

## VOLCAN COMPAÑÍA MINERA S.A.A. AND SUBSIDIARIES 1<sup>ST</sup> QUARTER 2011 MANAGEMENT'S DISCUSSION AND ANALYSIS

US\$ Millions	IQ 2011	IQ 2010	Var (%)
SALES	273.7	210.1	30.3%
EBITDA	155.5	109.9	41.5%
NET PROFIT	90.2	61.0	48.0%

This document constitutes a brief analysis of the most significant economic and financial results for Q1 2011.

### I. General Overview:

For a proper analysis of the Company's results, it is important to describe the behavior of certain variables that have impacted such results.

1. During Q1 2011, average international prices for Zinc (Zn), Lead (Pb), and Silver (Ag), the main metals produced by the Company, increased 4.6%, 17.3%, and 87.2%, respectively, as compared to the same period of the previous year.

**Table 1: Average prices**

	IQ 11	IQ 10	Var (%)
Zn (US\$/TM)	2,395	2,289	4.6
Pb (US\$/TM)	2,604	2,221	17.3
Ag (US\$/Oz)	31.7	16.9	87.2

Source: Reuters

2. The average exchange rate during Q1 2011 was S/. 2.78 per U.S. dollar. This rate reflects a 2.5% appreciation of the Nuevo Sol when compared to the average rate during Q1 2010 (S/. 2.85 per U.S. dollar).
3. At the end of Q1 2011, Brent Crude oil price was quoted at US\$ 117.36 per barrel, which represents a 42% increase versus the quote at the end of Q1 2010 (US\$ 82.70 per barrel).
4. The accumulated inflation (WPI) for Q1 2011 was 2.28% versus 1.15% for the same period in 2010. The Consumer Price Index (CPI) for Q1 2011 was 1.48% versus 0.90% for Q1 2010.

5. The domestic production of most major metals declined during the first two months of 2011 as compared to the same period in 2010. The following table shows the details of such decline:

**Table 2: Peru's metal production**

Production	Units	Jan-Feb 11	Jan-Feb 10	Var (%)
Copper	FMT	193,142	195,943	(1.4)
Gold	Fine ounces	826,044	995,248	(17.0)
Zinc	FMT	226,703	244,343	(7.2)
Silver	Fine kg	562,329	574,237	(2.1)
Lead	FMT	34,535	45,459	(24.0)
Iron	LFT	1,073,787	888,131	20.9
Tin	FMT	4,335	5,955	(27.2)
Molybdenum	FMT	2,702	2,166	24.7
Tungsten	FMT	113	113	0.0

Source: Ministry of Energy and Mines

## II. Analysis of Operating Results

### 1. Production

The volume of treated ore during Q1 2011 increased by 1.9% in the Yauli Mining Unit, and by 0.6% in the Chungar Mining Unit, as compared to the same period in 2010. In the Cerro de Pasco Mining Unit, the volume of treated ore declined by 41.6% due to the previously announced underground-mine and open-pit operations optimization program. It is noteworthy that this program involved a 5,000 MT reduction in the volume of ore treated per day as of Q4 2010. Nevertheless, this reduction is compensated by higher grades and greater recoveries from the underground mine.

The optimization program involves the execution of metallurgical projects, such as the Ag Oxides and Ag Pyrite projects, as well as the development of the Vinchos Unit. Such projects will lead to improved profitability of this mining unit in the short and medium term. It is worth highlighting in this regard the promising results observed in the Ag Pyrite project: during the pre-operating stage, this project has already produced 310,000 ounces of silver in the first quarter of 2011.

In regards to the production of fine ores during Q1 2011, when compared to Q1 2010 production, we can observe that the production of fine Zn and Pb ores declined by 7.3% and 27.7%, respectively. This is mainly due to a lower tonnage treated in Cerro de Pasco and, in the case of Pb, as a result of lower grades of the ore mined. The production of fine silver ore, on the other hand, increased by 6.4% on account of greater production at the Cerro de Pasco and Chungar mining units (24.2% and 15.5%, respectively). Finally, the production of fine copper ore increased by 9.3%, mainly due to the 18.5% production increase in Yauli, which is explained by the increased contribution of certain projects undergoing evaluation.

