SOUTHERN COPPER CORP/
Form 10-Q
October 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2009

or

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

For the transition period from to

Commission File Number: 1-14066

SOUTHERN COPPER CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**13-3849074** (I.R.S. Employer Identification No.)
11811 North Tatum Blvd. Suite 2500 Phoenix, AZ (Address of principal executive offices)	**85028** (Zip Code)

Registrant s telephone number, including area code: **(602) 494-5328**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

As of October 31, 2009 there were outstanding 850,000,000 shares of Southern Copper Corporation common stock, par value $0.01 per share.

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Southern Copper Corporation (SCC)

INDEX TO FORM 10-Q

Exhibit 32.2	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
Exhibit 101	Financial statements for the quarter ended September 30, 2009 Formatted in XBRL: (i) the Condensed Consolidated Statement of Earnings, (ii) the Condensed Consolidated Balance Sheet, (iii) the Condensed Consolidated Statement of Cash Flows, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.	Submitted electronically with this report

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Part I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Southern Copper Corporation

CONDENSED CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

	3 Months Ended September 30, 2009	3 Months Ended September 30, 2008	9 Months Ended September 30, 2009	9 Months Ended September 30, 2008
	(in thousands, except per share amounts)			
Net sales	$ 1,151,769	$ 1,440,077	$ 2,598,276	$ 4,401,079
Operating costs and expenses:				
Cost of sales (exclusive of depreciation, amortization and depletion shown separately below)	529,893	645,798	1,324,824	1,716,845
Selling, general and administrative	23,804	25,937	60,697	77,318
Depreciation, amortization and depletion	82,266	83,944	239,202	248,339
Exploration	7,075	8,452	17,498	25,504
Total operating costs and expenses	643,038	764,131	1,642,221	2,068,006
Operating income	508,731	675,946	956,055	2,333,073
Interest expense	(25,126)	(25,610)	(74,402)	(80,275)
Capitalized interest	(3,287)	2,305	2,156	4,834
Gain(loss) on derivative instruments	(37)	(13,621)	4,144	(12,700)
Other income (expense)	760	21,274	2,628	19,689
Interest income	845	9,764	6,018	39,360
Income before income taxes	481,886	670,058	896,599	2,303,981
Income taxes	167,661	249,700	327,099	764,614
Net income	314,225	420,358	569,500	1,539,367
Less: Net income attributable to the non-controlling interest	1,774	2,556	3,389	8,115
Net income attributable to SCC	$ 312,451	$ 417,802	$ 566,111	$ 1,531,252
Per common share amounts:				
Net income attributable to SCC - basic and diluted	$ 0.37	$ 0.47	$ 0.67	$ 1.73
Dividends paid to SCC common shareholders	$ 0.10	$ 0.57	$ 0.26	$ 1.61

Weighted average common shares outstanding - basic and diluted	850,009	882,696	850,929	883,165

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

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Southern Copper Corporation

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

	September 30, 2009	December 31, 2008
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 413,280	$ 716,740
Short-term investments	25,956	62,376
Accounts receivable trade, less allowance for doubtful accounts (2009 - $4,611; 2008 - $4,811)	449,373	104,149
Accounts receivable other (including affiliates 2009 - $2,978; 2008 - $1,925)	17,315	29,439
Inventories	417,657	451,597
Deferred income tax	14,650	64,711
Other current assets	64,791	124,681
Total current assets	1,403,022	1,553,693
Property, net	3,942,922	3,810,508
Leachable material, net	119,520	156,294
Intangible assets, net	114,335	115,059
Deferred income tax	45,060	83,106
Other assets	51,661	45,664
Total assets	$ 5,676,520	$ 5,764,324
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 10,000	$ 10,000
Accounts payable	231,407	413,351
Accrued income taxes	17,904	34,378
Due to affiliated companies	5,079	8,965
Accrued workers participation	93,427	205,466
Interest	18,983	40,968
Other accrued liabilities	35,307	24,335
Total current liabilities	412,107	737,463
Long-term debt	1,275,182	1,279,972
Deferred income taxes	120,766	169,342
Non-current taxes payable	73,171	70,266
Other liabilities and reserves	89,161	93,875
Asset retirement obligation	34,489	18,007
Total non-current liabilities	1,592,769	1,631,462
Commitments and Contingencies (Note L)		
STOCKHOLDERS EQUITY		
Common stock	8,846	8,846
Additional paid-in capital	1,007,844	993,826

Retained earnings		3,258,501		2,916,517
Accumulated other comprehensive loss		(23,142)		(23,477)
Treasury stock		(597,233)		(514,453)
Total SCC stockholders equity		3,654,816		3,381,259
Non-controlling interest		16,828		14,140
Total equity		3,671,644		3,395,399
Total liabilities and equity	$	5,676,520	$	5,764,324

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

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Southern Copper Corporation

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	3 Months Ended September 30, 2009	3 Months Ended September 30, 2008	9 Months Ended September 30, 2009	9 Months Ended September 30, 2008
	(in thousands)			
OPERATING ACTIVITIES				
Net income attributable to SCC	$ 312,451	$ 417,802	$ 566,111	$ 1,531,252
Adjustments to reconcile net earnings to net cash provided from operating activities:				
Depreciation, amortization and depletion	82,266	83,944	239,202	248,339
Capitalized leachable material				(2,246)
(Gain) loss on currency translation effect	(3,786)	(15,533)	9,599	6,498
Provision (benefit) for deferred income taxes	(13,274)	4,440	40,116	(10,290)
Gain on sale of property		(26,330)		(28,573)
(Gain) loss on sale of short-term investment	(881)	2,661	(3,200)	4,596
Unrealized (gain) loss on derivative instruments	(8,319)	(20,543)	(57,037)	(18,444)
Non-controlling interest	1,774	2,556	3,389	8,115
Cash provided from (used for) operating assets and liabilities:				
Accounts receivable	(103,312)	109,372	(302,840)	23,617
Inventories	38,872	(943)	33,940	(44,238)
Accounts payable and accrued liabilities	(9,281)	28,057	(360,446)	(172,697)
Other operating assets and liabilities	84,113	114,857	127,895	66,563
Net cash provided from operating activities	380,623	700,340	296,729	1,612,492
INVESTING ACTIVITIES				
Capital expenditures	(110,559)	(137,627)	(316,740)	(320,573)
Net proceeds from sale of short-term investments	8,815	11,816	39,620	30,295
Sale of property	858	55,447	2,798	59,727
Other		1,101		1,101
Net cash used for investing activities	(100,886)	(69,263)	(274,322)	(229,450)
FINANCING ACTIVITIES				
Debt repaid			(5,000)	(155,025)
Dividends paid to common stockholders	(86,322)	(503,543)	(224,128)	(1,416,437)
Distributions to non-controlling interest	(381)	(2,387)	(570)	(9,123)
Repurchase of common shares	(337)	(68,471)	(71,903)	(68,471)
Other	351	61	990	855
Net cash used for financing activities	(86,689)	(574,340)	(300,611)	(1,648,201)
Effect of exchange rate changes on cash and cash equivalents	(15,308)	(31,348)	(25,256)	31,535
	177,740	25,389	(303,460)	(233,624)

Increase (decrease) in cash and cash equivalents								
Cash and cash equivalents, at beginning of period		235,540		1,150,259		716,740		1,409,272
Cash and cash equivalents, at end of period	$	413,280	$	1,175,648	$	413,280	$	1,175,648

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

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Southern Copper Corporation

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

A. In the opinion of Southern Copper Corporation, (the Company , Southern Copper or SCC), the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to state fairly the Company s financial position as of September 30, 2009 and the results of operations and cash flows for the three and nine months ended September 30, 2009 and 2008. The condensed consolidated financial statements for the three and nine months ended September 30, 2009 have been subject to a review by Galaz, Yamazaki, Ruiz Urquiza S.C., a member firm of Deloitte Touche Tohmatsu, the Company s independent registered public accounting firm, whose report dated October 30, 2009, is presented on page 54. The results of operations for the three and nine months ended September 30, 2009 and 2008 are not necessarily indicative of the results to be expected for the full year. The December 31, 2008 balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements at December 31, 2008 and notes included in the Company s 2008 annual report on Form 10-K.

B. Adoption of New Accounting Standards:

On June 30, 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update No. 2009-01 (ASU No. 2009-01) to amend topic Accounting Standard Codification 105 (ASC-105) Generally Accepted Accounting Principles an amendment based on Statement of Financial Accounting Standard No. 168 the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles . This amendment establishes the FASB Accounting Standards Codification (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification is effective for interim and annual periods ending on or after September 15, 2009. Therefore, the Company is applying the Codification to its third-quarter interim financial statements.

Starting with this ASU, the FASB only will issue ASUs which will not be considered as authoritative in their own right and will serve only to update the Codification.

Prior authoritative literature:

As of June 30, 2009 the Company adopted the following pronouncements of the FASB which are now part of the Codification:

In May 2009, the FASB issued topic ASC 855 Subsequent Events (prior authoritative literature FAS 165 Subsequent Events) to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, this topic sets forth: the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

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This topic introduces the concept of financial statements being available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. This topic is effective for interim or annual reporting periods ending after June 15, 2009 and therefore became effective for the Company as of June 30, 2009. Please see disclosures required in Note Q, Subsequent events.

In April 2009, the FASB issued ASC 825-10-50 Disclosure about Fair Value of Financial Instruments (formerly FASB issued Staff Position (FSP) FAS 107-1) to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This ASC also amends ASC 270 Interim Financial Reporting (formerly APB Opinion No. 28), to require those disclosures in summarized financial information at interim reporting periods. This ASC applies to all financial instruments within the scope of ASC 825-10-15 and requires disclosing in the body or in the accompanying notes, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position. Fair value information disclosed shall be presented together with the related carrying amount in a form that makes clear whether the fair value and carrying amount represents assets or liabilities and how the carrying amount is reported in the statement of financial position. Also the entity shall disclose the methods and significant assumptions used to estimate the fair value of financial instruments and shall describe their changes, if any, in the period. This ASC is effective for interim reporting periods ending after June 15, 2009 and therefore became effective for the Company as of June 30, 2009. Please see disclosures required in Note P, Financial instruments.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2 Recognition and Presentation of Other-than-temporary Impairments and FSP FAS 157-4 Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly . These FASB Staff positions are effective for interim reporting periods ending after June 15, 2009 and therefore became effective for the Company as of June 30, 2009 and do not have a material impact on its financial position or results of operations.

On January 1, 2009 the Company adopted the following pronouncements of the FASB which are now part of the Codification:

On March 19, 2008 the FASB issued ASC 815-10-50 Disclosures about Derivative Instruments and Hedging Activities (formerly FAS No. 161). This ASC improves financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. The adoption of this statement has not had a material effect on the Company s financial position and results of operations. See disclosures required in Note G, Derivative instruments.

In December 2007, the FASB published ASC 805 Business Combinations (former SFAS No. 141-R). This statement improves the reporting of information about a business combination and its effects. This statement establishes principles and requirements for how the acquirer will recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquisition. Also, the statement determines the recognition and measurement of goodwill acquired in the business combination or a gain from a bargain purchase, and finally, determines the disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company has adopted this pronouncement on January 1, 2009 and will apply its requirements to future business combinations.

