2007, Kaminak Gold Corporation ("Kaminak") and the Company entered into a generative strategic alliance targeting primarily nickel-copper-platinum group element deposits over parts of eastern North America. Each company initially funded \$50,000 for data compilation, targeting and field work during 2007.

By September 2007, Kaminak and the Company had acquired, through staking, a number of nickel targets within the Grenville geological province of southern Québec. A 50-50 joint venture was formed on each separate property. An airborne geophysical survey was conducted over selected targets in 2008. In early 2009, the Company sold its 50% interest in the joint venture to Kaminak for a nominal amount.

Gatineau and Weedon Projects

During the third quarter of 2008, the Company gave Midland Exploration Inc. notice that it would no longer participate in the joint ventures formed for the Gatineau and Weedon projects.

Other Properties

The reclamation work was largely complete at Bouchard-Hébert, Bougrine and Nanisivik by the end of 2008. The crushing and grinding circuits and certain other components at Bougrine remain intact, dismantling of the mill at Bouchard-Hébert is continuing and the tank farm remains intact at Nanisivik.

FOURTH QUARTER REVIEW

The Company realized a net loss of \$53.5 million or \$0.12 per share in the fourth quarter of 2008 compared with \$38.3 million or \$0.09 per share in the fourth quarter of 2007. The improved results quarter-over-quarter were primarily due to:

- a \$19.5 million higher write-down of mineral properties and fixed assets primarily due to \$25.3 million and \$8.3 million write-downs at Myra Falls and Mochito respectively partially offset by a \$16.0 million write-down at Myra Falls in 2007
- a \$19.1 million positive move in investment and other income from an \$8.4 million expense in 2007 to income of \$10.7 million in the fourth quarter of 2008 relating to the disposal of certain non-core assets
- \$35.4 million (US\$54.4 million) lower gross sales revenue, despite 2% greater tonnes of concentrate sold, largely due to a 49% drop in the price of zinc, a 40% decline in copper prices and lead prices decreasing by 64% quarter-over-quarter
- \$6.6 million higher treatment and marketing costs primarily due to higher freight rates and the impact of a weaker C\$
- \$5.9 million higher depreciation and depletion expenses primarily due to higher fixed asset bases and lower mineral reserves at Mochito and Toqui and the impact of higher production at Langlois
- \$19.9 million change in income and mining tax from a provision in 2007 of \$14.3 million to a recovery of \$5.6 million in 2008 primarily due to lower earnings before tax at Mochito and Toqui and a future tax asset write-down at Myra Falls in 2007

Concentrate produced in the fourth quarter of 2008 decreased by 9% to 65,986 tonnes largely due to decreased production at Toqui, Myra Falls and Langlois.

Please refer to the Highlights section of this MD&A for specific highlights in the fourth quarter of 2008.

Fourth Quarter 2008	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Other	Total
Ore milled (tonnes)	162,083	130,893	126,140	67,611	n.a.	486,727
Zinc (%)	4.6%	6.6%	6.9%	9.7%	n.a.	6.4%
Concentrate produced (tonnes):						
Zinc	12,198	15,253	14,161	11,175	n.a.	52,787
Copper	n.a.	n.a.	4,039	1,475	n.a.	5,514
Lead	4,943	1,193	n.a.	n.a.	n.a.	6,136
Gold	n.a.	1,549	n.a.	n.a.	n.a.	1,549
Total	17,141	17,995	18,200	12,650	n.a.	65,986
Concentrate sold (tonnes):						
Zinc	13,928	16,618	21,197	29,078	n.a.	80,821
Copper	n.a.	n.a.	9,436	4,152	n.a.	13,588
Lead	6,610	2,087	n.a.	n.a.	n.a.	8,697
Gold	n.a.	1,192	1	n.a.	n.a.	1,193
Total	20,538	19,897	30,634	33,230	n.a.	104,299
Gross sales revenue	20,411	18,763	33,915	27,012	n.a.	100,101
Treatment and marketing costs	6,933	9,265	10,392	13,074	n.a.	39,664
Net revenue	13,478	9,498	23,523	13,938	n.a.	60,437
Direct operating costs	15,309	11,107	31,933	17,897	n.a.	76,246
Depreciation and depletion	3,750	3,117	2,562	7,257	40	16,726
Reclamation and closure costs	390	3	178	20	98	689
	19,449	14,227	34,673	25,174	138	93,661
Loss from mining activities	(5,971)	(4,729)	(11,150)	(11,236)	(138)	(33,224)
General and administrative						990
Interest and financing						(272)
Investment and other						(10,669)
Foreign exchange and other						(3,703)
Exploration						3,382
Write-down of mineral properties and fixed assets						35,508
Other non-producing property costs						590
						25,826
Loss before income and mining tax recovery						(59,050)
Income and mining tax recovery						5,564
Net loss						(53,486)

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Fourth Quarter 2007	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Other	Total
Ore milled (tonnes)	151,149	132,489	182,040	118,683	n.a.	584,361
Zinc (%)	4.6%	7.3%	4.7%	6.8%	n.a.	5.7%
Concentrate produced (tonnes):						
Zinc	11,656	17,813	13,599	13,935	n.a.	57,003
Copper	n.a.	n.a.	7,825	2,060	n.a.	9,885
Lead	3,527	922	n.a.	n.a.	n.a.	4,449
Gold	n.a.	1,133	n.a.	n.a.	n.a.	1,133
Total	15,183	19,868	21,424	15,995	n.a.	72,470
Concentrate sold (tonnes):						
Zinc	27,801	26,241	15,960	15,562	n.a.	85,564
Copper	n.a.	n.a.	11,300	2,407	n.a.	13,707
Lead	1,878	n.a.	n.a.	n.a.	n.a.	1,878
Gold	n.a.	1,266	n.a.	n.a.	n.a.	1,266
Total	29,679	27,507	27,260	17,969	n.a.	102,415
Gross sales revenue	37,820	34,395	42,123	21,117	n.a.	135,455
Treatment and marketing costs	9,891	10,588	7,868	4,674	n.a.	33,021
Net revenue	27,929	23,807	34,255	16,443	n.a.	102,434
Direct operating costs	13,590	10,292	34,689	15,368	n.a.	73,939
Depreciation and depletion	1,656	1,285	3,383	4,451	70	10,845
Reclamation and closure costs	353	63	3,635	25	184	4,260
	15,599	11,640	41,707	19,844	254	89,044
Contribution (loss) from mining activities	12,330	12,167	(7,452)	(3,401)	(254)	13,390
General and administrative						4,272
Interest and financing						2,009
Investment and other income						8,415
Foreign exchange and other						(155)
Exploration						6,161
Write-down of mineral properties and fixed assets						16,000
Other non-producing property costs						701
						37,403
Loss before income and mining tax provision						(24,013)
Income and mining tax provision						14,323
Net Loss						(38,336)

⁽¹⁾ Commenced commercial production on July 1, 2007.

For a more detailed discussion of the Company's fourth quarter results, please refer to the Company's press release of the results of operations for the three and twelve months ending December 31, 2008 dated February 26, 2009.

NON-GAAP RECONCILIATIONS

Operating cost per tonne milled on a production basis is a performance indicator. It is a non-GAAP measure and because there is no standard method for calculating it, operating costs per tonne milled on a production basis is not a reliable way to compare the Company against other companies. It can however allow an understanding of how production costs have changed from year-to-year and the impact on cash flows.

Year ended December 31, 2008 (\$000's)	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Total
Direct operating costs per financial statements	42,463	37,385	88,247	61,734	229,829
Adjustment to production basis	(4,234)	(9,605)	(12,230)	(8,672)	(34,741)
Less: stock-based compensation	(54)	(138)	(293)	(61)	(546)
Less: royalties	n.a.	(1,229)	n.a.	n.a.	(1,229)
Operating costs on a production basis	38,175	26,413	75,724	53,001	193,313
Average exchange rate	1.0675	1.0675	1.0675	1.0675	1.0675
Operating costs on production basis (US\$)	35,761	24,744	70,936	49,650	181,091
Tonnes milled	646,845	519,379	592,072	514,444	2,272,740
Operating cost per tonne milled – US\$	\$55	\$48	\$120	\$97	\$80
Operating cost per tonne milled – C\$	\$59	\$51	\$128	\$103	\$85

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Year ended December 31, 2007 (\$000's)	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Total
Direct operating costs per financial statements	32,540	28,262	83,667	17,145	161,614
Adjustment to production basis	1,631	(33)	8,689	9,633	19,920
Less: stock-based compensation	(186)	(313)	(620)	(53)	(1,172)
Less: royalties	n.a.	(1,965)	n.a.	n.a.	(1,965)
Operating costs on a production basis	33,985	25,951	91,736	26,725	178,397
Average exchange rate	1.0736	1.0736	1.0736	1.0736	1.0736
Operating costs on production basis (US\$)	31,655	24,172	85,447	24,893	166,167
Tonnes milled	607,583	522,082	726,460	437,875	2,294,000
Less: preproduction tonnes	n.a.	n.a.	n.a.	(186,517)	(186,517)
Tonnes milled, production basis	607,583	522,082	726,460	251,358	2,107,483
Operating cost per tonne milled – US\$	\$52	\$46	\$118	\$99	\$79
Operating cost per tonne milled – C\$	\$56	\$50	\$126	\$106	\$85

⁽¹⁾ Commenced commercial production on July 1, 2007.

SUMMARY OF QUARTERLY RESULTS

	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross sales revenue (\$ millions)	77.9	103.4	87.5	135.5	81.9	115.1	101.0	100.1
Net earning (loss) (\$ millions)	15.3	38.7	7.8	(38.4)	(6.9)	8.1	(36.1)	(53.5)
Basic earnings (loss) per share	\$0.04	\$0.09	\$0.02	\$(0.09)	\$(0.02)	\$0.02	\$(0.08)	\$(0.12)
Weighted-average number of Common Shares outstanding (millions)	396.4	418.0	418.7	421.6	425.8	446.4	446.5	446.8
Diluted earnings (loss) per share	\$0.04	\$0.09	\$0.02	\$(0.09)	\$(0.02)	\$0.02	\$(0.08)	\$(0.12)
C\$/US\$ realized exchange rate	1.1683	1.0914	1.0374	0.9857	1.0047	1.0100	1.0457	1.2050
Average realized zinc price (US\$/t)	3,434	3,710	3,200	2,608	2,409	2,205	1,830	1,331
Average realized zinc price (C\$/t)	4,012	4,049	3,320	2,571	2,420	2,227	1,914	1,604
Concentrate tonnes sold ⁽¹⁾	39,333	51,553	50,748	102,415	59,210	95,188	87,978	104,229
Concentrate tonnes produced ⁽¹⁾	66,895	75,596	73,122	72,470	73,481	86,856	89,514	65,986

⁽¹⁾ Langlois commenced commercial production effective July 1, 2007. On November 2, 2008, Langlois operations were temporarily suspended. Included in concentrate produced in Q1 2007 and Q2 2007 were 9,571 and 14,921 tonnes respectively which are not included in concentrate tonnes sold.

The quantity and mix of concentrates sold directly affects gross sales revenue. The recognition of revenue from the sale of concentrate can vary from quarter-to-quarter for the reasons discussed in the "Gross Sales Revenue" section of this MD&A. As all sales are based in US\$, the US\$/C\$ movement against the C\$ over the past eight quarters impacts the realized C\$ gross sales revenue.

CONTRACTUAL OBLIGATIONS

Contractual Obligations (\$ millions)	Payments Due by Period				Total
	< 1 year	>1-3 years	4-5 years	> 5 years	
Capital leases	0.2	0.2	—	—	0.4
Operating leases	0.8	0.9	0.1	—	1.8
Debt	4.9	1.0	0.8	—	6.7
Accrued benefit obligations ⁽¹⁾	2.4	5.7	7.2	22.7	38.0
Reclamation ⁽¹⁾	4.7	7.0	9.5	7.3	28.5
Royalty obligations ⁽¹⁾	—	—	—	78.4	78.4
Total	13.0	14.8	17.6	108.4	153.8

⁽¹⁾ Accrued benefit obligations, reclamation and royalty obligations have funding sources from pension plan assets (\$30.1 million), restricted reclamation investments (\$35.0 million) and restricted promissory notes (\$80.9 million) respectively. See the Company's 2008 audited consolidated financial statements for additional details.

TRANSACTION WITH RELATED PARTIES

On March 2, 2007 and March 14, 2007, Dundee Corporation ("Dundee") exercised 15,400,705 and 15,400,705 warrants respectively to purchase 30,801,410 Common Shares at \$0.20 per Common Share. In December 2007, the Company issued 6,122,449 flow-through Common Shares by way of private placement at a price of \$1.96 per Common Share exclusive of share issuance costs of \$12,000 to a wholly-owned subsidiary of Dundee. The flow-through Common Shares had a four-month hold period. The proceeds of the flow-through shares were used to finance exploration activities principally in Québec. Additionally, in 2007 an affiliated company of Dundee provided consulting services of \$50,000. Dundee is a significant shareholder of the Company.

CRITICAL ACCOUNTING ESTIMATES

Going Concern

The audited consolidated financial statements of the Company for the years ended December 31, 2008 and 2007 were prepared in accordance with GAAP applicable to a going concern which assume that the Company will realize its assets, discharge its liabilities and meet its future obligations in the normal course of business. Accordingly, the audited consolidated financial statements for the years ended December 31, 2008 and 2007 do not include any adjustments to the recoverability and reclassification of recorded assets, or the amounts or classification of liabilities, that might be necessary should the Company be unable to continue as a going concern.

While the audited consolidated financial statements for the years ended December 31, 2008 and 2007 were prepared on the basis of accounting principles applicable to a going concern, certain market conditions, including falling metal prices and higher operating costs, cast significant doubt upon the validity of this assumption. For the year ended December 31, 2008, the Company incurred a loss of \$88.3 million, had a net decrease in cash of \$42.6 million and used cash in operating activities of \$3.7 million.

The Company's ability to continue its operations in the normal course of business is dependent upon its ability to achieve and sustain profitable operations. Alternatively, the Company is dependent on continued support from shareholders and creditors. In 2009, metal prices remain low and the Company continues to experience operating losses and the Company's cash has been significantly reduced. Management is exploring all available options to secure additional funding including equity and debt financing, sale of non-core assets and strategic partnerships. It is not possible to determine with any certainty the success and adequacy of these initiatives.

The audited consolidated financial statements for the years ended December 31, 2008 and 2007 do not give effect to adjustments to the carrying values of assets and liabilities and the reported revenues and expenses and balance sheet classifications that would be necessary should the Company be unable to continue as a going concern. These adjustments could be material.

Asset Impairment

The carrying values of producing mineral properties, including properties placed on a care and maintenance basis and related deferred expenditures, are reviewed when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. Estimated future net cash flows, on an undiscounted basis, are calculated for each property using: estimated recoverable reserves; estimated future metal price realization (considering historical and current prices, price trends and related factors); and, estimated operating, capital and other cash flows.

For 2008 testing purposes, the Company used the price assumptions contained in the Sensitivity to Metal Prices and Exchange Rates section in this MD&A for 2009 and estimated future price realizations and exchange rates for 2010 to the end of each mine's life. Estimates of future cash flows are subject to risks and uncertainties. It is possible that changes may be required to these assumptions in the future which may affect the assessment of recoverability of the carrying value of mineral properties. See Sensitivity to Metal Prices and Exchange Rates section in this MD&A.

Provisional Payments For Concentrate Shipped And Not Priced

Provisional payments for concentrate inventory shipped and not priced are based on price estimates prevailing close to the date the concentrate is shipped and final pricing can occur several months later, therefore, if there is a dramatic decline in metal pricing during this period, the Company could be required to remit funds back to its customers.

Employee Future Benefits

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Actuarial reports valuing this hourly plan are prepared every three years using the projected accumulated benefit method, with December 31, 2007 being the most recent valuation. Employee future benefits relate only to employees at Myra Falls and include amounts related to unionized hourly employee defined benefit pension plan and post-retirement supplements and medical benefits to certain non-union employees. The determination of employee future benefit expenses, obligations and funding requirements require the use of estimates which can produce significant measurement uncertainty into the actuarial valuation process. Such estimates include: mine closure assumptions, expected average remaining service lifetime, termination of employment, retirement timing, mortality, marital status, discount rates, rate of return on plan assets and health care and dental cost inflation assumptions.

Due to the current general economic uncertainty and the volatility of the financial markets, readers are cautioned that there is no assurance the above estimates can be achieved and that the plan deficit could be significantly understated. Contributions significantly greater than those estimated may be required in the future.

Reserves

Every year the Company estimates its proven and probable mineral reserves (the "Reserves") in accordance with National Instrument 43-101 ("NI 43-101"), a rule adopted by Canadian securities administrators as the standard of disclosure for mineral projects. This estimate is used to determine mine viability, mine life and amortization rates. The estimation of Reserves is based on drill hole information, historical mining results, historical metallurgical results, estimated future operating costs and estimated future metal prices. A "Qualified Person", as defined by NI 43-101, performs the Reserves estimate. As all of the Company's operations have had an operating history, the factor that could have the greatest impact on the Reserves estimate is future metal prices.

Amortization

The Company uses the units-of-production method for amortization of mineral properties and some of its fixed assets based on the Reserves. Any significant changes in the Reserves could impact the amount of annual amortization.

Inventory

The Company values its concentrate inventories at the lower of cost or realizable value at the end of the reporting period. Costs represent the average cost, and include direct labour and materials costs, mine site overhead and depreciation and depletion. Realizable value includes metal prices, net of treatment charges and freight. Metal prices can be subject to significant change from period-to-period.

Future Tax Assets and Liabilities

Future tax assets and liabilities are calculated using the asset and liability method. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using current tax rates. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period the change is known. To the extent that the Company considers it to be more likely than not that a future tax asset will be recovered, a tax asset will be set up, otherwise the Company provides a valuation allowance against the excess. It is possible that changes could occur in the future that may affect the recoverability of the carrying value of future tax assets and a write-down may be required.

Reclamation

The Company provides for the fair value of liabilities and capitalized costs for asset retirement obligations in the period in which they are incurred. Over time, the liability is accreted to its present value and the capitalized cost is amortized over the useful life of the related asset. Asset retirement obligations are obligations of the Company that arise as a result of an existing law, regulation or contract related to asset retirements. Estimates of the liability associated with the retirement of an asset are based on current laws and regulations and the expected resulting costs, all of which are subject to change. If actual costs of reclamation exceed the recorded amount the Company will record a loss. Alternatively, if reclamation costs incurred are less than those recorded, the Company will record a gain. Currently the Company is not able to set up a liability for reclamation at Mochito as there is no law, regulation or contract related to this asset's retirement.

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.

OUTSTANDING SHARE DATA AND FULL DILUTION CALCULATION

The Company is authorized to issue an unlimited number of Common Shares and 200,000,000 preferred shares, issuable in series. There are no preferred shares outstanding. Each Common Share entitles the holder of record thereof to one vote at all meetings of shareholders of the Company, except at meetings at which only holders of another class or series of shares of the Company are entitled to vote. The table set forth below summarizes the Capital Stock. For a more complete description of certain elements please refer to note 16 to the 2008 audited consolidated financial statements of the Company.

Common Shares or Securities Convertible into Common Shares		February 26, 2009
Issued and outstanding		447,664,693
Share options outstanding (weighted-average exercise price \$1.20)		7,269,442
Future fully diluted		454,934,135

CONCLUSION RELATING TO DISCLOSURE CONTROLS AND PROCEDURES

An evaluation was performed under the supervision of and with the participation of management, including the President and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined in the Multilateral Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of the Company's disclosure controls and procedures were effective as at December 31, 2008.

CAUTION ON FORWARD-LOOKING INFORMATION

This MD&A contains certain statements which constitute forward-looking information. These forward-looking statements are not descriptive of historical matters and may refer to management's expectations or plans. These statements include but are not limited to statements concerning the Company's business objectives and plans; future trends in the Company's industry; future production costs and volumes; mineral grades, reserve and resource estimates and types; sales volumes and realized prices; capital spending plans; exploration plans; expansion plans; expected market fundamentals and prices; availability of equipment and supplies; expected plant availability; success of process changes; the Company's processing technologies; global economic growth and industrial demand; production of base metal concentrates by the Company's operations; future metal prices and treatment and freight charges; future royalties payable; changes in global metal and concentrate inventories; currency exchange rates; costs of energy, materials and supplies; the outcome of disputes and legal proceedings in which the Company is involved; future effective tax rates; and, future benefits costs.

Inherent in forward-looking statements are risks and uncertainties beyond the Company's ability to predict or control, including risks that may affect the Company's operating or capital plans, including risks generally encountered in the development and operation of mineral properties and processing facilities such as unusual or unexpected geological formations, unanticipated metallurgical difficulties, ground control problems, process upsets and equipment malfunctions; risks associated with labour disturbances and unavailability of skilled labour; fluctuations in the market prices of the Company's principal products, which are cyclical and subject to substantial price fluctuations; risks created through competition for mining properties; risks associated with lack of access to markets; risks associated with mineral reserve and resource estimates, including the risk of errors in assumptions or methodologies; risks posed by fluctuations in exchange rates and interest rates, as well as general economic conditions; risks associated with environmental compliance and permitting, including those created by changes in environmental legislation and regulation; risks associated with the Company's dependence on third parties in the provision of transportation and other critical services; risks associated with aboriginal title claims and other title risks; social and political risks associated with operations in foreign countries; and, risks associated with legal proceedings.

Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements contained in this MD&A. Such statements are based on a number of assumptions which may prove to be incorrect, including, but not limited to, the following assumptions: that there is no material deterioration in general business and economic conditions; that there is no unanticipated fluctuation of interest rates and foreign exchange rates; that the supply and demand for, deliveries of, and the level and volatility of prices of zinc, copper, lead, gold and silver and the Company's other primary metals and minerals develop as expected; that the Company receives regulatory and governmental approvals for its development projects and other operations on a timely basis; that the Company is able to obtain financing for its development projects on reasonable terms; that there is no unforeseen deterioration in the Company's costs of production or production and productivity levels; that the Company is able to continue to secure adequate transportation for its products; that the Company is able to procure mining equipment and operating supplies in sufficient quantities and on a timely basis; that engineering and construction timetables and capital costs for the Company's development and expansion projects are not incorrectly estimated or affected by unforeseen circumstances; that costs of closure of various operations are accurately estimated; that there are no unanticipated changes to market competition; that the Company's reserve estimates are within reasonable bounds of accuracy

(including with respect to size, grade and recoverability) and that the geological, operational and price assumptions on which these are based are reasonable; that environmental and other proceedings or disputes are satisfactorily resolved; and, that the Company maintains its ongoing relations with its employees and with its business partners and joint venturers.

Readers are cautioned that the foregoing list of important factors and assumptions is not exhaustive. Forward-looking statements are not guarantees of future performance. Events or circumstances could cause the Company's actual results to differ materially from those estimated or projected and expressed in, or implied by, these forward-looking statements. Readers should also carefully consider the matters discussed under "Risk Factors" in the Company's Annual Information Form. Given these uncertainties, investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking statements or the foregoing list of factors, whether as a result of new information or future events or otherwise, except as may be required under applicable laws.

ACCOUNTING CHANGES

Inventories and Financial Instruments

On January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants' ("CICA") new accounting requirements for inventories and financial instruments disclosure and presentation. Adoption of those requirements did not have a significant impact. For details of the specific accounting changes and related impacts, refer to note 3 of the Company's 2008 audited consolidated financial statements.

International Financial Reporting Standards

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently in the planning stages and cannot at this time determine the impact of the transition to IFRS. As at December 31, 2008, the Company is in the process of completing "Phase 1 – Preliminary study" which is to analyse the existing financial reporting and identify the key impact areas of IFRS.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Breakwater Resources Ltd. (the "Company") and all of the information contained in the Financial Report are the responsibility of management and have been approved by the Company's Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to a going concern (*note 1*). When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly, in all material respects. Management has prepared the financial information presented elsewhere in the Financial Report and has ensured that it is consistent with that in the consolidated financial statements.

The Company maintains a system of internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that the Company's assets are appropriately accounted for and adequately safeguarded. This system of internal control includes an organizational arrangement with clearly defined lines of responsibility. PricewaterhouseCoopers LLP, the independent auditors appointed by the shareholders to audit the consolidated financial statements, have full and unrestricted access to the Audit Committee. During the course of their audit, PricewaterhouseCoopers LLP reviewed the Company's system of internal control to the extent necessary to render their opinion on the consolidated financial statements.

The Audit Committee is appointed by the Company's Board of Directors and all its members are outside directors. The Audit Committee meets periodically with management, as well as the independent auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities and to review the consolidated financial statements and the independent auditors' report. The Company's Audit Committee reports its findings to the Company's Board of Directors for consideration when approving the consolidated financial statements for issuance to shareholders. The Company's Audit Committee also considers, for review by the Company's Board of Directors and the approval by the shareholders, the engagement or reappointment of independent auditors.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

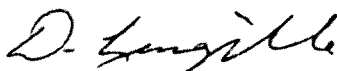
Management is responsible for establishing and maintaining adequate control over financial reporting. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2008.

CONCLUSION RELATING TO DISCLOSURE CONTROLS AND PROCEDURES

An evaluation was performed under the supervision of and with the participation of management, including the President and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined in the Multilateral Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of the Company's disclosure controls and procedures were effective as at December 31, 2008.



George E. Pirie
President and
Chief Executive Officer



David C. Langille
Vice President, Finance and
Chief Financial Officer

Auditors' Report

To the Shareholders of Breakwater Resources Ltd.