**Table 3: Treated Ore**

Treated Ore (Thousand MT )			
Unit	IQ 11	IQ 10	Var (%)
Yauli	853	837	1.9
Cerro de Pasco	565	968	(41.6)
Chungar	365	363	0.6
Vinchos	0	42	
Alpamarca	0	40	
<b>Total Volcan</b>	<b>1,784</b>	<b>2,249</b>	<b>(20.7)</b>

**Table 4: Production of fine ores**

Production of Fines			
	IQ 11	IQ 10	Var (%)
<b>Zinc ( MT )</b>			
Yauli	40,125	38,070	5.4
Cerro de Pasco	16,413	24,410	(32.8)
Chungar	25,616	25,526	0.4
Vinchos	0	114	
Alpamarca	0	459	
<b>Total Volcan</b>	<b>82,154</b>	<b>88,580</b>	<b>(7.3)</b>
<b>Lead ( MT )</b>			
Yauli	5,201	4,289	21.3
Cerro de Pasco	3,677	7,450	(50.6)
Chungar	4,076	5,496	(25.8)
Vinchos	0	282	
Alpamarca	0	407	
<b>Total Volcan</b>	<b>12,955</b>	<b>17,925</b>	<b>(27.7)</b>
<b>Silver ( Thousand oz )</b>			
Yauli	2,732	2,636	3.6
Cerro de Pasco	1,205	970	24.2
Chungar	1,165	1,009	15.5
Vinchos	0	97	
Alpamarca	0	83	
<b>Total Volcan</b>	<b>5,102</b>	<b>4,795</b>	<b>6.4</b>
<b>Copper ( MT )</b>			
Yauli	717	606	18.5
Cerro de Pasco	0	2	
Chungar	222	239	(7.1)
Alpamarca	0	13	
<b>Total Volcan</b>	<b>939</b>	<b>859</b>	<b>9.3</b>

## 2. Operating Costs

The consolidated unit cost in Q1 2011 was 48.0 US\$/MT as compared to 38.2 US\$/MT in the same period last year (55.3 US\$/MT in Q4 2010), mainly due to the reasons explained below.

- Change in de production mix of the Cerro de Pasco Mining Unit, with increased ore contribution from the underground mine (58% in Q1 2011 against 37% in Q1 2010), and a lower ore contribution from the open pit. In Q1 2011, the underground mine unit cost was 29.4 US\$/MT while the open-pit unit cost was 4.6 US\$/MT. Nevertheless, as a result of higher grades and greater recoveries of underground ore, its unit value offsets its higher unit cost, thus generating a greater contribution per MT.
- Increased fixed cost per ton treated at the Cerro de Pasco Unit, as a result of the scheduled reduction in treated ore tonnage coming from the open pit.

It should be mentioned that the largest component of fixed costs in the Cerro de Pasco Mining Unit is personnel expenses. The Company's personnel reduction target given the new production levels, covers roughly 720 workers, out of which, as of March 31, 2011, 453 individuals had voluntarily tendered their resignation through a company-sponsored incentive program. The estimated impact of this cutback on fixed cost was approximately US\$ 5 per treated ton. This contributed to a reduced unit cost of US\$ 48.0 US\$/MT for Q1 2011. The extraordinary expenses related to compensations granted to the personnel terminated during Q1 2011 were roughly US\$ 6 million.

Additionally, such increase in the unit cost is explained to a lesser extent by higher service rates and increased prices of materials and supplies, as a consequence of inflation resulting from increases in commodity prices.

**Table 5: Cost per treated ton (US\$/MT)**

Unit	IQ 11	IQ 10	Var (%)
Yauli	49.8	48.3	3.0
Cerro de Pasco	41.3	23.5	75.8
Chungar	52.7	49.6	6.2
Vinchos*	-	59.7	
Alpamarca*	-	35.1	
<b>Total Volcan</b>	<b>48.0</b>	<b>38.2</b>	<b>25.8</b>

\* Operations at Vinchos and Alpamarca were temporarily stopped on April and August, 2010, respectively.