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C. Short-term Investments:

Short-term investments were as follows (in millions):

	At	
Investments	**September 30,2009**	**December 31, 2008**
Short-term investments in securities issued by public companies with a weighted average interest rate of 0.66% at September 30, 2009 and 1.85% at December 31, 2008	$ 26.0	$ 62.4

Short-term investments in securities consist of available for sale securities issued by public companies. Each security is independent of the others.

Related to these investments for the three and nine months ended September 30, 2009 the Company earned interest of $0.1 million and $0.7 million, respectively, compared with $0.8 million and $3.4 million in the same periods of 2008, which were recorded as interest income in the condensed consolidated statement of earnings. In addition, for the three and nine months ended September 30, 2009, the Company redeemed $8.8 million and $39.6 million, respectively, of these investments, compared with $11.8 million and $30.3 million in the same periods of 2008.

For the three and nine months ended September 30, 2009 the Company recorded gains of $0.9 million and $3.2 million, respectively, compared with losses of $2.7 million and $4.6 million in the same periods of 2008. These gains/losses were recorded as other income (expense) in the condensed consolidated statement of earnings.

D. Inventories were as follows:

(in millions)	**September 30, 2009**	**December 31, 2008**
Metals at lower of average cost or market:		
Finished goods	$ 40.3	$ 46.7
Work-in-process	128.9	135.8
Supplies at average cost	248.4	269.1
Total inventories	$ 417.6	$ 451.6

E. Income taxes:

The income tax provision for the nine months ended September 30, 2009 and 2008 were $327.1 million and $764.6 million, respectively. These provisions include income taxes for Peru, Mexico and the United States. The provision for income taxes was based on our effective tax rate of

36.5% for the nine months of 2009 as compared to 33.2% during the same period in 2008. The increase in the effective tax rate for the nine months ended September 30, 2009 is largely due to the incremental U.S. tax provided on dividend distributions made by our Mexican subsidiary to the U.S. parent. This dividend distribution is taxable in the U.S. at the difference between the 35% U.S. statutory rate and the foreign tax credit rate of 28.0%.

As of March 27, 2009, Grupo Mexico, through its wholly-owned subsidiary, Americas Mining Corporation (AMC), became the beneficial owner of 80% of SCC s common stock. As a result of this new level of ownership, beginning March 27, 2009 SCC will no longer file a separate U.S. federal income tax return and its operating results will be included in the AMC consolidated U.S. federal income tax return. In addition to now holding an 80% interest in SCC, AMC also owns 100% of ASARCO LLC (Asarco) and its subsidiaries. In accordance with paragraph 30-27 of ASC 740-10-30, it is expected that current and deferred taxes will be allocated to members of the AMC group as if each were a separate taxpayer. The Company has initiated

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discussions with AMC to put in place a tax sharing agreement in order to establish this allocation as well as other procedures and policies necessary for an equitable management of U.S. federal income tax matters. SCC provides current and deferred income taxes, as if it were a separate filer.

Accounting for Uncertainty in Income Taxes

There was no material changes in the unrecognized tax benefits in the nine months ended September 30, 2009. In the United States, all tax years through 2004 are closed and generally are not subject to change. The tax years 2005, 2006 and 2007 are currently under IRS field examination, which commenced in November 2008. Management does not expect that any of the open years will result in a cash payment within the preceding twelve months of September 30, 2010. The Company s reasonable expectations about future resolutions of uncertain items did not materially change during the nine month period ended September 30, 2009.

F. Provisionally Priced Sales:

At September 30, 2009, the Company has recorded provisionally priced sales of 22.6 million pounds of copper, at an average forward price of $2.80 per pound. Also the Company has recorded provisionally priced sales of 11.6 million pounds of molybdenum at the September 30, 2009 market price of $13.55 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, 2009:

Copper (million lbs.)	**Priced at**	**Month of Settlement**
22.6	2.80	October 2009

Molybdenum (million lbs.)	**Priced at**	**Month of Settlement**
3.1	13.55	October 2009
2.9	13.55	November 2009
3.3	13.55	December 2009
2.3	13.55	January 2010
11.6	13.55	

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.

G. Derivative Instruments

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

Copper derivatives:

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

The Company did not hold any copper or zinc derivative contracts in the nine months

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ended September 30, 2009.

In the nine months ended September 30, 2008, the Company entered into copper collar and swap contracts to protect a portion of its 2008 sales of copper production. As a result, the Company recorded a gain of $18.5 million and $29.2 million in the third quarter and nine months of 2008, respectively. Related to the fair value of these copper derivative contracts the Company recorded an unrealized gain of $33.7 million at the end of September 2008. These gains and losses were recorded in net sales in the condensed consolidated statement of earnings.

Gas swaps:

In 2009 and 2008 the Company entered into gas swap contracts to protect part of its gas consumptions as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Gas volume (MMBTUs)	122,000	305,000	122,000	305,000
Fixed price (per MMBTU)	$ 3.6350	$ 8.2175	$ 3.6350	$ 8.2175
Gain (loss) (in millions)	$ 0.1	$ (0.7)	$ 0.1	$ (0.7)

The gains (losses) obtained were charged to production cost. As of September 30, 2009 the Company held a gas swap contract to protect 184,000 MMBTUs of its gas consumption with a fixed price of $3.6350 per MMBTU for the fourth quarter of 2009. Related to the settlement of this gas swap contract the Company recorded an unrealized gain of $0.2 million in the third quarter of 2009 which was included in the $0.1 million gain reported in the table above.

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

Because more than 85% of the Company s sales collections in Mexico are in U.S. dollars and many of its costs are in Mexican pesos, the Company entered into zero-cost derivative contracts with the purpose of protecting, within a range, against an appreciation of the Mexican peso to the U.S. dollar.

Related to the exchange rate derivative contracts the Company recorded a loss of less than $0.1 million and a gain of $4.1 million for the three and nine months ended September 30, 2009, compared with losses of $13.6 million and $12.7 million, respectively, in the same periods of 2008. These gains and losses were recorded as gain (loss) on derivative instruments in the condensed consolidated statements of earnings.

At September 30, 2009 the Company did not hold any exchange rate derivative contracts.

H. Asset Retirement Obligation:

The Company maintains an estimated asset retirement obligation for its mining properties in Peru, as required by the Peruvian Mine Closure Law. In accordance with the requirements of this law the Company has prepared and submitted the closure plans to the Peruvian Ministry of Energy and Mines (MEM). These plans have been reviewed by the responsible governmental agency and have been open to public discussion in the areas of the Company s operations. The closure plan for the Cuajone facility was approved by MEM in the third quarter of 2009 and the closure plan for Ilo facility was approved in October 2009, it is anticipated that the closure plan for the Toquepala facility will be approved in the fourth quarter. As part of the closure plan, commencing in January 2010 the Company will be required to make annual installments over a 34 year period of guarantees sufficient to provide the funds for the asset

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retirement obligation. In the near term future the Company plans to use the value of its Lima office complex as support for this obligation. The Company has adjusted its original retirement obligation for the Cuajone facility to record the liability established in the new agreement and will adjust its retirement obligation for Toquepala in the fourth quarter of 2009 (no adjustment is necessary for Ilo). The Company does not believe that such adjustment will have a material effect on its financial results.

The closure cost recognized for this liability includes the agreed upon cost for Cuajone and the estimated cost for the Toquepala and Ilo operations, the tailings disposal, and dismantling the Toquepala and Cuajone concentrators, and the shops and auxiliary facilities.

As of September 30, 2009, the Company has made an estimated provision of $34.5 million for this liability in its financial statements, but expects to adjust this estimate in the fourth quarter of 2009 when closure plans for Toquepala and Ilo are finalized.

The following table summarizes the asset retirement obligation activity for the nine months ended September 30, 2009 and 2008 (in millions):

		2009		**2008**
Balance as of January 1	$	18.0	$	13.1
Changes in estimates		15.9		0.7
Additions				
Accretion expense		0.6		0.7
Balance as of September 30,	$	34.5	$	14.5

I. Related Party Transactions:

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

		September 30,2009		**December 31,2008**
Affiliate receivable:				
Grupo Mexico S.A.B de C.V. and affiliates	$	0.8	$	0.8
Ferrocarril Mexicano S.A. de C.V.		0.8		0.3
Mexico Proyectos y Desarrollos S.A. de C.V. and affiliates		1.4		0.8
	$	3.0	$	1.9
Affiliate payable:				
Grupo Mexico S.A.B. de C.V. and affiliates	$	5.1	$	9.0
	$	5.1	$	9.0

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

Grupo Mexico, the Company s ultimate parent and the majority indirect stockholder of the Company, and its affiliates provide various services to the Company. These services are principally related to accounting, legal, tax, financial, treasury, human resources, price risk assessment and hedging, purchasing, procurement and

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logistics, sales and administrative and other support services. The Company pays Grupo Mexico Servicios S.A de C.V., a subsidiary of Grupo Mexico for these services. The total amount paid by the Company for such services in the nine months of 2009 and 2008 was $10.3 million and $9.6 million, respectively. The Company expects to continue to pay for these services in the future.

The Company s Mexican operations paid fees of $8.4 million and $7.9 million in the nine months of 2009 and 2008, respectively, for freight services provided by Ferrocarril Mexicano S.A de C.V and $12.1 million and $16.0 million in the nine months of 2009 and 2008, respectively, for construction services provided by Mexico Constructora Industrial; both companies are subsidiaries 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, sale of vehicles and air transportation and construction services. In connection with this, the Company paid fees of $0.2 million and $1.7 million in the nine months of 2009 and 2008, respectively, for maintenance services and sale of vehicles provided by Mexico Compañia de Productos Automotrices, S.A. de C.V., a company controlled by the Larrea family. Additionally, in 2007, our Mexican subsidiaries have provided guaranties for loans totaling $10.8 million obtained by Mexico Transportes Aereos, S.A. de C.V. (MexTransport), a company controlled by the Larrea family. These loans mature in 2010 ($2.3 million) and 2013 ($8.4 million). MexTransport provides aviation services to our Mexican operations. The guaranty provided to MexTransport is backed up by the transport services provided by MexTransport to the Company s Mexican subsidiaries. The Company paid fees of $1.6 million and $2.2 million in the nine months of 2009 and 2008, respectively, to MexTransport for aviation services.

The Company purchased $4.0 million and $3.4 million in the nine months of 2009 and 2008, respectively, of industrial materials from Higher Technology S.A.C in which Mr. Carlos Gonzalez has a proprietary interest. The Company paid fees of $0.2 million and $0.6 million in the nine months of 2009 and 2008, respectively, for maintenance services provided by Servicios y Fabricaciones Mecanicas S.A.C., a company in which Mr. Carlos Gonzalez has a proprietary interest. Mr. Carlos Gonzalez is the son of SCC s Chief Executive Officer.

The Company purchased $0.6 million and $0.7 million in the nine months of 2009 and 2008, respectively, of industrial material from Sempertrans France Belting Technology, in which Mr. Alejandro Gonzalez is employed as a sales representative. Also, the Company purchased $0.1 million and $0.5 million in the nine months of 2009 and 2008, respectively, of industrial material from PIGOBA, S.A. de C.V., a company in which Mr. Alejandro Gonzalez has a proprietary interest. Mr. Alejandro Gonzalez is the son of SCC s Chief Executive Officer.

The Company purchased $0.8 million and $1.7 million in the nine months of 2009 and 2008, respectively, of industrial material and services from Breaker, S.A. de C.V., a company in which Mr. Jorge Gonzalez, son-in-law of SCC s Chief Executive Officer, has a proprietary interest.