We have audited the consolidated balance sheets of Breakwater Resources Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations and retained earnings, accumulated other comprehensive income (loss), other comprehensive (loss) income 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 consolidated 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, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PriceWaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

February 26, 2009

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)

As at December 31

2008

2007

Assets**Current**

Cash and cash equivalents		
Restricted cash (note 5)	20,328	62,934
Short-term investments (note 6)	761	629
Accounts receivable – concentrate	142	6,532
Other receivables	614	3,585
Concentrate inventory (note 7)	12,451	17,025
Materials and supplies inventory	21,816	64,775
Prepaid expenses and other current assets	37,278	28,976
Income and mining tax receivable	5,748	7,541
Future income tax assets (note 19)	1,550	–
	621	1,491
Total current assets	101,309	193,488
Future income tax assets, long-term (note 19)	–	19,915
Restricted reclamation investments (note 8)	35,026	33,500
Mineral properties and fixed assets (note 9)	277,990	267,462
Long-term investments (note 10)	–	32,922
Restricted promissory notes (note 13)	80,886	62,285
	495,211	609,572

Liabilities and Shareholders' Equity**Current**

Accounts payable and accrued liabilities (note 23(g))	50,837	61,900
Provisional payments for concentrate inventory shipped and not priced	10,512	32,248
Short-term debt including current portion of long-term debt (note 11)	4,854	190
Income and mining taxes payable	264	10,078
Current portion of reclamation, closure cost accruals and other environmental obligations (note 14)	5,622	6,486
Total current liabilities	72,089	110,902
Deferred income (note 13)	5,924	5,666
Long-term lease obligations (notes 9 and 23(g))	125	267
Royalty obligations (note 13)	78,449	82,479
Long-term debt (note 12)	1,851	1,851
Reclamation, closure cost accruals and other environmental obligations (note 14)	22,906	33,262
Employee future benefits (note 15)	994	2,817
Future income tax liabilities (note 19)	3,211	7,942
Total liabilities	185,549	245,186
Shareholders' equity (note 16)	309,662	364,386
	495,211	609,572

Going concern (note 1)

Contingencies and commitments (note 23)

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

Approved by the Board



Garth A.C. MacRae
Director



George E. Pirie
Director

Consolidated Statements of Operations and Retained Earnings

(Expressed in thousands of Canadian dollars except share and per share amounts)

Years ended December 31	2008	2007
Gross sales revenue	398,110	404,335
Treatment and marketing costs	135,796	100,288
Net revenue	262,314	304,047
Direct operating costs	229,829	161,614
Depreciation and depletion	47,677	22,791
Reclamation and closure costs	3,358	6,984
	280,864	191,389
(Loss) contribution from mining activities	(18,550)	112,658
General and administrative	12,423	15,679
Interest and financing	2,706	5,117
Investment and other income (note 17)	(24,205)	(3,146)
Foreign exchange and other	(5,191)	9,810
Exploration	17,212	17,036
Write-down of mineral properties and fixed assets (notes 9 and 10)	46,478	16,000
Other non-producing property costs (note 18)	1,834	2,153
	51,257	62,649
(Loss) earnings before income and mining tax provision	(69,807)	50,009
Income and mining tax provision (note 19)	18,533	26,602
Net (loss) earnings	(88,340)	23,407
Retained earnings, beginning of year	168,908	139,795
Changes in accounting policy (note 3)	-	5,706
Retained earnings, end of year	80,568	168,908
Basic (loss) earnings per Common Share (note 26)	(\$0.20)	\$0.06
Diluted (loss) earnings per Common Share (note 26)	(\$0.20)	\$0.05
Basic weighted-average number of Common Shares outstanding (000's) (note 26)	441,378	413,681

Going concern (note 1)

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

Consolidated Statements of Accumulated Other Comprehensive Income (Loss)

(Expressed in thousands of Canadian dollars)

Years ended December 31	2008	2007
Accumulated other comprehensive loss, beginning of year	(3,817)	(7,689)
Remeasurement of available-for-sale securities at January 1, 2007	-	11,980
Other comprehensive income (loss)	7,074	(8,108)
Accumulated other comprehensive income (loss), end of year (note 16)	3,257	(3,817)

Going concern (note 1)

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

Consolidated Statements of Other Comprehensive (Loss) Income

(Expressed in thousands of Canadian dollars)

Years ended December 31	2008	2007
Net (loss) earnings	(88,340)	23,407
Other comprehensive income (loss), net of income taxes:		
Unrealized gains (losses) on translating financial statements of self sustaining foreign operations	19,789	(9,386)
Unrealized loss on short-term available-for-sale securities, net of income tax provision of \$5 (2007 - \$109) (note 6)	(26)	(570)
Unrealized gain on restricted investment, net of income tax provision of \$94 (note 8)	533	-
Unrealized gain on long-term available-for-sale securities, net of income tax provision of \$352 (note 10)	-	1,848
Reclassification of gains on sale of available-for-sale securities to income (notes 6 and 10)	(13,222)	-
Other comprehensive income (loss), net of income taxes	7,074	(8,108)
Comprehensive (loss) income	(81,266)	15,299

Going concern (note 1)

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

Consolidated Statements of Cash Flow

(Expressed in thousands of Canadian dollars)

Years ended December 31	2008	2007
Operating Activities		
Net (loss) earnings	(88,340)	23,407
Items not affecting cash:		
Depreciation and depletion	47,677	22,791
Gain on sale of investment (note 17)	(9,021)	(306)
Write-down of mineral properties and fixed assets (notes 9 and 10)	46,478	16,000
Gain on sale of Lapa royalties (note 17)	(6,350)	-
Unrealized loss on investments	1,337	7,601
Other non-cash items	4,383	(4,418)
Stock-based compensation (note 16(b))	1,091	2,149
Unrealized deferred income	(611)	(611)
Future income taxes	13,454	7,594
Reclamation, closure cost accruals and other environmental obligations	3,358	6,984
Employee future benefits (note 15)	1,633	1,483
Payment of reclamation, closure cost accruals and other environmental obligations	(5,420)	(6,785)
Payment of employee future benefits (note 15)	(3,456)	(3,159)
Changes in non-cash working capital items (note 25)	(9,946)	6,386
Net cash (used in) provided by operating activities	(3,733)	79,116
Investing Activities		
(Increase) decrease in restricted cash (note 5)	(132)	592
Restricted reclamation investments	(899)	(20,000)
Short-term investments	7,003	(5,055)
Long-term investments	13,350	-
Funds advanced on promissory notes (note 13(b))	(15,970)	-
Issue of common shares to purchase Myra Falls Limited Partnership (note 13)	(34)	-
Acquisition of Metco Resources Inc., net of cash acquired (note 4)	23	-
Mineral properties and fixed assets	(76,839)	(113,782)
Proceeds from sale of mineral properties and fixed assets	7,210	304
Net cash used in investing activities	(66,288)	(137,941)
Financing Activities		
Proceeds from sale of royalty interest (notes 13(a) and (b))	15,970	20,000
Proceeds from sale of Lapa royalty	6,350	-
Issue of common shares for cash (note 16)	381	20,699
Deferred income relating to royalties	869	-
Decrease in long-term lease obligations	(142)	(234)
Increase (decrease) in short-term debt	3,987	(118)
Net cash provided by financing activities	27,415	40,347
Net decrease in cash during the year	(42,606)	(18,478)
Cash and cash equivalents, beginning of year	62,934	81,412
Cash and cash equivalents, end of year	20,328	62,934
Supplemental Information		
Cash interest paid	214	321
Cash income and mining taxes paid	15,494	22,939
Cash interest received	1,396	4,299

Going concern (note 1)

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

Notes to the Consolidated Financial Statements

For the Years Ended December 31, 2008 and 2007

1. GOING CONCERN

The consolidated financial statements of Breakwater Resources Ltd. (the "Company") have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") applicable to a going concern. Accordingly, the accompanying consolidated financial statements do not include any adjustments to the carrying values of assets and liabilities, the reported expenses, and the classifications used, that might be necessary should the Company be unable to continue as a going concern in the normal course of operations. Such adjustments could be material.

While these consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, certain market conditions including falling metal prices and higher operating costs cast significant doubt upon the validity of this assumption. For the year ended December 31, 2008, the Company incurred a loss of \$88,340,000, had a net decrease in cash of \$42,606,000 and used net cash in operating activities of \$3,733,000.

The Company's ability to continue its operations in the normal course of business is dependent upon its ability to secure additional funding and achieve or sustain profitable operations. Management is exploring all available options to secure additional funding including equity and debt financing, sale of non-core assets and strategic partnerships.

Nevertheless, it is not possible to determine with any certainty the success and adequacy of these initiatives.

2. SIGNIFICANT ACCOUNTING POLICIES

Generally accepted accounting principles

The consolidated financial statements of the Company have been prepared in accordance with GAAP. The more significant of the accounting policies are summarized as follows:

Principles of consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries all of which are controlled through the ownership of majority voting interests. All inter-company accounts and transactions have been eliminated on consolidation.

Translation of foreign currencies - domestic and foreign operations

The Company reports its financial statements in Canadian dollars, while the currency of measurement for the Company's operations varies depending upon location.

The currency of measurement for the Company's operations domiciled in Canada is the Canadian dollar, while the currency of measurement for the Company's foreign operations is the United States ("US") dollar, since all of the Company's revenue, and a substantial portion of its expenses relating to the foreign operations, are in US dollars. US dollar amounts for the Company's foreign operations are translated into Canadian dollars for reporting purposes using the current rate method. Under the current rate method, assets and liabilities are translated at the exchange rates in effect at the balance sheet date, revenues and expenses are translated at average rates for the year, and the resulting gains and losses are included in accumulated other comprehensive income (loss) which is a separate component of shareholders' equity (*note 16*).

As indicated above, the currency of measurement for the Company's foreign operations, including those in Honduras, Chile and Tunisia, is the US dollar. In each of these operations, the temporal method is used to translate local currency amounts into US dollars. Under the temporal method, all non-monetary items and the related income statement amounts are translated at the historical rates. Monetary assets and liabilities are translated at exchange rates in effect at the balance sheet date, while revenues and expenses, other than those related to non-monetary items, are translated at the average rate of exchange for the year, and gains and losses on translation are reflected in income for the year.

Monetary assets and liabilities of the Company's domestic operations in Canada, denominated in US dollars, are translated at the rate of exchange at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at the average rate of exchange for the year. Exchange gains and losses are included in income for the year.

Use of estimates

The preparation of financial statements, in accordance with 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 financial statements, and the reported amounts of revenues and expenses during the year. Actual results could differ significantly from those estimates. The assets and liabilities which require management to make significant estimates and assumptions in determining carrying values include accounts receivable, concentrate inventory, materials and supplies inventory, mineral properties and fixed assets, long-term investments, reclamation, closure cost accruals and other environmental obligations, future income tax assets and future income tax liabilities.

Financial instruments

The Company enters into derivative financial instrument contracts to manage certain market risks which result from the underlying nature of its business. When the Company chooses to apply hedge accounting, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge transaction. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company may use forward contracts to hedge exposure to commodity price risk for metals production, and foreign exchange forward contracts to hedge exposure to fluctuations in foreign currencies, relating primarily to the US dollar and may designate these contracts as cash flow hedges as they occur. Hedge effectiveness is assessed based on the degree to which the cash flow on the derivative contracts is expected to offset the cash flow of the underlying position or transaction being hedged. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are, and continue to be, effective. Derivatives designated as hedges are carried on the consolidated balance sheets at their fair value. Unrealized gains and losses on effective cash flow hedges will be carried in "Accumulated other comprehensive income" ("AOCI"), a component of "Shareholders' equity" on the consolidated balance sheets, while any gains or losses on ineffective hedges will be recognized in earnings. The premiums received at the inception of written call options are recorded as a liability and changes in the fair value of the liability are recognized currently in income. Contracts for which hedge accounting has not been applied, are classified as held-for-trading which are carried at their fair value and any gains and losses are recognized in the relevant period and included in "Gross sales revenue" on the consolidated statements of operations and retained earnings.

Cash and cash equivalents

Cash and cash equivalents include cash and highly liquid investments with original maturities of three months or less. The Company invests cash in term deposits maintained in high credit quality institutions.

Short-term investments

Short-term investments are designated as either "held-for-trading" or "available-for-sale" and are carried at their fair value. Unrealized gains and losses on held-for-trading securities are recognized in earnings and unrealized gains and losses on available-for-sale securities are recognized in "Other comprehensive income" ("OCI").

Concentrate inventory

Concentrate inventory is valued at the lower of cost and net realizable value. Cost represents the weighted-average cost and includes direct labour and material costs, mine site overhead, depreciation and depletion.

Materials and supplies inventory

Materials and supplies inventory is valued at the lower of weighted-average cost and replacement cost.

Mineral properties and fixed assets

The Company records its interest in mineral properties at cost and capitalizes development expenditures. When the properties are brought into commercial production, the capitalized costs are amortized on a units-of-production basis using current reserve estimates. If the properties are abandoned, the cost of the mineral property and any capitalized expenditures are written-down to fair value at that time. Administrative costs are expensed as incurred. Expenditures incurred to earn an interest in a joint venture are capitalized until the Company's interest is earned.

The carrying values of producing mineral properties and fixed assets (*note 9*), including properties placed on a care and maintenance basis (*note 18*) are reviewed when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. An impairment loss would be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds the assets' fair value which is based on the present value of expected future net cash flow. Estimated future net cash flow, on an undiscounted basis, is calculated for each property using: estimated recoverable reserves; estimated future metal price realization (considering historical and current prices, price trends and related factors); and, estimated operating, capital and other cash flow. Estimates of future cash flow are subject to risks and uncertainties. It is possible that changes could occur which may affect the recoverability of the carrying value of mineral properties.

Fixed assets are stated at cost. Fixed assets are depreciated over their useful lives. In calculating depreciation, the Company employs the straight-line method and the units-of-production method. Principally, the rates of depreciation being applied, using the straight-line method, are intended to fully depreciate the related fixed assets over periods from 2 to 12 years.

In accordance with EIC 152 – “Mining Assets - Impairment and Business Combinations” the Company includes value beyond proven and probable reserves in its estimate of future cash flow when testing for impairment and determining fair value.

Development costs

Development costs involve the preparation of identified reserves for production once the technical feasibility and commercial viability of the mineral deposit is established. These costs are capitalized. For a new mine, the development phase begins after the completion of a feasibility study and ends upon the commencement of commercial production. Development costs are amortized over the life of the area of interest from the date that commercial production of the related mineral occurs. Commercial production is deemed to have commenced when the Company determines that the completion of operational commissioning of major mine and plant components is completed, operating results are being achieved consistently for a period of time and there are indicators that these operating results will continue.

Long-term investments

Long-term investments which are classified as held-for-trading or available-for-sale are carried at their fair value and those which are classified as held-to-maturity are carried at their amortized cost. Unrealized gains and losses on held-for-trading securities are recognized in earnings and unrealized gains and losses on available-for-sale securities are recognized in OCI.

Asset retirement obligations and asset retirement costs

The Company records the fair value of liabilities for asset retirement obligations in the year in which they are incurred. A corresponding increase in the carrying amount of the related asset is recorded and then depreciated over the life of the asset. Over time, the liability is accreted to its present value each year.

Asset retirement obligations are provided for obligations that are required to be settled as a result of an existing law, regulation or contract related to asset retirements. Collateral on deposit with third parties to fund reclamation costs is included in “Restricted reclamation investments” and “Restricted cash” on the consolidated balance sheets.

Employee future benefits

The employee future benefits plan relates only to the employees at the Company’s Myra Falls mine.

The actuarial determination of the accrued benefit obligations for pensions and other retirement benefits uses the projected accumulated benefit method pro-rated on service (which incorporates management’s best estimate of the expected future return on plan assets, cost escalations, retirement ages of employees and other actuarial factors). For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains (losses) arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period, or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the lesser of the average remaining service period of active employees or to the date that Myra Falls mine operations are assumed to cease, which is currently December 31, 2020. The average remaining service period of the active employees covered by all plans is 5 years.

Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the lesser of the average remaining service period of employees active at the date of amendment or to the date that mine operations are assumed to cease, December 31, 2020.

Revenue recognition

Revenue is recognized following the transfer of title and risk of ownership and the determination of the final settlement price in accordance with contractual arrangements with customers. Title is generally transferred on receipt of provisional payment from the customer. Risk is transferred either when the metal concentrate is delivered to the discharge port or to the load port depending on the terms of the contract. Under a delivered ex-ship term, risk passes when the concentrate is delivered to the discharge (destination) port. Under a cost, insurance and freight term, risk passes when the concentrate is delivered to the load (departure) port. Generally, the final settlement price is computed with reference to the average quoted metal prices for a specified period of time, normally one to three months subsequent to shipment to the customer. Concentrate sales and receivables are subject to adjustment on final determination of weights and assays. Provisional payments made by customers upon receipt of shipments of metal concentrate are classified as current liabilities captioned as “Provisional payments for

concentrate inventory shipped and not priced" on the consolidated balance sheets. The Company produces zinc, copper, lead and gold concentrates. By-products such as gold and silver are often contained within concentrate shipped to customers and revenue from these by-products is recognized when all of the above revenue criteria are met and when the corresponding major metal is recognized in revenue. All concentrate revenues are recorded in gross sales revenue on the consolidated statements of operations and retained earnings.

Exploration and evaluation expenditures

The Company expenses all exploration and evaluation expenditures until the Company determines that the mineral deposit is deemed commercially viable, at which time all subsequent costs are capitalized.

Exploration and evaluation expenditures on properties which do not have any known mineral deposits are expensed as incurred until a pre-feasibility study has been completed, after which, future development costs are capitalized if the pre-feasibility study demonstrates that future economic benefits are probable.

Exploration and evaluation expenditures on properties adjacent to mineral deposits which are already being mined or developed are expensed until the Company is able to conclude that a future economic benefit is probable through the completion of a pre-feasibility study, after which the expenditure is capitalized as a mine development cost.

Expenditures related to extensions of mineral deposits which are already being mined or developed, including expenditures on the definition of mineralization of such mineral deposits, is capitalized as a mine development cost when the Company is able to conclude that a future economic benefit is probable following the completion of an economic evaluation which is equivalent to the completion of a pre-feasibility study.

Properties purchased are recorded at fair value on the date of acquisition and are included in "Mineral properties and fixed assets" on the consolidated balance sheets.

Income and mining taxes

The provisions for income and mining taxes are based on the liability method. Future income taxes arise from the recognition of the tax consequences of temporary differences by applying substantively enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of certain assets and liabilities. The Company records a valuation allowance against any portion of those future income tax assets that it believes will, more likely than not, fail to be realized.

Future withholding taxes are provided on the unremitted net earnings of foreign subsidiaries, to the extent that dividends or other repatriations are anticipated in the future and will be subject to such taxes.

Share incentive plan

The Company has a share incentive plan (the "Plan"), which consists of a share purchase plan ("Share Purchase Plan"), a share option plan ("Share Option Plan") and a share bonus plan ("Share Bonus Plan"), which is administered by the directors of the Company. The Plan provides that eligible persons thereunder include any director, full-time or part-time employee, officer or consultant of the Company or any subsidiary thereof. The Plan is described in note 15. The Company uses the fair value method of accounting to recognize an expense for stock-based compensation issued to employees through the Share Option Plan. The expense is recognized over the vesting period of the options. Common Shares issued under the Plan are recorded at the issue price.

New pronouncements not adopted

The Canadian Institute of Chartered Accountants ("CICA") issued accounting standard Section 3064 – Goodwill and Intangible Assets which replaces Section 3062 – Goodwill and Other Intangible Assets, Section 3450 – Research and Development and EIC27 – Revenues and Expenditures During the Pre-operating Period. The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The impact of this new standard is being assessed and cannot be determined at this time.

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently in the planning stages and cannot at this time determine the impact of the transition to IFRS. As at December 31, 2008, the Company is in the process of completing "Phase 1 – Preliminary study" which is to analyse the existing financial reporting and identify the key impact areas of IFRS.

2007 figures

Certain of the 2007 figures have been reclassified to conform to the 2008 presentation.

3. CHANGES IN ACCOUNTING POLICY

- a) On January 1, 2008, the Company adopted the following CICA accounting standards which were effective for fiscal years beginning on or after October 1, 2007 and January 1, 2008 (i) Accounting Standards Section 3031 "Inventories"; (ii) Accounting Standards Section 3862 "Financial Instruments – Disclosures"; (iii) Accounting Standards Section 3863 "Financial Instruments – Presentation". Adoption of these standards is on a prospective basis without retroactive restatement of prior periods.
- b) Accounting Standards Section 3031 "Inventories" provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories and was effective for fiscal years beginning on or after January 1, 2008. The effect of adopting Section 3031 is a reclassification of items classified as capital spares from materials and supplies inventory to fixed assets of \$762,000 and the expensing of depreciation of \$14,000.
- c) Accounting Standards Section 3862 "Financial Instruments – Disclosures" require disclosures in the financial statements that will enable users to evaluate: the significance of financial instruments for the Company's financial position and performance; and the nature and extent of risks arising from financial instruments to which the Company is exposed during the period and at the balance sheet date, and how the company manages those risks. This standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. (See note 20)
- d) Accounting Standards Section 3863 "Financial Instruments – Presentation" carries forward, unchanged, the presentation requirements of Section 3861 – "Financial Instruments – Disclosure and Presentation". Adopting this standard did not have an impact on the financial statements. This standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007.
- e) Accounting Standards Section 1400 (paragraphs .08A to .08C) "General Standards for Financial Statement Presentation" requires management to make an assessment of an entity's ability to continue as a going concern and disclose material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. This provision applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

4. ACQUISITION OF METCO RESOURCES INC.

On April 15, 2008, the Company acquired, through 9192-3573 Québec Inc. ("Québec Inc."), a wholly-owned subsidiary of the Company, 100% of the shareholdings of Metco Resources Inc. ("Metco") for a purchase price of \$7,648,000. The purchase price comprises 7,000,000 common shares of the Company ("Common Shares") at \$1.04 per share for a total of \$7,264,000, net of share issue expense of \$16,000 and other acquisition expenditures of \$384,000. The value of the Common Shares issued was determined based on the weighted-average market price of the Company's Common Shares over the two-day period before and after April 15, 2008, which was the date the terms of the acquisition were agreed to. Québec Inc. was subsequently merged with Metco to form 9195-7209 Québec Inc.

The acquisition has been accounted for using the purchase method of accounting and the results of 9195-7209 Québec Inc. have been consolidated into the Company's financial statements from April 15, 2008. The Company's interest in the net assets acquired was allocated as follows:

(\$000's)	
Cash	407
Non-cash current assets	756
Mineral properties and fixed assets	6,596
Current liabilities	(111)
Total	7,648
Total consideration comprised:	
Common shares, net of share issue expenses	7,264
Expenditures	384
Total	7,648

5. RESTRICTED CASH

The restricted cash balance at December 31, 2008 of \$761,000 (2007 - \$629,000) represents amounts placed on deposit to cover certain reclamation costs of \$511,000 (2007 - \$379,000) and an amount of \$250,000 to guarantee an operating lease.

6. SHORT-TERM INVESTMENTS

(\$000's)	2008	2007
Marketable securities:		
Available-for-sale (note 10)	21	547
Held-for-trading	121	5,985
	142	6,532

Marketable securities are carried at fair value with the net unrealized loss on available-for-sale securities for the year ended December 31, 2008 of \$26,000 (2007 - \$570,000) recorded in OCI until realized and the unrealized loss of \$1,933,000 (2007 - \$3,345,000) on held-for-trading securities for the same period recorded in earnings. For the year ended December 31, 2008, the realized gain on sale of short-term investments of \$691,000 (2007 - \$306,000) are included in investment and other income on the consolidated statements of operations and retained earnings. The realized gain for the year ended December 31, 2008 includes \$221,000 (2007 - \$Nil) that was previously recorded in OCI as unrealized gains.

7. CONCENTRATE INVENTORY

Concentrate inventory as at December 31, 2008 includes an amount of \$10,111,000 (2007 - \$39,383,000) for shipments where title and risk of ownership have been transferred to the customer but the final settlement price has not been determined. These shipments will be recognized as revenue in accordance with the Company's revenue recognition policy set out in note 2.

8. RESTRICTED RECLAMATION INVESTMENTS

Restricted reclamation investments at December 31, 2008 consisting of cash collateral on deposit of \$13,500,000 (2007 - \$13,500,000) and investments of \$21,526,000 (2007 - \$20,000,000) are related to future reclamation activities and are held by third parties to fund future reclamation costs at Myra Falls. The investments of \$21,526,000 (December 31, 2007 - \$20,000,000) were funded through a qualifying environmental trust and are classified as available-for-sale securities and are carried at fair value (see note 13(a)). The net unrealized gain on the investments for the year ended December 31, 2008 of \$533,000 is recorded in OCI until realized and the realized loss of \$15,000 is recorded in income. Interest receivable of \$913,000 on the investments at December 31, 2008 is recorded in income.

9. MINERAL PROPERTIES AND FIXED ASSETS

(\$000's)	2008			2007		
	Cost	Accumulated depreciation and depletion	Net book value	Cost	Accumulated depreciation and depletion	Net book value
Equipment	199,622	124,761	74,861	164,191	102,584	61,607
Mineral properties,						
buildings and improvements	184,751	76,182	108,569	167,398	69,535	97,863
Development	152,806	58,538	94,268	142,424	35,202	107,222
Asset retirement costs	3,062	2,770	292	9,551	8,781	770
	540,241	262,251	277,990	483,564	216,102	267,462

At December 31, 2008, the carrying value of a number of exploration properties in Quebec of \$598,000 was written off as the properties were deemed not commercially viable. A number of fixed assets at the non-producing properties were written down by an amount of \$1,283,000 to their estimated net realizable value of \$1,100,000.

For the year ended December 31, 2008, the carrying value of the mineral properties and fixed assets at Myra Falls and Mochito were written down by an amount of \$25,300,000 (2007 - \$16,000,000) to \$22,307,000 and \$8,327,000 (2007 - \$Nil) to \$55,714,000 respectively as the net book values exceeded the fair values. Fair value was determined by using estimated future net cash flow which included: estimated recoverable reserves; future metal prices and foreign exchange rates; and, estimated operating and capital costs. The write-downs were allocated against the fixed assets of Myra Falls and Mochito on a pro-rata basis, based on the net book values before the write-down.

The carrying values of the Company's wholly-owned mines are tested for impairment when conditions warrant. In view of the current market volatility, the Company has reviewed all of its wholly-owned mines for impairment using long-term estimated metal prices and exchange rates and has concluded that no impairment exists except as noted above. The Company will continue to monitor these assets for impairment.

Development costs are amortized using the unit-of-production method. The amortization expense for 2008 was \$19,179,000 (2007 - \$11,683,000).

Of the net book value of equipment of \$74,861,000, approximately US\$900,000 is granted as a security for a US\$ bank loan (note 11).

Equipment under capital lease at December 31 was:

(\$000's)	2008	2007
Equipment cost	2,475	2,416
Less: accumulated amortization	1,919	1,430
	556	986

Equipment under capital lease is amortized on a straight-line basis over its economic life of five years. The amount of equipment lease costs that were amortized in 2008 is \$489,000 (2007 - \$483,000).

10. LONG-TERM INVESTMENTS

Long-term investments are classified as available-for-sale securities and are carried at fair value. The Company recorded, for the year ended December 31, 2008, an unrealized loss on the long-term investments of \$Nil (2007 - \$2,055,000) which included an unrealized loss of \$Nil (2007 - \$4,255,000) for the valuation of the conversion rights which are considered embedded derivatives and recorded through earnings and an unrealized gain of \$Nil (2007 - \$2,200,000) for the increase in fair value of the debentures which is recorded in OCI, net of tax of \$Nil (2007 - \$352,000).

(\$000's)	2008	2007
Blue Note Mining Inc. unsecured convertible debenture	—	15,689
Taseko Mines Limited unsecured convertible debenture	—	17,233
	—	32,922

On August 29, 2008, the Company exercised its rights to convert the unsecured subordinated convertible debenture from Blue Note Mining Inc. (formerly Blue Note Metals Inc. together with its affiliates) ("Blue Note") to a 20% interest in the mineral properties and mine facilities which comprise the Caribou and Restigouche mines ("20% interest"). At December 31, 2008, based on the estimated undiscounted cash flow for the fair value of the 20% interest and the prevailing market conditions the investment was deemed to be impaired and was written off. The loss on the write-down of \$9,089,000 comprised a loss of \$10,970,000 which is recognized in the current year and an unrealized gain of \$1,881,000 recorded in income in prior periods. The loss for the current year of \$10,970,000 is net of an unrealized gain of \$4,746,000 that was reclassified from AOCI and is included in write-down of mineral properties and fixed assets on the consolidated statements of operations and retained earnings.

