

SOUTHERN COPPER CORP/  
Form 10-Q  
November 03, 2006

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

2006  
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, 2006

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) 977-6595**

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.

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, 2006 there were outstanding 294,460,850 shares of Southern Copper Corporation common stock, par value \$0.01 per share.



Southern Copper Corporation

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Exhibit 32.1	- Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	- Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

## Part I FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Combined Financial Statements

## Southern Copper Corporation

CONDENSED CONSOLIDATED COMBINED STATEMENT OF EARNINGS

(Unaudited)

	<b>3 Months Ended September, 30 2006 (in thousands)</b>	<b>2005</b>	<b>9 Months Ended September 30, 2006</b>	<b>2005</b>
<b>Net sales:</b>				
Non affiliates	\$ 1,412,238	\$ 1,030,193	\$ 3,810,278	\$ 2,894,730
Affiliates				28,357
Total net sales	1,412,238	1,030,193	3,810,278	2,923,087
<b>Operating costs and expenses:</b>				
Cost of sales (exclusive of depreciation, amortization and depletion shown separately below)	509,258	382,994	1,437,990	1,185,669
Selling, general and administrative	25,162	20,199	72,491	59,202
Depreciation, amortization and depletion	67,702	74,818	198,787	206,329
Exploration	5,655	6,361	14,864	17,205
Total operating costs and expenses	607,777	484,372	1,724,132	1,468,405
Operating income	804,461	545,821	2,086,146	1,454,682
Interest expense	(31,602 )	(37,675 )	(82,711 )	(86,231 )
Capitalized interest	7,403	4,747	19,009	12,316
Gain on derivative instruments		5,489		2,789
Loss on debt prepayments	(100 )		(960 )	(7,664 )
Other income (expense)	5,320	126	12,808	310
Interest income	10,848	5,051	34,456	13,541
Earnings before taxes on income and minority interest	796,330	523,559	2,068,748	1,389,743
Taxes on income	271,944	152,573	679,680	405,443
Minority interest	2,803	1,576	6,630	4,598
Net earnings	\$ 521,583	\$ 369,410	\$ 1,382,438	\$ 979,702
<b>Per common share amounts:</b>				
Net earnings basic and diluted	\$ 1.77	\$ 1.25	\$ 4.69	\$ 3.33
Dividends paid	\$ 1.00	\$ 0.52	\$ 3.75	\$ 2.34
Weighted average common shares outstanding (Basic)	294,461	294,456	294,461	294,456
Weighted average common shares outstanding (Diluted)	294,461	294,456	294,461	294,456

The accompanying notes are an integral part of these condensed consolidated combined financial statements. All the share and per share amounts for prior periods had been restated to reflect the common stock split see note H.



## Southern Copper Corporation

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

	September 30, 2006 (in thousands)	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 918,099	\$ 876,003
Accounts receivable trade Non-affiliates	474,577	342,412
Accounts receivable Affiliates	3,717	9,099
Accounts receivable other	45,008	34,949
Inventories	480,473	395,845
Deferred income tax	23,138	5,248
Prepaid and other current assets	60,426	50,798
Total current assets	2,005,438	1,714,354
Property, net	3,486,514	3,326,126
Capitalized mine stripping, net		289,369
Leachable material, net	221,956	210,118
Intangible assets, net	118,761	120,861
Other assets, net	43,219	26,746
Total Assets	\$ 5,875,888	\$ 5,687,574
<b>LIABILITIES</b>		
Current liabilities:		
Current portion of long-term debt	\$ 10,000	\$ 10,000
Accounts payable	232,646	284,977
Accrued income taxes	121,210	275,763
Due to affiliated companies	4,892	6,355
Accrued workers participation	206,426	195,552
Other accrued liabilities	34,259	22,985
Total current liabilities	609,433	795,632
Long-term debt	1,527,793	1,162,065
Deferred income taxes	208,556	259,089
Other liabilities	89,494	120,795
Asset retirement obligation	11,943	11,221
Total non-current liabilities	1,837,786	1,553,170
Commitments and Contingencies (Note J)		
MINORITY INTEREST	13,207	12,695
<b>STOCKHOLDERS EQUITY</b>		
Common stock	2,946	2,946
Additional paid-in capital	772,108	772,696
Retained earnings	2,745,800	2,648,359
Other accumulative comprehensive loss	(8,407 )	(13,090 )
Treasury stock	(96,985 )	(84,834 )
Total Stockholders Equity	3,415,462	3,326,077
Total Liabilities, Minority Interest and Stockholders Equity	\$ 5,875,888	\$ 5,687,574

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



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Southern Copper Corporation

CONDENSED CONSOLIDATED COMBINED STATEMENT OF CASH FLOWS

(Unaudited)

