



CAPSTONE MINING CORP.

FINANCIAL REPORTING FOR 2009

DECEMBER 31, 2009

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CAPSTONE MINING CORP.

Message to Shareholders

On November 24th, 2008 the shareholders of Capstone Mining Corp. and Sherwood Copper Corporation approved a “merger of equals” thereby forming a premier base metal mining company and a new and more robust Capstone Mining Corporation. The merger brought together two ambitious young mining companies with the intent of becoming the next growth oriented mining house in the base metal sector. The transition from two companies to one was successfully completed in early 2009 and we have become a strong player in the copper business, with significant by-products of gold, silver, lead and zinc. The new Capstone has the following key assets:

- Two producing mines in two mining friendly countries; Cozamin Mine (a copper-zinc-lead-silver mine in the State of Zacatecas, Mexico) and Minto Mine (a copper-gold-silver mine in Yukon, Canada);
- The Kutcho Project (a copper-zinc-silver-gold deposit in British Columbia, Canada);
- Greenfield and near-mine exploration in Mexico and Yukon, Canada;
- Strategic investment in Silver Wheaton, providing enhanced leverage to precious metals, and Nevada Copper Corp. with its large copper project in Nevada, USA;
- A balance sheet with over US\$115 million in cash and little debt.

During 2009, we benefited from an increase in copper prices which, like all commodities, had suffered under the vagaries of the extraordinary financial crisis which occurred in the latter part of 2008 and into early 2009. The year closed with stronger base and precious metal prices than were foreseen just 12 months before, which proved to be tremendously beneficial for Capstone and for copper miners globally. Nonetheless, as prices strengthened to near record highs in real terms, management worked hard to control total cash operating costs as other commodity prices also made dramatic increases. The total cash costs for the year came in at \$1.03 per pound of payable copper, while the average copper price for the year was \$2.34 per pound. This combination of higher metal prices and controlled costs meant our financial results were strong, with adjusted net earnings of \$65.2 million and cash flow from operating activities of \$112.1 million.

The following were our results on the key objectives established for 2009:

- Successful integration of Capstone and Sherwood following the merger;
- Strong recovery of the share price during the year, attributable to a recovery of the copper price and the overall performance of operations;
- Produced 86.6 million pounds of payable copper at a cost of \$1.03 per pound (89.8 million pounds of copper contained in concentrate);
- Strong operating cash flow of \$112.1 million or \$0.60 per share;
- Significantly strengthened the balance sheet, with project bank debt reduced to less than \$10 million at year end, with the balance to be paid off in 2010;
- Extended the lives of both the Cozamin and Minto mines to eight years, with potential recognized to go beyond;
- Success from the exploration program at Minto, with two discoveries, and the potential for discoveries at Cozamin increased with the acquisition of new claims adjacent to the mine;
- Completed a Preliminary Economic Assessment of the Kutcho Project as the Company continues with all opportunities that offer organic growth potential;



- Completed the exchange of Silverstone Resources Corp. shares and warrants for Silver Wheaton Corp. shares increasing the Company's liquidity and subsequently the value of its holdings;
- Our employees achieved an exceptional safety record with no lost time accidents and very low incident rates at both mines.

Capstone's management has outlined several key objectives for the year 2010 including the following:

- Production of 90 to 100 million pounds of copper with total cash costs of \$1.10 to \$1.20 per pound of payable copper, along with significant by-product lead, zinc, silver and gold based on:
 - Expanded output from the Minto copper mine, as well as continued exploration for more copper-rich discoveries;
 - Increased production from the Cozamin mine, building off the successful exploration, reserve definition and mill expansions of prior years;
- Completion of a pre-feasibility study on the Kutcho copper-zinc-silver-gold project incorporating enhancements targeted for 2010;
- Increased emphasis on our exploration programs in the near-mine land holdings of both our Mexican and Yukon operations;
- Increased productivity at both mining operations;
- Continued aggressive growth strategy, as demonstrated over the past two years, including the possible addition of a further accretive project or producer to the existing stable of assets;
- Continued focus on our safety and environmental protection performance at our operations.

We expect the demand for our concentrates will continue to remain firm in 2010 and for the years going forward due to increased demand from developing countries. The demand out of China was a major driving force in recovery of metal prices in 2009 and we expect this demand to continue to grow for several years as we see a similar situation developing in India, Brazil and other emerging economies.

The strength and growth rate of these economies provides continued optimism that the strong prices of copper, zinc, gold and silver will remain at levels higher than the historical average for the last 10 years and continue well into the future. Capstone is well situated to take advantage of these price levels with its strong balance sheet, mineral reserves and resources and by the experienced management team and work forces in place.

Looking forward to 2010, we can summarize our priorities as:

- Continued throughput expansions at both operations;
- Continued organic growth through expanded exploration adjacent to our existing mines and through the advancement of the Kutcho project;
- Grow externally through mergers/acquisitions utilizing our strong balance sheet, solid cash flow and technical team skills.

While much can be said about our accomplishments in terms of growth through acquisitions and organically, we cannot lose sight of what underpins and supports our ability to complete such accomplishments: it is the talents and abilities of our employees applied to the operating of our mines that generates the returns for our shareholders. Ensuring that all employees of the Company have the safest work environment possible within which to carry out their duties continues to be one of the cornerstones of our foundation for the development of a successful company.



Capstone is only as effective and efficient as its employees. We are fortunate to have a management team who has proven their ability to manage costs aggressively without jeopardizing the safety and well-being of our employees or the integrity of the physical assets.

In addition to internal growth opportunities, there exists – as always – opportunities outside of our Company that are being considered. Through a combination of internal focus and external growth, it has been and continues to be our stated objective to grow Capstone, build value for the shareholders and firmly entrench the Company as a global base metal producer.

We would like to extend thanks to the directors of Capstone, who provided their knowledge and guidance during the year, our employees for their dedication and hard work, and to our shareholders – we extend special thanks for your continued support.

(signed) ***Darren M. Pylot***

Executive Vice Chairman and Chief Executive Officer

March 29, 2010



MANAGEMENT DISCUSSION AND ANALYSIS

FOR

CAPSTONE MINING CORP.

Management Discussion and Analysis

For

Capstone Mining Corp.

("Capstone" or the "Company")

The following management discussion and analysis of the Company has been prepared as of March 19, 2010 and should be read in conjunction with the Company's audited consolidated financial statements and notes for the year ended December 31, 2009. All financial information has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and all dollar amounts disclosed are United States dollars unless otherwise stated.

Nature of Business

Capstone is a Canadian mining company engaged in the production of and the exploration for strategic metals in Canada and Mexico. On November 24, 2008, the Company completed a reverse takeover transaction with Sherwood Copper Corporation ("Sherwood") (the "Business Combination").

Minto Explorations Ltd. ("MintoEx"), a wholly-owned Canadian subsidiary of the Company, owns and operates a high-grade copper-gold-silver mine located in Yukon Territory, Canada (the "Minto Mine"). Capstone Gold, S.A. de C.V. ("Capstone Gold"), a wholly-owned Mexican subsidiary of the Company, owns and operates a high-grade copper-silver-zinc-lead mine located in Zacatecas, Mexico (the "Cozamin Mine"). Kutcho Copper Corp. ("Kutcho Copper"), another wholly-owned Canadian subsidiary of the Company, formerly Western Keltic Mines Inc. ("Western Keltic"), is advancing the high-grade Kutcho copper-zinc-silver-gold project (the "Kutcho Project") in British Columbia towards a production decision.

2009 Overview

| | Total 2009 | Total 2008² |
|--|-----------------------|-----------------------------------|
| Gross sales revenue (\$ millions) | 250.4 | 122.8 |
| | | |
| Payable copper produced (millions lbs) | 86.6 | 71.3 |
| <i>Total cash cost per payable pound of copper ⁽¹⁾ (\$)</i> | <i>1.03</i> | <i>1.25</i> |
| Copper sold - (millions lbs) | 85.3 | 42.0 |
| | | |
| Earnings (loss) for the period (\$ millions) | (18.3) | 131.8 |
| <i>Earnings (loss) per share (\$)</i> | <i>(0.10)</i> | <i>1.47</i> |
| | | |
| Adjusted net earnings ⁽¹⁾ (\$ millions) | 65.2 | 2.9 |
| <i>Adjusted Earnings ⁽¹⁾ per share (\$)</i> | <i>0.35</i> | <i>0.03</i> |
| | | |
| Cash flow from operating activities (\$ millions) | 112.1 | 18.7 |
| <i>Cash flow from operating activities per share (\$)</i> | <i>0.60</i> | <i>0.21</i> |
| | | |
| Cash on hand (\$ millions) | 115.9 | 27.3 |

²The Total 2008 information only includes results from the Cozamin Mine from November 24, 2008 to December 31, 2008, except for the payable copper produced and the cash cost per pounds of payable copper which are for the full year.

2009 Highlights

Financial and Production Highlights for the Year Ended December 31, 2009

- Recorded a net loss of \$18.3 million or \$0.10 per common share which mainly included:
 - Earnings from mining operations of \$81.4 million;
 - Gains on disposal of investments of \$46.4 million; and
 - Loss of \$142.1 million on derivative instruments which was comprised of:
 - A realized gain of \$17.7 million on metal derivative instruments settled; and
 - A net unrealized loss of \$159.8 million on outstanding derivative instruments, primarily the result of the increase in the price of copper.
- Adjusted net earnings¹ were \$65.2 million or \$0.35 per common share after making adjustments for certain non-cash and one-time items.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

- Generated cash flow from operating activities of \$112.1 million or \$0.60 per common share.
- Working capital was \$86.0 million at December 31, 2009, which included \$115.9 million in unrestricted cash compared with working capital of \$35.4 million at December 31, 2008 which included \$27.3 million of unrestricted cash.
- Produced a total of 86.6 million pounds of payable copper at an estimated total cash cost¹ of \$1.03 per pound of payable copper.
- Recorded gross sales revenue of \$250.4 million on the sale of 85.3 million pounds of copper, 15.0 million pounds of zinc, 9.3 million pounds of lead, 31,571 ounces of gold and 1,719,548 ounces of silver.

Additional Highlights

Cozamin

- Completed an updated eight year life-of-mine plan for the Cozamin Mine, incorporating results to December 31, 2008.
- Purchased three mineral claims that are within the immediate vicinity of the Cozamin Mine resources and reserves, opening up potential for resource additions on the newly acquired claims.
Subsequent to year end, updated mineral resource and mineral reserve estimates were completed incorporating activities to December 31, 2009.

Minto

- Completed the Minto Mine Phase IV Prefeasibility Study (the “Phase IV PFS”) that includes:
 - An updated eight year life-of-mine plan for the Minto Mine, incorporating results to May 2009.
 - Planned increase in mill throughput to 1.37 million tonnes per year;
 - Opportunities identified that could further increase production and reserves from underground sources.
- Exploration at Minto lead to the discovery of the high grade Minto North deposit in early 2009, which was drilled to reserve standards and included in the Phase IV PFS, and a second discovery of high grade copper-gold mineralization at Minto East towards the end of 2009.
- Experienced an unusually high freshet in spring 2009, which necessitated diversion of run-off water into the open pit and affected access to higher grade ore. Permission was received from regulators to discharge this excess run-off water and access to the pit was re-established at the end of the third quarter 2009. Milling continued during this period by drawing from lower grade stock piles.

Kutcho

- Issued a Preliminary Economic Assessment on the Kutcho Project that defined a higher grade, lower risk underground development scenario with a significantly reduced environmental footprint. Recommendations for going forward included focusing on opportunities for enhanced returns from improved metallurgical performance and reduced energy costs.

Financial

- Arranged and drew \$40.0 million on a corporate revolving term credit facility with the Bank of Nova Scotia (the “RTF”). \$31.1million (C\$39.3 million) of these funds were used for the partial repurchase of the Debentures (as defined below) leaving an outstanding Debentures balance at December 31, 2009 of \$3.7 million (C\$4.7 million).
- Exchanged 24,042,340 shares and 2,747,428 special warrants of Silverstone Resources Corp. (“Silverstone”) held by the Company for 4,956,106 shares of Silver Wheaton Corp. (“Silver Wheaton”) as per the plan of arrangement between Silverstone and Silver Wheaton. Subsequently sold 3,500,000 of the Silver Wheaton shares and recorded a gain on the exchange and share sale of \$46.3 million.
- Fully repaid the \$29.9 million balance of the Macquarie project loan facility (the “PLF”).
- Sold by way of a bought deal equity financing 31,165,000 common shares at a price of C\$1.85 per common share for gross proceeds of C\$57.7 million (\$49.5 million). A portion of net proceeds were used to fully repay the RTF.
- Purchased 4.5 million units in Nevada Copper Corp. (“Nevada Copper”) by way of a private placement, each unit consisting of one common share and one-half of a common share purchase warrant. The investment gives Capstone exposure to a large tonnage, relatively higher grade copper deposit located in a mining friendly jurisdiction.
- Provided the following production guidance for 2010:

2010 Production Forecast
(All numbers approximate)

| | Cozamin | Minto | Total |
|--|------------------|------------------|------------------|
| Tonnes milled (millions) | 1.1 | 1.2 | 2.3 |
| Copper grade (%) | 2.0% | 2.2% | 2.1% |
| Copper recovery (%) | 92% | 92% | 92% |
| Contained copper (millions pounds) | 40 to 45 | 50 to 55 | 90 to 100 |
| Total cash cost per pound of payable copper ² | \$0.80 to \$0.90 | \$1.30 to \$1.40 | \$1.10 to \$1.20 |

² Basis US\$1.00 to C\$1.09

- The Company has approximately 35% of the 2010 copper production sold forward at an average price of \$2.38 per pound and approximately 12% or 66.6 million of the total pounds in the life of mine plans, at an average price of \$2.51 per pound.
- As a result of ongoing expansions and operations optimization, including implementation of the Phase IV expansion at the Minto Mine, production will ramp up throughout 2010.

Selected Annual Information

| | Years Ended December 31 | | |
|---|--------------------------------|-------------|-------------|
| (\$ millions except for per share numbers) | 2009 | 2008 | 2007 |
| Net revenues | 219.3 | 106.0 | 0.7 |
| Operating costs | (137.9) | (86.1) | (3.0) |
| Income (loss) from mining operations | 81.4 | 19.9 | (2.3) |
| General and administrative expenses | (8.0) | (6.5) | (2.1) |
| Stock-based compensation | (2.8) | (3.3) | (4.6) |
| Gain (loss) on derivative instruments | (142.1) | 123.6 | (36.4) |
| Gain on disposal of investments | 46.4 | nil | nil |
| Asset impairment charge | nil | (53.4) | nil |
| Non-recurring gain on acquisition of Capstone | nil | 72.0 | nil |
| Current & future taxes recovery (expense) | 11.2 | (4.5) | 0.6 |
| Other income (expense) | (4.4) | (16.0) | 4.1 |
| Net income (loss) for the period: | | | |
| - In total | (18.3) | 131.8 | (40.7) |
| - Basic earnings (loss) per share | (0.10) | 1.47 | (0.59) |
| - Diluted earnings (loss) per share | (0.10) | 1.31 | (0.59) |
| Total assets | 551.1 | 497.9 | 224.7 |
| Total long term financial liabilities | 172.7 | 165.5 | 145.7 |

Results of Operations

The Business Combination between the Company and Sherwood was effective November 24, 2008 and was considered a reverse takeover for accounting purposes as the majority of the shareholders, board of directors and management of the continuing entity are former shareholders, directors and management of Sherwood. Effective January 1, 2008 the Company elected to adopt the new business combination accounting standards as described in CICA Handbook Section 1582 “Business Combinations” and the merger was accounted for as a business combination with Sherwood being identified as the acquirer. The combined company is considered a continuation of Sherwood with the net assets of Capstone acquired on November 24, 2008 and consolidated with the operations of Sherwood from that date forward. Comparability of production and mining operation financial results between 2009 and 2008 is limited as 2008 only includes the operational results of the Cozamin Mine from November 24, 2008.

The Company recorded a net loss of \$18.3 million for the year ended December 31, 2009 (the “Current Period”) compared with net earnings of \$131.8 million for the year ended December 31, 2008 (the Comparative Period”). The principal contributor to the swing in earnings was changes in the non-cash mark-to-market valuation of derivative instruments.

Gross sales revenue of \$250.4 million was generated in the Current Period on the sale of copper, zinc, lead, gold and silver as detailed below. These net sales generated earnings from mining operations of \$81.4 million. Gross revenue in the Comparative Period of \$122.8 million generated earnings from mining operations of \$19.9 million.

¹ These are non-GAAP performance measures: please see “Non-GAAP Performance Measures” below.

Significantly higher volumes of metals were sold during the Current Period as compared with the Comparative Period.

Sales Quantities by Metal

| | Current Period | Comparative Period ¹ |
|------------------------------|-------------------|---------------------------------|
| Copper – pounds | | |
| Cozamin | 33,141,849 | 3,371,277 |
| Minto | <u>52,169,720</u> | <u>38,613,137</u> |
| | 85,311,569 | 41,984,414 |
| Realized copper price | \$2.31 | \$2.35 |
| Average copper price | \$2.34 | \$3.15 |
| Zinc – pounds | | |
| Cozamin | 15,018,716 | 1,983,240 |
| Lead - pounds | | - |
| Cozamin | 9,316,986 | |
| Gold – ounces | | |
| Minto | 31,571 | 24,344 |
| Silver – ounces | | |
| Cozamin | 1,475,633 | 103,815 |
| Minto | <u>243,915</u> | <u>164,058</u> |
| | 1,719,548 | 267,873 |

¹The Comparative Period only includes sales from the Cozamin Mine from November 24, 2008 to December 31, 2008. The current and subsequent periods may include final settlement quantity adjustments from prior shipments

Gross Sales Revenue by Metal

| | Current Period (\$ 000's) | Current ¹ Period % | Comparative ⁴ Period (\$ 000's) | Comparative Period ² % |
|---------------------------|------------------------------|-------------------------------------|--|---|
| Copper | 197,098 | 78.7% | 98,740 | 80.4% |
| Zinc | 11,607 | 4.6% | 1,373 | 1.1% |
| Lead | 7,708 | 3.1% | - | - |
| Gold³ | 19,463 | 7.8% | 19,077 | 15.5% |
| Silver³ | <u>14,528</u> | <u>5.8%</u> | <u>3,648</u> | <u>3.0%</u> |
| Total | 250,404 | 100% | 122,838 | 100% |

²The Comparative Period only includes sales from the Cozamin Mine from November 24, 2008 to December 31, 2008

³Gold and silver revenue include non cash amount for deferred revenue amortization related to the precious metal stream sales.

⁴The current and subsequent periods may include final settlement price adjustments from prior shipments

At December 31, 2009 the following metal quantities were provisionally priced and included in gross sales revenue. The provisional prices are subject to change on final price settlement (QP):

- Copper - all final priced;
- Lead - all final priced; and
- Zinc - 269,203 pounds provisionally priced at \$1.13 per pound.
 - QP January 2010 at \$1.12 per pound.

All of the Company's concentrate sales are covered by off take agreements with terms of 6 months to 24 months. The Minto agreement, which expires in June 2010, is currently under negotiation.

Cost of sales in the Current Period was \$92.5 million, 42.2% of net revenue compared with \$62.6 million, 59.1% of net revenue in the Comparative Period. The gross difference represents the higher volume of metals sold in the Current Period while the lower percent of net revenue is due lower unit costs of the metals sold and to the positive contribution of the by-product metals to revenues from the Cozamin Mine for the full Current Period. The realized copper metal price was essentially unchanged from period to period due to negative price adjustments in the Comparative Period with the significant metal price reductions in the last quarter.

Concentrate production, sales and inventory is provided in the table below:

| | Copper (dmt) | Zinc (dmt) | Lead (dmt) |
|-------------------------------|-------------------------|-----------------------|-----------------------|
| Cozamin Mine | | | |
| Inventory - December 31, 2008 | 7,751 | 3,378* | 1,378 |
| Production | 66,988 | 15,008 | 6,575 |
| Sales | (68,280) | (16,571)* | (6,771) |
| Inventory – December 31, 2009 | 6,459 | 1,815 | 1,182 |
| Minto Mine | | | |
| Inventory - December 31, 2008 | 13,285 | - | - |
| Production | 59,863 | - | - |
| Sales | (59,460) | - | - |
| Inventory – December 31, 2009 | 13,688 | - | - |

**Does not include 2,015 tonnes of low grade zinc carried at no value that was sold in Q2 2009.*

Truck transport is not available for two periods of eight to ten weeks beginning in April and in October of each year as the Yukon River freeze-up and breakup prevents access to the Minto Mine. Up to 20,000 dmt of concentrate produced during these periods can be stored at the mine site. The Company's reported revenue from the Minto Mine may vary significantly from period to period due to this truck transport limitation.

Since production from the Cozamin Mine is trucked to the Port of Manzanillo on a regular, almost daily, basis, there are only minor concentrate inventory build ups at the mine.

The Company's revenue recognition policy requires that title and risk pass to the customer and that the settlement price be reasonably determinable in accordance with the Company's off-take agreement in order to record revenue in the period. As final metal price settlement may occur a number of months after the initial revenue recognition, changes in metal prices during that time may have a material impact on the final revenue recognition.

Administrative costs in the Current Period were \$8.0 million compared with \$6.5 million in Comparative Period. All the major administrative costs (salaries, professional fees, office costs, travel, investor relations, etc.) increased following the Business Combination between the Company and Sherwood.

Stock-based compensation, a non-cash cost, was \$2.8 million in Current Period compared with \$3.3 million in Comparative Period, due mainly to a lower fair value of options granted during the Current Period.

Interest expense of \$3.9 million was incurred in the Current Period related to the interest and accretion on debentures issued in February 2007 and interest on capital leases and bank debt. This amount is lower compared with \$8.5 million in the Comparative Period as the debenture and bank debt balances were significantly reduced during the Current Period.

The Company recorded a foreign exchange gain of \$1.2 million in the Current Period mainly related to the PLF, the RTF Facility and the capital lease on the Skagway Port facility, all denominated in US dollars, due to the strengthening of the Canadian dollar. In the Comparative Period, a loss of \$7.5 million was recorded mainly related to the PLF and the capital lease on the Skagway Port facility both denominated in US Dollars, due to the decline in the Canadian dollar.