On April 2, 2008, the Company converted the \$17,000,000 unsecured convertible debenture from Taseko Mines Limited ("Taseko") for 3,307,393 shares at a conversion price of \$5.14. Taseko issued 2,612,971 shares to the Company and withheld 694,422 shares with a value of \$3,569,000 as a set off, as set out in a statement of claim (see note 23 (b)). On April 28, 2008, the Company filed an action with the Supreme Court of British Columbia seeking an order that Taseko pay to the Company \$3,569,000 being the cash equivalent of the 694,422 shares withheld at a conversion price of \$5.14 per share. In May 2008, the Company sold the 2,612,971 shares for \$13,350,000, net of commission and realized a gain on sale of \$8,914,000 which

comprises \$7,667,000 which is recognized in the current year and \$1,247,000 which was recorded in income in prior periods as unrealized gains. In September 2008, the Company was successful in its action and Taseko settled the order and paid the amount of \$3,569,000 being the cash equivalent of the 694,422 shares which were withheld. The Company recorded a realized gain of \$2,390,000 which comprises \$2,059,000 which is recognized in the current year and \$331,000 which was recorded in income in prior periods as unrealized gains. The realized gain for the current year includes an amount of \$8,255,000 of unrealized gains that was reclassified from AOCI.

11. SHORT-TERM DEBT

(\$000's)	2008	2007
Reimbursable government assistance, unsecured, non-interest bearing, current portion (note 12)	—	190
US\$ Bank Loan No.1	4,303	—
US\$ Bank Loan No.2	551	—
	4,854	190

In June 2008, Sociedad Contractual Minera El Toqui ("Toqui") a wholly-owned subsidiary of the Company obtained a bank loan ("US\$ Bank Loan No.1") for US\$4,000,000, for a one year term, repayable by instalments due on December 6, 2008 and June 6, 2009 of US\$500,000 and US\$3,500,000 respectively, plus interest and bears interest of 4.8%. Toqui has the option to request a renewal of the loan on June 6 each year for a one year period repayable by semi-annual instalments of US\$500,000 plus interest payable on June 6 and December 6 at the LIBOR rate for 180 days plus 1.2%. The option to request a renewal expires on June 6, 2012. In December 2008, an instalment of US\$500,000 plus interest of US\$95,000 was paid. The carrying value of the US\$ Bank Loan No.1 approximates its fair value. Interest expense for the year ended December 31, 2008 was \$114,000.

In December 2008, Toqui obtained an additional bank loan ("US\$ Bank Loan No.2") for US\$450,000, for a five month term, repayable in four monthly instalments of US\$50,000 and a final instalment of US\$250,000 plus interest and bears interest of 7.3% for the first instalment and thereafter at the LIBOR rate for 180 days plus 4%. The instalments plus interest are due on the 9th of each month with the first instalment being paid on January 9, 2009. The US\$ Bank Loan No.2 is secured by a charge against mobile equipment with an approximate value of US\$900,000. The carrying value of the US\$ Bank Loan No.2 approximates its fair value. Interest expense for the year ended December 31, 2008 was \$2,000.

12. LONG-TERM DEBT

(\$000's)	2008	2007
Reimbursable government assistance, unsecured, non-interest bearing	1,851	2,041
Less current portion	—	190
	1,851	1,851

The reimbursable government assistance is for Langlois and consists of an amount of \$500,000 (December 2007 - \$500,000) relating to Zone 97 and \$1,351,000 (December 2007 - \$1,541,000) for the installation of a hydro line. The amount of \$500,000 will be repaid with an instalment of \$200,000 on April 1, 2010 and two instalments of \$150,000 in the following two years and the amount of \$1,351,000 will be repaid by three annual instalments of \$300,000, the first of which is due on April 1, 2010, with a final instalment on April 1, 2012 of \$451,000. In March 2008, an instalment of \$190,000 was paid, reducing the loan for the installation of the hydro line from \$1,541,000 to \$1,351,000. The carrying value of the reimbursable government assistance approximates its fair value.

13. ROYALTY OBLIGATIONS

- In December 2007, the Company entered into a joint venture with the Myra Falls Mine Limited Partnership ("MFML Partnership") whereby the MFML Partnership is entitled to a revenue interest of production from the Myra Falls mine consisting of a 3% net smelter royalty. The MFML Partnership has deposited \$20,000,000 with a trustee into a qualifying environmental trust ("QET") as security for a portion of the reclamation obligations of NVI Mining Ltd., a wholly-owned subsidiary of the Company, which owns the Myra Falls mine. The \$20,000,000 was included in "Restricted reclamation

investments" and "Royalty obligations" on the consolidated balance sheets. A financing fee of \$1,000,000 was paid and was included in "Interest and financing" on the consolidated statements of operations and retained earnings.

On March 25, 2008, the Company exercised its right to purchase the interests of the limited and general partners of MFML Partnership for approximately \$18,180,000 (90.9% of the \$20,000,000 contribution to the QET). On April 10, 2008, the Company elected to purchase the interest by issuing 13,518,739 Common Shares at \$1.3448 which, pursuant to the agreement, was the 20-day weighted-average trading price of the Common Shares on the Toronto Stock Exchange the day before the exercise of the right. The Common Shares issued as part of the exercise of its rights were not freely tradeable until April 21, 2008.

Pursuant to the joint venture agreement entered into with the limited partners of the MFML Partnership in December 2007, the MFML Partnership was entitled to a 3% net smelter royalty from the Myra Falls mine.

The purchase of the MFML Partnership terminated the royalty obligation of \$20,000,000. The gain on the purchase of \$1,820,000 was allocated to contributed surplus. The amount allocated to share capital of \$18,146,000 is net of issue expenses of \$34,000.

- b) In December 2008, the Company entered into a royalty agreement ("2008 Third Royalty Agreement") with Red Mile Resources No. 5 Limited Partnership ("Red Mile No.5 - 2008") whereby the Company sold a basic royalty ("Third Basic Royalty") on a portion of the payable zinc production over the life of the Myra Falls mine. The Company received \$18,206,000 which included royalty income of \$15,970,000, prepaid indemnity fee income of \$1,091,000 and prepaid interest income of \$1,145,000.

In December 2005, the Company entered into a royalty agreement ("2005 Second Royalty Agreement") with Red Mile Resources No. 4 Limited Partnership ("Red Mile No.4") whereby the Company sold a basic royalty ("Second Basic Royalty") on a portion of the payable zinc production over the life of the Myra Falls mine. The Company received \$56,500,000 which included royalty income of \$50,500,000, indemnity fee income of \$1,141,000, interest income of \$4,469,000 and prepaid interest income of \$390,000.

In December 2004, the Company entered into a royalty agreement ("2004 First Royalty Agreement") with Red Mile Resources No. 5 Limited Partnership ("Red Mile No.5") whereby the Company sold a basic royalty ("First Basic Royalty") on a portion of the payable zinc production over the life of the Myra Falls mine. The Company received \$13,540,000, which included royalty income of \$11,979,000, indemnity fee income of \$564,000, interest income of \$520,000 and prepaid interest income of \$477,000.

Under the terms of the 2008 Third Royalty Agreement (2005 Second Royalty Agreement; 2004 First Royalty Agreement), the Company is required to make Third Basic Royalty (Second Basic Royalty; First Basic Royalty) payments at fixed amounts per pound of payable zinc produced, which escalates from \$0.003 per pound to \$0.075 per pound (Second Basic Royalty from \$0.0016 per pound to \$0.1373 per pound; First Basic Royalty from \$0.003 per pound to \$0.016 per pound) over the first 12 years of the agreement. In addition, for the years 2014 through 2018 (Red Mile No.4 years 2011 through 2015; Red Mile No.5 years 2010 through 2014), the Company granted Red Mile No.5 - 2008 a net smelter return of 1.00%, 1.25% or 1.40% (Red Mile No.4 a net smelter return of 1.50%, 2.25% or 3.00%; Red Mile No.5 a net smelter return of 0.4%, 0.5% or 0.7%) if the average price of zinc in a given calendar year exceeds US\$4,250, US\$4,500 or US\$4,750 per tonne (Red Mile No.4 average zinc prices US\$2,600, US\$2,800 or US\$3,000 per tonne; Red Mile No.5 average zinc prices of US\$2,250, US\$2,500 or US\$2,750 per tonne), respectively.

The Red Mile No.5 - 2008 royalty income component of \$15,970,000 (Red Mile No.4 - \$50,500,000; Red Mile No.5 - \$11,785,000) was placed with a financial institution for which the Company received a restricted promissory note. The restricted promissory note earns interest at 7% (Red Mile No.4 - 6%; Red Mile No.5 - 6%) per annum which is recorded in "Investment and other income" on the consolidated statements of operations and retained earnings and matures on February 15, 2018 (Red Mile No.4 - February 15, 2015; Red Mile No.5 - December 15, 2014). Pursuant to the 2008 Third Royalty Agreement, 2005 Second Royalty Agreement and the 2004 First Royalty Agreement, interest earned from the restricted promissory notes and a portion of the principal must be used to fund the expected basic royalty payments during the first ten years of each agreement.

Under certain circumstances, the Company has the right, by way of a call option, to acquire the partnership units of Red Mile No.5 - 2008, Red Mile No.4 and Red Mile No.5 for the lower of market value or the outstanding amount of the restricted promissory note at the end of the tenth year of the respective royalty agreements.

The royalty income received from Red Mile No.5 - 2008, Red Mile No.5 and Red Mile No.4 is accounted for as debt. The long-term portion is included in "Royalty obligations" and the current portion is included in "Accounts payable and accrued liabilities" on the consolidated balance sheets. The deemed interest rate for these amounts under the 2008 Third Royalty Agreement, 2005 Second Royalty Agreement and the 2004 First Royalty Agreement are 7.00%, 6.00% and 6.11% per annum respectively and the charges are included in "Interest and financing" on the consolidated statements of operations and retained earnings.

The prepaid interest income and the indemnity fee received under the 2008 Third Royalty Agreement, 2005 Second Royalty Agreement and the 2004 First Royalty Agreement have been recorded in "Deferred income" on the consolidated balance sheets and are being amortized into income over the life of the respective agreements reflected in "Investment and other income" on the consolidated statements of operations and retained earnings. As at December 31, 2008, prepaid interest income was \$4,246,000 (2007 - \$3,575,000) which included a short-term portion of \$447,000 (2007 - \$447,000) and deferred indemnity fee was \$2,125,000 (2007 - \$1,198,000). Total interest expense for the year ended December 31, 2008 was \$2,472,000 (2007 - \$3,796,000) and total interest income for the year ended December 31, 2008 was \$3,920,000 (2007 - \$4,243,000).

14. RECLAMATION, CLOSURE COST ACCRUALS AND OTHER ENVIRONMENTAL OBLIGATIONS

(\$000's)	2008	2007
Asset retirement obligations	24,293	32,874
Closure cost accruals	1,535	1,505
Other environmental obligations	2,700	5,369
	28,528	39,748
Less current portion	5,622	6,486
	22,906	33,262

Other environmental obligations represent expenditures required to complete modifications to the tailings facility at the Myra Falls mine. The Company expects to complete the required work by 2010. The estimated obligation was recorded and is being reduced by actual expenditures incurred. During the year ended December 31, 2007, the provision for other environment obligations was increased by \$3,233,000 for additional costs estimated to complete the modifications. The amount of \$3,233,000 was included in "Reclamation and closure costs" on the consolidated statements of operations and retained earnings for the year ended December 31, 2007. As at December 31, 2008, the expenditures since acquisition have been \$15,397,000 (2007 - \$12,728,000). The current portion of \$500,000 (2007 - \$1,600,000) is included in "Current portion of reclamation, closure cost accruals and other environmental obligations" on the consolidated balance sheets.

Asset Retirement Obligations

(\$000's)	
As at December 31, 2007	32,874
Change in timing of cash flow	(10,485)
Accretion (included in reclamation and closure costs)	2,240
Expenditures	(1,113)
Impact of foreign exchange	777
As at December 31, 2008	24,293
Less: current portion included in Current portion of reclamation, closure cost accruals and other environmental obligations	4,734
	19,559

The estimated amount of undiscounted cash flow required to satisfy the asset retirement obligations as at December 31, 2008, was \$97,806,000 (2007 - \$98,102,000). The expected timing of payments ranges from 2009 to 2111, and the credit-adjusted risk-free rates at which the estimated cash flow has been discounted to arrive at the obligation, ranges from 7.17% to 7.89% (2007 - 7.17% to 7.89%). The estimated amount of undiscounted cash flow for December 31, 2008, includes an amount of \$66,329,000 (2007 - \$66,329,000) which is for water treatment at Myra Falls in perpetuity.

15. EMPLOYEE FUTURE BENEFITS

The Company's unionized hourly employees at Myra Falls have a defined benefit pension plan with the employees' benefits under this plan specified by a collective agreement. The pension plan is a flat benefit plan which is not affected by future salary increases or cost escalations. The Company also provides post retirement pension supplements and non-pension benefits (extended health, dental, medical service plan and life insurance) for certain employees and former employees of Myra Falls. The dental, extended health and medical services plans are subject to possible future cost escalations. The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Actuarial reports for funding purposes valuing the defined benefit pension plan are prepared every three years using the accumulated benefit method, with December 31, 2007 being the most recent funding valuation and December 31, 2010 being the next required funding valuation. There is no required valuation for funding purposes for the post retirement pension supplements and benefits plans.

Effective April 1, 2008, the defined benefit pension plan was improved for active members, to increase the benefit rate for both past and future service from \$54 to \$55. The cost of this change has been included in the 2008 pension expense and year end disclosures.

The details of the Company's benefit plans as at December 31 are as follows:

	Pension Benefit Plans		Other Benefit Plans	
	2008	2007	2008	2007
Expected long-term rate of return on plan assets	7.0%	7.0%	n.a.	n.a.
Discount rate – net periodic benefit cost for plan year	5.50%	5.25%	5.50%	5.25%
Discount rate – accrued benefit obligation at December 31	7.50%	5.50%	7.50%	5.50%
Rate of compensation increase	n.a.	n.a.	n.a.	n.a.
Assumed health care cost trend rates at December 31:				
Initial health care cost trend rate	n.a.	n.a.	10.0%	12.0%
Cost trend rate declines to	n.a.	n.a.	5.0%	5.0%
Year that the rate reaches the rate it is assumed to remain at	n.a.	n.a.	2019	2015
Dental care rate of expense increase	n.a.	n.a.	4.0%	4.0%

	Pension Benefit Plans		Other Benefit Plans	
	2008	2007	2008	2007
(\$000's)				
Pension expense				
Current service cost	1,361	1,396	10	10
Interest cost on accrued benefit obligation	2,267	2,140	39	41
Actual return on pension fund assets	4,924	(700)	–	–
Actuarial (gains) losses on accrued benefit obligation	(1,185)	(1,259)	1,839	(4)
Plan amendments	621	–	–	–
Elements of benefit cost before adjustments for long-term nature of future benefit costs	7,988	1,577	1,888	47
Adjustments to recognize long-term nature of future benefit costs:				
Difference between expected return and actual return on plan assets	(7,370)	(1,643)	–	–
Difference between actuarial (gains) losses recognized and actual actuarial (gains) losses on benefit obligation	1,185	1,248	(1,869)	(23)
Difference between amortization of past service costs and actual plan amendments	(250)	216	61	61
Net periodic benefit cost	1,553	1,398	80	85

(\$000's)	Pension Benefit Plans		Other Benefit Plans	
	2008	2007	2008	2007
Accrued benefit obligations				
Balance, beginning of year	40,780	40,223	775	826
Current service cost	1,361	1,396	10	10
Interest cost	2,267	2,140	39	41
Benefits paid	(3,085)	(1,721)	(150)	(98)
Actuarial (gain) loss	(1,185)	(1,258)	1,839	(4)
Plan improvements	620	-	-	-
Balance, end of year	40,758	40,780	2,513	775
Plan assets				
Fair value, beginning of year	34,835	32,795	-	-
Actual return on plan assets	(4,925)	700	-	-
Employer contributions	3,306	3,061	150	98
Benefits paid	(3,085)	(1,721)	(150)	(98)
Fair value, end of year	30,131	34,835	-	-
Funded status				
Fair value of plan assets	30,131	34,835	-	-
Accrued benefit obligations	40,758	40,780	2,513	775
Plan deficit	(10,627)	(5,945)	(2,513)	(775)
Unamortized actuarial loss (gain)	9,178	2,993	1,672	(197)
Unamortized past service costs	1,113	864	183	243
Net accrued benefit liability	(336)	(2,088)	(658)	(729)

The assumed health care cost trend rates can affect the amounts reported for the health care plan:

(\$000's)	2008		2007	
	1 Percentage - Point increase	1 Percentage - Point decrease	1 Percentage - Point increase	1 Percentage - Point decrease
Effect on service cost	0.2	0.0	0.2	(0.3)
Effect on interest cost	0.6	(0.7)	1.0	(1.6)
Effect on year-end accrued benefit obligation	169.3	(156.8)	12.1	(11.3)

Plan Assets

The allocation of plan assets is set forth in the Investment Policy Statement. The Investment Policy Statement delegates authority to the Employee Benefits Committee to maintain and establish investment policies relating to the defined benefit plans. These policies and any changes to these policies are approved by the Board of Directors of a subsidiary of the Company. The subsidiary has adopted the following standards for the Employee Benefits Committee to follow when deciding how to invest the plan assets.

Assets shall be invested:

- in the sole interest of the plan participants and beneficiaries;
- with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and of like aims; and
- by diversifying the investments so as to minimize the risk of large losses as well as provide a reasonable rate of return on the assets.

The following table summarizes the pension plan's weighted-average asset allocation percentages by asset category:

(\$000's)	2008	2007
Money market	6%	7%
Fixed income	36%	37%
Equity	58%	56%
Total	100%	100%

The benefit plan assets are managed by a major insurance company and the Company has chosen to invest in their diversified fund which has a target investment allocation of 40% - 65% in equity and 35% - 60% in fixed income. The diversified fund invests in several of its segregated funds, which include Canadian and foreign stocks, Canadian bonds and mortgages to achieve diversification. The performance objective of the diversified fund is to exceed the median rate of return of a representative sample of comparable funds over rolling five-year periods. The assumption for the expected long-term rate of return on plan assets is based on the relative weighting of plan assets, the historical experience of the portfolio and the review of projected returns by asset class on broad, publicly traded equity and fixed-income indices.

Contributions

The Company expects to contribute \$2,934,000 to its defined benefit pension plan, \$372,000 to the retirement supplements and \$150,000 for its post-retirement benefit plans in 2009.

Estimated future benefit payments

(\$000's)	Defined benefit pension plan	Other benefits
2009	2,289	131
2010	2,466	154
2011	2,837	191
2012	3,188	241
2013	3,498	298
Aggregate of five years thereafter	20,403	2,289

Effective December 31, 2008, it was assumed that the mine will cease operations once reserves and resources have been exhausted, which is estimated to occur on December 31, 2020. As a result, in determining the accrued benefit obligation and current service cost for the Thirty-Year Retirement Supplement, the Voluntary Early Retirement Allowance and the non-pension post-retirement benefit plans, it was assumed that no benefits will be payable to current or future pensioners after December 31, 2020, as there will be no general revenues to fund these benefits. Prior to December 31, 2008, a closure date of December 31, 2011 was assumed.

No change was made to the Pension Plan assumptions as pension payments are assumed to continue after the mine ceases operations.

16. SHAREHOLDERS' EQUITY

Shareholders' equity consists of the following:

(\$000's)	2008	2007
Capital stock	212,374	188,726
Warrants (f)	8,538	8,540
Contributed surplus (notes 13(a) and 16(b))	4,925	2,029
Retained earnings	30,568	168,908
Accumulated other comprehensive income (loss)	3,257	(3,817)
	309,662	364,386

The Company is authorized to issue 200,000,000 preferred shares and an unlimited number of common shares ("Common Shares"). No preferred shares were issued or outstanding on December 31, 2008 and 2007.

Common shares issued:

(\$000's)	Number of shares	Amount \$
As at December 31, 2006	385,646	167,093
Private placement (a)	6,123	11,988
Exercise of warrants (e)	30,802	6,160
Exercise of warrants (f)	83	83
Reclassification of fair value of warrants exercised from "Warrants" (f)	-	21
Cancellation of shares (g)	(121)	(211)
Employee share option plan - proceeds of options exercised (b)	3,002	2,115
Value ascribed to options exercised under stock-based compensation (b)	-	1,124
Employee share purchase plan (c)	165	353
As at December 31, 2007	425,700	188,726
Renunciation of flow-through share tax value (a)	-	(2,160)
Issue of Common Shares for the acquisition of Metco (note 4)	7,000	7,264
Additional private placement costs (a)	-	(26)
Issue of Common Shares for the acquisition of Myra Falls Mine Ltd. Partnership (note 13(a))	13,519	18,146
Exercise of warrants (f)	6	6
Reclassification of fair value of warrants exercised from "Warrants" (f)	-	2
Employee share option plan - proceeds of options exercised (b)	47	26
Value ascribed to options exercised under stock-based compensation (b)	-	15
Employee share purchase plan (c)	571	375
As at December 31, 2008	446,843	212,374

a) In December 2007, the Company issued 6,122,449 flow-through Common Shares by way of private placement at a price of \$1.96 per Common Share exclusive of share issuance costs of \$12,000 to a wholly-owned subsidiary of Dundee Corporation ("Dundee"). The flow-through Common Shares had a four-month hold period. Dundee is a significant shareholder of the Company. The proceeds of the flow-through shares were used to finance exploration activities in Québec.

In March 2008, the Company renounced \$12,000,000 in Canadian exploration expenses to investors of flow-through Common Shares in 2007. The tax value of the renunciation has been recorded as a liability and charged against share capital. Since the Company has a valuation allowance, which reduces the future income tax assets, the valuation allowance has been reduced and an income tax recovery has been recognized in the consolidated statements of operation and retained earnings.

b) Share option transactions were as follows:

	Options (000's)	Weighted-average exercise price
As at December 31, 2006	9,535	\$1.00
Granted	2,360	2.38
Exercised	(3,002)	0.70
Forfeited	(403)	2.06
Expired	(310)	4.74
As at December 31, 2007	8,180	\$1.31
Granted	355	0.85
Exercised	(47)	0.55
Forfeited	(290)	2.08
Expired	(849)	1.87
As at December 31, 2008	7,349	\$1.19

As at December 31, 2008:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Outstanding (000's)	Weighted-average remaining contractual life	Weighted-average exercise price	Exercisable (000's)	Weighted-average exercise price
\$0.19 - \$0.50	2,011	2 years 141 days	\$0.32	2,011	\$0.32
\$0.51 - \$1.00	1,610	1 year 83 days	\$0.73	1,400	\$0.72
\$1.01 - \$1.50	1,467	2 years 131 days	\$1.13	1,440	\$1.13
\$1.51 - \$2.00	693	3 years 101 days	\$1.58	602	\$1.57
\$2.00 - \$2.50	331	3 years 52 days	\$2.09	217	\$2.09
\$2.51 - \$3.00	1,082	3 years 211 days	\$2.71	743	\$2.71
\$3.01 - \$3.50	50	315 days	\$3.19	50	\$3.19
\$3.51 - \$4.00	100	353 days	\$3.90	100	\$3.90
\$4.01 - \$4.30	5	1 year 9 days	\$4.30	5	\$4.30
	7,349			6,568	

Pursuant to the Share Option Plan, the Board of Directors have the authority to grant options, and to establish the exercise price of the option at the time each option is granted, at a price not less than the closing price of the Common Shares on the TSX on the trading day immediately preceding the date of the grant of such option.

Options issued after 2003 must be exercised no later than five years after the date of the grant, and options issued prior to 2003 must be exercised no later than ten years after the date of the grant and are subject to vesting provisions unless the Board of Directors of the Company determines otherwise. One third of the options become exercisable on each of: the date of granting such options; the first anniversary date of the date of granting such options; and, the second anniversary date of the date of granting such options.

The outstanding share options at December 31, 2008 expire at various dates between January 25, 2009 and August 11, 2013. The number of shares available for grants of options under the share option plan as at December 31, 2008, was 21,776,502.

On or after January 1, 2002, compensation expense for the stock-based compensation plan for employees under the Company's Share Option Plan has been determined based upon the fair value of awards granted. Stock-based compensation of \$1,091,000 (2007 - \$2,149,000) less the initial fair value of options exercised of \$15,000, (2007 - \$1,123,000), for a net amount of \$1,076,000 (2007 - \$1,026,000) was credited to "Contributed surplus" within shareholders' equity on the consolidated balance sheets. The proceeds of options exercised noted above were credited to "Capital stock" within shareholders' equity on the consolidated balance sheets.

The fair value of each option grant has been estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2008	2007
Weighted-average exercise price per Common Share	\$0.85	\$2.38
Weighted quoted market price per Common Share at date of grant	\$0.85	\$2.38
Weighted-average grant-date fair value price per Common Share	\$0.36	\$1.21
Expected life (years)	3.00	3.91
Risk free interest rate	3.31%	4.24%
Expected volatility	60%	64%
Dividend yield	0%	0%

- c) Under the Share Purchase Plan, employees of the Company who fall under a certain classification can contribute up to 10% of their annual basic salary to purchase Common Shares. All other employees who qualify under the Share Purchase Plan can contribute up to 5% of their annual basic salary to purchase Common Shares. The Company matches each participant's contribution. The purchase price per Common Share is the weighted-average of the trading prices of the Common Shares on the TSX for the calendar quarter in respect of which the Common Shares are issued. Common Shares acquired with the Company's contribution are held in trust and delivered to employees 12 months following their date of issue. The Company issued 571,000 Common Shares pursuant to the Share Purchase Plan during 2008 (2007 - 165,000). The number of shares authorized for issue and available for issue under the share purchase plan as at December 31, 2008 was 8,500,000 (2007 - 8,500,000) and 2,521,304 (2007 - 3,091,930) respectively.
- d) The Company's Share Bonus Plan permits Common Shares to be issued as a discretionary bonus to any director, full-time or part-time employee, officer or consultant of the Company, or any subsidiary thereof, who is designated under the Share Bonus Plan from time to time. As at December 31, 2008 and 2007, the Company had issued 1,200,000 Common Shares under the Share Bonus Plan and had available but unissued at December 31, 2008 3,800,000 Common Shares (2007 - 3,800,000 Common Shares).
- e) In consideration for restructuring a debt facility in 2001 and 2002, Dundee received warrants to purchase an aggregate of 30,801,410 Common Shares at \$0.20 per Common Share. One-half of these warrants were exercisable until March 2, 2007 and the remainder were exercisable until May 2, 2007. No value was ascribed to these warrants on the date of issue. On March 2, 2007 and March 14, 2007, Dundee exercised 15,400,705 and 15,400,705 warrants respectively to purchase 30,801,410 Common Shares at \$0.20 per Common Share. At December 31, 2007, none of these warrants were outstanding.
- f) On January 28, 2004, the Company completed the sale of 57,142,858 units to a syndicate of underwriters at a purchase price of \$0.70 per unit, for net proceeds of \$37,027,000, net of costs of issue of approximately \$2,973,000. Each unit consisted of one Common Share and one-half of one Common Share purchase warrant. Each whole warrant entitles the holder to acquire one Common Share at a price of \$1.00 at any time until January 28, 2009. The fair value of the warrants of \$7,211,000, net of costs of issue, is included in shareholders' equity on the consolidated balance sheets as "Warrants".
- On July 23, 2004, the Company acquired the Myra Falls mine for consideration which included 5,000,000 warrants exercisable at \$1.00 per Common Share with an expiry date of January 28, 2009. The fair value ascribed to the warrants of \$1,350,000 is included in shareholders' equity on the consolidated balance sheets as "Warrants".
- The above warrants are listed on the TSX and as at December 31, 2008 entitled warrants holders to acquire 33,481,849 (December 31, 2007 - 33,488,329) Common Shares of the Company (*note 27*). As at December 31, 2008, the fair value ascribed to the warrants at the date of issue, net of warrants exercised was \$8,538,000 (December 31, 2007 - \$8,540,000) which is included in shareholders' equity on the consolidated balance sheets.
- For the year ended December 31, 2008, the fair value of \$2,000 (December 31, 2007 - \$21,000) relating to warrants exercised was transferred from "Warrants" to share capital.
- g) In November 2000, the Company acquired Jascan Resources Inc. and as part of the purchase consideration issued 9,491,162 Common Shares at an ascribed value of \$1.75 per share. Under the agreement any unclaimed Common Shares would be held in trust for a period of six years ("expiration"). After the expiration date any unclaimed Common Shares would revert back to the Company. In April 2007, 120,747 unclaimed Common Shares were released to the Company and were subsequently cancelled and the subscribed value of the common shares of \$211,000 was transferred from share capital to contributed surplus.