## 3. Investments

The investments made by the Company during Q1 2011 totaled US\$ 55.8 million. This figure represents a 31% increase in comparison to the investments made in the same period of the previous year (US\$ 42.6 million).

During Q1 2011, the investments made in the Cerro de Pasco, Yauli, and Chungar operating units totaled US\$ 38.5 million (including exploration and development investments), which represents a 19.2% increase versus the US\$ 32.3 million registered in the same period of 2010. Such increase results mainly from investments focused on

operating improvements, cost optimization and safety improvement projects, such as the Jacob Timmers Shaft located in Chungar, power-based projects aimed at guaranteeing power supply to support our future growth plans, and greater local exploration and development investments. Regional exploration investments (outside the operating units) amounted to US\$ 3.6 million, and investments focused on new unit/business development projects, among others, amounted to US\$ 13.6 million, including US\$ 6.3 million invested in Rondoní, US\$ 3.3 million in the Baños V Hydroelectric Power Plant, US\$ 2.2 million in Alpamarca, and US\$ 1.8 million in Vinchos.

**Table 6: Investments\***

US\$ (000)	IQ 11	IQ 10	Var. %
Investments in Operating Units	38,542	32,330	19.2
Regional Explorations	3,642	3,846	(5.3)
Projects and Others	13,616	6,423	112.0
<b>Total</b>	<b>55,800</b>	<b>42,599</b>	<b>31.0</b>

\* Stock investments are excluded.

### III. Analysis of Economic and Financial Results

#### 1. Sales and Profits

During Q1 2011, Volcan's sales reached US\$ 273.7 million, which represents a 30.3% increase compared to the same period in 2010. This is explained mainly by higher international metal prices and a higher Cu concentrate sales volume (69%), partially offset by lower Zn and Pb concentrate sales volumes (-5% and -16%, respectively).

As of March 31, 2011, concentrate inventory totaled 23,333 MT, with a value of roughly US\$ 60 million<sup>1</sup>.