	<b>3 Months Ended September 30, 2006 (in thousands)</b>	<b>2005</b>	<b>9 Months Ended September 30, 2006</b>	<b>2005</b>
<b>OPERATING ACTIVITIES</b>				
Net earnings	\$ 521,583	\$ 369,410	\$ 1,382,438	\$ 979,702
Adjustments to reconcile net earnings to net cash provided from operating activities:				
Depreciation, amortization and depletion	67,702	74,818	198,787	206,329
Capitalized mine stripping and leachable material	(43,384 )	(25,353 )	(43,384 )	(77,898 )
Remeasurement loss(gain)	6,172	(1,089 )	(5,210 )	10,946
Gain on sale of property	(1,881 )	(2,084 )	(1,881 )	(2,084 )
Provision for deferred income taxes	1,105	(51,653 )	17,340	(18,217 )
Amortization of deferred financing cost		12,530		14,965
Unrealized gain on derivative instruments	(8,330 )		(6,512 )	
Minority interest	2,803	1,576	6,630	4,598
Cash provided from (used for) operating assets and liabilities:				
Accounts receivable	(12,453 )	(85,814 )	(147,686 )	46,061
Inventories	(19,132 )	(15,620 )	(84,628 )	(31,778 )
Accounts payable and accrued liabilities	(4,149 )	245,993	(240,843 )	(42,108 )
Other operating assets and liabilities	12,549	(64,361 )	18,053	(97,901 )
Net cash provided by operating activities	522,585	458,353	1,093,104	992,615
<b>INVESTING ACTIVITIES</b>				
Capital expenditures	(102,311 )	(118,081 )	(333,031 )	(263,311 )
Purchase of marketable securities				(74,339 )
Sales of marketable securities				119,606
Sales of property	3,220	1,177	4,586	1,177
Other	(2,813 )	1,455	(2,176 )	(11,678 )
Net cash used for investing activities	(101,904 )	(115,449 )	(330,621 )	(228,545 )
<b>FINANCING ACTIVITIES</b>				
Debt repaid	(2,315 )	(680,080 )	(23,825 )	(1,098,685 )
Debt incurred	361	793,646	389,553	993,646
Escrow on long-term loans			(149 )	(311 )
Dividends paid to common stockholders	(294,458 )	(153,556 )	(1,104,212 )	(603,599 )
Distributions to minority interest	(1,465 )	(650 )	(6,336 )	(4,159 )
Other	6,967			123
Net cash used for financing activities	(290,910 )	(40,640 )	(744,969 )	(712,985 )
Effect of exchange rate changes on cash and cash equivalents	(12,622 )	(6,560 )	24,582	5,078
Increase in cash and cash equivalents	117,149	295,704	42,096	56,163
Cash and cash equivalents, at beginning of period	800,950	471,166	876,003	710,707
Cash and cash equivalents, at end of period	\$ 918,099	\$ 766,870	\$ 918,099	\$ 766,870





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	<b>3 Months Ended September 30, 2006 (in thousands)</b>	<b>2005</b>	<b>9 Months Ended September 30, 2006</b>	<b>2005</b>
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	\$ 18,672	\$ 19,121	\$ 40,620	\$ 74,808
Income taxes	\$ 251,200	\$ 122,624	\$ 978,838	\$ 569,309
Non cash transactions:				
Common stock split:				
Increase in Common stock	1,472			
Decrease in Additional paid-in capital	1,472			

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

## Southern Copper Corporation

## NOTES TO CONDENSED CONSOLIDATED COMBINED FINANCIAL STATEMENTS

(Unaudited)

A. In the opinion of Southern Copper Corporation, (the Company, Southern Copper or SCC), the accompanying unaudited condensed consolidated combined financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position as of September 30, 2006 and the results of operations and cash flows for the three and nine months ended September 30, 2006 and 2005. The condensed consolidated combined financial statements for the three and nine month periods ended September 30, 2006 and 2005 have been subjected to a review by PricewaterhouseCoopers, the Company's independent registered public accounting firm, whose report dated November 2, 2006, is presented on page 46. The results of operations for the three and nine months ended September 30, 2006 and 2005 are not necessarily indicative of the results to be expected for the full year. The December 31, 2005 balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The accompanying condensed consolidated combined financial statements should be read in conjunction with the consolidated combined financial statements at December 31, 2005 and notes included in the Company's 2005 annual report on Form 10-K/A Amendment No. 2.

In the first quarter of 2006, the Company reclassified from additional paid-in capital to treasury stock the carrying value of its investment in shares held by one of its Mexican subsidiaries in its controlling shareholder, Grupo Mexico, S.A.B. de C.V. (Grupo Mexico). At September 30, 2006 and December 31, 2005, the carrying amount was \$92.5 million and \$80.3 million, respectively. Certain prior year amounts have been reclassified to conform to the current presentation.

#### B. Changes in Accounting Principle Capitalized Mine Stripping

At the March 17, 2005 meeting of the Emerging Issues Task Force (EITF), the EITF reached a consensus that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced (extracted) during the period that the stripping costs are incurred. The EITF noted that the consensus does not address the accounting for stripping costs incurred during the pre-production phase of a mine. The consensus with respect to this issue was ratified by the FASB on March 30, 2005, and is effective for the first reporting period in fiscal years beginning after December 15, 2005, with early adoption permitted.

On January 1, 2006 the Company adopted this consensus by reversing \$289.4 million of net cumulative capitalized stripping cost as of December 31, 2005 and recording a net charge of \$181.3 million to retained earnings after recognition of workers' participation and tax benefit of \$108.1 million.