17. INVESTMENT AND OTHER INCOME

(\$000's)	2008	2007
Gain on sale of investments	9,021	306
Gain on sale of Lapa royalties	6,350	-
Interest, indemnity fees and royalties	5,423	4,543
Interest income	2,064	4,749
Unrealized loss on mark-to-market on investments held for trading	(1,933)	(7,600)
Other	3,280	1,148
	24,205	3,146

18. OTHER NON-PRODUCING PROPERTY COSTS

Due to the depletion of mineral reserves, the Company closed the Nanisivik, Bouchard-Hébert and Bougrine mines in September 2002, February 2005 and September 2005 respectively. The Company also suspended operations at the Caribou mine in 1998. In 2008, \$1,668,000 (2007 - \$2,026,000) of care and maintenance costs were incurred on the Nanisivik, Bouchard-Hébert, Bougrine and Caribou mines.

In November 2008, the Company temporarily suspended operations at Langlois due to the decline in commodity prices and the general deterioration of the short-term economic outlook globally, which have mitigated the overall operational improvements in production and costs at this mine.

19. INCOME AND MINING TAXES

Income and mining taxes differ from the amount computed by applying the statutory federal income tax rate for the year ended December 31, 2008 of 33% (2007 - 35%) to net earnings, excluding income and mining taxes. The differences are summarized as follows:

(\$000's)	2008	2007
Tax (recovery) provision at statutory rate	(22,840)	17,551
Unrecognized tax benefit relating to losses	28,925	21,340
Reduction in valuation allowance	(2,160)	-
Different effective tax rates on losses in foreign subsidiaries	(668)	(13,254)
Cost of previously unrecognized losses available for carry forward	20,331	5,441
Permanent timing differences and other	19	(2,296)
Mining taxes	(5,074)	(2,180)
	18,533	26,602

As at December 31, the significant components of the Company's future tax assets (liabilities) were as follows:

(\$000's)	2008	2007
Future tax assets		
Loss carry forwards	30,247	33,187
Mineral properties and fixed assets	261,175	232,999
Reclamation and closure cost accruals	6,819	10,673
Deferred income	1,827	1,915
Future tax assets before valuation allowance	300,068	278,774
Valuation allowance	299,447	257,368
Future tax assets	621	21,406
Future tax liabilities		
Mineral properties - mining tax	(3,211)	(7,942)
Net future tax assets	(2,590)	13,464

(\$000's)	2008	2007
Income and mining tax provision		
Current income and mining tax provision	3,346	23,219
Future income and mining tax provision	15,187	3,383
	18,533	26,602

At December 31, 2008, the Company has net operating loss carry forwards in Canada of approximately \$106,000,000, which expire at various dates through 2018.

20. FINANCIAL INSTRUMENTS

Credit Risk

The Company is subject to credit risk through trade receivables. The Company manages this risk through evaluation and monitoring processes and carries credit insurance when necessary. Credit risk is further mitigated through the use of provisional payment arrangements and the use of letters of credit where appropriate. Credit risk also relates to derivative contracts arising from the possibility that a counterparty to an instrument in which the Company has an unrealized gain fails to perform. The Company does not consider the credit risk associated with these financial instruments to be significant.

Foreign Exchange Risk

The Company operates using principally the Canadian dollar and the US dollar, and may be negatively affected by fluctuations in foreign exchange rates. The Company manages this risk by minimizing the number of transactions that result in the settlement currency differing from the currency of the initial transaction. In addition, the Company's sales are denominated primarily in US dollars, while a significant percentage of its expenses are denominated in non-US dollars. This exposes the Company to increased volatility in earnings due to fluctuations in foreign exchange rates. The Company's hedging policy enables it to use forward foreign exchange contracts to hedge the exchange rates on identifiable foreign currency exposures. Gains and losses on these contracts when they are designated as hedges are reported as a component of the related transactions. The Company had no foreign exchange contracts outstanding at December 31, 2008 and 2007.

Commodity Price Risk

The profitability of the Company is directly related to the market price of metals produced. The Company may reduce price risk by hedging against the price of metals for a portion of its production. The main tools used to protect against price risk are forward contracts and options. Various strategies are available using these tools including spot deferred and synthetic puts.

The Company periodically enters into forward sales and options to effectively provide a minimum price for a portion of inventories and future production. In 2008 and 2007, the Company chose not to apply hedge accounting. As a result, outstanding derivative contracts were classified as held-for-trading and are carried at their fair value. Any gains and losses are recognized in the relevant period and included in "Gross sales revenue" on the consolidated statements of operations and retained earnings. The Company had no commodity hedges outstanding at December 31, 2008 and 2007.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. The Company's objectives and policies for managing capital are set out in note 2. The Company only invests in highly liquid investments with reputable counterparts and monitors its cash flow to ensure that there are adequate funds to meet its obligations. As at December 31, 2008, these consolidated financial statements have been prepared in accordance with Canadian GAAP applicable to a going concern (see note 1).

Interest Rate Risk

The Company normally invests in short-term interest-bearing financial instruments. A change in the interest rate would have a minimal effect on the profitability of the Company. At December 31, 2008, interest bearing liabilities amounted to \$4,854,000 with interest rates of between 4.8% and 7.3%.

Sensitivity

The Company's cash flow and net earnings are sensitive to the movement in a variety of prices and costs and are particularly sensitive to movements in the price of zinc, smelter treatment charges and the C\$/US\$ exchange rate. The following table provides the Company's estimates of the sensitivity of net income to changes in the various metal prices, smelter treatment charges and C\$/US\$ exchange rate movements based on realized prices and exchange rates for the twelve months ended December 31, 2008.

Variable	Realized price (US\$)	Change	Change to net earnings for the year ended December 31, 2008 (\$ 000s)
Zinc	1,882 per tonne	10%	11,469
Copper	6,042 per tonne	10%	2,723
Lead	1,930 per tonne	10%	2,090
Gold	873 per ounce	10%	2,542
Silver	14.69 per ounce	10%	2,547
Exchange rate (C\$/US\$)	1.0675	10%	11,266
Combined weighted-average treatment charges per dry metric tonne sold	369.18	10%	7,140

21. RELATED PARTY TRANSACTIONS

All related party transactions are disclosed elsewhere in these consolidated financial statements (*note 16*) except for the following:

- As at December 31, 2008 and 2007, management fees payable to Dundee totalling \$500,000 relating to \$250,000 in each of 2003 and 2002 are outstanding and are included in "Accounts payable and accrued liabilities" on the consolidated balance sheets.
- For the year ended December 31, 2008, consulting fees of \$Nil (2007 - \$50,000) were paid to Dundee Securities Corporation, an affiliate of Dundee.

22. GUARANTEES

- At December 31, 2008 and 2007, the Company has an outstanding letter of credit in the amount of \$250,000 which is renewable annually and relates to the operating lease at the Nanisivik mine (*note 5*).
- In consideration for the receipt of indemnity fees of \$564,000, \$1,141,000 and \$1,091,000 from Wilshire Financial Services Inc. ("Wilshire") related to the 2004 First Royalty Agreement (*note 13(b)*), the 2005 Second Royalty Agreement (*note 13(b)*) and the 2008 Third Royalty Agreement (*note 13(b)*) respectively, the Company has indemnified and holds harmless Wilshire from and against any and all losses based upon, arising out of, or otherwise in connection with or as a result of any claims relating to a breach or default by the Company under the 2004 First Royalty Agreement, the 2005 Second Royalty Agreement and the 2008 Third Royalty Agreement. As at December 31, 2008, the maximum liability was \$11,785,000 (2007 - \$11,785,000), \$50,500,000 (2007 - \$50,500,000) and \$15,970,000 (2007 - Nil) under the 2004 First Royalty Agreement, the 2005 Second Royalty Agreement and the 2008 Third Royalty Agreement respectively. The indemnity fees were deferred and are being amortized on a straight-line basis over the term of the respective agreements.

23. CONTINGENCIES AND COMMITMENTS

- a) On October 10, 2002, the Nunavut Water Board ("NWB") issued to the Company a renewal of its water license, for a period of 5.5 years commencing on October 1, 2002. One of the conditions contained in the water license renewal was a requirement that the Company guarantee the financial security required by the license. The NWB established that the amount of security required by the license was \$17,600,000. Three unsecured promissory notes were posted to satisfy the requirement for financial security set out in the water license.

The water license issued in 2002 expired in late 2008 and an application and review process is currently underway to secure a renewal license. In the interim, the conditions of the 2002 license remain in force. With the exception of the Nanisivik tank farm, which is still being discussed with the Department of National Defence and others, cleanup and remediation work at Nanisivik has been completed. As the renewal process for the water license proceeds and as the regulators are in a position to review and comment upon remediation efforts, there will be an opportunity for the Company to argue that the amount of financial security in place of \$17,600,000 should be drastically reduced to an amount more consistent with post closure monitoring only.

- b) Taseko and Gibraltar Mines Ltd. ("Gibraltar") had notified Boliden Westmin (Canada) Limited ("BWCL") (now a wholly-owned subsidiary of the Company) and others in 2001 about indemnification claims made by Gibraltar pursuant to the asset purchase agreement entered into in 1999, whereby Gibraltar acquired certain assets from BWCL on July 21, 1999.

In June 2006, Taseko and Gibraltar served a statement of claim on the Company and Boliden Ltd. (former parent corporation of BWCL). The claims were described as (a) latent tax liabilities estimated to be \$3,750,000 relating to an environmental reclamation deposit that was transferred to Gibraltar, and (b) potential tax liability estimated to be in excess of \$500,000 with respect to an employee severance trust (if this claim is successful, it exposes the Company to further direct liabilities which have not been quantified).

In December 2006, the Company filed a statement of defense on its own behalf and on behalf of Boliden Ltd. in accordance with the indemnification obligations pursuant to the share exchange agreement dated July 8, 2004 between the Company and Boliden Ltd. While a final outcome cannot be determined at this stage, the Company believes at this time that the claims are without substantial merit and that liability, if any, is not likely to have a material effect on the Company's financial position.

- c) In August, 2007, the Company and CanZinco Ltd. ("CanZinco"), a wholly-owned subsidiary of the Company, were added as defendants by counterclaim in a New Brunswick Court of Queen's Bench action by Merlin Group Securities Ltd., as Trustee of the Fern Trust (the "Fern Trust"). The Plaintiff and defendant by counterclaim in the action is Blue Note which acquired the Caribou mine in New Brunswick from CanZinco in August 2006 (see note 10). At issue in the action is a 10% net profit interest ("NPI") in the Caribou mine claimed by the Fern Trust. The claim against the Company and CanZinco, made in addition to the claim against Blue Note in the alternative, is for: (a) a declaration that CanZinco and the Company are liable to the Fern Trust for its interest in the NPI; (b) damages in the amount of \$40,000,000, or an amount calculated in accordance with the NPI based upon current market prices, whichever is greater, for breach of duties and obligations to the Fern Trust pursuant to the NPI, and; (c) prejudgment interest and costs of the action. On October 12, 2007, the Company and CanZinco served and filed statements of defence denying any liability whatsoever. The Company believes that this action is without merit and in any event expects to be indemnified by Blue Note under agreements entered into in connection with the Caribou mine sale transaction. The Company therefore anticipates that this claim is not likely to have a material effect on the Company's financial position.

- d) The Company claims that Blue Note is not in compliance with its obligations under the debenture and related documents and accordingly the 20% interest has not been conveyed to the Company. In addition to the current claims made against Blue Note by the Company and/or CanZinco, and claims made against the Company and/or CanZinco by Blue Note, there is current litigation between the Company, CanZinco and Blue Note which in part relates to this conveyance and joint venture obligation. The Company claims that Blue Note has an obligation prior to conveying the 20% interest to the Company to discharge or vacate liens and claims against the properties, other than claims specifically permitted under the agreements to which the Company is a party.
- e) The Company is also involved in other legal proceedings and claims, which arise in the ordinary course of its business. The Company believes these claims are without merit and is vigorously defending them. In the opinion of the management, the amount of ultimate liability with respect to these actions will not materially affect the financial position, results of operations or cash flow of the Company.

- f) The Company's mining and exploration activities are subject to various federal, provincial and state laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company conducts its operations so as to protect public health and the environment and believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations.

g) Lease Commitments

The Company is committed to payments for operating leases for business premises and equipment and future minimum lease payments under capital leases as follows:

(\$000's)	Operating Lease Payments	Future Minimum Lease Payments
2009	839	237
2010	617	161
2011	223	14
2012	102	-
Sub-total	1,781	412
Less: amount representing interest at rates ranging from 4.1% to 9.0%	n.a.	31
	1,781	381
Lease Obligations (\$000's)	2008	2007
Lease obligations	289	502
Less current portion included in accounts payable and accrued liabilities	164	235
	125	267

24. SEGMENT INFORMATION

The Company operates in the mining industry and has operating mines in Honduras (Mochito), Chile (Toqui), and Canada (Myra Falls and Langlois). The Langlois mine commenced commercial production on July 1, 2007. The Company has three mines which have been closed and are undergoing reclamation, two in Canada (Nanisivik and Bouchard-Hébert) and one in Tunisia (Bougrine). In November 2008, the Company temporarily suspended operations at Langlois and put the mine on care and maintenance.

The Company's operations produce a variety of concentrates for sale which are dependant on the particular mineralized deposits at each location and include zinc, copper, lead and gold concentrates some of which also contain silver and gold.

The accounting policies adopted by these segments are the same as those described in the Summary of Significant Accounting Policies (*note 2*). The products and services in each of the reportable segments, except for corporate activities, are essentially the same, the reportable segments have been determined at the level where decisions are made on the allocation of resources and capital, and where internal financial statements are available.

Segment Information

For the Year Ended December 31, 2008

(\$000's)								
Operating Segment	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Gross sales revenue	98,596	96,056	109,404	94,054	398,110	-	-	398,110
Treatment and marketing costs	(28,978)	(40,187)	(32,886)	(33,745)	(135,796)	-	-	(135,796)
Net revenue	69,618	55,869	76,518	60,309	262,314	-	-	262,314
Direct operating costs	(42,463)	(37,385)	(88,247)	(61,734)	(229,829)	-	-	(229,829)
Depreciation and depletion	(10,033)	(9,372)	(7,031)	(21,075)	(47,511)	-	(166)	(47,677)
Reclamation and closure costs	(1,314)	955	(1,466)	(80)	(1,905)	(1,453)	-	(3,358)
Contribution (loss) from mining activities	15,808	10,067	(20,226)	(22,580)	(16,931)	(1,453)	(166)	(18,550)
General and administrative	-	-	-	-	-	-	(12,423)	(12,423)
Interest and financing	-	-	-	-	-	-	(2,706)	(2,706)
Investment and other income	-	-	-	-	-	-	24,205	24,205
Foreign exchange and other	-	-	-	-	-	-	5,191	5,191
Exploration	(2,609)	(943)	(1,033)	(3,905)	(8,490)	(444)	(8,278)	(17,212)
Write-down of mineral properties and fixed assets	(8,327)	-	(25,300)	-	(33,627)	(1,282)	(11,569)	(46,478)
Other non-producing property costs	-	-	-	-	-	(1,668)	(166)	(1,834)
Net earnings (loss) before income and mining tax (provision) recovery	4,872	9,124	(46,559)	(26,485)	(59,048)	(4,847)	(5,912)	(69,807)
Income and mining tax (provision) recovery	(3,270)	(2,051)	(7,873)	(6,302)	(19,496)	-	963	(18,533)
Net earnings (loss)	1,602	7,073	(54,432)	(32,787)	(78,544)	(4,847)	(4,949)	(88,340)
Capital expenditures	28,091	20,890	3,670	24,992	77,643	-	(804)	76,839
Mineral properties and fixed assets	55,714	67,874	22,307	129,377	275,272	1,100	1,618	277,990
Identifiable assets	81,862	84,659	159,056	134,220	459,797	1,785	33,629	495,211

Information about major customers – Summary of net revenue from major customers for the year ended December 31, 2008.

Revenue Source					
(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Customer 1	5,832	15,216	32,441	671	54,160
Customer 2	35,925	4,554	-	-	40,479

Segment Information

For the Year Ended December 31, 2007

(\$000's)								
Operating Segment	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Gross sales revenue	130,005	114,785	134,666	24,879	404,335	-	-	404,335
Treatment and marketing costs	(23,252)	(40,245)	(31,347)	(5,444)	(100,288)	-	-	(100,288)
Net revenue	106,753	74,540	103,319	19,435	304,047	-	-	304,047
Direct operating costs	(32,540)	(28,262)	(83,667)	(17,145)	(161,614)	-	-	(161,614)
Depreciation and depletion	(4,374)	(4,311)	(8,839)	(5,032)	(22,556)	-	(235)	(22,791)
Reclamation and closure costs	(1,099)	(276)	(4,840)	(101)	(6,316)	(668)	-	(6,984)
Contribution (loss) from mining activities	68,740	41,691	5,973	(2,843)	113,561	(668)	(235)	112,658
General and administrative	-	-	-	-	-	-	(15,679)	(15,679)
Interest and financing	-	-	-	-	-	-	(5,117)	(5,117)
Investment and other income	-	-	-	-	-	-	3,146	3,146
Foreign exchange and other	-	-	-	-	-	-	(9,810)	(9,810)
Exploration	(2,919)	(2,734)	(3,328)	(4,313)	(13,294)	(744)	(2,998)	(17,036)
Write-down of mineral properties and fixed assets	-	-	(16,000)	-	(16,000)	-	-	(16,000)
Other non-producing property costs	-	-	-	-	-	(2,026)	(127)	(2,153)
Net earnings (loss) before income and mining tax (provision) recovery	65,821	38,957	(13,355)	(7,156)	84,267	(3,438)	(30,820)	50,009
Income and mining tax (provision) recovery	(19,132)	(5,919)	(18,890)	15,470	(28,471)	(67)	1,936	(26,602)
Net earnings (loss)	46,689	33,038	(32,245)	8,314	55,796	(3,505)	(28,884)	23,407
Capital expenditures	23,130	26,738	21,362	35,105	106,335	-	7,447	113,782
Mineral properties and fixed assets	34,848	41,152	60,915	116,452	253,367	5,233	8,862	267,462
Identifiable assets	57,202	66,714	222,895	138,534	485,345	6,818	117,409	609,572

Information about major customers – Summary of net revenue from major customers for the year ended December 31, 2007.

Revenue Source				
(\$000's)	Mochito	Toqui	Myra Falls	Total
Customer 1	32,481	28,556	7,146	68,183
Customer 2	19,892	-	34,844	54,736
Customer 3	19,640	3,903	24,712	48,255

25. ANALYSIS OF CHANGES IN NON-CASH WORKING CAPITAL ITEMS

(\$000's)	2008	2007
Accounts receivable -- concentrate	2,970	21,954
Other receivables	19,430	(12,743)
Concentrate inventory	39,656	(21,150)
Materials and supplies inventory	(4,239)	(8,703)
Prepaid expenses and other current assets	2,115	(3,685)
Income and mining tax receivable	(1,351)	—
Accounts payable and accrued liabilities	(14,278)	22,074
Provisional payments for concentrate inventory shipped and not priced	(43,604)	8,002
Income and mining taxes payable	(10,645)	637
	(9,946)	6,386

26. (LOSS) EARNINGS PER COMMON SHARE

Basic (loss) earnings per Common Share ("EPS") has been calculated using the weighted-average number of shares outstanding during the year. Incremental Common Shares on assumed exercise of options and warrants are not included in computing the diluted (loss) earnings per share amount for 2008, as the exercise of options would not have been dilutive. The calculation of diluted (loss) earnings per Common Share has been computed using the treasury stock method which assumes that options and warrants with an exercise price lower than the average quoted market price were exercised at the later of the beginning of the period, or time of issue. In applying the treasury stock method, options and warrants with an exercise price greater than the average quoted market price of the Common Shares are not included in the calculation of diluted earnings per Common Share as the effect is anti-dilutive. The average quoted market price of the Common Shares during 2008 was \$0.63 (2007 - \$2.33).

	2008	2007
Basic (loss) earnings per Common Share	(\$0.20)	\$0.06
Diluted (loss) earnings per Common Share	(\$0.20)	\$0.05
Basic weighted-average number of Common Shares outstanding (000's)	441,378	413,681
Incremental Common Shares on assumed exercise of options and warrants (000's)	—	28,089
Weighted-average number of Common Shares used for diluted (loss) earnings per Common Share (000's)	441,378	441,770

27. SUBSEQUENT EVENTS

The 33,481,849 outstanding warrants at December 31, 2008 expired on January 28, 2009 (note 16(f)).

Corporate Information

DIRECTORS

Garth A. C. MacRae ^{1, 3, 4, 6}
Chairman

Grant A. Edey ^{1, 5, 6}

Joanne Ferstman ^{1, 5}

Jonathan C. Goodman ^{4, 5}

Ned Goodman ²

John W. Ivany

W. Murray John ^{3, 5}

George E. Pirie ^{3, 5}

A. Murray Sinclair, Jr. ^{2, 4}

¹ Member of Audit Committee

² Member of Compensation Committee

³ Member of Hedging Committee

⁴ Member of Corporate Governance and Nominating Committee

⁵ Member of Environmental, Health and Safety Committee

⁶ Member of Special Committee

CORPORATE AND REGISTERED OFFICE

95 Wellington Street West
Suite 950
Toronto, ON
M5J 2N7

Tel: (416) 363-4798 Fax: (416) 363-1315

E-Mail: investorinfo@breakwater.ca

OFFICERS

George Pirie
President and Chief Executive Officer

Steven Hayes
Chief Commercial Officer

Fred Hermann
Chief Operating Officer

Dave Langille
Vice President, Finance & Chief Financial Officer

Bill Heath
Executive Vice President

Bert Boivin
Vice President, Canada

Bob Carreau
Vice President, CSR and Sustainability

Dr. Bob Cuttriss
Vice President, Technical Services

Daniel Goffaux
Vice President, Latin America

Torben Jensen
Vice President, Engineering

Ann Wilkinson
Vice President, Investor Relations
and Assistant Secretary

Lesley Duncan
Corporate Secretary

Leroy Fong
Controller

John Laurie
Treasurer

Shareholder Information

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.
100 University Ave.
9th Floor
Toronto, ON
M5J 2Y1

North America Toll-free
Tel: (800) 564-6253 Fax: (888) 453-0330

International
Tel: (514) 982-7555 Fax: (416) 263-9524

E-Mail: service@computershare.com

www.computershare.com

CO-TRANSFER AGENTS

Computershare Investor Services Inc.
510 Burrard Street
2nd Floor
Vancouver, BC
V6C 3B9

Computershare Trust Company N.A.
350 Indiana Street
Suite 800
Golden, Colorado
U.S.A. 80401

Tel: (303) 262-0600 Fax: (303) 262-0603

SHARES

Toronto Stock Exchange (TSX)
Symbol - BWR

WEBSITE

www.breakwater.ca





BREAKWATER
R E S O U R C E S L T D



Mixed Sources

Product group from well-managed
forests and other controlled sources
www.fsc.org Cert no. SW-COC-002854
© 1996 Forest Stewardship Council



Printed in Canada using vegetable based
inks on paper that is 100% recyclable.

The following is Exhibit "J" referred to in the Affidavit
of Robert C. Smith, sworn before me at the City of
Moncton in the Province of New Brunswick the
10th day of December, 2009.



A Commissioner of Oaths
Being a Solicitor



BREAKWATER
RESOURCES LTD

Third Quarter Report 2009

[Handwritten mark]



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

This management's discussion and analysis of financial condition and results of operations ("MD&A") of Breakwater Resources Ltd. (the "Company") should be read in conjunction with the Company's unaudited interim consolidated financial statements for the nine months ended September 30, 2009, and related notes thereto (the "third quarter 2009 financial statements") which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A should also be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2008, and related annual management's discussion and analysis, and the Amended and Restated Annual Information Form on file with the Canadian provincial and territorial securities regulatory authorities. Unless otherwise indicated, this MD&A has been prepared as of November 5, 2009. The reporting currency is Canadian dollars ("C\$" or "\$") and all amounts disclosed are in Canadian dollars unless otherwise indicated. Unless the context indicates otherwise, a reference to the "Company" in this MD&A means Breakwater Resources Ltd. and its subsidiaries and other entities owned or controlled, directly or indirectly, by the Company.

The Company is a mining, exploration and development company which produces zinc, copper, lead and gold concentrates. For the nine months ended September 30, 2009, the Company's concentrate production was derived from mines located in Canada, Chile and Honduras. The Company also owns base metal and gold exploration properties in Canada, Honduras, Chile and Tunisia. On November 2, 2008, the Company temporarily suspended operations at Langlois due to the decline in commodity prices and the general deterioration of the economic outlook globally. The temporary suspension of Langlois affects all aspects of the Company's financial results which makes comparisons between years difficult.

HIGHLIGHTS

The strategic focus by Management on cost containment, extraction of higher value mineralized material and prudent capital expenditures have resulted in a significant improvement in the balance sheet. The Company has protected future earnings by purchasing zinc put options leaving shareholders the benefit of higher zinc prices and the Company's financial position is significantly stronger than it was nine to twelve months ago.

The Company had earnings of \$6.5 million or \$0.01 per share in the third quarter of 2009 compared with a net loss of \$36.1 million or \$0.08 per share in the third quarter of 2008. Included in the \$6.5 million net earnings was \$1.6 million of price protection losses related to the purchase of put options to protect the minimum price on certain zinc sales while retaining further price increase exposure. The temporary suspension of operations at Langlois in the fourth quarter of 2008 significantly impacted quarter-over-quarter results. The change in the results quarter-over-quarter were primarily due to:

- \$29.4 million (US\$31.2 million) or 29% lower gross sales revenue due to a 38% decrease in concentrate sold
- \$18.5 million or 54% lower treatment and marketing costs primarily due to lower concentrate sales, more favourable smelter terms and lower freight rates
- \$21.1 million or 38% lower direct operating costs primarily due to lower concentrate sales and cost improvements at all operations
- \$18.0 million lower income and mining tax provisions primarily due to \$19.0 million of future tax assets written off in 2008 which did not recur in 2009
- \$11.0 million write-down of a 20% interest in the mineral properties and fixed assets at Caribou in 2008 which did not recur in 2009

Concentrate produced in the third quarter of 2009 decreased by 34,926 tonnes to 54,588 tonnes primarily due to a 30,501 tonne decrease related to Langlois being placed on care and maintenance and lower planned production at Myra Falls and Toqui partially offset by higher production at Mochito.

