# VOLCAN COMPAÑÍA MINERA S.A.A. AND SUBSIDIARIES
# 1ST QUARTER 2012 MANAGEMENT'S DISCUSSION AND ANALYSIS

| US$ Millions | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| SALES | 289.8 | 262.9 | 10.2% |
| EBITDA | 143.6 | 151.0 | -4.9% |
| NET PROFIT | 70.8 | 76.2 | -7.2% |

This document represents a brief analysis of the most significant economic and financial results for Q1 2012.

## I. General Overview:

For a proper analysis of the Company's results, it is important to describe the behavior of certain prices and macroeconomic variables that have had an impact on such results.

1. During Q1 2012, average international prices for Zinc (Zn) and Lead (Pb) declined by 15.5% and 19.6%, respectively; on the other hand, Silver (Ag) prices increased by 3.1%, as compared to the same period of the previous year.

**Table 1: Average prices**

| | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Zn (US$/TM) | 2,024 | 2,395 | (15.5) |
| Pb (US$/TM) | 2,094 | 2,604 | (19.6) |
| Ag (US$/Oz) | 32.7 | 31.7 | 3.1 |

Source: Metals Week - Platts

2. Average exchange rate during Q1 2012 was S/. 2.683 per US$ Dollar. This rate reflects a 3.5% appreciation of the Nuevo Sol if compared to the average rate for Q1 2011 (S/. 2.780 per US$ Dollar).
Source: bcrp.gob.pe

3. At the end of Q1 2012, Brent Crude oil price was quoted at US$ 122.80 per barrel, which represents a 6.67% increase with regard to the price at the end of Q1 2011 (US$ 115.1 per barrel) and a 48.5% increase compared to the price at the end of Q1 2010 (US$ 82.70).
Source: Invertis

4. Inflation, measured based on the variations in the Consumer Price Index, and annualized as of March 31, 2012, reached 4.23%. On the other hand, the Wholesale Price Index increased by 4.10%.
Source: bcrp.gob.pe

During the first two months of 2012, domestic production of Gold, Silver and Lead increased by 13.3%, 6% and 15.9%, respectively, while Zinc and Copper production decreased by 7.5% and 2.7%, respectively, when compared to volumes produced during the first two months of 2011.

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

| Production | Unit | Jan - Feb 2012 | Jan - Feb 2011 | Var (%) |
|---|---|---|---|---|
| Copper | MT Fines | 187,324 | 192,612 | (2.7) |
| Gold | Kg Fines | 28,241 | 24,916 | 13.3 |
| Zinc | MT Fines | 208,315 | 225,311 | (7.5) |
| Silver | Kg Fines | 575,301 | 542,615 | 6.0 |
| Lead | MT Fines | 38,749 | 33,444 | 15.9 |

Source: Ministry of Energy and Mines

## II. Analysis of Operating Results

### 1. Production

On a consolidated basis, the volume of ore treated during Q1 2012 increased by 6.4% when compared to the volume treated during Q1 2011. In Cerro de Pasco, Chungar and Yauli Mining Units, the volume of treated ore increased by 12.5%, 6.7% and 2.2%, respectively. Cerro de Pasco Unit registered the largest increase, with additional 71 thousand tons treated on account of the processing of Silver Pyrite ore in the San Expedito Plant while still on pre-operating stage, achieving approximately a treated tonnage of 1,800 tons per day.

**Table 3: Treated Ore (Thousand MT)**

| Unit | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Yauli | 872 | 853 | 2.2 |
| Cerro de Pasco | 636 | 565 | 12.5 |
| Chungar | 390 | 365 | 6.7 |
| **Total Volcan** | **1,898** | **1,784** | **6.4** |

With regards to Q1 production of fine ores, it may be noted that the production of Lead fines grew by 36.1%, from 12,949 MT in 2011 to 17,623 MT in 2012, At the same time the production of Silver ounces increased by 6.3%, from 5.1 million in 2011 to 5.4 million in 2012. However, Zinc production decreased by 7.8%, from 82,123 MT in 2011 to 75,697 MT in 2012. The production of copper fines decreased as well, from 939 MT in 2011 to 736 MT in 2012, mainly as a consequence of lower grades of the ore processed in the concentrating plants.

