

SOUTHERN COPPER CORP/  
Form 10-Q  
November 01, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

2007

Third Quarter

**FORM 10-Q**

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

For Quarter Ended September 30, 2007

Commission file number 1-14066

**SOUTHERN COPPER CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**13-3849074**

(I.R.S. Employer  
Identification No.)

**11811 North Tatum Blvd. Suite 2500 Phoenix, AZ**  
(Address of principal executive offices)

**85028**

(Zip Code)

Registrant's telephone number, including area code

**(602) 494-5328**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act).

Yes

No

As of October 31, 2007 there were outstanding 294,465,650 shares of Southern Copper Corporation common stock, par value \$0.01 per share.

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Southern Copper Corporation

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## Part I FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

## Southern Copper Corporation

CONDENSED CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

|  | 3 Months Ended<br>September 30, |              | 9 Months Ended<br>September 30, |              |
|--|---------------------------------|--------------|---------------------------------|--------------|
|  | 2007                            | 2006         | 2007                            | 2006         |
|  | (in thousands)                  |              |                                 |              |
| Net sales  | \$ 1,606,414                    | \$ 1,412,238 | \$ 4,791,213                    | \$ 3,810,278 |
| Operating costs and expenses:  |                                 |              |                                 |              |
| Cost of sales (exclusive of depreciation, amortization and depletion shown separately below) | 559,815                         | 509,258      | 1,588,794                       | 1,437,990    |
| Selling, general and administrative  | 23,570                          | 25,162       | 73,276                          | 72,491       |
| Depreciation, amortization and depletion   | 81,538                          | 67,702       | 240,102                         | 198,787      |
| Exploration  | 7,710                           | 5,655        | 22,681                          | 14,864       |
| Total operating costs and expenses   | 672,633                         | 607,777      | 1,924,853                       | 1,724,132    |
| Operating income   | 933,781                         | 804,461      | 2,866,360                       | 2,086,146    |
| Interest expense   | (31,181)                        | (31,602)     | (91,969)                        | (82,711)     |
| Capitalized interest   | 3,703                           | 7,403        | 10,146                          | 19,009       |
| Gain (loss) on derivative instruments  | 2,993                           |              | (73,699)                        |              |
| Loss on debt prepayments   |                                 | (100)        |                                 | (960)        |
| Other income (expense)   | (5,714)                         | 5,320        | 19,958                          | 12,808       |
| Interest income  | 23,528                          | 10,848       | 63,532                          | 34,456       |
| Earnings before income taxes and minority interest   | 927,110                         | 796,330      | 2,794,328                       | 2,068,748    |
| Income taxes   | 296,109                         | 271,944      | 881,199                         | 679,680      |
| Minority interest  | 3,156                           | 2,803        | 7,640                           | 6,630        |
| Net earnings   | \$ 627,845                      | \$ 521,583   | \$ 1,905,489                    | \$ 1,382,438 |
| Per common share amounts:  |                                 |              |                                 |              |
| Net earnings basic and diluted   | \$ 2.13                         | \$ 1.77      | \$ 6.47                         | \$ 4.69      |
| Dividends paid   | \$ 1.60                         | \$ 1.00      | \$ 4.80                         | \$ 3.75      |
| Weighted average common shares outstanding (basic and diluted)                               | 294,466                         | 294,461      | 294,466                         | 294,461      |

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



## Southern Copper Corporation

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
|  | (in thousands)        |                      |
| <b>ASSETS</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$ 1,195,208          | \$ 1,022,778         |
| Marketable securities  | 320,000               | 280,000              |
| Accounts receivable trade, less allowance for doubtful accounts (2007 - \$5,949; 2006 - \$5,948) | 648,450               | 560,227              |
| Accounts receivable other  | 29,551                | 43,569               |
| Accounts receivable other, from affiliates   | 897                   | 2,630                |
| Inventories  | 462,708               | 413,652              |
| Deferred income taxes  | 38,050                | 65,638               |
| Prepaid and other current assets   | 77,920                | 54,383               |
| Total current assets   | 2,772,784             | 2,442,877            |
| Property, net  | 3,582,546             | 3,538,295            |
| Leachable material, net  | 239,888               | 231,516              |
| Intangible assets, net   | 116,387               | 118,107              |
| Deferred income taxes  |                       | 14,549               |
| Other assets, net  | 37,661                | 31,070               |
| Total Assets   | \$ 6,749,266          | \$ 6,376,414         |
| <b>LIABILITIES</b>   |                       |                      |
| Current liabilities:   |                       |                      |
| Current portion of long-term debt  | \$ 160,000            | \$ 10,000            |
| Accounts payable   | 264,851               | 271,064              |
| Accrued income taxes   | 136,016               | 226,047              |
| Due to affiliated companies  | 4,039                 | 3,581                |
| Accrued workers participation  | 243,703               | 299,892              |
| Interest   | 22,376                | 37,140               |
| Other accrued liabilities  | 21,708                | 11,847               |
| Total current liabilities  | 852,693               | 859,571              |
| Long-term debt   | 1,363,293             | 1,518,111            |
| Deferred income taxes  | 197,543               | 194,759              |
| Non-current taxes payable  | 54,943                |                      |
| Other liabilities  | 121,555               | 111,196              |
| Asset retirement obligation  | 12,905                | 12,183               |
| Total non-current liabilities  | 1,750,239             | 1,836,249            |
| Commitments and contingencies (Note M)   |                       |                      |
| MINORITY INTEREST  | 16,363                | 13,989               |
| <b>STOCKHOLDERS EQUITY</b>   |                       |                      |
| Common stock   | 2,949                 | 2,949                |
| Additional paid-in capital   | 775,096               | 772,693              |
| Retaining earnings   | 3,498,614             | 3,010,307            |

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|   |              |              |
|---|--------------|--------------|
| Other accumulated comprehensive loss                          | (23,288)     | (22,332)     |
| Treasury stock  | (123,400)    | (97,012)     |
| Total stockholders' equity                                    | 4,129,971    | 3,666,605    |
| Total Liabilities, Minority Interest and Stockholders' Equity | \$ 6,749,266 | \$ 6,376,414 |

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

## Southern Copper Corporation

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

|   | 3 Months Ended<br>September 30, |            | 9 Months Ended<br>September 30, |              |
|---|---------------------------------|------------|---------------------------------|--------------|
|   | 2007                            | 2006       | 2007                            | 2006         |
|   | (in thousands)                  |            |                                 |              |
| <b>OPERATING ACTIVITIES</b>   |                                 |            |                                 |              |
| Net earnings  | \$ 627,845                      | \$ 521,583 | \$ 1,905,489                    | \$ 1,382,438 |
| Adjustments to reconcile net earnings to net cash provided from operating activities: |                                 |            |                                 |              |
| Depreciation, amortization and depletion  | 81,538                          | 67,702     | 240,102                         | 198,787      |
| Capitalized leachable material  | (5,874)                         | (43,384)   | (45,903)                        | (43,384)     |
| Remeasurement loss(gain)  | 4,205                           | 6,172      | 4,772                           | (5,210)      |
| Provision for deferred income taxes   | 714                             | 1,105      | 59,054                          | 17,340       |
| Loss on sale of marketable securities   | 13,799                          |            | 43,187                          |              |
| Unrealized (gain)loss on derivative instruments                                       | (14,895)                        | (8,330)    | 46,782                          | (6,512)      |
| Minority interest   | 3,157                           | 2,803      | 7,640                           | 6,630        |
| <b>Cash provided from (used for) operating assets and liabilities:</b>                |                                 |            |                                 |              |
| Accounts receivable   | (119,386)                       | (12,453)   | (133,389)                       | (147,686)    |
| Inventories   | 8,494                           | (19,132)   | (49,056)                        | (84,628)     |
| Accounts payable and accrued liabilities  | 70,670                          | (4,149)    | (303,082)                       | (256,843)    |
| Other operating assets and liabilities  | 57,994                          | 10,668     | 150,426                         | 32,102       |
| Net cash provided by operating activities   | 728,261                         | 522,585    | 1,926,022                       | 1,093,034    |
| <b>INVESTING ACTIVITIES</b>   |                                 |            |                                 |              |
| Capital expenditures  | (72,086)                        | (102,311)  | (251,078)                       | (333,031)    |
| Purchase of marketable securities   |                                 |            | (100,000)                       |              |
| Proceeds from sale of marketable securities   | 6,201                           |            | 16,813                          |              |
| Other   | 155                             | 407        | 891                             | 2,410        |
| Net cash used for investing activities  | (65,730)                        | (101,904)  | (333,374)                       | (330,621)    |
| <b>FINANCING ACTIVITIES</b>   |                                 |            |                                 |              |
| Debt repaid   |                                 | (1,954)    | (5,000)                         | (23,464)     |
| Debt incurred   |                                 |            |                                 | 389,192      |
| Dividends paid to common stockholders   | (471,113)                       | (294,458)  | (1,413,380)                     | (1,104,212)  |
| Distributions to minority interest  | (1,429)                         | (1,465)    | (4,593)                         | (6,336)      |
| Other   | (881)                           | 6,967      | (604)                           | (79)         |
| Net cash used for financing activities  | (473,423)                       | (290,910)  | (1,423,577)                     | (744,899)    |
| Effect of exchange rate changes on cash and cash equivalents                          | (7,514)                         | (12,622)   | 3,359                           | 24,582       |
| Increase in cash and cash equivalents   | 181,594                         | 117,149    | 172,430                         | 42,096       |
| Cash and cash equivalents, at beginning of period                                     | 1,013,614                       | 800,950    | 1,022,778                       | 876,003      |
| Cash and cash equivalents, at end of period   | \$ 1,195,208                    | \$ 918,099 | \$ 1,195,208                    | \$ 918,099   |





|  | 3 Months Ended<br>September 30, |            | 9 Months Ended<br>September 30, |            |
|--|---------------------------------|------------|---------------------------------|------------|
|  | 2007                            | 2006       | 2007                            | 2006       |
| (in thousands)                                   |                                 |            |                                 |            |
| Supplemental disclosure of cash flow information |                                 |            |                                 |            |
| Cash paid during the period for:                 |                                 |            |                                 |            |
| Interest   | \$ 6,471                        | \$ 18,672  | \$ 27,976                       | \$ 40,620  |
| Income taxes                                     | \$ 267,039                      | \$ 236,833 | \$ 828,372                      | \$ 805,568 |
| Workers participation                            | \$ 1,021                        | \$ 14,367  | \$ 299,872                      | \$ 173,270 |

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

Southern Copper Corporation

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

A. In the opinion of Southern Copper Corporation, (the Company, Southern Copper or SCC), the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position as of September 30, 2007 and the results of operations and cash flows for the three and nine months ended September 30, 2007 and 2006. The condensed consolidated financial statements for the three and nine month periods ended September 30, 2007 and 2006 have been subjected to a review by PricewaterhouseCoopers, the Company's independent registered public accounting firm, whose report dated October 31, 2007, is presented on page 55. The results of operations for the three and nine months ended September 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year. The December 31, 2006 balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements at December 31, 2006 and notes included in the Company's 2006 annual report on Form 10-K.

B. Change in Accounting Principle Adoption of FIN 48:

Financial Accounting Standards Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes, (FIN 48) was issued in July 2006 and interprets FASB Statement of Financial Accounting Standards (SFAS) No. 109. FIN 48 replaces SFAS No.5 with respect to accounting for all tax positions, both certain and uncertain. FIN 48 became effective for the Company on January 1, 2007 and prescribes a comprehensive model for the recognition, measurement, financial statement presentation and disclosure of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company classifies income tax-related interest and penalties as income taxes in the financial statements.

The total amount of unrecognized tax benefits as of the January 1, 2007 date of adoption of FIN 48 was \$32.0 million. This amount related entirely to U.S. income tax matters. The Company has no unrecognized Peruvian or Mexican tax benefits. The cumulative effect of the implementation of FIN 48 on retained earnings was a net reduction of \$3.5 million. There were no material changes to the amount of unrecognized tax benefits during the nine months ended September 30, 2007.

The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$25.4 million at adoption and did not materially change by September 30, 2007.

As of the January 1, 2007 adoption of FIN 48, the Company's liability for uncertain tax positions included accrued interest of \$13.9 million. The liability included no accrued penalties because management expects no penalties to apply to the resolution of any of its uncertain tax positions. The amount of the increase in accrued interest during the nine months ended September 30, 2007 was not material.

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Various tax positions are currently under review by the U.S. Internal Revenue Service ( IRS ) Appeals Office. It is not likely that this review will result in a cash payment within twelve months of September 30, 2007.

Such positions include the determination of appropriate depreciation periods for fixed assets, the capitalization of costs to the copper inventory inherent in leachable dumps, and depletion deductions.

The IRS requests the Company to use longer depreciable lives, resulting in the same expense being spread over a longer period. The IRS also requests the Company to capitalize more interest expense against capital projects, converting current interest expense into future depreciation expense.

The IRS requests the Company capitalize the cost of drilling, blasting, hauling, and dumping leachable material and waste as an inventory item. This will result in a deferral of these expenses for ten to fifteen years, until electrowon copper leached from the dumped material is sold. These three adjustments, if accepted by the company, will generally not affect the company's total tax expense, but will accelerate taxes due to earlier years.

The IRS has also questioned the value of services rendered by a sister company, SAASA, and seeks to disallow a portion of the fees paid.

Lastly, the Company deducts, for U.S. tax purposes, a depletion allowance based on a percentage of its income from mining. The IRS requests the Company report a lower income from mining, and allocate more profit to smelting and refining. These last two adjustments would result in a permanent increase in taxable income and, if accepted by the Company, will result in a greater tax expense. All five adjustments would change the year in which tax is due, and result in interest charges. Any interest paid will be an expense deductible for tax purposes.

As of the January 1, 2007 adoption of FIN 48, management did not expect that a final resolution of the IRS review would result in a significant change in the Company's liability. The Company's reasonable expectations about future resolutions of uncertain items did not materially change during the nine months ended September 30, 2007.

The following tax years remain open to examination and adjustment by the Company's three major tax jurisdictions:

|         |   |
|---------|---|
| Peru:   | 2003 and all following years (years 1997 through 2002 have been examined by the Peruvian tax authority and the issues raised are being contested; no new issues can be raised for these years). |
| U.S.:   | 1997 and all following years  |
| Mexico: | 2001 and all following years  |

In May 2007 the FASB published FASB Staff Position (FSP) FIN 48-1, Definition of Settlement on FASB Interpretation No. 48. This FSP amends FIN 48 to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. This FSP makes a number of conforming changes throughout FIN-48 to the term *ultimate settlement* or *ultimately settled*: When the term was used to describe recognition that term is replaced with *effectively settled* and when the term is used to describe measurement that term is replaced with *settlement* or *settled*. FSP FIN 48-1 has not had an effect on the Company's

financial results.

## C. Marketable Securities:

Commencing in 2006 the Company began making short term investments (90 days to 1 year) in leveraged, indexed instruments. The marketable securities were as follows (in millions):

| Investment  | Face Value            |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2007 | December 31,<br>2006 |
| 3 month note, issued December 12, 2006, with extensions every 3 months up to a maximum of 12 months, and with an interest rate of 7%; established by a pool of Mexican and Peruvian bond issues.        | \$ 100.0              | \$ 100.0             |
| 3 month note, issued December 12, 2006, with extensions every 3 months up to a maximum of 13 months and 5 days, with an interest rate of 7%; established by a pool of Mexican and Peruvian bond issues. | 100.0                 | 100.0                |
| 3 month note, issued January 19, 2007, with extensions every 3 months up to a maximum of 12 months, and with an interest rate of 7.25%; established by a pool of Mexican and Peruvian bond issues.      | 100.0                 |                      |
| 180 day note, maturing June 12, 2007 with an interest rate of 6%, with barrier range of \$37.669 and \$69.957 of SCC stock price, NYSE symbol PCU.  |                       | 40.0                 |
| 180 day note, maturing June 28, 2007 with an interest rate of 6%, with barrier range of \$38.738 and \$71.942 of SCC stock price, NYSE symbol PCU.  |                       | 20.0                 |
| 300 day note, maturing December 24, 2007 with an interest rate of 3.6%, with barrier range of \$50.00 and \$75.00 of SCC stock price, NYSE symbol PCU.  | 20.0                  | 20.0                 |
|   | \$ 320.0              | \$ 280.0             |

Some of these investment instruments are indexed to SCC common stock prices while others are leveraged and indexed to certain bond pools. Both types of instruments could cause the principal of the investment to be reduced if the established ranges are breached. Since the notes are not principal protected the Company may lose part or all of the initial investment. These instruments have been deemed to contain embedded derivatives and have been subject to valuation using a binomial model.

Related to these marketable securities, the Company has recorded a gain of \$1.6 million and a loss of \$79.9 million in the 2007 third quarter and the first nine months of 2007, respectively. In addition, the Company recorded a loss on these marketable securities of \$11.6 million in the fourth quarter of 2006. The realized amount of these losses was \$13.8 million and \$43.2 million for the third quarter of 2007 and the first nine months of 2007, respectively. The losses on these marketable securities are recorded as loss on derivative instruments in the condensed consolidated statement of earnings. The unrealized portion of the loss of \$48.3 million, at September 30, 2007 is recorded in accounts payable.

On October 3, 2007, the Company liquidated \$300 million of the marketable securities investments and received \$276.4 million. As of September 30, 2007, the loss was recorded as unrealized loss on derivative instruments.

In the three and nine months ended September 30, 2007 the Company earned interest of \$5.6 million and \$18.0 million on these investments, respectively, which were recorded in interest income in the condensed consolidated statement of earnings.





## D. Inventories were as follows:

(in millions)

|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| Metals at lower of average cost or market: |                       |                      |
| Finished goods                             | \$ 86.1               | \$ 116.1             |
| Work-in-process                            | 159.5                 | 121.9                |
| Supplies at average cost                   | 217.1                 | 175.7                |
| Total inventories                          | \$ 462.7              | \$ 413.7             |

## E. Financing

On October 3, 2007, as part of the transaction involving the liquidation of the marketable securities investments (as mentioned in Note C), the Company redeemed \$68.6 million of its series B Yankee bonds, for \$85.2 million. The excess paid over the face value of the bonds, of \$16.6 million will be recorded in the fourth quarter of 2007 as loss on repurchase of debt.

## F. Income taxes:

The income tax for the nine months ended September 30, 2007 and 2006 was \$881.2 million and \$679.7 million, respectively. These provisions include income taxes for Peru, Mexico and the United States. The effective tax rates for the 2007 and 2006 periods are 31.5% and 32.9%, respectively. A decrease of 1% in the statutory Mexican tax rate contributed to the decrease in the 2007 effective income tax rate. In addition, a tax inflation adjustment and the effect of currency conversion adjustment in our Mexican operations also contributed to the reduction in the effective tax rate.

On October 1, 2007, the Mexican government enacted a new law, which generally takes effect on January 1, 2008. The law introduces a flat tax, which replaces Mexico's asset tax and will apply to taxpaying entities along with Mexico's regular income tax. This new law will not generate additional current tax liabilities unless the Mexican subsidiaries of the Company report annual net loss positions. For purposes of deferred tax accounting under FAS No. 109, the Company will calculate the impact of this new law in the fourth quarter of 2007 and record the effect, if any, in its fourth quarter financial statements.