During the Current Period the Company recorded a loss on derivative instruments of \$142.1 million compared with a gain of \$123.6 million in the Comparative Period. \$160.8 million was a non-cash unrealized loss related to the change in the mark-to-market value of the Company's metal derivative instruments as metal prices increased compared with a non-cash unrealized gain of \$126.2 million in the Comparative Period when metal prices decreased, thereby increasing the mark-to-market value of the derivative instruments. As well, the Company recorded an unrealized gain of \$1.0 million on the Nevada Copper share purchase warrants. In the Current Period, \$17.7 million was a realized net gain on the settlement of 43.1 million pounds of copper, 0.7 million pounds of zinc and 0.3 million pounds of lead forward positions. This compared to a realized loss of \$2.6 million in the Comparative Period with the close out of the entire gold and silver forward sales positions at a loss of \$6.1 million, which was partially offset by a realized gain \$3.5 million on the settling of 33.4 million pounds of copper forward positions. The Company accounts for its derivative instruments as "held for trading investments" and records changes in the fair value of these instruments in its consolidated statements of (loss) earnings.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

An asset impairment charge of \$53.4 million was recorded against the Minto Mine in the Comparative Period, due to the significant reduction in the copper price over the period. No impairments were taken in the Current Period.

Income and mining tax expense of \$19.9 million was recorded in the Current Period related to an estimate of the Yukon Quartz Mining Act Royalty (the "QMAR") payable of \$5.6 million, income taxes payable related to the Cozamin Mine of \$11.8 million and \$2.5 million related to securities sales in Canada. This compares with \$0.7 million, \$0.4 million related to the QMAR and \$0.3 million related to the Cozamin Mine in the Comparative Period.

The future income tax recovery of \$31.1 million recorded in the Current Period is primarily as a result of recording a future income tax benefit related to the derivative instrument losses of the Canadian operations and a reversal of a portion of the future income tax liability related to the Mexican operations, as they had taxable income for the year even though they had a loss for accounting purposes. This recovery was partially offset by future income tax expense related to the accounting gain on the Silverstone and Silver Wheaton share sales.

Capstone-Sherwood Merger

On September 8, 2008, the Company and Sherwood entered into a letter agreement to combine the two companies to create a well-funded, low-cost, growth-oriented, copper company with two producing mines in mining friendly jurisdictions in North America. The two companies agreed to combine on an "at-market" basis by way of plan of arrangement (the "Arrangement") whereby each Sherwood shareholder received 1.566 shares of Capstone. Outstanding options and warrants of Sherwood were adjusted in accordance with their terms so that the number of Capstone shares received upon exercise and the exercise price were adjusted proportionately to reflect the same exchange ratio. The effective date of the combination was November 24, 2008 when Sherwood and a wholly-owned subsidiary of Capstone were amalgamated under the name "Capstone Mining North Ltd.". On December 31, 2008, Capstone Mining North Ltd. was amalgamated with Capstone and, as a result, MintoEx and Kutcho Copper became direct subsidiaries of Capstone.

Pursuant to a share exchange agreement with an effective date of November 24, 2008, Capstone acquired all of the issued and outstanding shares of Sherwood. Capstone issued 84,334,104 of its common shares in exchange for 53,853,198 shares of Sherwood, with the effect that, subsequent to the Business Combination, the former shareholders of Sherwood controlled 51.20% of the outstanding common shares of Capstone. Prior to this exchange, Capstone had 80,370,781 shares outstanding. Taking into account the composition of the board and senior management and the relative ownership percentages of Sherwood and Capstone shareholders in the newly combined enterprise, from an accounting perspective Sherwood is considered to have acquired Capstone, and hence the Business Combination has been recorded for accounting purposes as a reverse takeover.

For financial reporting purposes, the Company is considered to be a continuation of Sherwood, the legal subsidiary, except with regard to the authorized and issued share capital, which is that of Capstone, the legal parent. The consolidated statements of operations and cash flows for the year ended December 31, 2008 include the results of operations and cash flows of Sherwood for the period from January 1, 2008 to November 23, 2008, and the results of operations and cash flows of Capstone and Sherwood for the period from November 24, 2008 to December 31, 2008. The primary reason for the Business Combination was to create a well-funded, low-cost, growth-oriented copper company with two producing mines in politically stable and mining friendly jurisdictions.

The Business Combination has been accounted for using the purchase method of accounting. The purchase price has been determined based on the number of shares that Sherwood would have had to issue on the date of closing to give the owners of Capstone the same percentage equity (48.80%) of the combined entity as they hold subsequent to the Business Combination. The costs of the Business Combination have been allocated as follows:

| | |
|---|-------------|
| <i>Consideration transferred: (millions)</i> | |
| Deemed issuance of Sherwood shares* | 43.6 |
| Deemed issuance of Sherwood options and warrants | 0.7 |
| | 44.3 |
| <i>Net assets acquired</i> | |
| Cash | 31.8 |
| Non-cash current assets** | 19.1 |
| Investments | 8.2 |
| Property, plant and equipment | 21.5 |
| Mineral property | 102.3 |
| Derivative instruments asset | 26.0 |
| Other assets** | 2.8 |
| Current liabilities | (5.5) |
| Concentrate advances | (6.2) |
| Unfavourable contract on silver | (45.7) |
| Capital lease obligation | (0.1) |
| Asset retirement obligation | (2.1) |
| Future income taxes | (29.4) |
| Gain on acquisition | (78.4) |
| | 44.3 |
| * Based on the deemed issuance of 51,328,829 common shares of Sherwood at a price of C\$1.05 per share, converted at the exchange rate of 1.2345 US\$/C\$ on the date of transaction. | |
| | |
| ** Included in the net assets acquired are receivables totaling \$11.5 million, against which management has not provided any allowance for bad debt. | |

As part of the Business Combination, Capstone issued 7,178,512 options and 4,142,546 warrants in exchange for 4,637,667 options and 2,645,306 warrants of Sherwood, respectively, on the same terms and conditions as those exchanged by Sherwood holders. No amount has been recorded in respect of these actual issuances of options and warrants. Rather, given that this Business Combination has been accounted for as a reverse takeover of Capstone by Sherwood, from an accounting perspective it is Sherwood that is deemed to have issued options and warrants to Capstone holders. At November 24, 2008, Capstone had 3,194,000 and 3,835,986 options and warrants outstanding, respectively. The fair value of the deemed issuance of 3,194,000 options and 3,835,986 and warrants of Capstone was \$0.7 million, and this amount has been included as a component of the purchase price.

During the fourth quarter of 2008, the price of copper declined sharply, resulting in market prices for the shares of Sherwood and Capstone that, in management's view, were not reflective of the underlying fair value of the net assets on the date of the Business Combination. Given that the Business Combination was effected by way of a pre-determined share-exchange ratio negotiated in September 2008, the effect of recording the share consideration exchanged, using market prices for the shares on the closing date of the transaction, resulted in a \$72.0 million excess of fair value of identifiable net assets over the fair value of consideration transferred, which has been recorded as a gain on acquisition of Capstone.

In connection with the closing of the Arrangement, Capstone, Sherwood and Computershare Trust Company of Canada ("Computershare") entered into an indenture (the "First Supplemental Indenture") supplemental to the trust indenture made as of February 28, 2007 (the "Original Indenture") between Sherwood and Computershare, which indenture contains the terms and conditions governing the outstanding convertible unsecured subordinated debentures of Sherwood with the designation of 5% Convertible Unsecured Subordinated Debentures due March 31, 2012 (the "Debentures"). The First Supplemental Indenture contains an agreement by Capstone to assume the obligations of Sherwood under the Debentures and the Original Indenture. The Debentures were delisted from the TSX Venture Exchange and listed as securities of Capstone on the Toronto Stock Exchange under the symbol "CS.DB". In accordance with the terms of the Original Indenture, on December 23, 2008 Capstone made an offer to purchase all outstanding Debentures at a purchase price per C\$1,000 principal amount of the Debentures equal to the aggregate of 101% of the principal amount of the Debentures and all accrued and unpaid interest thereon. On January 22, 2009, C\$38.9 million of the C\$43.6 million of Debentures were re-purchased at a total cost of C\$39.9 million, including interest, leaving C\$4.8 million of Debentures still outstanding under the original terms.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

Precious Metal Sale

The Company entered into the Silverstone Agreement with Silverstone whereby Silverstone purchased the majority of the payable gold and all of the payable silver from the Minto Mine, over the life of the mine starting December 1, 2008. MintoEx received an up-front payment from Silverstone of \$37.5 million and will receive a further payment of the lesser of \$300 per ounce of gold and \$3.90 per ounce of silver (subject to a 1% inflationary adjustment after three years and each year thereafter) and the prevailing market price of gold and silver quoted on the London Bullion Market Association, for each ounce delivered. If production from the Minto Mine exceeds 50,000 ounces of payable gold in the first two years of the agreement or 30,000 ounces of payable gold per year thereafter, Silverstone will be entitled to purchase only 50% of the amount in excess of those thresholds. Kutcho Copper has also granted Silverstone a right of first refusal to purchase any gold or silver streams from the Kutcho Project, should Kutcho Copper elect to sell such metals on terms and conditions to be agreed. Silverstone was subsequently acquired by Silver Wheaton.

Fourth Quarter 2009

The Company had a net loss for the three months ended December 31, 2009 (the “Current Quarter”) of \$17.6 million, the main reason for this loss was:

- A loss of \$37.4 million on derivative instruments with the increase in metal prices during the Current Quarter, partially offset by earnings from mining operations of \$16.4 million and the gain on the sale of investments of \$5.6 million.

The Company had net earnings for the three months ended December 31, 2008 (the “Comparative Quarter”) of \$116.8 million. The main components of the earnings were as follows:

- \$138.8 million gain on derivative instruments as copper prices decreased significantly; and
- A \$72.0 million gain on the acquisition of Capstone as the fair value of the net assets and liabilities was greater than the purchase price; which was

Offset by:

- \$29.9 million a loss from mining operations due to mainly negative metal price adjustments on previous concentrate sales with the decline in metal prices; and
- \$53.4 million asset impairment charge, due to the significant reduction in the copper price.

Production Results

Minto Mine

The Minto Mine is a high-grade copper-gold mine located in Yukon Territory of Canada. The Company acquired a 100% working interest (subject to an NSR in favour of the Selkirk First Nation) in the Minto Mine in June 2005. Commercial production was achieved at a rate of 1,560 tonnes per day (“tpd”) as of October 1, 2007. The Phase II mill expansion, bringing the mill throughput to a nominal 2,400 tpd, was completed and commissioned in early 2008. The mill was then expanded to a nominal 3,200 tpd of throughput at the end of 2008, with the Phase III expansion completed and commissioned in the first quarter of 2009.

Production Results

As planned, mining in the first four months of 2009 involved completion of the Phase 3 North pit push-back, with high grades from that phase processed in the first five months of 2009. The Phase 3 South push-back was partially completed in the first four months of 2009, but temporarily halted as a result of excess spring run-off waters being diverted into the pit to ensure that no non-compliant discharges occurred, thereby restricting access to higher grade ore in the bottom of the pit. This interruption of ore mining was anticipated in the 2009 operating budget and the milling process continued uninterrupted from stockpiled material, albeit of somewhat lower grade than in prior months. However, freshet began earlier than expected and more water than was anticipated was diverted into the pit. The latter delayed re-entry to the pit and resulted in the operation having to rely on lower grade stockpiles for an extended period, until access to the pit was regained in early October. The Minto Main pit also noted some movement in semi-frozen overburden on the south wall, which movement continues to be monitored, but no adverse consequences have occurred. During the fourth quarter, full production continued from the Phase 3 south push-back, providing high grade mill feed in the quarter, and stripping of the Phase 4 north push-back continued, with high grade ore anticipated to be exposed in the first quarter of 2010. The overall impact of the water inflows was lower copper production in 2009 than the 60-65 million pounds originally forecast. The rate of mining in the fourth quarter of 2009 and into 2010 has been accelerated to ensure sufficient ore is stockpiled outside of the pit to avoid any interruptions in production in 2010.

In the table below are the 2009 quarterly and full year production results for the Minto Mine. In 2009, a total of 1,031,190 tonnes of ore at a grade of 2.55% copper were processed producing 59,863 dmt of copper concentrate containing 51.9 million pounds of payable copper with an estimated average total cash cost ⁽¹⁾ of \$1.12 per pound.

Key operating statistics² for the Minto Mine for 2009 are presented below:

| | Q1 2009 | Q2 2009 | Q3 2009 | Q4 2009 | Total 2009 (Adjusted) ⁽⁵⁾ |
|---|-----------|-----------|-----------|-----------|---|
| Production ⁽³⁾ (contained in concentrates) | | | | | |
| - Copper (000s pounds) | 16,228 | 13,178 | 9,455 | 15,772 | 53,657 |
| - Gold (ounces) ⁽²⁾ | 8,527 | 7,564 | 3,698 | 8,790 | 28,579 |
| - Silver (ounces) | 100,714 | 64,637 | 45,198 | 89,218 | 299,767 |
| Mining | | | | | |
| - Waste (tonnes) | 2,196,728 | 2,845,300 | 3,401,120 | 2,689,363 | 11,132,511 |
| - Ore (tonnes) | 292,594 | 289,010 | 7,698 | 561,786 | 1,151,088 |
| - Total material mined (tonnes) | 2,489,322 | 3,134,310 | 3,408,818 | 3,251,149 | 12,283,599 |
| Milling | | | | | |
| - Tonnes processed | 233,529 | 267,254 | 269,411 | 260,996 | 1,031,190 |
| - Tonnes processed per day | 2,595 | 2,937 | 2,870 | 2,837 | 2,825 |
| - Copper grade (%) | 3.39 | 2.41 | 1.76 | 2.95 | 2.55 |
| - Gold grade (g/t) ^{(2), (3)} | 1.57 | 0.97 | 0.60 | 1.14 | 1.14 |
| - Silver grade (g/t) | 16.0 | 9.6 | 6.7 | 12.7 | 11.0 |
| Recoveries | | | | | |
| - Copper (%) | 93.0 | 92.6 | 91.9 | 92.4 | 92.6 |
| - Gold (%) ^{(2), (3)} | 72.8 | 71.9 | 71.6 | 83.7 | 75.3 |
| - Silver (%) | 83.5 | 79.6 | 80.0 | 83.4 | 81.9 |
| Concentrate | | | | | |
| - Dry tonnes produced | 17,283 | 14,667 | 10,834 | 17,079 | 59,863 |
| - Copper grade (%) | 42.6 | 40.8 | 40.3 | 41.9 | 40.7 |
| - Gold grade (g/t) ^{(2), (3)} | 15.5 | 12.5 | 10.3 | 16.0 | 14.9 |
| - Silver grade (g/t) | 183 | 139 | 133 | 163 | 156 |
| On site Operating Costs (\$/t milled) ⁽⁴⁾ | \$47.85 | \$44.52 | \$42.72 | \$55.42 | \$47.64 |
| Payable pounds of copper produced (000s lbs) | 15,700 | 12,749 | 9,147 | 15,252 | 51,913 |
| Total cash cost per pound ⁽¹⁾ of payable copper ⁽⁴⁾ | \$0.87 | \$1.09 | \$1.48 | \$1.10 | \$1.12 |

⁽²⁾ Gold is not assayed on site, resulting in a significant lag in receiving this data.

⁽³⁾ Adjustments based on final settlements will be made in future periods.

⁽⁴⁾ Minto's operating costs are adjusted to exclude mining of ore and waste not related to concentrate produced in the period, these costs are capitalized or inventoried in the financial statements, then expensed when the associated ore is processed.

⁽⁵⁾ Some totals will not sum, due to adjustments on final settlements on copper sales during the year. These adjustments are only reflected in the year to date column.

National Instrument 43-101 Technical Report

The Company completed a NI 43-101 compliant pre-feasibility study and technical report in December 2009 (the "the Phase IV PFS") that justifies an increase in mill throughput to a nominal 4,100 tonnes per operating day (1.37 million tonnes per year processed), increased the mine life to 8 years with a life-of-mine average production of 45 million pounds of copper. The Phase IV PFS also identified opportunities for increased production at higher grades by supplementing open pit production with feed from higher grade underground sources.

Exploration

The Company completed 202 holes for a total of 31,948 meters of drilling in 2009, significantly more than originally planned. The additional meters drilled were added because of the discovery of the Minto North deposit, which returned high grades over significant thicknesses and warranted infilling drilling to mineral reserve standards in time to include in the Phase IV expansion study later in the year. Updated mineral resource estimates were included in the Phase IV PFS noted above, incorporating the Minto North discovery. Towards the end of 2009, the Company reported the discovery of high grade copper mineralization in the deeper Minto East area, which is expected to represent an underground mining opportunity.

Outlook

The Company has provided guidance that production from the Minto Mine in 2010 is expected to be 50 to 55 million pounds of copper in concentrate at a total cash cost of approximately \$1.30 to \$1.40 per pound.

A total of \$5.3 million is expected to be spent on exploration during 2010, focused on (a) evaluating the potential of the Minto East discovery, (b) on testing for expansions of the mineralization in the Area 2/118 area that may be

amenable to underground mining and (c) continuing the exploration on the balance of the prospective Minto Mine property.

Capital expenditures at the Minto Mine are forecast to total \$12.7 million and include completion of the installation and commissioning water conveyance network and water treatment plant, community infrastructure development and permitting and regulatory costs related to implementation of the Phase IV expansion.

Cozamin Mine

In December 2003, Capstone entered into an option agreement with Grupo Minero Bacis S.A. de C.V. (“Bacis”) to acquire the Cozamin Mine. Capstone assumed a 100% interest in the Cozamin Mine in 2006, with a 3% Net Smelter Royalty (“NSR”) paid to Bacis on all metals produced. Commercial production commenced in September 2006 at 1,000 tpd. In 2007, the mine underwent a significant expansion when throughput was increased to 2,200 tpd. In 2008, the mine was further expanded to 3,000 tpd, which was completed at the end of 2008, with expanded mill throughput and access to new areas of wider, higher grade ore. Commissioning of the 3,000 tpd expansion was completed in February 2009.

On June 1, 2009, the Company issued an updated life-of-mine plan and mineral reserve estimate prepared by the SRK Consulting (Canada) Inc. that demonstrated an extended mine life for the Cozamin Mine. On March 2, 2010, the Company announced an increased mineral resource, primarily a result of higher metal prices bring mineralization above cut-off.

Production Results

The quarterly and full year 2009 results for the Cozamin Mine are set out in the table below. In 2009, a total of 975,728 tonnes of ore at a grade of 1.84% copper were processed producing 66,977 dmt of copper concentrate containing 34.6 million pounds of payable copper with an estimated average total cash cost ⁽¹⁾ of \$0.90 per pound. Production at the Cozamin Mine was affected by delays in bringing new, higher grade stopes on line as a result of higher grade ore zones being wider than anticipated and modified extraction methodology to ensure geotechnical stability. In the interim, production came from shallower areas with lower copper but higher lead and zinc content. During this period, mine production was less than the capacity of the mill to process ore, resulting in the lower mill throughput in the second half of 2009 as compared to the first six months.

Development of the wider ore zones was completed at the end of the third quarter of 2009 and production from these areas commenced in October 2009. Production continues to ramp up at a steady rate, as a strong focus on ground control remains a priority to ensure long term stability of these critical production areas. As this production continues to ramp up, Cozamin is taking advantage of currently high lead and zinc prices to mine areas with high grades in these metals.

Key operating statistics for the Cozamin Mine are presented below:

| | Q1 2009 | Q2 2009 | Q3 2009 | Q4 2009 | Total 2009 (Adjusted) ⁽³⁾ |
|--|---------|---------|---------|---------|---|
| Production (contained in concentrates) ⁽²⁾ | | | | | |
| Copper (000s) pounds | 9,813 | 9,881 | 8,196 | 8,934 | 36,121 |
| - Lead (000s pounds) | 1,157 | 2,332 | 3,193 | 3,452 | 10,134 |
| - Zinc (000s pounds) | 2,386 | 3,324 | 5,062 | 4,704 | 15,476 |
| - Silver (ounces) | 317,963 | 390,639 | 366,210 | 387,665 | 1,520,806 |
| Mine | | | | | |
| - Tonnes of ore mined | 248,507 | 243,494 | 236,803 | 243,795 | 972,599 |
| Mill | | | | | |
| - Tonnes processed | 248,325 | 249,975 | 236,938 | 240,490 | 975,728 |
| - Tonnes processed per day | 2,759 | 2,741 | 2,581 | 2,614 | 2,673 |
| - Copper grade (%) | 1.96 | 1.92 | 1.73 | 1.83 | 1.84 |
| - Lead grade (%) | 0.33 | 0.61 | 0.89 | 0.93 | 0.69 |
| - Zinc grade (%) | 0.81 | 1.01 | 1.51 | 1.33 | 1.17 |
| - Silver grade (g/t) | 56 | 66 | 67 | 69 | 66 |
| Recoveries | | | | | |
| - Copper (%) | 91.4 | 93.4 | 91.3 | 92.0 | 91.2 |
| - Lead (%) | 64.8 | 69.4 | 67.6 | 70.0 | 68.4 |
| - Zinc (%) | 59.3 | 59.5 | 63.2 | 66.7 | 61.7 |
| - Silver (%) | 71.0 | 73.6 | 72.0 | 73.1 | 73.1 |
| Concentrate | | | | | |
| - Copper concentrate produced (dmt) | 18,461 | 17,595 | 14,711 | 16,221 | 66,977 |
| - Copper (%) | 24.1 | 25.5 | 25.3 | 25.0 | 24.5 |
| - Silver (g/t) | 463 | 561 | 595 | 569 | 571 |
| - Lead concentrate produced (dmt) | 782 | 1,500 | 2,060 | 2,233 | 6,575 |
| - Lead (%) | 67.1 | 70.5 | 70.3 | 70.2 | 69.9 |
| - Silver (g/t) | 1,738 | 1,511 | 1,282 | 1,264 | 1,382 |
| - Zinc concentrate produced (dmt) | 2,415 | 3,312 | 4,782 | 4,499 | 15,008 |
| - Zinc (%) | 44.8 | 45.5 | 48.0 | 47.4 | 46.8 |
| On site Operating Costs (\$/t milled) | \$34.97 | \$34.03 | \$38.93 | \$51.60 | \$39.79 |
| Payable pounds of copper produced (000s lbs) | 9,405 | 9,493 | 7,872 | 8,577 | 34,645 |
| Total cash cost per pound of payable copper ⁽¹⁾ | \$1.00 | \$0.81 | \$0.75 | \$0.94 | \$0.90 |

² Adjustments based on final settlements will be made in future periods.