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

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J. Benefit Plans:

SCC Defined Benefit Pension Plans-

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

		2009		2008
Interest cost	$	0.5	$	0.5
Expected return on plan assets		(0.4)		(0.4)
Amortization of net loss (gain)		0.1		0.1
Net periodic benefit costs	$	0.2	$	0.2

SCC Post-retirement Health Care Plan-

The components of the net periodic benefit costs for the post-retirement health care plan for the nine months ended September 30, 2009 and 2008 are individually, and in total, less than $0.1 million.

Minera Mexico Pension Plans-

The components of the net periodic benefit costs for the nine months ended September 30, 2009 and 2008 are as follows (in millions):

		2009		2008
Interest cost	$	1.2	$	1.5
Service cost		1.4		1.9
Expected return on plan assets		(1.8)		(2.3)
Amortization of transition assets, net		(0.4)		(*)
Amortization of net actuarial loss		(*)		(*)
Amortization of prior services cost		0.1		(*)
Net periodic benefit cost	$	0.5	$	1.1

(*) amount is lower than $0.1 million

Minera Mexico Post-retirement Health Care Plan-

The components of the net periodic cost for the nine months ended September 30, 2009 and 2008 are as follows (in millions):

	2009	2008
Interest cost	$ 2.9	$ 2.3
Service cost	0.4	0.5
Amortization of net loss (gain)	0.4	*
Amortization of transition obligation	0.9	*
Net periodic benefit cost	$ 4.6	$ 2.8

(*) amount is lower than $0.1 million

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K. Comprehensive Income (in millions):

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Net income	$ 314.2	$ 420.4	$ 569.5	$ 1,539.4
Other comprehensive income (loss) net of tax:				
Additional decrease in liability for employee benefit obligation	0.3		0.3	
Comprehensive income	314.5	420.4	569.8	1,539.4
Comprehensive income attributable to the non-controlling interest	1.8	2.6	3.4	8.1
Comprehensive income attributable to SCC	$ 312.7	$ 417.8	$ 566.4	$ 1,531.3

L. Commitments and Contingencies

Environmental matters:

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

Peruvian operations

The Company s operations are subject to applicable Peruvian environmental laws and regulations. The Peruvian government, through the MEM conducts annual audits of the Company s Peruvian mining and metallurgical operations. Through these environmental audits, matters related to environmental commitments, compliance with legal requirements, atmospheric emissions, and effluent monitoring are reviewed. The Company believes that it is in material compliance with applicable Peruvian environmental laws and regulations.

In 2003 the Peruvian congress published a new law announcing future closure and remediation obligations for the mining industry. In accordance with the requirements of this law the Company has submitted the required closure plans to MEM and were open to public discussion. The closure plan for the Cuajone facility was approved by MEM in the third quarter of 2009, and the closure plan for the Ilo facility was approved in October 2009. It is anticipated that the closure plan for the Toquepala facility, will be approved in the fourth quarter. As part of the closure plan, commencing in January 2010 the Company will be required to make annual installments over a 34 year period of guarantees sufficient to provide the funds for the asset retirement obligation. See Note H, Asset retirement obligation, for further discussion of this matter.

For the Company s Peruvian operations, environmental capital expenditures were $1.3 million and $5.1 million in the nine months ended September 30, 2009 and 2008, respectively.

Mexican operations

The Company s operations are subject to applicable Mexican federal, state and municipal environmental laws, to Mexican official standards, and to regulations for the protection of the environment, including regulations relating to water supply, water quality, air quality, noise levels and hazardous and solid waste.

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The principal legislation applicable to the Company s Mexican operations is the Federal General Law of Ecological Balance and Environmental Protection, which is enforced by the Federal Bureau of Environmental Protection (PROFEPA). PROFEPA monitors compliance with environmental legislation and enforces Mexican environmental laws, regulations and official standards. PROFEPA may initiate administrative proceedings against companies that violate environmental laws, which in the most extreme 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 Federal Criminal Code, PROFEPA must inform corresponding authorities regarding environmental non-compliance.

Mexican environmental regulations have become increasingly stringent in recent years, 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 1999. However, the Company s management does not believe that continued compliance with the federal environmental law or Mexican state environmental laws will have a material adverse effect on the Company s business, properties, results of operations, financial condition or prospects or will result in material capital expenditures. Although the Company believes that all of its facilities are in material compliance with applicable environmental, mining and other laws and regulations, the Company cannot assure that future laws and regulations would not have a material adverse effect on the Company s business, properties, results of operations, financial condition or prospects.

For the Company s Mexican operations, environmental capital expenditures were $18.5 million and $6.7 million in the nine months ended September 30, 2009 and 2008, respectively.

Litigation matters:

Peruvian operations

Garcia Ataucuri and Others against SCC s Peruvian Branch (SCC s Peruvian Branch , Branch or Peruvian Branch):

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

The Company conducts its operations in Peru through its Peruvian Branch, a registered branch. Although the Peruvian Branch has neither capital nor liability separate from that of the Company, under Peruvian law it is deemed to have an equity capital for purposes of determining the economic interest of the holders of the labor shares. The labor share litigation is based on claims of former employees for ownership of labor shares issued during the 1970s until 1979 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 in the mining industry. 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

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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 Branch 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, now called non-controlling interest, on the Company s balance sheet. What remains of the workers equity participation is now included on the consolidated balance sheet under the caption Non-controlling interest.

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

1) As stated above, in April 1996, the Branch was served with a complaint filed in Peru by approximately 800 former employees, (Garcia Ataucuri and others vs. SCC s Peruvian Branch), seeking the delivery of 38,763,806.80 labor shares (acciones laborales), now investment shares (acciones de inversion) (or Nuevos Soles (S/.) 3,876,380,679.56), as required by Law No. 22333, to be issued in a proportional way to each former employee or worker in accordance with their time of employment with SCC s Peruvian Branch, plus dividends on such shares. In 2000, the Branch appealed an adverse decision of an appellate civil court, affirming a decision of a lower civil court, to the Peruvian Supreme Court. On September 19, 2001, the Peruvian Supreme Court annulled the proceedings noting that the civil courts lacked jurisdiction and that the matter had to be decided by a labor court.

In October 2007, in a separate proceeding initiated by the plaintiffs, the Peruvian Constitutional Court nullified the September 19, 2001 Peruvian Supreme Court decision and ordered the Supreme Court to decide again on the merits of the case accepting or denying the Branch s 2000 appeal.

In May 2009, the Supreme Court rejected the 2000 appeal of the Branch affirming the adverse decision of the appellate civil court and lower civil court. While the Supreme Court has ordered SCC s Peruvian Branch to deliver the labor shares and dividends to the former employees of SCC s Peruvian Branch it has clearly stated that SCC s Peruvian Branch may prove, by all legal means, its assertion that the labor shares and dividends were distributed to the former employees in accordance with the profit sharing law then in effect, an assertion which SCC s Peruvian Branch continues to make.

On June 9, 2009 SCC s Peruvian Branch filed an extraordinary appeal before a civil court in Peru seeking the nullity of the 2009 Supreme Court decision and other protective measures. The civil court has now rendered a favorable decision suspending the enforcement of the Supreme Court decision, among other reasons, because, as was indicated above, the Supreme Court decision had clearly stated that SCC s Peruvian Branch may prove, by all legal means, its assertion that the labor shares and dividends were distributed to the former employees in accordance with the profit sharing law then in effect. In view of this and the recent civil court decision, SCC´s Peruvian Branch continues to analyze the manner in which the Supreme Court decision may be enforced and what financial impact, if any, said decision may have.

2) On May 10, 2006, the Branch was served with a second complaint filed in Peru, this time by 44 former employees, (Cornejo Flores and others vs. SCC s Peruvian Branch), seeking delivery of (1) labor shares (or shares of whatever other current

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legal denomination) corresponding to years 1971 to December 31, 1977 (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 No. 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 Branch answered this new complaint, denying the validity of the claim. As of September 30, 2009 the case remains open with no new developments.

3) On June 27, 2008, the Branch was served with a new complaint filed in Peru, this time by 82 former employees, (Alejandro Zapata Mamani and others vs. SCC s Peruvian Branch), seeking delivery of labor shares (or shares of whatever other current legal denomination) corresponding to years 1971 to December 31, 1977 (the plaintiffs are seeking the same 38,763,806.80 labor shares mentioned in the two previous labor share lawsuits), that should have been issued in accordance with Law No. 22333, plus interest, and labor shares resulting from capital increases, plus dividends. The Branch answered this new complaint, denying the validity of the claim. As of September 30, 2009 the case remains open with no new developments.

4) Additionally, in January 2009, the Branch was served with a new complaint filed in Peru, this time by 12 former employees (Arenas Rodriguez and others represented by Mr. Cornejo Flores- vs. SCC s Peruvian Branch) seeking delivery of labor shares (or shares of whatever other current legal denomination) corresponding to years 1971 to December 31, 1977 (the plaintiffs are seeking the same 38,763,806.80 labor shares mentioned in the three previous labor share lawsuits), that should have been issued in accordance with Law No. 22333, plus interest, and labor shares resulting from capital increases, plus dividends. The Branch answered this new complaint, denying the validity of the claim. As of September 30, 2009 the case remains open with no new developments.

The Company asserts that the labor shares were distributed to the former employees in accordance with the profit sharing law then in effect. 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.

Exploraciones de Concesiones Metalicas S.A.C.:

In August 2009 a new lawsuit was filed against SCC s Branch by the former stockholders of Exploraciones de Concesiones Metalicas S.A.C. (Excomet). The plaintiffs allege that the acquisition of their shares in Excomet by the Branch is null and void because the $2 million purchase price paid by the Branch for the shares of Excomet was not fairly negotiated by the plaintiffs and the Branch. In 2005, the Branch acquired the shares of Excomet after lengthy negotiations with the plaintiffs, and after the plaintiffs, which were all of the stockholders of Excomet, approved the transaction in a general stockholders meeting. Excomet was at the time owner of a mining concession which forms part of the Tia Maria project

The Company asserts that the lawsuit is without merit and is vigorously defending against this lawsuit.

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 (La Caridad) the payment of royalties since 1997. In December 2005, Mexcobre signed an agreement with MGS. Under the terms of this agreement the parties established a new procedure to calculate the royalty payments applicable for 2005 and

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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. On January 22, 2007 the Third Federal District Judge issued a ruling regarding the payment related to the period from the third quarter of 1997 through the fourth quarter of 2004. This ruling was appealed by both parties in February 2007. The appeal was lost by the Company in October 2007. The Company filed a protective action (Amparo) before the Ninth Collegiate Civil Tribunal which rendered a negative ruling on August 27, 2008. The Company is defending its economic interest in the courts to determine the final amount to be paid to MGS. On an ongoing basis the Company is required to pay a 1% royalty on La Caridad s copper production value after deduction of treatment and refining charges and certain other carrying costs.

On September 25, 2009, Southern Copper Corporation (SCC) announced that its subsidiary, Industrial Minera Mexico S. A. (IMMSA), Desarrolladora Intersaba, S.A. de C.V. (INTERSABA) and the Municipality of San Luis Potosí had reached an agreement by means of which IMMSA agrees to change the technology in order to stop using anhydrous ammonia gas in the production process at its San Luis zinc plant. The San Luis municipality also confirmed that local regulations permit IMMSA to use the land of the zinc plant for industrial purposes.