## G. Provisionally Priced Sales:

At September 30, 2007, the Company has recorded provisionally priced sales of 204.7 million pounds of copper, at an average forward price of \$3.64 per pound. Also the Company has recorded provisionally priced sales of 61.1 million pounds of molybdenum at the September 30, 2007 market price of \$31.35 per pound. These sales are subject to final pricing based on the average monthly LME or COMEX copper prices and Dealer Oxide molybdenum prices in the future month of settlement.

Following are the provisionally priced copper and molybdenum sales outstanding at September 30, 2007:

| <b>Copper<br/>(million lbs.)</b> | <b>Priced at</b> | <b>Month of<br/>Settlement</b> |
|----------------------------------|------------------|--------------------------------|
| 70.2                             | 3.654706         | October 2007                   |
| 44.9                             | 3.647771         | November 2007                  |
| 28.4                             | 3.641911         | December 2007                  |
| 19.3                             | 3.633750         | January 2008                   |
| 6.5                              | 3.618310         | February 2008                  |
| 24.3                             | 3.602430         | March 2008                     |
| 11.1                             | 3.583380         | April 2008                     |
| 204.7                            | 3.638193         |                                |

| <b>Molybdenum<br/>(million lbs.)</b> | <b>Priced at</b> | <b>Month of<br/>Settlement</b> |
|--------------------------------------|------------------|--------------------------------|
| 2.3                                  | 31.35            | October 2007                   |
| 2.4                                  | 31.35            | November 2007                  |
| 1.4                                  | 31.35            | December 2007                  |
| 6.1                                  | 31.35            |                                |

Management believes that the final pricing of these sales will not have a material effect on the Company's financial position or results of operations.

#### H. Derivative Instruments

The Company occasionally uses derivative instruments to manage its exposure to market risk from changes in commodity prices, interest rate and exchange rate risk exposures and to enhance return on assets. The Company does not enter into derivative contracts unless it anticipates a future activity that is likely to occur that will result in exposing the Company to market risk.

Copper and zinc derivatives:

From time to time the Company has entered into derivative instruments to protect a fixed copper, or zinc price for a portion of our metal sales.

In 2007 and 2006 the Company entered into copper collar and swaps contracts to protect a portion of its 2007 and 2006 sales of copper production. Related to the settlement of these copper swap contracts the Company recorded losses of \$0.3 million and \$30.1 million in the third quarter of 2007 and 2006, respectively, and a gain of \$3.0 million and a loss of \$288.0 million in the nine months period of 2007 and 2006, respectively. These gains and losses were recorded in net sales in the condensed consolidated statement of earnings.

In the third quarter of 2006 the Company entered into a zinc swap contract to protect a portion of the sale of zinc concentrates purchased during the recovery from a fire at the San Luis Potosi zinc refinery. Related to the settlement of this contract the Company recorded in the third quarter of 2006, a loss of \$0.2 million which was recorded in net sales in the condensed consolidated statement of earnings. The Company did not enter into any zinc derivative contracts in the first nine months of 2007 and did not hold any open zinc contract at the end of September of 2007.

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At September 30, 2007 the Company has copper collar contracts to protect 73.1 million pounds of copper production for the October - December 2007 period at weighted average minimum and maximum LME prices of \$3.20 per pound and \$4.07 per pound, respectively. If the price falls below the minimum LME price, the Company will be in a gain position. If the price exceeds the maximum LME price, the Company will be in a loss position.

Gas swaps:

In 2006 and 2007 the Company entered into gas swap contracts to protect part of its gas consumptions as follows:

|                          | Three months ended<br>September 30, |         | Nine months ended<br>September 30, |           |
|--------------------------|-------------------------------------|---------|------------------------------------|-----------|
|                          | 2007                                | 2006    | 2007                               | 2006      |
| Gas volume (MMBTUs)      |                                     | 920,000 | 900,000                            | 2,730,000 |
| Fixed price              |                                     | 4.2668  | 7.5250                             | 4.2668    |
| Gain (loss) (in million) | \$                                  | 1.3     | \$ (0.9)                           | \$ 4.9    |

The gains (losses) obtained were included in the production cost. At September 30, 2007, the Company did not hold any open gas swap contract.

Exchange rate derivatives, U.S. dollar/Mexican peso contracts:

Because more than 85% of the Company's sales collections in Mexico are in US dollars and many of its costs are in Mexican pesos, during 2006 the Company entered into zero-cost derivative contracts with the purpose of protecting, within a range, against an appreciation of the Mexican peso to the US dollar. In these contracts if the exchange rate settles at or below the barrier, the Company does not sell US dollars, if the exchange rate settles above the barrier price established in the contract the Company sells US dollars at the strike price established in the contract.

In the third quarter and first nine months of 2007 the exercise of these zero-cost derivative contracts resulted in gains of \$1.9 million and \$6.0 million, respectively, which were recorded as gain on derivative instruments in the condensed consolidated statement of earnings.

At September 30, 2007 the Company held the following exchange rate derivative operations:

| Notional Amount<br>(millions) | Due Date, Weekly<br>expiration during | Strike Price<br>(Mexican<br>Pesos/U.S.<br>Dollars) | Barrier Price<br>(Mexican<br>Pesos/U.S.<br>Dollars) |
|-------------------------------|---------------------------------------|--|---|
| \$ 24.0                       | 4th Quarter 2007                      | 11.35  | 10.65   |
| \$ 24.0                       | 4th Quarter 2007                      | 11.65  | 11.35   |
| \$ 28.0                       | 1st Quarter 2008                      | 11.60  | 11.28   |
| \$ 28.0                       | 1st Quarter 2008                      | 11.28  | 10.70   |

At September 30, 2007, the fair value of the above listed exchange rate derivative contracts is a gain of \$1.6 million which was recorded as gain on derivative instruments in the condensed consolidated statement of earnings. Each notional amount includes a group of weekly transactions that have the same strike and barrier price.

Dual currency notes:

In 2007 the Company invested \$560.0 million in dual currency notes which provided an above market interest return subject to a barrier range of the Mexican peso/US dollar exchange rates. These investments matured in the first and second quarters of 2007. Related to these investments, in the second quarter of 2007 the Company realized an exchange loss of \$1.3 million, which was recorded as a loss on derivative instruments in the condensed consolidated statement of earnings.

The Company earned no interest income in the third quarter of 2007 and earned interest income of \$2.1 million in the first nine months of 2007 which was recorded as interest income in the condensed consolidated statement of earnings.

There were no open positions at September 30, 2007.

Additionally, the Company holds embedded derivatives which are described in note C Marketable Securities.

I. Asset Retirement Obligation:

In 2005 the Company added an estimated asset retirement obligation for its mining properties in Peru, as required by the Mine Closure Law, enacted in 2003 and regulated in 2005. In accordance with the law, a conceptual mine closure plan, without costs, was submitted to the Peruvian Ministry of Energy and Mines ( MEM ) in August 2006. According to regulations, the plan was subject to review by MEM for 45 days. After the MEM review the Company will have 90 days to prepare and resubmit the mine closure plan, including costs, which will then be subject to MEM approval and open to public discussion and comment in the area of the Company operations. The Company is still awaiting MEM 's initial review. However, as of September 30, 2007, the Company has made an estimated provision of \$6.2 million for this liability in its financial statements, but believes that this estimate should be viewed with caution, pending final approval of the mine closure plan.

The closure cost recognized for this liability includes the estimated cost required at the Peruvian operations, based on the Company 's experience, and includes cost at the Ilo smelter, the tailing disposal, and dismantling the Toquepala and Cuajone concentrators, and the shops and auxiliary facilities. Based on this estimated cost, we recorded an additional asset retirement liability in 2005 of \$5.2 million, which increased our previously recorded asset retirement liability to \$11.2 million. This increased net property by \$4.6 million.

The following table summarizes the asset retirement obligation activity for the first nine months of 2007 and 2006 (in millions):

|                                 | 2007 |      | 2006 |      |
|---------------------------------|------|------|------|------|
| Balance as of January 1         | \$   | 12.2 | \$   | 11.2 |
| Additions, changes in estimates |      |      |      |      |
| Accretion expense               |      | 0.7  |      | 0.7  |
| Balance as of September 30      | \$   | 12.9 | \$   | 11.9 |

J. Related Party Transactions:

Receivable and payable balances with affiliated companies and related parties are shown below (in millions):

As of

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|   | September 30,<br>2007 | December 31,<br>2006 |
|---|-----------------------|----------------------|
| Affiliate receivable:                                       |                       |                      |
| Mexico Proyectos y Desarrollos S.A. de C. V. and affiliates | \$ 0.7                | \$ 2.6               |
| Other   | 0.2                   |                      |
| Total   | \$ 0.9                | \$ 2.6               |
| Affiliate payable:  |                       |                      |
| Grupo Mexico S.A.B. de C.V.                                 | \$ 2.2                | \$ 0.4               |
| Ferrocarril Mexicano S.A. de C. V.                          | 1.4                   | 3.2                  |
| Other   | 0.4                   |                      |
| Total   | \$ 4.0                | \$ 3.6               |



The Company has entered into certain transactions in the ordinary course of business with parties that are controlling shareholders or their affiliates. These transactions include the lease of office space, air transportation and construction services and products and services relating to mining and refining. The Company lends and borrows funds among affiliates for acquisitions and other corporate purposes. These financial transactions bear interest and are subject to review and approval by senior management, as are all related party transactions. It is our policy that the Audit Committee of the Board of Directors shall review all related party transactions. The Company is prohibited from entering or continuing a material related party transaction that has not been reviewed and approved or ratified by the Audit Committee.

Grupo Mexico, the Company's ultimate parent and the majority indirect stockholder of the Company, and its affiliates provide various services to the Company. These activities were principally related to accounting, legal, tax, financial, treasury, human resources, price risk assessment and hedging, purchasing, procurement and logistics, sales and administrative, and other support services. Grupo Mexico is paid for these support services by the Company. The total amount paid by the Company to Grupo Mexico for such services in the first nine months of 2007 and 2006 was \$10.3 million. The Company expects to continue to pay \$13.8 million per year for these services in future years.

The Company's Mexican operations paid fees of \$10.4 million and \$12.7 million in the first nine months of 2007 and 2006, respectively, primarily for freight services provided by Ferrocarril Mexicano, S.A. de C.V., a subsidiary of Grupo Mexico.

In addition, the Company's Mexican operations paid fees of \$10.3 million and \$24.7 million in the first nine months of 2007 and 2006, respectively, for construction services provided by Mexico Constructora Industrial S.A. de C.V., an indirect subsidiary of Grupo Mexico.

The Larrea family controls a majority of the capital stock of Grupo Mexico, and has extensive interests in other businesses, including oil drilling services, construction, and real estate. The Company engages in certain transactions in the ordinary course of business with other entities controlled by the Larrea family relating to mining and refining services, the lease of office space, and air transportation and construction services. In connection with this, the Company paid fees of \$1.9 million and \$1.7 million in the first nine months of 2007 and 2006, respectively, for maintenance services provided by Mexico Compañía de Productos Automotrices S.A. de C.V., a company controlled by the Larrea family. Also, in the third quarter of 2007, the Company paid fees of \$0.8 million for drilling services provided by Perforadora Mexico S.A de C.V, a company controlled by the Larrea family. Additionally, in the third quarter of 2006, one of our Mexican subsidiaries provided a short-term interest bearing loan of \$10.6 million to Mexico Transportes Aereos, S.A. de C.V. ( MexTransport ) for the purchase of an airplane, which was paid in the first quarter of 2007, Mextransport, a company controlled by the Larrea family, provides aviation services to our Mexican operations. Our Mexican subsidiaries have provided a guaranty for a new \$10.8 million loan obtained by MexTransport. The guaranty provided to MexTransport is backed up by the transport services provided by MexTransport to the Company's Mexican subsidiaries. The Company also paid fees of \$0.8 million in the first nine months of 2007 to MexTransport.

The Company purchased \$4.2 million and \$3.0 million in the first nine months of 2007 and 2006, respectively, of industrial materials from Higher Technology S.A.C a company in which Mr. Carlos Gonzalez has a proprietary interest; also the Company paid fees \$0.5 million and \$0.4 million in the in the first nine months of 2007 and 2006, respectively, for maintenance services provided by Servicios y Fabricaciones Mecanicas S.A.C a company in which Mr. Carlos Gonzalez has a proprietary interest. Mr. Carlos Gonzalez is the son of SCC's Chief Executive Officer. In addition, the Company purchased \$0.5 million and \$0.4 million in the first nine months of 2007 and 2006, respectively, of industrial material from Sempertrans France Belting Technology in which Mr. Alejandro Gonzalez is employed as a sales representative. Mr. Alejandro Gonzalez is the son of SCC's Chief Executive Officer

It is anticipated that in the future the Company will enter into similar transactions with such parties.

K. Employee Benefit Plan:

SCC Defined Benefit Pension Plan-

The components of the net periodic benefit costs for the nine months ended September 30 are as follows (\$ in millions):

|                                | 2007   | 2006(1) |
|--------------------------------|--------|---------|
| Interest cost                  | \$ 0.5 | \$ 0.5  |
| Expected return on plan assets | (0.4)  | (0.4)   |
| Amortization of net loss       | 0.1    | 0.1     |
| Net periodic benefit cost      | \$ 0.2 | \$ 0.2  |

(1) 2006 quarter based on average of annual amount.

SCC Post-retirement Health Care Plan-

The components of the net period benefit costs for the post-retirement health care plan for the nine months ended September 30, 2007 and 2006 are individually, and in total, less than \$0.1 million.

Minera Mexico Pension Plans-

The components of the net periodic benefit costs for the nine month ended September 30 are as follows (\$ in millions):

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|                                | 2007 |       | 2006 |       |
|--------------------------------|------|-------|------|-------|
| Interest cost                  | \$   | 1.4   | \$   | 1.4   |
| Service cost                   |      | 1.5   |      | 1.5   |
| Expected return of plan assets |      | (1.5) |      | (1.5) |
| Net periodic benefit cost      | \$   | 1.4   | \$   | 1.4   |

Minera Mexico Post-retirement Health Care Plan

The components of the net periodic cost for the nine months ended September 30, 2007 and 2006 are as follows (\$ in millions):

|                           | 2007 |     | 2006 |     |
|---------------------------|------|-----|------|-----|
| Interest cost             | \$   | 1.7 | \$   | 1.7 |
| Service cost              |      | 0.4 |      | 0.4 |
| Net periodic benefit cost | \$   | 2.1 | \$   | 2.1 |

## L. Comprehensive Income:

|  | Three months ended<br>September 30, |         | Nine months ended<br>September 30, |         |    |           |    |           |
|--|-------------------------------------|---------|------------------------------------|---------|----|-----------|----|-----------|
|  | 2007                                | 2006    | 2007                               | 2006    |    |           |    |           |
| Net income                                       | \$                                  | 627,845 | \$                                 | 521,583 | \$ | 1,905,489 | \$ | 1,382,438 |
| Other comprehensive income (loss) net<br>of tax: |                                     |         |                                    |         |    |           |    |           |
| Unrealized gain (loss) on investments            |                                     | (2)     |                                    | 2,975   |    | (956)     |    | 4,683     |
| Comprehensive income                             | \$                                  | 627,843 | \$                                 | 524,558 | \$ | 1,904,533 | \$ | 1,387,121 |

The unrealized gain (loss) on investment activity in the 2007 and 2006 periods were related to an investment in Promotora y Operadora de Infraestructura, S.A. de C.V, formerly known as Grupo Tribasa S.A. de C.V. (TRIBASA), a Mexican construction company. This investment was accounted for as an available for-sale investment.

## M. Commitments and Contingencies

## Peruvian Operations

## Regional development contribution:

On December 28, 2006, the Company's Peruvian branch signed a contract with the Peruvian government that commits the Company to make annual contributions for five years for the regional development of Peru. This has been in response to an appeal by the president of Peru to the mining industry. The Company, as well as the mining industry, has responded positively to help with this cause. The programs envisioned will focus initially on nutrition for young children and expectant mothers, education and health services. The Company has a program of contributions, starting in 2007 with a contribution of \$16.1 million, calculated based on 2006 Peruvian earnings after income tax. In accordance with the agreement, the contribution from 2006 earnings was segregated from the Branch's resources by April 30, 2007. The funds were deposited with a separate entity, the Asociación Civil Ayuda del Cobre which will make disbursements for approved investments in accordance with the agreement. The following four years' contributions could increase or decrease depending on copper prices. The commitment of the Branch is for a total of 1.25% of its annual earnings, after Peruvian income tax. If the copper price drops below \$1.79 per pound the contribution will cease. The Company made a provision of \$11.6 million in the first nine months of 2007 based on Peruvian branch earnings.

## Royalty charge:

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In June 2004, the Peruvian Congress enacted legislation imposing a royalty charge to be paid by mining companies in favor of the regional governments and communities where mining resources are located. Under this law, the Company is subject to a 1% to 3% royalty, based on sales, applicable to the value of the concentrates produced in our Toquepala and Cujone mines. The Company made provisions of \$46.7 million and \$48.6 million in the first nine months of 2007 and 2006, respectively, for this royalty.

These provisions are included in Cost of sales (exclusive of depreciation, amortization and depletion) in the condensed consolidated statement of earnings.

In 2005, a Constitutional Tribunal ruled the law constitutional and additionally stated that the royalty charge applies to all concessions held in the mining industry, implying that those entities with tax stability contracts are subject to this charge. In 1996, the Company entered into a tax stability contract with the Peruvian government (a Guarantee and Promotional Measures for Investment Contract), relating to our solvent extraction and electrowinning (SX/EW) production, which agreement purports to, among other things, fix tax rates and other charges relating to such production. The Company believes that the Constitutional Tribunal's interpretation relating to entities with tax stability contracts is incorrect and intends to protest the imposition of the royalty charge on SX/EW production, when and if assessed. Provisions made by the Company for the royalty charge do not include approximately \$20.6 million of additional potential liability relating to its SX/EW production from June 30, 2004 through September 30, 2007.

#### Power purchase agreement:

In 1997, SCC sold its Ilo power plant to an independent power company, Enersur S.A. (Enersur). In connection with the sale, a power purchase agreement was also completed under which SCC agreed to purchase all of its power needs for its Peruvian operations from Enersur for twenty years, commencing in 1997.

In 2003 the agreement was amended releasing Enersur from its obligation to construct additional capacity to meet the Company's increased electricity requirements. SCC believes it can satisfy the need for increased electricity requirements from other sources, including local power providers.

#### Environmental matters:

The Company has instituted extensive environmental conservation programs at its mining facilities in Peru and Mexico. The Company's environmental programs include water recovery systems to conserve water and minimize impact on nearby streams, reforestation programs to stabilize the surfaces of the tailings dams, and the implementation of scrubbing technology in the mines to reduce dust emissions.