OUTLOOK

Mochito

Production at Mochito has been running ahead of budget as it relates to throughput and zinc contained in concentrate, on target for costs and behind target for silver and lead due to changes in the mining cycle resulting in the exploitation of lower grade areas. Accordingly, management now expects that silver contained in concentrate will be approximately 1.8 million ounces and that lead contained in concentrate will be approximately 13,000 tonnes.

Toqui

At Toqui, management has been exploring augmenting its 2.0 megawatts of installed hydro electric capacity with both additional hydro electric and wind power. Subsequent to the quarter end, an agreement was reached with a contractor to install an additional 1.65 megawatts of wind power. At a capital cost of US\$5.5 million, the project has a payback of approximately four and a half years and has been fully financed locally by term debt. As part of the project to install the wind turbines, application will be made to register this project under the Clean Development Mechanism which will enable Toqui to sell certified emission reductions, better known as carbon credits, in the market. Wind power will lower the Company's electrical costs going forward and help meet increased electrical requirements once the thickened tailings backfill plant is up and running. A used thickened tailings backfill plant has been dismantled and transported to Chile. This plant will enable Toqui to deposit thickened tails and allow pillar recovery in the future.

The wind power plant cost was not included in the capital expenditure projections previously provided.

Myra Falls

Production from the South Flank area commenced ahead of plan and this area will continue as a significant source of mill feed for the balance of 2009 and 2010. Operating costs per tonne milled were expected to meet projections, while metals in concentrates were expected to be approximately 31,500 tonnes for zinc, 3,500 tonnes for copper and 557,000 ounces of silver compared with previous guidance.

On November 4, 2009 a fire occurred in the production hoist. The fire was contained and there were no injuries. However, an electrical switch gear was destroyed in the fire rendering the production hoist currently unusable. The Company is currently assessing the impact of the damage and its effect on near term production and costs.

The collective bargaining agreement at Myra Falls expired on September 30, 2009. On November 4, 2009 at 6:30pm (PST), the Company was served with 72 hour strike notice and the union is in a legal strike position effective November 7, 2009 at 6:30pm (PST).

Langlois

The rally in zinc prices from their lows earlier this year has prompted the Company to actively review the economics of a reopening plan for Langlois which contemplates six months of preproduction development work. The recent strength in the Canadian dollar has somewhat offset the rise in zinc prices.

STATEMENT OF OPERATIONS REVIEW – THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008

Gross Sales Revenue

Sales of concentrate fluctuate period-to-period due to production levels, shipping volumes, ship schedules, price determination terms, and risk and title transfer terms with the Company's various customers. The Company has a relatively conservative revenue recognition policy (see below) and the recognition of sales can be as much as six months after the date of concentrate production. The Company's sales are primarily denominated in United States dollars ("US\$").

Concentrate Sold (tonnes)	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Zinc				
Mochito	18,661	18,251	46,407	41,389
Toqui	10,048	10,185	37,055	56,870
Myra Falls	11,645	19,574	39,588	47,164
Langlois ⁽¹⁾	–	22,310	3,618	52,652
	40,354	70,320	126,668	198,075
Copper				
Myra Falls	5,140	4,737	14,375	14,064
Langlois ⁽¹⁾	–	3,462	321	7,666
	5,140	8,199	14,696	21,730
Lead				
Mochito	6,101	4,720	16,510	14,059
Toqui	697	3,323	1,120	4,741
	6,798	8,043	17,630	18,800
Gold				
Toqui	2,298	1,416	5,309	3,702
Myra Falls	–	–	9	–
	2,298	1,416	5,318	3,702
All Metals	54,590	87,978	164,312	242,307

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

	Third Quarter 2009				Third Quarter 2008			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (US\$000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (US\$000's)
Zinc	40,354	17,613	1,678	29,549	70,320	31,302	1,830	57,290
Copper	5,140	1,203	5,115	6,153	8,199	1,633	7,299	11,919
Lead	6,798	4,034	2,037	8,216	8,043	4,487	1,886	8,461
Gold ⁽²⁾	2,298	10,981	957	10,511	1,416	9,082	871	7,907
Silver	n.a.	847,480	14.57	12,352	n.a.	721,541	15.45	11,151
Price protection loss	n.a.			(1,476)	n.a.			–
Other ⁽³⁾	n.a.			122	n.a.			(114)
	54,590				87,978			
Gross sales revenue in US\$				65,427				96,614
Exchange rate				1.0947				1.0454
Gross sales revenue in C\$				71,622				101,004

⁽¹⁾ Payable metal and realized prices for zinc, copper and lead are per tonne and for gold and silver are per ounce.

⁽²⁾ Gold concentrate sales are principally from Toqui while payable metal is from all operations except Mochito.

⁽³⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Concentrate sold decreased 38% in the third quarter of 2009 compared with the third quarter of 2008. The 33,388 tonne decrease in 2009 was primarily due to the impact of the temporary care and maintenance at Langlois (25,772 tonnes sold in the third quarter of 2008) and 1,881 and 7,526 fewer tonnes of concentrate sold at Toqui and Myra Falls respectively partially offset by 8% more tonnes at Mochito. In payable metal terms, zinc, copper and lead decreased by 44%, 26% and 10% respectively while gold and silver sales increased by 21% and 17% respectively.

Realized prices denominated in US\$ increased for lead and gold by 8% and 10% respectively in the third quarter of 2009 while zinc, copper and silver decreased by 8%, 30% and 6% respectively. The Company periodically hedges against fluctuations in metal prices and foreign exchange rates using forward sales or options. The Company has not applied hedge accounting historically; therefore, mark-to-market gains or losses have been included in gross sales revenue at the end of each period.

During the third quarter of 2009, the Company purchased zinc put options at a cost of \$0.9 million to guarantee a minimum price on a portion of its zinc production for 2010. During the third quarter of 2009, the Company recorded a \$1.6 million loss in gross sales revenue related to the marking-to-market of the puts outstanding at September 30, 2009 and the expiry of put option contracts in the third quarter. The put options outstanding at September 30, 2009 had a fair market value of \$0.5 million and their value is recorded in other receivables. At September 30, 2009, the Company's zinc put option position consisted of:

Period	Tonnes	Strike price per tonne (weighted average)
Q4 2009	7,200	US\$1,362
Q1 2010	4,200	US\$1,543
Q2 2010	4,200	US\$1,543

Gross sales revenue decreased by US\$31.2 million or 32% in the third quarter of 2009 primarily due to the 38% decline in sales volumes noted above. A weaker C\$ resulted in an increase in the average C\$/US\$ exchange rate of 5%. In C\$ terms, gross sales revenue decreased \$29.4 million or 29% compared with the third quarter of 2008.

The Company's revenue recognition policy requires that, among other things, final pricing of concentrate inventories be known prior to the recognition of revenue. Using commodity prices and exchanges rates prevailing at September 30, 2009, the following schedule provides details regarding inventories shipped but not recognized for revenue purposes and the related provisional payments.

	Net smelter Concentrate (DMT)	Inventory return (\$'000's)	Earnings Provisional value (\$'000's)	Weighted-average before taxes (\$'000's)	payments (\$'000's)	months to settlement
Zinc	8,091	5,217	3,584	1,633	793	1.9
Copper	1,926	4,073	3,315	758	-	1.0
Gold	1,452	3,796	2,465	1,331	1,113	1.4
	11,469	13,086	9,364	3,722	1,906	

As at September, 2008, the Company estimated that inventories shipped but not recognized for revenue purposes had earnings before tax of \$2.9 million consisting of \$33.0 million of net smelter return less \$30.1 million of inventory value on 40,041 tonnes of concentrate.

The following table provides the average base and precious metal prices and exchange rates for the periods indicated.

Average Metal Prices & Foreign Exchange Rate	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Zinc (US\$/tonne)	1,761	1,770	1,469	2,105
Copper (US\$/tonne)	5,859	7,680	4,650	7,973
Lead (US\$/tonne)	1,928	1,912	1,528	2,373
Gold (US\$/ounce)	960	869	931	898
Silver (US\$/ounce)	14.70	15.03	13.68	16.63
C\$/US\$ exchange rate	1.0976	1.0417	1.1694	1.0188

Treatment and Marketing Costs

Treatment and marketing costs decreased 54% to \$15.5 million in the third quarter of 2009 from \$33.9 million in the third quarter of 2008 primarily due to the 38% decrease in concentrate sold, lower freight rates and more favourable smelter terms. Treatment and marketing costs for the third quarter of 2009 were 22% of gross revenue compared with 34% in 2008. See details of treatment and marketing under each mine's Expenses in the Production Results section of this MD&A.

Direct Operating Costs

Direct operating costs were 38% lower in the third quarter of 2009 at \$34.0 million compared with \$55.0 million in the third quarter of 2008. The decreased costs were primarily due to lower concentrate sales and the temporary suspension of Langlois. Also see details of direct operating costs under each mine's Expenses in the Production Results section of this MD&A.

Depreciation and Depletion

Depreciation and depletion decreased \$5.9 million or 43% in the third quarter of 2009 compared with the corresponding period in 2008. The decrease was primarily due to the temporary suspension of Langlois, lower concentrate sales and lower asset base at Myra Falls due to the \$25.3 million write-down at December 31, 2008. Also see details of depreciation and depletion costs under each mine's Expenses in the Production Results section of this MD&A.

Reclamation and Closure Costs

Reclamation and closure costs decreased by \$1.1 million to \$0.9 million in the third quarter of 2009 compared with \$2.0 million in the corresponding period in 2008 primarily due to a \$1.1 million expense at Bouchard-Hébert which did not recur in 2009.

General and Administrative

General and administrative expenses decreased by \$1.3 million or 34% in the third quarter of 2009 compared with 2008 primarily due to lower bonus accruals, salary and benefits, corporate development, legal and audit fees.

Investment and Other Income

Investment and other income was \$2.6 million in the third quarter of 2009 compared with \$8.5 million in 2008. The \$5.9 million swing was primarily due to a realized gain on sale of investment of \$4.1 million and a \$2.1 million unrealized gain on the mark-to-market of investments both in the third quarter of 2008.

Foreign Exchange and Other

The \$2.9 million change in foreign exchange and other was primarily due to the weaker C\$ at September 30, 2009 compared with September 30, 2008.

Exploration

Exploration expenses decreased by \$4.6 million in the third quarter of 2009 compared with 2008. Significantly lower expenses at corporate, Mochito and Langlois accounted for the decrease.

Other Non-Producing Property Costs

Other non-producing property costs increased by \$1.0 million for the third quarter of 2009 compared with the equivalent period in 2008 primarily due to \$1.2 million of care and maintenance costs at Langlois.

Income and Mining Tax Provision

In the third quarter of 2009, income and mining tax provision decreased by \$18.0 million compared with the respective 2008 period primarily due a \$19.0 million write-off of tax assets at Myra Falls and Langlois in 2008 and reduced tax provisions at Mochito partially offset by an increased tax provision at Toqui.

LIQUIDITY AND FINANCIAL POSITION REVIEW

Working Capital

Working capital at the September 30, 2009 was \$63.3 million compared with \$29.2 million at December 31, 2008, an increase of \$34.1 million.

Current Assets

Total current assets decreased \$3.4 million to \$97.9 million at September 30, 2009 compared with December 31, 2008. The main components of the current asset change were:

- Restricted cash increased by \$5.8 million due to a loan to finance a wind power plant at Toqui for which collateral arrangements had not yet been finalized at September 30, 2009 and the related cash was therefore restricted
- Concentrate inventory increased by \$3.4 million due to increased concentrate inventories at Toqui partially offset by the elimination of concentrate inventories at Langlois
- Materials and supplies inventory decreased by \$4.7 million primarily due to lower supplies inventories at Mochito and Toqui and disposals of certain inventories at Langlois

Current Liabilities

Current liabilities decreased by \$37.5 million to \$34.6 million at September 30, 2009 compared with December 31, 2008. The main components of the current liabilities change were:

- Accounts payable and accrued liabilities decreased by \$26.5 million primarily due to a decrease of \$11.0 million of provisional payments refundable to customers, \$7.4 million decrease at Langlois related to the temporary suspension of operations and \$3.8 million and \$2.2 million lower payables at Mochito and Myra Falls respectively
- Provisional payments for concentrate inventory shipped and not priced, which represent payments received for concentrate shipments that were not recognized as revenue, decreased by \$8.6 million. Refer to the table in Gross Sales Revenue section of this MD&A for additional details

Provisional payments for concentrate inventory shipped and not priced are based on prices prevailing on the date of payment. Recognition of sales can be as much as six months after the date of concentrate production based on contract terms. In the event that prices deteriorate significantly, a portion of the provisional payment may have to be repaid to the customer.

Restricted Reclamation Investments

At September 30, 2009, the Company had restricted reclamation investments of \$31.5 million compared with \$35.0 million at December 31, 2008. Reclamation deposits of \$10.9 million and \$20.6 million are held under a safe keeping agreement and a trust indenture respectively to fund future reclamation requirements at Myra Falls.

Restricted Promissory Notes

The Company held four restricted promissory notes at September 30, 2009 totalling \$105.7 million compared with three restricted promissory notes totalling \$80.9 million at December 31, 2008. All promissory notes are related to Myra Falls royalty transactions¹ completed in 2004, 2005, 2008 and 2009. The interest earned and a portion of the principal of these restricted promissory notes will be used to meet the Company's royalty obligations.

Deferred Income

Deferred income of \$6.8 million at September 30, 2009 consisted of deferred indemnity agreement fees and prepaid interest income related to the Myra Falls royalty transactions¹ in 2004, 2005, 2008 and 2009 which will be recognized as income over the terms of the four agreements.

¹ For further information on the Myra Falls royalty please see the Company's most recent audited consolidated financial statement filed on SEDAR at www.sedar.com or available on the Company's website at www.breakwater.ca.

Royalty Obligations

The royalty obligations of \$101.9 million at September 30, 2009 relate to the royalty amounts received from the 2004, 2005, 2008 and 2009 Myra Falls royalty transactions¹. See restricted promissory notes above.

Long-term Debt

Long-term debt increased by \$7.1 million to \$9.0 million primarily due to a \$5.9 million (US\$5.5 million) loan entered into the third quarter of 2009 to finance a wind power plant at Toqui and the movement of a certain debt from short-term to long-term.

Reclamation, Closure Cost Accruals and Other Environmental Obligations

Reclamation, closure cost accruals and other environmental obligations represent the Company's obligation for reclamation and severance costs accrued for its mine sites. At September 30, 2009, total reclamation, closure cost accruals and other environmental obligations were \$30.5 million compared with \$28.5 million at December 31, 2008.

Of the \$30.5 million, \$5.2 million is classified as current and is expected to be spent over the next 12 months at Nanisivik, Bouchard-Hébert, Bougrine and Myra Falls. The Company spent \$0.6 million in reclamation and closure costs in the third quarter of 2009 compared with \$1.3 million in the third quarter of 2008. As there is currently no law, regulation or contract in Honduras related to reclamation and closure costs, GAAP does not permit the Company to set up a liability for reclamation at the Mochito mine. Closure and reclamation costs for Mochito are estimated to be \$7.1 million (US\$6.6 million).

Reclamation and Closure Cost Accruals and Other Environmental Obligations at September 30, 2009

(\$ millions)	Current	Long-term	Total
Myra Falls	0.7	19.2	19.9
Mochito ⁽¹⁾	0.0	1.3	1.3
Toqui	0.0	2.9	2.9
Langlois	0.0	1.1	1.1
Bouchard-Hébert	2.5	0.1	2.6
Nanisivik	1.4	0.4	1.8
Bougrine	0.6	0.3	0.9
Total	5.2	25.3	30.5

⁽¹⁾ Reclamation and closure cost accruals for Mochito relate to accrued severances.

Future Income Tax Liabilities

Future income tax liabilities increased \$2.4 million to \$5.6 million at September 30, 2009. The increase was primarily due to a \$2.2 million increase in Québec mining duties at Langlois in 2009 partially offset by a \$0.3 million decrease at Toqui related to timing differences.

¹ For further information on the Myra Falls royalty please see the Company's most recent audited consolidated financial statement filed on SEDAR at www.sedar.com or available on the Company's website at www.breakwater.ca.

Shareholders' Equity

Shareholders' equity at September 30, 2009 was \$311.3 million compared with \$309.7 million at December 31, 2008. The increase of \$1.6 million was primarily due to the Company closing a public offering for gross proceeds of \$23.0 million in April 2009 (the "Offering") partially offset by a net loss of \$4.6 million and an other comprehensive loss of \$16.0 million.

Shareholders' Equity (\$'000's)	Capital stock	Warrants	Contributed surplus	Retained earnings	Other comprehen- sive income	Total shareholders' equity
As at December 31, 2008	212,374	8,538	4,925	80,568	3,257	309,662
Common Shares issued to a third party	12	-	-	-	-	12
Unit offering	16,865	4,519	-	-	-	21,384
Value ascribed to options exercised under stock-based compensation	21	-	(21)	-	-	-
Expiry of Warrants	-	(8,538)	8,538	-	-	-
Exercise of Warrants	5	(1)	-	-	-	4
Employee share option plan - proceeds of options exercised	29	-	-	-	-	29
Employee share purchase plan	243	-	-	-	-	243
Stock-based compensation	-	-	432	-	-	432
Other comprehensive loss	-	-	-	-	(15,959)	(15,959)
Loss	-	-	-	(4,551)	-	(4,551)
As at September 30, 2009	229,549	4,518	13,874	76,017	(12,702)	311,256

In the first nine months of 2009, the Company issued the following Common Shares: 230,000,000 Common Shares and 115,000,000 warrants pursuant to the Offering; 100,000 Common Shares to a third party; 1,821,765 Common Shares pursuant to the Company's employee share purchase plan and 150,000 Common Shares pursuant to the Company's share option plan. The 33,481,849 warrants outstanding at December 31, 2008 expired on January 28, 2009.

Capital Expenditures

The Company invested \$18.1 million in mineral properties and fixed assets in the first nine months of 2009. At mining operations, \$9.4 million, \$6.9 million, \$1.1 million and \$0.1 million were invested at Mochito, Toqui, Myra Falls and Langlois respectively. For details of these expenditures, please refer to the financial results discussion for each mine. Corporate capital expenditures of \$0.5 million primarily related to earn-in payments made on certain joint venture properties.

Financial Capability

With the existing working capital, the current metal prices and current C\$/US\$ exchange rate, the Company expects to be able to carry out its operating, capital, exploration and environmental programs in 2009. The Company's financial capability is sensitive to operating performance, metal prices, smelter treatment charges and the C\$/US\$ exchange rate.

PRODUCTION RESULTS

The table below contains the Company's production for the periods presented. On November 2, 2008, the Company temporarily suspended operations at Langlois due to the decline in commodity prices and the general deterioration of the economic outlook globally.

All Mines	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Tonnes Milled	436,287	596,713	1,247,614	1,786,013
Zinc (%)	6.0	7.4	5.7	6.7
Concentrate Production (tonnes)				
Zinc				
Mochito	17,584	14,191	48,213	41,559
Toqui	10,498	16,243	30,866	49,523
Myra Falls	15,669	17,539	40,289	51,890
Langlois ⁽¹⁾	—	26,561	—	60,693
	43,751	74,534	119,368	203,665
Copper				
Myra Falls	3,079	4,495	10,602	17,530
Langlois ⁽¹⁾	—	3,940	—	9,186
	3,079	8,435	10,602	26,716
Lead				
Mochito	4,912	4,912	14,880	13,922
Toqui	413	1,362	1,582	4,202
	5,325	6,274	16,462	18,124
Gold				
Toqui	2,433	271	6,469	1,346
Myra Falls	—	—	2	—
	2,433	271	6,471	1,346
Total	54,588	89,514	152,903	249,851
C\$ operating costs, production basis (\$000's)	28,092	46,103	89,157	152,535
C\$ operating cost per tonne milled (production basis)	64	77	71	85

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Concentrate produced in the third quarter of 2009 decreased by 39% to 54,588 tonnes primarily due to Langlois being placed on care and maintenance during the fourth quarter of 2008 as well as lower planned zinc concentrate production at Toqui and Myra Falls, lower lead concentrate production at Toqui and lower copper concentrate production at Myra Falls.

Aggregate operating costs and operating costs per tonne milled decreased in the third quarter of 2009 compared with 2008 due to the temporary suspension of Langlois and reduced operating costs at Toqui and Myra Falls partially offset by the impact of a weaker C\$. Also see details under each mine's production in the respective production results section of this MD&A.

The table below summarizes the Company's metal contained in concentrate, before smelting deductions, for periods presented.

Metal in Concentrate	Third Quarter			First Nine Months		
	2009	2008	%	2009	2008	%
Zinc (tonnes)						
Mochito	9,284	7,594	22%	25,686	21,992	17%
Toqui	5,077	8,064	-37%	14,820	24,474	-39%
Myra Falls	8,475	9,615	-12%	21,788	28,103	-22%
Langlois ⁽¹⁾	—	14,366	n.a.	—	32,574	n.a.
	22,836	39,639	-42%	62,294	107,143	-42%
Copper (tonnes)						
Myra Falls	789	1,057	-25%	2,457	4,129	-40%
Langlois ⁽¹⁾	—	742	n.a.	—	1,713	n.a.
	789	1,799	-56%	2,457	5,842	-58%
Lead (tonnes)						
Mochito	3,146	3,315	-5%	9,673	9,240	5%
Toqui	223	763	-71%	853	2,126	-60%
	3,369	4,078	-17%	10,526	11,366	-7%
Gold (ounces)						
Toqui	10,191	3,718	174%	30,977	13,327	132%
Myra Falls	4,019	2,996	34%	9,652	11,124	-13%
Langlois ⁽¹⁾	—	494	n.a.	—	1,227	n.a.
	14,210	7,208	97%	40,629	25,678	58%
Silver (ounces)						
Mochito	462,024	479,617	-4%	1,314,046	1,462,986	-10%
Toqui	51,325	84,048	-39%	181,912	248,558	-27%
Myra Falls	156,443	159,760	-2%	355,699	526,331	-32%
Langlois ⁽¹⁾	—	88,905	n.a.	—	255,439	n.a.
	669,792	812,330	-18%	1,851,657	2,493,314	-26%

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Aggregate production of zinc in concentrate in the third quarter of 2009 was 42% lower at 22,836 tonnes. The decrease in zinc production was primarily due to Langlois being placed on care and maintenance as well as planned lower production from Toqui and Myra Falls partially offset by higher production from Mochito. Production of copper in concentrate decreased 56% in the third quarter of 2009 due to fewer tonnes milled at Myra Falls and no production from Langlois. Production of lead in concentrate decreased 17% in the third quarter of 2009 due to lower lead grades at Mochito despite more tonnes milled and lower planned lead production at Toqui. Gold in concentrate increased 97% in the third quarter of 2009 due to higher production from Myra Falls and the planned increase in milling of gold material at Toqui. Silver in concentrate decreased 18% primarily due to lower silver grades at Mochito and Toqui and no production from Langlois.

MOCHITO

(i) Mochito Financial Results

(\$'000's)	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Gross sales revenue	35,918	27,009	71,608	78,185
Treatment and marketing costs	(7,279)	(8,546)	(20,717)	(22,045)
Net revenue	28,639	18,463	50,891	56,140
Direct operating costs	(14,319)	(10,503)	(31,841)	(27,154)
Depreciation and depletion	(5,355)	(2,504)	(11,954)	(6,283)
Reclamation and closure costs	(314)	(391)	(1,010)	(925)
Contribution from mining activities	8,651	5,065	6,086	21,778
Exploration	(112)	(821)	(319)	(1,788)
	8,539	4,244	5,767	19,990
Income and mining tax provision	(811)	(1,206)	(1,006)	(5,198)
Net earnings	7,728	3,038	4,761	14,792
Capital expenditures	3,116	5,820	9,424	19,776

Revenue:

The following tables and discussion provide details of Mochito's gross sales revenue for the periods indicated:

	Third Quarter 2009				Third Quarter 2008			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)
Zinc	18,661	8,336	1,726	14,389	18,251	8,044	1,782	14,332
Lead	6,101	3,689	2,046	7,547	4,720	2,910	1,891	5,503
Silver	n.a.	737,068	14.70	10,835	n.a.	410,851	14.70	6,040
Other ⁽²⁾	n.a.			117	n.a.			
	<u>24,762</u>				<u>22,971</u>			
Gross sales revenue in US\$				32,888				25,875
Exchange rate				1.0921				1.0438
Gross sales revenue in C\$				<u>35,918</u>				<u>27,009</u>

⁽¹⁾ Payable metal and realized price(s) for zinc and lead are per tonne and for silver is per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Concentrate sold in the third quarter of 2009 was 8% higher due to the timing of shipments. The increase and mix of concentrates sold resulted in a 27% rise in gross sales revenues in US\$ terms. A weakening of the C\$ resulted in gross sales revenue in C\$ terms increasing by 33% in the third quarter of 2009.

Expenses:

Aggregate treatment and marketing costs quarter-over-quarter decreased 15% primarily due to more favourable smelter terms and lower freight rates partially offset by a weaker C\$ and the increase in concentrate sold.

Direct operating costs increased \$3.8 million or 36% in the third quarter of 2009 due to the 8% increase in concentrate sold and higher hydro rates, labour costs and ground control costs. Direct operating cost per tonne of concentrate sold were \$578 in the third quarter of 2009 compared with \$457 in 2008 primarily due to the factors noted above.

Depreciation and depletion for the third quarter of 2009 increased \$2.9 million or 114% when compared with 2008 largely due to the higher quantity of concentrate sold, depreciation of capital spares and lower reserves used for depletion purposes.

Exploration expenses in the third quarter of 2009 were \$0.7 million lower compared with the respective period in 2008. Please refer to the drilling section below for additional details.

Income and mining tax provision for the third quarter of 2009 decreased by \$0.4 million compared with the respective period in 2008 principally due to changes in foreign exchange adjustments which are not tax effected.

Capital Expenditures:

At Mochito, \$9.4 million was invested in the first nine months of 2009 primarily as follows: \$3.6 million for mine development; \$1.7 million for spare parts for mining equipment, \$1.1 million for road construction and \$1.3 million for tailings facilities.

(ii) Mochito Production

Mochito's production is set out in the following table.