#### C. Inventories were as follows:

(In millions)

	September 30, 2006	December 31, 2005
Metals at lower of average cost or market:		
Finished goods	\$ 165.8	\$ 106.9
Work-in-process	138.9	135.4
Supplies at average cost	175.8	153.5
Total inventories	\$ 480.5	\$ 395.8



**D. Income taxes:**

The Company's income tax provision for the nine months ended September 30, 2006 and 2005 was \$679.7 million and \$405.4 million, respectively. These provisions include income taxes for Peru, Mexico and the United States. The effective tax rates for the 2006 and 2005 periods are 32.9% and 29.2%, respectively. The increase in the 2006 effective tax rate is attributable to the following factors: 1) a non-deductible expense of \$29.4 million for workers' participation resulting from a change in Mexican law regarding the basis of calculation in the 2005 period, 2) a tax refund of \$43.4 million received by our Mexican subsidiary in the 2005 period for asset-based taxes (minimum income tax) paid in prior years, and 3) a decrease of 1% in the 2006 statutory tax rate for our Mexican operations.

**E. Provisionally Priced Sales:**

At September 30, 2006, the Company has recorded provisionally priced sales of 123.8 million pounds of copper, at an average forward price of \$3.44 per pound. Also, the Company has recorded provisionally priced sales of 2.9 million pounds of molybdenum at September 30, 2006 market price of \$27.00 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, 2006:

Copper (million lbs.)	Priced at	Month of Settlement
74.2	3.44222	October 2006
36.7	3.44616	November 2006
2.2	3.42553	December 2006
4.8	3.38652	March 2007
5.9	3.36702	April 2007
123.8	3.43737	

Molybdenum (million lbs.)	Priced at	Month of Settlement
1.4	27.00000	October 2006
0.7	27.00000	November 2006
0.8	27.00000	December 2006
2.9	27.00000	

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.

**F. Derivative Instruments:**

The Company occasionally uses derivative instruments to manage its exposure to market risk from changes in commodity prices and interest rate risk exposure. 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 swaps:**

Transactions under this copper price protection program are not accounted for as hedges under SFAS No. 133 and are adjusted to fair market value based on the copper price as of the last day of the respective reporting period with the gain or loss recorded in total net sales. The actual impact of this protection program

on the Company's fourth quarter copper production can not be fully determined until the maturity of each copper swap contract with final adjustments based on the average annual copper price. As a result of this copper price protection program, the Company decided to change its accounting policy to recognize the change in the fair market value of these financial instruments against net sales. The Company believes that this income statement classification reflects better the intention of this copper price protection program. Before the second quarter of 2006, the change in the fair market value of our derivative instruments was accounted for in a separate non-operating income statement line item.

In the first nine months of 2006 and 2005 the Company entered into copper swaps contracts to protect a portion of its 2006 and 2005 copper production for future sales at a fixed copper price. Related to the settlement of these copper swap contracts the Company recorded a loss of \$30.3 million in the third quarter of 2006 and \$288.2 million and \$11.2 million in the nine month period of 2006 and 2005, respectively. These losses were recorded in net sales on the condensed consolidated combined statement of earnings.

At September 30, 2006, the Company has copper swap contracts to protect 57.3 million pounds of copper production for the October-December period of 2006 at prices ranging from \$3.52 per pound through \$3.68 per pound. These contracts are as follows:

Pounds (in millions)	Period	Copper Swap Price (1)	
26.5	October 2006	\$3.58	(2)
22.0	November 2006	\$3.56	(2)
8.8	December 2006	\$3.59	(2)

(1) SCC will receive (pay) if the actual average COMEX copper price for period is under (over) swap price on quantity hedged.

(2) The copper swap price is the per pound weighted average for the month or a portion of the month in the case of some contracts. Prices for October 2006 range from \$3.52 to \$3.68, prices for November 2006 range from \$3.52 to \$3.60, and the price for December 2006 range from \$3.58 to \$3.59.

Interest rate swaps:

In 2005, the Company entered into interest rate swap agreements to hedge its exposure to interest rate changes on its variable rate debt. These facilities were terminated in July 2005 and the Company recorded a gain of \$3.9 million and \$1.1 million in the third quarter and first nine months of 2005, respectively.

#### G. Asset Retirement Obligation:

In 2005, the Company accrued an asset retirement obligation for its mining properties in Peru, as required by the Mine Closure Law, enacted in 2003 and adopted in 2005. This law requires the Company to present a mine closure plan to the Peruvian Ministry of Energy and Mines ( MEM ) by August 2006. In April 2006, the Company selected Walsh Peru S.A., a Peruvian subsidiary of Walsh Environmental Scientists and Engineers, Inc. (Boulder, Colorado), and the Mines Group, Inc. (Reno, Nevada) both independent consultants, to work in the development of the mine closure plan. The Conceptual plan, without costs, was submitted to MEM in August 2006 and is subject to review by MEM for 45 days. After the MEM review, the Company will have 90 days to prepare and submit the mine closure plan, including costs, which is then subject to approval by MEM and open to public discussion and comment in the area of Company operations. In application of SFAS No. 143 and according to the criteria established by FIN-47, the Company has made an estimate of this potential liability and recorded such

liability, based on its review of the law. However, the Company cannot assure that the amount of this liability recorded will be adequate until our mine plan is reviewed and accepted by MEM.