#### Peruvian operations:

The Company's operations are subject to applicable Peruvian environmental laws and regulations. The Peruvian government, through its Ministerio de Energia y Minas (Ministry of Energy and Mines, or MEM) conducts annual audits of the Company's Peruvian mining and metallurgical operations. Through these environmental audits, matters related to environmental commitments, compliance with legal requirements, atmospheric emissions, and effluent monitoring are reviewed. The Company believes that it is in material compliance with applicable Peruvian environmental laws and regulations.

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In accordance with Peruvian regulations, in 1996 SCC submitted its Programa de Adecuacion y Manejo Ambiental (the Environmental Compliance and Management Program, known by its Spanish acronym, PAMA) to the MEM. A third-party environmental audit was conducted in order to elaborate the PAMA. The PAMA applied to all current operations that did not have an approved environmental impact study at the time. SCC's PAMA was approved in January 1997 and contained 34 mitigation measures and projects necessary to (1) bring the existing operations into compliance with the environmental standards established by the MEM and (2) identify areas impacted by operations that were no longer active and needed to be reclaimed. By the end of the first quarter of 2007, all PAMA related projects were completed.

With the smelter modernization project, the Company increased sulfur capture over the 92% requirement established by the PAMA. The new smelter maintains production at current levels. There are still some unresolved technical issues that need to be worked through before the performance test can be completed and the Company can receive the necessary warranties from the major contractors. The nominal and design capacity for the Isasmelt furnace was reached in less than 45 days; compared with other smelting furnaces using this technology, the start-up of the Ilo smelter has been achieved in the shortest time. Also, the sulfur capture during the second and third quarters of 2007 was over the 92% required by Peruvian regulations.

As of September 30, 2007, spending on this project was \$570.4 million, including \$58.5 million of capitalized interest.

In 2003 the Peruvian congress published a new law announcing future closure and remediation obligations for the mining industry. In accordance with this law and its amendments the Company prepared and submitted to MEM a conceptual plan in August 2006. See note I Asset Retirement Obligation for further disclosure of this matter.

For the Company's Peruvian operations, environmental capital expenditures were \$21.3 million and \$117.3 million in the first nine months of 2007 and 2006, respectively.

#### Mexican operations:

The Company's operations are subject to applicable Mexican federal, state and municipal environmental laws, to Mexican official standards, and to regulations for the protection of the environment, including regulations relating to water supply, water quality, air quality, noise levels and hazardous and solid waste. Some of these laws and regulations are relevant to legal proceedings pertaining to the Company's San Luis Potosi copper facilities.

The principal legislation applicable to the Company's Mexican operations is the federal Ley General del Equilibrio Ecologico y la Proteccion al Ambiente (the General Law of Ecological Balance and Environmental Protection), or the Environmental Law, which is enforced by the Procuraduria Federal de Proteccion al Ambiente (Federal Bureau of Environmental Protection or the PROFEPA). The PROFEPA monitors compliance with environmental legislation and enforces Mexican environmental laws, regulations and official standards. PROFEPA may initiate administrative proceedings against companies that violate environmental laws, which in the most egregious cases may result in the temporary or permanent closing of non-complying facilities, the revocation of operating licenses and/or other sanctions or fines. Also, according to theCodigo Penal Federal (Federal Criminal Code), the PROFEPA must inform corresponding authorities regarding environmental non-compliance.

Mexican environmental regulations have become increasingly stringent over the last decade, and this trend is likely to continue and has been influenced by the environmental treaty entered into by Mexico, United States and Canada in connection with NAFTA in February 1999. However, the Company's management does not believe that continued compliance with the Environmental Law or Mexican State environmental laws will have a material adverse effect on the Company's business, properties, results of operations, financial condition or prospects or will result in material capital expenditures. Although the Company believes that all of its facilities are in material compliance with applicable environmental, mining and other laws and regulations, the Company cannot assure that future laws and regulations would not have a material adverse effect on the Company's business, properties, results of operations, financial condition or prospects.



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Due to the proximity of certain facilities of Minera Mexico to urban centers, the authorities may implement certain measures that may impact or restrain the operation of such facilities.

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For the Company's Mexican operations, environmental capital expenditures were \$20.4 million and \$5.3 million in the first nine months of 2007 and 2006, respectively.

Litigation matters:

Peruvian operations:

**Garcia-Ataucuri and Others against SCC:** In April 1996, the Company was served with a complaint filed in Peru by approximately 800 former employees seeking the delivery of a substantial number of labor shares (acciones laborales) of its Peruvian Branch plus dividends on such shares, to be issued in a proportional way to each former employee in accordance with their time of work with SCC's Branch in Peru.

The Company conducts its operations in Peru through a registered Branch. Although the Branch has neither capital nor liability separate from that of the Company, under Peruvian law it is deemed to have an equity capital for purposes of determining the economic interest of the holders of the labor shares. The labor share litigation is based on claims of former employees for ownership of labor shares issued during the 1970s until 1989 under a former Peruvian mandated profit sharing system. In 1971, the Peruvian Government enacted legislation providing that workers in the mining industry would participate in the pre-tax profits of the enterprises for which they worked at a rate of 10%. This participation was distributed 40% in cash and 60% as an equity interest in the enterprise. Under the law, the equity participation was originally delivered to the Mining Community, an organization representing all workers. The cash portion was distributed to the workers after the close of the year. The accrual for this participation was (and continues to be) a current liability of the Company, until paid. In 1978, the law was amended and the equity distribution was calculated at 5.5% of pre-tax profits and was made to individual workers of the enterprise in the form of labor shares to be issued in Peru by the Peruvian Branch of SCC. These labor shares represented an equity interest in the enterprise. In addition, according to the 1978 law, the equity participations previously distributed to the Mining Community were returned to the Company and redistributed in the form of labor shares to the individual employees or former employees. The cash participation was adjusted to 4.0% of pre-tax earnings and continued to be distributed to employees following the close of the year. Effective in 1992, the law was amended to its present status, and the workers' participation in pre-tax profits was set at 8%, with 100% payable in cash. The equity participation component was eliminated from the law.

In 1995, the Company offered to exchange new common shares of the Company for the labor shares issued under the prior Peruvian law. Approximately 80.8% of the issued labor shares were exchanged for the Company's common shares, greatly reducing the minority interest on the Company's balance sheet. What remains of the workers' equity participation is now included in the condensed consolidated balance sheet under the caption *Minority Interest*.

In relation to the issuance of labor shares by the Branch in Peru, the Company is a defendant in the following lawsuits:

1) As stated above, in April 1996, the Company was served with a complaint filed in Peru by approximately 800 former employees, (Garcia Ataucuri and others vs. SCC), seeking the delivery of 38,763,806.80 labor shares (acciones laborales) (or S/. 3,876,380,679.56), as required by Law # 22333, to be issued in a proportional way to each former employee or worker in accordance with their time of work with SCC's Branch in Peru, plus dividends on such shares. The amount claimed corresponds to the total number of labor shares for all of the Company's Peruvian workers. In December 1999, a civil court of first instance of Lima decided against the Company, ordering the delivery of the labor

shares and dividends to the plaintiffs. The Company appealed this decision in January 2000. On October 10,

2000, the Superior Court of Lima affirmed the lower court's decision, which had been adverse to the Company. On appeal by the Company, the Peruvian Supreme Court annulled the proceeding noting that the civil courts lacked jurisdiction and that the matter had to be decided by a labor court. On March 8, 2002, Mr. García Ataucuri restated the claim to comply with Peruvian labor law and procedure requirements, and increased the number of plaintiffs to approximately 958 ex-workers. The lower labor judge dismissed the lawsuit in January 2005 on procedural grounds without deciding on the merits of the case. In March 2005, the plaintiffs appealed to the Lima Labor Superior Court. The Superior Court annulled the appeal due to procedural defects and remanded the case to the lower court for further proceedings. The lower court, on motions from the plaintiffs, reinstated the appeal of the dismissal of the case of seven plaintiffs that had cured the procedural defects. As of September 30, 2007, the case remains open with no further new developments.

In October 2007, in a separate proceeding initiated by Mr. García Ataucuri against the justices of the Peruvian Supreme Court, the Peruvian Constitutional Court notified its decision that nullified the Peruvian Supreme Court decision issued on September 19, 2001 in the Garcia Ataucuri vs. SCC case. That decision had been favorable to the Company as it had annulled all proceedings in the Garcia Ataucuri vs. SCC lawsuit noting that the civil courts lacked jurisdiction and that the matter had to be decided by a labor court. Mr. Garcia Ataucuri, in his extraordinary constitutional appeal, alleged that the members of the Peruvian Supreme Court had violated his constitutional due process rights when they issued a decision that obligated him and the other plaintiffs to commence a new proceeding before the labor courts when they had litigated against the Company in civil courts for over 10 years. The decision of the Peruvian Constitutional Court orders the Supreme Court to decide again on the merits of the case accepting or denying the Company's extraordinary appeal submitted to the Supreme Court in 2000.

Although the Company was not formally a party to the Garcia Ataucuri proceedings before the Peruvian Constitutional Court, the nullity of the originally favorable decision of the Supreme Court (issued on September 19, 2001) is final and cannot be appealed by the Company.

It is uncertain how the Supreme Court will decide on the Company's 2000 appeal and the merits of the case in view of the decision of the Peruvian Constitutional Court. In October 2007, a Peruvian prosecuting attorney in charge of investigating an accusation made by Mr. Garcia Ataucuri against various officers of the Company's Peruvian branch, alleging that the non issuance of the labor shares requested by him in the Garcia Ataucuri vs. SCC case presumably constitutes an illegal appropriation of the same, has rendered his opinion on the merits of the accusation to the pertinent criminal judge. The prosecuting attorney's opinion is under review by the criminal judge, who has the option of accepting it and initiating the corresponding criminal proceeding or declaring it without merit. The Company asserts that the accusations of Mr. Garcia Ataucuri are without merit and will vigorously fight them.

In response to Mr. Garcia Ataucuri's criminal accusation, SCC filed a Habeas Corpus against the prosecuting attorney. The judge from the 39th criminal court has declared founded the Habeas Corpus considering that the due process has been affected and has also nullified and declared without grounds the criminal accusation filed by the prosecuting attorney. This resolution can be appealed.

2) Additionally, on May 10, 2006, the Company was served with a new complaint filed in Peru, this time by 44 former employees, (Cornejo Flores and others vs. SCC), seeking delivery of (1) labor shares (or shares of whatever other current legal denomination) corresponding to years 1971 to December 31, 1977 (we understand the plaintiffs are seeking the same 38,763,806.80 labor shares mentioned in the prior

lawsuit), that should have been issued in accordance with Law # 22333, plus interest and (2) labor shares resulting from capital increases made by the Branch in 1980 for the amount of the workers' participation of S/.17,246,009,907.20, equivalent to 172,460,099.72 labor shares, plus dividends. On May 23, 2006, the Company answered this new complaint, denying the validity of the claim. As of September 30, 2007 the case remains in the discovery stage.

The Company asserts that the claims are without merit and that the labor shares were distributed to the former employees in accordance with the profit sharing law then in effect. We do not believe that an unfavorable outcome is reasonably possible. The Company has not made a provision for these lawsuits because it believes that it has meritorious defenses to the claims asserted in the complaints.

#### Mineria Integral S.A.C.:

In January 2007, the Company was served with three claims filed in Peru by Minería Integral S.A.C. The claims allege that the Company has trespassed on certain mining rights of the plaintiff, in Ilo, Department of Moquegua, and seek that the Company desist from the trespass and pay compensation in the amount of \$49,139,476. The Company believes that these administrative procedures are without merit and is vigorously defending itself against these actions.

#### Class actions

Three purported class action derivative lawsuits have been filed in the Delaware Court of Chancery (New Castle County) late in December 2004 and early January 2005 relating to the acquisition of Minera Mexico by SCC. On January 31, 2005, the three actions *Lemon Bay, LLP v. Americas Mining Corporation, et al.*, Civil Action No. 961-N, *Therault Trust v. Luis Palomino Bonilla, et al.*, and *Southern Copper Corporation, et al.*, Civil Action No. 969-N, and *James Sousa v. Southern Copper Corporation, et al.*, Civil Action No. 978-N were consolidated into one action titled, *In re Southern Copper Corporation Shareholder Derivative Litigation*, Consol. C. A. No. 961-N and the complaint filed in *Lemon Bay* was designated as the operative complaint in the consolidated lawsuit. The consolidated action purports to be brought on behalf of the Company's common stockholders.

The consolidated complaint alleges, among other things, that the acquisition of Minera Mexico is the result of breaches of fiduciary duties by the Company's directors and is not entirely fair to the Company and its minority stockholders. The consolidated complaint seeks, among other things, a preliminary and permanent injunction to enjoin the acquisition, the award of damages to the class, the award of damages to the Company and such other relief that the court deems equitable, including interest, attorneys' and experts' fees and costs. The Company believes that this lawsuit is without merit and is vigorously defending itself against this action.

The Company's management believes that the outcome of the aforementioned legal proceeding will not have a material adverse effect on the Company's financial position or results of operations.

#### Mexican operations-

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The Mexican Geological Services (MGS) Royalties:

In August 2002, MGS (formerly named Council of Mineral Resources ( COREMI )) filed with the Third Federal District Judge in Civil Matters, an action demanding from Mexcobre the payment of royalties since 1997. In December 2005, Mexcobre signed an agreement with MGS. Under the terms of this agreement the parties established a new

procedure to calculate the royalty payments applicable for 2005 and the following years, and the Company paid in January 2006, \$6.9 million of royalties for 2005 and \$8.5 million as payment on account of royalties from the third quarter 1997 through the last quarter of 2004. We estimate that the payment made on January 11, 2006 will cover 100% of the royalty payments required for 2004 and prior periods. On January 22, 2007 the Third Federal District Judge issued a ruling regarding the payment related to the period from the third quarter of 1997 through the fourth quarter of 2004. This ruling was appealed by both parties in February 2007. The appeal is still pending. The Company believes that the payment made on account for this period is correct.

On an ongoing basis the Company is required to pay a 1% royalty on La Caridad's copper production value after deduction of treatment and refining charges and certain other carrying costs.

San Luis Potosi Facilities:

The municipality of San Luis Potosi has granted Desarrolladora Intersaba, S.A. de C.V. ( Intersaba ), licenses for use of land and construction of housing and/or commercial zones in the former Ejido Capulines zone, where the residential project Villa Magna is expected to be developed in the near future.

The Villa Magna residential project is being developed within an area that IMMSA's Risk Analysis approved by SEMARNAT (the federal environmental authority), has secured as a safeguard and buffer zone due to the use by IMMSA of anhydrous ammonia gas.

Based on the foregoing, IMMSA has initiated two different actions regarding this matter. First, against the municipality of San Luis Potosi, requesting the annulment of the authorization and licenses granted to Intersaba to develop Villa Magna within the zinc plant's safeguard and buffer zone; and second, filed before SEMARNAT for the declaration of a safeguard and buffer zone surrounding IMMSA's zinc plant.

In August 2006, the first action was resolved by a Federal Court, which denied IMMSA's request. In September 2006, IMMSA submitted its final appeal to the Supreme Court of Justice and in February 2007, the court ruled against IMMSA.

IMMSA believes that while this outcome was adverse to its interests, the construction of the Villa Magna housing and commercial development will not, in itself, affect the operations of IMMSA's zinc plant.

Intersaba has filed a lawsuit against IMMSA, requesting payment of damages in the amount of approximately \$11.0 million supposedly caused by IMMSA during these proceedings. IMMSA intends to vigorously defend against this lawsuit.

In addition to the foregoing, IMMSA has initiated a series of legal and administrative procedures against the Municipality of San Luis Potosi due to its refusal to issue IMMSA's use of land permit (*licencia de uso de suelo*) in respect to its zinc plant. A federal judge ruled that IMMSA's use of land permit should be granted. The municipal authorities are evaluating how to comply with the ruling.

Tax contingency matters-

The Company is regularly audited by federal, state and foreign tax authorities, both, in the United States and internationally. The amount of unrecognized tax benefits resulting from uncertain tax positions has been developed in consultation with legal and tax counsel and in accordance with the requirements of FIN 48, which was adopted effective January 1, 2007, see Note B above.



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### U.S. Internal Revenue Service (IRS)

IRS audits can result in proposed assessments. In 2002, the IRS issued a preliminary Notice of Proposed Adjustment for the years 1994 through 1996. In 2003, the Company settled these differences with the IRS and made a payment of \$4.4 million, including interest. The years 1994 through 1996 are now closed to further adjustment.

In the second quarter of 2007, the IRS completed field audit work for the years 2003 and 2004. Issues raised were the same as those pending resolution from prior audits. No new issues were raised and no new federal audits have been scheduled.

During the audit of the tax years 1997 through 1999, the IRS questioned the Company's accounting policy for determination of useful lives for depreciable property, the calculation of deductible and creditable Peruvian taxes, the methodology of capitalizing interest and the capitalizing of certain costs (drilling, blasting and hauling) into inventory value as items for possible adjustment. In 2003, the Company and the IRS jointly requested technical advice from the IRS National Office to help resolve the inventory value dispute. In 2005 the National Office of the IRS responded to the request for technical advice with the issuance of a technical advice memorandum (TAM). This TAM allowed the IRS to close the field audit work for the audit cycles 1997 through 1999 and 2000 through 2002. The TAM accepts the position of the IRS field office and concludes that the Company is required to capitalize the drilling, blasting and hauling costs of material transported to its leach dumps based on the weight of material moved, without regard to metal content or recoverability.

In October 2005, the Company filed two formal protests, covering the years 1997 through 2002, with the IRS to appeal the proposed changes with respect to the TAM conclusion, as well as other items of adjustment proposed by the IRS field audit group.

These other adjustments include the methodology of capitalizing interest, the determination of useful lives for depreciable property, the calculation of deductible and creditable Peruvian taxes and the established service fee between the Company and related parties. Discussions with the Appeals Office representatives have begun and the parties have agreed to working through the protested issues and concluding the appeals process as soon as practicable. During the quarter ending September 30, 2007 the Company and the IRS continued to exchange information aimed at settling the disputes.

On June 12, 2007 the Company filed a formal protest with the IRS to appeal the proposed changes raised from the 2003 and 2004 audit. Although no new issues were identified, the application of the prior cycle issues to new years did give rise to additional proposed adjustments. The resulting liability amounts for these probable proposed adjustments as well as their possible effects on taxes through the current reporting period were included within the FIN 48 liability.

### Peruvian operations:

In Peru the Superintendencia Nacional de Administracion Tributaria ( SUNAT ), the Peruvian Tax Administration, regularly audits the Company. These audits can result in proposed assessments.