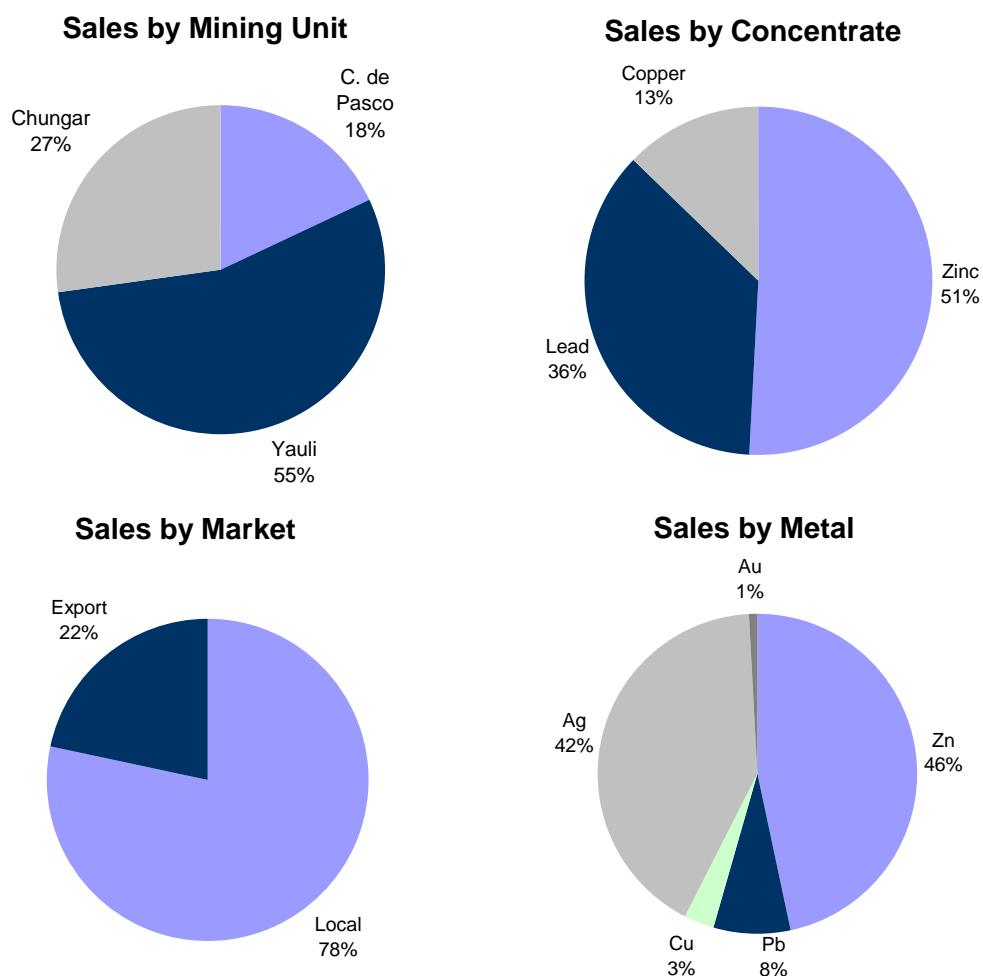
**Table 7: Sales Volume (MT)**

Product	IQ 11	IQ 10	Var. %
Zinc Concentrate	158,390	166,432	(4.8)
Lead Concentrate	23,899	28,429	(15.9)
Copper Concentrate	4,736	2,806	68.8

During Q1 2011, the Yauli Mining Unit continued contributing the highest sales value (55% of the total) to the Company, followed by Chungar with 27%, and Cerro de Pasco with 18%. As a result of higher silver production and of an increase in the international price of silver, the share of this metal in the Company's sales value increased significantly, reaching 42% compared to 46% for Zn, and 8%, 3%, and 1% for Pb, Cu, and Au, respectively.

<sup>1</sup> This amount was calculated by using the concentrate average sale value during March.

**Chart 1: Q1 2011 Sales (% of value in US\$)**



Higher sales value per ton was the fundamental factor behind the Q1 2011 gross margin exceeding the one registered in the same period of 2010 (58% against 54%).

Additionally, the operating profit for Q1 2011 reached US\$ 132.8 million, representing a 45.6% increase versus the same quarter of 2010. Operating results for Q1 2011 include extraordinary compensations granted to personnel (Cerro de Pasco Optimization Program) in the amount of US\$ 6.0 million.

The Company uses derivative instruments, in particular futures contracts involving metal commodities, in order to reduce the risk of price fluctuations. During Q1 2011, due to the significant increase in silver prices, the Company registered a US\$ 9.3 million loss related to such financial instruments, whereas in the same period of 2010, the loss amounted to US\$ 1.1 million.

Finally, the net profit for Q1 2011 reached US\$ 90.2 million, 48% higher than Q1 2010 results.

**Table 8: Main items of the income statement**

US\$ (000)	IQ 11	IQ 10	Var (%)
Sales	273,720	210,071	30.3
Cost to Sales	(114,235)	(96,961)	17.8
<b>Gross Profit</b>	<b>159,485</b>	<b>113,110</b>	<b>41.0</b>
Administrative Expenses	(13,064)	(10,680)	22.3
Selling Expenses	(11,457)	(10,428)	9.9
Other Income/(Expenses)	(2,162)	(778)	177.9
<b>Utilidad Operativa</b>	<b>132,801</b>	<b>91,224</b>	<b>45.6</b>
Finance Income/(Costs)	349	(757)	(146.1)
Options and Hedging	(9,308)	(1,106)	741.6
Profit Sharing, Taxes	(33,612)	(28,400)	18.4
<b>Net Income</b>	<b>90,230</b>	<b>60,961</b>	<b>48.0</b>

Note: According to International Financial Reporting Standards (IFRS), the workers' profit sharing is included in the cost to sell and administrative expenses items both for Q1 2010 and Q1 2011.

## 2. Profitability

Q1 2011 EBITDA registered a 41.5% increase when compared to the same period of 2010. Such increase is mainly explained by higher international metal prices. In addition, the EBITDA margin rose from 52% in Q1 2010 to 57% in Q1 2011.