³ Some totals will not sum, due to adjustments on final settlements on copper sales during the year. These adjustments are only reflected in the year to date column.

Exploration

During 2009, the Company purchased three mineral claims that are immediately adjacent to Cozamin's mineral resources and mineral reserves, opening up potential for mineral resource additions. The purchase price was comprised of: (a) an upfront payment of \$1.0 million; (b) future cash payments equivalent to a 1.5% net smelter return on the first one million tonnes of production from the acquired claims; and (c) future cash payments equivalent to a 3.0% net smelter return on production in excess of one million tonnes from the acquired claims, the calculation of which is subject to escalation at a rate of 0.5% for each \$0.50 increment in the copper price above \$3.00 per pound.

A property-wide compilation and assessment of the exploration potential at the Cozamin Mine was conducted in 2009 and continues into early 2010, which assessment is focused on assessing the potential of: (a) approximately four kilometers of relatively unexplored Mala Noche vein, east and west of the 1.5 kilometers containing the current mineral resources and reserves, (b) largely unexplored parallel vein structures, all within the Company's existing mineral rights and (c) the three recently acquired claims. Airborne geophysics has been completed over the entire property; reassessment of historic geophysical data is underway and ground geophysics, mapping and geochemical

sampling being conducted over principal target areas. Capstone intends to use this data to complete a comprehensive assessment of the mineral potential of the Cozamin property, prioritize targets and commence exploration in priority areas during the balance of 2010 and beyond. Additionally, a total of \$3.0 million is expected to be spent on exploration at the Cozamin Mine in 2020, primarily focused on exploring for extensions to high grade mineral reserves immediately adjacent to the current workings, but also exploring additional targets along strike for possible new deposits.

Outlook

The Company provided guidance that the Cozamin Mine production in 2010 is expected to total 40 to 45 million pounds of copper in concentrates, with by-product lead, zinc and silver, at a cash cost of approximately \$0.80 to \$0.90 per pound. Capital expenditures for 2010 are forecast to total \$5.7 million and are primarily focused on completing items related to the Phase III expansion, such as connecting to grid power, installation and commissioning of the in-mine crusher and shaft deepening.

Kutcho Copper

In 2008, the Company acquired Western Keltic Mines Inc. and renamed that company “Kutcho Copper Corp.”. Kutcho Copper owns a 100% interest, subject to certain third party rights, in the Kutcho Project, a high-grade copper-zinc-silver-gold property in British Columbia.

In 2008, the Company completed an 83-hole drill program within the Main Deposit at Kutcho, aimed at better defining the high-grade zone within the overall mineral resource. The program was successful and a new mineral resource estimate for the three deposits (Main, Sumac and Esso) that comprise the Kutcho Project was announced in February 2009. Based on the new mineral resource estimate, a comprehensive re-assessment of potential development options for the Kutcho Project was completed, including consideration of open pit and/or underground extraction of some or all of the mineral resources thus defined. This work resulted in the publication of a Preliminary Economic Assessment (“PEA”) in September 2009 that defined the potential for the development of a higher grade, lower cost, underground mine with a significantly reduced environmental footprint. Two of the principal recommendations contained in the PEA were to focus on enhanced project returns by (a) improving metallurgical performance and (b) reducing power costs.

Only minimal exploration work was carried out 2009, and was primarily focused on regional targets, with encouraging results

Outlook

Work is underway to follow up on both of the principal recommendations in the PEA. Metallurgical testing on core collected in the 2008 drill program is being conducted at SGS Lakefield and at the Company’s Cozamin Mine metallurgical facilities. Expenditures in 2010 are expected to be approximately \$1.4 million.

Summary of Quarterly Results

The following table sets out selected unaudited quarterly financial information of Company and is derived from unaudited quarterly financial statements prepared by management. The Company’s interim financial statements are prepared in accordance with Canadian GAAP.

| Period | Net Revenues (\$ millions) | Net income (loss) for the period (\$ millions) | Basic earnings (loss) per share (\$) |
|------------------------------|-------------------------------|---|---|
| 4 th Quarter 2009 | 51.5 | (17.6) | (0.09) |
| 3 rd Quarter 2009 | 70.2 | (10.3) | (0.05) |
| 2 nd Quarter 2009 | 43.1 | 25.8 | 0.14 |
| 1 st Quarter 2009 | 54.5 | (16.2) | (0.10) |
| 4 th Quarter 2008 | (3.1) | 116.8 | 0.99 |
| 3 rd Quarter 2008 | 52.9 | 82.0 | 0.97 |
| 2 nd Quarter 2008 | 32.0 | (0.2) | 0.00 |
| 1 st Quarter 2008 | 28.5 | (65.8) | (0.88) |

With the Business Combination between Capstone and Sherwood being effective in the 4th Quarter of 2008, the results prior are only those of Sherwood. The mark-to-market of the Company’s derivative instruments has had a significant impact on the Company’s net income (loss) due to the volatility in metal prices over the last eight quarters. The significant metal price decline in the fourth quarter of 2008 negatively impacted net revenues with the final settlement of previous provisionally priced sales. The fourth quarter of 2008 also includes the impairment charge taken on the Minto Mine and the gain recorded on the acquisition of Capstone.

Liquidity and Financial Position Review

Working Capital

Working capital was \$86.0 million at December 31, 2009 compared with \$35.4 million at December 31, 2008. The major components of the working capital at December 31, 2009 included \$115.9 million of cash and \$44.4 million of inventories offset by \$19.8 million in accounts payables and accrued liabilities, \$16.7 million of advances on concentrate inventories and \$33.6 million of unrealized derivative liabilities.

Current Assets

Current assets were \$35.3 million higher at \$178.8 million at the end of the Current Period compared with \$143.5 million at December 31, 2008. Cash increased to \$115.9 million from \$27.3 million due to cash flow from operations, funds received from the May 2009 bought-deal equity financing, a reduction in sales tax receivables (partially offset by an increase in concentrate receivables), a reduction of restricted cash due to debt repayments and the sale of a portion of the Silver Wheaton shares. Inventories increased with the buildup of ore stock pile and concentrate inventories at the Minto Mine. As well, the current future income tax asset increases due to the excess of tax basis over accounting values of the deferred revenue and the derivative liability. These increases were partially offset by the elimination of a \$42.5 million derivative instrument asset with the significant increase in metal prices.

Investments

The investment balance at December 31, 2009 was of \$39.1 million (December 31, 2008 - \$8.1 million).

The balance consisted primarily of \$30.5 million for the 1,456,106 common shares held of Silver Wheaton. In May 2009, the Company exchanged the 26,789,768 shares and warrants held in Silverstone for 4,956,106 shares of Silver Wheaton. The Silverstone shares had been accounted for on an equity basis, the Silver Wheaton shares received were recorded at fair value with a gain of \$39.9 million. The Company sold 3,500,000 of the Silver Wheaton shares during the year and recorded a further gain of \$6.4 million. The Silver Wheaton shares are classified as available-for-sale investments and marked-to-market with any gains or losses being recorded in accumulated other comprehensive income at the end of each period.

In addition the Company purchased 4.5 million units in Nevada Copper Corp. ("Nevada Copper") by way of a private placement, each unit consisting of one common share and one-half of a common share purchase warrant. The cost of each unit was C\$2.50 for a total investment of C\$11.25 million. Each whole warrant is exercisable into one common share for a period of two years at a price of C\$3.00 per common share, expiring November 3, 2011. If at any time prior to expiry, the closing price of Nevada Copper's common shares is greater than C\$3.50 for at least 20 consecutive trading days, Nevada Copper can send a notice to Capstone stating that the warrants will expire if not exercised within 30 days. The shares are classified as an available-for-sale investment and the warrants are classified as a derivative investment.

Property, Plant and Equipment

Property, plant and equipment ("PP&E") increased to \$144.5 million in the Current Period from \$118.1 million at December 31, 2008. The increase included:

- Additions of \$38.2 million, comprised of \$3.0 million for PP&E at the Cozamin Mine and \$35.2 million for PP&E at the Minto Mine including \$23.0 million for deferred stripping, \$4.9 million for water management, \$2.9 million for the Skagway Port expansion and \$4.4 million of sustaining capital,
- Amortization of \$27.6 million, and
- A positive cumulative translation adjustment ("CTA") of \$15.8 million due to the stronger Canadian dollar and the translation of Canadian denominated assets owned by Minto.

Mineral Property Costs

Mineral property costs increased to \$176.9 million in the Current Period from \$161.0 million at December 31, 2008. The increase included:

- Additions of \$21.1 million, primarily related to exploration activity (\$4.9 million), mine development (\$7.9 million), and an increase in asset retirement obligations (\$2.5 million) at the Minto Mine, development work (\$1.2 million) at Kutcho and exploration activity (\$0.4 million), mine development (\$2.4 million), mineral claims purchased (\$1.0 million), and an increase in asset retirement obligations (\$0.8 million) at the Cozamin Mine,
- Depletion of \$14.2 million; and
- A positive CTA of \$8.8 million due to the effects of the stronger Canadian dollar on the translation of Canadian denominated mineral properties owned by Minto and Kutcho.

Future Income Tax Asset

The future income tax asset of \$18.2 million at December 31, 2009 (\$7.6 million current and \$10.6 million long-term) is related mainly to the excess of tax basis over accounting values of the deferred revenue and the derivative liability.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

Current Liabilities

Current liabilities decreased by \$15.3 million to \$92.8 million during the Current Period from \$108.1 million at December 31, 2008. The reduction resulted from repayment of \$42.5 million of long term debt, the reduction in future income liabilities of \$15.4 million with the reversal of the derivative instrument asset to a liability and lower advances drawn against the Minto concentrate inventories by \$3.9 million. These reductions were partially offset with accounts payable higher by \$6.5 million, taxes payable higher by \$7.7 million related to Mexican income taxes and the QMAR and the reversal of the derivative instrument asset recorded at the end of the Comparative Period to a liability at the end of the Current Period with the increased metal prices.

Derivative Instruments

At December 31, 2009, the Company had a net derivative instrument liability on its metal hedging program of \$54.4 million compared with a \$105.3 million asset at December 31, 2008. This reversal of the mark-to-market value of the asset was a direct result of the increase in metal prices during the Current Period. As these derivative instruments mature over the next five years, the actual realized gain or loss on the final settlement could be significantly different from the amount currently recorded.

Deferred Revenue

The Company's deferred revenue at the end of the Current Period of \$73.5 million (\$82.9 million at December 31, 2008) relates to the two precious metal sales agreements that were entered into with Silverstone (now a subsidiary of Silver Wheaton). This amount will be amortized to revenue as the related delivery obligations under these agreements are met. During the Current Period, \$14.6 million was amortized to gross sales revenue, offset by a positive foreign currency translation adjustment of \$5.2 million.

Project Bank Debt

In October 2006, MintoEx received credit approval from Macquarie Bank for a debt package totaling C\$85 million, which was comprised of a C\$65 million PLF (which was converted at the time of the draw down to \$57.8 million equivalent) and a C\$20 million subordinated loan facility ("SLF"). The PLF carries an interest rate of US LIBOR plus 2.25%. The first payment was made on April 1, 2008 and the final payment was made December 31, 2009. During the Current Period US LIBOR on the PLF ranged from 0.26% to 0.51%.

The SLF carries an interest rate of Canadian LIBOR plus 2.65% with the first payment due October 1, 2010 and the final payment due May 31, 2011. A total of \$9.6 (C\$10.0) million was outstanding at December 31, 2009. During the Current Period Canadian LIBOR on the SLF ranged from 0.30 % to 2.25%.

Bank of Nova Scotia Loan Facility

On January 16, 2009, the Company completed a \$40 million RTF with The Bank of Nova Scotia. Under the terms of the RTF, the funds are re-drawable over a three-year term, subject to a reduction of \$8 million every six months commencing on the first anniversary, it attracts an interest rate of US LIBOR plus 3.5% (adjustable in certain circumstances). The US LIBOR rates on the RTF ranged from 0.36% to 0.52% from the initial date of drawdown in January 2009 until repayment in May 2009.

The RTF is secured against the present and future real and personal property, assets and undertakings of Capstone other than the security already pledged against the PLF, SLF and the Power Purchase Agreement ("PPA") with Yukon Energy Corporation ("YEC"). The Lender requires certain ratios related to debt and interest coverage. At December 31, 2009, no funds were drawn against the RTF.

Yukon Energy Corporation capital cost contribution

In February 2007, MintoEx executed the PPA with YEC. Under the terms of the PPA, MintoEx agreed to make payments representing its capital cost contribution of C\$7.2 million for the Carmacks-Minto Landing portion of the main power line. The implied interest rate on the contribution was revised to 6.5% from the original 7.5%, and the original repayment schedule was revised from 60 months of interest and principal, to interest only during the first 48 months, followed by equal blended payments of interest and principal during the ensuing 60 months such that the principal will be fully repaid at the end of nine years. MintoEx's connection to the YEC's electrical grid in November 2008 triggered the first monthly payment commencing December 2008.

In addition, the Company classified its obligation for the C\$10.8 million cost of the spur power line to the Minto Mine site as a capital lease. This amount will be repaid over the same terms as the main power line.

The PPA is secured against a charge over all assets of MintoEx, subject only to the security already pledged against the PLF and SLF.

Convertible Debenture

In February 2007, Sherwood issued convertible senior unsecured debentures (the “Debentures”) for gross proceeds of C\$43.6 million. The Debentures, due March 31, 2012, bear interest at a rate of 5.0% per annum payable semi-annually in arrears on March 31 and September 30 of each year commencing on September 30, 2007. Each of the Debentures is convertible at the option of the holder at any time into common shares of the Company at a conversion rate of 248.5715 common shares per C\$1,000 principal amount of Debentures, which is equal to a Conversion Price of C\$4.02 per common share. The Company may redeem the Debentures on or after April 1, 2010 at a redemption price equal to their principal amount, provided that the weighted average trading price of the common shares of the Company for 20 consecutive days is at least 125% of the Conversion Price. The Company may repay the principal amount in common shares at the then market price or cash.

GAAP for compound financial instruments requires the Company to allocate the proceeds received from the Debentures between: (i) the estimated fair value of the holder’s option to convert the Debentures into common shares and (ii) the estimated fair value of the future cash outflows related to the Debentures. At the date of issuance, the Company estimated the fair value of the conversion option by deducting the present value of the future cash outflows of the Debentures, calculated using a risk-adjusted discount rate of 11.5%, from the face value of the principal of the Debentures. The residual value allocated to the conversion option is added to the face value of the Debentures over the life of the Debentures by a charge to earnings, using the effective interest rate method.

The Debentures included a provision whereby within 30 days of the occurrence of a change of control, an offer to purchase all Debentures then outstanding must be made. Following the change of control on November 24, 2008, as a result of the Business Combination, the Company made an offer on December 24, 2008 to purchase all outstanding Debentures at a price equal to 101% of the principal amount of the Debentures, plus accrued and unpaid interest. On January 22, 2009, the Company paid \$31.3 million (C\$39.3 million) for Debentures tendered under the offer with an aggregate book value at the date of redemption of \$33.4 million (C\$41.3 million), consisting of the debt component of \$26.1 million (C\$32.7 million) and the equity component of \$7.3 million (C\$8.6 million). As a result, the Company recognized a gain during the Current Period on settlement of the debt component of \$0.6 million and a gain on the settlement of the equity component of \$1.1 million.

The financial liability component of the convertible debentures at December 31, 2009 is as follows (*expressed in thousands*):

| | | |
|---|----|--------------|
| Principal amount of convertible debentures | \$ | 4,036 |
| Less: residual value allocated to the conversion option | | (933) |
| Financial liability component at issuance (present value of future cash outflows) | | <u>3,103</u> |
| Accretion of the residual value allocated to the conversion option | | 494 |
| Foreign currency translation adjustments | | <u>373</u> |
| Balance of financial liability component | | 3,970 |
| Less: current portion of financial liability component | | - |
| Long term balance of financial liability component | \$ | <u>3,970</u> |

The principal amount of the convertible debentures plus accrued interest to December 31, 2009 amounted to \$4.6 million.

Capital Leases

The principal capital leases amounts outstanding at the end of 2009 were; (a) the Minto Spur Power Line (\$9.7 million) and; (b) the AIDEA Skagway Port facilities (\$10.4 million). Total capital lease obligations at December 31, 2009 were \$20.6 million compared with \$20.2 million at the end of December 31, 2008.

Future Income Tax Liability

The future income tax liability of \$42.1 million at December 31, 2009, (\$3.0 million current and \$39.1 million long-term) is related mainly to the excess of accounting values over tax basis resulting from the past acquisition of Western Keltic and the merger between Capstone and Sherwood. In addition, the excess of accounting values over the tax basis of the Silver Wheaton shares contributed to the amount of the future income tax liability.

Asset Retirement Obligations and Reclamation Funding

Asset retirement obligations of \$9.1 million represent the present value of the future reclamation and closure costs of the Cozamin and Minto mines. These amounts were based on third-party-prepared closure plans.

¹ These are non-GAAP performance measures: please see “Non-GAAP Performance Measures” below.

The Cozamin Mine closure plan does not have formal approval of the regulatory authorities. There is currently no regulatory mechanism in Mexico which contemplates formal approval of closure plans or for a formal sign-off on completion of planned closure activities. The closure plan for the Cozamin Mine has been provided to the Mexican government, and both closure cost updates and a report on reclamation completed (including costs expended to date) are submitted annually or each six months respectively to the regulators. The estimated undiscounted value of the obligation at December 31, 2009 was \$2.6 million. At present, funding is not required.

The Minto Mine submitted a revised closure plan to the regulatory authorities in September 2009 which is expected to be finalized by mid 2010. The revised plan includes a water treatment plant that was not included in the previous plan, longer post closure water treatment and monitoring and an increase in surface disturbance. At December 31, 2009, the estimated undiscounted value of the obligation was \$7.7 million, an increase of \$4.3 million, of which \$3.5 million is funded with cash and by a letter of credit in favour of the Yukon Territory Government. On February 15, 2010 the Company received notice from the regulatory authorities that the total funding requirement, based on the revised plan increased to \$7.9 million, which will have to be in place by April 15, 2010.

Shareholders' Equity

Shareholders' equity at December 31, 2009 increased to \$285.6 million from \$224.2 million at December 31, 2008. The \$61.4 million increase was due to:

- Share capital increased by \$49.6 million:
 - net proceeds of \$47.4 million from the May 2009 bought-deal equity financing,
 - purchase of mineral properties \$1.6 million, and
 - exercise of share purchase options of \$2.1 million, offset by:
 - net future income tax expense of \$1.6 million related to flow-through shares and share issue costs, reducing share capital;
- an increase in contributed surplus of \$3.7 million related to stock-based compensation and purchase of mineral properties;
- a \$6.9 million reduction of the equity component of the Debentures with the partial repurchase of the Debentures;
- a \$32.2 million accumulative comprehensive income, primarily due to unrealized gain of \$12.0 million on available-for-sale investments of which \$2.1 million was transferred to the consolidated statement of (loss) earnings on realization and \$22.3 million related to the effects of foreign currency translation adjustments; and
- a \$17.2 million decrease in retained earnings, a net loss of \$18.3 million combined with a gain of \$1.1 million on the repurchase of the Debentures.

Financial Capability

The Company's long term success and ability to service its ongoing debt obligations and cover anticipated corporate and exploration costs is dependent on the Cozamin and Minto Mines continuing to generate positive cash flow. At this time, based on the current metal prices and production forecasts and current working capital, the Company believes it has the financial capability to meet its debt obligations, planned exploration, capital expenditures, operational and corporate activities for the next twelve months.

Capital Management

The Company considers that its capital consists of the items included in shareholders' equity, short term credit facilities, long term debt, capital lease obligations, cash and long-term investments. The Company manages the capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of the Company's assets.

The Company's capital management objectives are intended to safeguard the entity's ability to support the Company's normal operating requirements on an ongoing basis as well as continue the development and exploration of its mineral properties and support any expansionary plans.

To effectively manage its capital requirements, the Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company ensures that there are sufficient committed loan facilities to meet its short term business requirements, taking into account its anticipated operational cash flows and its cash balances.

The PLF, SLF and RTF contain various covenants, including: a) ratios of estimated future cash flows to total debt; b) debt coverage ratios with respect to minimum proven and probable reserves for the life of mine plan approved by Macquarie; and c) a tangible net worth requirement.

Contractual Obligations and Commitments

The following table summarizes at December 31, 2009 certain contractual obligations for the periods specified:

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015+ | Total |
|----------------------|------|------|------|------|------|-------|-------|
| (\$ millions) | | | | | | | |
| Debt | 4.8 | 4.8 | 4.6 | 1.2 | 1.3 | 4.3 | 21.0 |
| Leases | 4.4 | 4.2 | 4.0 | 5.0 | 4.0 | 7.1 | 28.7 |
| Purchase Obligations | 3.0 | 3.0 | 2.6 | - | - | - | 8.6 |
| Reclamation | 0.2 | 0.6 | 1.0 | 4.0 | 2.3 | 2.6 | 10.7 |
| Total | 12.4 | 12.6 | 12.2 | 10.2 | 7.6 | 14.0 | 69.0 |

Commitments

Agreements with the Selkirk First Nation

Under the terms of a revised co-operation agreement between Minto and the Selkirk First Nation (“Selkirk”) dated October 15, 2009, the Company has made various commitments to Selkirk to enhance Selkirk participation in the Minto Mine, including a variable net sales royalty on production from the Minto Mine that fluctuates with the price of copper, as well as various commitments in respect of employment, contracting, training, and scholarship opportunities.

In June 2006, the Company entered into five leases with the Selkirk for the use of the surface areas in and around the planned development of the Minto Project. The leases have a term of ten years and three months, expiring June 30, 2016. The total annual rent payable under the terms of these leases is \$0.1 million.

Off-take agreements

The Company has a concentrate off-take agreement with MRI Trading AG (“MRI”) whereby MRI will purchase 100% of the concentrate produced by the Minto Mine up to the end of June 2010. As part of the agreement, MRI has provided Minto with an inventory financing facility.

The Company has a concentrate off-take agreement with Trafigura Beheer B.V. (“Trafigura”) whereby Trafigura will purchase 100% of the copper concentrate produced by the Cozamin mine up to the end of December 2011.

The Company has a concentrate off-take agreement with Louis Dreyfus Commodities Metals Suisse SA (“Louis Dreyfus”) whereby Louis Dreyfus will purchase 100% of the lead concentrate produced by the Cozamin mine up to the end of December 2011.