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In 2002, the Company received assessments and penalties from SUNAT for fiscal years 1996 through 1999, in which several deductions taken were disallowed. After appeal, the Company settled many of the issues with SUNAT in 2003. However, the portion of the assessment related to the disallowance of financial expenses was pending resolution. In addition, the Company did not recognize a liability for penalties and interest related to the portion of the assessments settled in 2003 or for the pending assessment related to financial expenses, as it considered that they were not

applicable. The status of these pending issues as well as other tax contingencies is as follows:

a) Year 1996: With regard to the appeal of the penalty related to fiscal year 1996, the Company was required to issue a letter of credit to SUNAT of \$3.6 million, which was issued in July 2003. This deposit is recorded in other assets in the condensed consolidated balance sheet. The Company was not required to issue a deposit for the appeal of the assessments and rulings with respect to any other year. In February 2004, the Peruvian tax court denied the Company's appeal. Subsequently, in April 2004, the Company filed a lawsuit against the Peruvian tax court and SUNAT before the Superior Court of Peru. In September 2005, the Superior Court declared the Company's claim valid. SUNAT appealed this decision to the Peruvian Supreme Court in Lima. In December 2006, the Peruvian Supreme Court confirmed the opinion of the lower court that declared valid SPCC's claim. SUNAT has not appealed this decision and in March 2007 issued a resolution in favor of SPCC's claim. In August 2007 SUNAT refunded to the Company the \$3.6 million deposit plus and additional \$1 million of interest. The case is now closed.

b) Year 1997: In November 2002, with regard to the penalty issued by SUNAT related to fiscal year 1997, the Peruvian tax court indicated that the penalty needed to be modified and declared the previously issued penalty null. Consequently, SUNAT issued a new penalty in December 2003. This penalty had been protested before SUNAT. The Company's appeal before the Peruvian tax court related to the assessments (pertaining to the deduction of certain financial expense) for fiscal year 1997 was denied. In May 2003, the Company filed a lawsuit before the Superior Court against SUNAT and the Peruvian tax court, seeking the reversal of the ruling of the tax court. In July 2005 the Superior Court decided in favor of the Company and remanded the case to SUNAT for a new pronouncement. SUNAT has appealed the court's decision to the Peruvian Supreme Court in Lima. In December 2006, the Supreme Court declared null the lower court's opinion and remanded the case back to the lower court for final resolution.

In March 2007 the lower court declared null the original resolutions issued by SUNAT and the tax court, found in SPCC's favor, and ordered SUNAT to accept the 1997 interest deduction. SUNAT has appealed this decision and resolution is still pending in the Supreme Court. This decision, if it is affirmed on appeal, is very important for SPCC as assessments related to the years 1998 through 2001 are based on SUNAT's disallowance of similar interest expense deductions.

c) Years 1998 and 1999: In August 2006, SUNAT ruled on the part of the 1998/1999 issues related to payment of commissions to certain financial institutions. The ruling resolved one issue in favor of the Company and other issues against the Company. The Company has appealed before the Peruvian tax court the portion of the claim decided against the Company.

In July 2007, SUNAT ruled on the remaining 1998/1999 issues related to financial deductions. The ruling resolved one issue in favor of the Company and other issue against the Company. The Company will continue to contest the adverse portion of this ruling.

d) Years 2000 and 2001: In December 2004 and January 2005, the Company received assessments and penalties from SUNAT for fiscal years 2000 and 2001, in which certain deductions taken by the Company were disallowed. SUNAT has objected to the Company's method of deducting vacation pay accruals in 2000, a deduction in 2000 for a fixed asset write-off, as well as certain other deductions in both years. The Company has appealed these assessments and resolution is still pending. Additionally, the Company received penalties and assessments from SUNAT relating to treatment of foreign exchange differences for 2000 and 2001. The Company has appealed these assessments before the Peruvian tax court and resolution is still pending.

In June 2006, a tax court decision was published with regards to another company, which states that profits related to foreign exchange differences need not be included in calculations for monthly advance tax payments. The tax court has indicated that this decision is applicable to all future cases that are similar. In view of this, the Company expects that the portion of the 2000/2001 tax assessment related to foreign exchange difference will be removed from the assessment.

In September 2006, SUNAT declared invalid the Company's claim related to the income tax rate applied to commissions paid to certain financial institutions. The Company has appealed SUNAT's decision before the Peruvian tax court.

e) Year 2002: In December 2006, the Company received assessments and penalties from SUNAT for fiscal year 2002 disallowing the income tax rate applied to services received from non domiciled companies and certain deductions taken. In February 2007, the Company filed a protest before SUNAT regarding these assessments.

f) Year 2003: In August 2007, the Company received assessments and penalties from SUNAT for fiscal year 2003 disallowing the income tax rate applied to services received from non domiciled companies and certain deductions taken. In September 2007, the Company filed a protest before SUNAT regarding these assessments.

#### Mexican Operations:

MM is regularly examined by the Servicios de Administracion Tributaria ( SAT ), the Mexican tax administration. These examinations can result in proposed assessments.

a) Year 1995: In March 2001, SAT issued an assessment related to the 1995 tax year, disallowing certain deductions related to the Company's housing and local travel expenses. The Company has appealed this assessment. The tax court ruled against the Company. In March 2007, SAT made the final liquidation of MM's consolidated income tax and the Company paid \$0.9 million. With this payment the case is closed.

b) Year 1999: In May 2005 SAT issued an assessment against MM claiming that MM understated the asset value used in the determination of the asset tax. In addition, SAT claimed that MM improperly reduced its consolidated results through the consolidation of two subsidiaries.

MM believes that the 1999 SAT assessment is not legal. Accordingly, in July 2005, MM filed a nullity motion with the Metropolitan Regional Tax Court, Exchequer Division, against the assessment, which is currently at the stage of submission of expert and documentary evidence.

#### Labor matters:

In recent years the Company has experienced a number of strikes or other labor disruptions that have had an adverse impact on its operations and operating results.

Mexican operations

During 2006, there were a number of work stoppages at some of the Company's Mexican operations. While some of these work stoppages were of a short-term nature with little or no production loss, others have been more disruptive. A strike at the La Caridad copper mine in Sonora began in the first quarter of 2006 and ended in July 2006. A strike at the San Martin polymetallic complex in Zacatecas commenced in the first quarter of 2006 and ended in May 2006. Workers at the Cananea copper mine went on a strike on June 1, 2006, returning to work six weeks later on July 17, 2006. These work stoppages were declared illegal by the Mexican authorities. On June 9, 2006, the Company announced the closing of the La Caridad mine as picketing workers

made it impossible to continue operations. As a result of these strikes, the Company declared *force majeure* on certain of its June and July copper contracts. On July 14, 2006, with the approval of a labor court, the Company dismissed the La Caridad workers. Individual work agreements, and the collective union contract, were terminated in compliance with the provisions of the ruling rendered by federal labor authorities. On July 26, 2006, the installations were returned to the Company and the Company commenced to hire workers to resume operations. In July 2006, the Company reopened the La Caridad mine and in the fourth quarter of 2006 restored production to 100% capacity.

Since July 30, 2007, our Mexican mines of Cananea, Taxco and San Martin have ceased operations due to work stoppages promoted, by a minority group of the union workers. Even though the labor authorities declared these stoppages illegal, operations have not yet resumed at the mines. Proceedings in this regards are currently in process in Mexican federal courts and we are confident that the final outcome will be favorable to us, and plan to sign new labor contracts, and to establish modern productivity practices for the benefit of the workers and the Company.

The contribution of these three mining units to the Company's revenue is less than 14% and the Company was for the most part, able to offset the loss of revenue due to these work stoppages with additional volumes of molybdenum and copper from our other mines and from better molybdenum prices.

The 4,201 workers from eight of eleven mining units and plants of Minera Mexico voted on September 5, 2007 to elect union representation, from among the *Sindicato de Trabajadores Mineros Metalurgicos y Similares de la Republica Mexicana* and the *Sindicato Nacional de Trabajadores de la Exploracion, Explotacion y Beneficio de Minas de la Republica Mexicana* which belongs to the National Federation of Independent Unions with 332,000 members. The individual re-count was made in the presence of the legal representatives of the unions and the government labor authorities.

By overwhelming majority, 97% of the workers decided to change to the union *Sindicato Nacional de Trabajadores de la Exploracion, Explotacion y Beneficio de Minas de la Republica Mexicana* looking for solid work stability, better union representatives and improved conditions for the workers.

On October 15, 2007 the Federal Labor Board for Conciliation and Arbitration pronounced a legal decision in favor of the *Sindicato Nacional de Trabajadores de la Exploracion, Explotacion y Beneficio de Minas de la Republica Mexicana* .

#### Peruvian Operations

Collective bargaining agreements with the Company's nine Peruvian labor unions were due to expire in 2007. As a result, on April 28, 2007 the workers of a newly unified workers union at our Peruvian smelter in Ilo initiated a strike to demand better wages and benefits. In addition, on April 30, 2007 Peru's largest mining union launched a nationwide strike to demand better job benefits. The workers at our two Peruvian mines joined the nationwide miners' strike and also supported the unified Ilo union. The labor minister declared the strike inappropriate and the workers returned to work after five days when the nationwide strike was resolved by the government. The workers received guarantees from the government over working conditions and contracts.

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On June 9, 2007 the workers of the Toquepala employees union signed a five year and nine month collective bargaining agreement with the Company. This agreement includes a salary increase of 11% retroactive to December 1, 2006.

On June 23, 2007 the unionized workers at some of our Peruvian operations initiated a strike demanding better wages and benefits. At the request of the Peruvian labor

authorities, the workers returned to work after five days to restart negotiations with the Company.

On July 11, 2007 the workers of four Peruvian unions, the Ilo workers union, the refinery employees union, and the unified workers of Toquepala and Cuajone unions, signed a six year agreement with the Company. These agreements include a salary increase of 41.67% over the six years, 11% of which is for the first year retroactive to December 1, 2006. In addition, each worker will receive a one time payment of approximately \$5,000 upon subscribing.

On October 2, 2007, the workers of Ilo, Toquepala and Cuajone belonging to the three unions did not signed the July 11, 2007 agreements, began a strike demanding higher wages and benefits. After eight days of strike, the workers returned to work when union leaders and the Company signed a settlement pact giving the Peruvian labor ministry the authority to settle the final conditions.

On October 26, 2007, the Peruvian labor ministry issued its final pronouncement, settling the open issues with these three unions. The settlement, for a three year agreement, includes a salary increase of 11% in the first year and 5% in both the second and third years. In addition, each worker will receive a one time payment of approximately \$2,700 upon signing the agreement. Also, the Company will have the ability to adjust work schedules to more adequately meet production needs.

During these brief strikes at the Peruvian operations, the Company continued normal operations with the support of staff and administrative personnel and contractors.

#### Mine accident:

On February 19, 2006 an explosion occurred at the IMMSA unit's Pasta de Conchos coal mine, located in San Juan de Sabinas, Coahuila, Mexico. Immediately thereafter and for 14 months, IMMSA conducted a comprehensive rescue effort. Federal and local governmental help and support was received. As a result of the accident eight miners were injured and 65 perished.

Both the Coahuila Public District Attorney (Procuraduria de Justicia) and the Federal Attorney's Office (Procuraduria Federal de la Republica) initiated investigations to establish the causes of the accident and the responsible party. A local judge at San Juan de Sabinas ordered five mine representatives to stand trial for the accident. On April 16, 2007 the judge terminated the case due to the indemnification for damages to the families of the victims. Recovery efforts have stopped due to increased hazards and potential health risks for the recovery workers. Federal labor officials are evaluating the conditions of the mine.

#### Other legal matters:

The Company is involved in various other legal proceedings incidental to its operations, but the Company does not believe that decisions adverse to it in any such proceedings individually or in the aggregate would have a material adverse effect on its financial position or results of operations.



Our direct and indirect parent corporations, including AMC and Grupo Mexico, have from time to time been named parties in various litigations involving Asarco. In August 2002 the U.S. Department of Justice brought a claim alleging fraudulent conveyance in connection with AMC's then-proposed purchase of SCC from Asarco. That action was settled pursuant to a Consent Decree dated February 2, 2003. In March 2003, AMC purchased its interest in SCC from Asarco. In October 2004, AMC, Grupo Mexico, Mexicana de Cobre and other parties, not including SCC, were named in a lawsuit filed in New York State court in connection with alleged asbestos liabilities,

which lawsuit claims, among other matters, that AMC's purchase of SCC from Asarco should be voided as a fraudulent conveyance. The lawsuit filed in New York State court was stayed as a result of the August 9, 2005 Chapter 11 bankruptcy filing by Asarco, as described below. On February 2, 2007 a complaint was filed by Asarco, the debtor in possession, alleging many of the matters previously claimed in the New York State lawsuit, including that AMC's purchase of SCC from Asarco should be voided as a fraudulent conveyance. While Grupo Mexico and its affiliates believe that these claims are without merit, we cannot assure you that these or future claims, if successful, will not have an adverse effect on the Company's parent corporation or the Company. Any increase in the financial obligations of the Company's parent corporation, as a result of matters related to Asarco or otherwise could, among other effects; result in the Company's parent corporation attempting to obtain increased dividends or other funding from the Company. In 2005, certain subsidiaries of Asarco filed bankruptcy petitions in connection with alleged asbestos liabilities. In July 2005, the unionized workers of Asarco commenced a work stoppage. As a result of various factors, including the above-mentioned work stoppage, on August 9, 2005 Asarco filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code before the U.S. Bankruptcy Court in Corpus Christi, Texas. Asarco's bankruptcy case is being joined with the bankruptcy cases of its subsidiaries. Asarco's bankruptcy could result in additional claims being filed against Grupo Mexico and its subsidiaries, including SCC, Minera Mexico or its subsidiaries.

N. Segment and Related Information:

The Company operates in a single industry, namely mining copper. Prior to the April 1, 2005 acquisition of Minera Mexico, the Company determined that its operations in Peru fell within one segment. With the acquisition of Minera Mexico the Company continues to operate principally in one industry, the mining of copper. However, because of the demands of managing operations in two countries, effective April 1, 2005 Company management views the new Southern Copper as having three operating segments and manages the Company on the basis of these segments. Additionally, in mining copper, the Company produces a number of by-products, most important of which are molybdenum, silver and zinc. The significant increase in the price of molybdenum over recent years has had an important impact on the Company's earnings. Nevertheless, the Company continues to manage its operations on the basis of the three copper segments. Added to the segment information is the information regarding the Company's molybdenum sales. The segments identified by the Company are:

1. Peruvian operations, which include the Toquepala and Cuajone mine complexes and the smelting and refining plants, industrial railroad and port facilities which service both mines.
2. Mexican open pit copper mines, which include La Caridad and Cananea mine complexes and the smelting and refining plants and support facilities which service both mines.
3. Mexican underground mining operations, which include five underground mines that produce zinc, copper, silver and gold, a coal and coke mine, and several industrial processing facilities for zinc and copper. This group is identified as the IMMSA unit.

The Chief Operating Officer of the Company focuses on operating income as a measure of performance to evaluate different segments, and to make decisions to allocate resources to the reported segments.

Financial information relating to Southern Copper's segments is as follows:

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Three Months Ended September 30, 2007  
(in millions)

|  | Mexican<br>Open Pit | Mexican<br>IMMSA<br>Unit | Peruvian<br>Operations | Corporate<br>and other<br>Eliminations | Consolidated |
|--|---------------------|--------------------------|------------------------|--|--------------|
| Net sales outside of segments  | \$ 418.9            | \$ 158.7                 | \$ 1,028.8             |  | \$ 1,606.4   |
| Intersegment sales   | 62.4                | 19.8                     |                        | \$ (82.2)                              |              |
| Cost of sales (exclusive of depreciation,<br>amortization and depletion) | 171.3               | 96.4                     | 373.8                  | (81.7)                                 | 559.8        |
| Selling, general and administrative                                      | 8.3                 | 5.5                      | 9.0                    | 0.8                                    | 23.6         |
| Depreciation, amortization and depletion                                 | 43.7                | 9.9                      | 27.4                   | 0.5                                    | 81.5         |
| Exploration  | 0.7                 | 2.9                      | 4.1                    |  | 7.7          |
| Operating income   | \$ 257.3            | \$ 63.8                  | \$ 614.5               | \$ (1.8)                               | 933.8        |
| Less:  |                     |                          |                        |  |              |
| Interest, net  |                     |                          |                        |  | (4.0)        |
| Gain on derivative instruments   |                     |                          |                        |  | 3.0          |
| Other income (expense)   |                     |                          |                        |  | (5.7)        |
| Income taxes   |                     |                          |                        |  | (296.1)      |
| Minority interest  |                     |                          |                        |  | (3.2)        |
| Net earnings   |                     |                          |                        |  | \$ 627.8     |
| Capital expenditure  | \$ 39.8             | \$ 7.3                   | \$ 24.5                | \$ 0.5                                 | \$ 72.1      |
| Property, net  | \$ 1,604.2          | \$ 245.7                 | \$ 1,662.4             | \$ 70.2                                | \$ 3,582.5   |
| Total assets   | \$ 3,400.7          | \$ 647.4                 | \$ 3,383.7             | \$ (682.5)                             | \$ 6,749.3   |

Three Months Ended September 30, 2006  
(in millions)

|  | Mexican<br>Open Pit | Mexican<br>IMMSA<br>Unit | Peruvian<br>Operations | Corporate<br>and other<br>Eliminations | Consolidated |
|--|---------------------|--------------------------|------------------------|--|--------------|
| Net sales outside of segments  | \$ 366.6            | \$ 160.2                 | \$ 885.4               |  | \$ 1,412.2   |
| Intersegment sales   | 87.9                | 29.1                     | 32.6                   | \$ (149.6)                             |              |
| Cost of sales (exclusive of depreciation,<br>amortization and depletion) | 240.0               | 96.8                     | 343.9                  | (171.5)                                | 509.2        |
| Selling, general and administrative                                      | 8.3                 | 6.5                      | 8.4                    | 1.9                                    | 25.1         |
| Depreciation, amortization and depletion                                 | 39.5                | 7.0                      | 21.1                   | 0.2                                    | 67.8         |
| Exploration  | 0.5                 | 2.1                      | 3.0                    |  | 5.6          |
| Operating income   | \$ 166.2            | \$ 76.9                  | \$ 541.6               | \$ 19.8                                | 804.5        |
| Less:  |                     |                          |                        |  |              |
| Interest, net  |                     |                          |                        |  | (13.4)       |
| Loss on debt prepayment  |                     |                          |                        |  | (0.1)        |
| Other income (expense)   |                     |                          |                        |  | 5.3          |
| Income taxes   |                     |                          |                        |  | (271.9)      |
| Minority interest  |                     |                          |                        |  | (2.8)        |
| Net earnings   |                     |                          |                        |  | \$ 521.6     |
| Capital expenditure  | \$ 34.1             | \$ 12.7                  | \$ 55.5                | \$                                     | \$ 102.3     |
| Property, net  | \$ 1,587.9          | \$ 277.6                 | \$ 1,587.5             | \$ 33.5                                | \$ 3,486.5   |
| Total assets   | \$ 2,625.7          | \$ 617.3                 | \$ 3,201.1             | \$ (568.2)                             | \$ 5,875.9   |

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Nine Months Ended September 30, 2007