**Table 4: Production by metal**

| Unit | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| **Zinc (MT)** | | | |
| Yauli | 36,820 | 40,094 | (8.2) |
| Cerro de Pasco | 14,853 | 16,413 | (9.5) |
| Chungar | 24,025 | 25,616 | (6.2) |
| **Total Volcan** | **75,697** | **82,123** | **(7.8)** |
| **Lead (MT)** | | | |
| Yauli | 7,065 | 5,195 | 36.0 |
| Cerro de Pasco | 5,690 | 3,677 | 54.7 |
| Chungar | 4,869 | 4,076 | 19.4 |
| **Total Volcan** | **17,623** | **12,949** | **36.1** |
| **Silver (Ounces 000)** | | | |
| Yauli | 2,770 | 2,732 | 1.4 |
| Cerro de Pasco | 1,362 | 1,205 | 13.0 |
| Chungar | 1,294 | 1,165 | 11.0 |
| **Total Volcan** | **5,426** | **5,102** | **6.3** |
| **Copper (MT)** | | | |
| Yauli | 505 | 717 | (29.6) |
| Cerro de Pasco | 0 | 0 | |
| Chungar | 231 | 222 | 4.1 |
| **Total Volcan** | **736** | **939** | **(21.6)** |

## 2. Operating Costs

Volcan's consolidated unit cost of production in Q1 2012 reached 52.3 US$/MT, as compared to 46.7 US$/MT in the same period of the previous year, representing a 12.0% increase. This is explained primarily by the effects of the inflationary trend experienced by the mining sector, the appreciation of the Nuevo Sol, increased energy rates and higher costs incurred in order to raise safety and maintenance standards in the mining units.

During 2011, the mining sector experienced growing inflation ranging from 15% to 20%, which resulted in increased service rates and higher prices of the main supplies during Q1 2012. Service rate inflation is explained mainly by the increase in labor costs due to the higher demand of mining operators as a result of the development of mining projects in Peru. On the other hand, price inflation of supplies resulted in an increase in the prices of certain materials and supplies, such as lime, copper sulfate, timber, steel balls, and fuel.

In addition, the 3.5% appreciation of the Nuevo Sol with regard to the U.S. Dollar had a negative effect on the total cost, given that approximately 40% of our operating costs are expressed in Nuevos Soles.

### Table 5: Production Unit Cost (US$/MT)

| Production Cost (US$/MT)* | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Yauli | 60.2 | 49.8 | 21.0 |
| Cerro de Pasco | 40.8 | 38.6 | 5.8 |
| Chungar | 55.2 | 52.6 | 4.8 |
| **Total Volcan** | **52.3** | **46.7** | **12.0** |

* The calculation of Cerro de Pasco's production cost and Volcan's consolidated production cost includes the Pyrite ore treated in San Expedito.

## 3. Investments

During Q1 2012, investments made by Volcan on fixed and intangible assets totaled US$ 51.5 million, a 7.7% decline with regard to the investments made in the same period of the previous year (US$ 55.8 million).

First, operating investments during Q1 2012 amounted to US$ 40 million and remained at similar levels to the ones made during Q1 2011, which totaled US$ 39.9 million. The aforementioned investments made during Q1 2012 were mainly addressed to the following areas: local exploration and development (US$ 18.9 million), plants and tailing storage facilities (US$ 6.2 million), mine investments (US$ 5.3 million), operating projects (US$ 3.4 million), operating power, safety, IT, camps and others (US$ 6.2 million). In addition, regional exploration investments amounted to US$ 1.9 million, a 7.9% decline compared to the same period of the previous year. This is explained by reduced working volumes and diamond drilling exploration activities in Cerro de Pasco, Yauli, and Chungar Units. Finally, investments made during Q1 2012 in corporate development and growth projects reached US$ 9.5 million, representing a 31.1% decline with regard to Q1 2011, due to seasonality issues in the execution of growth projects. Despite this, it should be noted that investments in growth projects during 2012 will be significantly higher than those made during 2011, due to the execution of Ag Oxides projects in Cerro de Pasco and Alpamarca-Río Pallanga.