The Company has a concentrate off-take agreement with MRI Trading AD (“MRI”) whereby MRI will purchase 100% of the zinc concentrate produced by the Cozamin mine up to the end of December 2011.

Power purchase agreement

In February 2007, Minto signed a Purchase Power Agreement (the “PPA”) with the Yukon Energy Corp. (“YEC”), which was subsequently amended and approved by the Yukon Utilities Board in May 2007, whereby the YEC will deliver grid power to the Minto Mine by constructing the Carmacks/Minto main line and the spur line to the mine site. Minto is obligated to repay C\$7.2 million of the costs of the main line and C\$10.8 million for the cost of the spur line. On April 9, 2009 YEC and Minto agreed to additional amendments that increased the repayment terms to nine years and reduced the interest rate to 6.5%, starting on the commencement of power delivery, which occurred in November 2008. Minto is obligated to purchase a minimum of C\$3.0 million of power for each of the first four years of the agreement, to a maximum of C\$12.0 million. Power pricing is fixed at C\$15.00/KVA and C\$0.076/KWH as per YEC Rate Schedule 39 (Industrial Primary) until December 31, 2009, then subject to escalation once each calendar year, starting January 1, 2010, based on the latest percentage increase in the 12 month implicit chain price index for gross domestic product at market for Canada as reported by Stats Canada. After four years (post take-or-pay period), YEC will perform its normal cost of service analysis to set go forward rates. The Company is obligated to fund the mine spur line reclamation costs on the closure of the mine.

Forward Metal Sales Contracts

As a condition of the loans with Macquarie the Company must maintain a price protection program of copper forward metal sales contracts as they relate to the Minto Mine. Additionally, the Company uses forward sales contracts for its Cozamin mine in order to manage price risk on future production.

In addition to its copper forward sales contracts, during the third quarter of 2009, the Company entered into lead and zinc forward sales contracts for its Cozamin mine, the details of which are in the table below.

¹ These are non-GAAP performance measures: please see “Non-GAAP Performance Measures” below.

Details of the Company's forward sales contracts at December 31, 2009 are as follows:

| Metal | Maturity | Quantity (pounds 000's) | Forward Price (per pound) |
|---------------|-----------------|------------------------------------|--------------------------------------|
| Copper | 2010 | 34,412 | \$ 2.38 |
| | 2011 | 22,293 | \$ 2.41 |
| | 2012 | 4,630 | \$ 3.21 |
| | 2013 | 3,968 | \$ 3.15 |
| | 2014 | 1,323 | \$ 3.12 |
| | | 66,626 | \$ 2.51 |
| Lead | 2010 | 1,323 | \$ 1.05 |
| | 2011 | 1,323 | \$ 1.04 |
| | | 2,646 | \$ 1.04 |
| Zinc | 2010 | 3,307 | \$ 0.94 |
| | | 3,307 | \$ 0.94 |

As at December 31, 2009, the Company has a mark-to-market metal derivative instrument liability of \$55.4 million (December 31, 2008 – \$105.3 million asset) recorded for these forward sales contracts, of which a \$33.6 million liability (December 31, 2008 – \$48.5 million asset) relates to metal derivative contracts maturing in less than one year, and a \$21.8 million liability (December 31, 2008 – \$56.8 million asset) relates to derivative contracts with a maturity date greater than one year.

During the year ended December 31, 2009, the Company recorded a realized gain of \$17.7 million (2008 – realized gain of \$2.7 million) on metal derivative contracts that were closed out and settled for cash. This was offset by an unrealized non-cash loss of \$160.8 million (2008 – unrealized loss of \$126.3 million) related to changes in the mark-to-market value of open metal derivative contracts at the end of the period, for a resulting net loss on metal derivative instruments of \$143.0 million (2008 – net loss of \$123.6 million).

Precious Metals Streams

Minto Mine

Under its November 2008 agreement with Silverstone (now Silver Wheaton), the Company must sell all of the Minto Mine gold and silver production to Silver Wheaton for the lesser of US\$300 per ounce of gold and US\$3.90 per ounce of silver (subject to a 1% inflationary adjustment after three years and each year thereafter) and the prevailing market price for each ounce delivered. If production from the Minto Mine exceeds 50,000 oz of gold in the first two years of the agreement or 30,000 oz of gold per year thereafter, Silver Wheaton will be entitled to purchase only 50% of the amount in excess of those thresholds. During 2009 the Company delivered 26,600 ounces of gold and 0.2 million ounces of silver to Silver Wheaton.

Cozamin Mine

Under its April 2007 agreement with Silverstone (now Silver Wheaton), the Company has a commitment to sell the Cozamin mine's silver production over a 10 year period to Silver Wheaton. Under the terms of the arrangement, Silver Wheaton agreed to pay for each ounce of refined silver from the mine the lesser of \$4.00 per ounce of silver and the prevailing market price on the London Metal Exchange for each ounce of silver. Further, the Company agreed to deliver a minimum of 10 million ounces of silver to Silverstone over a ten year period. If, at the end of ten years, the Company has not delivered the agreed upon 10 million ounces of silver, then it has agreed to pay Silver Wheaton \$1.00 per ounce of silver not delivered. During 2009 the Company delivered concentrate containing 1.5 million ounces of silver to Silver Wheaton. To date, a total of 3.1 million ounces have been delivered against the contract since its inception.

Risks and Uncertainties

Commodity Price Risk

The Company is exposed to commodity price risk given that its revenues are derived from the sale of metals, the prices for which have been historically volatile. It manages this risk by entering into forward-sale agreements with various counterparties, both as a condition of certain debt facilities as well as to mitigate price risk when management believes it a prudent decision. Currently the Company has in place derivative contracts for the sale of copper, lead and zinc. Additionally, it has sold forward to Silver Wheaton all the gold and silver production from the Minto Mine and silver production from the Cozamin Mine.

Liquidity Risk

The Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company maintains adequate cash balances and credit facilities in order to meet short-and long-term business requirements, after taking into account cash flows from operations, and believes that these sources will be sufficient to cover the likely short-and long-term cash requirements. The Company's cash is invested in business accounts with quality financial institutions and which is available on demand for the Company's programs, and is not invested in any asset-backed commercial paper.

Trade Credit Risk

The Company will be exposed to trade credit risk through its trade receivables on concentrate sales. The Company manages this risk by dealing with a number of different trade creditors and by requiring provisional payments of 90% of the value of the concentrate shipped. The Company enters into derivative instruments with a number of counterparties. These counterparties are large, well-diversified multinational corporations, and credit risk is considered to be minimal. As at December 31, 2009, the Company's maximum exposure to credit risk is the carrying value of its cash and restricted cash, receivables, note receivables and derivative instruments asset.

Foreign Exchange Risk

The Company is exposed to foreign exchange risk as the Company's operating costs will be primarily in Canadian dollars and Mexican pesos, while revenues will be received in US dollars, hence any fluctuation of the US dollar in relation to these currencies may impact the profitability of the Company and may also affect the value of the Company's assets and liabilities. The Company currently does not enter in to financial instruments to manage this risk but the draws on debt facilities are made in US dollars to mitigate the risk on loan repayments if available.

Derivative Instrument Risk

The Company manages its exposure to fluctuations in metal prices by entering into derivative instruments approved by the Company's board of directors. The Company does not hold or issue derivative instruments for speculation or trading purposes. These derivative instruments are mark-to-market at the end of each period and may not necessarily be indicative of the amounts the Company might pay or receive as the contracts are settled.

Interest Rate Risk

Currently the Company's long-term liabilities are based on both fixed and variable interest rates. The Company is exposed to interest rate risk on its variable rate debt facilities. Variable interest rates are based on both US dollar and Canadian dollar LIBOR plus a fixed margin. The Company does not enter into derivative contracts to manage this risk.

Mineral Reserve and Mineral Resource Risk

Mineral reserve and mineral resource figures are estimates, and the Company provides no assurance that the estimated tonnage and grades will be achieved or that the indicated level of recovery will be realized. Metal price fluctuations may make the ore reserves, including low grade stockpiles, uneconomical and require the Company to write down assets or discontinue operations. The Company's mineral resource and mineral reserves will be depleted as operations continue and, if the Company is unsuccessful in replacing the depleted materials, the mines will eventually run out of ore to process.

Operating Risk

The Company operates two mines, one open pit and one underground. The financial viability of these operations is dependent on many factors, and is subject to interruption or disruption as a result of factors including, but not limited to, weather, ground stability, changes in recoveries, increases in capital and operating costs, changing metal prices, personnel and equipment shortages, all of which may affect the viability of the mining operations.

Political and Country Risk

Political and related legal and economic uncertainty may exist in countries where the Company may operate. The Company's mineral exploration and mining activities may be adversely affected by political instability and changes to government regulation relating to the mining industry. Other risks of foreign operations include political unrest, labour disputes, invalidation of governmental orders and permits, corruption, war, civil disturbances and terrorist actions, arbitrary changes in law or policies of particular countries, foreign taxation, price controls, delays in obtaining or the inability to obtain necessary environmental permits, opposition to mining from environmental or other non-governmental organizations, limitations on foreign ownership, limitations on the repatriation of earnings, limitations on mineral exports and increased financing costs. These risks may limit or disrupt the Company's projects, restrict the movement of funds or result in the deprivation of contract rights or the taking of property by nationalization or expropriation without fair compensation. Presently, all of the Company's mineral properties are

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

located in Mexico and Canada. While the Company believes that Mexico and Canada represent favourable environments for mining companies to operate, the Company provides no assurance that changes in the government or laws or changes in the regulatory environment for mining companies or for non-domiciled companies will not be made that would adversely affect the Company.

Title Risk

Although the Company has exercised the usual due diligence with respect to determining title to properties in which it has a material interest, there is no guarantee that title to such properties will not be challenged or impugned. The Company's mineral property interests may be subject to prior unregistered agreements or transfers and title may be affected by undetected defects. Surveys have not been carried out on the majority of the Company's mineral properties and therefore, in accordance with the laws of the jurisdictions in which such properties are situated, their existence and area could be in doubt.

Environmental Regulations

The Company's operations are subject to various laws and regulations governing the protection of the environment, exploration, development, production, taxes, labour standards, occupational health, waste disposal, safety and other matters. Environmental legislation provides for restrictions and prohibitions on spills, releases or emissions of various substances produced in association with certain mining industry operations, such as seepage from tailings disposal areas, which would result in environmental pollution. A breach of such legislation may result in imposition of fines and penalties. In addition, certain types of operations require the submission and approval of environmental impact assessments. Environmental legislation is evolving in a direction of stricter standards, and enforcement, and higher fines and penalties for non-compliance. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in governmental regulations has the potential to reduce the profitability of operations. The Company intends to fully comply with all environmental regulations.

Economic Conditions

Unfavourable economic conditions may negatively impact the Company's financial viability and could also increase the Company's financing costs, decrease net income, limit access to capital markets and negatively impact any of the availability of credit facilities to the Company.

Transactions with Related Parties

During the period January 1 to May 21, 2009, the Company sold silver of \$6.7 million (2008 - \$nil) to Silverstone, an equity investment. At December 31, 2009, the Company has a receivable of \$nil (December 31, 2008 - \$0.3 million payable) related to these silver sales. Additionally, during the same period the Company received from Silverstone exploration services for \$0.7 million (2008 - \$nil) and at December 31, 2009 has a payable of \$nil (December 31, 2008 - \$1.1 million) related to such services. Silverstone was no longer a related party as of May 21, 2009.

During the year ended December 31, 2009, the Company paid consulting fees of \$0.1 million (2008 - \$nil) to certain directors of the Company.

These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties. Amounts due to related parties are unsecured, non-interest bearing and have no specific repayment terms.

Off Balance Sheet Arrangements

The Company has no off-balance-sheet arrangements other than disclosed under Contractual Obligations.

Critical Accounting Estimates

The Company's significant accounting policies are presented in Note 2 of the audited consolidated statements for the year ended December 31, 2009. The preparation of consolidated financial statements in accordance with GAAP requires management to select accounting policies and make estimates. Such estimates may have a significant impact on the consolidated financial statements. The Company regularly reviews these estimates; however, actual amounts could differ from the estimates used and accordingly affect the results of operations. These estimates include:

- purchase price allocation in business combinations;
- mineral resources and mineral reserves;
- the carrying values of inventories;
- the carrying values of mineral properties and property, plant and equipment;
- rates of amortization of mineral properties and property, plant and equipment;
- the assumptions used for the determination of asset-retirement obligations;

- the valuation of future income taxes and allowances;
- the valuation of financial instruments;
- the carrying values of the receivables; and
- the valuation of stock-based compensation.

Changes in Accounting Policies

Accounting policies implemented effective January 1, 2009

The Company adopted Section 3064, Goodwill and Intangible Assets, which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Upon adoption of this standard, there were no resulting material changes to the Company's financial position or results of operations.

The Company adopted EIC-173, Credit Risk and the Fair Value of Financial Assets and Liabilities, which provides guidance on how to take into account an entity's own credit risk and that of the counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. Upon adoption of this EIC, there were no resulting material changes to the Company's financial position or results of operations.

The Company adopted EIC-174, Mining Exploration Costs, which provides guidance on how to account for mineral exploration costs as well as when and how to assess for impairment when such exploration costs are capitalized. Upon adoption of this EIC, there were no resulting material changes to the Company's financial position or results of operations.

International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed that International Financial Reporting Standards ("IFRS") will replace GAAP on January 1, 2011. The process of changing from GAAP to IFRS will be a significant undertaking that may materially affect reported financial position and results of operations, and may also affect certain business functions. The Company has not yet completed a full evaluation of the adoption of IFRS and its impact on its financial position and results of operations.

In 2009, the Company completed a scoping study which identified the major areas of focus in the conversion from GAAP to IFRS.

In 2010 the Company will:

- complete a detailed evaluation and selection of the available IFRS exemptions,
- prepare a position paper for each accounting policy, assessing the differences between GAAP and IFRS, each paper will include a qualification and quantification of the impact on the Company's financial position and results of operations,
- prepare draft mock-up financial statements and notes under IFRS
- prepare a January 1, 2010 opening balance sheet and 2010 comparative data under IFRS, and
- identify and implement any system or internal control changes required with the conversion to IFRS.

Updates on the progress of the conversion process will be provided to the Company's audit committee and disclosed in the Company's MD&A on a quarterly basis throughout 2010.

Non-GAAP Performance Measures

Non-GAAP performance measures are furnished to provide additional information. These performance measures are included in this MD&A because these statistics are key performance measures that management uses to monitor performance, to assess how the Company is performing, to plan and to assess the overall effectiveness and efficiency of mining operations. These performance measures do not have a meaning within GAAP and, therefore, amounts presented may not be comparable to similar data presented by other mining companies. These performance measures should not be considered in isolation as a substitute for measures of performance in accordance with GAAP.

Non-GAAP reconciliation of cash cost per pound of payable copper:

The Company has reported an estimate of this non-GAAP measure for both the Cozamin Mine and the Minto Mine for the full year 2009. No comparative figures for 2008 are provided as the operating results of the Cozamin Mine were only included in the consolidated financial statements from November 24, 2008, the effective date of the Business Combination between Capstone and Sherwood.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.

| | Cozamin Mine | Minto Mine | Current Period |
|---|---------------------|-------------------|-----------------------|
| Payable pounds of copper produced (000's) | 34,645 | 51,913 | 86,558 |
| Cash cost of sales - per consolidated financial statements (\$ millions) | 42.2 | 50.3 | 92.5 |
| Inventory adjustment (\$ millions) | (3.4) | (1.2) | (4.6) |
| Production costs (\$ millions) | 38.8 | 49.1 | 87.9 |
| Total Cash cost per payable pound of copper produced - \$ per pound | | | |
| Production costs - \$ per pound | 1.12 | 0.95 | 1.02 |
| - By-product credits - \$ per pound - estimated | (0.52) | (0.18) | (0.32) |
| - Selling costs - \$ per pound - estimated | 0.30 | 0.35 | 0.33 |
| Total Cash Cost per payable pound of copper produced - \$ per pound - estimated | 0.90 | 1.12 | 1.03 |

Non-GAAP reconciliation of adjusted net earnings:

| <i>(\$ millions except per share amounts)</i> | Current Period | Comparative Period |
|---|-----------------------|---------------------------|
| Net earnings (loss) (per consolidated financial statements) | (18.3) | 131.8 |
| Stock-based compensation | 2.8 | 3.3 |
| Foreign exchange (gain) loss - unrealized | (1.6) | 8.8 |
| Derivative instrument loss - unrealized | 159.8 | (126.3) |
| Gain on disposal of investments | (46.4) | - |
| Impairment charges | - | 53.4 |
| Gain on acquisition of Capstone Mining | - | (72.0) |
| Future income tax (recovery) expense | (31.1) | 3.9 |
| Adjusted net earnings | 65.2 | 2.9 |
| Weighted average common shares (per consolidated financial statements) | 185,691,755 | 89,825,636 |
| Adjusted net earnings per common share | 0.35 | 0.03 |

Outstanding Share Data and Dilution Calculation

The Company is authorized to issue an unlimited number of common shares, without par value. The table below summarizes the Company's common shares and securities convertible into common shares as at March 19, 2010:

| | |
|---|-------------|
| Issued and outstanding | 197,908,428 |
| Share options outstanding @ a weighted average exercise price of \$2.30 | 11,684,382 |
| Convertible debentures @ 248.5715 shares per C\$1,000 principle amount, total debenture amount of C\$4.7 million, expiry March 31, 2012 | 1,175,495 |
| Fully Diluted | 210,768,305 |

Disclosure Controls and Procedures

As of December 31, 2009, management has evaluated the design and the operating effectiveness of the disclosure controls and procedures as defined by National Instrument 52-109. This evaluation was performed under the supervision of and with the participation of the CEO and the CFO. Based on this evaluation, management, the CEO and the CFO concluded that the design and operation of the disclosure controls and procedures were effective as of December 31, 2009.

Internal Control over Financial Reporting

As of December 31, 2009, management has evaluated the design and the operating effectiveness of the internal control over financial reporting ("ICFR") as defined by National Instrument 52-109. This evaluation was performed under the supervision of and with the participation of the CEO and the CFO.

Based on this evaluation, management, the CEO and the CFO concluded that the design and operating effectiveness of ICFR were effective as of December 31, 2009. The Company uses the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") internal control framework to design ICFR. Due to its inherent limitations, ICFR may not prevent or detect misstatements on a timely basis as such systems can only be designed to provide reasonable as opposed to absolute assurance. Also projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control over Financial Reporting

National Instrument 52-109 also requires Canadian public companies to disclose in their MD&A any change in ICFR during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, ICFR. There were no changes in ICFR during the quarter ended December 31, 2009 that materially affected or are reasonably likely to materially affect the Company's ICFR.

Approval

The board of directors of Capstone has approved the disclosure contained in this Annual MD&A. A copy of this MD&A will be provided to anyone who requests it from the Company.

Additional Information

Additional information is available for viewing at the Company's website at www.capstonemining.com or on the SEDAR website at www.sedar.com.

Forward-Looking Information

"This document may contain "forward-looking information" within the meaning of Canadian securities legislation and "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 (collectively, "forward-looking statements"). These forward-looking statements are made as of the date of this document and Company does not intend, and does not assume any obligation, to update these forward-looking statements, except as required under applicable securities legislation.

Forward-looking statements relate to future events or future performance and reflect Company management's expectations or beliefs regarding future events and include, but are not limited to, statements with respect to the estimation of mineral reserves and mineral resources, the realization of mineral reserve estimates, the timing and amount of estimated future production, costs of production, capital expenditures, success of mining operations, environmental risks, unanticipated reclamation expenses, title disputes or claims and limitations on insurance coverage. In certain cases, forward-looking statements can be identified by the use of words such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved" or the negative of these terms or comparable terminology. In this document, certain forward-looking statements are identified by words including "may", "future", "expected", "intends" and "estimates". By their very nature forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to actual results of current exploration activities; changes in project parameters as plans continue to be refined; future prices of resources; possible variations in ore reserves, grade or recovery rates; accidents, labour disputes and other risks of the mining industry; delays in obtaining governmental approvals or financing or in the completion of development or construction activities; as well as those factors detailed from time to time in the Company's interim and annual financial statements and management's discussion and analysis of those statements, all of which are filed and available for review under the Company's profile on SEDAR at www.sedar.com. Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. The Company provides no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

Accordingly, readers should not place undue reliance on forward-looking statements.

National Instrument 43-101 Compliance

Unless otherwise indicated, Capstone has prepared the technical information in this MD&A ("Technical Information") based on information contained in the technical reports and news releases (collectively the "Disclosure Documents") available under Capstone Mining Corp.'s company profile on SEDAR at www.sedar.com. Each Disclosure Document was prepared by or under the supervision of a qualified person (a "Qualified Person") as defined in National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* of the Canadian Securities Administrators ("NI 43-101"). Readers are encouraged to review the full text of the Disclosure Documents which qualifies the Technical Information. Readers are advised that mineral resources that are not mineral reserves do not have demonstrated economic viability. The Disclosure Documents are each intended to be read as a whole, and sections should not be read or relied upon out of context. The Technical Information is subject to the assumptions and qualifications contained in the Disclosure Documents.

The disclosure in this MD&A of all technical information has been prepared under the supervision of Stephen Quin, Professional Geologist, President and Chief Operating Officer of the Company, Robert Barnes, P.Eng., Vice President Operations of the Company, and Brad Mercer, P.Geo., Vice President Exploration of the Company, all Qualified Persons under NI 43-101.

¹ These are non-GAAP performance measures: please see "Non-GAAP Performance Measures" below.



CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009 and 2008

(Expressed in US Dollars)

Capstone Mining Corp.