The closure cost recognized for this liability includes the estimated cost required at the Peruvian operations, based on the Company's experience and includes costs at the Ilo smelter and refinery, tailings disposal and the dismantling of the Toquepala and Cuajone concentrators, repair shops and auxiliary services. In this regard, the Company recorded an additional asset retirement liability in 2005 of \$5.2 million for this new law and increased net property by \$4.6 million.

The following table summarizes the asset retirement obligation activity for the first nine months of 2006 and 2005 (in millions):

	2006	2005
Balance as of January 1,	\$ 11.2	\$ 5.6
Additions, changes in estimates		
Accretion expense	0.7	0.3
Balance as of September 30,	\$ 11.9	\$ 5.9

## H. Stockholders Equity

Common stock:

On August 30, 2006 the Executive Committee of the Board of Directors declared a two-for-one split of the Company's outstanding common stock. On October 2, 2006 common shareholders of record at the close of business on September 15, 2006, received one additional share of common stock for every share owned. The Company's common stock began trading at its post-split price on October 3, 2006. The split increased the number of shares outstanding to 294,460,850 from 147,230,425. The stock split has been recorded in our nine month 2006 financial statements. All share and per share amounts have been retroactively adjusted to reflect the stock split.

## I. Related Party Transactions:

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

	As of September 30, 2006	December 31, 2005
<b>Affiliate receivable:</b>		
Grupo Mexico Servicios, S.A de C.V.	\$	\$ 2.6
Grupo Mexico, S.A.B. de C.V.		0.4
Mexico Constructora Industrial, S.A. de C.V.	3.4	5.0
Intermodal Mexico, S.A. de C.V.		0.4
Ferrocarril Mexicano, S.A. de C.V.		0.4
Other	0.3	0.3
	\$ 3.7	\$ 9.1
<b>Affiliate payable:</b>		
Grupo Mexico, S.A.B. de C.V.	\$ 2.5	\$ 2.5
Ferrocarril Mexicano, S.A. de C.V.	2.1	3.0
Other	0.3	0.9
	\$ 4.9	\$ 6.4

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.

The Company sold to Asarco LLC ( Asarco ), an affiliate of Grupo Mexico, \$0.3 million and \$11.6 million of metal products in the first nine months of 2006 and 2005, respectively; and purchased metal products from Asarco for \$1.1 million in the first nine months of 2005. In addition, the Company paid \$0.9 million to Asarco in the first nine months of 2005 for tolling services. There were no purchases of metal products and tolling services from Asarco in the first nine months of 2006.

Grupo Mexico, the Company's ultimate parent and the majority indirect stockholder of the Company, and its affiliates provide various services to the Company. In 2005, 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 reimbursed for these support services. The total amount paid by the Company to Grupo Mexico for such services in the first nine months of 2006 and 2005 was \$10.3 million. The Company expects to continue to pay for these services going forward in an amount of \$13.8 million per year.

The Company's Mexican operations paid fees of \$12.7 million and \$18.9 million in the first nine months of 2006 and 2005, 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 \$24.7 million and \$18.9 million in the first nine months of 2006 and 2005, 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, aviation 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 \$0.8 million and \$1.7 million in the first nine months of 2006 and 2005, respectively, for maintenance services provided by Mexico Compañía de Productos Automotrices S.A. de C.V., a company controlled by the Larrea family. Additionally, in the third quarter of 2006 our Mexican subsidiary 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. MexTransport, a company controlled by the Larrea family, provides aviation services to our Mexican operations.

The Company purchased \$3.4 million and \$2.9 million in the first nine months of 2006 and 2005, respectively; of industrial material from companies 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 \$0.2 million in the first nine months of 2006 and 2005, respectively, of industrial material from companies 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.



J. Commitments and Contingencies:

Peruvian Operations

Royalty charge-

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 the new 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 Cuajone mines. The Company made provisions of \$48.6 million and \$26.2 million in the first nine months of 2006 and 2005 respectively, for this royalty. These provisions are included in Cost of sales (exclusive of depreciation, amortization and depletion) on the condensed consolidated combined statement of earnings.

In April 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 \$11.9 million of additional potential liability relating to its SX/EW production from June 30, 2004 through September 30, 2006.

Power purchase agreement-

In 1997, SCC sold its Ilo power plant to an independent power company, Enersur S.A. (Enersur), for \$33.6 million. 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.

The Company agreed to amend its power purchase agreement in June 2003, resolving certain issues that arose between the parties and reducing power costs for the remaining life of the agreement. The Company made a one-time contractual payment of \$4.0 million to Enersur under the terms of the new agreement. The new agreement releases Enersur from the obligation to construct additional capacity upon notice to meet the Company's increased electricity requirements from the planned expansion and modernization. SCC believes it can satisfy the need for increased electricity requirements from other sources, including local power providers.

Environmental matters-

The Company's operations are subject to applicable Peruvian environmental laws and regulations. The Peruvian government, through its *Ministerio de Energía y Minas* (the Ministry of Energy and Mines, or MEM) conducts certain 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.