**Table 9: EBITDA**

US\$ (000)	IQ 11	IQ 10	Var (%)
EBITDA* (US\$ '000)	155,510	109,911	41.5
EBITDA/Sales	57%	52%	

\* The allowance for collection of Doe Run's debt at Q1 2011 amounting to US\$ 2.2 million, and the compensations granted to the personnel in Q1 2011 amounting to US\$ 6 million are excluded.

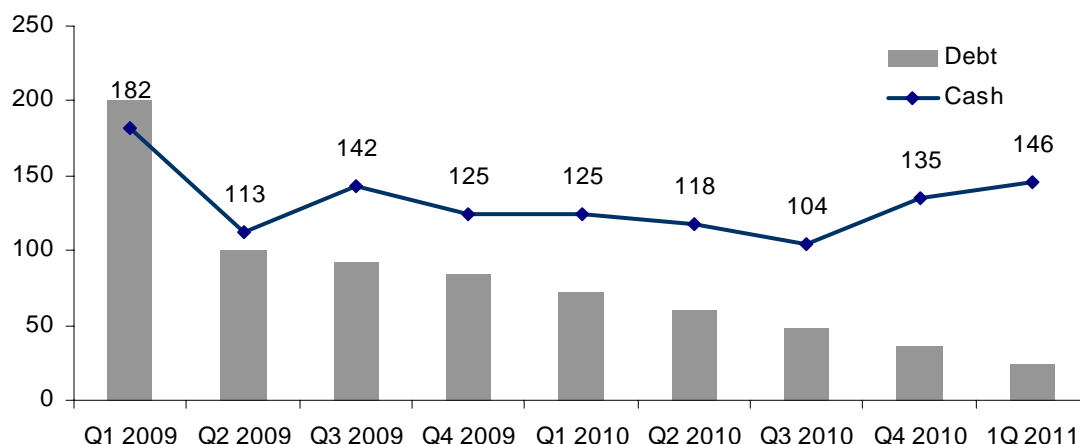
## 4. Liquidity and Creditworthiness

Volcan's operating cash flow in Q1 2011 was US\$ 82 million, which enabled the Company to finance investments totaling US\$ 55.8 million, to pay down debt for US\$ 13.2 million, and to generate a net cash flow for the quarter amounting to US\$ 10.7 million. As of March 31, 2011, the balance of the Company's syndicated loan was US\$ 24 million.

As a consequence of the above, Volcan's leverage ratio (Financial Debt / EBITDA) remained below 0.1x.

The chart below shows the evolution of Volcan's cash position and the balance of its debt.

**Chart 2: Cash position and debt balance**



## IV. Conclusions

1. Volcan's Q1 2011 financial results were significantly better than those of Q1 2010. This was mainly the result of the significant increase in the international prices of the metals produced by the Company. It is noteworthy that silver production increased by 6.4%, while silver price increased by 87%.
2. Investments made in order to extend the life of our mines were successful. Mine reserve life increased from 16 years in 2009 to 18 years in 2010. In addition, if resources are included, the life of mine increased from 25 years in 2009 to 31 years in 2010.
3. Investments to increase Ag production growth in our operations have started to yield good results. During Q1 2011, the Cerro de Pasco Pyrite project contributed 300,000 ounces of silver while still in pre-operating stage. Volcan is the first producer of silver in Peru, with a production of over 20 million ounces, and projects such as Alpamarca - Rio Pallanga, Vinchos, Islay, Ag Oxides, and Ag Pyrite are expected increase production by more than 50% in the years to come.
4. Investments aimed at reducing operating costs and increasing efficiency levels in our operations are progressing at a good pace. Investments made in exploration projects such as Rondoní and Oyama-Triunfo are yielding similar results. In Rondoní, progress is being made with an exploration program covering 70,000 meters of drilling, which is aimed at defining approximately 100 million tons of resources.
5. Our power-based investments are also on schedule. The Baños V and Belo Horizonte projects, as well as the 220 KV transmission line, are being executed according to schedule and on budget.
6. Finally, it should be mentioned that the process of consolidating the new management team and formalizing the new organizational structure, are well underway. The Company is determined to continue to establish the foundations for strong future growth while developing a high performance culture that lasts through time as a key component of its business strategy.