As part of the agreement, INTERSABA and the Municipality of San Luis Potosi agreed to donate an area that was considered by IMMSA as a buffer zone, in order for IMMSA to construct a park for the recreation of the San Luis population. Also IMMSA and INTERSABA agreed to settle all litigation between them relating to land permits and buffer zone.

In addition to the foregoing, IMMSA has initiated a series of legal and administrative procedures against the municipality of San Luis Potosi due to its refusal to issue IMMSA s use of land permit (licencia de uso de suelo) in respect to its zinc plant. A federal judge ruled that IMMSA s use of land permit should be granted. In February 2009, the municipal authorities confirmed that local regulations permit IMMSA to use the land for industrial purposes.

On September 17, 2009, the San Luis municipality also confirmed that local regulations permit IMMSA to use the land for industrial purposes.

The Ejidal Commissariat of the Ejido Pilares de Nacozari , initiated a protective action (Amparo) against the second expropriation decree (by means of which 2.322 hectares were expropriated for public use), ignoring the judicial settlement reached with the Company on this matter. The judicial settlement had been ratified in January 2006. This case was solved by a federal judge, in first instance dismissing the Ejido case. The Company will defend the settlement reached with the Ejido and seek the definitive dismissal of the case.

Pasta de Conchos Accident:

Mrs. Martinez, the wife of a miner, who died in the Pasta de Conchos accident, initiated a protective action against the negative ruling issued by the Ministry of Economy denying her request to launch a procedure to cancel IMMSA s coal concessions, which she argued the accident should trigger.

The First District Administrative judge flatly dismissed the case, but this ruling was later reviewed by an appeals court. In August 2009 the court definitely dismissed Mrs. Martinez case on the grounds of lack of standing.

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Labor matters:

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

Peruvian Operations

Approximately 68% of the Company s Peruvian labor force was unionized at December 31, 2008, represented by eight separate unions. Three of these unions, one at each major production area, represent the majority of the Company s workers. The collective bargaining agreements for these unions last through February 2010. Additionally, there are five smaller unions, representing the balance of workers. Collective bargaining agreements for this group are in force through November 2012.

From June 30 to July 5, 2008 the three major unions went on strike in support of a mining federation strike. During this strike operations were near normal; an insignificant amount of production was lost as work continued with the support of staff and administrative personnel and with contractors.

Mexican operations

Approximately 75% of the Mexican labor force was unionized at December 31, 2008, represented by two separate unions. Under Mexican law, the terms of employment for unionized workers is set forth in collective bargaining agreements. Mexican companies negotiate the salary provisions of collective bargaining agreements with the labor unions annually and negotiate other benefits every two years. The Company conducts negotiations separately at each mining complex and each processing plant.

In the last eight years the Cananea mine has experienced more than nine labor stoppages totaling more than 816 days of inactivity through September 30, 2009. The Company has tried unsuccessfully to resolve the current labor stoppage that obstructs production at Cananea. In the second quarter 2008 the Board of Directors offered all Cananea employees a severance payment in accordance with the collective bargaining agreement and applicable law. This was offered in order to award the employees a significant severance payment that allows them to choose the labor alternative that is best for each of them. During 2008, under this plan a group of employees was terminated at a cost to the Company of $15.2 million, which was recorded in cost of sales on the consolidated statement of earnings. There were no termination payments made in the nine months ended September 30, 2009. In accordance with SFAS No. 112, the Company has estimated a liability of $35.1 million, which was recorded on the condensed consolidated balance sheet

On March 20, 2009 the Company notified the Mexican Federal Labor Court of the termination of all the individual labor contracts of the Cananea workers, including the collective bargaining agreement with the union. This decision was based upon a finding by the Mexican mining authorities that confirmed that the Cananea mine was in a force majeure situation since it was unable to operate due to severe damages caused by striking workers. On April 14, 2009, the Mexican Federal Labor Court issued a resolution approving the termination of Cananea s labor relationships with individual and unionized employees, as well as the termination of its collective bargaining agreement with its employees and with the National Mining and Metal Workers Union. This ruling has been challenged before federal tribunals. Most of the individual challenges by unionized workers have been resolved by a federal judge, who dismissed their complaints. The case presented by the Union is expected to be resolved in the fourth quarter of 2009.

The Company, the state of Sonora and the Mexican federal government are working to restore the necessary legal and safety conditions to resume operations at Cananea.

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Due to the lengthy work stoppage the Company has performed an impairment analysis on the assets at the Cananea mine. The Company has determined through its impairment analysis that no impairment exists as of September 30, 2009. Should estimates of future copper and molybdenum prices decrease significantly, such determination could change.

Additionally, the Taxco and San Martin mines have been on strike since July 2007. It is expected that operations at these mines will remain suspended until these labor issues are resolved.

Other legal matters:

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. Civil Action 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 defendants believe that this lawsuit is without merit and are vigorously defending against the 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.

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.

The Company s direct and indirect parent corporations, including AMC and Grupo Mexico, have from time to time been named parties in various litigations involving Asarco. In August 2002 the U.S. Department of Justice brought a claim alleging fraudulent conveyance in connection with AMC s then-proposed purchase of SCC from a subsidiary of Asarco. That action was settled pursuant to a Consent Decree dated February 2, 2003. In March 2003, AMC purchased its interest in SCC from Asarco. In October 2004, AMC, Grupo Mexico, Mexicana de Cobre and other parties, not including SCC, were named in a lawsuit filed in New York State court in connection with alleged asbestos liabilities, which lawsuit claims, among other matters, that AMC s purchase of SCC from Asarco should be voided as a fraudulent conveyance. The lawsuit filed in New York State court was stayed as a result of the August 2005 Chapter 11 bankruptcy filing by Asarco, as described below. However, on November 16, 2007, this lawsuit after being removed to federal court was transferred to the United States District Court for the Southern District of Texas in Brownsville, Texas, for resolution in conjunction with a new lawsuit filed by Asarco s creditors, as described below. On February 2, 2007 a complaint was filed by Asarco on behalf of Asarco s creditors, alleging many of the matters previously claimed in the New York State lawsuit,

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including that AMC s purchase of SCC from Asarco should be voided as a fraudulent conveyance. In June 2008 the lawsuit was concluded in Brownsville, Texas. The constructive fraudulent conveyance claim was dismissed; however the actual fraud and the aiding and abetting the breach of fiduciary duties counts were favorable to plaintiffs. On April 15, 2009, the United States District Court for the Southern District of Texas entered a judgment awarding Asarco certain shares of SCC, which represents approximately 30.6% of SCC s current outstanding common shares, and an amount equal to the dividends paid on those shares of common stock of SCC since the date of their acquisition by AMC, plus interest. Grupo Mexico announced that AMC is appealing that judgment and that the enforcement of the judgment has been stayed pending the appeal.

In 2005, certain subsidiaries of Asarco filed bankruptcy petitions in connection with alleged asbestos liabilities. In July 2005, the unionized workers of Asarco commenced a work stoppage. As a result of various factors, including the above-mentioned work stoppage, in August 2005 Asarco filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code before the U.S. Bankruptcy Court in Corpus Christi, Texas. Asarco s bankruptcy case is being joined with the bankruptcy cases of its subsidiaries. Asarco s bankruptcy could result in additional claims being filed against Grupo Mexico and its subsidiaries, including SCC, Minera Mexico or its subsidiaries.

The Company cannot assure you that these or future claims, if successful, will not have an adverse effect on the Company s parent corporation or the Company. Any increase in the financial obligations of the Company s parent corporation, as a result of matters related to Asarco or otherwise could, among other effects, result in the Company s parent corporation attempting to obtain increased dividends or other funding from the Company.

Other commitments:

Regional development contribution:

In December 2006, the Company s Peruvian Branch signed a contract with the Peruvian government committing the Company to make annual contributions for five years to support the regional development of Peru. This was in response to an appeal by the president of Peru to the mining industry. The contributions are being used for social benefit programs. In 2009, 2008 and 2007, the Company made non-deductible contributions of $12.7 million, $18.9 million and $16.1 million out of 2008, 2007 and 2006 earnings, respectively. These contributions were deposited with a separate entity, Copper Assistance Civil Association (Asociación Civil Ayuda del Cobre) which will make disbursements for approved investments in accordance with the agreement. Future contributions could increase or decrease depending on copper prices. The commitment of the Branch is for a total of 1.25% of its annual earnings, after Peruvian income tax. If the average annual LME copper price is below $1.79 per pound the contribution will cease. In the nine months ended September 30, 2009 the Company made a provision of $5.0 million based on Peruvian Branch earnings.

Royalty charge

In June 2004, the Peruvian Congress enacted legislation imposing a royalty charge to be paid by mining companies. Under this law, the Company is subject to a 1% to 3% royalty, based on sales, applicable to the value of the concentrates produced in our Toquepala and Cuajone mines. The Company made provisions of $28.6 million and $50.6 million in the nine months ended September 30, 2009 and 2008, respectively, for this royalty. These provisions are included in Cost of sales (exclusive of depreciation, amortization and depletion) in the condensed consolidated statement of earnings.

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Power purchase agreement

In 1997, SCC sold its Ilo power plant to an independent power company, Enersur S.A. (Enersur). In connection with the sale, a power purchase agreement was also completed under which SCC agreed to purchase all of its power needs for its Peruvian operations from Enersur for twenty years, commencing in 1997. In 2003 the agreement was amended releasing Enersur from its obligation to construct additional capacity to meet the Company s increased electricity requirements and changing the power tariff as called for in the original agreement.

The Company has recently signed a Memorandum of Understanding (MOU) with Enersur regarding its power supply agreement. The MOU contains new economic terms that the Company believes better reflect current economic conditions in the power industry and in Peru. The Company expects to obtain savings in its future power costs. The new economic conditions agreed in the MOU have been applied by Enersur to its invoices to the Company since May 2009. Additionally, the MOU includes an option for providing power for the Tia Maria project.

Tax contingency matters:

Tax contingencies are provided for under ASC 740-10-50-15 Uncertain tax position (see Note E, Income taxes).

M. Segment and Related Information:

Company management views Southern Copper as having three operating segments and manages on the basis of these segments. Each of its segments report independently to the Chief Operating Officer and he focuses on operating income as a measure of performance to evaluate different segments, and to make decisions to allocate resources to the reported segments.

The three segments identified are groups of mines with similar economic characteristics, type of products, processes and support facilities, similar regulatory environments, similar employee bargaining contracts and similar currency risks. In addition, each mine within the individual group earns revenues from similar type of customers for their products and services and each group incurs expenses independently, including commercial transactions between groups.

Intersegment sales are based on arms-length prices at the time of sale. These may not be reflective of actual prices realized by the Company due to various factors, including additional processing, timing of sales to outside customers and transportation cost. Added to the segment information is information regarding the Company s sales. The segments identified by the Company are:

1. Peruvian operations segment, 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 operations segment, 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 segment, which includes five underground mines that produce zinc, copper, silver and gold, a coal mine which produces coal and coke, and several industrial processing facilities for zinc and copper. This group is identified as the IMMSA unit.

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The Peruvian operations include two open pit copper mines whose mineral output is transported by rail to Ilo, Peru where it is processed at the Company s smelter and refinery, without distinguishing between the products of the two mines. The resulting product, anodes and refined copper, are then shipped to customers throughout the world. These shipments are recorded as revenue of the Company s Peruvian mines.

The Mexican open pit segment includes two copper mines whose mineral output is processed in the same smelter and refinery without distinguishing between the products of the two mines. The resultant product, anodes and refined copper, are then shipped to customers throughout the world. These shipments are recorded as revenues of the Company s Mexican open pit mines.