(in millions)

|  | Mexican<br>Open Pit | Mexican<br>IMMSA<br>Unit | Peruvian<br>Operations | Corporate<br>and other<br>Eliminations | Consolidated |
|--|---------------------|--------------------------|------------------------|--|--------------|
| Net sales outside of segments  | \$ 1,620.9          | \$ 471.5                 | \$ 2,698.8             |  | \$ 4,791.2   |
| Intersegment sales   | 210.3               | 71.3                     |                        | \$ (281.6)                             |              |
| Cost of sales (exclusive of depreciation,<br>amortization and depletion) | 569.0               | 268.5                    | 1,036.2                | (284.9)                                | 1,588.8      |
| Selling, general and administrative                                      | 29.2                | 18.3                     | 29.1                   | (3.4)                                  | 73.2         |
| Depreciation, amortization and depletion                                 | 130.7               | 27.6                     | 80.7                   | 1.1                                    | 240.1        |
| Exploration  | 3.3                 | 6.9                      | 12.5                   |  | 22.7         |
| Operating income   | \$ 1,099.0          | \$ 221.5                 | \$ 1,540.3             | \$ 5.6                                 | \$ 2,866.4   |
| Less:  |                     |                          |                        |  |              |
| Interest, net  |                     |                          |                        |  | (18.4)       |
| Loss on derivative instruments   |                     |                          |                        |  | (73.7)       |
| Other income (expense)   |                     |                          |                        |  | 20.0         |
| Income taxes   |                     |                          |                        |  | (881.2)      |
| Minority interest  |                     |                          |                        |  | (7.6)        |
| Net earnings   |                     |                          |                        |  | \$ 1,905.5   |
| Capital expenditure  | \$ 102.1            | \$ 16.8                  | \$ 104.9               | \$ 27.3                                | \$ 251.1     |
| Property, net  | \$ 1,604.2          | \$ 245.7                 | \$ 1,662.4             | \$ 70.2                                | \$ 3,582.5   |
| Total assets   | \$ 3,400.7          | \$ 647.4                 | \$ 3,383.7             | \$ (682.5)                             | \$ 6,749.3   |

Nine Months Ended September 30, 2006

(in millions)

|   | Mexican<br>Open Pit | Mexican<br>IMMSA<br>Unit | Peruvian<br>Operations | Corporate<br>and other<br>Eliminations | Consolidated |
|---|---------------------|--------------------------|------------------------|--|--------------|
| Net sales outside of segments   | \$ 1,092.1          | \$ 430.3                 | \$ 2,287.9             |  | \$ 3,810.3   |
| Intersegment sales  | 247.5               | 54.5                     | 32.6                   | \$ (334.6)                             |              |
| Cost of sales (exclusive of<br>depreciation, amortization and<br>depletion) | 624.7               | 258.5                    | 898.1                  | (343.3)                                | 1,438.0      |
| Selling, general and<br>administrative                                      | 24.6                | 15.5                     | 27.4                   | 5.0                                    | 72.5         |
| Depreciation, amortization and<br>depletion                                 | 116.3               | 21.1                     | 61.2                   | 0.3                                    | 198.9        |
| Exploration   | 1.1                 | 5.1                      | 8.6                    |  | 14.8         |
| Operating income  | \$ 572.9            | \$ 184.6                 | \$ 1,325.2             | \$ 3.4                                 | 2,086.1      |
| Less:   |                     |                          |                        |  |              |
| Interest, net   |                     |                          |                        |  | (29.2)       |
| Loss on debt prepayment   |                     |                          |                        |  | (1.0)        |
| Other income (expense)  |                     |                          |                        |  | 12.8         |
| Income taxes  |                     |                          |                        |  | (679.7)      |
| Minority interest   |                     |                          |                        |  | (6.6)        |
| Net earnings  |                     |                          |                        |  | \$ 1,382.4   |
| Capital expenditure   | \$ 122.1            | \$ 32.3                  | \$ 178.6               | \$                                     | \$ 333.0     |
| Property, net   | \$ 1,587.9          | \$ 277.6                 | \$ 1,587.5             | \$ 33.5                                | \$ 3,486.5   |
| Total assets  | \$ 2,625.7          | \$ 617.3                 | \$ 3,201.1             | \$ (568.2)                             | \$ 5,875.9   |

Sales value per segment:

|            | Three Months Ended September 30, 2007 |                       |   |                             |            | Consolidated |
|------------|---------------------------------------|-----------------------|---|-----------------------------|------------|--------------|
|            | Mexican<br>Open Pit                   | Mexican<br>IMMSA Unit | (in millions)<br>Peruvian<br>Operations | Intersegment<br>Elimination |            |              |
| Copper     | \$ 375.9                              | \$ 32.7               | \$ 791.1                                | \$ (62.6)                   | \$ 1,137.1 |              |
| Molybdenum | 86.2                                  |                       | 188.6                                   |                             | 274.8      |              |
| Other      | 19.2                                  | 145.8                 | 49.1                                    | (19.6)                      | 194.5      |              |
| Total      | \$ 481.3                              | \$ 178.5              | \$ 1,028.8                              | \$ (82.2)                   | \$ 1,606.4 |              |

|            | Three Months Ended September 30, 2006 |                       |   |                             |            | Consolidated |
|------------|---------------------------------------|-----------------------|---|-----------------------------|------------|--------------|
|            | Mexican<br>Open Pit                   | Mexican<br>IMMSA Unit | (in millions)<br>Peruvian<br>Operations | Intersegment<br>Elimination |            |              |
| Copper     | \$ 422.9                              | \$ 42.7               | \$ 764.5                                | \$ (115.3)                  | \$ 1,114.8 |              |
| Molybdenum | 3.0                                   |                       | 108.9                                   |                             | 111.9      |              |
| Other      | 28.6                                  | 146.6                 | 44.6                                    | (34.3)                      | 185.5      |              |
| Total      | \$ 454.5                              | \$ 189.3              | \$ 918.0                                | \$ (149.6)                  | \$ 1,412.2 |              |

|            | Nine Months Ended September 30, 2007 |                       |   |                             |            | Consolidated |
|------------|--------------------------------------|-----------------------|---|-----------------------------|------------|--------------|
|            | Mexican<br>Open Pit                  | Mexican<br>IMMSA Unit | (in millions)<br>Peruvian<br>Operations | Intersegment<br>Elimination |            |              |
| Copper     | \$ 1,441.2                           | \$ 83.9               | \$ 2,099.1                              | \$ (209.9)                  | \$ 3,414.3 |              |
| Molybdenum | 314.2                                |                       | 463.2                                   |                             | 777.4      |              |
| Other      | 75.8                                 | 458.9                 | 136.5                                   | (71.7)                      | 599.5      |              |
| Total      | \$ 1,831.2                           | \$ 542.8              | \$ 2,698.8                              | \$ (281.6)                  | \$ 4,791.2 |              |

|            | Nine Months Ended September 30, 2006 |                       |   |                             |            | Consolidated |
|------------|--------------------------------------|-----------------------|---|-----------------------------|------------|--------------|
|            | Mexican<br>Open Pit                  | Mexican<br>IMMSA Unit | (in millions)<br>Peruvian<br>Operations | Intersegment<br>Elimination |            |              |
| Copper     | \$ 1,215.6                           | \$ 100.3              | \$ 1,887.6                              | \$ (263.6)                  | \$ 2,939.9 |              |
| Molybdenum | 38.7                                 |                       | 334.7                                   |                             | 373.4      |              |
| Other      | 85.3                                 | 384.5                 | 98.2                                    | (71.0)                      | 497.0      |              |
| Total      | \$ 1,339.6                           | \$ 484.8              | \$ 2,320.5                              | \$ (334.6)                  | \$ 3,810.3 |              |

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Geographic breakdown of Southern Copper's sales is as follows:

|   | (in millions)                       |                   |                                    |                   |
|---|-------------------------------------|-------------------|------------------------------------|-------------------|
|   | Three Months<br>Ended September 30, |                   | Nine Months<br>Ended September 30, |                   |
|   | 2007                                | 2006              | 2007                               | 2006              |
| United States                             | \$ 455.4                            | \$ 494.0          | \$ 1,359.4                         | \$ 1,355.8        |
| Europe                                    | 467.2                               | 424.3             | 1,093.9                            | 1,182.1           |
| Mexico                                    | 237.2                               | 245.2             | 971.7                              | 776.4             |
| Peru                                      | 50.7                                | 18.4              | 103.1                              | 73.9              |
| Latin America (excluding Mexico and Peru) | 327.4                               | 159.7             | 762.9                              | 449.2             |
| Australia                                 |                                     | 1.0               |                                    | 1.0               |
| Asia                                      | 68.8                                | 99.9              | 497.2                              | 260.1             |
| Derivative instruments                    | (0.3)                               | (30.3)            | 3.0                                | (288.2)           |
| <b>Total</b>                              | <b>\$ 1,606.4</b>                   | <b>\$ 1,412.2</b> | <b>\$ 4,791.2</b>                  | <b>\$ 3,810.3</b> |

### Major Customer Segment Information:

For the nine months ended September 30, 2007, the Company had revenue from two copper customers of the Mexican and Peruvian operations, which amounted to 21.8% of total revenue; revenues from one of these customers amounted to 14.0% of total revenue. In addition, the Company had revenue from two molybdenum customers of the Peruvian and Mexican operations, which amounted to 13.0% of total revenues; these customers represent 80.0% of the Company's molybdenum sales value.

For the nine months ended September 30, 2006, the Company had revenue from two copper customers of the Mexican and Peruvian operations, which amounted to 17.7% of total revenue; revenues from one of these customers amounted to 12.5% of total revenue. In addition, the Company had revenue from two molybdenum customers of the Peruvian and Mexican operations, which amounted to 6.1% of total revenues; these customers represent 67.0% of the Company's molybdenum sales value.

### O. Impact of New Accounting standards:

In February 2007 the FASB published SFAS No. 159, *The Fair Value Option for Financial Assets and Financial liabilities*. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the Board's long-term measurement objectives for accounting for financial instruments.

This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This Statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. This Statement does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. This Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, *Fair Value Measurements*, and No. 107, *Disclosures about Fair Value of Financial Instruments*.



SFAS No. 159 will be effective for all the companies after the beginning of a reporting entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact of this statement will have on its financial position or results of operations.

In September 2006 the FASB published SFAS No. 157 Fair Value Measurements, which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 establishes a common definition of fair value provides a framework for measuring fair value under U.S. GAAP and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact, if any; the adoption of SFAS No. 157 will have on our financial reporting and disclosures.

P. Stockholders Equity:

Treasury Stock:

Activity in treasury stock in the nine month period ended September 30, 2007 is as follows (in millions):

|  |    |       |
|--|----|-------|
| Southern Copper common shares                                      |    |       |
| Balance as of December 31, 2006                                    | \$ | 4.4   |
| Purchase of shares   |    |       |
| Used for corporate purposes  |    | (0.1) |
| Balance as of September 30, 2007                                   |    | 4.3   |
| Parent Company (Grupo Mexico) common shares                        |    |       |
| Balance as of December 31, 2006                                    |    | 92.6  |
| Other activity, including interest and currency translation effect |    | 26.5  |
| Balance as of September 30, 2007                                   |    | 119.1 |
| Treasury stock balance as of September 30, 2007                    | \$ | 123.4 |

In the first nine months of 2007, the Company distributed 4,400 shares of Southern Copper to directors under the Directors' Stock Award Plan.

In the first nine months of 2007 the Company awarded 4.7 million shares of Grupo Mexico under the employee stock purchase plan.

Directors Stock Award Plan:

The Company established a stock award compensation plan for certain directors who are not compensated as employees of the Company. Under this plan, participants will receive 400 shares of common stock upon election and 400 additional shares following each annual meeting of stockholders thereafter. 200,000 shares of Southern Copper common stock have been reserved for this plan. At September 30, 2007 and 2006, 72,000 and 67,200 shares, respectively, have been granted under this plan. The fair value of the award is measured each year at the date of the



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grant. For the nine months ended September 30, 2007 and 2006, the stock based compensation expense under this plan equaled \$0.4 million and \$0.3 million, respectively.

Employee Stock Purchase Plan:

In January 2007, the Company offered to eligible employees a stock purchase plan (the Employee Stock Purchase Plan ) through a trust that acquires shares of Grupo

Mexico stock for sale to its employees, and employees of subsidiaries, and certain affiliated companies. The purchase price is established at the approximate fair market value on the grant date. Every two years employees will be able to acquire title to 50% of the shares paid in the previous two years. The employees will pay for shares purchased through monthly payroll deductions over the eight year period of the plan. At the end of the eight year period, the Company will grant the participant a bonus of 1 share for every 10 shares purchased by the employee.

If Grupo Mexico pays dividends on shares during the eight year period, the participants will be entitled to receive the dividend in cash for all shares that have been fully purchased and paid as of the date that the dividend is paid. If the participant has only partially paid for shares, the entitled dividends will be used to reduce the remaining liability owed for purchased shares.

In the case of voluntary resignation of the employee, the Company will pay to the employee the difference between the fair market value of the shares at the date of termination of employment, and the purchase price. When the fair market value of the shares is higher than the purchase price, the Company will apply a deduction over the amount to be paid to the employee based on the following schedule.

| <b>If the resignation occurs during:</b> | <b>% Deducted</b> |
|--|-------------------|
| 1st year after the grant date            | 90%               |
| 2nd year after the grant date            | 80%               |
| 3rd year after the grant date            | 70%               |
| 4th year after the grant date            | 60%               |
| 5th year after the grant date            | 50%               |
| 6th year after the grant date            | 40%               |
| 7th year after the grant date            | 20%               |

In the case of involuntary termination of the employee, the Company will pay to the employee the difference between the fair market value of the shares at the date of termination of employment, and the purchase price. When the fair market value of the shares is higher than the purchase price, the Company will apply a deduction over the amount to be paid to the employee based on the following schedule.

| <b>If the termination occurs during:</b> | <b>% Deducted</b> |
|--|-------------------|
| 1st year after the grant date            | 100%              |
| 2nd year after the grant date            | 95%               |
| 3rd year after the grant date            | 90%               |
| 4th year after the grant date            | 80%               |
| 5th year after the grant date            | 70%               |
| 6th year after the grant date            | 60%               |
| 7th year after the grant date            | 50%               |

In case of retirement or death of the employee, the Company will render the buyer or his legal beneficiary, the shares effectively paid as of the date of retirement or death.

For the nine months ended September 30, 2007, the stock based compensation expenses under this plan was \$1.5 million. As of September 30, 2007, there was \$15.5 million of unrecognized compensation expenses under this plan, which is expected to be recognized over a period of 8 years.

The following table presents the stock award activity for the nine months ended September 30, 2007:

|  | Shares    |    | Unit Weighted<br>Average Grant<br>Date Fair Value |
|--|-----------|----|---|
| Outstanding shares at January 1, 2007    |           |    |   |
| Granted                                  | 4,714,698 | \$ | 3.50  |
| Exercised                                |           |    |   |
| Forfeited                                |           |    |   |
| Outstanding shares at September 30, 2007 | 4,714,698 | \$ | 3.50  |

Executive Stock Purchase Plan:

Grupo Mexico also offers a stock purchase plan for certain members of its executive management and the executive management of its subsidiaries and certain affiliated companies. Under this plan, participants will receive incentive cash bonuses which are used to purchase up to 750,000 shares of Grupo Mexico over an eight year period. The fair value of the award is estimated on the date of grant and is recognized as compensation expense over a weighted average requisite service period of eight years. The Company recorded \$0.5 million, net of tax, in compensation expense in the first nine months of 2007. As of September 30, 2007, there was \$3.2 million of unrecognized compensation cost, related to this plan, which is expected to be recognized over a weighted average period of eight years.

The following table presents the stock award activity for the nine months ended September 30, 2007:

|  | Shares    |    | Unit Weighted<br>Average Grant<br>Date Fair Value |
|--|-----------|----|---|
| Outstanding shares at January 1, 2007    | 750,000   | \$ | 2.30  |
| Granted                                  |           |    |   |
| Exercised                                | (217,500) |    | 2.30  |
| Forfeited                                |           |    |   |
| Outstanding shares at September 30, 2007 | 532,500   | \$ | 2.30  |

Q. Subsequent events:

On October 18, 2007 the Board of Directors approved a quarterly dividend of \$2.00 per share, totaling \$588.9 million, to be paid on November 27, 2007 to shareholders of record as of November 7, 2007.

Part I Item 2 and 3.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

EXECUTIVE OVERVIEW

Our business is primarily the production and sale of copper. In the process of producing copper, a number of valuable metallurgical by-products are recovered, such as molybdenum, zinc, silver, lead and gold, which we also produce and sell. Market forces outside of our control largely determine the sales prices for our products. Our management, therefore, focuses on copper production cost control, production enhancement and maintaining a prudent and conservative capital structure to improve profitability. We believe we achieve these goals through capital spending programs, exploration efforts and cost reduction programs. Our aim is to remain profitable during periods of low copper prices and to maximize financial performance in periods of high copper prices.

Our net income and earnings per share for the three months ended September 30, 2007 and 2006 were \$627.8 million and \$2.13 per share and \$521.6 million and \$1.77 per share, respectively. Net income and earnings per share for the nine months ended September 30, 2007 and 2006 were \$1,905.5 million and \$6.47 per share and were \$1,382.4 million and \$4.69 per share, respectively. The increase in net earnings in the third quarter period was due principally to the higher sales volume and the higher sales price for molybdenum. The increase in net earnings in the nine month period of 2007 was favorably impacted by higher prices for copper and all of our principal byproducts, as well as, higher copper and molybdenum sales volume. Also losses on copper and zinc derivatives, included in net sales, amounted to \$288.0 million and \$0.2 million, respectively, in the 2006 nine-month period, the comparable 2007 period included a gain on copper derivatives of \$3.0 million. In addition, the nine months ended September 30, 2007, included a loss on derivative instruments of \$73.7 million, principally related to losses on marketable securities. Strike activity at some of our Mexican operations reduced sales volumes in 2007 and 2006. However, we believe that this strike activity in 2007 will not result in an impairment of our assets.

We discuss below several matters that we believe are important to understand our results of operations and financial condition. These matters include, (i) our operating cash costs as a measure of our performance, (ii) metal prices, (iii) business segments, (iv) the effects of inflation and other local currency issues, (v) our expansion and modernization program and (vi) our community relations and environmental protection programs. This discussion should be read in conjunction with the management discussion and analysis of financial condition and results of operations at December 31, 2006 included in the Company's 2006 annual report on Form 10-K.