### Table 6: Investments*

| US$ (000) | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Investments in Mining Units | 40,051 | 39,923 | 0.3 |
| Regional Explorations | 1,928 | 2,094 | (7.9) |
| Growth Projects and Others | 9,501 | 13,782 | (31.1) |
| **Total** | **51,480** | **55,800** | **-7.7** |

* The total indicated in this table does not reflect the same amount reported in the Cash Flow Statement of the quarterly Financial Statements, given that the latter includes other items such as advances, Goodwill, municipal agreements, among others, and excludes investments made in Vichaycocha.

It is worth mentioning additional investments made in Q1 2012, such as the purchase the Huanchor Hydroelectric Power Plant, for US$ 46.7 million, and the purchase of additional stock in Cementos Polpaico, in the amount of US$ 4.1 million.

# III. Analysis of Economic and Financial Results

## 1. Sales and Profits

The following analysis of results is based on the figures presented in Q1 2012 Financial Statements, prepared according to International Financial Reporting Standards (IFRS). The figures reported in 2011 included in this section have been re-stated according to IFRS so that they are comparable to the 2012 figures.

During Q1 2012, Volcan's sales totaled US$ 289.8 million, representing a 10.2% increase with regard to the same period of 2011. This figure, however, includes sales adjustments related to the application of IFRS. At the closing of Q1 2012, the amount referred to IFRS adjustments was US$ 24.8 million, while the amount related to IFRS adjustments at the end of Q1 2011 was minus US$ 10.8 million.

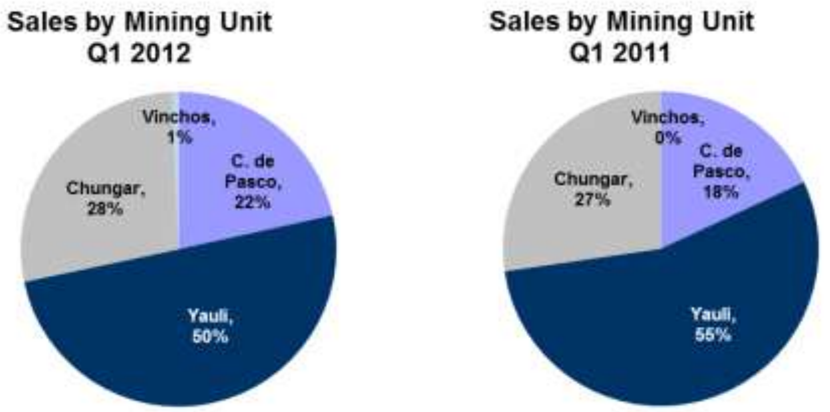
Zinc, Lead and Silver concentrate volumes (in Dry MT) sold in Q1 2012 increased by 3%, 21% and 332%, respectively, compared to the same period of 2011. However, sales in U.S. Dollars were affected mainly by the decline in the international prices of Zinc (-15.5%) and Lead (-19.6%).

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

| Product | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Zinc Concentrate | 163,148 | 158,390 | 3.0 |
| Lead Concentrate | 27,705 | 22,887 | 21.1 |
| Copper Concentrate | 4,738 | 4,736 | 0.0 |
| Silver Concentrate | 4,373 | 1,012 | 332.2 |

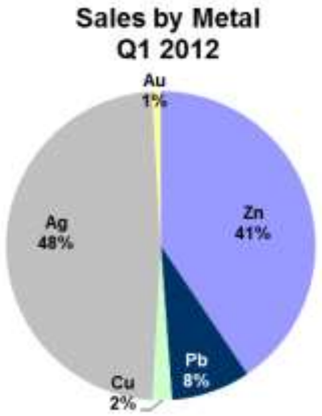
During Q1 2012, Yauli mining unit continued to have the largest share of the Company's sales (50% of the total), followed by Chungar with 28% and Cerro de Pasco with 22%.