In accordance with Peruvian regulations, in 1996 SCC submitted its *Programa de Adecuación 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 contains 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 are no longer active and need to be reclaimed or remedied. By the end of 2005, 31 of these projects were completed, including all PAMA commitments related to the Company's operations in Cuajone and Toquepala. The three pending PAMA projects all relate to the Ilo smelter operations. The primary areas of environmental concern are the smelter reverberatory slag eroded from slag deposits up until 1994, and atmospheric emissions from the Ilo smelter.

The slag remediation program is progressing as scheduled and is expected to be completed by January 2007. With respect to the smelter emissions, the third phase of the Ilo modernization has started and is scheduled to be completed by January 2007. In July 2003, the Company awarded the contract to provide the technology and basic engineering for the modernization of the Ilo smelter to Fluor Chile S.A. and Xstrata plc (formerly M.I.M. Holdings Limited). The Company believes that the selected proposal complies with the current environmental regulations. This project is the Company's largest capital investment project and is estimated at \$500 million, including \$505.8 million expended through September 2006 (which includes \$51.5 million of capitalized interest not included in the budget). Beginning in 1995 and continuing while this project is under construction, the Company established an emissions curtailment program that has allowed SCC to comply with the annual sulfur dioxide air quality standard (established by the MEM in 1996) in the populated areas of the city of Ilo.

In 2003, the Peruvian Congress published a new law announcing future closure and remediation obligations for the mining industry. The law was amended in May 2004 and again in May 2005. The current modification establishes that mining companies must submit their mine closure plans within one year of publication of final regulations. On August 16, 2005 final regulations were published and the Company initiated the preparation of the required mine closure plan. This plan, in its final form, will include the estimated cost required for the Peruvian operations, including cost at the Ilo smelter and refinery, tailings disposal, and the dismantling of the Toquepala and Cuajone concentrators, shops and auxiliary services.

As the law requires that the mine closure plan be prepared by an independent consulting entity, the Company engaged Walsh Peru S.A., a Peruvian subsidiary of Walsh Environmental Scientists and Engineers, Inc. (Boulder, Colorado), and the Mines Group Inc (Reno, Nevada) independent consulting entities to prepare the mine closure plan. The conceptual plan, without costs, was submitted to MEM in August 2006 and is 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 is then subject to approval by MEM and open to public discussion and comment in the area of Company operations. Additionally, the law requires companies to provide financial guarantees to insure that remediation programs are completed. The Company believes the liability for these asset retirement obligations cannot currently be precisely measured, or estimated, until the Company has completed its final mine closure plan and is reasonably confident that it will be approved by MEM in most material respects. However, the Company has made a preliminary estimate of this liability and has recorded such amount in its financial statements. As of September 30, 2006, the Company has recorded \$5.6 million for this liability. The Company believes that this

estimate should be viewed with caution, pending final approval of its mine closure plan, expected later in 2006 or early 2007.

For the Company's Peruvian operations, environmental capital expenditures were \$117.2 million and \$140.3 million in the first nine months of 2006 and 2005, respectively. The Company expects to spend approximately \$148.2 million for environmental capital expenditures in 2006, for the Ilo smelter modernization project.

Mexican operations-

Environmental matters-

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 pollution, air pollution, noise pollution and hazardous and solid wastes. 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 Ecológico y la Protección al Ambiente* (the General Law of Ecological Balance and Environmental Protection, or the Environmental Law), which is enforced by the *Procuraduría Federal de Protección 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 and, if warranted, the 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 the *Código Penal Federal* (Federal Criminal Code), the PROFEPA must inform corresponding authorities regarding environmental crimes.

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, result 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 you that stricter enforcement of existing laws and regulations or the adoption of additional laws and regulations would not have a material adverse effect on the Company's business, properties, results of operations, financial condition or prospects.

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. Any enforcement action to shut down any such facilities may have an adverse effect on the operating results of the relevant subsidiary.

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 contamination of 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.

For the Company's Mexican operations, environmental capital expenditures were \$5.3 million and \$5.0 million in the first nine months of 2006 and 2005, respectively. Approximately \$25.7 million has been budgeted for environmental capital expenditures in 2006, 77% of which belongs to projects at La Caridad mine which have been delayed as a result of the mine closure.

Litigation matters-

Peruvian operations-

Garcia-Ataucuri and Others vs. 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 shares 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. At September 30, 2006, the labor share minority interest in the Company's Peruvian Branch amounted to 0.71%.

Since 1995, the Company has periodically purchased labor shares on the open market.

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, (García 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. This amount corresponds to the total number of labor shares for all of the Company's Peruvian workers, and the complaint is seeking to have labor shares issued to the plaintiffs proportionally to each in accordance with their time of work with the Company, plus dividends on such labor shares. 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 labor judge dismissed the lawsuit in January 2005. The plaintiffs have appealed to the Lima Labor superior court.

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), of the Company 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.

These two (2) complaints are similar to an April 1996 lawsuit filed by Mr. Garcia Ataucuri and others seeking delivery of 38,763,806.80 labor shares plus dividends and S/. 1,118,439,980.23 in labor shares resulting from capital increases made by the Branch. This case was dismissed on August 21, 1997 and the dismissal confirmed on appeal.