Consolidated Balance Sheets

At December 31

(expressed in thousands of US dollars)

| ASSETS | 2009 | 2008 |
|--|-------------------|-------------------|
| Current | | |
| Cash | \$ 115,931 | \$ 27,267 |
| Restricted cash | 2,496 | 14,345 |
| Receivables (Note 6) | 6,946 | 12,768 |
| Inventories (Note 7) | 44,438 | 37,005 |
| Prepays and other | 1,404 | 954 |
| Future income tax asset (Note 19) | 7,567 | 2,665 |
| Derivative instrument asset (Note 14) | - | 48,522 |
| | 178,782 | 143,526 |
| Investments (Note 8) | 39,105 | 8,064 |
| Property, plant and equipment (Note 9) | 144,525 | 118,124 |
| Notes receivable (Note 10) | 872 | 571 |
| Taxes receivable | - | 2,271 |
| Mineral property costs (Note 11) | 176,667 | 161,024 |
| Future income tax asset (Note 19) | 10,625 | 7,100 |
| Other assets (Note 13) | 505 | 350 |
| Derivative instrument asset (Note 14) | - | 56,822 |
| | \$ 551,081 | \$ 497,852 |
| LIABILITIES | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 19,782 | \$ 12,884 |
| Taxes payable | 8,041 | 669 |
| Advances on concentrate inventories | 16,702 | 20,632 |
| Current portion of other liabilities (Note 15) | 48,288 | 73,904 |
| | 92,813 | 108,089 |
| Long term debt (Note 16) | 10,821 | 22,048 |
| Capital lease obligations (Note 17) | 18,425 | 16,654 |
| Derivative instrument liability (Note 14) | 21,757 | - |
| Deferred revenue (Note 18) | 73,465 | 82,854 |
| Future income tax liability (Note 19) | 39,137 | 39,143 |
| Asset retirement obligations and other (Note 20) | 9,072 | 4,821 |
| | 265,490 | 273,609 |
| SHAREHOLDERS' EQUITY | | |
| Share capital (Note 21) | 195,861 | 146,314 |
| Contributed surplus | 16,275 | 12,559 |
| Convertible debentures - equity component (Note 16) | 1,311 | 8,191 |
| Accumulated other comprehensive income (loss) | 23,378 | (8,840) |
| Retained earnings | 48,766 | 66,019 |
| | 285,591 | 224,243 |
| | \$ 551,081 | \$ 497,852 |

Commitments (Note 27)

ON BEHALF OF THE BOARD:

(Signed) Colin K. Benner, Director

(Signed) Dale Peniuk, Director

See accompanying notes to these consolidated financial statements.

Capstone Mining Corp.

Consolidated Statements of (Loss) Earnings

Years Ended December 31

(expressed in thousands of US dollars, except share and per share amounts)

| | 2009 | 2008 |
|--|--------------------|-------------------|
| | | (Note 2) |
| Gross sales revenue | \$ 250,404 | \$ 122,838 |
| Treatment and selling costs | (31,111) | (16,886) |
| Net revenue | <u>219,293</u> | <u>105,952</u> |
| Operating costs | | |
| Cost of sales | (92,463) | (62,599) |
| Royalty | (4,338) | (587) |
| Depletion and amortization | (40,787) | (22,734) |
| Accretion of asset retirement obligations | (325) | (178) |
| Earnings from mining operations | <u>81,380</u> | <u>19,854</u> |
| General and administrative expenses | (7,999) | (6,517) |
| Stock-based compensation (Note 21) | (2,791) | (3,259) |
| Earnings from operations | <u>70,590</u> | <u>10,078</u> |
| Other income (expense) | | |
| Interest on long term debt | (2,563) | (7,547) |
| Interest on capital lease obligations | (1,318) | (938) |
| Financing fees | (600) | (1,465) |
| Foreign exchange gain (loss) | 1,221 | (7,463) |
| (Loss) gain on derivative instruments (Note 14) | (142,074) | 123,591 |
| Gain on disposal of investments (Note 8) | 46,391 | - |
| Loss on disposal of property, plant & equipment | (474) | - |
| Gain on disposal of mineral properties | - | 1,118 |
| Gain on redemption of convertible debentures (Note 16) | 571 | - |
| Loss in equity investment (Note 8) | (1,505) | - |
| Interest and other income (net) | 228 | 361 |
| Impairment charges (Note 12) | - | (53,435) |
| Gain on acquisition of Capstone Mining Corp. (Note 4) | - | 72,043 |
| (Loss) earnings before income taxes | <u>(29,533)</u> | <u>136,343</u> |
| Current income and mining tax expense | (19,857) | (667) |
| Future income tax recovery (expense) | 31,064 | (3,855) |
| Net (loss) earnings | <u>\$ (18,326)</u> | <u>\$ 131,821</u> |
| (Loss) earnings per share - basic | \$ (0.10) | \$ 1.47 |
| Weighted average number of shares - basic | 185,691,755 | 89,825,636 |
| (Loss) earnings per share - diluted | \$ (0.10) | \$ 1.31 |
| Weighted average number of shares - diluted | 185,691,755 | 103,752,580 |

See accompanying notes to these consolidated financial statements.

Capstone Mining Corp.

Consolidated Statements of Comprehensive Earnings Years Ended December 31

(expressed in thousands of US dollars)

| | 2009 | 2008 |
|--|--------------------|-------------------|
| | | (Note 2) |
| Net (loss) earnings | \$ (18,326) | \$ 131,821 |
| Other comprehensive income (loss) | | |
| Change in fair value of available-for-sale securities, net of tax of \$1,298 | 12,023 | (1,024) |
| Gains reclassified to net earnings on realization, net of tax of \$333 | (2,086) | - |
| Currency translation adjustment | 22,281 | (12,026) |
| | 32,218 | (13,050) |
| Comprehensive earnings | \$ 13,892 | \$ 118,771 |

See accompanying notes to these consolidated financial statements.

Capstone Mining Corp.
Consolidated Statements of Cash Flows
Years Ended December 31

(expressed in thousands of US dollars)

| | 2009 | 2008 |
|--|-------------------|------------------|
| | | (Note 2) |
| Cash provided by (used in): | | |
| Operating activities | | |
| Net (loss) earnings | \$ (18,326) | \$ 131,821 |
| Items not affecting cash | | |
| Depletion, amortization and accretion | 41,380 | 24,264 |
| Amortization of deferred revenue | (14,549) | (458) |
| Non-cash cost of sales | 651 | 1,148 |
| Stock-based compensation | 2,791 | 3,259 |
| Future income tax (recovery) expense | (31,064) | 3,855 |
| Financing fees | - | 1,387 |
| Loss in equity investment | 1,505 | - |
| Gain on disposal of investments | (46,391) | - |
| Loss on disposal of property, plant & equipment | 474 | - |
| Gain on disposal of mineral properties | - | (1,093) |
| Gain on redemption of convertible debentures | (571) | - |
| Gain on acquisition of Capstone Mining Corp. | - | (72,043) |
| Impairment charges | - | 53,435 |
| Unrealized loss (gain) on derivative instruments | 159,809 | (126,272) |
| Unrealized (gain) loss on foreign exchange | (1,596) | 8,758 |
| Other | 118 | - |
| Payments on asset retirement obligations | (158) | - |
| Changes in non-cash working capital (Note 25) | 18,027 | (9,327) |
| | 112,100 | 18,734 |
| Investing activities | | |
| Decrease (increase) in the balance of restricted cash | 11,881 | (15,499) |
| Proceeds on sale of investments | 40,672 | - |
| Purchase of investments | (11,137) | - |
| Property, plant and equipment additions | (35,218) | (19,845) |
| Mineral property additions | (17,204) | (12,541) |
| Acquisition of Capstone Mining Corp. (Note 4) | - | 31,789 |
| Acquisition of mineral property, net of cash acquired (Note 4) | - | (356) |
| Other deposits | (76) | (14) |
| Proceeds from forward sale of metal production (Note 18) | - | 37,500 |
| | (11,082) | 21,034 |
| Financing activities | | |
| Short term credit facility drawdown | - | 1,374 |
| Project loan facility repayment | (29,927) | (27,757) |
| Repayments of capital lease obligations | (4,317) | (2,594) |
| Redemption of convertible debentures | (31,315) | - |
| Proceeds from issuance of share capital | 50,902 | 9,965 |
| Share issue costs | (2,752) | - |
| | (17,409) | (19,012) |
| Effect of exchange rate changes on cash | 5,055 | 231 |
| Increase in cash | 88,664 | 20,987 |
| Cash - beginning of period | 27,267 | 6,280 |
| Cash - end of period | \$ 115,931 | \$ 27,267 |

Supplemental cash flow information (Note 24)

See accompanying notes to these consolidated financial statements.

Capstone Mining Corp.

Consolidated Statements of Shareholders' Equity

(expressed in thousands of US dollars, except share amounts)

| | Number of shares | Share capital | Contributed surplus | Equity component of convertible debentures | Accumulated other comprehensive income | Retained earnings (deficit) | Total |
|---|---------------------|---------------|------------------------|---|---|-----------------------------------|------------|
| December 31, 2007 | 44,814,449 | \$ 60,400 | \$ 7,713 | \$ 8,191 | \$ 4,210 | \$ (65,802) | \$ 14,712 |
| Private placements | 1,205,000 | 7,196 | - | - | - | - | 7,196 |
| Exercise of options | 875,100 | 3,611 | (1,453) | - | - | - | 2,158 |
| Exercise of warrants | 331,175 | 831 | (172) | - | - | - | 659 |
| Share issue costs | - | (57) | - | - | - | - | (57) |
| Acquisition of mineral property (Note 4) | 6,606,874 | 32,205 | 1,179 | - | - | - | 33,384 |
| Debt financing fees | 19,000 | 100 | 1,287 | - | - | - | 1,387 |
| Property payment | 1,600 | 8 | - | - | - | - | 8 |
| Acquisition of Capstone (Note 4) | | | | | | | |
| Sherwood shares exchanged | (53,853,198) | - | - | - | - | - | - |
| Capstone shares received in exchange for Sherwood shares | 84,334,104 | - | - | - | - | - | - |
| Outstanding shares of Capstone acquired in reverse takeover | 80,370,781 | 43,658 | 651 | - | - | - | 44,309 |
| Stock-based compensation | - | - | 3,354 | - | - | - | 3,354 |
| Future income tax on flow- through shares | - | (1,638) | - | - | - | - | (1,638) |
| Change in fair value of available- for-sale securities | - | - | - | - | (1,024) | - | (1,024) |
| Net earnings | - | - | - | - | - | 131,821 | 131,821 |
| Effects of foreign currency translation | - | - | - | - | (12,026) | - | (12,026) |
| December 31, 2008 | 164,704,885 | 146,314 | 12,559 | 8,191 | (8,840) | 66,019 | 224,243 |
| Equity financing (Note 21) | 31,165,000 | 50,457 | (981) | - | - | - | 49,476 |
| Share issue costs | - | (3,732) | 981 | - | - | - | (2,751) |
| Future income tax on share issue costs | - | 743 | - | - | - | - | 743 |
| Exercise of options | 1,187,417 | 2,054 | (629) | - | - | - | 1,425 |
| Stock-based compensation | - | - | 2,791 | - | - | - | 2,791 |
| Purchase of mineral properties | 600,000 | 1,554 | 1,554 | - | - | - | 3,108 |
| Bonus shares cancelled | (11,500) | (20) | - | - | - | - | (20) |
| Redemption of convertible debentures (Note 16) | - | - | - | (6,880) | - | 1,073 | (5,807) |
| Future income tax on flow- through shares | - | (1,509) | - | - | - | - | (1,509) |
| Change in fair value of available- for-sale securities, net of tax of \$1,298 | - | - | - | - | 12,023 | - | 12,023 |
| Gains reclassified to loss, net of tax of \$333 | - | - | - | - | (2,086) | - | (2,086) |
| Net loss | - | - | - | - | - | (18,326) | (18,326) |
| Effects of foreign currency translation | - | - | - | - | 22,281 | - | 22,281 |
| December 31, 2009 | 197,645,802 | \$ 195,861 | \$ 16,275 | \$ 1,311 | \$ 23,378 | \$ 48,766 | \$ 285,591 |

See accompanying notes to these consolidated financial statements.

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

1. Nature of operations

Capstone Mining Corp. (the “Company” or “Capstone”) is a Canadian mining company engaged in the exploration for and production of strategic metals in Canada and Mexico. Minto Explorations Ltd. (“Minto”), a wholly owned Canadian subsidiary of the Company, owns and operates the high-grade copper-gold-silver Minto Mine located in Yukon Territory, Canada. Capstone Gold, S.A. de C.V. (“Capstone Gold”), a wholly owned Mexican subsidiary of the Company, owns and operates the high-grade copper-silver-zinc-lead Cozamin Mine located in Zacatecas, Mexico. Kutcho Copper Corp. (“Kutcho Copper”), another wholly owned Canadian subsidiary of the Company, formerly Western Keltic Mines Inc. (“Western Keltic”), is advancing the high-grade Kutcho copper-zinc-silver-gold project in British Columbia towards a production decision.

2. Significant accounting policies

Basis of presentation and consolidation

These consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company transactions and balances have been eliminated.

Capstone completed the 100% acquisition of the outstanding shares of Sherwood Copper Corporation (“Sherwood”) (Note 4) effective November 24, 2008. As the shareholders of Sherwood obtained control of the Company through the exchange of their shares of Sherwood for shares of Capstone, the acquisition of Sherwood was accounted for as a reverse takeover, whereby Sherwood was considered the acquirer. Consequently, the comparative consolidated statements of earnings (loss), comprehensive earnings (loss) and cash flows for the year ended December 31, 2008 include the results of operations and cash flows of Sherwood, the legal subsidiary, combined with those of Capstone, the legal parent, from the acquisition on November 24, 2008 to December 31, 2008, in accordance with generally accepted accounting principles for reverse takeovers.

Use of estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to select accounting policies and make estimates. Such estimates may have a significant impact on the consolidated financial statements. The Company regularly reviews its estimates; however, actual amounts could differ from the estimates used and, accordingly, materially affect the results of operations.

These estimates include:

- purchase price allocation on business combinations;
- mineral resources and mineral reserves;
- the carrying values of inventories;
- the carrying values of mineral properties and property, plant and equipment;
- rates of amortization of mineral properties and property, plant and equipment;
- the assumptions used for the determination of asset retirement obligations;
- the valuation of future income taxes and allowances;
- the valuation of financial instruments;
- the carrying values of the receivables; and
- the valuation of stock-based compensation.

Translation of foreign currencies

The Company considers the currency of measurement of its Canadian operations to be the Canadian dollar and the currency of measurement of its self-sustaining Mexican mining operations to be the US dollar. The reporting currency of the Company is the US dollar.

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

The accounts of self-sustaining foreign operations are translated into Canadian dollars at year-end exchange rates, and revenues and expenses and cash flows are translated at the average exchange rates. Differences arising from these foreign currency translations are recorded as cumulative translation adjustments within other comprehensive income and as accumulated other comprehensive income until they are realized by a reduction in the investment.

For integrated foreign operations, monetary assets and liabilities are translated into the currency of measurement of the operation at year-end exchange rates and non-monetary assets and liabilities are translated at historical rates. Revenues, expenses and cash flows are translated at average exchange rates, except for items related to non-monetary assets and liabilities which are translated at historical rates. Gains or losses on translation of monetary assets and monetary liabilities are included in earnings.

Business combinations

Effective January 1, 2008, the Company elected to early adopt CICA Section 1582, Business Combinations, Section 1601, Consolidation, and Section 1602, Non-controlling Interests. Under these new standards the Company measures all business acquisitions at fair value, measures non-controlling interests at fair value, and recognizes acquisition-related costs of business combinations as expenses. Non-controlling interests are classified as a separate component of equity, not as a liability or other item outside of equity. The excess of the cost of the business combination over the fair value of the net assets acquired is recorded as goodwill. If the cost of the business combination is less than the fair value of the net assets acquired, the difference is recognized directly in the income statement as a gain on acquisition.

Cash

Cash is comprised of cash on hand and demand deposits.

Short-term deposits

The Company considers short-term deposits to include amounts held in banks and highly liquid investments with maturities at the date of purchase of more than 90 days and less than one year.

Inventories

Inventories for consumable parts and supplies, ore stockpiles, and ore concentrates, are valued at the lower of cost and net realizable value. Costs allocated to consumable parts and supplies are based on average costs. Costs allocated to ore stockpiles and ore concentrates are based on average costs, which include an appropriate share of direct mining costs, direct labour and material costs, mine site overhead, depletion and amortization.

Investments

Investments in shares of companies over which the Company exercises neither control nor significant influence are designated as available-for-sale and recorded at fair value. Fair values are determined by reference to quoted market prices at the balance sheet date. Unrealized gains and losses on available-for-sale investments are recognized in other comprehensive income, other than unrealized losses considered other than temporary, which are recorded in the statement of earnings (loss).

Investments in warrants of companies over which the Company exercises neither control nor significant influence are designated as derivatives despite the fact they are held for long-term investment purposes. Warrants are recorded at fair value, with fair values determined by a Black-Scholes option pricing model at the balance sheet date. Unrealized gains and losses on warrants are recognized in the statement of earnings (loss).

Investments in shares and warrants of associated companies over which the Company exercises significant influence are accounted for by the equity method whereby the investment is initially recorded at cost, adjusted to recognize the Company's share of earnings or loss in the investment and reduced by dividends received.

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Property, plant and equipment

Items are recorded at cost. Amortization is computed using the following rates:

| <u>Item</u> | <u>Methods</u> | <u>Rates</u> |
|---|---------------------------------------|--|
| Property, plant & equipment | Straight line, Units of production | 4 – 10 years, Estimated proven and probable reserves |
| Development costs | Units of production | Estimated proven and probable reserves |
| Equipment and facilities under capital leases | Straight line | 7 years |
| Deferred stripping costs | Units of production | Estimated proven and probable reserves accessible due to stripping |

Amortization begins when the asset is placed into service.

Mineral property costs

The Company capitalizes acquisition and exploration expenditures related to mineral properties on an individual prospect basis until such time as an economic ore body is defined or a prospect is abandoned. Amortization of assets used in connection with capitalized mineral property costs is also capitalized. Unrecoverable costs for projects determined not to be commercially feasible are expensed in the period in which the determination is made. Holding costs to maintain a property on a care and maintenance basis are expensed as incurred.

The recoverability of the amounts capitalized for the undeveloped mineral properties is dependent upon the determination of economically recoverable ore reserves, confirmation of the Company's interest in the underlying mineral claims, the ability to obtain the necessary financing to complete their development and future profitable production or proceeds from the disposition thereof.

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties is in good standing.

Deferred stripping

Stripping costs are accounted for as variable production costs and included in the costs of inventory produced during the period that the stripping costs are incurred. However, stripping costs will be capitalized and recorded on the balance sheet as deferred stripping, as a component of property, plant and equipment, if the stripping activity can be shown to represent a betterment to the mineral property. Betterment occurs when the stripping activity provides access to sources of reserves that will be produced in future periods that would not have otherwise been accessible in the absence of this activity. The deferred stripping will be amortized on a unit of production basis over the reserves that directly benefited from the stripping activity when they are actually mined.

Capitalized interest

Interest and other financing costs relating to the construction of property, plant and equipment or development of mineral properties are capitalized as construction in progress or in mineral properties until they are complete and available for use, at which time they are transferred to property, plant and equipment or to depletable mineral properties. Interest costs incurred after the asset has been placed into service are charged to earnings (loss).

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Commercial and pre-commercial production

Commercial production is deemed to have commenced when management determines that the operational commissioning of major mine and plant components is complete, operating results are being achieved consistently for a period of time and that there are indicators that these operating results will continue. The Company determines commencement of commercial production based on the following factors, which indicate that planned principal operations have commenced. These include one or more of the following:

- a significant portion of plant/mill capacity is achieved;
- a significant portion of available funding is directed towards operating activities;
- a pre-determined, reasonable period of time has passed; and
- a development project significant to the primary business objectives of the enterprise has been completed as to significant milestones being achieved.

Impairment of long-lived assets

The Company assesses the possibility of impairment in the net carrying value of its long-lived assets when events or circumstances indicate impairment may have occurred. Management calculates the estimated undiscounted future net cash flows relating to the asset or asset group using estimated future prices, proven and probable reserves and other mineral resources, and operating, capital and reclamation costs. When the carrying value of an asset exceeds the related undiscounted future net cash flows, the asset is written down to its estimated fair value, which is usually determined using discounted future net cash flows.

Taxes receivable

Taxes receivable are comprised of value added taxes in Mexico and goods and services tax in Canada that the Company has paid.

Derivative instruments

The Company uses derivative instruments to reduce the potential impact of changing metal prices and foreign exchange rates. Derivative instruments are marked to market at the end of each reporting period and the mark-to-market adjustment is recorded as a gain or loss on derivative instruments in earnings (loss). The Company does not apply hedge accounting to its derivative transactions.

Financial instruments

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as “held-for-trading”, “available-for-sale”, “held-to-maturity”, “loans and receivables”, or “other financial liabilities” as defined by the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3855, Financial Instruments – Recognition and Measurement.

Financial assets and financial liabilities classified as “held-for-trading” are measured at fair value with changes in those fair values recognized in net earnings (loss). Financial assets classified as “available-for-sale” are measured at fair value, with changes in those fair values recognized in other comprehensive income (“OCI”) except for other-than-temporary impairment which is recorded as a charge to net earnings (loss). Financial assets classified as “held-to-maturity”, “loans and receivables” and “other financial liabilities” are measured at amortized cost.

Cash, restricted cash, and short-term deposits are designated as “held-for-trading” and are measured at fair value. Receivables and long-term deposits are designated as “loans and receivables”. Accounts payable and accrued liabilities, long term debt, and capital lease obligations are designated as “other financial liabilities”. Derivative financial instruments are classified as “held-for-trading”.

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Deferred revenue

Deferred revenue consists of payments received by the Company in consideration for future commitments to deliver payable gold and silver contained in concentrate at contracted prices. In addition, it includes the fair value of such commitments acquired by way of business combination. As deliveries are made, the Company records a portion of the deferred revenue as sales, based on a proportionate share of deliveries made compared with the total estimated contractual commitment.

Capital lease obligations

Leases are classified as either capital or operating. Leases that transfer substantially all of the benefits and risks of ownership of property, plant and equipment to the Company are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded with its obligation. Payments made under operating leases are expensed as incurred or capitalized, if applicable.

Income and mining taxes

The asset and liability method is used for determining future taxes. Under the asset and liability method, the change in the net future tax asset or liability is included in earnings. Future tax assets and liabilities are determined based on the differences between the tax basis of assets and liabilities and the amount reported in the financial statements. Future tax assets also result from unused loss carry forwards, resource-related pools, and other deductions. Future tax assets and liabilities are measured using substantively enacted rates that are expected to apply in the years in which temporary differences are expected to be recovered or settled. The amount of future tax assets recognized is limited to the amount that is more likely than not to be realized. The valuation of future tax assets is adjusted, if necessary, by the use of a valuation allowance to reflect the estimated realizable amount.