The Company has determined that it is necessary to classify the Peruvian open pit operations as a separate operating segment from the Mexican open pit operations due to the very distinct regulatory and political environments in which they operate. The Company s Chief Operating Officer must consider the operations in each country separately when analyzing results of the Company and making key decisions. The open pit mines in Peru must comply with stricter environmental rules and must continually deal with a political climate that has a very distinct vision of the mining industry as compared to Mexico. In addition, the collective bargaining agreement contracts are negotiated very distinctly in each of the two countries. These key differences result in the Company taking varying decisions with regards to the two countries.

The IMMSA segment includes five mines whose minerals are processed in the same smelter and refinery. This segment also includes an underground coal mine. Sales of product from this segment are recorded as revenues of the Company s IMMSA unit. While the Mexican underground mines are subject to a very similar regulatory environment as the Mexican open pit mines, the nature of the products and processes of the two Mexican operations vary distinctly. These differences cause the Company s Chief Operating Officer to take a very different approach when analyzing results and making decisions regarding the two Mexican operations.

Financial information is regularly prepared for each of the three segments and the results of the Company s operations are regularly reported to the Chief Operating Officer on the segment basis. The Chief Operating Officer of the Company focuses on operating income and on total assets as measures of performance to evaluate different segments and to make decisions to allocate resources to the reported segments. These are common measures in the mining industry.

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

	Three Months Ended September 30, 2009 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate, other and Eliminations	Consolidated
Net sales outside of segments	$ 315.7	$ 111.9	$ 710.8	$ 13.4	$ 1,151.8
Intersegment sales	12.6	38.3		(50.9)	
Cost of sales (exclusive of depreciation, amortization and depletion)	145.5	105.1	322.0	(42.7)	529.9
Selling, general and administrative	7.2	3.1	12.6	0.9	23.8
Depreciation, amortization and depletion	43.3	5.9	32.7	0.4	82.3
Exploration	0.9	2.9	3.3		7.1
Operating income	$ 131.4	$ 33.2	$ 340.2	$ 3.9	508.7
Less:					
Interest, net					(27.5)
Gain on derivative instruments					
Other income (expense)					0.8
Income taxes					(167.7)
Non-controlling interest					(1.8)
Net income attributable to SCC					$ 312.5
Capital expenditure	$ 13.7	$ 3.3	$ 82.7	$ 10.9	$ 110.6
Property, net	$ 1,630.0	$ 268.7	$ 1,988.9	$ 55.3	$ 3,942.9
Total assets	$ 2,598.9	$ 568.5	$ 2,343.1	$ 166.0	$ 5,676.5

	Three Months Ended September 30, 2008 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate, other and Eliminations	Consolidated
Net sales outside of segments	$ 465.3	$ 109.8	$ 814.9	$ 50.1	$ 1,440.1
Intersegment sales	36.4	16.9		(53.3)	
Cost of sales (exclusive of depreciation, amortization and depletion)	207.8	116.7	324.2	(2.9)	645.8
Selling, general and administrative	9.6	5.4	9.4	1.6	26.0
Depreciation, amortization and depletion	47.3	8.4	28.5	(0.2)	84.0
Exploration	1.2	3.1	4.1		8.4
Operating income	$ 235.8	$ (6.9)	$ 448.7	$ (1.7)	675.9
Less:					
Interest, net					(13.5)
Loss on derivative instruments					(13.6)
Other income (expense)					21.3
Income taxes					(249.7)
Non-controlling interest					(2.6)
Net income attributable to SCC					$ 417.8
Capital expenditure	$ 29.9	$ 11.6	$ 86.5	$ 9.6	$ 137.6
Property, net	$ 1,625.3	$ 263.2	$ 1,737.3	$ 41.7	$ 3,667.5
Total assets	$ 2,789.9	$ 683.3	$ 2,157.3	$ 716.2	$ 6,346.7

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Nine Months Ended September 30, 2009 (in millions)	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate, other and Eliminations	Consolidated
Net sales outside of segments	$ 737.0	$ 289.6	$ 1,532.9	$ 38.8	$ 2,598.3
Intersegment sales	26.8	99.0		(125.8)	
Cost of sales (exclusive of depreciation, amortization and depletion)	397.7	281.5	738.4	(92.7)	1,324.9
Selling, general and administrative	21.3	9.3	27.0	3.1	60.7
Depreciation, amortization and depletion	126.4	17.8	93.8	1.2	239.2
Exploration	1.7	5.2	10.6		17.5
Operating income	$ 216.7	$ 74.8	$ 663.1	$ 1.4	956.0
Less:					
Interest, net					(66.2)
Gain on derivative instruments					4.2
Other income (expense)					2.6
Income taxes					(327.1)
Non-controlling interest					(3.4)
Net income attributable to SCC					$ 566.1
Capital expenditure	$ 55.8	$ 17.9	$ 220.9	$ 22.1	$ 316.7
Property, net	$ 1,630.0	$ 268.7	$ 1,988.9	$ 55.3	$ 3,942.9
Total assets	$ 2,598.9	$ 568.5	$ 2,343.1	$ 166.0	$ 5,676.5

Nine Months Ended September 30, 2008 (in millions)	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate, other and Eliminations	Consolidated
Net sales outside of segments	$ 1,343.0	$ 369.0	$ 2,571.7	$ 117.4	$ 4,401.1
Intersegment sales	96.5	82.9		(179.4)	
Cost of sales (exclusive of depreciation, amortization and depletion)	591.8	312.9	876.0	(63.8)	1,716.9
Selling, general and administrative	28.1	16.6	29.4	3.2	77.3
Depreciation, amortization and depletion	139.9	24.4	84.2	(0.2)	248.3
Exploration	4.1	7.2	14.2		25.5
Operating income	$ 675.6	$ 90.8	$ 1,567.9	$ (1.2)	2,333.1
Less:					
Interest, net					(36.1)
Loss on derivative instruments					(12.7)
Other income (expense)					19.7
Income taxes					(764.6)
Non-controlling interest					(8.1)
Net income attributable to SCC					$ 1,531.3
Capital expenditure	$ 107.9	$ 30.9	$ 167.9	$ 13.9	$ 320.6
Property, net	$ 1,625.3	$ 263.2	$ 1,737.3	$ 41.7	$ 3,667.5
Total assets	$ 2,789.9	$ 683.3	$ 2,157.3	$ 716.2	$ 6,346.7

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Sales value per segment:

	Three Months Ended September 30, 2009 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate & Elimination	Consolidated
Copper	$ 205.6	$ 23.4	$ 582.0	$ (11.0)	$ 800.0
Molybdenum	87.9		93.6		181.5
Other	34.9	126.8	35.1	(26.5)	170.3
Total	$ 328.4	$ 150.2	$ 710.7	$ (37.5)	$ 1,151,8

	Three Months Ended September 30, 2008 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate & Elimination	Consolidated
Copper	$ 311.7	$ 14.4	$ 598.7	$ 2.9	$ 927.7
Molybdenum	139.2		179.7		318.9
Other	50.8	112.3	36.5	(6.1)	193.5
Total	$ 501.7	$ 126.7	$ 814.9	$ (3.2)	$ 1,440.1

	Nine Months Ended September 30, 2009 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate & Elimination	Consolidated
Copper	$ 476.8	$ 55.9	$ 1,283.0	$ (16.8)	$ 1,798.9
Molybdenum	187.8		159.0		346.8
Other	99.4	332.6	90.7	(70.1)	452.6
Total	$ 764.0	$ 388.5	$ 1,532.7	$ (86.9)	$ 2,598.3

	Nine Months Ended September 30, 2008 (in millions)				
	Mexican Open Pit	Mexican IMMSA Unit	Peruvian Operations	Corporate & Elimination	Consolidated
Copper	$ 939.6	$ 75.3	$ 1,984.4	$ (20.9)	$ 2,978.4
Molybdenum	382.4		485.6		868.0
Other	117.5	376.7	101.7	(41.2)	554.7
Total	$ 1,439.5	$ 452.0	$ 2,571.7	$ (62.1)	$ 4,401.1

The geographic breakdown of the Company s sales is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
United States	$ 313.7	$ 417.2	$ 809.9	$ 1,182.3
Europe	248.1	284.7	532.5	1,006.2

Mexico		256.1		347.4		574.4		1,017.7
Peru		64.7		33.3		105.5		111.5
Latin America (excluding Mexico and Peru)		178.8		251.5		368.5		806.1
Asia		90.4		51.8		207.5		214.4
Derivative instruments				54.2				62.9
Total	$	1,151.8	$	1,440.1	$	2,598.3	$	4,401.1

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Major Customer Segment Information:

For the nine months ended September 30, 2009, the Company had revenues from two copper customers of the Mexican and Peruvian operations, which amounted to 18.6% of total revenue; revenues from one of these customers amounted to 10.8% of total revenue. In addition, the Company had revenues from two molybdenum customers of the Peruvian and Mexican operations, which amounted to 11.5% of total revenues; revenues from one of these customers amounted to 7.0% of total revenue. These customers represent 85.8% of the Company s molybdenum sales revenue.

For the nine months ended September 30, 2008, the Company had revenues from two copper customers of the Mexican and Peruvian operations, which amounted to 16.1% of total revenue; revenues from one of these customers amounted to 11.4% of total revenue. In addition, the Company had revenues from two molybdenum customers of the Peruvian and Mexican operations, which amounted to 16.4% of total revenues; revenues from one of these customers amounted to 9.0% of total revenue. These customers represent 83.0% of the Company s molybdenum sales revenue.

N. Impact of New Accounting Standards:

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, Fair Value Measurements and Disclosures (Topic 820) . This amendment to the FASB Accounting Standards Codification provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

1. A valuation technique that uses:

a. The quoted price of the identical liability when traded as an asset.

b. Quoted prices for similar liabilities or similar liabilities when traded as assets.

2. Another valuation technique that is consistent with the principles of Topic 820.

Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

The amendments in this Update also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability.

The amendments in this Update also clarify that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The guidance provided in this Update is effective for the Company beginning in the fourth quarter of 2009. The Company does not expect any material impact on its financial position.

O.   Stockholders   Equity:

Common stock:

During the first quarter of 2009 Grupo Mexico, through its wholly owned subsidiary AMC, purchased 4.9 million shares. With this purchase and the Company   s repurchase of its common shares, the indirect ownership of Grupo Mexico increased to 80% at

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March 31, 2009 and remains at 80% at September 30, 2009. Please see Note E, Income taxes, for disclosure about the U.S. federal income tax implications of this increase in ownership. In addition, the Company purchased 12,000 shares in the third quarter of 2009, at a cost of $0.3 million.

Treasury Stock:

Activity in treasury stock in the nine month period ended September 30, 2009 and 2008 is as follows (in millions):

	2009	2008
Southern Copper common shares		
Balance as of January 1,	$ 389.0	$ 4.4
Purchase of shares	71.9	68.5
Used for corporate purposes	(0.2)	(0.1)
Balance as of September 30,	460.7	72.8
Parent Company (Grupo Mexico) common shares		
Balance as of January 1,	125.5	170.3
Other activity, including dividend, interest and currency translation effect	11.0	46.5
Balance as of September 30,	136.5	216.8
Treasury stock balance as of September 30,	$ 597.2	$ 289.6

In the nine months ended September 30, 2009 and 2008 the Company distributed 12,000 and 13,200 shares of Southern Copper, respectively, to Directors under the Directors Stock Award Plan.