	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Tonnes Milled	193,479	160,427	539,012	484,762
Zinc (%)	5.4	5.3	5.4	5.1
Lead (%)	2.0	2.5	2.2	2.3
Silver (g/t)	88	105	89	106
Concentrate Production				
Zinc (tonnes)	17,584	14,191	48,213	41,559
Recovery (%)	88.6	89.3	88.0	89.0
Grade (%)	52.8	53.5	53.3	52.9
Lead (tonnes)	4,912	4,912	14,880	13,922
Recovery (%)	81.2	82.7	82.7	82.2
Grade (%)	64.1	67.5	65.0	66.4
Metal in Concentrates				
Zinc (tonnes)	9,284	7,594	25,686	21,992
Lead (tonnes)	3,146	3,315	9,673	9,240
Silver (ounces)	462,024	479,617	1,314,046	1,462,986
US\$ operating costs, production basis (\$000's)	10,252	8,949	28,252	26,472
US\$ operating cost per tonne milled (production basis)	53	56	52	55

Production of zinc in concentrate was 22% higher in the third quarter of 2009 compared with the same period in 2008 due to more tonnes milled at a slightly higher zinc head grade. Production of lead in concentrate in the third quarter of 2009 was 5% lower than the same period in 2008 due to lower lead grades despite higher mill throughput.

Compared with previously disclosed guidance, mill throughput was higher than target with higher zinc grades and lower lead and silver grades than planned resulting in higher zinc and lower lead and silver production on a metal contained in concentrate basis.

(iii) Mochito Drilling

Exploration efforts during the third quarter of 2009 continued to extend the Imperial, Santo Niño, Barbasco and Port Royal chimneys. All four chimneys remain open in at least one direction and the Company will continue drilling in these areas during the next three months.

A total of 5,258 metres was drilled from underground during the third quarter of 2009. Definition and valuation drilling accounted for 4,043 metres while exploration and extensional drilling accounted for 1,215 metres.

Exploration indicates that the Imperial zone is of considerable interest and is open above, below and to the north. The current known size of the zone confirms that the Barbasco-Imperial trend has great potential along strike and that further exploration along the trend is warranted.

Access drifting continues towards the Imperial zone on both the 1850 and 2050 levels. The upper level will be extended to the north of the Imperial zone in the search for the next deposit along this mineral trend. The underground exploration program is complemented by surface drilling 500 metres to the north of the known deposit. The surface drill program has commenced and the first drillhole is in progress. It is expected to intersect the manto at a depth of 1,150 metres.

The Port Royal chimney has been drill tested up to 200 metres above the 1850 level. A new drill station on this level will test the chimney higher in the stratigraphy where it intersects the Mochito shale (200 metres higher still).

During the third quarter of 2009, five holes were drilled in search of the San Juan chimney above the Mochito shales, however, the holes were not able to pass through the Mochito shales as planned, so the program was cancelled. An alteration pipe was traced within the Mochito shales which indicates a larger deposit may exist where the alteration pipe intersects the upper Atima limestone. This area will be drill tested from surface.

Exploration commenced during the quarter on the Raiz de Salvador chimney. The objective is to explore the area above and below the Mochito shales directly beneath the Salvador chimney. Several other known chimneys have large deposits where the chimney intersects the Mochito shales (upper and lower contact). In the past, this chimney was mined above the 1225 level and was never explored below this level. The first hole drilled from underground to the lower contact of the shales intersected the shales farther down than expected. The shales were partly to heavily altered and showed a one metre thick band of strong dissemination of sphalerite and lesser galena. The results indicate that mineralizing fluids passed through this area and further exploration of this zone is warranted.

(iv) Mochito Outlook

Production at Mochito has been running ahead of budget as it relates to throughput and zinc contained in concentrate, on target for costs and behind target for silver and lead due to changes in the mining cycle resulting in the exploitation of lower grade areas. Accordingly, management now expects that silver contained in concentrate will be approximately 1.8 million ounces and that lead contained in concentrate will be approximately 13,000 tonnes.

TOQUI

(i) Toqui Financial Results

(\$000's)	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Gross sales revenue	17,369	18,190	50,067	77,292
Treatment and marketing costs	(4,194)	(7,683)	(15,977)	(30,922)
Net revenue	13,175	10,507	34,090	46,370
Direct operating costs	(6,343)	(8,594)	(15,360)	(26,278)
Depreciation and depletion	(2,228)	(2,281)	(5,317)	(6,255)
Reclamation and closure (costs) recovery	(55)	(36)	(175)	958
Contribution (loss) from mining activities	4,549	(404)	13,238	14,795
Exploration	(95)	(129)	(459)	(816)
	4,454	(533)	12,779	13,979
Income and mining tax provision	(1,302)	(271)	(1,721)	(2,678)
Net earnings (loss)	3,152	(804)	11,058	11,301
Capital expenditures	2,842	3,681	6,902	17,755

Revenue:

The following tables and discussion provide details of Toqui's gross sales revenue for the periods indicated:

	Third Quarter 2009				Third Quarter 2008			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (US\$000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (US\$000's)
Zinc	10,048	3,946	1,533	6,049	10,185	4,041	1,801	7,278
Lead	697	345	1,938	669	3,323	1,577	1,876	2,958
Gold	2,298	9,036	962	8,690	1,416	6,338	863	5,472
Silver	n.a.	31,119	14.51	452	n.a.	103,022	16.27	1,676
Other ⁽²⁾	n.a.			5	n.a.			(108)
	<u>13,043</u>				<u>14,924</u>			
Gross sales revenue in US\$				15,865				17,276
Exchange rate				1.0948				1.0529
Gross sales revenue in C\$				<u>17,369</u>				<u>18,190</u>

⁽¹⁾ Payable metal and realized prices for zinc and lead are per tonne and for gold and silver are per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Total concentrate sold in the third quarter of 2009 was 13% less than in the third quarter of 2008 primarily due to lower planned production levels and the timing of shipments. Lower concentrate sales and a lower zinc price resulted in an 8% decrease in gross sales revenue in US\$ terms. A 4% increase in the exchange rate resulted in 5% lower gross sales revenue in C\$ terms.

Expenses:

Treatment and marketing costs were 45% lower on an aggregate basis in the third quarter of 2009 compared with the third quarter of 2008 primarily due to 13% fewer tonnes of concentrate sold, more favourable smelter terms and lower freight rates partially offset by a weaker C\$. As a percentage of gross revenue, treatment and marketing costs decreased to 24% from 42% in the same period in 2008 primarily due to the factors noted above.

Direct operating costs in the third quarter of 2009 were 26% lower than in the same period in 2008 primarily due to lower tonnes of concentrate sold, the impact of cost savings initiatives and lower diesel prices.

Income and mining tax provision for the third quarter of 2009 increased by \$1.0 million primarily due to higher earnings before tax in the 2009 period compared with respective period in 2008.

Capital Expenditures:

Toqui capital expenditures of \$6.9 million in the first nine months of 2009 consisted primarily of: \$1.9 million for development of Mina Profunda; \$1.9 million for other development; \$2.3 million for thickened tailings plant equipment and tailings facilities and \$0.3 million for equipment.

(ii) Toqui Production

Toqui's production is set out in the following table.

	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Tonnes Milled	128,679	128,673	365,829	388,486
Zinc (%)	4.7	7.1	4.8	7.1
Lead (%)	0.3	1.0	0.4	0.9
Gold (g/t)	3.3	1.4	3.5	1.5
Silver (g/t)	16	29	22	27
Concentrate Production				
Zinc (tonnes)	10,498	16,243	30,866	49,523
Recovery (%)	85.8	88.8	86.1	89.0
Grade (%)	48.4	49.7	48.0	49.4
Lead (tonnes)	413	1,362	1,582	4,202
Recovery (%)	62.5	60.4	59.9	59.9
Grade (%)	54.0	56.0	53.9	50.6
Gold (tonnes)	2,433	271	6,469	1,346
Recovery (%)	60.6	51.0	60.4	54.8
Grade (g/t)	96.9	221.1	108.1	159.5
Metal in Concentrates				
Zinc (tonnes)	5,077	8,064	14,820	24,474
Lead (tonnes)	223	763	853	2,126
Gold (ounces)	10,191	3,718	30,977	13,327
Silver (ounces)	51,325	84,048	181,912	248,558
US\$ operating costs, production basis (\$000's)	5,734	6,170	15,989	18,903
US\$ operating cost per tonne milled (production basis)	45	48	44	49

Production of zinc in concentrate was 37% lower in the third quarter of 2009 compared with the same period in 2008 due to lower zinc grades and recoveries. Production of lead in concentrate was 71% lower due to lower planned lead grades. Production of gold in concentrate was 174% higher in the third quarter of 2009 due to higher planned gold grades.

As the price of zinc exceeded expected prices, the Company did not reduce throughput as projected but continued to mine zinc bearing deposits in addition to the gold bearing deposits. Mining the zinc deposits in addition to the gold deposits in the third quarter of 2009 resulted in higher cash flows and lower costs per tonne than planned.

(iii) Toqui Drilling

During the third quarter of 2009, a total of 3,580 metres of underground definition drilling was carried out from several in-mine locations. A total of 600 metres was drilled in order to define the limits of Mina Profunda II, a horizon of calcareous sandstone with economic gold values, situated approximately 40 metres beneath the Aserradero North area. Another 400 metres was drilled in the main Aserradero South mine, which has extended the southern limits of the deposit as well as identifying the presence of copper mineralization on the south side of the Fortuna fault, one of the principal limiting faults of the Aserradero mine. An additional 2,040 metres was drilled from several locations into the calcareous sandstone horizon beneath the Doña Rosa mine, identifying sub-economic zinc and gold mineralization. The final 566 metres was drilled to the west of the Estatuas mine, with good indications of zinc mineralization.

(iv) Toqui Outlook

At Toqui, management has been exploring augmenting its 2.0 megawatts of installed hydro electric capacity with both additional hydro electric and wind power. Subsequent to the quarter end, an agreement was reached with a contractor to install an additional 1.65 megawatts of wind power. At a capital cost of US\$5.5 million, the project has a payback of approximately four and a half years and has been fully financed locally by term debt. As part of the project to install the wind turbines, application will be made to register this project under the Clean Development Mechanism which will enable Toqui to sell certified emission reductions, better known as carbon credits, in the market. Wind power will lower the Company's electrical costs going forward and help meet increased electrical requirements once the thickened tailings backfill plant is up and running. A used thickened tailings backfill plant has been dismantled and transported to Chile. This plant will enable Toqui to deposit thickened tails and allow pillar recovery in the future.

The wind power plant cost was not included in the capital expenditure projections previously provided.

MYRA FALLS

(i) Myra Falls Financial Results

(\$'000's)	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Gross sales revenue	19,918	28,354	54,844	75,490
Treatment and marketing costs	(3,987)	(9,351)	(13,798)	(22,494)
Net revenue	15,931	19,003	41,046	52,996
Direct operating costs	(13,291)	(19,252)	(38,378)	(56,314)
Depreciation and depletion	(343)	(1,675)	(1,165)	(4,469)
Reclamation and closure costs	(394)	(427)	(2,698)	(1,287)
Contribution (loss) from mining activities	1,903	(2,351)	(1,195)	(9,074)
Exploration	–	(49)	–	(1,027)
	1,903	(2,400)	(1,195)	(10,101)
Income and mining tax provision	–	(5,297)	–	(8,164)
Net earnings (loss)	1,903	(7,697)	(1,195)	(18,265)
Capital expenditures	389	283	1,104	3,250

Revenue:

The following tables and discussion provide details of Myra Falls' gross sales revenue for the periods indicated:

	Third Quarter 2009				Third Quarter 2008			
	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)	Concentrate sold (tonnes)	Payable metal ⁽¹⁾	Realized price ⁽¹⁾ (US\$)	Gross sales revenue (\$'000's)
Zinc	11,645	5,332	1,709	9,111	19,574	9,023	1,741	15,710
Copper	5,140	1,203	5,117	6,153	4,737	1,047	7,096	7,430
Gold	n.a.	1,945	936	1,821	n.a.	2,381	887	2,113
Silver	n.a.	79,293	13.43	1,065	n.a.	101,839	17.21	1,753
Other ⁽²⁾	n.a.			n.a.	n.a.			n.a.
	<u>16,785</u>				<u>24,311</u>			
Gross sales revenue in US\$				18,150				27,006
Exchange rate				1.0974				1.0499
Gross sales revenue in C\$				<u>19,918</u>				<u>28,354</u>

⁽¹⁾ Payable metal and realized prices for zinc and copper are per tonne and for gold and silver are per ounce.

⁽²⁾ Other gross sales revenue represents revaluations of prior period concentrate receivables.

Concentrate sold in the third quarter of 2009 was 31% lower than in the third quarter of 2008. Lower concentrate sales and lower realized zinc and copper prices resulted in revenues for the quarter decreasing by 33% in US\$ terms. A 5% higher exchange rate resulted in gross sales revenue decreasing 30% in C\$ terms to \$19.9 million.

Expenses:

In the third quarter of 2009, treatment and marketing costs were 57% lower on an aggregate basis primarily due to 31% lower concentrate sales, lower freight rates and more favourable smelter terms partially offset by the higher exchange rate. As a percentage of gross revenue, in the third quarter of 2009, treatment and marketing costs decreased 20% from 33% in the same period in 2008 primarily due to the factors noted above.

Aggregate direct operating costs decreased 31% primarily due to 31% lower concentrate sales and cost reductions achieved in 2008 and 2009, reduced write-downs related to marking inventory to the lower of cost and net realizable value and reduced restructuring expenses partially offset by increased pension expenses.

Income and mining taxes decreased \$5.3 million in the third quarter of 2009 primarily due to a \$5.3 million write-down of a future tax asset in the third quarter of 2008 which did not recur in 2009.

Capital Expenditures:

Myra Falls' capital expenditures in the first nine months of 2009 of \$1.1 million consisted primarily of \$0.3 million for a new tailings disposal area; \$0.4 million for equipment; and, \$0.2 million in ramp development.

(ii) Myra Falls Production

Myra Falls' production is set out in the following table.

	Third Quarter		First Nine Months	
	2009	2008	2009	2008
Tonnes Milled	114,129	131,043	342,773	465,932
Zinc (%)	8.4	8.4	7.2	6.9
Copper (%)	1.1	1.1	1.0	1.2
Gold (g/t)	1.6	1.2	1.3	1.2
Silver (g/t)	54	51	43	45
Concentrate Production				
Zinc (tonnes)	15,669	17,539	40,289	51,890
Zinc recovery (%)	88.6	87.7	88.2	87.0
Zinc grade (%)	54.1	54.8	54.1	54.2
Gold recovery (%)	23.8	24.9	22.0	25.2
Gold grade (g/t)	2.8	2.3	2.5	2.8
Copper (tonnes)	3,079	4,495	10,602	17,530
Copper recovery (%)	57.9	71.8	68.7	74.4
Copper grade (%)	25.6	23.5	23.2	23.5
Gold recovery (%)	37.9	32.2	34.7	35.2
Gold grade (g/t)	21.8	11.8	14.9	11.5
Gold (tonnes)	0.03	-	1.94	-
Recovery (%)	8.8	-	8.1	-
Grade (g/t)	441,912	-	21,442	-
Metal in Concentrates				
Zinc (tonnes)	8,475	9,615	21,788	28,103
Copper (tonnes)	789	1,057	2,457	4,129
Gold (ounces)	4,019	2,996	9,652	11,124
Silver (ounces)	156,443	159,760	355,699	526,331
C\$ operating costs, production basis (\$000's)	11,028	15,318	38,231	61,548
C\$ operating cost per tonne milled (production basis)	97	117	112	132

Production of zinc in concentrate was 12% lower in the third quarter of 2009 compared with the same period in 2008 due to fewer tonnes milled despite higher recoveries. Production of copper in concentrate was 25% lower in the third quarter of 2009 due to fewer tonnes milled and lower recoveries.

Compared with previously disclosed guidance, mill throughput and zinc, copper and silver grades were lower than expectations. Lower head grades were primarily due to ore dilution compounded by decreased mining recovery to plan, both associated with remnant mining. Mill recoveries were also negatively affected by the lower head grade. Copper recoveries were affected by a period of high lead grades resulting in a lead to copper ratio of 1:1. The mine plan is being adjusted to increase blending to reduce this problem in the future.

(iii) Myra Falls Drilling

During the third quarter of 2009, exploration drilling was entirely focused on the west side of the Battle lens towards three targets: the West Gap area, the West Gopher Down-Drop, and a new zone called the RE-108 lens. A total of 2,845 metres was drilled during the quarter.

The West Gopher Down-Drop drill program has been deferred, pending core logging and interpretation.

During the third quarter of 2009, delineation of a new polymetallic zone - RE-108 - was undertaken. The lens has now been substantiated to the point where the development is being accelerated in order to bring some of this material into the mine plan in the fourth quarter of 2009. The zone is currently open to the west.

The South Flank area is presently in production as well as undergoing increased development. The South Flank Main lens and South Flank East lens accesses are now under development and any additional drilling in this area has been deferred to the fourth quarter of 2009.

A drill has been moved up to 20 level in the HW mine to drill two orientation holes into the Price-South Flank stratigraphy.

(iv) Myra Falls Outlook

Production from the South Flank area commenced ahead of plan and this area will continue as a significant source of mill feed for the balance of 2009 and 2010. Operating costs per tonne milled were expected to meet projections, while metals in concentrates were expected to be approximately 31,500 tonnes for zinc, 3,500 tonnes for copper and 557,000 ounces of silver compared with previous guidance.

On November 4, 2009 a fire occurred in the production hoist. The fire was contained and there were no injuries. However, an electrical switch gear was destroyed in the fire rendering the production hoist currently unusable. The Company is currently assessing the impact of the damage and its effect on near term production and costs.

The collective bargaining agreement at Myra Falls expired on September 30, 2009. On November 4, 2009 at 6:30pm (PST), the Company was served with 72 hour strike notice and the union is in a legal strike position effective November 7, 2009 at 6:30pm (PST).

LANGLOIS OUTLOOK

The rally in zinc prices from their lows earlier this year has prompted the Company to actively review the economics of a reopening plan for Langlois which contemplates six months of preproduction development work. The recent strength in the Canadian dollar has somewhat offset the rise in zinc prices..

NON-GAAP RECONCILIATIONS

Operating cost per tonne milled on a production basis is a performance indicator. It is a non-GAAP measure and because there is no standard method for calculating it, operating costs per tonne milled on a production basis is not a reliable way to compare the Company against other companies. It can however allow an understanding of how production costs have changed from year-to-year and the impact on cash flows.

Three Months ended September 30, 2009

(\$000's)	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Total
Direct operating costs per financial statements	14,319	6,343	13,291	13	33,966
Adjustment to production basis	(3,427)	235	(2,252)	n.a.	(5,444)
Less: stock-based compensation	(1)	(14)	(11)	(13)	(39)
Less: royalties	n.a.	(391)	n.a.	n.a.	(391)
Operating costs on production basis (C\$)	10,891	6,173	11,028	—	28,092
Average exchange rate	1.0623	1.0766	1.0882	n.a.	1.0755
Operating costs on production basis (US\$)	10,252	5,734	10,134	n.a.	26,120
Tonnes milled	193,479	128,679	114,129	n.a.	436,287
Operating cost per tonne milled – US\$	53	45	89	n.a.	60
Operating cost per tonne milled – C\$	56	48	97	n.a.	64

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Three Months ended September 30, 2008

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Direct operating costs per financial statements	10,503	8,594	19,252	16,671	55,020
Adjustment to production basis	(1,175)	(1,583)	(3,850)	(1,661)	(8,269)
Less: stock-based compensation	(10)	(20)	(44)	(14)	(88)
Less: royalties	n.a.	(560)	n.a.	n.a.	(560)
Operating costs on production basis (C\$)	9,318	6,431	15,358	14,996	46,103
Average exchange rate	1.0412	1.0423	1.0552	1.0424	1.0464
Operating costs on production basis (US\$)	8,949	6,170	14,555	14,386	44,060
Tonnes milled	160,427	128,673	131,043	176,570	596,713
Operating cost per tonne milled – US\$	56	48	111	81	74
Operating cost per tonne milled – C\$	58	50	117	85	77

Nine Months ended September 30, 2009

(\$000's)	Mochito	Toqui	Myra Falls	Langlois ⁽¹⁾	Total
Direct operating costs per financial statements	31,841	15,360	38,378	1,175	86,754
Adjustment to production basis	738	3,886	(84)	(1,133)	3,407
Less: stock-based compensation	(9)	(42)	(63)	(42)	(156)
Less: royalties	n.a.	(848)	n.a.	n.a.	(848)
Operating costs on production basis (C\$)	32,570	18,356	38,231	–	89,157
Average exchange rate	1.1528	1.1480	1.1694	n.a.	1.1589
Operating costs on production basis (US\$)	28,252	15,989	32,693	n.a.	76,934
Tonnes milled	539,012	365,829	342,773	n.a.	1,247,614
Operating cost per tonne milled – US\$	52	44	95	n.a.	62
Operating cost per tonne milled – C\$	60	50	112	n.a.	71

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

Nine Months ended September 30, 2008

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Direct operating costs per financial statements	27,154	26,278	56,314	43,837	153,583
Adjustment to production basis	(140)	(5,664)	5,483	968	647
Less: stock-based compensation	(45)	(119)	(249)	(46)	(459)
Less: royalties	n.a.	(1,236)	n.a.	n.a.	(1,236)
Operating costs on production basis (C\$)	26,969	19,259	61,548	44,759	152,535
Average exchange rate	1.0188	1.0188	1.0188	1.0188	1.0188
Operating costs on production basis (US\$)	26,472	18,903	60,412	43,933	149,720
Tonnes milled	484,762	388,486	465,932	446,833	1,786,013
Operating cost per tonne milled – US\$	55	49	130	98	84
Operating cost per tonne milled – C\$	56	50	132	100	85

SUMMARY OF QUARTERLY RESULTS

	2007	2008	2008	2008	2008	2009	2009	2009
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Gross sales revenue (<i>\$ millions</i>)	135.5	81.9	115.1	101.0	100.1	64.1	40.9	71.6
Net earning (loss) (<i>\$ millions</i>)	(38.4)	(6.9)	8.1	(36.1)	(53.5)	(6.5)	(4.5)	6.5
Basic earnings (loss) per share	\$(0.09)	\$(0.02)	\$0.02	\$(0.08)	\$(0.12)	\$(0.01)	\$(0.01)	\$0.01
Weighted-average number of Common								
Shares outstanding (<i>millions</i>)	421.6	425.8	446.4	446.5	446.8	447.7	678.4	678.9
Diluted earnings (loss) per share	\$(0.09)	\$(0.02)	\$0.02	\$(0.08)	\$(0.12)	\$(0.01)	\$(0.01)	\$0.01
C\$/US\$ realized exchange rate	0.9857	1.0047	1.0100	1.0457	1.2050	1.2499	1.1599	1.0947
Average realized zinc price (<i>US\$/t</i>)	2,608	2,409	2,205	1,830	1,331	1,156	1,413	1,678
Average realized zinc price (<i>C\$/t</i>)	2,571	2,420	2,227	1,914	1,604	1,445	1,639	1,837
Concentrate tonnes sold ⁽¹⁾	102,415	59,210	95,188	87,978	104,229	66,051	43,670	54,590
Concentrate tonnes produced ⁽¹⁾	72,470	73,481	86,856	89,514	65,986	49,803	48,512	54,588

⁽¹⁾ On November 2, 2008, Langlois operations were temporarily suspended.

The quantity and mix of concentrates sold directly affects gross sales revenue. The recognition of revenue from the sale of concentrate can vary from quarter-to-quarter for the reasons discussed in the "Gross Sales Revenue" section of this MD&A. As all sales are based in US\$, the US\$'s movement against the C\$ over the past eight quarters impacts the realized C\$ gross sales revenue.

RELATED PARTY TRANSACTIONS

In the second quarter of 2009, Dundee Corporation, a significant shareholder of the Company, purchased 57,960,000 units under the Offering to maintain its approximate 25.2% equity interest in the Company.

CRITICAL ACCOUNTING ESTIMATES

Asset Impairment

The carrying values of producing mineral properties, including properties placed on a care and maintenance basis and related deferred expenditures, are reviewed when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. Estimated future net cash flows, on an undiscounted basis, are calculated for each property using: estimated recoverable reserves; estimated future metal price realization (considering historical and current prices, price trends and related factors); and, estimated operating, capital and other cash flows.

For 2008 testing purposes, the Company used the price assumptions contained in the Sensitivity to Metal Prices and Exchange Rates section in the MD&A dated February 26, 2009 and estimated future price realizations and exchange rates for 2010 to the end of each mine's life. Estimates of future cash flows are subject to risks and uncertainties. It is possible that changes may be required to these assumptions in the future which may affect the assessment of recoverability of the carrying value of mineral properties. See Sensitivity to Metal Prices and Exchange Rates section in the year-end MD&A dated February 26, 2009 at www.sedar.com.

Provisional Payments for Concentrate Shipped and Not Priced

Provisional payments for concentrate inventory shipped and not priced are based on price estimates prevailing close to the date the concentrate is shipped and final pricing can occur several months later, therefore, if there is a dramatic decline in metal pricing during this period, the Company could be required to remit funds back to its customers.

Employee Future Benefits

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. Actuarial reports valuing this hourly plan are prepared every three years using the projected accumulated benefit method, with December 31, 2007 being the most recent valuation. Employee future benefits relate only to employees at Myra Falls and include amounts related to unionized hourly employee defined benefit pension plan and post-retirement supplements and medical benefits to certain non-union employees. The determination of employee future benefit expenses, obligations and funding requirements require the use of estimates which can produce significant measurement uncertainty into the actuarial valuation process. Such estimates include: mine closure assumptions, expected average remaining service lifetime, termination of employment, retirement timing, mortality, marital status, discount rates, rate of return on plan assets and health care and dental cost inflation assumptions.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Canadian Institute of Chartered Accountants announced that GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently in the planning stages and cannot at this time determine the final impact of the transition to IFRS. As at September 30, 2009, the Company has completed a "Phase 1 - Preliminary Study" which analyses the Company's existing financial reporting and provides a preliminary assessment of the potential key impact areas of the IFRS conversion. The Company has formed a steering committee to oversee the implementation of the conversion to IFRS and plans to hold training sessions for staff and directors in the final quarter of 2009. The Company has commenced "Phase 2 - Planning and Implementation" which is to develop a detailed project plan, evaluate the potential key impact areas and the options available under IFRS.

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 Amended and Restated Annual Information Form filed with the Canadian securities regulators, a copy of which is posted on the SEDAR website at www.sedar.com.

OUTSTANDING SHARE DATA AND FULL DILUTION CALCULATION

The Company is authorized to issue an unlimited number of Common Shares and 200,000,000 preferred shares, issueable in series. There are no preferred shares outstanding. Each Common Share entitles the holder of record thereof to one vote at all meetings of shareholders of the Company, except at meetings at which only holders of another class or series of shares of the Company are entitled to vote. The table set forth below summarizes the Capital Stock. For a more complete description of certain elements please refer to note 16 to the 2008 audited consolidated financial statements and to note 20 to the third quarter 2009 unaudited consolidated financial statements of the Company.