It should be noted that these two (2) lawsuits refer to the original Peruvian currency called sol de oro, which was later changed to the new sol. One billion of soles de oro is equivalent to today's one new sol. The labor shares are currently called investment shares.

The Company asserts that the claims are meritless 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.

#### 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-

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. Mexcobre answered and denied MGS's claims in October 2002. 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 will cover 100% of the royalty payments required for past periods. Any residual payments will be determined by a judicial ruling from the above mentioned court. On an ongoing basis the Company will be 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., licenses for use of land and construction for housing and/or commercial zones in the former Ejido Capulines, where the residential project Villa Magna is expected to be developed in the near future.

The Villa Magna residential project will be developed within an area that IMMSA's approved Risk Analysis 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:

- (1) First, against the municipality of San Luis Potosi, requesting the annulment of the authorization and licenses granted to Desarrolladora Intersaba S.A. de C.V. to develop Villa Magna within the zinc plant's safeguard and buffer zone; and

(2) Second, filed before SEMARNAT a request for a declaration of a safeguard and buffer zone surrounding IMMSA's zinc plant.

The first action was resolved by denying IMMSA's interest on August 23rd by a Federal court. IMMSA submitted on September 21st its last appeal before the Supreme Court of Justice.

Based on the foregoing, IMMSA is expecting that in the near future Desarrolladora Intersaba, S.A. de C.V., files a lawsuit against IMMSA, requesting payment of certain damages supposedly caused by IMMSA, during the procedure of annulment requested.

These actions are awaiting final resolutions. IMMSA believes that, should the outcome of the above mentioned legal proceedings be adverse to IMMSA's interests, the construction of the Villa Magna housing and commercial development would not, in itself, affect the operations of IMMSA's zinc plant.

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 a use of land permit in respect to its zinc plant. The Municipality has refused to grant such license based on the argument that IMMSA has failed to submit, as part of the application process, a *manifestación de impacto ambiental* (environmental impact assessment). IMMSA believes that the environmental impact assessment is not required because IMMSA will not undertake construction activities. The trial judge has ordered the Municipality to continue the analysis of IMMSA's request to issue the *licencia de uso de suelo* (land use permit). The municipality has refused to issue the land use permit. IMMSA has filed a request for relief against such resolution to compel the court to issue the land use permit.

These procedures are awaiting final resolution.

Additionally, on May 11, 2006 the municipality of San Luis Potosi published regulations regarding commercial, industrial and rendering services activities, which entered into force on May 12, 2006. These regulations establish the obligation to obtain within 30 days of the publication, a municipal license to operate said activities. After the publication it was known that it would also cover any local environmental and health activities.

IMMSA, due to its activities, has always been legally considered a federally regulated corporation, and the Company has initiated legal actions against the regulations mentioned above.

Based on the foregoing, IMMSA has submitted an Amparo action before a Federal court in Mexico challenging the constitutionally and legality of the regulations.

Tax contingency matters-

U.S. Internal Revenue Service ( IRS )

The Company is regularly audited by the federal, state and foreign tax authorities both in the United States and internationally. These 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. Generally, the years 1994 through 1996 are now closed to further adjustment.

The IRS completed field audit work for all years preceding 2003 and currently is auditing 2003 and 2004. 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 the fourth quarter of 2003, the Company and the IRS had jointly requested technical advice from the IRS National Office to help resolve the inventory value dispute. In August 2005 the National Office of the IRS responded to the IRS field audit group's request for technical advice. The issuance of this technical advice memorandum ( 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.

On October 5, 2005 the Company filed a formal protest 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. The Company believes that the positions that it is reporting to the IRS are correct and appropriate. The Company believes that it has substantial defenses to the proposed IRS adjustments and that adequate provisions have been made so that resolution of any issues raised by the IRS will not have a material adverse effect on its financial condition or results of operations. Discussions with the Appeals Office representatives have begun and the parties have agreed to working through the protested issues and concluding the appeals process by December 31, 2007.

Significant management judgment is required in determining the provision for tax contingencies. The estimate of the probable cost for resolution of the tax contingencies has been developed in consultation with legal and tax counsel. The Company does not believe that there is a reasonable likelihood that there is an exposure to loss in excess of the amounts accrued.

Peruvian operations:

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

1) In 2002 the Company received assessments and penalties from SUNAT for fiscal years 1996 through 1999, in which several deductions taken were disallowed. SUNAT has challenged the Company's depreciation method and deduction of other expenses related to charges incurred outside of Peru from 1996 through 1999, and the deduction of certain exchange differences and interest expenses from 1997 through 1999. The Company appealed these various assessments and resolution is still pending.

In February 2003, the Peruvian tax court confirmed SUNAT's assessments and penalties with regard to depreciation and deductions of other expenses incurred outside of Peru for fiscal years 1996 and 1997. Consequently, the Company recognized an additional tax and workers participation liability for fiscal years 1998 and 1999 on the amounts assessed by SUNAT. Therefore, in 2003 the Company recorded a charge to workers' participation, included in cost of sales (exclusive of depreciation amortization and depletion) on the statement of earnings and income tax expense of \$0.5 million and \$4.4 million, respectively.