In the nine months ended September 30, 2009 and 2008 the Company awarded 11.8 million shares and 14.5 million shares of Grupo Mexico, respectively, under the employee stock purchase plan.

SCC share repurchase program:

Pursuant to the $500 million share repurchase program authorized by the Company s Board of Directors in 2008, in the first quarter of 2009 the Company purchased 4.9 million shares of its common stock at a cost of $71.6 million. In addition the Company purchased 12,000 shares in the third quarter of 2009 at a cost of $0.3 million. These shares will be available for general corporate purposes. The Company may purchase additional shares from time to time, based on market conditions and other factors. This repurchase program has no expiration date and may be modified or discontinued at any time.

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The following table summarizes the repurchase program activity since its inception in 2008:

Period From	Period To	Total Number of Shares Purchased		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan @ $30.69		Total Cost ($ in million)
2008:								
08/11/08	12/31/08	28,510,150	$	13.49	28,510,150			384.6
First quarter 2009:								
01/12/09	01/31/09	1,075,000		15.17	29,585,150			16.3
02/01/09	02/28/09	2,260,350		13.45	31,845,500			30.4
03/01/09	03/27/09	1,564,650		15.89	33,410,150			24.9
Total		4,900,000		14.61				71.6
Second Quarter 2009								
Third Quarter 2009:								
09/01/09	09/30/09	12,000		28.05	33,422,150	1,415,476		0.3
Total purchased		33,422,150	$	13.66			$	456.5

As a result of the repurchase of SCC common shares and AMC s purchase of SCC shares, Grupo Mexico s direct and indirect ownership increased to 80% at March 27, 2009.

Directors Stock Award Plan:

The Company established a stock award compensation plan for certain directors who are not compensated as employees of the Company. Under this plan, participants will receive 1,200 shares of common stock upon election and 1,200 additional shares following each annual meeting of stockholders thereafter. 600,000 shares of Southern Copper common stock have been reserved for this plan. As of September 30, 2009 the Company has granted 241,200 shares under this plan which includes 12,000 additional shares granted since September 30, 2008 at which time the cumulative amount of shares granted was 229,200 shares. The fair value of the award is measured each year at the date of the grant.

Employee Stock Purchase Plan:

In January 2007, the Company offered to eligible employees a stock purchase plan (the Employee Stock Purchase Plan) through a trust that acquires shares of Grupo Mexico stock for sale to its employees, and employees of subsidiaries, and certain affiliated companies. The purchase price is established at the approximate fair market value on the grant date. Every two years employees will be able to acquire title to 50% of the shares paid in the previous two years. The employees will pay for shares purchased through monthly payroll deductions over the eight year period of the plan. At the end of the eight year period, the Company will grant the participant a bonus of 1 share for every 10 shares purchased by the employee.

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

In the case of voluntary resignation of the employee, the Company will pay to the employee the purchase price applying a deduction over the amount to be paid to the employee based on the following schedule.

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

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

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

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

For the nine months ended September 30, 2009 and 2008, the stock based compensation expense under this plan was $1.6 million in both periods. As of September 30, 2009, there was $11.2 million of unrecognized compensation expense under this plan, which is expected to be recognized over the remaining five years and three months period.

The following table presents the stock award activity for the nine months ended September 30, 2009 and 2008:

	Shares		Unit Weighted Average Grant Date Fair Value
Outstanding shares at January 1, 2009	14,577,011	$	1.16
Granted			
Exercised	(2,700,588)		1.16
Forfeited	(267,230)		1.16
Outstanding shares at September 30, 2009	11,609,193	$	1.16
Outstanding shares at January 1, 2008	14,504,151	$	1.17
Granted			
Exercised	(23,655)		1.17
Received as dividend	96,515		
Forfeited			

Outstanding shares at September 30, 2008	14,577,011	$ 1.16

Executive Stock Purchase Plan:

Grupo Mexico also offers a stock purchase plan for certain members of its executive management and the executive management of its subsidiaries and certain affiliated companies. Under this plan, participants will receive incentive cash bonuses which are used to purchase up to 2,250,000 shares of Grupo Mexico over an eight year

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period. The fair value of the award is estimated on the date of grant and is recognized as compensation expense over a weighted average requisite service period of eight years. The Company recorded $0.1 million and $1.3 million, net of tax, in compensation expense in the nine months of 2009 and 2008, respectively. As of September 30, 2009, there was $1.9 million of unrecognized compensation cost, related to this plan, which is expected to be recognized over the remaining period.

The following table presents the stock award activity for the nine months ended September 30, 2009 and 2008:

	Shares		Unit Weighted Average Grant Date Fair Value
Outstanding shares at January 1, 2009	697,500	$	0.77
Granted			
Exercised			
Forfeited			
Outstanding shares at September 30, 2009	697,500	$	0.77
Outstanding shares at January 1, 2008	1,372,500	$	0.77
Granted			
Exercised	(675,000)	$	0.77
Forfeited			
Outstanding shares at September 30, 2008	697,500	$	0.77

P. Financial instruments:

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Inputs that are observable, either directly or indirectly, but do not qualify as Level 1 inputs. (i.e., quoted prices for similar assets or liabilities)

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The carrying amounts of certain financial instruments, including cash and cash equivalents, accounts receivable (other than accounts receivable associated with provisionally priced sales) and accounts payable approximate fair value due to their short maturities. Consequently, such financial instruments are not included in the following table that provides information about the carrying amounts and estimated fair values of other financial instruments that are not measured at fair value in the condensed consolidated balance sheet as of September 30, 2009 (in millions):

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	Balance at September 30, 2009	
	Carrying Value	Fair Value
Liabilities:		
Long-term debt	$ 1,285.2	$ 1,328.0

Fair values of assets and liabilities measured at fair value on a recurring basis were calculated as follows:

		Fair Value at Measurement Date Using:		
	Fair Value as of 09/30/09	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Short-term investments	$ 26.0		$ 21.8	$ 4.2
Provisionally priced sales:				
Copper	(47.0)		(47.0)	
Molybdenum	(16.9)		(16.9)	

	$ 0.34			
Diluted earnings per share	$ 0.39	$ 0.37	$ 0.43	$ 0.33

Options to purchase 390,087 shares and 592,303 shares of common stock were outstanding during the thirteen weeks ended December 24, 2016 and December 26, 2015, respectively, but were not included in the computation of weighted average diluted shares of common stock outstanding as the effect of doing so would have been anti-dilutive.

Options to purchase 694,972 shares and 355,153 shares of common stock were outstanding during the thirty-nine weeks ended December 24, 2016 and December 26, 2015, respectively, but were not included in the computation of weighted average diluted shares of common stock outstanding as the effect of doing so would have been anti-dilutive.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the financial condition and results of our operations should be read together with the financial statements and related notes of Boot Barn Holdings, Inc. and Subsidiaries included in Item 1 of this Quarterly Report on Form 10-Q and with our audited financial statements and the related notes included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on June 3, 2016 (the "Fiscal 2016 10-K"). As used in this Quarterly Report on Form 10-Q, except where the context otherwise requires or where otherwise indicated, the terms "company", "Boot Barn", "we", "our" and "us" refer to Boot Barn Holdings, Inc. and its subsidiaries.

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate", "believe", "can", "continue", "could", "estimate", "expect", "intend", "may", "plan", "project", "seek" "will", "would" and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. These forward-looking statements are subject to numerous risks and uncertainties, including the risks and uncertainties described under the section titled "Risk Factors" in our Fiscal 2016 10-K, those identified in this "Management's Discussion and Analysis of Financial Condition and Results of Operations", and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in an evolving environment. New risks and uncertainties emerge from time to time and it is not possible for our management to predict all risks and uncertainties, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ materially from those contained in any forward-looking statement. We qualify all of our forward-looking statements by these cautionary statements.

We caution you that the risks and uncertainties identified by us may not be all of the factors that are important to you. Furthermore, the forward-looking statements included in this Quarterly Report on Form 10-Q are made only as of the date hereof. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments that we may make. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

Overview

We believe that Boot Barn is the largest lifestyle retail chain devoted to western and work-related footwear, apparel and accessories in the U.S. As of December 24, 2016, we operated 219 stores in 31 states, as well as an e-commerce channel, consisting of www.bootbarn.com and www.sheplers.com. Our product offering is anchored by an extensive selection of western and work boots and is complemented by a wide assortment of coordinating apparel and accessories. Our stores feature a comprehensive assortment of brands and styles, coupled with attentive, knowledgeable store associates. Many of the items that we offer are basics or necessities for our customers' daily lives and typically represent enduring styles that are not meaningfully impacted by changing fashion trends.

We strive to offer an authentic, one-stop shopping experience that fulfills the everyday lifestyle needs of our customers, and as a result, many of our customers make purchases in both the western and work wear sections of our stores. We target a broad and growing demographic, ranging from passionate western and country enthusiasts, to workers seeking dependable, high-quality footwear and apparel. Our broad geographic footprint, which comprises more than twice as many stores as our nearest direct competitor that sells primarily western and work wear, provides us with significant economies of scale, enhanced supplier relationships, the ability to recruit and retain high quality store associates and the ability to reinvest in our business at levels that we believe exceed those of our competition.

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How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of performance and financial measures. The key indicators we use to evaluate the financial condition and operating performance of our business are net sales and gross profit. In addition, we also review other important metrics, such as same store sales, new store openings, selling, general and administrative expenses, earnings before interest, taxes, depreciation and amortization ("EBITDA") and Adjusted EBITDA.

Net sales

Net sales reflect revenue from the sale of our merchandise at retail locations, as well as sales of merchandise through our e-commerce websites. We recognize revenue upon the purchase of merchandise by customers at our stores and upon delivery of the product in the case of our e-commerce websites. Net sales also include shipping and handling fees for e-commerce shipments that have been delivered to our customers. Net sales are net of returns on sales during the period as well as an estimate of returns and award redemptions expected in the future stemming from current period sales. Revenue from the sale of gift cards is deferred until the gift cards are used to purchase merchandise.

Our business is moderately seasonal and as a result our revenues fluctuate from quarter to quarter. In addition, our revenues in any given quarter can be affected by a number of factors including the timing of holidays, weather patterns, rodeos and country concerts. The third quarter of our fiscal year, which includes the Christmas shopping season, has historically produced higher sales and disproportionately larger operating income than the other quarters of our fiscal year. However, neither the western nor the work component of our business has been meaningfully impacted by fashion trends or seasonality historically. We believe that many of our customers are driven primarily by utility and brand, and our best-selling styles.

Same store sales

The term "same store sales" refers to net sales from stores that have been open at least 13 full fiscal months as of the end of the current reporting period, although we include or exclude stores from our calculation of same store sales in accordance with the following additional criteria:

- stores that are closed for five or fewer days in any fiscal month are included in same store sales;
- stores that are closed temporarily, but for more than five days in any fiscal month, are excluded from same store sales beginning in the fiscal month in which the temporary closure begins until the first full month of operation once the store re-opens;

- stores that are closed temporarily and relocated within their respective trade areas are included in same store sales;
- stores that are permanently closed are excluded from same store sales beginning in the month preceding closure; and
- acquired stores are added to same store sales beginning on the later of (a) the applicable acquisition date and (b) the first day of the first fiscal month after the store has been open for at least 13 full fiscal months regardless of whether the store has been operated under our management or predecessor management.