Asset retirement obligations

The Company's asset retirement obligations ("ARO") relate to required mine reclamation and closure activities. An ARO is recognized initially at fair value with a corresponding increase in related assets. The ARO is accreted to full value over time through periodic accretion charges recorded to operations using the Company's credit adjusted risk free rate. In subsequent periods, the Company adjusts the carrying amounts of the ARO and the related asset for changes in estimates of the amount or timing of underlying future cash flows.

Share capital

The proceeds from the exercise of stock options or warrants together with amounts previously recorded on grant date or issue date are recorded as share capital.

Share capital issued for non-monetary consideration is recorded at an amount based on fair market value on the date of issue.

The proceeds from the issue of units is allocated between common shares and common share purchase warrants on a pro-rata basis based on relative fair values as follows: the fair value of the common shares is based on the market close on the date the units are issued and the fair value of the common share purchase warrants is determined using the Black-Scholes option pricing model.

Flow-through shares

Under the terms of Canadian flow-through share legislation, the tax attributes of qualifying expenditures are renounced to subscribers. To recognize the foregone tax benefits, share capital is reduced and a future income tax liability is recognized as the related expenditures are renounced. This future income tax liability may then be reduced by the recognition of previously unrecorded future income tax assets on unused tax losses and deductions.

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Stock-based compensation

Contributions to the Company's employee share purchase plan ("ESPP") are recorded on a payroll cycle basis as the Company's obligation to contribute is incurred.

The fair value of stock options granted under the Company's stock option plan is estimated at the grant date using the Black-Scholes option pricing model. Compensation expense is recognized on a straight-line basis over the stock option vesting period.

Revenue recognition

Sales are recognized and revenue is recorded at market prices following the transfer of title and risk of ownership provided that collection is reasonably assured, and the price is reasonably determinable. The Company's metal concentrates are sold under a pricing arrangement where final prices are determined by quoted market prices in a period subsequent to the date of sale. Until prices are final, revenues are recorded upon delivery based on forward market prices for the expected period of final settlement. Subsequent variations in the final determination of the metal concentrate weight, assay, and price are recognized as revenue adjustments as they occur until finalized. Under the terms of the Company's off-take agreements, it may request advances from its customers which are recorded as advances on concentrate inventories until the related revenue is recognized.

Earnings per share

Basic earnings per share is computed by dividing net earnings (loss) available (attributable) to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method.

3. Changes in accounting policies

Accounting policies implemented effective January 1, 2009

The Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets, which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Upon adoption of this standard, there were no resulting material changes to the Company's financial position or results of operations.

The Company adopted the amendments of CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement. The various changes include the following:

- Reclassification of financial assets out of assets held for trading and assets held for sale categories into the loans and receivable category is permitted under certain circumstances;
- The definition of loans and receivables category has been update so that certain debt instruments may be classified as loans if they do not have a quoted price in an active market and the Company does not have the intent to sell the instruments immediately or in the near term; and
- Impairment losses relating to available for sale debt instruments must be reversed if the fair value of the instrument increase due to an event occurring after the loss was recognized.

Upon adoption of these amendments, there were no resulting material changes to the Company's financial position or results of operations.

The Company adopted the amendments of CICA Handbook Section 3862, Financial Instruments – Disclosures, which require financial instruments recognized at fair value on the consolidated balance sheet to be classified into one of three hierarchy levels. Each level is based on the transparency of inputs to the valuation of the financial asset or liability as of the measurement date. Upon adoption of the amendments, there are additional disclosures related to financial instruments included in the consolidated financial statements.

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The Company adopted EIC-173, Credit Risk and the Fair Value of Financial Assets and Liabilities, which provides guidance on how to take into account an entity's own credit risk and that of the counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. Upon adoption of this EIC, there were no resulting material changes to the Company's financial position or results of operations given that Capstone's credit risk was previously considered when fair valuing its financial instruments.

The Company adopted EIC-174, Mining Exploration Costs, which provides guidance on how to account for mineral exploration costs as well as when and how to assess for impairment when such exploration costs are capitalized. Upon adoption of this EIC, there were no resulting material changes to the Company's financial position or results of operations.

International Financial Reporting Standards

The Canadian Accounting Standards Board recently confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian standards and interpretations on January 1, 2011. The process of changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect reported financial position and results of operations, and also affect certain business functions.

The Company has not yet completed a full evaluation of the adoption of IFRS and its impact on its financial position and results of operations.

4. Acquisitions

Sherwood Copper Corporation

Pursuant to a share exchange agreement with an effective date of November 24, 2008, Capstone acquired all of the issued and outstanding shares of Sherwood. Capstone issued 84,334,104 common shares in exchange for 53,853,198 shares of Sherwood, with the effect that subsequent to the transaction the former shareholders of Sherwood controlled 51.20% of the outstanding common shares. Prior to this exchange, Capstone had 80,370,781 shares outstanding. Taking into account the composition of the Board and senior management and the relative ownership percentages of Sherwood and Capstone shareholders in the newly combined enterprise, from an accounting perspective Sherwood is considered to have acquired Capstone, and hence the transaction has been recorded as a reverse takeover.

For financial reporting purposes, the Company is considered to be a continuation of Sherwood, the legal subsidiary, except with regard to the authorized and issued share capital, which is that of Capstone, the legal parent. The primary reason for the business combination was to create a well-funded, low-cost, growth-oriented copper company with two producing mines in politically stable and mining friendly jurisdictions.

The acquisition of Capstone by Sherwood has been accounted for as a business combination using the purchase method of accounting. The purchase price has been determined based on the number of shares that Sherwood would have had to issue on the date of closing to give the owners of Capstone the same percentage equity (48.80%) of the combined entity as they hold subsequent to the reverse takeover.

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(expressed in thousands of US dollars, except share amounts)

The costs of the acquisition have been allocated as follows (expressed in thousands, except share amounts):

Consideration transferred:

| | | |
|--|----|---------------|
| Deemed issuance of Sherwood shares* | \$ | 43,657 |
| Deemed issuance of Sherwood options and warrants | | 651 |
| | \$ | <u>44,308</u> |

Net assets acquired:

| | | |
|---|----|---------------|
| Cash | \$ | 31,789 |
| Non-cash current assets** | | 26,658 |
| Investments | | 8,200 |
| Property, plant and equipment | | 21,540 |
| Mineral property | | 102,348 |
| Derivative instruments asset | | 16,704 |
| Other assets** | | 2,840 |
| Current liabilities | | (7,833) |
| Advances on concentrate inventories | | (6,231) |
| Unfavourable contract to deliver silver (Note 18) | | (45,700) |
| Capital lease obligations | | (117) |
| Asset retirement obligations | | (2,102) |
| Future income taxes | | (31,745) |
| Gain on acquisition | | (72,043) |
| | \$ | <u>44,308</u> |

* Based on the deemed issuance of 51,328,829 common shares of Sherwood at a price of C\$1.05 per share, converted at the exchange rate of 1.2345 US\$/C\$ on the date of transaction.

** Included in the net assets acquired are receivables totaling \$11.5 million, against which management has not provided any allowance for bad debt.

As part of the acquisition, Capstone issued 7,178,512 and 4,142,546 options and warrants, respectively, in exchange for 4,637,667 and 2,645,306 options and warrants of Sherwood, respectively. The options and warrants issued by Capstone were on the same terms and conditions as those exchanged by Sherwood holders. No amount has been recorded in respect of the actual issuances of these options and warrants. Rather, given that this business combination has been accounted for as a reverse takeover of Capstone by Sherwood, from an accounting perspective it is Sherwood that is deemed to have issued options and warrants to Capstone holders. At November 24, 2008, Capstone had 3,194,000 and 3,835,986 options and warrants outstanding, respectively. The fair value of the deemed issuance of Sherwood options and warrants in exchange for 3,194,000 options and 3,835,986 warrants of Capstone was \$0.7 million, and this amount has been included as a component of the purchase price. Costs related to the transaction were \$5.2 million, and were expensed as incurred.

During the fourth quarter of 2008 the price of copper declined sharply, resulting in a decline in market prices for the shares of Sherwood and Capstone. Given that the acquisition was effected by way of a pre-determined share exchange ratio negotiated in September 2008, the effect of recording the share consideration exchanged using market prices for the shares on the closing date of the transaction resulted in an excess of \$72.0 million with respect to the fair value of identifiable net assets over the fair value of the consideration transferred, which was recorded as a gain during the fourth quarter of 2008 in earnings.

Western Keltic Mines Inc.

In November 2007, Sherwood entered into an agreement with Western Keltic, owner of the Kutcho project, under which Sherwood offered to acquire all of Western Keltic's shares through the issuance of 0.08 of a share of Sherwood for each share of Western Keltic. On February 11, 2008, Sherwood acquired a controlling interest in Western Keltic, and its results of operations and cash flows have been consolidated with those of Sherwood since that date. On May 27, 2008, Sherwood acquired, by plan of arrangement, the remaining outstanding shares of

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Western Keltic. Western Keltic and a wholly owned subsidiary of Sherwood were then amalgamated and named Kutcho Copper Corp. The Company is continuing advancement of the Kutcho project in north-western British Columbia towards a production decision.

The transaction has been recorded as an asset purchase of mineral property interests with the costs of the acquisition allocated as follows (expressed in thousands, except share amounts):

Purchase price:

| | | |
|---|----|---------------|
| Common shares of Sherwood issued (6,606,874 shares) | \$ | 32,205 |
| Warrants and options exchanged | | 1,179 |
| Transaction costs | | 1,020 |
| | \$ | <u>34,404</u> |

Net assets acquired:

| | | |
|---|----|---------------|
| Cash | \$ | 657 |
| Investments | | 24 |
| Equipment | | 36 |
| Mineral property interests | | 44,720 |
| Other assets | | 51 |
| Non-cash operating working capital (<i>net</i>) | | (5,629) |
| Asset retirement obligations | | (50) |
| Future income and mining tax liability | | (5,405) |
| | \$ | <u>34,404</u> |

As part of the acquisition, Sherwood issued 323,640 and 1,134,496 options and warrants, respectively, in exchange for 4,045,500 and 14,181,200 options and warrants of Western Keltic. The options and warrants issued by Sherwood were on the same terms and conditions as those exchanged by Western Keltic holders. As a result of these exchanges, Sherwood recorded the fair value of the vested options and warrants of \$1.2 million as transaction costs (Note 21).

5. Financial instruments

Overview

The Company's activities expose it to financial risks of varying degrees of significance which could affect its ability to achieve its strategic objectives for growth and shareholder returns. The principal financial risks to which the Company is exposed are commodity price risk, credit risk, foreign exchange risk, liquidity risk, and interest rate risk. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

Commodity price risk

The Company is exposed to commodity price risk given that its revenues are derived from the sale of metals, the prices for which have been historically volatile. It manages this risk by entering into forward sale agreements with various counterparties, both as a condition of certain debt facilities as well as to mitigate price risk when management believes it a prudent decision. Currently the Company has in place derivative contracts for the sale of copper from its Minto Mine and for the sale of copper, lead and zinc from its Cozamin Mine. Additionally, it has sold forward to Silver Wheaton Corp. the gold and silver production from the Minto Mine and silver production from the Cozamin Mine (Note 18).

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For the year ended December 31, 2009, with all other variables unchanged, an increase of \$0.10 in the price of copper would have increased pre-tax earnings by \$8.5 million, not taking into consideration any changes with respect to price participation of smelters on changes to the commodity price or the derivative financial instruments. An increase of \$0.10 in the forward price of copper for all future periods would increase the unrealized loss on derivative instruments and earnings before income taxes by \$6.9 million.

Credit risk

The Company is exposed to credit risk through its trade receivables on concentrate sales. The Company manages this risk by requiring provisional payments of 90 percent of the value of the concentrate shipped. The Company enters into derivative instruments with a number of counterparties. These counterparties are large, well diversified multinational corporations, and credit risk is considered to be minimal.

As at December 31, 2009, the Company's maximum exposure to credit risk is the carrying value of its cash and restricted cash, receivables, and note receivables.

Foreign exchange risk

The Company is exposed to foreign exchange risk as the Company's operating costs will be primarily in Canadian dollars and Mexican Pesos, while revenues will be received in US dollars, hence any fluctuation of the US dollar in relation to these currencies may impact the profitability of the Company and may also affect the value of the Company's assets and liabilities. The Company currently does not enter into financial instruments to manage this risk but the draws on debt facilities are made in US dollars to mitigate the risk on loan repayments.

As at December 31, 2009, the Company is exposed to foreign exchange risk through the following assets and liabilities denominated in currencies other than the measurement currency of the applicable subsidiary (expressed in thousands):

| | US dollar | Mexican peso |
|--|---------------|---------------|
| Cash and restricted cash | \$ 45,167 | \$ 17,921 |
| Accounts receivable and other current assets | 1,732 | 3,048 |
| Deposits and other long-term assets | 350 | 358 |
| Total Assets | 47,249 | 21,327 |
| | | |
| Accounts payable & accrued liabilities | 2,367 | 1,371 |
| Taxes payable | - | 2,940 |
| Capital lease obligations | 10,352 | - |
| Derivative instrument liability | 50,679 | - |
| Future income tax liabilities | - | 11,040 |
| Asset retirement obligations | - | 3,218 |
| Total Liabilities | 63,398 | 18,569 |

| | | |
|---------------------------------|--------------------|-----------------|
| Net (Liabilities) Assets | \$ (16,149) | \$ 2,758 |
|---------------------------------|--------------------|-----------------|

Based on the above net exposures at December 31, 2009 a 10% appreciation of the Canadian dollar vis-à-vis the US dollar would result in a \$1.6 million increase in the Company's earnings before income taxes. A 10% appreciation of the Mexican peso vis-à-vis the US dollar would result in a \$0.3 million decrease in the Company's earnings before income taxes.

Liquidity risk

The Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company maintains adequate cash balances and credit facilities in order to meet short and long term business requirements, after taking

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into account cash flows from operations and believes that these sources will be sufficient to cover the likely short and long term cash requirements. The Company's cash is invested in business accounts with quality financial institutions and which is available on demand for the Company's programs, and is not invested in any asset backed commercial paper.

Interest rate risk

Currently the Company's long term liabilities are based on both fixed and variable interest rates. The Company is exposed to interest rate risk on its variable rate debt facilities. Variable interest rates are based on both US dollar and Canadian dollar London Inter-bank Offered Rates ("LIBOR") plus a fixed margin. The Company does not enter into derivative contracts to manage this risk.

The Company's subordinated loan facility carries an interest rate of Canadian LIBOR plus 2.65% while its revolving term credit facility carries an interest rate of Canadian LIBOR plus 3.5% (adjustable in certain circumstances). At December 31, 2009, with all other variables unchanged, a 1% increase in interest rates would result in a pre-tax interest expense of \$0.1 million on an annualized basis on the Company's variable rate debt facilities.

The Company is also exposed to interest rate risk with respect to the interest it earns on its cash balances.

Financial instruments carrying value and fair value

The Company's financial instruments consist of cash, restricted cash, receivables, long term investments, accounts payable and accrued liabilities, taxes payable, advances on concentrate inventories, debt facilities, convertible debentures, capital lease obligations, and derivative instruments.

Cash, restricted cash, and derivative instruments are classified as "held-for-trading" and measured at fair value. Certain of the Company's long term investments that are not accounted for using the equity method are classified as "available-for-sale". Receivables are designated as "loans and receivables". Long term investments are designated as "available for sale". Accounts payable and accrued liabilities, taxes payable, advances on concentrate inventories, debt facilities, convertible debentures, and capital lease obligations are designated as "other financial liabilities".

The carrying value of receivables, and accounts payable and accrued liabilities, taxes payable and advances on concentrate inventories approximate their fair values due to their immediate or short-term maturity. Investments that are available-for-sale are recorded at fair value based on quoted market prices at the balance sheet date. The fair value of the Company's loan facilities and capital lease obligations are approximated by their carrying values given that the facilities bear interest at variable rates or, in the case of capital lease obligations, the interest rates have not changed materially. The fair value of the convertible debentures based on the market price at December 31, 2009 was \$4.3 million. The fair value of the derivative contracts is based on quoted market prices for comparable contracts and approximates the amount the Company would have received from (or paid to) a counterparty to settle the contract at the market rates in effect at the balance sheet date.

During 2009, CICA Handbook Section 3862, Financial Instruments – Disclosures was amended to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measure. The three levels of the fair value hierarchy are as follows:

- Level 1 – Fair values measured using unadjusted quoted prices in active markets for identical instruments
- Level 2 – Fair values measured using directly or indirectly observable inputs, other than those included in Level 1
- Level 3 – Fair values measured using inputs that are not based on observable market data

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As of December 31, 2009 the Company's classification of financial instruments within the fair value hierarchy are summarized below (expressed in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|--------------|-----------|----------|---------|-----------|
| Investments | \$ 37,196 | \$ 1,909 | \$ - | \$ 39,105 |
| Total Assets | 37,196 | 1,909 | - | 39,105 |

| | | | | |
|---------------------------------|---|--------|---|--------|
| Derivative instrument liability | - | 55,405 | - | 55,405 |
| Total Liabilities | - | 55,405 | - | 55,405 |

The Company uses valuation models to determine the fair value of its derivative instruments. The inputs to these models are primarily external observable inputs such as forward prices for metal contracts and the market price of underlying securities for warrants.

As of December 31, 2009 the Company's liabilities that have contractual maturities are summarized below (expressed in thousands):

| | Total | 2010 | 2011-2012 | 2013-2014 | After 2014 |
|--|-----------|-----------|-----------|-----------|------------|
| Accounts payable & accrued liabilities | \$ 19,782 | \$ 19,782 | \$ - | \$ - | \$ - |
| Taxes payable | 8,041 | 8,041 | - | - | - |
| Long-term debt | 20,866 | 9,515 | 4,596 | 2,491 | 4,263 |
| Capital lease obligations | 26,152 | 3,539 | 6,714 | 8,805 | 7,094 |
| Total* | \$ 74,841 | \$ 40,877 | \$ 11,310 | \$ 11,296 | \$ 11,357 |

* Amounts above do not include payments related to the Company's asset retirement obligations and other mine closure costs (Note 20).

6. Receivables

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|---|-------------------|-------------------|
| Concentrate | \$ 2,999 | \$ - |
| Taxes | 3,060 | 8,631 |
| Other | 62 | 3,536 |
| Current portion of notes receivable (Note 10) | 825 | 601 |
| Total receivables | \$ 6,946 | \$ 12,768 |

7. Inventories

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|-------------------------------|-------------------|-------------------|
| Consumable parts and supplies | \$ 7,378 | \$ 7,807 |
| Ore stockpiles | 14,259 | 10,953 |
| Concentrates | 22,801 | 18,245 |
| Total inventories | \$ 44,438 | \$ 37,005 |

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8. Investments

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|---|-------------------|-------------------|
| Available-for-sale investment in Silver Wheaton Corp. (c) | \$ 21,900 | \$ - |
| Available-for-sale investment in Nevada Copper Corp. (a) | 14,850 | - |
| Other available-for-sale investments (a) | 446 | 198 |
| Derivative investment in Nevada Copper Corp. (b) | 1,909 | - |
| Equity investment in Silverstone Resources Corp. (c) | - | 7,866 |
| Total investments | \$ 39,105 | \$ 8,064 |

a) Available-for-sale investments

Investments in available-for-sale securities consist of marketable securities in companies over which the Company does not exercise significant influence. They are recorded at fair value, with any unrealized gains and losses considered to be temporary recognized in other comprehensive income.

On November 3, 2009, the Company purchased 4.5 million units in Nevada Copper Corp. ("Nevada Copper") by way of a private placement, each unit consisting of one common share and one-half of a common share purchase warrant. The cost of each unit was C\$2.50 for a total investment of C\$11.25 million. Each whole warrant is exercisable into one common share for a period of two years at a price of C\$3.00 per common share, expiring November 3, 2011. If at any time prior to expiry, the closing price of Nevada Copper's common shares is greater than C\$3.50 for at least 20 consecutive trading days, Nevada Copper can send a notice to Capstone stating that the warrants will expire if not exercised within 30 days. The shares are classified as an available-for-sale investment and the warrants are classified as a derivative investment.

b) Derivative investment

Investments in derivative securities consist of 2.25 million common share purchase warrants in Nevada Copper. They are recorded at fair value, with any unrealized gains and losses recognized in earnings.

During 2009, the Company recorded an unrealized gain of \$0.9 million (2008 – \$nil) in respect of its derivative investment in Nevada Copper.

c) Equity investment in Silverstone Resources Corp.

On November 24, 2008, as a result of the business combination between Sherwood and Capstone (Note 4), the Company acquired an equity investment in Silverstone Resources Corp. ("Silverstone"), consisting of 24,042,340 shares and 2,747,428 special warrants of Silverstone, representing a 19.5% equity interest.

On May 21, 2009, Silver Wheaton Corp. ("Silver Wheaton") completed its acquisition of Silverstone by plan of arrangement whereby for each share of Silverstone a shareholder received 0.185 shares of Silver Wheaton. As a result, Capstone exchanged its shares and special warrants of Silverstone for a total of 4,956,106 shares of Silver Wheaton, recording a gain of \$39.9 million on deemed proceeds of \$46.6 million. The gain recorded on the exchange was equal to the fair value of the Silver Wheaton shares received less the cost basis of the Silverstone equity investment on the date of exchange. On this date, given that its ownership interest in Silver Wheaton represented 1.6%, Capstone commenced accounting for the investment as available-for-sale securities.

The Company subsequently disposed of 3,500,000 shares of Silver Wheaton during 2009 for total cash proceeds of \$40.5 million. The cost base of the shares disposed was \$34.1 million, resulting in a gain of \$6.4 million.