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The Company, however, has not recognized a liability for penalties and interest assessed by SUNAT in connection with the depreciation and other expenses deduction as it considers they are not applicable. The status of the penalty appeals and 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 \$3.4 million, which was issued in July 2003. This deposit is recorded in other assets on the condensed consolidated balance sheet. The Peruvian tax court denied the Company's appeal in February 2004. Consequently, in April 2004, the Company filed a lawsuit against the Peruvian tax court and SUNAT in the superior court of Peru. The Company was not required to issue a deposit for appeal of assessments and rulings with respect to any other years. In September 2005, the Superior Court declared the Company's claim valid. SUNAT has appealed this decision to the Supreme Court in Lima.

b) Year 1997: With regard to the penalty issued by SUNAT related to fiscal year 1997, in November 2002 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 and penalties related to fiscal years 1998 and 1999 have been protested before SUNAT. The Company's appeal before the Peruvian tax court related to the assessments (pertaining to the deduction of certain interest expense) for fiscal year 1997 was denied. In this regard, 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 remanded the case to SUNAT for a new pronouncement. SUNAT has appealed the court's decision to the Supreme Court in Lima.

c) SUNAT has not ruled on the portion of the 1998 and 1999 assessment related to the interest deductions. However, in August 2006, SUNAT ruled on other 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.

d) Years 2000 and 2001: In December 2004 and January 2005, the Company received assessments and penalties from SUNAT for the 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 and resolution is still pending.

In June 2006, a resolution of the fiscal court was published which found in favor of the tax payer, that profits related to foreign exchange differences need not be included in calculations for monthly advance tax payments. This resolution is mandatory in future cases. Therefore, 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 not valid 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) The Company has not recorded any expense associated with the assessment challenging deductions of interest expense for the years 1997, 1998, nor has the

Company recorded any expense associated with the assessments for the years 2000 and 2001.

#### Mexican operations

##### Labor matters

During the first half of 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. An illegal work stoppage at the La Caridad copper mine in Sonora began in the first quarter of 2006 and ended when the mine was returned to the Company on July 26, 2006. An illegal work stoppage at the San Martin polymetallic complex in Zacatecas commenced in the first quarter of 2006 and ended in May 2006. Additionally, workers at the Cananea copper mine went on an illegal work stoppage on June 1, 2006 returning to work six weeks later on July 17, 2006. These work stoppages have been 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 illegal work stoppages, 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 fired 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 La Caridad 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 by September 30, 2006 restored production to 70% of capacity. The Company expects to restore 100% of productive capacity in the fourth quarter of 2006.

Additionally, 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. For example, in Peru on August 31, 2004, unionized workers at the mining units in Toquepala and Cuajone initiated strike and sought additional wage increases based on high metal prices. In Mexico, on July 12, 2004, the workers of La Caridad went on strike asking for the review of certain contractual clauses. Such a review was performed and the workers returned to work 18 days later. On October 15, 2004, the workers of Cananea went on strike, followed by La Caridad workers. The strike lasted for six days at La Caridad and nine days at Cananea. In each case, the operations at the particular mine ceased until the strike was resolved. The Company cannot give assurances that they will not experience strikes or other labor-related work stoppages in the future that could have a material adverse effect on its financial condition and results of operations.

##### 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, IMMSA along with neighboring industry initiated a rescue effort. Federal and local governmental help and support was received. As a result of the accident 8 miners were injured and 65 perished.

The Coahuila Public District Attorney (*Procurador de Justicia*) initiated an investigation to establish (1) the causes of the accident and (2) the responsible party. The investigation is underway; however, it will be necessary for the investigation team to have access to the site where the explosion occurred, which at present is blocked. Recovery efforts are also continuing, however progress is very slow as access is blocked by debris and rocks. It may still take several more months to complete this effort. The underground coal mining operations at

Pasta de Conchos have been suspended and it is uncertain if and when such operations will resume.

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 March 2003, AMC purchased its interest in SCC from 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. The consent decree is binding solely on the U.S. government. 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. 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 matters, 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, which was settled in November 2005. 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 is operating and managing its businesses as a debtor in possession. Asarco LLC's bankruptcy could result in additional claims being filed against Grupo Mexico and its subsidiaries, including SCC, Minera Mexico or its subsidiaries.

Asarco has informed us that it believes that by utilizing the Chapter 11 process it can achieve an orderly restructuring of its business and finally resolve, among other contingencies, its environmental and asbestos claims. However, it is impossible to predict how the bankruptcy court will ultimately rule with respect to such petitions and the impact such rulings will have on Asarco and its subsidiaries.