Common Shares or Securities Convertible into Common Shares	November 5, 2009
Issued and outstanding	683,191,280
Share options outstanding weighted-average exercise price \$1.10	6,844,408
Warrants issued at \$0.12, expire April 9, 2014 - traded on TSX	111,053,000
Future fully diluted	801,088,688

CAUTION ON FORWARD-LOOKING INFORMATION

This MD&A contains certain statements which constitute forward-looking information. These forward-looking statements are not descriptive of historical matters and may refer to management's expectations or plans. These statements include but are not limited to statements concerning the Company's business objectives and plans; future trends in the Company's industry; future production costs and volumes; mineral grades, reserve and resource estimates and types; sales volumes and realized prices; capital spending plans; exploration plans; expansion plans; expected market fundamentals and prices; availability of equipment and supplies; expected plant availability; success of process changes; the Company's processing technologies; global economic growth and industrial demand; production of base metal concentrates by the Company's operations; future metal prices and treatment and freight charges; future royalties payable; changes in global metal and concentrate inventories; currency exchange rates; costs of energy, materials and supplies; the outcome of disputes and legal proceedings in which the Company is involved; future effective tax rates; and, future benefits costs.

Inherent in forward-looking statements are risks and uncertainties beyond the Company's ability to predict or control, including risks that may affect the Company's operating or capital plans, including risks generally encountered in the development and operation of mineral properties and processing facilities such as unusual or unexpected geological formations, unanticipated metallurgical difficulties, ground control problems, process upsets and equipment malfunctions; risks associated with labour disturbances and unavailability of skilled labour; fluctuations in the market prices of the Company's principal products, which are cyclical and subject to substantial price fluctuations; risks created through competition for mining properties; risks associated with lack of access to markets; risks associated with mineral reserve and resource estimates, including the risk of errors in assumptions or methodologies; risks posed by fluctuations in exchange rates and interest rates, as well as general economic conditions; risks associated with environmental compliance and permitting, including those created by changes in environmental legislation and regulation; risks associated with the Company's dependence on third parties in the provision of transportation and other critical services; risks associated with aboriginal title claims and other title risks; social and political risks associated with operations in foreign countries; and, risks associated with legal proceedings.

Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements contained in this MD&A. Such statements are based on a number of assumptions which may prove to be incorrect, including, but not limited to, the following assumptions: that there is no material deterioration in general business and economic conditions; that there is no unanticipated fluctuation of interest rates and foreign exchange rates; that the supply and demand for, deliveries of, and the level and volatility of prices of zinc, copper, lead, gold and silver and the Company's other primary metals and minerals develop as expected; that the Company receives regulatory and governmental approvals for its development projects and other operations on a timely basis; that the Company is able to obtain financing for its development projects on reasonable terms; that there is no unforeseen deterioration in the Company's costs of production or production and productivity levels; that the Company is able to continue to secure adequate transportation for its products; that the Company is able to procure mining equipment and operating supplies in sufficient quantities and on a timely basis; that engineering and construction timetables and capital costs for the Company's development and expansion projects are not incorrectly estimated or affected by unforeseen circumstances; that costs of closure of various operations are accurately estimated; that there are no unanticipated changes to market competition; that the Company's reserve estimates are within reasonable bounds of accuracy (including with respect to size, grade and recoverability) and that the geological, operational and price assumptions on which these are based are reasonable; that environmental and other proceedings or disputes are satisfactorily resolved; and, that the Company maintains its ongoing relations with its employees and with its business partners and joint venturers.

Readers are cautioned that the foregoing list of important factors and assumptions is not exhaustive. Forward-looking statements are not guarantees of future performance. Events or circumstances could cause the Company's actual results to differ materially from those estimated or projected and expressed in, or implied by, these forward-looking statements. Readers should also carefully consider the matters discussed under "Risk Factors" in the Company's Amended and Restated Annual Information Form. Given these uncertainties, investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking statements or the foregoing list of factors, whether as a result of new information or future events or otherwise, except as may be required under applicable laws.

Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)
(Unaudited)

	September 30, 2009	December 31, 2008
Assets		
Current		
Cash and cash equivalents	18,313	20,328
Restricted cash (note 3)	6,590	761
Short-term investments (note 4)	180	142
Accounts receivable – concentrate	1,820	614
Other receivables	10,196	12,451
Concentrate inventory (note 5)	25,223	21,816
Materials and supplies inventory	32,545	37,278
Prepaid expenses and other current assets	3,044	5,748
Income and mining tax receivable	32	1,550
Future income tax assets (note 12)	–	621
Total current assets	97,943	101,309
Restricted reclamation investments (note 6)	31,541	35,026
Mineral properties and fixed assets	260,628	277,990
Restricted promissory notes (note 9)	105,724	80,886
	495,836	495,211
Liabilities and Shareholders' Equity		
Current		
Accounts payable and accrued liabilities	24,373	50,837
Provisional payments for concentrate inventory shipped and not priced	1,906	10,512
Short-term debt including current portion of long-term debt (note 7)	2,049	4,854
Income and mining taxes payable	1,152	264
Current portion of reclamation, closure cost accruals and other environmental obligations (note 10)	5,147	5,622
Total current liabilities	34,627	72,089
Deferred income (note 9)	6,822	5,924
Long-term lease obligations	76	125
Royalty obligations (note 9)	101,852	78,449
Long-term debt (note 8)	8,964	1,851
Reclamation, closure cost accruals and other environmental obligations (note 10)	25,318	22,906
Employee future benefits (note 11)	1,292	994
Future income tax liabilities (note 12)	5,629	3,211
Total liabilities	184,580	185,549
Shareholders' equity (note 13)	311,256	309,662
	495,836	495,211

Contingencies and commitments (note 17).

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

Approved by the Board

"Garth A.C. MacRae"

Garth A.C. MacRae
Director

"George E. Pirie"

George E. Pirie
Director

Consolidated Statements of Operations and Retained Earnings

(Expressed in thousands of Canadian dollars except share and per share amounts)

(Unaudited)

For the periods ended September 30	Three Months Ended		Nine Months Ended	
	2009	2008	2009	2008
Gross sales revenue	71,622	101,004	176,694	298,009
Treatment and marketing costs	15,460	33,949	51,676	96,132
Net revenue	56,162	67,055	125,018	201,877
Direct operating costs	33,966	55,020	86,754	153,583
Depreciation and depletion	7,972	13,904	18,573	30,951
Reclamation and closure costs	887	2,036	4,492	2,669
	42,825	70,960	109,819	187,203
Contribution (loss) from mining activities	13,337	(3,905)	15,199	14,674
General and administrative	2,443	3,706	8,120	11,433
Interest and financing	776	1,031	2,334	2,978
Investment and other income	(2,614)	(8,497)	(7,292)	(13,536)
Foreign exchange and other expense (income)	2,217	(642)	4,723	(1,488)
Exploration	300	4,923	1,139	13,830
Other non-producing property costs	1,449	437	5,212	1,244
Write-down of mineral properties and fixed assets	-	10,970	-	10,970
	4,571	11,928	14,236	25,431
Earnings (loss) before income and mining tax provision	8,766	(15,833)	963	(10,757)
Income and mining tax provision (note 12)	2,285	20,239	5,514	24,097
Net earnings (loss)	6,481	(36,072)	(4,551)	(34,854)
Retained earnings, beginning of period	69,536	170,126	80,568	168,908
Retained earnings, end of period	76,017	134,054	76,017	134,054
Basic earnings (loss) per Common Share (note 20)	\$0.01	(\$0.08)	(\$0.01)	(\$0.08)
Diluted earnings (loss) per Common Share (note 20)	\$0.01	(\$0.08)	(\$0.01)	(\$0.08)
Basic weighted-average number of Common Shares outstanding (000's) (note 20)	678,926	446,508	601,701	439,556

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

Consolidated Statements of Accumulated Other Comprehensive (Loss) Income

(Expressed in thousands of Canadian dollars)
(Unaudited)

	September 30, 2009	December 31, 2008
Accumulated other comprehensive income (loss), beginning of period	3,257	(3,817)
Other comprehensive (loss) income	(15,959)	7,074
Accumulated other comprehensive (loss) income, end of period	(12,702)	3,257

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

Consolidated Statements of Other Comprehensive (Loss) Income

(Expressed in thousands of Canadian dollars)
(Unaudited)

For the periods ended September 30	Three Months Ended		Nine Months Ended	
	2009	2008	2009	2008
Net earnings (loss)	6,481	(36,072)	(4,551)	(34,854)
Other comprehensive (loss) income, net of income taxes:				
Unrealized (losses) gains on translating financial statements of self sustaining foreign operations	(9,521)	3,974	(15,797)	6,167
Unrealized loss on short-term available-for-sale securities, net of income tax provision for the 3 months of \$Nil (2008 - \$3) and 9 months of \$1 (2008 - \$4) (note 4)	(1)	(18)	(6)	(23)
Unrealized gain (loss) on restricted investments net of income tax provision for the 3 months of \$9 (2008 - \$23) and 9 months of \$10 (2008 - \$23) (note 6)	49	126	(55)	126
Unrealized loss on long-term available-for-sale securities, net of income tax provision for the 3 months of \$Nil (2008 - \$27) and 9 months of \$Nil (2008 - \$Nil)	-	(172)	-	-
Reclassification of gain (loss) on sale of available-for-sale securities to income (notes 5)	2	(6,479)	(101)	(13,222)
Other comprehensive loss, net of income taxes	(9,471)	(2,569)	(15,959)	(6,952)
Comprehensive loss	(2,990)	(38,641)	(20,510)	(41,806)

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

Consolidated Statements of Cash Flow

(Expressed in thousands of Canadian dollars)

(Unaudited)

For the periods ended September 30	Three Months Ended		Nine Months Ended	
	2009	2008	2009	2008
Operating Activities				
Net earnings (loss)	6,481	(36,072)	(4,551)	(34,854)
Items not affecting cash:				
Depreciation and depletion	7,972	13,904	18,573	30,951
Loss (gain) on sale of investments	3	(2,059)	(118)	(9,035)
Unrealized (gain) loss on investments	(156)	(4,127)	77	1,722
Write-down of mineral properties and fixed assets	—	10,970	—	10,970
Other non-cash items	(202)	443	(416)	2,815
Stock-based compensation (note 13(c))	83	190	433	901
Unrealized deferred income	(912)	(153)	(1,847)	(458)
Future income taxes	1,132	18,377	3,453	15,685
Reclamation, closure cost accruals and other environmental obligations	887	2,036	4,492	2,669
Employee future benefits (note 11)	858	675	2,577	1,384
Payment of reclamation, closure cost accruals and other environmental obligations	(563)	(1,336)	(1,874)	(2,883)
Payment of employee future benefits	(754)	(772)	(2,279)	(2,481)
Changes in non-cash working capital items (note 19)	(9,676)	(17,219)	(31,123)	(23,596)
Net cash provided by (used in) operating activities	5,153	(15,143)	(12,603)	(6,210)
Investing Activities				
(Increase) decrease in restricted cash	(5,829)	68	(5,829)	118
Short-term investments	—	3,569	—	7,017
Long-term investments	—	—	—	13,350
Funds advanced on promissory note (note 9)	—	—	(23,428)	—
Restricted reclamation investments	(224)	(476)	3,302	(476)
Issue of common shares to purchase Myra Falls Limited Partnership	—	—	—	(34)
Acquisition of Metco Resources Inc., net of cash acquired	—	—	—	23
Mineral properties and fixed assets	(6,196)	(16,503)	(18,057)	(65,150)
Proceeds from sale of mineral properties and fixed assets	—	164	1,906	192
Net cash used in investing activities	(12,249)	(13,178)	(42,106)	(44,960)
Financing Activities				
Proceeds from sale of royalty interest (note 9)	—	—	23,428	—
Issue of common shares and warrants for cash, net of issue costs (note 13)	89	97	21,659	284
Deferred income relating to royalties (note 9)	—	—	2,745	—
Decrease in long-term lease obligations	(60)	(72)	(49)	(109)
Increase (decrease) in short-term debt	564	60	(557)	891
Increase in long-term debt	5,468	35	5,468	3,057
Net cash provided by financing activities	6,061	120	52,694	4,123
Net decrease in cash during the period	(1,035)	(28,201)	(2,015)	(47,047)
Cash and cash equivalents, beginning of period	19,348	44,088	20,328	62,934
Cash and cash equivalents, end of period	18,313	15,887	18,313	15,887
Supplemental Information				
Cash interest paid	43	5	549	66
Cash income and mining taxes paid	114	4,328	964	14,635
Cash interest received	185	624	765	984

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

Notes to the Consolidated Financial Statements

For the Periods Ended September 30, 2009 and 2008
(Unaudited)

1. Basis of Presentation

These unaudited interim consolidated financial statements of Breakwater Resources Ltd. (the "Company") for the three and nine months ended September 30, 2009 and 2008 have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and follow the same accounting principles and methods of application as those disclosed in note 2 to the Company's audited consolidated financial statements for the year ended December 31, 2008, except for the changes in accounting policies described in note 2 below. These unaudited financial statements include all adjustments that are, in the opinion of management, necessary for a fair presentation. These unaudited financial statements do not include all disclosures required by Canadian GAAP for annual financial statements and, accordingly, should be read in conjunction with the Company's audited consolidated financial statements included in the 2008 Financial Report.

New Pronouncements Not Adopted

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") announced that Canadian GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently in the planning stages and cannot at this time determine the final impact of the transition to IFRS. As at September 30, 2009, the Company has completed a "Phase 1 - Preliminary Study" which analyses the Company's existing financial reporting and provides a preliminary assessment of the potential key impact areas of the IFRS conversion. The Company has formed a steering committee to oversee the implementation of the conversion to IFRS and plans to hold training sessions for staff and directors in the final quarter of 2009. The Company has commenced "Phase 2 - Planning and Implementation" which is to develop a detailed project plan, evaluate the potential key impact areas and the options available under IFRS.

In June 2009, the CICA amended section 3862, "Financial Instruments - Disclosures", to include enhanced disclosures on liquidity risk of financial instruments and new disclosures on fair value measurements of financial instruments. The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009, with early adoption permitted. The Company will apply these amendments for its 2009 annual consolidated financial statements. The impact of the amendments to the fair value measurement and liquidity risk disclosure requirements of the Company are not expected to be significant.

2. Changes in Accounting Policies

On January 1, 2009, the Company adopted CICA accounting standard Section 3064 – Goodwill and Intangible Assets which replaces Section 3062 – Goodwill and Other Intangible Assets, Section 3450 – Research and Development and EIC-27 – Revenues and Expenditures During the Pre-operating Period. The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This standard was effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. Adopting this standard did not have a significant impact on the financial statements.

Effective January 1, 2009, the Company adopted EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities retroactively, without restatement. This EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of EIC-173 did not have a significant impact on the financial statements.

Effective January 1, 2009, the Company adopted the Amendments to CICA accounting standard Section 3855 – Financial Instruments: Recognition and Measurement. These amendments permit or require in certain circumstances entities to reclassify certain investments in debt instruments and amended the guidance regarding impairment measurement for Held to Maturity debt instruments and require reversals of impairment of losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity instruments or to debt instruments that have been designated at origination as Held for Trading. The adoption of the Amendments to Section 3855 did not have a significant impact on the financial statements.

3. Restricted Cash

The restricted cash balance at September 30, 2009 of \$6,590,000 (December 31, 2008 - \$761,000) represents amounts placed on deposit to cover certain reclamation costs of \$511,000 (December 31, 2008 - \$511,000), an amount of \$250,000 (December 31, 2008 - \$250,000) to guarantee an operating lease and \$5,829,000 (US\$5,436,000) (December 31, 2008 - \$Nil) held in trust pending finalization of collateral arrangements for US\$ Bank Loan No.3 (note 8).

4. Short-term Investments

(\$000's)	September 30, 2009	December 31, 2008
Marketable securities:		
Available-for-sale	14	21
Held-for-trading	166	121
	<u>180</u>	<u>142</u>

Marketable securities are carried at fair value with the net unrealized loss on available-for-sale securities for the three and nine months ended September 30, 2009 of \$1,000 (2008 - \$18,000) and \$6,000 (2008 - \$23,000) respectively, recorded in OCI until realized and the unrealized gain of \$100,000 (2008 - loss of \$604,000) and unrealized loss of \$5,000 (2008 - \$1,843,000) on held-for-trading securities for the same periods respectively, recorded in earnings. For the three and nine months ended September 30, 2009 the realized gains on sale of investments of \$Nil (2008 - \$Nil) and \$Nil (2008 - \$691,000) respectively, are included in investment and other income on the consolidated statements of operations and retained earnings. The realized gain includes \$Nil (2008 - \$221,000) that was previously recorded in OCI as unrealized gains.

5. Concentrate Inventory

Concentrate inventory as at September 30, 2009 includes an amount of \$9,364,000 (December 31, 2008 - \$10,111,000) for shipments where title and risk of ownership have been transferred to the customer but the final settlement price has not been determined. These shipments will be recognized as revenue in accordance with the Company's revenue recognition policy set out in note 2 of the audited consolidated financial statements for the year ended December 31, 2008.

6. Restricted Reclamation Investments

Restricted reclamation investments at September 30, 2009 consisting of cash collateral on deposit of \$10,900,000 (December 31, 2008 - \$13,500,000) and investments of \$20,641,000 (December 31, 2008 - \$21,526,000) are related to future reclamation activities and are held by third parties to fund future reclamation costs at Myra Falls. The investments of \$20,641,000 (December 31, 2008 - \$21,526,000) were funded through a qualifying environmental trust and are classified as available-for-sale securities and are carried at fair value. In the first quarter ended March 31, 2009, the cash collateral on deposit and the investment were reduced by \$2,600,000 and \$1,500,000 respectively, representing surplus amounts. The net unrealized gain on the investments for the three months ended September 30, 2009 of \$49,000 (2008 - \$126,000) and the net unrealized loss of \$55,000 (2008 - unrealized gain of \$126,000) for the nine months ended September 30, 2009 are recorded in OCI until realized. The realized loss on the investments for the three months ended September 30, 2009 of \$3,000 (2008 - \$Nil) and the realized gain for the nine months ended September 30, 2009 of \$118,000 (2008 - \$Nil) are recorded in income. The realized gain includes \$101,000 (2008 - \$Nil) that was previously recorded in OCI. Interest on the investments for the three and nine months ended September 30, 2009 of \$227,000 (2008 - \$Nil) and \$680,000 (2008 - \$Nil) respectively, are recorded in income.

7. Short-term Debt

(\$000's)	September 30, 2009	December 31, 2008
US\$ Bank Loan No. 1	—	4,303
US\$ Bank Loan No. 2	—	551
	—	4,854
Current portion of long-term debt (note 8)	2,049	—
	2,049	4,854

In December 2008, Sociedad Contractual Minera El Toqui ("Toqui") a wholly-owned subsidiary of the Company obtained a bank loan ("US\$ Bank Loan No.2") for US\$450,000, for a five month term, repayable in four monthly instalments of US\$50,000 and a final instalment of US\$250,000 plus interest and bears interest of 7.3% for the first instalment and thereafter at the LIBOR rate for 180 days plus 4%. As at June 30, 2009, the loan was repaid. Instalments totalling US\$450,000 plus interest of US\$8,000 were paid during 2009. Interest expense for 2009 was \$7,000.

8. Long-term Debt

(\$000's)	September 30, 2009	December 31, 2008
US\$ Bank Loan No. 1	3,251	—
US\$ Bank Loan No. 3	5,911	—
Reimbursable government assistance, unsecured, non-interest bearing	1,851	1,851
	11,013	1,851
Less current portion	2,049	—
	8,964	1,851

In September 2009, Toqui obtained a bank loan ("US\$ Bank Loan No.3") for US\$5,500,000, for a one year term, bearing interest of 2.8% per annum for the first three months and thereafter at the LIBOR rate for 90 days plus 2% and other financing costs. The loan is repayable by instalments of US\$200,000, US\$100,000 and the remaining balance due on February 28, 2010, May 29, 2010 and August 27, 2010 respectively. Toqui has the right to renew the loan on August 27 each year for a one year period provided Toqui's total export equals or exceeds the remaining balance and pays a minimum instalment of US\$100,000. The remaining balance would be repayable by quarterly instalments of US\$200,000 plus interest payable on February 28, May 29, August 27 and November 30 at the LIBOR rate for 90 days plus 2% and other financing costs. The right to renew expires on July 26, 2016. The loan is secured by certain fixed assets with a fair value of US\$5,500,000. The carrying value of the US\$ Bank Loan No.3 approximates its fair value. Interest expense for the three and nine months ended September 30, 2009 was \$15,000.

In June 2008, Toqui obtained a bank loan ("US\$ Bank Loan No.1") for US\$4,000,000, for a one year term, bearing interest of 4.8% per annum. Toqui has the right to renew the loan on June 6 each year for a one year period repayable by semi-annual instalments of US\$500,000 plus interest payable on June 6 and December 6 at the LIBOR rate for 180 days plus 1.2%. The right to renew expires on June 6, 2012. For the nine months ended September 30, 2009, instalments totalling US\$500,000 (December 2008 - US\$500,000) plus interest of US\$85,000 (December 2008 - US\$95,000) were paid. The carrying value of the US\$ Bank Loan No.1 approximates its fair value. Interest expense for the three and nine months ended September 30, 2009 were \$23,000 (2008 - \$62,000) and \$123,000 (2008 - \$62,000) respectively.

The reimbursable government assistance is for Langlois and consists of an amount of \$500,000 (December 2008 - \$500,000) relating to Zone 97 and \$1,351,000 (December 2008 - \$1,351,000) for the installation of a hydro line. The amount of \$500,000 will be repaid with an instalment of \$200,000 on April 1, 2010 and two instalments of \$150,000 in the following two years and the amount of \$1,351,000 will be repaid by three annual instalments of \$300,000, the first of which is due on April 1, 2010, with a final instalment on April 1, 2012 of \$451,000. The carrying value of the reimbursable government assistance approximates its fair value.

9. Royalty Obligations

In addition to the agreements in place at December 31, 2008, in March 2009, the Company entered into a new royalty agreement ("2009 Fourth Royalty Agreement") with Red Mile Resources No. 6 Limited Partnership ("Red Mile No.6 - 2009") whereby the Company sold a basic royalty ("Fourth Basic Royalty") on a portion of the payable zinc production over the life of the Myra Falls mine. The Company received \$26,171,000 which included royalty income of \$23,428,000, prepaid indemnity fee income of \$1,485,000 and prepaid interest income of \$1,258,000.

Under the terms of the 2009 Fourth Royalty Agreement, the Company is required to make Fourth Basic Royalty payments at fixed amounts per pound of payable zinc produced, which escalate from \$0.004 per pound to \$0.107 per pound over the first 12 years of the agreement. In addition, for the years 2015 through 2019, the Company granted Red Mile No.6 - 2009 a net smelter return of 1.50%, 1.75% or 2.00% if the average price of zinc in a given calendar year exceeds US\$4,250, US\$4,500 or US\$4,750 per tonne respectively.

The Red Mile No.6 - 2009 royalty income component of \$23,428,000 was placed with a financial institution for which the Company received a restricted promissory note. The restricted promissory note earns interest at 7% per annum which is recorded in "Investment and other income" on the consolidated statements of operations and retained earnings and matures on February 15, 2019. Pursuant to the 2009 Fourth Royalty Agreement, interest earned from the restricted promissory notes and a portion of the principal must be used to fund the expected basic royalty payments during the first ten years of the agreement.

Under certain circumstances, the Company has the right, by way of a call option, to acquire the partnership units of Red Mile No.6 - 2009 for the lower of market value or the outstanding amount of the restricted promissory note at the end of the tenth year of the royalty agreement.

The royalty income received from Red Mile No.6 - 2009 is accounted for as debt. The long-term portion is included in "Royalty obligations" and the current portion is included in "Accounts payable and accrued liabilities" on the consolidated balance sheets. The deemed interest rate for the amount under the 2009 Fourth Royalty Agreement is 7% per annum and the charges are included in "Interest and financing" on the consolidated statements of operations and retained earnings.

The prepaid interest income and the indemnity fee received under the 2009 Fourth Royalty Agreement have been recorded in "Deferred income" on the consolidated balance sheets and are being amortized into income over the life of the agreement reflected in "Investment and other income" on the consolidated statements of operations and retained earnings. As at September 30, 2009, prepaid interest income was \$3,492,000 (December 31, 2008 - \$4,246,000) which included a short-term portion of \$Nil (December 31, 2008 - \$447,000) and deferred indemnity fee was \$3,330,000 (December 31, 2008 - \$2,125,000). Total interest expense for the three and nine months ended September 30, 2009 was \$695,000 (2008 - \$373,000) and \$1,748,000 (2008 - \$2,273,000) respectively. Total interest income for the three and nine months ended September 30, 2009 was \$1,810,000 (2008 - \$1,062,000) and \$4,981,000 (2008 - \$3,185,000) respectively.

10. Reclamation, Closure Cost Accruals and Other Environmental Obligations

(\$000's)	September 30, 2009	December 31, 2008
Asset retirement obligations	26,263	24,293
Closure cost accruals	1,665	1,535
Other environmental obligations	2,537	2,700
	30,465	28,528
Less current portion	5,147	5,622
	25,318	22,906

Other environmental obligations represent expenditures required to complete modifications to the tailings facility at the Myra Falls mine. The Company expects to complete the required work by 2010. The estimated obligation was recorded and is being reduced by actual expenditures incurred. As at September 30, 2009, the expenditures since acquisition have been \$15,560,000 (December 31, 2008 - \$15,397,000). The current portion of \$500,000 (December 31, 2008 - \$500,000) is included in "Current portion of reclamation, closure cost accruals and other environmental obligations" on the consolidated balance sheets.

Asset Retirement Obligations

(\$000's)

As at December 31, 2008	24,293
Change in cash flow estimate (included in reclamation and closure costs)	2,005
Accretion (included in reclamation and closure costs)	386
Expenditures	(931)
Impact of foreign exchange	(188)
As at June 30, 2009	26,065
Accretion (included in reclamation and closure costs)	571
Expenditures	(97)
Impact of foreign exchange	(276)
	26,263
Less: current portion included in Current portion of reclamation, closure cost accruals and other environmental obligations	4,286
As at September 30, 2009	21,977

The change in cash flow estimate includes \$1,783,000, which is for reclamation cost related to exploration oil and gas wells acquired on the purchase of Myra Falls in 2004. The Company expects to complete the required work by 2011.

The estimated amount of undiscounted cash flow required to satisfy the asset retirement obligations as at September 30, 2009, was \$101,293,000 (December 31, 2008 - \$97,806,000). The expected timing of payments ranges from 2009 to 2111, and the credit-adjusted risk-free rates at which the estimated cash flow has been discounted to arrive at the obligation, ranges from 7.17% to 7.89% (December 31, 2008 - 7.17% to 7.89%). The estimated amount of undiscounted cash flow for September 30, 2009, includes an amount of \$66,329,000 (December 31, 2008 - \$66,329,000) which is for water treatment at Myra Falls in perpetuity.

11. Employee Future Benefits

The defined benefit pension plan cost for the three and nine months ended September 30, 2009 were \$858,000 (2008 - \$675,000) and \$2,577,000 (2008 - \$1,384,000) respectively. The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The estimated unamortized loss for the year ending December 31, 2009 exceeds 10% of the greater of the plan assets and obligations and is being expensed over the average remaining service period of active employees. For the three and nine months ended September 30, 2009, unamortized losses of \$163,000 and \$489,000 respectively, are included in pension expense. Actuarial reports for funding purposes valuing the defined benefit pension plan are prepared every three years using the accumulated benefit method, with December 31, 2007 being the most recent funding valuation and December 31, 2010 being the next required funding valuation. There is no required valuation for funding purposes for the post retirement pension supplements and benefits plans.