If the criteria described above are met, then all net sales of an acquired store, excluding those net sales before our acquisition of that store, are included for the period presented. However, when an acquired store is included for the period presented, the net sales of such acquired store for periods before its acquisition are included (to the extent relevant) for purposes of calculating “same store sales growth” and illustrating the comparison between the applicable periods. Pre-acquisition net sales numbers are derived from the books and records of the acquired company, as prepared prior to the acquisition, and have not been independently verified by us.

In addition to retail store sales, same store sales also includes e-commerce sales, e-commerce shipping and handling revenue and actual retail store or e-commerce sales returns. We exclude gift card escheatment, provision for sales returns and estimated future loyalty award redemptions from sales in our calculation of net sales per store.

Measuring the change in year-over-year same store sales allows us to evaluate how our store base is performing. Numerous factors affect our same store sales, including:

- national and regional economic trends;
- our ability to identify and respond effectively to regional consumer preferences;
- changes in our product mix;
- changes in pricing;
- competition;
- changes in the timing of promotional and advertising efforts;
- holidays or seasonal periods; and
- weather.

Opening new stores is an important part of our growth strategy and we anticipate that a significant percentage of our net sales in the near future will come from stores not included in our same store sales calculation. Accordingly, same store sales are only one measure we use to assess the success of our business and growth strategy. Some of our competitors and other retailers may calculate “same” or “comparable” store sales differently than we do. As a result, data in this Quarterly Report on Form 10-Q regarding our same store sales may not be comparable to similar data made available by other retailers.

New store openings

New store openings reflect the number of stores, excluding acquired stores, that are opened during a particular reporting period. In connection with opening new stores, we incur pre-opening costs. Pre-opening costs consist of costs incurred prior to opening a new store and primarily consist of manager and other employee payroll, travel and training costs, marketing expenses, initial opening supplies and costs of transporting initial inventory and certain fixtures to store locations, as well as occupancy costs incurred from the time that we take possession of a store site to the opening of that store. Occupancy costs are included in cost of goods sold and the other pre-opening costs are included in selling, general and administrative (“SG&A”) expenses. All of these costs are expensed as incurred.

New stores often open with a period of high sales levels, which subsequently decrease to normalized sales volumes. In addition, we experience typical inefficiencies in the form of higher labor, advertising and other direct operating expenses, and as a result, store-level profit margins at our new stores are generally lower during the start-up period of operation. The number and timing of store openings has had, and is expected to continue to have, a significant impact on our results of operations. In assessing the performance of a new store, we review its actual sales against the sales that we projected that store to achieve at the time we initially approved its opening. We also review the actual number of stores opened in a fiscal year against the number of store openings that we included in our budget at the beginning of that fiscal year.

Gross profit

Gross profit is equal to our net sales less our cost of goods sold. Cost of goods sold includes the cost of merchandise, obsolescence and shrinkage provisions, store and warehouse occupancy costs (including rent, depreciation and utilities), inbound and outbound freight, supplier allowances, occupancy-related taxes, compensation costs for merchandise purchasing and warehouse personnel, and other inventory acquisition-related costs. These costs are significant and can be expected to continue to increase as we grow. The components of our reported cost of goods sold may not be comparable to those of other retail companies, including our competitors.

Our gross profit generally follows changes in net sales. We regularly analyze the components of gross profit, as well as gross profit as a percentage of net sales. Specifically, we examine the initial markup on purchases, markdowns and reserves, shrinkage, buying costs, distribution costs and occupancy costs. Any inability to obtain acceptable levels of initial markups, a significant increase in our use of markdowns or in inventory shrinkage, or a significant increase in freight and other inventory acquisition costs, could have an adverse impact on our gross profit and results of operations.

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Gross profit is also impacted by shifts in the proportion of sales of our private brand products compared to third-party brand products, as well as by sales mix changes within and between brands and major product categories such as footwear, apparel or accessories.

Selling, general and administrative expenses

Our SG&A expenses are composed of labor and related expenses, other operating expenses and general and administrative expenses not included in cost of goods sold. Specifically, our SG&A expenses include the following:

Labor and related expenses—Labor and related expenses include all store-level salaries and hourly labor costs, including salaries, wages, benefits and performance incentives, labor taxes and other indirect labor costs.

Other operating expenses—Other operating expenses include all operating costs, including those for advertising, marketing campaigns, operating supplies, utilities, and repairs and maintenance, as well as credit card fees and costs of third-party services.

General and administrative expenses—General and administrative expenses comprise expenses associated with corporate and administrative functions that support the development and operations of our stores, including compensation and benefits, travel expenses, corporate occupancy costs, stock compensation costs, legal and professional fees, insurance and other related corporate costs.

The components of our SG&A expenses may not be comparable to those of our competitors and other retailers. We expect our selling, general and administrative expenses will increase in future periods as a result of incremental share-based compensation, legal, accounting, and other compliance-related expenses associated with being a public company and increases resulting from growth in the number of our stores.

EBITDA and Adjusted EBITDA

EBITDA and Adjusted EBITDA are important financial measures used by our management, board of directors and lenders to assess our operating performance. We use EBITDA and Adjusted EBITDA as key performance measures because we believe that they facilitate operating performance comparisons from period to period by excluding potential differences primarily caused by the impact of variations from period to period in tax positions, interest expense and depreciation and amortization, as well as, in the case of Adjusted EBITDA, excluding non-cash expenses, such as stock-based compensation and the non-cash accrual for future award redemptions, and unusual or non-recurring costs and expenses that are not directly related to our operations, including acquisition-related expenses, acquisition-related integration costs, amortization of inventory fair value adjustment, loss/(gain) on disposal of assets and contract termination costs and SEC filing costs. See "Results of Operations" below for a reconciliation of our

EBITDA and Adjusted EBITDA to net income, the most directly comparable financial measure calculated and presented in accordance with GAAP. Because EBITDA and Adjusted EBITDA facilitate internal comparisons of our historical operating performance on a more consistent basis, we also use EBITDA and Adjusted EBITDA (or some variations thereof) for business planning purposes, in calculating covenant compliance for our credit facilities, in determining incentive compensation for members of our management and in evaluating acquisition opportunities. In addition, we believe that EBITDA and Adjusted EBITDA and similar measures are widely used by investors, securities analysts, ratings agencies and other parties in evaluating companies in our industry as a measure of financial performance and debt-service capabilities. Given that EBITDA and Adjusted EBITDA are measures not deemed to be in accordance with GAAP and are susceptible to varying calculations, our EBITDA and Adjusted EBITDA may not be comparable to similarly titled measures of other companies, including companies in our industry, because other companies may calculate EBITDA and Adjusted EBITDA in a different manner than we calculate these measures.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, as well as the related disclosures of contingent assets and liabilities at the date of the financial statements. A summary of our significant accounting policies is included in Note 2 to our consolidated financial statements included in the Fiscal 2016 10-K.

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Certain of our accounting policies and estimates are considered critical, as these policies and estimates are the most important to the depiction of our consolidated financial statements and require significant, difficult or complex judgments, often about the effect of matters that are inherently uncertain. Such policies are summarized in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Fiscal 2016 10-K. As of the date of this filing, there were no significant changes to any of the critical accounting policies and estimates described in the Fiscal 2016 10-K.

Results of Operations

We operate on a fiscal calendar that results in a 52- or 53-week fiscal year ending on the last Saturday of March unless April 1st is a Saturday, in which case the fiscal year ends on April 1st. In a 52-week fiscal year, each quarter includes thirteen weeks of operations; in a 53-week fiscal year, the first, second and third quarters each include thirteen weeks of operations and the fourth quarter includes fourteen weeks of operations. The fiscal year ending on April 1, 2017 ("fiscal 2017") will consist of 53 weeks; whereas, the fiscal year ended on March 26, 2016 ("fiscal 2016") consisted of 52 weeks. We identify our fiscal years by reference to the calendar year in which the fiscal year ends.

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The following table summarizes key components of our results of operations for the periods indicated, both in dollars and as a percentage of our net sales:

(dollars in thousands)	Thirteen Weeks Ended December 24, 2016	Thirteen Weeks Ended December 26, 2015	Thirty-Nine Weeks Ended December 24, 2016	Thirty-Nine Weeks Ended December 26, 2015
Condensed Consolidated Statements of Operations Data (Unaudited):				
Net sales	$ 199,431	$ 193,842	$ 466,813	$ 419,554
Cost of goods sold	136,068	129,891	326,255	289,176
Amortization of inventory fair value adjustment	—	(228)	—	(453)
Total cost of goods sold	136,068	129,663	326,255	288,723
Gross profit	63,363	64,179	140,558	130,831
Operating expenses:				
Selling, general and administrative expenses	42,500	43,986	110,803	105,323
Acquisition-related expenses	—	—	—	891
Total operating expenses	42,500	43,986	110,803	106,214
Income from operations	20,863	20,193	29,755	24,617
Interest expense, net	3,637	3,553	10,848	9,347
Income before income taxes	17,226	16,640	18,907	15,270
Income tax expense	6,719	6,712	7,298	6,414
Net income	$ 10,507	$ 9,928	$ 11,609	$ 8,856
Percentage of Net Sales (Unaudited):				
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	68.2 %	67.0 %	69.9 %	68.9 %
Amortization of inventory fair value adjustment	— %	(0.1) %	— %	(0.1) %
Total cost of goods sold	68.2 %	66.9 %	69.9 %	68.8 %
Gross profit	31.8 %	33.1 %	30.1 %	31.2 %
Operating expenses:				
Selling, general and administrative expenses	21.3 %	22.7 %	23.7 %	25.1 %
Acquisition-related expenses	— %	— %	— %	0.2 %
Total operating expenses	21.3 %	22.7 %	23.7 %	25.3 %
Income from operations	10.5 %	10.4 %	6.4 %	5.9 %
Interest expense, net	1.8 %	1.8 %	2.3 %	2.2 %
Income before income taxes	8.7 %	8.6 %	4.1 %	3.7 %
Income tax expense	3.4 %	3.5 %	1.6 %	1.5 %
Net income	5.3 %	5.1 %	2.5 %	2.2 %

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The following table presents a reconciliation of EBITDA and Adjusted EBITDA to our net income, the most directly comparable financial measure calculated and presented in accordance with GAAP, for each of the periods indicated:

(in thousands)	Thirteen Weeks Ended December 24, 2016	Thirteen Weeks Ended December 26, 2015	Thirty-Nine Weeks Ended December 24, 2016	Thirty-Nine Weeks Ended December 26, 2015
EBITDA Reconciliation (Unaudited):				
Net income	$ 10,507	$ 9,928	$ 11,609	$ 8,856
Income tax expense	6,719	6,712	7,298	6,414
Interest expense, net	3,637	3,553	10,848	9,347
Depreciation and intangible asset amortization	4,207	3,593	12,303	9,522
EBITDA	25,070	23,786	42,058	34,139
Non-cash stock-based compensation(a)	754	761	2,260	2,143
Non-cash accrual for future award redemptions(b)	399	961	574	801
Acquisition-related expenses(c)	—	—	—	891
Acquisition-related integration costs (d)	—	3,153	—	8,521
Amortization of inventory fair value adjustment (e)	—	(228)	—	(453)
(Gain)/Loss on disposal of assets and contract termination costs(f)	(22)	53	163	1,106
SEC filing costs(g)	—	317	—	317
Adjusted EBITDA	$ 26,201	$ 28,803	$ 45,055	$ 47,465

(a) Represents non-cash compensation expenses related to stock options, restricted stock awards and restricted stock units granted to certain of our employees and directors.
(b) Represents the non-cash accrual for future award redemptions in connection with our customer loyalty program.
(c) Includes direct costs and fees related to the Sheplers Acquisition.
(d) Represents certain store integration, remerchandising, inventory obsolescence and corporate consolidation costs incurred in connection with the integration of Sheplers, which we acquired in June 2015. Includes an adjustment to normalize the gross margin impact of sales of discontinued inventory from Sheplers, which was sold at a discount or written off. The adjustment assumes such inventory was sold at Sheplers' normalized margin rate.
(e) Represents the amortization of purchase-accounting adjustments that decreased the value of inventory acquired to its fair value.
(f) Represents (gain)/loss on disposal of assets and contract termination costs from store closures and unused office and warehouse space.
(g) Represents professional fees and expenses incurred in connection with a Form S-1 Registration Statement filed in July 2015 and withdrawn in November 2015.