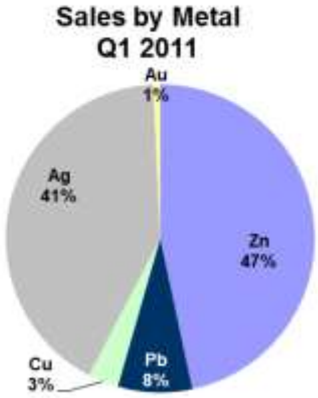
**Chart 1: Sales by Mining Unit (% of value in US$)**



With regards the composition of the Company's sales by metal, it is noteworthy the increase in the participation of Silver, mainly explained by the higher production, and by the 3% increase in its international price, when compared to Q1 2011. Thus, during Q1 2012, Silver accounted for 48% of Volcan's sales, exceeding the participation of Zinc (41%), Lead, (8%), Copper (2%), and Gold (1%).

**Chart 2: Sales by Metal (% of value in US$)**




Gross profit for Q1 2012 reached US$ 136.1 million, a 3.4% decline if compared to the same period of the previous year. This is explained by lower Zinc and Lead prices and the previously mentioned higher production costs, which resulted in a gross margin decline, from 53.6% in Q1 2011 to 47.0% in the same period of 2012.

Likewise, the operating profit for Q1 2012 reached US$ 115.3 million, a 3.5% decline if compared with US$ 119.5 million for the same quarter of 2011.

During Q1 2012, the Company registered a US$ 1.3 million gain related to its financial derivative instruments, whereas in the same period of 2011 it registered a US$ 9.3 million loss.

Finally, the net profit for Q1 2012 was US$ 70.8 million, down 7.2% from Q1 2011 results.

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

| Thousand US$ | Jan - Mar 2012 | | Jan - Mar 2011* | | Var (%) |
|---|---|---|---|---|---|
| Sales | 289,838 | 100% | 262,919 | 100% | 10.2 |
| Cost of Goods Sold | (153,708) | -53% | (122,029) | -46% | 26.0 |
| **Gross Profit** | **136,130** | **47.0%** | **140,891** | **53.6%** | **(3.4)** |
| Administrative Expenses | (13,608) | -5% | (12,892) | -5% | 5.6 |
| Selling Expenses | (7,465) | -3% | (6,169) | -2% | 21.0 |
| Exploration Expenses | (191) | 0% | (172) | 0% | 11.3 |
| Other Income/(Expenses) | 410 | 0% | (2,162.6) | -1% | (119.0) |
| **Operating Earnings** | **115,276** | **40%** | **119,495** | **45%** | **(3.5)** |
| Finance Income/(Costs) | (8,725) | -3% | 349 | 0% | (2,600.5) |
| Options and Hedging | 1,269 | 0% | (9,308) | -4% | (113.6) |
| Taxes | (32,863) | -11% | (29,003) | -11% | 13.3 |
| Royalties | (4,195) | -1% | (5,288) | -2% | (20.7) |
| **Net Profit** | **70,763** | **24%** | **76,245** | **29%** | **(7.2)** |

*** Re-stated according to IFRS.**

## 2. Profitability

Q1 2012 EBITDA[1] amounted to US$ 143.6 million, a 4.9% decline when compared to the similar period of 2011. Such decline is mainly explained by lower Zinc and Lead prices, higher production costs and a slight increase in operating expenses. As a result, EBITDA margin decreased from 57% in Q1 2011 to 50% in the same period of 2012.

### Table 9: EBITDA

| | Jan - Mar 2012 | Jan - Mar 2011 | Var (%) |
|---|---|---|---|
| Net Profit | 70,763 | 76,245 | (7.2) |
| EBITDA* (US$ '000) | 143,558 | 150,978 | (4.9) |
| EBITDA/Sales | 50% | 57% | |

## 3. Liquidity and Creditworthiness

In Q1 2012 Volcan generated operating cash flow of US$ 29.5 million. During the same period, the Company invested US$ 102.3 million, including investments in fixed and intangible assets for US$ 51.5 million, the purchase of Huanchor Hydroelectric Power Plant for US$ 46.7 million, and an additional investment in Cementos Polpaico for US$ 4.1 million.