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(expressed in thousands of US dollars, except share amounts)

A continuity of the investments is as follows (expressed in thousands):

| | Shares and warrants of Silverstone | Shares of Silver Wheaton | Amount |
|---|---------------------------------------|-----------------------------|-----------|
| At January 1, 2009 | 26,789,768 | - | \$ 7,866 |
| Equity loss from investment | - | - | (1,505) |
| Foreign currency translation adjustments | - | - | 334 |
| Silver Wheaton's acquisition of Silverstone | | | |
| Silverstone shares and warrants disposed | (26,789,768) | - | (6,695) |
| Silver Wheaton shares received for Silverstone shares and warrants | - | 4,956,106 | 46,637 |
| At May 21, 2009 | - | 4,956,106 | 46,637 |
| Cost base of Silver Wheaton shares disposed during 2009 | - | (3,500,000) | (34,139) |
| Reversal of unrealized gains on shares disposed during 2009 | - | - | (2,452) |
| Mark-to-market adjustment on Silver Wheaton shares during 2009 | - | - | 9,289 |
| Foreign currency translation adjustments | - | - | 2,565 |
| At December 31, 2009 | - | 1,456,106 | \$ 21,900 |

9. Property, plant and equipment

Details are as follows (expressed in thousands):

| | December 31, 2009 | | |
|--|-------------------|-----------------------------|----------------|
| | Cost | Accumulated amortization | Net book value |
| Property, plant and equipment | \$ 98,604 | \$ (22,887) | \$ 75,717 |
| Development costs | 18,395 | (4,042) | 14,353 |
| Equipment and facilities under capital leases | 25,575 | (6,111) | 19,464 |
| Deferred stripping costs | 45,820 | (20,820) | 25,000 |
| Construction in progress | 9,991 | - | 9,991 |
| | \$ 198,385 | \$ (53,860) | \$ 144,525 |

| | December 31, 2008 | | | |
|--|-------------------|-----------------------------|-------------------------|----------------|
| | Cost | Accumulated amortization | Impairment (Note 12) | Net book value |
| Property, plant and equipment | \$ 86,095 | \$ (12,297) | \$ (9,319) | \$ 64,479 |
| Development costs | 59,638 | (6,741) | (30,699) | 22,198 |
| Equipment and facilities under capital leases | 20,982 | (2,918) | - | 18,064 |
| Deferred stripping costs | 18,293 | (6,771) | - | 11,522 |
| Construction in progress | 1,861 | - | - | 1,861 |
| | \$ 186,869 | \$ (28,727) | \$ (40,018) | \$ 118,124 |

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At December 31, 2009, construction in progress relates to capital costs incurred in connection with sustaining capital at the Minto and Cozamin Mine sites.

During the year ended December 31, 2009, amortization of \$27.6 million was offset by additions of \$38.2 million and a currency translation adjustment of \$15.8 million on Canadian dollar denominated property, plant and equipment.

During the year ended December 31, 2009, the Company wrote off certain camp assets associated with its Minto operations. At the time of the write down the assets had a net book value of \$0.7 million, which has been included as a loss in "Loss on disposal of property, plant & equipment".

10. Notes receivable

On November 24, 2008, the Company acquired Capstone Mining (Note 4), owner of notes receivable in respect of agreements with a contractor at the Cozamin Mine. As part of the purchase price equation, the Company allocated \$1.2 million of fair value to the notes receivable. Under the terms of the agreement, the contractor has agreed to purchase certain mining equipment which the Company holds under capital leases through monthly payments over a three year period, such payments inclusive of interest at 8% per annum.

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|------------------------|-------------------|-------------------|
| Total notes receivable | \$ 1,697 | \$ 1,172 |
| Less: current portion | (825) | (601) |
| Long-term portion | \$ 872 | \$ 571 |

11. Mineral property costs

Details are as follows (expressed in thousands):

| | December 31, 2009 | | |
|---------------|-------------------|--------------------------|----------------|
| | Cost | Accumulated amortization | Net book value |
| MintoEx | \$ 34,304 | \$ (2,203) | \$ 32,101 |
| Cozamin | 112,381 | (18,744) | 93,637 |
| Kutcho Copper | 50,929 | - | 50,929 |
| | \$ 197,614 | \$ (20,947) | \$ 176,667 |

| | December 31, 2008 | | | |
|---------------|-------------------|--------------------------|----------------------|----------------|
| | Cost | Accumulated amortization | Impairment (Note 12) | Net book value |
| MintoEx | \$ 32,063 | \$ (2,981) | \$ (13,417) | \$ 15,665 |
| Cozamin | 108,774 | (6,612) | - | 102,162 |
| Kutcho Copper | 43,197 | - | - | 43,197 |
| | \$ 184,034 | \$ (9,593) | \$ (13,417) | \$ 161,024 |

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

| | December 31, 2009 | | | December 31, 2008 | | |
|---------------|-------------------|----------------|------------|-------------------|----------------|------------|
| | Depletable | Non-depletable | Total | Depletable | Non-depletable | Total |
| Minto | \$ 12,271 | \$ 19,830 | \$ 32,101 | \$ 7,353 | \$ 8,312 | \$ 15,665 |
| Cozamin | 88,336 | 5,301 | 93,637 | 102,162 | - | 102,162 |
| Kutcho Copper | - | 50,929 | 50,929 | - | 43,197 | 43,197 |
| | \$ 100,607 | \$ 76,060 | \$ 176,667 | \$ 109,515 | \$ 51,509 | \$ 161,024 |

During the year ended December 31, 2009, depletion of \$14.2 million was offset by additions of \$21.1 million and a currency translation adjustment of \$8.8 million on Canadian dollar denominated mineral properties.

Included in the additions for the year was the purchase of three mineral claims immediately adjacent to its Cozamin Mine. The purchase price was comprised of: a) an upfront payment of \$1.0 million; b) future cash payments equivalent to a 1.5% net smelter return royalty on the first one million tonnes of ore produced from the acquired claims; and c) future cash payments equivalent to a 3.0% net smelter return royalty on ore production in excess of one million tonnes from the acquired claims, the calculation of which is subject to escalation at a rate of 0.5% for each \$0.50 increment in the copper price above \$3.00 per pound.

12. Impairment

An asset impairment charge of \$53.4 million was recorded against the Minto Mine at December 31, 2008. Due to the significant reduction in the copper price over the fourth quarter of 2008, the Company, following CICA Handbook Section 3063 - Impairment of Long Lived Assets, performed an undiscounted life of mine cash flow analysis using management's best estimate of future commodity prices, reserves and resources, recovery rates, foreign exchange rates, and future operating costs. As the undiscounted cash flows were not sufficient to recover the net book value of the long lived assets, the cash flows were discounted at a rate of 15%, with the differential to the net book value being recorded as the impairment. The Minto Mine undiscounted cash flows are very sensitive to the copper price, the US dollar exchange rate, copper grade, reserves and resources and other estimates and there would be material adjustments to the amount of the impairment if different estimates were assumed.

13. Other assets

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|-----------------------------------|-------------------|-------------------|
| Security deposit on port facility | \$ 350 | \$ 350 |
| Other | 155 | - |
| Total other assets | \$ 505 | \$ 350 |

14. Derivative instruments

As a condition of the loans with Macquarie (Note 16) the Company must maintain a price protection program of copper forward metal sales contracts as they relate to the Minto Mine. Additionally, the Company uses forward sales contracts for its Cozamin Mine in order to manage price risk on its future production.

In addition to its copper forward sales contracts, during 2009, the Company entered into new lead and zinc forward sales contracts for its Cozamin Mine, the details of which are in the table below.

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Details of the Company's forward sales contracts at December 31, 2009 are as follows:

| Metal | Maturity | Quantity (pounds 000's) | Forward Price (per pound) |
|---------------|----------|----------------------------|------------------------------|
| Copper | 2010 | 34,412 | \$ 2.38 |
| | 2011 | 22,293 | 2.41 |
| | 2012 | 4,630 | 3.21 |
| | 2013 | 3,968 | 3.15 |
| | 2014 | 1,323 | 3.12 |
| | | 66,626 | \$ 2.51 |
| Lead | 2010 | 1,323 | \$ 1.05 |
| | 2011 | 1,323 | 1.04 |
| | | 2,646 | \$ 1.04 |
| Zinc | 2010 | 3,307 | \$ 0.94 |
| | | 3,307 | \$ 0.94 |

As at December 31, 2009, the Company has a mark-to-market derivative instrument liability of \$55.4 million (December 31, 2008 – \$105.3 million asset) recorded for these forward sales contracts, of which a \$33.6 million liability (December 31, 2008 – \$48.5 million asset) relates to derivative contracts maturing in less than one year, and a \$21.8 million liability (December 31, 2008 – \$56.8 million asset) relates to derivative contracts with a maturity date greater than one year.

During 2009, the Company recorded a realized gain of \$17.7 million (2008 – gain of \$2.7 million) on derivative contracts that were closed out and settled for cash. This was offset by an unrealized non-cash loss of \$160.7 million (2008 – loss of \$126.3 million) related to changes in the mark-to-market value of open derivative contracts at the end of the period, resulting in a net loss on derivative instruments of \$143.0 million (2008 – net loss of \$123.6 million).

During 2009, the Company recorded a total unrealized loss on derivative instruments of \$159.8 million (2008 – unrealized loss of \$126.3 million), which is comprised of a loss of \$160.7 million (2008 – \$126.3 million) related to metal derivative instruments and a gain of \$0.9 million (2008 – Nil) related to warrants in Nevada Copper (Note 8(b)).

15. Current portion of other liabilities

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|--|-------------------|-------------------|
| Current portion of: | | |
| Long term debt (Note 16) | \$ 9,515 | \$ 52,010 |
| Capital lease obligations (Note 17) | 2,201 | 3,497 |
| Derivative instrument liability (Note 14) | 33,648 | - |
| Future income tax liability and other | 2,924 | 18,397 |
| Total current portion of other liabilities | \$ 48,288 | \$ 73,904 |

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

16. Long term debt

Details are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|--|-------------------|-------------------|
| Macquarie Bank Limited – project loan facility | \$ - | \$ 29,926 |
| Macquarie Bank Limited – subordinated loan facility | 9,515 | 8,211 |
| Yukon Energy Corporation – capital cost contribution | 6,851 | 5,911 |
| Convertible debentures | 3,970 | 30,010 |
| Total long term debt | 20,336 | 74,058 |
| Current portion | (9,515) | (52,010) |
| Long term portion | \$ 10,821 | \$ 22,048 |

As of December 31, 2009, the long term debt repayments for each of the next five years ending December 31 are as follows (expressed in thousands):

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|--------------------------|----------|------|----------|----------|----------|
| Macquarie - SLF | \$ 9,515 | \$ - | \$ - | \$ - | \$ - |
| Yukon Energy Corporation | - | - | 97 | 1,205 | 1,286 |
| Convertible debentures | - | - | 4,500 | - | - |
| Total | \$ 9,515 | \$ - | \$ 4,597 | \$ 1,205 | \$ 1,286 |

Macquarie Bank Limited loan facilities

In October 2006, Minto received credit approval from Macquarie Bank Limited (“Macquarie”) for a debt package comprised of a \$57.8 million Project Loan Facility (“PLF”) and a C\$20.0 million subordinated loan facility (“SLF”). The PLF carried an interest rate of US LIBOR plus 2.25% and was repayable over three years with the first payment due April 1, 2008 and the final payment due on December 31, 2009. During the year ended December 31, 2009 US LIBOR ranged from 0.25% to 0.51%. The PLF was drawn in US dollars to mitigate the Minto Mine’s potential exposure to foreign exchange risk, given that mine revenues are being generated in US dollars. The SLF carries an interest rate of Canadian LIBOR plus 2.65% with the first payment due October 1, 2010 and the final payment due December 31, 2010. As at December 31, 2009, C\$10.0 million is outstanding on the SLF, all of which is current. During the year ended December 31, 2009 Canadian LIBOR ranged from 0.30% to 2.25%.

The PLF and SLF are secured against the Minto Mine and Kutcho project, and the Company has pledged its shares in Minto and Kutcho Copper as security for the loans. The lender requires certain minimum debt service reserves and ratios relating to projected debt service coverage and ratios. Failure to meet certain of these tests could result in a possible acceleration of the loan repayments.

Bank of Nova Scotia loan facility

On January 16, 2009, Capstone completed a \$40.0 million corporate revolving term credit facility with The Bank of Nova Scotia (the “RTF”). Under the terms of the RTF, the funds are re-drawable over a three year term, subject to a reduction of \$8 million every six months commencing on the first anniversary, and any funds drawn attract an interest rate of US LIBOR plus 3.5% (adjustable in certain circumstances). Upon completion of the equity financing in May 2009 (Note 21), the Company repaid the balance drawn on loan in full. The facility is available to the Company until January 15, 2012.

The RTF is secured against the present and future real and personal property, assets and undertakings of Capstone other than the security already pledged against the PLF, SLF and the Power Purchase Agreement (“PPA”) with Yukon Energy Corporation (“YEC”). The lender requires certain ratios related to debt and interest coverage. Failure to meet these covenants could result in repayment and termination of the RTF.

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Yukon Energy Corporation capital cost contribution

In February 2007, Minto executed the PPA with YEC. Under the terms of the agreement, Minto agreed to make payments representing its capital cost contribution on the Carmacks-Minto Landing portion of the main power line. These payments carry an interest rate of 6.5% on a stated principal of C\$7.2 million. As per the repayment schedule, the monthly payments during the first 48 months will represent interest only on the principal, followed by equal blended payments of interest and principal during the ensuing 60 months such that the principal is fully repaid at the end of nine years. Minto's connection to the YEC's electrical grid in November 2008 triggered the first of the monthly payments commencing December 2008.

In addition, the Company classified its obligation for the C\$10.8 million cost of the spur power line to the Minto Mine site as a capital lease. This amount will be repaid over the same terms as the main power line.

The PPA is secured against a charge over all assets of Minto, subject only to the security already pledged against the PLF and SLF.

Convertible debentures

In February 2007, Sherwood issued convertible senior unsecured debentures (the "Debentures") for gross proceeds of C\$43.6 million. The Debentures, due March 31, 2012, bear interest at a rate of 5.0% per annum payable semi-annually in arrears on March 31 and September 30 of each year commencing on September 30, 2007. Each Debenture is convertible at the option of the holder at any time into common shares of the Company at a conversion rate of 248.5715 common shares per C\$1,000 principal amount of Debentures, which is equal to a Conversion Price of C\$4.02 per common share. The Company may redeem the Debentures on or after April 1, 2010 at a redemption price equal to their principal amount, provided that the weighted average trading price of the common shares of the Company for 20 consecutive days is at least 125% of the Conversion Price. The Company may repay the principal amount in common shares at the then market price or cash.

Generally accepted accounting principles for compound financial instruments require the Company to allocate the proceeds received from the Debentures between; (i) the estimated fair value of the holder's option to convert the Debentures into common shares and (ii) the estimated fair value of the future cash outflows related to the Debentures. At the date of issuance the Company estimated the fair value of the conversion option by deducting the present value of the future cash outflows of the Debentures, calculated using a risk-adjusted discount rate of 11.5%, from the face value of the principal of the Debentures. The residual value allocated to the conversion option is added to the face value of the Debentures over the life of the debentures by a charge to earnings, using the effective interest rate method.

The Debentures include a provision whereby within 30 days of the occurrence of a change of control, an offer to purchase all Debentures then outstanding must be made. Following the change of control on November 24, 2008 as a result of the reverse takeover transaction with Sherwood, the Company made an offer on December 24, 2008 to purchase all outstanding Debentures at a price equal to the 101% of the principal amount of the Debentures, plus accrued and unpaid interest. On January 22, 2009, the Company paid \$31.3 million (C\$39.3 million) for Debentures tendered under the offer with an aggregate book value at the date of redemption of \$33.4 million (C\$41.3 million), consisting of the debt component of \$26.1 million (C\$32.7 million) and the equity component of \$7.3 million (C\$8.6 million). As a result, the Company recognized a gain during 2009 on settlement of the debt component of \$0.6 million and a gain on the settlement of the equity component of \$1.1 million.

Capstone Mining Corp.

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(expressed in thousands of US dollars, except share amounts)

The financial liability component of the convertible debentures at December 31, 2009 is as follows (expressed in thousands):

| | | |
|---|----|-------|
| Principal amount of Debentures | \$ | 4,036 |
| Less: residual value allocated to the conversion option | | (933) |
| Financial liability component at issuance (present value of future cash outflows) | | 3,103 |
| Accretion of the residual value allocated to the conversion option | | 494 |
| Foreign currency translation adjustments | | 373 |
| Balance of financial liability component | | 3,970 |
| Less: current portion of financial liability component | | - |
| Long term balance of financial liability component | \$ | 3,970 |

The principal of the convertible debentures plus accrued interest to December 31, 2009 amounted to \$4.6 million.

17. Capital lease obligations

The Company has certain assets that are classified as capital leases, with the applicable costs included in property, plant and equipment. Future minimum lease payments are as follows (expressed in thousands):

| | December 31, 2009 |
|---|--------------------------|
| 2010 | \$ 3,539 |
| 2011 | 3,398 |
| 2012 | 3,316 |
| 2013 | 4,831 |
| 2014 | 3,974 |
| Thereafter until 2017 | 7,094 |
| Total minimum lease payments | 26,152 |
| Less: interest at rates from 6.5% to 9.5% | (5,526) |
| Balance of unpaid obligations | 20,626 |
| Less: current portion | (2,201) |
| Long term portion | \$ 18,425 |

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Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

18. Deferred revenue

(a) Minto Mine

During 2008, the Company sold all of its gold and silver production from the Minto Mine over the life of mine to Silver Wheaton (formerly Silverstone) in consideration for an upfront payment of \$37.5 million and a further payment of the lesser of US\$300 per ounce of gold and US\$3.90 per ounce of silver (subject to a 1% inflationary adjustment after three years and each year thereafter) and the prevailing market price on the London Metal Exchange for each ounce delivered. If production from the Minto Mine exceeds 50,000 oz of gold in the first two years of the agreement or 30,000 oz of gold per year thereafter, Silver Wheaton (*Note 8(c)*) will be entitled to purchase only 50% of the amount in excess of those thresholds. The Company has recorded the proceeds received as deferred revenue and will recognize this amount as an adjustment to revenue as the appropriate ounces are delivered. During 2009 the Company delivered concentrate containing 26,600 ounces of gold (2008 – nil) and 0.2 million ounces of silver (2008 – nil) to Silver Wheaton.

(b) Cozamin mine

As part of the reverse takeover transaction between Capstone and Sherwood during 2008 (*Note 4*), Company acquired a commitment to sell the Cozamin Mine's silver production to Silver Wheaton over a 10 year period expiring April 30, 2017. Under the terms of the arrangement, Silver Wheaton agreed to pay for each ounce of refined silver from the mine the lesser of \$4.00 per ounce of silver and the prevailing market price on the London Metal Exchange for each ounce of silver. Further, the Company agreed to deliver a minimum of 10 million ounces of silver to Silver Wheaton over a ten year period. If, at the end of ten years, the Company has not delivered the agreed upon 10 million ounces of silver, then it has agreed to pay Silver Wheaton \$1.00 per ounce of silver not delivered. During 2009 the Company delivered concentrate containing 1.5 million ounces of silver to Silver Wheaton. To date, a total of 3.1 million ounces have been delivered against the contract since its inception. The Company has recorded this commitment (which represents an obligation to deliver silver at other than market rates) at its estimated fair value on the date of acquisition of the Cozamin Mine. The value assigned to the commitment will be recorded as an adjustment to revenue as the related ounces are delivered.

Details of changes in the balance of deferred revenue are as follows (expressed in thousands):

| | | |
|---|----|----------|
| Balance, December 31, 2008 | \$ | 82,854 |
| Amortization on delivery of gold and silver | | (14,549) |
| Foreign currency translation adjustments | | 5,160 |
| Balance, December 31, 2009 | \$ | 73,465 |

Capstone Mining Corp.

Notes to Consolidated Financial Statements

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(expressed in thousands of US dollars, except share amounts)

19. Income taxes

Income tax expense differs from the amount that would result from applying the Canadian federal and provincial income tax rates to earnings before income taxes. These differences result from the following items (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|---|-------------------|-------------------|
| | | (Note 2) |
| Earnings (loss) before income items | \$ (29,533) | \$ 136,343 |
| Canadian federal and provincial income tax rates | 34.00% | 34.50% |
| Income tax expense (recovery) based on the above rates | (10,041) | 47,038 |
| Increase (decrease) due to: | | |
| Non-deductible stock based compensation & other | 3,263 | 1,264 |
| Non-deductible (non-taxable) foreign exchange | (137) | 2,533 |
| Non-deductible interest accretion | 82 | 363 |
| Difference between Canadian and foreign tax rates | 104 | (523) |
| Yukon mining taxes | 3,385 | (3,905) |
| Income tax benefit recognized on changes in tax legislation | (463) | - |
| Gain on acquisition of Capstone not subject to tax | - | (24,855) |
| Non-taxable portion of capital gains | (7,400) | - |
| Benefit of previously unrecognized future income tax assets | - | (17,393) |
| Income tax expense/(recovery) | \$ (11,207) | \$ 4,522 |
| Breakdown of income tax expense/(recovery) | | |
| Current | 19,857 | 667 |
| Future | (31,064) | 3,855 |
| | \$ (11,207) | \$ 4,522 |

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The components of future income taxes are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|--|-------------------|-------------------|
| | | (Note 2) |
| <i>Future income and mining tax assets</i> | | |
| Non-capital losses | \$ 2,046 | \$ 1,810 |
| Accounts receivable and other current items | 389 | 281 |
| Share issue costs and other | 6,311 | 3,640 |
| Derivative instruments | 19,247 | - |
| Investments | 16 | - |
| Property, plant and equipment | 2,139 | 9,653 |
| Mineral property costs | - | 8,171 |
| Capital leases and long term debt | - | 888 |
| Asset retirement obligations | 2,487 | 1,279 |
| Future income and mining tax assets | 32,635 | 25,722 |
| Valuation allowance | (217) | (1,195) |
| Net future income and mining tax assets | 32,418 | 24,527 |
| <i>Future income and mining tax liabilities</i> | | |
| Inventory | 7,596 | 4,439 |
| Property, plant and equipment | 13,268 | 9,729 |
| Derivative instruments | - | 31,773 |
| Investments | 3,431 | - |
| Mineral property costs | 29,269 | 26,361 |
| Capital leases and long term debt | 87 | - |
| Future income and mining tax liabilities | 53,651 | 72,302 |
| <i>Net future income and mining tax liability</i> | \$ 21,233 | \$ 47,775 |
| <i>Breakdown of net future income and mining tax liability</i> | | |
| Current asset | (7,567) | (2,665) |
| Long term asset | (10,625) | (7,100) |
| Current liability | 288 | 18,397 |
| Long term liability | 39,137 | 39,143 |
| | \$ 21,233 | \$ 47,775 |

The Company has non-capital loss carry-forwards of approximately \$8.2 million that may be available for tax purposes. The loss carry-forwards are all in respect of Canadian operations and expire as follows (expressed in thousands):

| | |
|------|----------|
| 2011 | \$ 374 |
| 2012 | 493 |
| 2023 | 1,302 |
| 2024 | 2,432 |
| 2025 | 1,344 |
| 2026 | 1,108 |
| 2027 | 601 |
| 2028 | 192 |
| 2029 | 341 |
| | \$ 8,187 |

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A valuation allowance has been recorded against the net potential future income tax assets associated with non-capital losses as their utilization is not considered more likely than not at this time.