Operating Cash Costs: An overall benchmark used by us and a common industry metric to measure performance is operating cash costs per pound of copper produced. Operating cash cost is a non-GAAP measure that does not have a standardized meaning and may not be comparable to similarly titled measures provided by other companies. A reconciliation of our operating cash cost per pound to the cost of sales (including depreciation, amortization and depletion) as presented in the statement of earnings, is presented under the subheading Non-GAAP Information Reconciliation, below. We have defined operating cash cost per pound as cost of sales (including depreciation, amortization and depletion); plus selling, general and administrative charges, treatment and refining charges; less byproducts revenue and sales premiums, depreciation, amortization and depletion, workers' participation and other miscellaneous charges, the Peruvian royalty charge and the change in inventory levels; divided by total pounds of copper produced and purchased by us. In our calculation of operating cash cost per pound of copper produced, we

credit against our costs the

revenues from the sale of byproducts, principally molybdenum, zinc and silver and the premiums over market price that we receive on copper sales. We account for the byproduct revenue in this way because we consider our principal business to be the production and sale of copper. We believe that our Company is viewed by the investment community as a copper company, and is valued, in large part, by the investment community's view of the copper market and our ability to produce copper at a reasonable cost. We also include copper sales premiums as a credit, as these amounts are in excess of published copper prices. The increase in recent years in the price of molybdenum has had a significant effect on our traditional calculation of cash cost and its comparability between periods. Accordingly, we present cash costs with and without crediting the byproducts revenues against our costs.

We exclude from our calculation of operating cash cost depreciation, amortization and depletion, which are considered non-cash expenses. Exploration is considered a discretionary expenditure and is also excluded. Workers' participation provisions are determined on the basis of pre-tax earnings and are also excluded. Additionally excluded from operating cash cost are items of a non-recurring nature, and the Peruvian royalty.

Our operating cash costs per pound, as defined, are presented in the table below, for the three and nine months ended September 30, 2007 and 2006. We present cash costs with and without the inclusion of by-product revenues.

|  | Three Months<br>Ended September 30, |       | Nine Months<br>Ended September 30, |       |
|--|-------------------------------------|-------|------------------------------------|-------|
|  | 2007                                | 2006  | 2007                               | 2006  |
|  | (in cents per pound)                |       |                                    |       |
| Cash cost per pound of copper produced and purchased                             | (18.2)                              | 38.2  | (13.8)                             | 32.9  |
| Cash cost per pound of copper produced and purchased without by-products revenue | 155.1                               | 142.2 | 135.3                              | 135.4 |

As seen on the chart above, our per pound cash cost for the third quarter and nine months of 2007 when calculated with by-products revenue is a credit of 18.2 cents and 13.8 cents, respectively, compared with a cost of 38.2 cents and 32.9 cents in the third quarter and nine months of 2006, respectively. The increase in the byproducts credit in both 2007 periods was due to higher prices for molybdenum and silver, as well as the higher production and sale of molybdenum in both periods. The increased molybdenum production was the result of higher ore grades and recoveries at our Peruvian mines and increased production at La Caridad in Mexico, which was disrupted by strikes in 2006. Zinc production, however, was lower in both 2007 periods when compared to the 2006 periods, due to strikes in the Taxco and San Martin mines in Mexico and lower throughput and ore grades in Charcas. See page 41 for the average metal prices for these periods.

Our cash cost, excluding by-product revenues, was higher by 12.9 cents per pound in the third quarter of 2007 than the comparable 2006 period and is mainly due to the lower copper production at Cananea due to the work stoppage that began on July 30, 2007 and continues in the fourth quarter.

Metal Prices. The profitability of our operations is dependent on, and our financial performance is significantly affected by, the international market prices for the products we produce, especially for copper, molybdenum, zinc and silver. Metals prices historically have been subject to wide fluctuations and are affected by numerous factors beyond our control. These factors, which affect each commodity to varying degrees, include international economic and political conditions, levels of supply and demand, the availability and cost of substitutes, inventory levels maintained by





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producers and others and, to a lesser degree, inventory carrying costs and currency exchange rates. In addition, the market prices of certain metals have on occasion been subject to rapid short-term changes due to speculative activities.

We are subject to market risks arising from the volatility of copper and other metal prices. Assuming that expected metal production and sales are achieved, that tax rates are unchanged, giving no effect to potential hedging programs, metal price sensitivity factors would indicate the following change in estimated 2007 earnings resulting from metal price changes:

|   | Copper |      | Molybdenum |      | Zinc |      | Silver |      |
|---|--------|------|------------|------|------|------|--------|------|
| Change in metal prices (per pound, except silver - per ounce) | \$     | 0.01 | \$         | 1.00 | \$   | 0.01 | \$     | 1.00 |
| Annual change in net earnings (in millions)                   | \$     | 7.9  | \$         | 20.2 | \$   | 1.7  | \$     | 10.5 |

Business segments.

Our Company operates in a single industry, the copper industry. With the acquisition of Minera Mexico in April 2005, we determined that to effectively manage our business we needed to focus on three segments. These segments are our Peruvian operations, our Mexican open-pit operations and our Mexican underground operations, known as our IMMSA unit. Our Peruvian operations include the Toquepala and Cuajone mine complexes and the smelting and refining plants, industrial railroad and port facilities which service both mines. Our Mexican open-pit operations include La Caridad and Cananea mine complexes, the smelting and refining plants and support facilities which service both mines. Our IMMSA unit includes five underground mines that produce zinc, lead, copper, silver and gold, a coal and coke mine, and several industrial processing facilities for zinc, copper and silver.

Segment information is included in our review of Results of Operations and also in Note N of our Condensed Consolidated Financial Statements.

Inflation and Devaluation of the Peruvian Nuevo Sol and the Mexican Peso. Our functional currency is the U.S. dollar. Portions of our operating costs are denominated in Peruvian nuevos soles and Mexican pesos. Since our revenues are primarily denominated in U.S. dollars, when inflation/deflation in Peru or Mexico is not offset by a change in the exchange rate of the nuevo sol or the peso, respectively, to the dollar, our financial position, results of operations and cash flows could be adversely affected in our wage adjustments. In addition, the dollar value of our net monetary assets denominated in nuevos soles or pesos can be affected by devaluation of the nuevo sol or the peso, resulting in a remeasurement loss in our financial statements.

For the three and nine months ended September 30, 2007 and 2006, inflation and devaluation rates were as follows:

|                | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|----------------|-------------------------------------|------|------------------------------------|------|
|                | 2007                                | 2006 | 2007                               | 2006 |
| Peru:          |                                     |      |                                    |      |
| Inflation rate | 1.2%                                | 0.0% | 3.0%                               | 1.4% |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Nuevo sol/dollar (appreciation) / devaluation rate | (2.6)% | (0.3)% | (3.4)% | (5.3)% |
| Mexico:  |        |        |        |        |
| Inflation rate                                     | 1.6%   | 1.8%   | 2.2%   | 2.5%   |
| Peso/dollar (appreciation) / devaluation rate      | 1.2%   | (3.1)% | 0.4%   | 3.2%   |

Expansion and Modernization Program.

The Ilo smelter modernization project was completed in January 2007. Xstrata, the Isasmelt technology supplier, noted that the ramp up of this facility by SCC has been a world class accomplishment for a brownfield smelter modernization. There are still some unresolved technical issues that needed to be worked through before the performance test can be completed and we can receive the necessary warranties from our two major contractors. The concentrate throughput during September was 92,560 and a daily smelting record was reached on September 30, with 3,825 tons of concentrates smelted. Also, the sulfur capture during the third quarter was over the 92% required by Peruvian regulations. Additionally, the Company's crushing and conveying project at the Toquepala mine is in full production. The primary crusher and associated overland conveying system are fully operational. This overland conveying system has allowed us to move 58.4 million tons of material to the dams. The sedimentation, PLS and storm water retention dams and associated facilities at Toquepala are in operation since July, 2007.

As a result of the unstable labor situation at some of our Mexican properties, our Board of Directors have decided to suspend indefinitely previously announced expansion projects at the Cananea and Guaymas (Sonora), Mexico, consisting of the following projects: the Cananea SX/EW III, the Cananea concentrator expansion, the Cananea molybdenum circuit, the Buena Vista mine, the new Cananea concentrator, and the Guaymas smelter and refinery. These projects had a total investment budget of \$2,256 million.

Additionally, the Company's Board of Directors approved a new investment program to replace the suspended projects by authorizing the development of the following projects in Peru: the Tia Maria SX/EW copper project, the Toquepala concentrator expansion, the Cuajone concentrator expansion crusher conveyor for leach project, the Ilo smelter expansion and the Ilo copper refinery expansion, with a total investment of \$2,108 million. This investment will permit the Company to increase its copper production by 270,000 tons per year by 2011, which represents 39% of the current production level. In January 2007, the Company had considered a plan to develop these projects at a later date, as a second stage of its investment plan.

Regarding the Company's exploration activities, the pre-feasibility study at Los Chancas, a copper-molybdenum property in southern Peru was finished and is under evaluation in order to define the next step. Additionally, a feasibility study for Tia Maria, a copper oxide deposit in the department of Arequipa, Peru is almost completed and will be analyzed. The Environmental Impact Assessment (EIA) for this project is underway. In addition to these Peruvian properties, we are planning to develop our Mexican properties at El Arco in Baja California and Angangueo in Michoacan.

Community relations and environmental protection programs

Because of the physical nature of mining activities, we find it imperative in our business to work in harmony with our neighbors and the environment. Accordingly, our Company works to build and maintain a mutually beneficial relationship in the Mexican and Peruvian communities in which it operates. We co-participate with the local governments in the development of projects for improving education, health care, schools and secondary infrastructure, health programs, cultural and sports activities. We provide education to 3,713 students in our schools and we have established a program, with a trust, that funds more than 200 scholarships in Mexico and Peru. In 2007, we will invest \$27 million in social programs.

We have environmental protection programs in each of our operating units, in conformity with the environmental legislation and we have implemented an environmental management system to meet the requirements of the ISO-14001. In Mexico, SEMARNAT, the governmental



environmental agency, has awarded the Certificate of Clean Industry to five of our operating facilities that have complied with the environmental audits: Santa Barbara mines, Chihuahua; SXEW plant, precious metal plant and the rod plant, Sonora; and the gas pipeline. Our Peruvian operations have completed the 10-year environmental program known as the PAMA with a total investment of \$580 million. Our Mexican subsidiary is a leader company in Mexico's reforestation program and maintains and operates three tree nurseries with a capacity of 1,731,000 trees per year.

## ACCOUNTING ESTIMATES

Our discussion and analysis of financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with US GAAP. Preparation of these condensed consolidated financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Management makes its best estimate of the ultimate outcome for these items based on historical trends and other information available when the financial statements are prepared. Changes in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Areas where the nature of the estimate makes it reasonably possible that actual results could materially differ from amounts estimated include: ore reserves, revenue recognition, estimated mine stripping ratios, leachable material and related amortization, the estimated useful lives of fixed assets, asset retirement obligations, litigation and contingencies, valuation allowances for deferred tax assets, tax positions, fair value of financial instruments and inventory obsolescence. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

## RESULTS OF OPERATIONS

The following highlights key financial and operating results for three and nine months ended September 30, 2007 and 2006:

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2007                                | 2006       | 2007                               | 2006       |
| (dollars in millions)                       |                                     |            |                                    |            |
| <b>Statement of Earnings Data</b>           |                                     |            |                                    |            |
| Net sales                                   | \$ 1,606.4                          | \$ 1,412.2 | \$ 4,791.2                         | \$ 3,810.3 |
| Operating costs and expenses                | (672.6)                             | (607.7)    | (1,924.8)                          | (1,724.2)  |
| Operating income                            | 933.8                               | 804.5      | 2,866.4                            | 2,086.1    |
| Non-operating income (expense)              | (6.7)                               | (8.2)      | (72.1)                             | (17.4)     |
| Earnings before taxes and minority interest | 927.1                               | 796.3      | 2,794.3                            | 2,068.7    |
| Income taxes                                | (296.1)                             | (271.9)    | (881.2)                            | (679.7)    |
| Minority interest                           | (3.2)                               | (2.8)      | (7.6)                              | (6.6)      |
| Net earnings                                | \$ 627.8                            | \$ 521.6   | \$ 1,905.5                         | \$ 1,382.4 |

Mine copper production amounted to 303.9 million pounds in the third quarter of 2007, a decrease of 2.4% compared with the third quarter of 2006. This decrease amounting to 7.6 million pounds, included 11.0 million pounds from the Mexican open pit operations,



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2.4 million pounds from the Mexican underground mines and an increase of 5.8 million pounds from the Peruvian open pit mines.

The decrease of 11.0 million pounds in production from the Mexican open-pit mines included 53.7 million pounds from the Cananea mine net of an increase of 42.7 million pounds from the La Caridad mine. The decrease at the Cananea mine was result of a work stoppage that began on July 30, 2007 and continued into the fourth quarter, while the La Caridad mine operated at normal capacity. In 2006, the Cananea mine operated at normal capacity while La Caridad mine was on a work stoppage through July 26, 2006. The decrease of 2.4 million pounds at the Mexican underground mines was due to the work stoppage at the San Martin mine. The increased production at the Peruvian mines came principally from the Cuajone mine, which increased by 5.0 million pounds, and was the result of higher ore grades and from a 2.3 million pound increase in the SX/EW production, principally due to the processing of copper sulfate purchased from third parties, partially reduced by a decrease of 1.5 million pound in the production from the Toquepala mine, the result of lower ore grades.

Molybdenum production increased to 9.7 million pounds in the third quarter of 2007 from 5.1 million pounds in the third quarter of 2006. This increase in production was the result of 2.4 million pounds of higher strike-free production at La Caridad and an increase of 2.2 million pounds in the production from our Peruvian operations due to higher grades and recoveries in both mines.

Mine zinc production decreased 16.5 million pounds in the third quarter of 2007 to 64.6 million pounds compared with 81.1 million pounds in the third quarter of 2006. This 20.3% decrease in production was due to the work stoppages at San Martin and Taxco mines and lower throughput and ore grade in Charcas.

The table below outlines the average metal prices during the three and nine months periods ended September 30, 2007 and 2006:

### Average Metal Prices

|                               | Three Months Ended<br>September 30, |          |          | Nine Months Ended<br>September 30, |          |          |
|-------------------------------|-------------------------------------|----------|----------|------------------------------------|----------|----------|
|                               | 2007                                | 2006     | % Change | 2007                               | 2006     | % Change |
| Copper (\$ per pound - LME)   | \$ 3.50                             | \$ 3.48  | 0.6      | \$ 3.22                            | \$ 3.00  | 7.3      |
| Copper (\$ per pound - COMEX) | \$ 3.48                             | \$ 3.54  | (1.7)    | \$ 3.21                            | \$ 3.06  | 4.9      |
| Molybdenum (\$ per pound)     | \$ 31.33                            | \$ 25.94 | 20.8     | \$ 29.19                           | \$ 24.13 | 21.0     |
| Zinc (\$ per pound - LME)     | \$ 1.46                             | \$ 1.53  | (4.6)    | \$ 1.56                            | \$ 1.35  | 15.6     |
| Silver (\$ per ounce - COMEX) | \$ 12.70                            | \$ 11.65 | 9.0      | \$ 13.11                           | \$ 11.19 | 17.2     |

Net Sales. Net sales in the third quarter of 2007 increased \$194.2 million to \$1,606.4 million from \$1,412.2 million in the comparable period in 2006. The increase in net sales in the third quarter was the result of higher molybdenum and silver prices and higher molybdenum sales volume. Net sales in the first nine months of 2007 increased \$980.9 million to \$4,791.2 million from \$3,810.3 million in the comparable period in 2006. The increase in net sales in the nine month period was the result of higher metal prices and higher copper and molybdenum sales volumes. Net sales also include a loss of \$0.3 million and a gain of \$3.0 million on copper derivative instruments in the third quarter and nine months of 2007, respectively. Loss on copper and zinc derivative instruments decreased net sales by \$30.3 million and

\$288.2 million in the third quarter and the first nine months of 2006, respectively.

The table below presents information regarding the volume of our copper sales by segment for the three and nine months ended September 30, 2007 and 2006:



Copper Sales (million pounds):

|                          | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|--------------------------|-------------------------------------|--------|------------------------------------|--------|
|                          | 2007                                | 2006   | 2007                               | 2006   |
| <b>Copper:</b>           |                                     |        |                                    |        |
| Peruvian operations      | 219.9                               | 225.1  | 640.8                              | 620.6  |
| Mexican open-pit         | 105.9                               | 116.0  | 437.5                              | 420.5  |
| Mexican IMMSA unit       | 7.6                                 | 9.4    | 24.5                               | 28.4   |
| Intersegment elimination | (18.2)                              | (31.7) | (64.9)                             | (87.5) |
| Total copper sales       | 315.2                               | 318.8  | 1,037.9                            | 982.0  |

The table below presents information regarding the volume of sales by segment of our significant by-products for the three and nine months ended September 30, 2007 and 2006:

By-product Sales:

| (in million pounds except silver - in million ounces) | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|--------|------------------------------------|--------|
|   | 2007                                | 2006   | 2007                               | 2006   |
| <b>Peruvian operations</b>                            |                                     |        |                                    |        |
| Molybdenum contained in concentrates                  | 6.6                                 | 4.3    | 15.9                               | 15.2   |
| Zinc - refined and in concentrate                     | 8.9                                 | 15.9   | 32.1                               | 26.4   |
| Silver  | 1.5                                 | 1.2    | 3.6                                | 4.1    |
| <b>Mexican open-pit</b>                               |                                     |        |                                    |        |
| Molybdenum contained in concentrates                  | 2.5                                 | 0.1    | 10.3                               | 1.7    |
| Zinc - refined and in concentrate (1)                 |                                     | 6.0    |                                    | 15.4   |
| Silver  | 0.8                                 | 0.8    | 2.9                                | 3.4    |
| <b>Mexican IMMSA unit</b>                             |                                     |        |                                    |        |
| Zinc - refined and in concentrate                     | 57.3                                | 63.7   | 191.3                              | 198.0  |
| Silver  | 2.8                                 | 3.1    | 8.5                                | 9.0    |
| <b>Intersegment elimination</b>                       |                                     |        |                                    |        |
| Zinc - refined and in concentrate                     | (8.4)                               | (19.4) | (30.0)                             | (33.4) |
| Silver  | (0.2)                               | (0.2)  | (0.7)                              | (1.9)  |
| <b>Total by-product sales</b>                         |                                     |        |                                    |        |
| Molybdenum contained in concentrates                  | 9.1                                 | 4.4    | 26.2                               | 16.9   |
| Zinc - refined and in concentrate                     | 57.8                                | 66.2   | 193.4                              | 206.4  |
| Silver  | 4.9                                 | 4.9    | 14.3                               | 14.6   |

(1) Through 2006, the Mexican open pit operations purchased zinc products from IMMSA for resale to its customers. This practice was discontinued in 2006 and IMMSA's zinc sales were either to their customers or to the Peruvian segment, who in turn resold to their customers.

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At September 30, 2007, the Company has recorded provisionally priced sales of 204.7 million pounds of copper, at an average forward price of \$3.64 per pound. Also the Company has recorded provisionally priced sales of 6.1 million pounds of molybdenum at the September 30, 2007 market price of \$31.35 per pound. These sales are subject to final pricing based on the average monthly LME or COMEX copper prices and Dealer Oxide molybdenum prices in the future month of settlement, which will occur largely in the next seven months.

Management believes that the final pricing of these sales will not have a material effect on the Company's financial position or results of operations.