It should be noted that in the last few days of January 2012, Volcan successfully placed US$ 600 million worth of 10-year bonds in the international financial markets. The annual interest obtained for this placement was 5.375%. The funds from this transaction will be used to finance the Company's Silver and Copper growth projects.

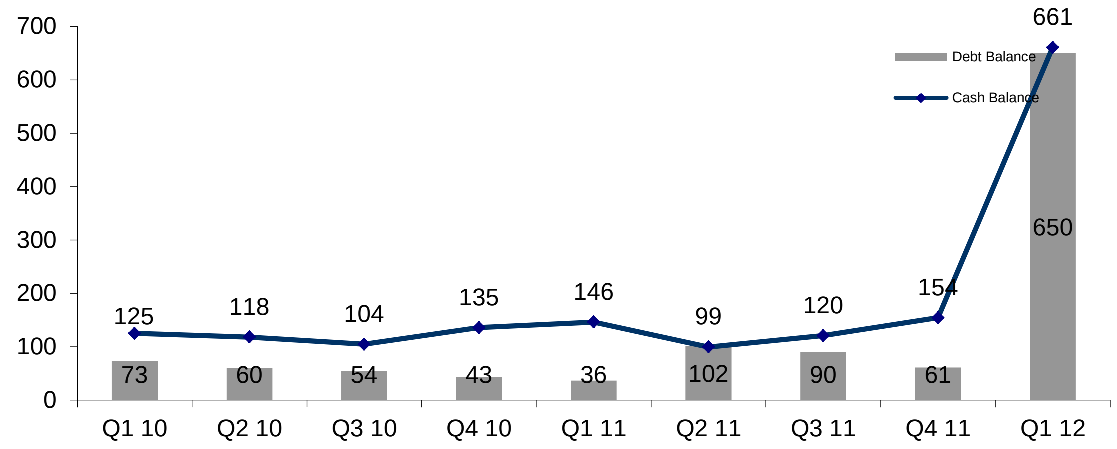
[1] EBITDA: Operating Profit + Depreciation and Amortization + Non-recurring Expenses.

As a result of this transaction, the cash balance of the Company increased from US$ 154.1 million at the end of 2011 to US$ 660.9 million at the end of Q1 2012.

Taking into consideration this new funding, Volcan's annualized Q1 2012 leverage ratio (Financial Debt / EBITDA) was 1.13x.

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

**Chart 3: Cash Position and Debt Balance[2] (US$ million)**




## IV. Final Comments

1. Q1 2012 sales were favored by higher Zinc, Lead and Silver concentrate volumes sold, increased prices of Silver, and adjustments arising from the application of IFRS. As a result of this, sales increased by 10.2% compared to Q1 2011, in spite of lower Zinc and Lead prices in the International Markets.

2. Production costs during Q1 2012 have been affected by the mining sector inflationary trend, having a significant impact in the areas in which Volcan operates, due to the presence of major mining projects. Costs were additionally affected by the appreciation of the Nuevo Sol, increased electric power rates of the National Interconnected System, and higher costs related to improved safety and maintenance standards in our operations.

3. The financing obtained through the US$ 600 million international long-term debt placement, at a rate of 5.375%, gives us the support needed to secure the execution of our growth projects, the same which will allow us to increase our Silver production by approximately 50% within the next 24 months, and to significantly increase our Copper production as of 2016.

4. The purchase of Huanchor Hydroelectric Power Plant, completed during Q1 2012, will allow us to consolidate Volcan's position in the power sector. This purchase, along with the start-up of Baños V Hydroelectric Power Plant in May 2012, will increase Volcan's power generation capacity to 42 MW, thus having a positive impact on our future operational costs.

[2] Financial debt includes loans granted by financial institutions, leasing contracts, among others.