12. Income and Mining Taxes

The significant components of the Company's future tax assets (liabilities) were as follows:

(\$000's)	September 30, 2009	December 31, 2008
Future tax assets		
Loss carry forwards	28,003	30,247
Mineral properties and fixed assets	253,613	261,175
Reclamation and closure cost accruals	6,887	6,819
Deferred income	1,814	1,827
Future tax assets before valuation allowance	290,317	300,068
Valuation allowance	290,317	299,447
Future tax assets	—	621
Future tax liabilities		
Mineral properties – mining tax	(5,629)	(3,211)
Net future tax liabilities	(5,629)	(2,590)

(\$000's)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Income and mining tax provision				
Current income and mining tax provision	1,162	1,508	2,017	6,610
Future income and mining tax provision	1,123	18,731	3,497	17,487
	2,285	20,239	5,514	24,097

13. Shareholders' Equity

Shareholders' equity consists of the following:

(\$000's)	September 30, 2009	December 31, 2008
Capital stock	229,549	212,374
Warrants (a) and (b)	4,518	8,538
Contributed surplus (a) and (c)	13,874	4,925
Retained earnings	76,017	80,568
Accumulated other comprehensive (loss) income	(12,702)	3,257
	311,256	309,662

The Company's objectives when managing shareholders' equity are to provide returns for shareholders and safeguard the ability to continue as a going concern. Mining is an inherently risky business which is capital intensive and, while the Company strives to achieve lowest quartile industry costs at all of its operations and meet cash flow requirements through internally generated cash flows, the Company periodically incurs significant debt to finance acquisitions and operational expansions and for working capital purposes. The Company monitors shareholders' equity on the basis of long-term debt to total shareholders' equity. For the periods ended September 30, 2009 and December 31, 2008, the Company had a nominal level of debt which did not impose any capital constraints or restrictions on the Company.

The Company is authorized to issue 200,000,000 preferred shares and an unlimited number of common shares ("Common Shares"). No preferred shares were issued or outstanding on September 30, 2009 and December 31, 2008.

Common shares issued: (000's)	Number of Shares	Amount \$
As at December 31, 2008	446,843	212,374
Shares issued on purchase of mineral property	100	12
Shares issued under public offering (b)	230,000	16,865
Employee share option plan - proceeds of options exercised (c)	150	29
Value ascribed to options exercised under stock-based compensation (c)	-	21
Employee share purchase plan	1,451	158
As at June 30, 2009	678,544	229,459
Exercise of warrants (b)	30	4
Reclassification of fair value of warrants exercised from "Warrants" (b)	-	1
Employee share purchase plan	370	85
As at September 30, 2009	678,944	229,549

- a) The fair value of the 33,481,849 warrants outstanding at December 31, 2008 of \$8,538,000 was reclassified to contributed surplus as the warrants expired on January 31, 2009.
- b) On April 9, 2009, the Company completed its public offering (the "Offering") for net proceeds of \$18,534,000, net of costs of \$1,466,000. A total of 200,000,000 units were issued at a price of \$0.10, with each unit ("Unit") comprising one Common Share and one-half of a warrant (a "Warrant"). Each whole Warrant entitles the holder to purchase one Common Share at a price of \$0.12 per share until April 9, 2014. The Company granted to the underwriters an over-allotment option to purchase up to 30,000,000 additional Units at a price of \$0.10 per Unit on the same terms and conditions of the Offering. On April 16, 2009, the Company completed the sale of an additional 30,000,000 Units for net proceeds of \$2,850,000, net of costs of \$150,000, pursuant to the exercise of the underwriters' over-allotment option. Dundee Corporation, which is a significant shareholder of the Company, purchased 57,960,000 Units under the Offering (equal to 25.2% of the total number of Units that were issued on closing plus the Units issued in respect of the underwriters' over-allotment option) to maintain its approximate 25.2% equity interest in the Company. The fair value of the 115,000,000 warrants, issued on completion of the sale in the amount of \$4,519,000, net of costs of issue, are shown within shareholders equity as "Warrants".

For the nine months ended September 30, 2009, the fair value of \$1,000 (December 31, 2008 - \$2,000) relating to warrants exercised was transferred from "Warrants" to share capital.

- c) Share option transactions were as follows

	Options (000's)	Weighted-average exercise price
As at December 31, 2008	7,349	\$1.19
Granted	990	0.30
Exercised	(150)	0.19
Forfeited	(45)	1.44
Expired	(1,091)	0.89
As at June 30, 2009	7,053	1.14
Granted	65	0.28
Expired	(254)	1.79
As at September 30, 2009	6,864	\$1.10

As at September 30, 2009:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Outstanding (000's)	Weighted-average remaining contractual life	Weighted-average exercise price	Exercisable (000's)	Weighted-average exercise price
\$0.19 - \$0.50	2,757	2 years 304 days	\$0.31	2,054	\$0.32
\$0.51 - \$1.00	670	1 year 257 days	\$0.73	583	\$0.72
\$1.01 - \$1.50	1,408	1 year 225 days	\$1.13	1,395	\$1.13
\$1.51 - \$2.00	659	2 years 180 days	\$1.58	579	\$1.56
\$2.01 - \$2.50	325	2 years 144 days	\$2.09	325	\$2.09
\$2.51 - \$3.00	985	2 years 298 days	\$2.71	985	\$2.71
\$3.01 - \$3.50	5	24 days	\$3.35	5	\$3.35
\$3.51 - \$4.00	50	80 days	\$3.90	50	\$3.90
\$4.01 - \$4.30	5	101 days	\$4.30	5	\$4.30
	6,864			5,981	

The Company's Share Option Plan is described in *note 16(b)* of the Company's audited consolidated financial statements for the year ended December 31, 2008. Compensation expense for the stock-based compensation plan for employees has been determined based upon the fair value of awards granted on or after January 1, 2002.

Stock-based compensation at September 30, 2009 of \$433,000 (2008 - \$901,000) less the initial fair value of options exercised of \$21,000 (2008 - \$15,000), for a net amount of \$412,000 (2008 - \$886,000) was credited to "Contributed surplus" within shareholders' equity on the consolidated balance sheets. The proceeds of options exercised are credited to "Capital stock" within shareholders' equity on the consolidated balance sheets.

The fair value of each option grant has been estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Weighted-average exercise price per Common Share	\$0.28	\$Nil	\$0.30	\$0.85
Weighted-average quoted market price per Common Share at date of grant	\$0.28	\$Nil	\$0.30	\$0.85
Weighted-average grant-date fair value price per Common share	\$0.13	\$Nil	\$0.13	\$0.35
Expected life (years)	3	-	3	3
Risk free interest rate	1.89%	0%	1.72%	3.31%
Expected volatility	67%	0%	66%	58%
Dividend yield	0%	0%	0%	0%

- d) At the annual and special shareholders' meeting held on June 18, 2009, the shareholders approved a special resolution to amend the Share Incentive Plan (the "Plan") which is described in *note 2* of the Company's consolidated financial statements for the year ended December 31, 2008, to increase the maximum number of Common Shares of the Company that may be reserved for issuance for all purposes under the Plan from 54,500,000 to 62,500,000. The increase of 8,000,000 Common Shares was used to increase the number of Common Shares reserved for issuance under the Share Purchase Plan from 8,500,000 to 16,500,000.

At the annual and special shareholders' meeting held on June 18, 2009, the shareholders approved a special resolution authorizing the adoption of a deferred share unit plan (the "DSU Plan"). The DSU Plan will be administered by the Compensation Committee (the "Committee") of the Board of Directors. Under the DSU Plan, eligible directors, officers and employees of the Company and affiliates thereof (the "Participants") may be granted units ("Units") as specified by the Committee based on certain criteria determined by the Committee including services performed or to be performed by the Participant. Units are fully vested at the grant date. Units may be redeemed when a participant is no longer a director, officer or employee of the Company or an affiliate and, as specified by the Committee in its sole discretion, be satisfied in its entirety through or as a combination of (i) the issuance of Common Shares (ii) a cash payment or (iii) a cash payment by the Company used to purchase Common Shares on the open market on behalf of the Participant. The maximum number of Common Shares reserved for issuance under the DSU Plan is 13,500,000. As at September 30, 2009, no Common Shares had been issued under the DSU Plan.

14. Financial Instruments

Credit Risk

The Company is subject to credit risk through trade receivables. The Company manages this risk through evaluation and monitoring processes and carries credit insurance when necessary. Credit risk is further mitigated through the use of provisional payment arrangements and the use of letters of credit where appropriate. Credit risk also relates to derivative contracts arising from the possibility that a counterparty to an instrument in which the Company has an unrealized gain fails to perform. The Company does not consider the credit risk associated with these financial instruments to be significant.

Foreign Exchange Risk

The Company operates using principally the Canadian dollar and the US dollar, and may be negatively affected by fluctuations in foreign exchange rates. The Company manages this risk by minimizing the number of transactions that result in the settlement currency differing from the currency of the initial transaction. In addition, the Company's sales are denominated primarily in US dollars, while a significant percentage of its expenses are denominated in non-US dollars. This exposes the Company to increased volatility in earnings due to fluctuations in foreign exchange rates. The Company's hedging policy enables it to use forward foreign exchange contracts to hedge the exchange rates on identifiable foreign currency exposures. Gains and losses on these contracts when, they are designated as hedges, are reported as a component of the related transactions. The Company had no foreign exchange contracts outstanding at September 30, 2009 and December 31, 2008.

Commodity Price Risk

The profitability of the Company is directly related to the market price of metals produced. The Company may reduce price risk by hedging against the price of metals for a portion of its production. The main tools used to protect against price risk are forward contracts and options. Various strategies are available using these tools including spot deferred and synthetic puts.

The Company periodically enters into forward sales and options to effectively provide a minimum price for a portion of inventories and future production. In 2009 and 2008, the Company chose not to apply hedge accounting. As a result, outstanding derivative contracts were classified as held-for-trading and are carried at their fair value and are included in "Other receivables" on the consolidated balance sheets. Any gains and losses are recognized in the relevant period and included in "Gross sales revenue" on the consolidated statements of operations and retained earnings. The Company had the following outstanding commodity hedges at September 30, 2009:

	Quantity	Average Price (US\$)	Fair Value (\$'000's)	Maturity
Zinc puts bought	3,600 tonnes	\$1,350 per tonne	4	October - December 2009
Zinc puts bought	3,600 tonnes	\$1,375 per tonne	6	October - December 2009
Zinc puts bought	8,400 tonnes	\$1,543 per tonne	481	January 2010 - June 2010
			491	

As at December 31, 2008, there were no outstanding contracts.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. The Company's objectives and policies for managing capital are set out in note 13. The Company only invests in highly liquid investments with reputable counterparts and monitors its cash flow to ensure that there are adequate funds to meet its obligations.

Interest Rate Risk

The Company normally invests in short-term interest-bearing financial instruments. A change in the interest rate would have a minimal effect on the profitability of the Company. At September 30, 2009, interest bearing liabilities amounted to \$9,661,000 with interest rates of LIBOR plus 1.2% and 2%.

Sensitivity

The Company's cash flow and net earnings are sensitive to the movement in a variety of prices and costs and are particularly sensitive to movements in the price of zinc, smelter treatment charges and the C\$/US\$ exchange rate. The following table provides the Company's estimates of the sensitivity of net income to changes in the various metal prices, smelter treatment charges and C\$/US\$ exchange rate movements based on realized prices and exchange rates for the nine months ended September 30, 2009.

Variable	Realized price (US\$)	Change	Change to net earnings for the nine months ended September 30, 2009 (\$'000's)
Zinc	1,394 per tonne	10%	3,988
Copper	4,201 per tonne	10%	647
Lead	1,569 per tonne	10%	1,358
Gold	922 per ounce	10%	1,978
Silver	13.56 per ounce	10%	1,482
Exchange rate (C\$/US\$)	1.1685	10%	3,525
Combined weighted-average treatment charges per dry metric tonnes sold	269.48	10%	2,545

15. Related Party Transactions

All related party transactions are disclosed elsewhere in these consolidated financial statements (*note 13(b)*) and as noted in note 21(a) of the audited consolidated financial statements for the year ended December 31, 2008

16. Guarantees

In consideration for the receipt of indemnity fees of \$564,000, \$1,141,000, \$1,091,000 and \$1,485,000 from Wilshire Financial Services Inc. ("Wilshire") related to the 2004 First Royalty Agreement, the 2005 Second Royalty Agreement, the 2008 Third Royalty Agreement and the 2009 Fourth Royalty Agreement (*note 9*) respectively, the Company has indemnified and holds harmless Wilshire from and against any and all losses based upon, arising out of, or otherwise in connection with or as a result of any claims relating to a breach or default by the Company under the 2004 First Royalty Agreement, the 2005 Second Royalty Agreement, the 2008 Third Royalty Agreement and the 2009 Fourth Royalty Agreement. As at September 30, 2009, the maximum liability was \$11,785,000 (December 31, 2008 - \$11,785,000), \$50,500,000 (December 31, 2008 - \$50,500,000), \$15,970,000 (December 31, 2008 - \$15,970,000) and \$23,428,000 (December 31, 2008 - Nil) under the 2004 First Royalty Agreement, the 2005 Second Royalty Agreement, the 2008 Third Royalty Agreement and the 2009 Fourth Royalty Agreement respectively. The indemnity fees were deferred and are being amortized on a straight-line basis over the term of the respective agreements.

17. Contingencies and Commitments

There were no significant changes in contingencies and commitments in the nine month period ended September 30, 2009. The contingencies and commitments are described in note 23 of the Company's audited consolidated financial statements for the year ended December 31, 2008.

18. Segment Information

Segment Information

For the Three Months Ended September 30, 2009 (Unaudited)

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Operating Segment								
Gross sales revenue	35,918	17,369	19,918	-	73,205	-	(1,583)	71,622
Treatment and marketing costs	7,279	4,194	3,987	-	15,460	-	-	15,460
Net revenue	28,639	13,175	15,931	-	57,745	-	(1,583)	56,162
Direct operating costs	14,319	6,343	13,291	13	33,966	-	-	33,966
Depreciation and depletion	5,355	2,228	343	23	7,949	-	23	7,972
Reclamation and closure costs	314	55	394	21	784	103	-	887
	19,988	8,626	14,028	57	42,699	103	23	42,825
Contribution (loss) from mining activities	8,651	4,549	1,903	(57)	15,046	(103)	(1,606)	13,337
General and administrative	-	-	-	-	-	-	2,443	2,443
Interest and financing	-	-	-	-	-	-	776	776
Investment and other income	-	-	-	-	-	-	(2,614)	(2,614)
Foreign exchange and other	-	-	-	-	-	-	2,217	2,217
Exploration	112	95	-	93	300	-	-	300
Other non-producing property costs	-	-	-	1,183	1,183	226	40	1,449
	112	95	-	1,276	1,483	226	2,862	4,571
Earnings (loss) before income and mining tax provision	8,539	4,454	1,903	(1,333)	13,563	(329)	(4,468)	8,766
Income and mining tax provision	811	1,302	-	172	2,285	-	-	2,285
Net earnings (loss)	7,728	3,152	1,903	(1,505)	11,278	(329)	(4,468)	6,481
Capital expenditures (recovery)	3,116	2,842	389	-	6,347	-	(151)	6,196
Mineral properties and fixed assets	48,774	59,193	22,278	121,172	251,417	994	8,217	260,628
Identifiable assets	71,731	84,775	179,773	125,344	461,623	1,155	33,058	495,836

Information about major customers – Summary of net revenue from major customers for the three months ended September 30, 2009.

Revenue Source

(\$000's)	Mochito	Toqui	Myra Falls	Total
Customer 1	10,385	-	3,336	13,721
Customer 2	6,242	37	8,155	14,434
Customer 3	3,958	5,415	-	9,373

Segment Information

For the Three Months Ended September 30, 2008 (Unaudited)

(\$000's)								
Operating Segment	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Gross sales revenue	27,009	18,190	28,354	27,451	101,004	—	—	101,004
Treatment and marketing costs	8,546	7,683	9,351	8,369	33,949	—	—	33,949
Net revenue	18,463	10,507	19,003	19,082	67,055	—	—	67,055
Direct operating costs	10,503	8,594	19,252	16,671	55,020	—	—	55,020
Depreciation and depletion	2,504	2,281	1,675	7,404	13,864	—	40	13,904
Reclamation and closure costs	391	36	427	20	874	1,162	—	2,036
	13,398	10,911	21,354	24,095	69,758	1,162	40	70,960
Contribution (loss) from mining activities	5,065	(404)	(2,351)	(5,013)	(2,703)	(1,162)	(40)	(3,905)
General and administrative	—	—	—	—	—	—	3,706	3,706
Interest and financing	—	—	—	—	—	—	1,031	1,031
Investment and other income	—	—	—	—	—	—	(8,497)	(8,497)
Foreign exchange and other income	—	—	—	—	—	—	(642)	(642)
Exploration	821	129	49	895	1,894	32	2,997	4,923
Other non-producing property costs	—	—	—	—	—	398	39	437
Write-down of mineral properties	—	—	—	—	—	—	10,970	10,970
	821	129	49	895	1,894	430	9,604	11,928
Earnings (loss) before income and mining tax provision (recovery)	4,244	(533)	(2,400)	(5,908)	(4,597)	(1,592)	(9,644)	(15,833)
Income and mining tax provision (recovery)	1,206	271	5,297	13,719	20,493	—	(254)	20,239
Net earnings (loss)	3,038	(804)	(7,697)	(19,627)	(25,090)	(1,592)	(9,390)	(36,072)
Capital expenditures	5,820	3,681	283	6,461	16,245	—	258	16,503
Mineral properties and fixed assets	51,609	57,914	58,538	132,105	300,166	5,292	9,786	315,244
Identifiable assets	79,091	76,522	191,960	158,522	506,095	6,207	32,826	545,128

Information about major customers – Summary of net revenue from major customers for the three months ended September 30, 2008.

Revenue Source

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Customer 1	6,648	—	—	6,393	13,041
Customer 2	—	2,652	10,155	—	12,807
Customer 3	9,435	312	—	—	9,747

18. Segment Information

Segment Information

For the Nine Months Ended September 30, 2009 (Unaudited)

(\$000's)								
Operating Segment	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Gross sales revenue	71,608	50,067	54,844	2,992	179,511	—	(2,817)	176,694
Treatment and marketing costs	20,717	15,977	13,798	1,184	51,676	—	—	51,676
Net revenue	50,891	34,090	41,046	1,808	127,835	—	(2,817)	125,018
Direct operating costs	31,841	15,360	38,378	1,175	86,754	—	—	86,754
Depreciation and depletion	11,954	5,317	1,165	68	18,504	—	69	18,573
Reclamation and closure costs	1,010	175	2,698	64	3,947	545	—	4,492
	44,805	20,852	42,241	1,307	109,205	545	69	109,819
Contribution (loss) from mining activities	6,086	13,238	(1,195)	501	18,630	(545)	(2,886)	15,199
General and administrative	—	—	—	—	—	—	8,120	8,120
Interest and financing	—	—	—	—	—	—	2,334	2,334
Investment and other income	—	—	—	—	—	—	(7,292)	(7,292)
Foreign exchange and other	—	—	—	—	—	—	4,723	4,723
Exploration	319	459	—	361	1,139	—	—	1,139
Other non-producing property costs	—	—	—	4,464	4,464	682	66	5,212
	319	459	—	4,825	5,603	682	7,951	14,236
Earnings (loss) before income and mining tax provision	5,767	12,779	(1,195)	(4,324)	13,027	(1,227)	(10,837)	963
Income and mining tax provision	1,006	1,721	—	2,176	4,903	—	611	5,514
Net earnings (loss)	4,761	11,058	(1,195)	(6,500)	8,124	(1,227)	(11,448)	(4,551)
Capital expenditures	9,424	6,902	1,104	91	17,521	—	536	18,057

Information about major customers – Summary of net revenue from major customers for the nine months ended September 30, 2009.

Revenue Source

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Customer 1	12,962	—	15,735	—	28,697
Customer 2	10,385	4,422	10,818	—	25,625
Customer 3	7,741	6,009	6,893	455	21,098

Segment Information

For the Nine Months Ended September 30, 2008 (Unaudited)

(\$000's)								
Operating Segment	Mochito	Toqui	Myra Falls	Langlois	Total	Non-operating mines	Corporate and Other	Consolidated
Gross sales revenue	78,185	77,292	75,490	67,042	298,009	-	-	298,009
Treatment and marketing costs	22,045	30,922	22,494	20,671	96,132	-	-	96,132
Net revenue	56,140	46,370	52,996	46,371	201,877	-	-	201,877
Direct operating costs	27,154	26,278	56,314	43,837	153,583	-	-	153,583
Depreciation and depletion	6,283	6,255	4,469	13,818	30,825	-	126	30,951
Reclamation and closure costs (income)	925	(958)	1,287	60	1,314	1,355	-	2,669
	34,362	31,575	62,070	57,715	185,722	1,355	126	187,203
Contribution (loss) from mining activities	21,778	14,795	(9,074)	(11,344)	16,155	(1,355)	(126)	14,674
General and administrative	-	-	-	-	-	-	11,433	11,433
Interest and financing	-	-	-	-	-	-	2,978	2,978
Investment and other income	-	-	-	-	-	-	(13,536)	(13,536)
Foreign exchange and other income	-	-	-	-	-	-	(1,488)	(1,488)
Exploration	1,788	816	1,027	3,598	7,229	422	6,179	13,830
Other non-producing property costs	-	-	-	-	-	1,069	175	1,244
Write-down of mineral properties	-	-	-	-	-	-	10,970	10,970
	1,788	816	1,027	3,598	7,229	1,491	16,711	25,431
Earnings (loss) before income and mining tax provision (recovery)	19,990	13,979	(10,101)	(14,942)	8,926	(2,846)	(16,837)	(10,757)
Income and mining tax provision (recovery)	5,198	2,678	8,164	9,003	25,043	-	(946)	24,097
Net earnings (loss)	14,792	11,301	(18,265)	(23,945)	(16,117)	(2,846)	(15,891)	(34,854)
Capital expenditures	19,776	17,755	3,250	23,286	64,067	-	1,083	65,150

Information about major customers – Summary of net revenue from major customers for the nine months ended September 30, 2008.

Revenue Source

(\$000's)	Mochito	Toqui	Myra Falls	Langlois	Total
Customer 1	5,951	13,495	19,482	-	38,928
Customer 2	-	4,600	31,678	-	36,278
Customer 3	6,648	-	-	13,986	20,634

19. Analysis of Changes in Non-Cash Working Capital Items

(\$000's)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Accounts receivable – concentrate	759	189	(1,206)	1,044
Other receivables	(509)	11,485	(4,413)	14,428
Concentrate inventory	1,052	14,064	(7,805)	4,267
Materials and supplies inventory	(274)	(3,310)	226	(6,331)
Prepaid expenses and other current assets	(49)	1,924	2,577	(569)
Income and mining tax receivable	210	–	1,426	–
Accounts payable and accrued liabilities	(7,357)	(27,871)	(24,906)	(25,093)
Provisional payments for concentrate inventory shipped and not priced	(4,245)	(10,686)	2,092	(3,319)
Income and mining taxes payable	737	(3,014)	886	(8,023)
	(9,676)	(17,219)	(31,123)	(23,596)

20. Earnings (Loss) per Common Share

Basic earnings (loss) per Common Share ("EPS") has been calculated using the weighted-average number of shares outstanding during the year. Incremental Common Shares on assumed exercise of options and warrants are not included in computing the diluted loss per share amount for the nine months ended September 30, 2009 and the three and nine months ended September 30, 2008, as the exercise of options would not have been dilutive. The calculation of diluted earnings (loss) per Common Share has been computed using the treasury stock method which assumes that options and warrants with an exercise price lower than the average quoted market price were exercised at the later of the beginning of the period, or time of issue. In applying the treasury stock method, options and warrants with an exercise price greater than the average quoted market price of the Common Shares are not included in the calculation of diluted earnings per Common Share as the effect is anti-dilutive. The average quoted market price of the Common Shares during the three and nine months ended September 30, 2009 were \$0.27 (2008 - \$0.78) and \$0.21 (2008 - \$1.06), respectively.

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Basic earnings (loss) per Common Share	\$0.01	(\$0.08)	(\$0.01)	(\$0.08)
Diluted earnings (loss) per Common Share	\$0.01	(\$0.08)	(\$0.01)	(\$0.08)
Basic weighted-average number of Common Shares outstanding (000's)	678,926	446,508	601,701	439,556
Incremental Common Shares on assumed exercise of options and warrants (000's)	63,021	–	–	–
Weighted-average number of Common Shares used for diluted earnings per Common Share (000's)	741,947	446,508	601,701	439,556

Corporate Information

DIRECTORS

Garth A. C. MacRae ^{1, 2, 3, 4}
Chairman

Grant A. Edey ^{1, 5}

Joanne Ferstman ¹

Jonathan C. Goodman ^{4, 5}

Ned Goodman ²

John W. Ivany

W. Murray John ³

David M. Petroff ^{1, 4}

George E. Pirie

¹ Member of Audit Committee

² Member of Compensation Committee

³ Member of Hedging Committee

⁴ Member of Corporate Governance and Nominating Committee

⁵ Member of Environmental, Health and Safety Committee

CORPORATE AND REGISTERED OFFICE

95 Wellington Street West
Suite 950
Toronto, ON
M5J 2N7

Tel: (416) 363-4798 Fax: (416) 363-1315

E-Mail: investorinfo@breakwater.ca

OFFICERS

David Petroff
President and Chief Executive Officer

Steven Hayes
Chief Commercial Officer

Fred Hermann
Chief Operating Officer

Dave Langille
Vice President, Finance & Chief Financial Officer

Bert Boivin
Vice President, Canada

Bob Carreau
Vice President, CSR and Sustainability

Dr. Bob Cuttriss
Vice President, Technical Services

Daniel Goffaux
Vice President, Latin America

Torben Jensen
Vice President, Engineering

Ann Wilkinson
Vice President, Investor Relations
and Assistant Secretary

Lesley Duncan
Corporate Secretary

Leroy Fong
Controller

John Laurie
Treasurer

Shareholder Information

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.
100 University Ave.
9th Floor
Toronto, ON
M5J 2Y1

North America Toll-free
Tel: (800) 564-6253 Fax: (888) 453-0330

International
Tel: (514) 982-7555 Fax: (416) 263-9524

E-Mail: service@computershare.com

www.computershare.com

CO-TRANSFER AGENTS

Computershare Investor Services Inc.
510 Burrard Street
2nd Floor
Vancouver, BC
V6C 3B9

Computershare Trust Company N.A.
350 Indiana Street
Suite 800
Golden, Colorado
U.S.A. 80401

Tel: (303) 262-0600 Fax: (303) 262-0603

SHARES

Toronto Stock Exchange (TSX)
Symbol - BWR & BWR.WT.A

WEBSITE

www.breakwater.ca





Mixed Sources
Product group from well-managed
forests and other controlled sources
www.fsc.org Cert no. SW-COC-002854
© 1996 Forest Stewardship Council



This report was printed in Canada using vegetable based inks. The paper is also certified by the Forest Stewardship Council (FSC). The use of their logo assures the end user that the forest-to-consumer process is responsibly managed, and that the product comes from a forest friendly source.