K. 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 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 the past two 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 includes 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 includes 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 includes 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:

	Three Months Ended September 30, 2006 (in millions)				Consolidated
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate and other Eliminations	
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, amortization and depletion)	240.0	96.8	343.9	(171.5)	509.2
Selling, general and administrative expense	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
Taxes on income					(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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**Three Months Ended September 30, 2005**  
(in millions)

	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Corporate and other Eliminations</b>	<b>Consolidated</b>
Net sales outside of segments	\$ 395.0	\$ 63.4	\$ 571.8	\$	\$ 1,030.2
Intersegment sales	13.9	21.6	7.9	(43.4 )	
Cost of sales (exclusive of depreciation, amortization and depletion)	151.0	67.0	191.3	(26.3 )	383.0
Selling, general and administrative expense	7.4	3.9	8.4	0.5	20.2
Depreciation, amortization and depletion	49.4	6.1	19.3		74.8
Exploration	0.9	1.9	3.6		6.4
Operating income	\$ 200.2	\$ 6.1	\$ 357.1	\$ (17.6 )	545.8
Less:					
Interest, net					(27.8 )
Gain on derivative instruments					5.5
Loss on debt prepayment					
Other income (expense)					0.1
Taxes on income					(152.6 )
Minority interest					(1.6 )
Net earnings					\$ 369.4
Capital expenditures	\$ 12.7	\$ 9.0	\$ 96.4	\$	\$ 118.1
Property net	\$ 1,540.0	\$ 263.0	\$ 1,360.3	\$ 23.5	\$ 3,186.8
Total assets	\$ 2,366.1	\$ 469.9	\$ 3,194.5	\$ (633.6 )	\$ 5,396.9

**Nine Months Ended September 30, 2006**  
(in millions)

	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Corporate and other Eliminations</b>	<b>Consolidated</b>
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 depreciation, amortization and depletion)	624.7	258.5	898.1	(343.3 )	1,438.0
Selling, general and administrative expense	24.6	15.5	27.4	5.0	72.5
Depreciation, amortization and 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
Taxes on income					(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

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Total assets                    \$    2,625.7                    \$    617.3                    \$    3,201.1                    \$    (568.2    )                    \$    5,875.9

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**Nine Months Ended September 30, 2005**  
(in millions)

	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Corporate and other Eliminations</b>	<b>Combined</b>
Net sales outside of segments	\$ 1,215.6	\$ 176.5	\$ 1,531.0	\$	\$ 2,923.1
Intersegment sales	88.4	151.5	7.9	(247.8 )	
Cost of sales (exclusive of depreciation, amortization and depletion)	644.3	255.5	538.0	(252.1 )	1,185.7
Selling, general and administrative expense	20.4	11.7	25.1	2.0	59.2
Depreciation, amortization and depletion	132.6	17.4	56.4	(0.1 )	206.3
Exploration	3.3	4.6	9.3		17.2
Operating income	\$ 503.4	\$ 38.8	\$ 910.1	\$ 2.4	1,454.7
Less:					
Interest, net					(60.3 )
Gain on derivative instruments					2.8
Loss on debt prepayment					(7.7 )
Other income (expense)					0.2
Taxes on income					(405.4 )
Minority interest					(4.6 )
Net earnings					\$ 979.7
Capital expenditures	\$ 40.4	\$ 24.9	\$ 198.0	\$	\$ 263.3
Property net	\$ 1,540.0	\$ 263.0	\$ 1,360.3	\$ 23.5	\$ 3,186.8
Total assets	\$ 2,366.1	\$ 469.9	\$ 3,194.5	\$ (633.6 )	\$ 5,396.9

Sales value per segment:

**Three Months Ended September 30, 2006**  
(in millions)

	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Intersegment Elimination</b>	<b>Consolidated</b>
Copper	\$ 422.9	\$ 42.7	\$ 764.5	\$ (115.3 )	\$ 1,114.8
Molybdenum	3.0		108.9		111.9
Other	28.8	146.8	44.6	(34.7 )	185.5
Total	\$ 454.7	\$ 189.5	\$ 918.0	\$ (150.0 )	\$ 1,412.2

**Three Months Ended September 30, 2005**  
(in millions)

	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Intersegment Elimination</b>	<b>Consolidated</b>
Copper	\$ 295.3	\$ 11.7	\$ 384.0	\$ (17.4 )	\$ 673.6
Molybdenum	72.5		183.8		256.3
Other	46.2	73.3	11.9	(31.1 )	100.3
Total	\$ 414.0	\$ 85.0	\$ 579.7	\$ (48.5 )	\$ 1,030.2

**Nine Months Ended September 30, 2006**  
(in millions)

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	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Intersegment Elimination</b>	<b>Consolidated</b>
Copper	\$ 1,215.6	\$ 100.3	\$ 1,887.6	\$ (263.6 )	\$ 2,939.9
Molybdenum	38.7		334.7		373.4
Other	85.4	384.7	98.2	(71.3 )	497.0
Total	\$ 1,339.7	\$ 485.0	\$ 2,320.5	\$ (334.9 )	\$ 3,810.3

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<b>Nine Months Ended September 30, 2005</b>					
<b>(in millions)</b>					
	<b>Mexican Open Pit</b>	<b>Mexican IMMSA Unit</b>	<b>Peruvian Operations</b>	<b>Intersegment Elimination</b>	<b>Combined</b>
Copper	\$ 942.0	\$ 110.7	\$ 946.3	\$ (177.8 )	\$ 1,821.2
Molybdenum	225.8		563.6		789.4
Other	141.4	217.2	28.9	(75.0 )	312.5
Total	\$ 1,309.2	\$ 327.9	\$ 1,538.8	\$ (252.8 )	\$ 2,923.1

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

	<b>Three Months Ended September 30, (in millions)</b>		<b>Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
United States	\$ 494.0	\$ 316.5	\$ 1,355.8	\$ 943.2