Operating Costs and Expenses. Operating costs and expenses were \$672.6 million in the third quarter of 2007 compared with \$607.7 million in the third quarter of 2006. The increase of \$64.9 million was principally due to higher cost of sales (exclusive of depreciation, amortization and depletion) and higher depreciation, amortization and depletion.

Cost of sales (exclusive of depreciation, amortization and depletion) for the three months ended September 30, 2007 was \$559.8 million compared with \$509.2 million in the comparable 2006 period. The increase in cost of sales of \$50.6 million in the third quarter 2007 was principally due to \$56.3 million of higher production cost due to increase in power, fuel, tires and material repair offset by \$66.6 million of lower metal purchased from third parties. Additionally, cost of sales was higher due to \$17.9 million of higher workers' participation, \$21.4 million of inventory consumption and \$8.2 million of higher freight and shipping expenses, mainly due to the sale of copper concentrates.

Operating costs and expenses were \$1,924.8 million in the first nine months of 2007 compared with \$1,724.2 million in the first nine months of 2006. Cost of sales (exclusive of depreciation, amortization and depletion) for the nine months ended September 30, 2007 was \$1,588.8 million compared with \$1,438.0 million in the comparable 2006 period.

The increase in cost of sales in the nine-month 2007 period is principally due to \$124.5 million of higher production cost as a consequence of the higher strike-free production at our La Caridad operations offset by a reduction of \$158.3 million in purchases of copper concentrates on the open market made in 2006 due to the strike activities. Other factors increasing cost of sales include an increase in workers' participation of \$55.2 million, an exchange loss of \$10.1 million mainly due to the appreciation of the Mexican peso, a consumption of initial inventory of \$54.7 million and \$30.8 million of higher freight and shipping expenses, mainly due to the sale of copper concentrates.

Depreciation, amortization and depletion for the three months and nine months ended September 30, 2007, were \$81.5 million and \$240.1 million, respectively compared with \$67.8 million and \$198.9 million in the comparable periods of 2006. The increases of \$13.7 million and \$41.2 million are mainly attributable to higher depreciation in our Peruvian operations due to the start-up of the modernized Ilo smelter and higher amortization of capitalized leachable material in our Mexican open pit operations.

Non-Operating Income (Expense): Interest expense in the third quarter and the first nine months of 2007 were approximately 1.3% lower and 11.2% higher, respectively, than the comparable 2006 periods. These variations are mainly result of the changes in average debt levels between the periods.

Interest income was \$23.5 million and \$63.5 million in the third quarter and first nine months of 2007, compared to \$10.8 million and \$34.5 million in the third quarter and first nine months of 2006. These increases were principally the result of higher cash balances in the periods and higher rates of interest earned.

The gain on derivative instruments was \$3.0 million in the third quarter and a loss of \$73.7 million in the first nine months of 2007. These amounts consist of the following (in millions):



|  | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|--|-------------------------------------|------|------------------------------------|------|
|  | 2007                                | 2006 | 2007                               | 2006 |
| Gain (loss) on marketable securities (1)                         | \$ 1.6                              | \$   | \$ (79.9)                          | \$   |
| Loss on dual currency notes                                      |                                     |      | (1.3)                              |      |
| Gain on exchange rate derivatives, U.S. dollar /<br>Mexican peso | 1.4                                 |      | 7.5                                |      |
| Net loss   | \$ 3.0                              | \$   | \$ (73.7)                          | \$   |

(1) The amount of the realized loss was \$43.2 million on investments of \$60.0 million which matured in June 2007; the unrealized portion is \$48.3 million. These unrealized losses are recorded in other accounts payable in the condensed consolidated balance sheet. A loss on these investments of \$11.6 million was recorded in the fourth quarter 2006 results.

For additional information please see Note C, Marketable securities and Note H, Derivative instruments to the Condensed Consolidated Financial Statements.

Other income (expense) was an expense of \$5.7 million and an income of \$20.0 million in the third quarter and first nine months of 2007, respectively, compared to incomes of \$5.3 million and \$12.8 million in the third quarter and first nine months of 2006. The decrease in the third quarter of 2007 was principally due to \$6.2 million of the Peruvian contribution to the regional development. The increase in the nine months period was due to lower consultant fees and lower cost of disposal of assets.

Income taxes: The income tax for the nine months ended September 30, 2007 and 2006 was \$881.2 million and \$679.7 million, respectively. These amounts include income taxes for Peru, Mexico and the United States. The effective tax rates for the 2007 and 2006 periods are 31.5% and 32.9%, respectively. A decrease of 1% in the statutory Mexican tax rate contributed to the decrease in the 2007 effective income tax rate. In addition, a tax inflation adjustment and the effect of currency conversion adjustment in our Mexican operations also contributed to the reduction in the effective tax rate.

On October 1, 2007, the Mexican government enacted a new law, which generally takes effect on January 1, 2008. The law introduces a flat tax, which replaces Mexico's asset tax and will apply to taxpaying entities along with Mexico's regular income tax. This new law will not generate additional current tax liabilities unless our Mexican subsidiaries report annual net loss positions. For purposes of deferred tax accounting under FAS No. 109, we will calculate the impact of this new law in the fourth quarter of 2007 and record the effect, if any, in our fourth quarter financial statements.

#### Segment Results Analysis

#### Peruvian Open Pit Operations

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The following table sets forth net sales, operating cost and expenses and operating income for our Peruvian open pit operations segment, for the three and nine months ended September 30, 2007 and 2006:

|                              | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |            |
|------------------------------|-------------------------------------|----------|------------------------------------|------------|
|                              | 2007                                | 2006     | 2007                               | 2006       |
|                              | (in millions)                       |          |                                    |            |
| Net sales                    | \$ 1,028.8                          | \$ 918.0 | \$ 2,698.8                         | \$ 2,320.5 |
| Operating costs and expenses | (414.3)                             | (376.4)  | (1,158.5)                          | (995.3)    |
| Operating income             | \$ 614.5                            | \$ 541.6 | \$ 1,540.3                         | \$ 1,325.2 |

Net sales in the third quarter 2007 increased \$110.8 million to \$1,028.8 million from \$918.0 million in the comparable period of 2006. The increase in net sales is principally the result of higher molybdenum price and sales volume due to higher production. Net sales in the first nine months of 2007 increased \$378.3 million to \$2,698.8 million from \$2,320.5 million in the first nine months of 2006. The increase in net sales is principally the result of higher metals prices and higher copper, zinc and molybdenum sales volume. The third quarter and first nine months periods of 2007 include a loss on copper derivatives of \$0.2 million and a gain of \$1.5 million, respectively, compared with losses of \$29.8 million and \$168.2 million in the third quarter and first nine months of 2006.

Operating costs and expenses in the third quarter of 2007 increased by \$37.9 million to \$414.3 million from 376.4 million in the first nine months of 2006, principally due to higher cost of sales and higher depreciation, amortization and depletion. Cost of sales (exclusive of depreciation, amortization and depletion) for the three months ended September 30, 2007 was \$373.8 million compared to \$343.9 million in the same period of 2006. The increase in cost of sales includes principally, \$12.2 million of higher production cost due to increases in salaries, power, explosives, tires and other operating material offset by \$17.1 million of lower metal purchased mainly rod and zinc from our Mexican operations. Cost of sales also increased by \$9.3 million of higher workers participation, \$8.0 million of higher freight and shipping expenses, due largely to the sale of concentrates; \$5.7 million of exchange loss due to appreciation of the nuevo sol and \$9.9 million of inventory consumption. Depreciation, amortization and depletion for the three months ended September 30, 2007 was \$27.4 million compared to \$21.1 million in the same period of 2006. The increase of \$6.3 million in depreciation, amortization and depletion is due to the depreciation of the newly completed Ilo smelter modernization project and the depreciation of other new investments.

Operating costs and expenses in the first nine months of 2007 increased by \$163.2 million to \$1,158.5 million from \$995.3 million in the first nine months of 2006, principally due to higher cost of sales and higher depreciation, amortization and depletion. Cost of sales (exclusive of depreciation, amortization and depletion) for the nine months ended September 30, 2007 was \$1,036.2 million compared to \$898.1 million in the same period of 2006. The increase of \$138.1 million in cost of sales includes mainly \$60.0 million of higher metals purchased mainly to our Mexican operations, \$18.4 million of higher production cost due to increases in salaries, power and other operating material, \$18.4 million of higher workers participation, \$10.6 million of inventory consumption and \$29.3 million of higher freight and shipping expenses due to the sale of concentrates. The increase of \$19.5 million in depreciation, amortization and depletion is due the depreciation of the newly completed Ilo smelter modernization project and the depreciation of other new capital additions.

#### Mexican Open Pit Operations

The following table sets forth net sales, operating cost and expenses and operating income for our Mexican open pit operations segment for the three and nine months periods ended September 30, 2007 and 2006:

|                              | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |            |
|------------------------------|-------------------------------------|----------|------------------------------------|------------|
|                              | 2007                                | 2006     | 2007                               | 2006       |
|                              | (in millions)                       |          |                                    |            |
| Net sales                    | \$ 481.3                            | \$ 454.5 | \$ 1,831.2                         | \$ 1,339.6 |
| Operating costs and expenses | (224.0)                             | (288.3)  | (732.2)                            | (766.7)    |
| Operating income             | \$ 257.3                            | \$ 166.2 | \$ 1,099.0                         | \$ 572.9   |

Net sales in the third quarter of 2007 increased \$26.8 million to \$481.3 million from \$454.5 million in the third quarter of 2006. Net sales in the first nine months of 2007 increased \$491.6 million to \$1,831.2 million from \$1,339.6 million in the first nine months of 2006. The increase in net sales in both periods is mainly due to higher metal prices. In addition, net sales in the third quarter and nine months of 2007 were improved by higher molybdenum sales volume due to a free-strike production at La Caridad mine, the nine month period also was improved for higher copper sales value which was reduced in the third quarter due to a strike at Cananea mine, which began on July 30, 2007 and continues into the fourth quarter of 2007. In addition, the net sales for the 2007 third quarter includes a loss on copper derivative of \$0.2 million compared with a loss on copper and zinc derivatives of \$0.2 million and \$0.2 million, respectively, in the third quarter of 2006 and the nine months of 2007 included a gain on copper derivatives of \$1.5 million compared with a loss of copper and zinc derivatives of \$119.8 million and \$0.2 million, respectively, in the comparable period of 2006.

Operating costs and expenses in the third quarter of 2007 decreased by \$64.3 million to \$224.0 million from \$288.3 million in the third quarter of 2006, principally due to lower cost of sales. Cost of sales (exclusive of depreciation, amortization and depletion) decreased \$68.7 million to \$171.3 million from \$240.0 million in 2006. The decrease in cost of sales was mainly due to the decrease of \$117.2 million of copper purchased from third parties; net of \$45.7 million of higher production cost mainly in power, fuel, tires, explosives and operating material and \$10.8 million of higher workers participation.

Operating costs and expenses in the first nine months of 2007 decreased by \$34.5 million to \$732.2 million from \$766.7 million in the nine months of 2006, mainly due to \$55.7 million of lower cost of sales (exclusive of depreciation, amortization and depletion) and \$14.4 million of higher depreciation, amortization and depletion. Cost of sales (exclusive of depreciation, amortization and depletion) decreased \$55.7 million to \$569.0 million from \$624.7 million in 2006. The decrease in cost of sales was principally due to \$258.9 million of lower metal purchased from third parties, partially offset by higher production cost of \$85.9 million due to a strike-free production in the first half of the year, \$71.9 million of inventory consumption and \$32.1 million of higher workers participation. The increase in depreciation, amortization and depletion is mainly due to the amortization of capitalized leach material.

#### Mexican Underground Operations (IMMSA)

The following table sets forth net sales, operating cost and expenses and operating income for our IMMSA segment, for the three and nine months periods ended September 30, 2007 and 2006:

|                              | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                              | 2007                                | 2006     | 2007                               | 2006     |
|                              | (in millions)                       |          |                                    |          |
| Net sales                    | \$ 178.5                            | \$ 189.3 | \$ 542.8                           | \$ 484.8 |
| Operating costs and expenses | (114.7)                             | (112.4)  | (321.3)                            | (300.2)  |
| Operating income             | \$ 63.8                             | \$ 76.9  | \$ 221.5                           | \$ 184.6 |

Net sales in the third quarter 2007 decreased \$10.8 million to \$178.5 million from \$189.3 million in the comparable period of 2006. Net sales in the first nine months of 2007 increased \$58.0 million to \$542.8 million from \$484.8 million in the comparable period. The decrease in net sales in the third quarter 2007 was caused by the strikes at San Martin and Taxco mines which lowered 2007 third quarter output and sales. The increase in net sales in the nine month period was principally due to higher market prices despite the lower sales volume.





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Operating costs and expenses in the third quarter of 2007 increased by \$2.3 million to \$114.7 million from \$112.4 million in the third quarter of 2006. This increase is principally related to an increase in depreciation, amortization and depletion due to the accelerated depreciation of the processing plant equipment at Pasta de Conchos over the remaining estimated production period of the mineral located in the open pit.

Operating costs and expenses in the first nine months of 2007 increased by \$21.1 million to \$321.3 million from \$300.2 million in the first nine months of 2006. This increase was principally due to higher cost of sales (exclusive of depreciation, amortization and depletion) and higher depreciation, amortization and depletion. Cost of sales (exclusive of depreciation, amortization and depletion) increased \$10.0 million in the first nine months of 2007 from the first nine months of 2006 mainly due to \$7.1 million of higher production and sales of mined metal and \$2.0 million of exchange loss due to the appreciation of Mexican peso. Depreciation amortization and depletion increased by \$6.5 million due to the accelerated depreciation of the processing plant equipment at Pasta de Conchos over the remaining estimated production period of the mineral located in the open pit.

### Intersegment Eliminations and Adjustments

The net sales, operating costs and expenses and operating income displayed above will not be directly equal to amounts in our condensed consolidated statement of earnings because the adjustments of intersegment operating revenues and expenses must be taken into account. Please see Note N of the condensed consolidated financial statements.

### CASH FLOW

The following table shows the cash flow for the three and nine months ended September 30, 2007 and 2006:

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2007                                | 2006       | 2007                               | 2006       |
|   | (in millions)                       |            |                                    |            |
| Net cash provided from operating activities | \$ 728.3                            | \$ 522.6   | \$ 1,926.0                         | \$ 1,093.0 |
| Net cash used for investment activities     | \$ (65.7)                           | \$ (101.9) | \$ (333.4)                         | \$ (330.6) |
| Net cash used for financing activities      | \$ (473.4)                          | \$ (290.9) | \$ (1,423.6)                       | \$ (744.9) |

Third Quarter: Net cash provided by operating activities was \$728.3 million in the third quarter of 2007, compared with \$522.6 million in the 2006 period. The increase of \$205.7 million was due to an increase in net earnings of \$106.3 million mainly due to higher molybdenum and silver prices and higher molybdenum sales volume; \$ 37.5 million of lower capitalized leachable material due to the work stoppage at the Cananea mine; \$13.8 million higher depreciation, amortization and depletion due to the capitalization of the Ilo smelter modernization project and the amortization of capitalized leachable material and \$42.8 million of decrease in working capital mainly due to the increase in workers participation and income tax provision due to higher earnings.

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Net cash used in investing activities was \$65.7 million in the third quarter of 2007 compared with \$101.9 million in the third quarter of 2006 and included \$72.1 million for capital expenditures and \$6.2 million received on the redemption of bonds with a face value of \$20.0 million. The capital expenditures included investments at our Peruvian operations of \$24.5 million which included \$12.7 million for four Komatsu trucks, \$2.7 million for a new ball mill at the Cuajone concentrator, \$4.4 million for

the tailing disposal project, \$1.9 million for the new PLS dams at Huanaquera project and \$2.8 million for various other replacement expenditures. In addition, we spent \$47.6 million for replacement assets at our Mexican operations, including, \$9.6 million for the leachable ore crushing, transportation and stacking system project at Cananea, \$3.4 million for the gas handling system in the smelter at La Caridad, \$1.8 million for the PLS dams and leaching system at Cananea, \$25.0 million for various other replacement expenditures at our Mexican open pit operations, \$7.3 million for our IMMSA unit and \$0.5 million for our Mexican corporate office. In the third quarter of 2006, cash used for investment activities was \$101.9 million; this amount includes capital spending of \$102.3 million, \$30.9 million of which was spent in the Ilo smelter modernization project, \$24.6 million for other replacement expenditures in Peru and \$46.8 million for replacement expenditures at our Mexican operations, \$34.1 million of which was for replacement equipment at our Mexican open pit operations and \$12.7 million for our IMMSA unit.

Net cash used in financing activities in the third quarter of 2007 was \$473.4 million, compared with \$290.9 million in the third quarter of 2006. The third quarter of 2007 includes a dividend distribution of \$471.1 million. The third quarter of 2006 includes a dividend distribution of \$294.5 million and the repurchase by our Mexican operation of \$2.0 million of Yankee bonds.

Nine Months: Net cash provided by operating activities was \$1,926.0 million in the first nine months of 2007 compared with \$1,093.0 million in the same period of 2006. The increase of \$833.0 million was principally due to \$523.1 million of higher earnings due to higher metal prices and higher copper and molybdenum sales volumes; \$41.3 million of higher depreciation, amortization and depletion due to the capitalization of the Ilo smelter modernization project and the amortization of capitalized leachable material and \$122.0 million of decrease in working capital mainly due to the increase in workers participation and income tax provision due to higher earnings. The nine months of 2007 includes an adjustment of earnings of \$43.2 million due to a realized loss on the sale of marketable securities which is presented in investing activities and \$48.3 million of an unrealized loss on an embedded derivative related to investment in marketable securities (see Note C) net of \$1.6 million of an unrealized gain on exchange rate derivatives (see Note H).

Net cash used in investing activities was \$333.4 million in the first nine months of 2007 compared with \$330.6 million in the first nine months of 2006, and in the 2007 period included \$251.1 million for capital expenditures, \$100.0 million for the purchase of marketable securities, less \$16.8 million received on the redemption of marketable securities. The capital expenditures included investments at our Peruvian operations of \$104.9 million, including, \$21.0 million for the Ilo smelter modernization project, \$13.5 million for four Komatsu trucks, \$3.9 million for a new ball mill at the Cuajone concentrator, \$10.8 million for the tailing disposal project, \$9.0 million for the new PLS dams at Huanaquera project and \$46.7 million for various other replacement expenditures. In addition, we spent \$146.2 million for replacement assets at our Mexican operations, including, \$10.6 million of which for the leachable ore crushing, transportation and stacking system project at Cananea, \$4.1 million for the PLS dams and leaching system project at Cananea, \$9.6 million for the gas handling system in the smelter at La Caridad and \$77.8 million for various other replacement expenditures at our Mexican open pit operations, \$16.8 million at our IMMSA unit and \$27.3 million for our Mexican corporate office. In the first nine months of 2006, cash used for investing activities was \$330.6 million; this amount includes capital spending of \$333.0 million, \$117.2 million of which was spent on the Ilo smelter modernization project, \$61.4 million for other replacement expenditures in Peru and \$154.4 million for replacement expenditures for our Mexican operations, of which \$122.1 million was for our Mexican open pit operations and \$32.3 million for our IMMSA unit.