20. Asset retirement obligations and other provisions

The asset retirement obligations relate to the operations of the Minto and Cozamin Mines, as well as the Kutcho development project.

Details of changes in the balances are as follows (expressed in thousands):

| | Asset Retirement Obligations | Other Long Term Obligations | Total |
|---|---|--|--------------|
| Balance, December 31, 2007 | \$ 3,061 | \$ - | \$ 3,061 |
| Accretion expense | 178 | 9 | 187 |
| Obligations assumed on acquisition of Capstone (Note 4) | 1,673 | 428 | 2,101 |
| Obligations assumed on acquisition of Western Keltic assets (Note 4) | 50 | - | 50 |
| Foreign currency translation adjustments | (583) | 5 | (578) |
| Balance, December 31, 2008 | 4,379 | 442 | 4,821 |
| Change in estimates | 3,331 | 137 | 3,468 |
| Accretion expense | 325 | - | 325 |
| Payments during the year | (158) | - | (158) |
| Foreign currency translation adjustments | 596 | 20 | 616 |
| Balance, December 31, 2009 | \$ 8,473 | \$ 599 | \$ 9,072 |

Asset retirement obligations have been recognized in respect of the mining operations of the Minto Mine, including associated infrastructure and buildings. The estimated undiscounted cash flows required to satisfy the Minto asset retirement obligations as at December 31, 2009 were C\$7.7 million, which were then discounted using credit-adjusted risk free rates ranging from 4.0% to 6.4%. The asset retirement obligations for the Minto Mine at December 31, 2009 totalled \$5.8 million, of which \$3.8 million is secured by a letter of credit from Macquarie Bank Limited in favour of the Yukon Government.

On November 24, 2008, the Company acquired Capstone, owner of the Cozamin Mine in Mexico (Note 4). As part of the purchase price equation, the Company allocated \$2.1 million for future site restoration and other mine closure costs. The estimated undiscounted cash flows required to satisfy the Cozamin asset retirement obligations as at December 31, 2009 was 35.4 million Mexican pesos, and then discounted using a credit-adjusted risk-free interest rates ranging from 6.2% to 7.1%. The asset retirement obligations for Cozamin at December 31, 2009 totalled \$2.6 million, with an additional \$0.6 million to other mine closure costs related to severance.

On February 11, 2008, the Company acquired the Kutcho project in Canada (Note 4). As part of the purchase price equation, the Company allocated C\$50,000 for future site restoration costs. The restoration costs were determined based on the known disturbance to date.

In view of uncertainties concerning asset retirement obligations, the ultimate costs could be materially different from the amounts estimated. The estimate of future asset retirement obligations is subject to change based on amendments to applicable laws and legislation. Futures changes in asset retirement obligations, if any, could have a significant impact.

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21. Share capital

Authorized

An unlimited number of common voting shares without par value.

Shares issuances

In May 2009 the Company completed a bought-deal equity financing with a syndicate of underwriters for the purchase of 31,165,000 common shares of the Company at a price of C\$1.85 per share for gross proceeds of C\$57.7 million.

During 2009, a total of 1,187,424 common shares of Capstone were issued upon the exercise of options at prices between C\$0.65 and C\$2.45 per option for total cash proceeds of \$1.4 million. As a result of these exercises, \$0.6 million was transferred from contributed surplus to share capital.

During 2009, a total of 600,000 common shares of Capstone were issued for the purchase of mineral property interests, with an additional 600,000 common shares reserved for issuance over the next six years. The shares were issued at a deemed fair value of C\$2.76 per share for total consideration of \$1.6 million. With respect to the shares reserved for issuance, a further \$1.6 million of fair value was recorded to contributed surplus.

Stock options

Pursuant to the Company's stock option plan, directors may, from time to time, authorize the granting of options to directors, officers, employees and consultants of the Company to a maximum of 10% of the issued and outstanding common shares at the time of grant, with a maximum of 5% of the Company's issued and outstanding shares reserved for any one person on a yearly basis. Options granted under the plan have a term not to exceed 5 years and vesting periods that range from zero to 3 years.

The continuity of stock options issued and outstanding is as follows:

| | Options outstanding | Weighted average exercise price (C\$) |
|--------------------------------|---------------------|---|
| Outstanding, December 31, 2008 | 10,084,112 | \$ 2.47 |
| Granted | 3,383,000 | 1.38 |
| Exercised | (1,187,424) | 1.30 |
| Expired | (160,058) | 3.39 |
| Forfeited | (322,622) | 2.75 |
| Outstanding, December 31, 2009 | 11,797,008 | \$ 2.25 |

As at December 31, 2009, the following options were outstanding:

| Exercise prices (C\$) | Number of options | Weighted average exercise price (C\$) | Weighted average remaining life (years) |
|--------------------------|-------------------|---|---|
| \$0.64 - \$0.95 | 810,901 | \$ 0.75 | 1.0 |
| \$1.05 - \$1.95 | 4,829,434 | 1.44 | 3.0 |
| \$2.32 - \$2.98 | 1,940,039 | 2.55 | 2.1 |
| \$3.03 - \$3.99 | 4,216,634 | 3.35 | 3.1 |
| | 11,797,008 | \$ 2.25 | 2.8 |

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As at December 31, 2009, the following options were both outstanding and exercisable:

| Exercise prices (C\$) | Number of options | Weighted average exercise price (C\$) | Weighted average remaining life (years) |
|--------------------------|-------------------|---|---|
| \$0.64 - \$0.95 | 736,516 | \$ 0.74 | 0.7 |
| \$1.05 - \$1.95 | 2,838,944 | 1.51 | 2.2 |
| \$2.32 - \$2.98 | 1,838,707 | 2.55 | 2.0 |
| \$3.03 - \$3.99 | 3,838,538 | 3.35 | 3.1 |
| | 9,252,705 | \$ 2.42 | 2.4 |

The Company uses the fair value method of accounting for all stock-based payments to directors, officers, employees and consultants. During 2009, the Company recorded a stock-based compensation expense of \$2.8 million (2008 – \$3.3 million). The portion of stock-based compensation recorded is based on the vesting schedule of the options.

During 2009, the total fair value of options granted or exchanged was \$2.1 million (2008 – \$4.5 million) and had a weighted average grant-date fair value of C\$0.75 (2008 – C\$0.75) per option. The fair values of the stock options granted were estimated on the respective issue dates using the Black-Scholes option pricing model, with the following weighted average assumptions:

| | December 31, 2009 | December 31, 2008 |
|---------------------------------|-------------------|-------------------|
| Risk-free interest rate | 1.61% | 2.47% |
| Expected dividend yield | nil | nil |
| Expected stock price volatility | 77% | 61% |
| Expected life | 3.5 years | 2.8 years |

Option pricing models require the input of subjective assumptions including the expected price volatility. Changes in the assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

Share purchase warrants

The continuity of share purchase warrants issued and outstanding is as follows:

| | Warrants outstanding | Weighted average exercise price (C\$) |
|---------------------------------|-------------------------|---|
| Outstanding, December 31, 2008 | 4,142,546 | \$ 3.73 |
| Expired | (2,959,582) | 3.88 |
| Outstanding, September 30, 2009 | 1,182,964 | \$ 3.35 |

As at December 31, 2009, the following share purchase warrants were outstanding:

| Expiry date | Warrants outstanding | Exercise price (C\$) |
|---------------|-------------------------|----------------------|
| March 7, 2010 | 1,182,964 | \$ 3.35 |
| | 1,182,964 | \$ 3.35 |

There were no warrants issued during 2009. During 2008, warrants issued or exchanged had a total fair value of \$2.4 million and a weighted average issue-date fair value of C\$0.48 per warrant. Of the total, \$1.3 million was expensed as financing fees related to the establishment of a corporate credit facility with Macquarie, \$1.0 million was included in the acquisition costs of Western Keltic (Note 4), and \$0.1 million related to the reverse takeover costs of Capstone (Note 4). The fair value was estimated on the issue date using the Black-Scholes option pricing model, with the following weighted average assumptions:

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

| | December 31, 2009 | December 31, 2008 |
|---------------------------------|-------------------|-------------------|
| Risk-free interest rate | n/a | 2.58% |
| Expected dividend yield | n/a | nil |
| Expected stock price volatility | n/a | 81% |
| Expected life | n/a | 0.8 years |

Warrant pricing models require the input of subjective assumptions including the expected price volatility. Changes in the assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's share purchase warrants.

Employee share purchase plan ("ESPP")

The Company has an ESPP which allows certain employees of Minto to purchase the Company's shares in the market through payroll deductions. Employees may contribute up to a maximum of 7% of their annual base salary and the Company will match 50% of the employee's contribution.

22. Earnings (loss) per share

Earnings (loss) per share, calculated on a basic and diluted basis, is as follows (expressed in thousands, except share and per share amounts):

| | December 31, 2009 | December 31, 2008 |
|---------------------------|-------------------|-------------------|
| Earnings (loss) per share | | |
| Basic | \$ (0.10) | \$ 1.47 |
| Diluted | \$ (0.10) | \$ 1.31 |

Net income (loss)

| | | |
|---|-------------|------------|
| Net earnings (loss) available (attributable) to common shareholders - basic | \$ (18,326) | \$ 131,821 |
| Interest obtainable upon conversion of debentures, net of tax | - | 3,656 |
| Net earnings (loss) available (attributable) to common shareholders - diluted | \$ (18,326) | \$ 135,477 |

Weighted average shares outstanding

| | | |
|---|-------------|-------------|
| Weighted average shares outstanding - basic | 185,691,755 | 89,825,636 |
| Dilutive securities | | |
| Stock options | - | 3,089,227 |
| Share purchase warrants | - | - |
| Convertible securities | - | 10,837,717 |
| Weighted average shares outstanding - diluted | 185,691,755 | 103,752,580 |

Weighted average shares excluded

| | | |
|-------------------------|------------|-----------|
| Stock options | 11,797,008 | 5,246,742 |
| Share purchase warrants | 1,182,964 | 2,645,306 |
| Convertible securities | 1,175,495 | - |

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Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

23. Related party balances and transactions

The Company had the following transactions with related parties:

- a) During the period January 1 to May 21, 2009, the Company recorded silver revenue of \$6.7 million (2008 - \$nil) to Silverstone, an equity investment (Note 8(b)). At December 31, 2009, the Company has a receivable of \$nil (December 31, 2008 - \$0.3 million payable) related to these silver sales. Additionally, during the same period the Company received from Silverstone exploration services for \$0.7 million (2008 - \$nil) and at December 31, 2009 has a payable of \$nil (December 31, 2008 - \$1.1 million) related to such services. Silverstone is no longer a related party as of May 21, 2009.
- b) During the year ended December 31, 2009, the Company paid consulting fees of \$0.1 million (2008 - \$nil) to certain directors of the Company.

These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties. Amounts due to/receivable from related parties are unsecured, non-interest bearing and have no specific repayment terms.

24. Supplemental cash flow information

The significant non-cash financing and investing transactions during the period are as follows (expressed in thousands):

| | December 31, 2009 | December 31, 2008 (Note 2) |
|--|-------------------|-------------------------------|
| Common shares issued to acquire Capstone Mining (Note 4) | \$ - | \$ 43,657 |
| Options and warrants issued to acquire Capstone Mining (Note 4) | - | 651 |
| Common shares issued to acquire Kutcho project (Note 4) | - | 32,205 |
| Options and warrants issued to acquire Kutcho project (Note 4) | - | 1,179 |
| Silverstone shares exchanged for Silver Wheaton shares (Note 8) | 46,637 | - |
| Equipment and vehicles acquired under capital lease obligations | 3,329 | 10,005 |
| Capitalized exploration expenditures included in accounts payable | 369 | 395 |
| Construction in progress expenditures included in accounts payable | 1,444 | 14 |
| Mineral property addition for change in estimate to Minto and Cozamin asset retirement obligations (Note 20) | 3,331 | - |
| Common shares issued and reserved for issuance related to mineral property additions | 3,108 | - |
| Fair value of stock options and warrants allocated to share capital upon exercise (Note 21) | 629 | 1,625 |

Operating activities during the period included the following cash payments (expressed in thousands):

| | December 31, 2009 | December 31, 2008 (Note 2) |
|-------------------|-------------------|-------------------------------|
| Interest paid | \$ 3,860 | \$ 8,268 |
| Income taxes paid | 9,420 | 2 |

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

25. Changes in non-cash working capital

The changes in non-cash working capital items are comprised of (expressed in thousands):

| | December 31, 2009 | December 31, 2008 |
|--|-------------------|-------------------|
| Receivables | \$ 9,729 | \$ (3,361) |
| Inventories | (2,320) | 151 |
| Prepays | (452) | (175) |
| Accounts payable and accrued liabilities | 5,491 | (12,812) |
| Taxes payable | 9,509 | 558 |
| Advances on concentrate inventories | (3,930) | 6,312 |
| Net change in non-cash working capital | \$ 18,027 | \$ (9,327) |

26. Capital management

The Company considers that its capital consists of the items included in shareholders' equity, short term credit facilities, long term debt, capital lease obligations, cash and long-term investments. The Company manages the capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of the Company's assets.

The Company's capital management objectives are intended to safeguard the entity's ability to support the Company's normal operating requirements on an ongoing basis as well as continue the development and exploration of its mineral properties and support any expansionary plans.

To effectively manage its capital requirements, the Company has in place a planning and budgeting process to help determine the funds required to ensure the Company has the appropriate liquidity to meet its operating and growth objectives. The Company ensures that there are sufficient committed loan facilities to meet its short term business requirements, taking into account its anticipated operational cash flows and its cash balances.

The PLF, SLF and RTF contain various covenants, including: a) ratios of estimated future cash flows to total debt; b) debt coverage ratios with respect to minimum proven and probable reserves for the life of mine plan approved by Macquarie; and c) a tangible net worth requirement.

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

27. Commitments

Agreements with the Selkirk First Nation

Under the terms of a revised co-operation agreement between Minto and the Selkirk First Nation ("Selkirk") dated October 15, 2009, the Company has made various commitments to Selkirk to enhance Selkirk participation in the Minto Mine, including a variable net sales royalty on production from the Minto Mine that fluctuates with the price of copper, as well as various commitments in respect of employment, contracting, training, and scholarship opportunities.

In June 2006, the Company entered into five leases with the Selkirk for the use of the surface areas in and around the planned development of the Minto Project. The leases have a term of ten years and three months, expiring June 30, 2016. The total annual rent payable under the terms of these leases is \$0.1 million.

Off-take agreements

The Company has a concentrate off-take agreement with MRI Trading AG ("MRI") whereby MRI will purchase 100% of the concentrate produced by the Minto Mine up to the end of June 2010. As part of the agreement, MRI has provided Minto with an inventory financing facility.

The Company has a concentrate off-take agreement with Trafigura Beheer B.V. ("Trafigura") whereby Trafigura will purchase 100% of the copper concentrate produced by the Cozamin Mine up to the end of December 2011.

The Company has a concentrate off-take agreement with Louis Dreyfus Commodities Metals Suisse SA ("Louis Dreyfus") whereby Louis Dreyfus will purchase 100% of the lead concentrate produced by the Cozamin Mine up to the end of December 2011.

The Company has a concentrate off-take agreement with MRI Trading AD ("MRI") whereby MRI will purchase 100% of the zinc concentrate produced by the Cozamin Mine up to the end of December 2011.

Power purchase agreement

In February 2007, Minto signed a PPA with the YEC, which was subsequently amended and approved by the Yukon Utilities Board in May 2007, whereby the YEC will deliver grid power to the Minto Mine by constructing the Carmacks/Minto main line and the spur line to the mine site. Minto is obligated to repay C\$7.2 million of the costs of the main line and C\$10.8 million for the cost of the spur line. On April 9, 2009 YEC and Minto agreed to additional amendments that increased the repayment terms to nine years and reduced the interest rate to 6.5%, starting on the commencement of power delivery, which occurred in November 2008. Minto is obligated to purchase a minimum of C\$3.0 million of power for each of the first four years of the agreement, to a maximum of C\$12.0 million. Power pricing is fixed at C\$15.00/KVA and C\$0.076/KWH as per YEC Rate Schedule 39 (Industrial Primary) until December 31, 2009, then subject to escalation once each calendar year, starting January 1, 2010, based on the latest percentage increase in the twelve month implicit chain price index for gross domestic product at market for Canada as reported by Stats Canada. After four years (post take-or-pay period), YEC will perform its normal cost of service analysis to set go forward rates. The Company is obligated to fund the mine spur line reclamation costs on the closure of the mine.

Capstone Mining Corp.

Notes to Consolidated Financial Statements Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

28. Segmented information

The Company is engaged in mining, exploration and development of mineral properties, and has operating mines in both Canada and Mexico. The Company has two reportable segments as identified by the individual mining operations at each of the Minto and Cozamin Mines. Segments are operations reviewed by the executive management. Each segment is identified based on quantitative factors whereby its revenues or assets comprise 10% or more of the total revenues or assets of the Company.

Sales from the Company's Minto Mine are to a single customer as per the off-take agreement, whereas sales from its Cozamin Mine are to different customers depending on the nature of the concentrate (copper, lead or zinc).

Operating segment details are as follows (expressed in thousands):

| December 31, 2009 | | | | |
|---|-------------|------------|------------|-------------|
| | Minto | Cozamin | Other | Total |
| Net revenue | \$ 124,628 | \$ 94,665 | \$ - | \$ 219,293 |
| Cost of sales | (50,301) | (42,162) | - | (92,463) |
| Royalty | (1,482) | (2,856) | - | (4,338) |
| Depletion and amortization | (27,206) | (13,581) | - | (40,787) |
| Accretion of asset retirement obligations | (218) | (107) | - | (325) |
| Earnings from mining operations | 45,421 | 35,959 | - | 81,380 |
| Interest (expense) income | (2,532) | (28) | (1,321) | (3,881) |
| Other (expense) income | (109,020) | (34,935) | 36,923 | (107,032) |
| (Loss) earnings before income taxes | (66,131) | 996 | 35,602 | (29,533) |
| Income taxes | 17,775 | (2,430) | (4,138) | 11,207 |
| Net (loss) earnings | \$ (48,356) | \$ (1,434) | \$ 31,464 | \$ (18,326) |
| Total assets | \$ 235,208 | \$ 185,768 | \$ 130,105 | \$ 551,081 |

| December 31, 2008 (Note 2) | | | | |
|---|------------|------------|-----------|------------|
| | Minto | Cozamin | Other | Total |
| Net revenue | \$ 103,387 | \$ 2,565 | \$ - | \$ 105,952 |
| Cost of sales | (56,700) | (5,899) | - | (62,599) |
| Royalty | (578) | (9) | - | (587) |
| Depletion and amortization | (21,712) | (1,020) | (2) | (22,734) |
| Accretion of asset retirement obligations | (178) | - | - | (178) |
| Earnings from mining operations | 24,219 | (4,363) | (2) | 19,854 |
| Interest expense | (4,454) | - | (4,031) | (8,485) |
| Impairment charges | (53,435) | - | - | (53,435) |
| Gain on acquisition of Capstone | - | - | 72,043 | 72,043 |
| Other (expense) income | 124,264 | 12,136 | (30,034) | 106,366 |
| Earnings before income taxes | 90,594 | 7,773 | 37,976 | 136,343 |
| Income taxes | (3,459) | (2,069) | 1,006 | (4,522) |
| Net earnings | \$ 87,135 | \$ 5,704 | \$ 38,982 | \$ 131,821 |
| Total assets | \$ 244,681 | \$ 188,713 | \$ 64,458 | \$ 497,852 |

Capstone Mining Corp.

Notes to Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(expressed in thousands of US dollars, except share amounts)

Geographic segment details are as follows (expressed in thousands):

| | December 31, 2009 | | | |
|-----------------------------|-------------------|-----------|---------------|------------|
| | Canada | Mexico | United States | Total |
| Net revenue | \$ 124,628 | \$ 94,665 | \$ - | \$ 219,293 |
| Property, plant & equipment | 110,010 | 24,934 | 10,393 | 145,337 |
| Mineral property costs | 83,030 | 92,825 | - | 175,855 |

| | December 31, 2008 (Note 2) | | | |
|-----------------------------|----------------------------|----------|---------------|------------|
| | Canada | Mexico | United States | Total |
| Net revenue | \$ 103,387 | \$ 2,565 | \$ - | \$ 105,952 |
| Property, plant & equipment | 88,358 | 22,024 | 7,742 | 118,124 |
| Mineral property costs | 59,122 | 102,162 | - | 161,284 |



CAPSTONE MINING CORP.

CORPORATE INFORMATION

OFFICERS, DIRECTORS & MANAGEMENT

Darren M. Pylot
Vice-Chairman & Chief Executive Officer
Director

Stephen P. Quin, P.Geo
President & Chief Operating Officer
Director

Richard Godfrey
Chief Financial Officer

Jason P. Howe, CA
Vice President – Business Development
and Investor Relations

Robert B. Barnes, P.Eng
Vice President – Operations

Brad Mercer, P.Geo
Vice President – Exploration

Peter T. Hemstead, CMA
Treasurer and Vice President – Marketing

Robert Blusson, CA
Corporate Controller

Colin K. Benner, P.Eng
Chairman

John Wright, P.Eng
Director

Bruce McLeod, P.Eng
Director

Larry Bell
Director

George Brack
Director

Dale Peniuk, CA
Director

Stock Symbol: CS

Stock Exchange Listing: TSX

CUSIP #14068G104

CAPITAL SHARE STRUCTURE

As of March 31st, 2010

Issued: 198,002,173

Fully Diluted: 214,417,985

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CAPSTONE MINING CORP.

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BANKERS

Bank of Montreal
Vancouver, B.C. Canada

ANNUAL GENERAL MEETING

The Annual General Meeting of the Shareholders
of Capstone Mining Corp. will be held at 10:00 am
Monday, May 17th, 2010 at the Vancouver Fairmont
Pacific Rim, B.C., Canada



CAPSTONE
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www.capstonemining.com