Net cash used in financing activities in the first nine months of 2007 was \$1,423.6 million, compared with \$744.9 million in the first nine months of 2006. The first nine

months of 2007 include a dividend distribution of \$1,413.4 million and a debt payment of \$5.0 million. The first nine months of 2006 include a dividend distribution of \$1,104.2 million and net debt incurred of \$365.7 million.

## LIQUIDITY AND CAPITAL RESOURCES

On August 1, 2007, the Company paid a quarterly dividend of \$1.60 per share, totaling \$471.1 million. On October 18, 2007, the Board of Directors approved a quarterly dividend of \$2.00 per share, totaling \$588.9 million, to be paid on November 27, 2007, to shareholders of record as of November 7, 2007.

On October 3, 2007, we liquidated \$300 million of the marketable securities investments and received \$276.4 million. As of September 30, 2007, the loss was recorded as unrealized loss on derivative instruments. Additionally, as part of this transaction, we redeemed \$68.6 million of our series B Yankee bonds, for \$85.2 million. The excess paid over the face value of the bonds, of \$16.6 million will be recorded in the fourth quarter of 2007 as loss on repurchase of debt.

We expect that we will meet our cash requirements for 2007 and beyond from internally generated funds, cash on hand and from additional external financing, if required. At September 30, 2007 the Company's debt as a percentage of total capitalization (the total of debt, minority interest and stockholders' equity) was 26.9% as compared with 29.3% at December 31, 2006. At September 30, 2007, the Company's cash and cash equivalent amounted to \$1,195.2 million compared to \$1,022.8 million at December 31, 2006.

## NON-GAAP INFORMATION RECONCILIATION

Reconciliation of operating cash cost to GAAP cost of sales in millions of dollars and cents per pound.

|   | 2007          |                | Three Months Ended<br>September 30, |                | 2006          |                |
|---|---------------|----------------|-------------------------------------|----------------|---------------|----------------|
|   | \$<br>million | ¢ per<br>pound | \$<br>million                       | ¢ per<br>pound | \$<br>million | ¢ per<br>pound |
| <b>CASH COST</b>  |               |                |                                     |                |               |                |
| Cost of sales (including depreciation, amortization and depletion) - GAAP | \$ 641.4      | 222.9          | \$ 577.0                            | 171.0          |               |                |
| Add:  |               |                |                                     |                |               |                |
| Selling, general and administrative expenses                              | 23.6          | 8.2            | 25.2                                | 7.5            |               |                |
| Treatment and refining charges  | 11.7          | 4.1            | 12.1                                | 3.6            |               |                |
| Less:   |               |                |                                     |                |               |                |
| By-products revenue   | (498.5)       | (173.3)        | (350.8)                             | (104.0)        |               |                |
| Depreciation, amortization and depletion                                  | (81.5)        | (28.3)         | (67.7)                              | (20.1)         |               |                |
| Workers' participation  | (84.9)        | (29.5)         | (66.8)                              | (19.8)         |               |                |
| Royalty charge and other  | (45.5)        | (15.8)         | (2.9)                               | (0.8)          |               |                |
| Inventory change  | (18.8)        | (6.5)          | 2.7                                 | 0.8            |               |                |
| Operating cash cost   | (52.5)        | (18.2)         | 128.8                               | 38.2           |               |                |

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|   |    |       |       |       |    |       |       |       |
|---|----|-------|-------|-------|----|-------|-------|-------|
| Add by-product revenue                                      |    | 498.5 |       | 173.3 |    | 350.8 |       | 104.0 |
| Operating cash cost, without by-product revenue             | \$ | 446.0 |       | 155.1 | \$ | 479.6 |       | 142.2 |
| Total pounds of copper produced and purchased (in millions) |    |       | 287.7 |       |    |       | 337.4 |       |

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|   | Nine Months Ended<br>September 30, |                |               |                |
|---|------------------------------------|----------------|---------------|----------------|
|   | 2007                               |                | 2006          |                |
|   | \$<br>Million                      | ¢ per<br>pound | \$<br>million | ¢ per<br>pound |
| <b>CASH COST</b>  |                                    |                |               |                |
| Cost of sales (including depreciation, amortization and depletion) - GAAP | \$ 1,828.9                         | 180.5          | \$ 1,636.8    | 165.4          |
| Add:  |                                    |                |               |                |
| Selling, general and administrative expenses                              | 73.3                               | 7.2            | 72.5          | 7.3            |
| Treatment and refining charges  | 47.2                               | 4.7            | 28.8          | 2.9            |
| Less:   |                                    |                |               |                |
| By-products revenue   | (1,511.0)                          | (149.1)        | (1,014.6)     | (102.5)        |
| Depreciation, amortization and depletion                                  | (240.1)                            | (23.7)         | (198.8)       | (20.1)         |
| Workers participation   | (258.0)                            | (25.5)         | (202.8)       | (20.5)         |
| Royalty charge and other  | (87.9)                             | (8.6)          | (58.6)        | (5.9)          |
| Inventory change  | 7.6                                | 0.7            | 62.4          | 6.3            |
| Operating cash cost   | (140.0)                            | (13.8)         | 325.7         | 32.9           |
| Add by-product revenue  | 1,511.0                            | 149.1          | 1,014.6       | 102.5          |
| Operating cash cost, without by-product revenue                           | \$ 1,371.0                         | 135.3          | \$ 1,340.3    | 135.4          |
| Total pounds of copper produced and purchased (in millions)               | 1,013.5                            |                | 989.4         |                |

Impact of New Accounting Standards

Please see note O to our condensed consolidated financial statements.

Quantitative and Qualitative Disclosure about Market Risk

A portion of our outstanding debt bears interest at variable rates and accordingly is sensitive to changes in interest rates. Interest rate changes would also result in gains or losses in the market value of our fixed rate debt portfolio due to differences in market interest rates and the rates at the inception of the debt agreements. Based upon our indebtedness at December 31, 2006, a change in interest rates of one percent (or 100 basis points) would impact net income and cash flows by \$0.7 million annually.

We are also exposed to market risk associated with changes in foreign currency exchange rates as certain costs incurred are in currencies other than our functional currency. To manage the volatility related to the risk, we may enter into forward exchange contracts, currency swaps or other currency hedging arrangements. We have only had limited involvement with derivative instruments and do not use them for trading purposes.

We are subject to market risks arising from the volatility of copper and other metal prices. Assuming that expected metal production and sales are achieved, that tax rates are unchanged, and giving no effects to potential hedging programs metal price sensitivity factors would indicate estimated change in net earnings resulting from metal price changes in 2007 as provided in the table below.

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|  | Copper |      | Molybdenum |      | Zinc |      | Silver |      |
|--|--------|------|------------|------|------|------|--------|------|
| Change in metal prices (per pound except silver per ounce) | \$     | 0.01 | \$         | 1.00 | \$   | 0.01 | \$     | 1.00 |
| Change in net earnings (in millions)                       | \$     | 7.9  | \$         | 20.2 | \$   | 1.7  | \$     | 10.5 |



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We occasionally uses derivative instruments to manage our exposure to market risk from changes in commodity prices, interest rate and exchange rate risk exposures and to enhance return on assets. We generally do not enter into derivative contracts unless it anticipates a future activity that is likely to occur that will result in exposing us to market risk.

Copper and zinc derivatives:

From time to time we enter into derivative instruments to protect a fixed copper, or zinc price for a portion of our metal sales.

In 2007 and 2006 we entered into copper collar and swaps contracts to protect a portion of our 2007 and 2006 sales of copper production. Related to the settlement of these copper swap contracts we recorded losses of \$0.3 million and a loss of \$30.1 million in the third quarter of 2007 and 2006, respectively, and a gain of \$3.0 million and a loss of \$288.0 million in the nine months period of 2007 and 2006, respectively. These gains and losses were recorded in net sales in the condensed consolidated statement of earnings.

In the third quarter of 2006 we entered into a zinc swap contract to protect a portion of the sale of zinc concentrates purchased during the recovery from a fire at the San Luis Potosi zinc refinery. Related to the settlement of this contract we recorded in the third quarter 2006, a loss of \$0.2 million which was recorded in net sales in the condensed consolidated statement of earnings. We did not hold any zinc derivative contracts at the end of September 2007.

At September 30, 2007 we have copper collar contracts to protect 73.1 million pounds of copper production for the October – December 2007 period at weighted average minimum and maximum LME prices of \$3.20 per pound and \$4.07 per pound, respectively. If the price falls below the minimum LME price, we will be in a gain position. If the price exceeds the maximum LME price, we will be in a loss position.

Gas swaps:

In 2006 and 2007 we entered into gas swap contracts to protect part of our gas consumption as follows:

|                          | Three months ended<br>September 30, |         | Nine months ended<br>September 30, |           |
|--------------------------|-------------------------------------|---------|------------------------------------|-----------|
|                          | 2007                                | 2006    | 2007                               | 2006      |
| Gas volume (MMBTUs)      |                                     | 920,000 | 900,000                            | 2,730,000 |
| Fixed Price              |                                     | 4.2668  | 7.5250                             | 4.2668    |
| Gain (loss) (in million) |                                     | \$ 1.3  | \$ (0.9)                           | \$ 4.9    |

The gains (losses) obtained were included in the production cost. At September 30, 2007, we did not hold any open gas swap contract.

Exchange rate derivatives, U.S. dollar / Mexican peso contracts:

Because more than 85% of our sales collections in Mexico are in US dollars and many of our costs are in Mexican pesos, during 2006 we entered into zero-cost derivative contracts with the purpose of protecting, within a range, against an appreciation of the Mexican peso to the US dollar. In these contracts if the exchange rate settles at or below the barrier, we do not sell US dollars, if the exchange rate settles above the barrier price established in the contract we sell US dollars at the strike price established in the contract.

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In the third quarter and first nine months of 2007 the exercise of these zero-cost derivative contracts resulted in gains of \$1.9 million and \$6.0 million, respectively, which were recorded as gain on derivative instruments in the condensed consolidated statement of earnings.

At September 30, 2007 we held the following exchange rate derivative operations:

| Notional Amount<br>(millions) | Due Date, Weekly<br>expiration during | Strike Price<br>(Mexican<br>Pesos/U.S.<br>Dollars) | Barrier Price<br>(Mexican<br>Pesos/U.S.<br>Dollars) |
|-------------------------------|---------------------------------------|--|---|
| \$ 24.0                       | 4th Quarter 2007                      | 11.35  | 10.65   |
| \$ 24.0                       | 4th Quarter 2007                      | 11.65  | 11.35   |
| \$ 28.0                       | 1st Quarter 2008                      | 11.60  | 11.28   |
| \$ 28.0                       | 1st Quarter 2008                      | 11.28  | 10.70   |

At September 30, 2007, the fair value of the above listed exchange rate derivative contracts is a gain of \$1.6 million which was recorded as gain on derivative instruments in the condensed consolidate statement of earnings. Each notional amount includes a group of weekly transactions that have the same strike and barrier price.

Dual currency notes:

In 2007 we invested \$560.0 million in dual currency notes which provided an above market interest return subject to a barrier range of the Mexican peso/US dollar exchange rates. These investments matured in the first and second quarters of 2007. Related to these investments, in the second quarter of 2007 we realized an exchange loss of \$1.3 million, which was recorded as a loss on derivative instruments in the condensed consolidated statement of earnings.

We earned no interest income in the third quarter of 2007 and earned interest income of \$2.1 million in the first nine months of 2007 which was recorded as interest income in the condensed consolidated statement of earnings.

There were no open positions at September 30, 2007.

Marketable Securities:

Commencing in 2006 we began making short term investments (90 days to 1 year) in leveraged, indexed instruments. The marketable securities were as follows (in millions):

**Investment**

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|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| 3-month note, issued December 12, 2006 with extensions every 3 months up to a maximum of 12 months, with an interest rate of 7%, established by a pool of Mexican and Peruvian bond issues.            | \$ 100.0              | \$ 100.0             |
| 3-month note, issued December 12, 2006 with extensions every 3 months up to a maximum of 13 months and 5 days, with an interest rate of 7%, established by a pool of Mexican and Peruvian bond issues. | 100.0                 | 100.0                |
| 3-month note, issued January 19, 2007 with extensions every 3 months up to a maximum of 12 months, with an interest rate of 7.25%, established by a pool of Mexican and Peruvian bond issues.          | 100.0                 |                      |

|  |    |       |          |
|--|----|-------|----------|
| 180-day note, maturing June 12, 2007 with an interest rate of 6%, with barrier range of \$37.669 and \$69.957 of SCC stock price, NYSE symbol PCU.     |    |       | 40.0     |
| 180-day note, maturing June 28, 2007 with an interest rate of 6%, with barrier range of \$38.738 and \$71.942 of SCC stock price, NYSE symbol PCU.     |    |       | 20.0     |
| 300-day note, maturing December 24, 2007 with an interest rate of 3.6%, with barrier range of \$50.00 and \$75.00 of SCC stock price, NYSE symbol PCU. |    | 20.0  | 20.0     |
|  | \$ | 320.0 | \$ 280.0 |

Some of these investment instruments are indexed to SCC common stock prices while others are leveraged and indexed to certain bond pools. Both types of instruments could cause the principal of the investment to be reduced if the established ranges are breached. Since the notes are not principal protected we may lose part or all of the initial investment. These instruments have been deemed to contain embedded derivatives and have been subject to valuation using a binomial model.

Related to these marketable securities, we have recorded a gain of \$1.6 million and a loss of \$79.9 million in the 2007 third quarter and the first nine months of 2007, respectively. In addition, we recorded a loss on these marketable securities of \$11.6 million in the fourth quarter of 2006. The realized amount of these losses was \$13.8 million and \$43.2 million for the third quarter of 2007 and the first nine months of 2007, respectively. The losses on these marketable securities are recorded as loss on derivative instruments in the condensed consolidated statement of earnings. The unrealized portion of the loss of \$48.3 million, at September 30, 2007 is recorded in accounts payable.

On October 3, 2007, we liquidated \$300 million of the marketable securities investments and received \$276.4 million. As of September 30, 2007, the loss was recorded as unrealized loss on derivative instruments.

In the three and nine months ended September 30, 2007 we earned interest of \$5.6 million and \$18.0 million on these investments, respectively, which were recorded in interest income in the condensed consolidated statement of earnings.

Cautionary Statement:

Forward-looking statements in this report and in other Company statements include statements regarding expected commencement dates of mining or metal production operations, projected quantities of future metal production, anticipated production rates, operating efficiencies, costs and expenditures as well as projected demand or supply for the Company's products. Actual results could differ materially depending upon factors including the risks and uncertainties relating to general U.S. and international economic and political conditions, the cyclical and volatile prices of copper, other commodities and supplies, including fuel and electricity, availability of materials, insurance coverage, equipment, required permits or approvals and financing, the occurrence of unusual weather or operating conditions, lower than expected ore grades, water and geological problems, the failure of equipment or processes to operate in accordance with specifications, failure to obtain financial assurance to meet closure and remediation obligations, labor relations, litigation and environmental risks as well as political and economic risk associated with foreign operations. Results of operations are directly affected by metal prices on commodity exchanges that can be volatile.

Item 4. Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of September 30, 2007, the Company conducted an evaluation under the supervision and with the participation of the Company's Disclosure Committee and the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness and the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of September 30, 2007, to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is:

1. recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and
2. accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There was no change in the Company's internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) that occurred during the quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Southern Copper Corporation:

We have reviewed the accompanying consolidated condensed balance sheet of Southern Copper Corporation and its subsidiaries as of September 30, 2007, and the related consolidated condensed statements of earnings for the nine-month periods ended September 30, 2007 and September 30, 2006 and the consolidated condensed statement of cash flows for the nine month periods ended September 30, 2007 and September 30, 2006. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated condensed interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2006 and the related consolidated statement of earnings, changes in stockholders' equity and of cash flows for the year then ended (not presented herein), and in our report dated February 28, 2007 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 31, 2006, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

PricewaterhouseCoopers

México, D.F.

October 31, 2007

PART II OTHER INFORMATION

Item 1. Legal Procedures

The information provided in Note M to the condensed consolidated financial statements contained in Part I of this Form 10-Q, is incorporated herein by reference.

Item 1a. Risk Factors

Set forth below are certain changes from the risk factors previously disclosed in SCC's Form 10-K for the year ended December 31, 2006 filed on March 1, 2007 with the Securities and Exchange Commission.

***We may be adversely affected by labor disputes.***

On April 28, 2007 the workers of a newly unified workers union at our Peruvian smelter in Ilo initiated a strike to demand better wages and benefits. In addition, on April 30, 2007 Peru's largest mining union launched a nationwide strike to demand better job benefits. The workers at our two Peruvian mines joined the nationwide miners' strike and also supported the unified Ilo union. The labor minister declared the strike inappropriate and the workers returned to work after five days when the nationwide strike was resolved by the government. The workers received guarantees from the government over working conditions and contracts. Also, SCC signed a general agreement indicating the terms under which the review of the unified union contracts would take place.

On June 23, 2007 the unionized workers at some of our Peruvian operations initiated a strike demanding better wages and benefits. At the request of the Peruvian labor authorities, the workers returned to work after five days to restart negotiations with the Company.

In June and July of 2007, five of the eight unions at the Company's Peruvian operations signed collective bargaining agreements expiring in 2013. On October 2, 2007, the workers of Ilo, Toquepala and Cuajone belonging to the three unions did not signed the July 11, 2007 agreements, began a strike demanding higher wages and benefits. After eight days of strike, the workers returned to work when union leaders and the Company signed a settlement pact giving the Peruvian labor ministry the authority to settle the final conditions. On October 26, 2007, the Peruvian labor ministry issued its final pronouncement, settling the open issues with these three unions.

During this brief strikes the Company continued normal operations with the support of staff and administrative personnel and contractors. However, we cannot assure you that we will not experience strikes or other labor-related work stoppages in the future that could have a material adverse effect on our financial condition and results of operations.



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Since July 30, 2007, our Mexican mines of Cananea, Taxco and San Martin have ceased operations due to work stoppages promoted by a minority group of the union workers. Even though the labor authorities declared these stoppages illegal, operations have not yet resumed at the mines. Proceedings in this regards are currently in process in Mexican federal courts.

Item 6. Exhibits

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>  |
|--------------------|--|
| 31.1               | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.2               | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1               | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C., Section 1350. This document is being furnished in accordance with SEC Release No. 33-8238. |
| 32.2               | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C., Section 1350. This document is being furnished in accordance with SEC Release No. 33-8238. |

PART II OTHER INFORMATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOUTHERN COPPER CORPORATION  
(Registrant)

/s/ Oscar Gonzalez Rocha  
Oscar Gonzalez Rocha  
President and Chief Executive Officer

October 31, 2007

/s/ Jose N. Chirinos  
Jose N. Chirinos  
Comptroller and Chief Financial Officer

October 31, 2007

SOUTHERN COPPER CORPORATION

List of Exhibits

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