The following table presents store operating data for the periods indicated:

	Thirteen Weeks Ended December 24, 2016	Thirteen Weeks Ended December 26, 2015	Thirty-Nine Weeks Ended December 24, 2016	Thirty-Nine Weeks Ended December 26, 2015

Selected Store Data (Unaudited):				
Same Store Sales growth/(decline)	0.2 %	(2.0) %	0.7 %	0.3 %
Stores operating at end of period	219	206	219	206
Total retail store square footage, end of period (in thousands)	2,494	2,374	2,494	2,374
Average store square footage, end of period	11,389	11,525	11,389	11,525
Average net sales per store (in thousands)	$ 704	$ 751	$ 1,723	$ 1,738

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Thirteen Weeks Ended December 24, 2016 Compared to Thirteen Weeks Ended December 26, 2015

Net sales. Net sales increased $5.6 million, or 2.9%, to $199.4 million for the thirteen weeks ended December 24, 2016 from $193.8 million for the thirteen weeks ended December 26, 2015. The increase in net sales was the result of 14 new stores opened between the beginning of the fourth quarter of fiscal 2016 and the end of the third quarter of fiscal 2017 and an increase of 0.2% in consolidated same store sales during the thirteen weeks ended December 24, 2016. This consolidated same store sales growth was partially offset by the planned closure of one Sheplers store and the closure of one Boot Barn store over the last twelve months.

Gross profit. Gross profit decreased $0.8 million, or 1.3%, to $63.4 million for the thirteen weeks ended December 24, 2016 from $64.2 million for the thirteen weeks ended December 26, 2015. As a percentage of net sales, gross profit was 31.8% and 33.1% for the thirteen weeks ended December 24, 2016 and December 26, 2015, respectively. The decline in gross profit and gross profit rate compared to the prior year resulted primarily from an increase in store occupancy, more e-commerce sales as a percentage of total sales, increased freight costs, higher redemption in our annual holiday bounce back promotion, and higher shrink.

Selling, general and administrative expenses. SG&A expenses decreased $1.5 million, or 3.4%, to $42.5 million for the thirteen weeks ended December 24, 2016 from $44.0 million for the thirteen weeks ended December 26, 2015. As a percentage of net sales, SG&A was 21.3% and 22.7% for the thirteen weeks ended December 24, 2016 and December 26, 2015, respectively. The decrease is primarily due to acquisition-related integration costs, loss on disposal of assets and SEC filing costs incurred in the thirteen weeks ended December 26, 2015 that were not incurred in the thirteen weeks ended December 24, 2016.

Income from operations. Income from operations for the thirteen weeks ended December 24, 2016 totaled $20.9 million, an increase of $0.7 million from $20.2 million for the thirteen weeks ended December 26, 2015. As a percentage of net sales, income from operations was 10.5% for the thirteen weeks ended December 24, 2016, compared to 10.4% for the thirteen weeks ended December 26, 2015. The change in income from operations was attributable to the factors noted above.

Interest expense, net. Interest expense, net, was $3.6 million for both the thirteen weeks ended December 24, 2016 and December 26, 2015.

Income tax expense. Income tax expense was $6.7 million for both the thirteen weeks ended December 24, 2016 and December 26, 2015. Our effective tax rate was 39.0% and 40.3% for the thirteen weeks ended December 24, 2016 and December 26, 2015, respectively. The effective tax rate for the thirteen weeks ended December 24, 2016 is lower than the comparable period in fiscal 2016 due to discrete items recognized during the periods presented.

Net income. Net income increased $0.6 million, from $9.9 million for the thirteen weeks ended December 26, 2015 to $10.5 million for the thirteen weeks ended December 24, 2016. The increase in net income was attributable to the factors noted above.

Adjusted EBITDA. Adjusted EBITDA decreased $2.6 million, or 9.0%, to $26.2 million for the thirteen weeks ended December 24, 2016 from $28.8 million for the thirteen weeks ended December 26, 2015. The decrease was primarily a result of the year-over-year decline in gross profit and an increase in operating expenses related to increased sales.

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Thirty-Nine Weeks Ended December 24, 2016 Compared to Thirty-Nine Weeks Ended December 26, 2015

Net sales. Net sales increased $47.3 million, or 11.3%, to $466.8 million for the thirty-nine weeks ended December 24, 2016 from $419.6 million for the thirty-nine weeks ended December 26, 2015. Net sales increased due to nine months of sales contributions from Sheplers (compared to six months in the prior-year period), the opening of 14 new stores between the beginning of the fourth quarter of fiscal 2016 and the end of the third quarter of fiscal 2017 and a 0.7% increase in consolidated same store sales. This consolidated same store sales growth was partially offset by the planned closure of one Sheplers store and the closure of one Boot Barn store over the last 12 months.

Gross profit. Gross profit increased $9.7 million, or 7.4%, to $140.6 million for the thirty-nine weeks ended December 24, 2016 from $130.8 million for the thirty-nine weeks ended December 26, 2015. The gross profit increase was a result of increased sales, the opening of 14 new stores over the last twelve months, and the acquisition-related integration costs of $1.0 million incurred in the prior year period that were not incurred in the thirty-nine weeks ended December 24, 2016. As a percentage of net sales, gross profit was 30.1% and 31.2% for the thirty-nine weeks ended December 24, 2016 and December 26, 2015, respectively. The decline in gross profit rate was primarily driven by nine months of historically lower-margin Sheplers sales compared to six months in the prior-year period and more e-commerce sales as a percentage of total sales. Also contributing to the decline in gross profit rate was an increase in store occupancy.

Selling, general and administrative expenses. SG&A expenses increased $5.5 million, or 5.2%, to $110.8 million for the thirty-nine weeks ended December 24, 2016 from $105.3 million for the thirty-nine weeks ended December 26, 2015. As a percentage of net sales, SG&A was 23.7% and 25.1% for the thirty-nine weeks ended December 24, 2016 and December 26, 2015, respectively. The increase in SG&A expense was primarily related to nine months of Sheplers operations versus six months in the prior-year period and increases in operations required to support higher sales volume. The decrease in rate is primarily due to acquisition-related integration costs, loss on disposal of assets and SEC filing costs incurred in the thirty-nine weeks ended December 26, 2015 that were not incurred in the thirty-nine weeks ended December 24, 2016.

Income from operations. Income from operations increased $5.1 million to $29.8 million for the thirty-nine weeks ended December 24, 2016 from $24.6 million for the thirty-nine weeks ended December 26, 2015. As a percentage of net sales, income from operations was 6.4% and 5.9% for the thirty-nine weeks ended December 24, 2016 and December 26, 2015, respectively. The change in income from operations was attributable to the factors noted above.

Interest expense, net. Interest expense, net, increased $1.5 million, or 16.1%, to $10.8 million for the thirty-nine weeks ended December 24, 2016 from $9.3 million for the thirty-nine weeks ended December 26, 2015. The increase in interest expense, net was primarily the result of nine months of higher outstanding debt and interest rates associated with the refinanced debt as compared to six months in the thirty-nine weeks ended December 26, 2015, partially offset by a $1.4 million write-off of debt issuance costs and debt discount incurred in the prior year period.

Income tax expense. Income tax expense increased $0.9 million, to $7.3 million for the thirty-nine weeks ended December 24, 2016 from $6.4 million for the thirty-nine weeks ended December 26, 2015. The increase in our income tax expense results from the $3.6 million increase in income before income taxes for the thirty-nine weeks ended December 24, 2016 as compared to the thirty-nine weeks ended December 26, 2015, partially offset by a reduction in tax rate year over year. Our effective tax rate was 38.6% and 42.0% for the thirty-nine weeks ended December 24, 2016 and December 26, 2015, respectively. The effective tax rate for the thirty-nine weeks ended December 24, 2016 is lower than the comparable period in fiscal 2016 due to discrete items recognized during the periods presented.

Net income. Net income increased $2.8 million, from $8.9 million for the thirty-nine weeks ended December 26, 2015 to $11.6 million for the thirty-nine weeks ended December 24, 2016. The increase in net income was attributable to the factors noted above.

Adjusted EBITDA. Adjusted EBITDA decreased $2.4 million, or 5.1%, to $45.1 million for the thirty-nine weeks ended December 24, 2016 from $47.5 million for the thirty-nine weeks ended December 26, 2015. The decrease was

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primarily a result of the year-over-year increase in operating expenses related to nine months of Sheplers operations versus six months in the prior-year period and increases in operations required to support higher sales volume.

Liquidity and Capital Resources

We rely on cash flows from operating activities and our credit facility as our primary sources of liquidity. Our primary cash needs are for inventories, operating expenses, capital expenditures associated with opening new stores and remodeling or refurbishing existing stores, improvements to our distribution facilities, marketing and information technology expenditures, debt service and taxes. We have also used cash for acquisitions, the subsequent rebranding and integration of the stores acquired in those acquisitions and costs to consolidate the corporate offices. In addition to cash and cash equivalents, the most significant components of our working capital are accounts receivable, inventories, accounts payable and accrued expenses and other current liabilities. We believe that cash flows from operating activities and the availability of cash under our credit facilities or other financing arrangements will be sufficient to cover working capital requirements, anticipated capital expenditures and other anticipated cash needs for at least the next 12 months.

Our liquidity is moderately seasonal. Our cash requirements generally increase in our third fiscal quarter as we increase our inventory in advance of the Christmas shopping season.

Our cash provided by operations increased in the thirty-nine weeks ended December 24, 2016 as compared to the thirty-nine weeks ended December 26, 2015, primarily as a result of a decrease in inventory purchases and a $2.8 million increase in net income in the thirty-nine weeks ended December 24, 2016, relative to the thirty-nine weeks ended December 26, 2015.

During the thirty-nine weeks ended December 24, 2016, we used $17.7 million in investing activities, primarily associated with capital expenditures related to store construction, improvements to our e-commerce information technology infrastructure, and the relocation of the Store Support Center in Irvine, California. We are planning to continue to open new stores, remodel and refurbish our existing stores, and make improvements to our e-commerce and information technology infrastructure, which will result in increased capital expenditures. We estimate that our total capital expenditures in fiscal 2017 will be between approximately $17.0 million and $18.0 million, net of landlord tenant allowances, and we anticipate that we will use cash flows from operations to fund these expenditures.

$150 Million Credit Facility (Wells Fargo Bank, N.A.)

On February 23, 2015, we and Boot Barn, Inc., our wholly-owned primary operating subsidiary, entered into the February 2015 Wells Fargo Credit Facility, which consisted of a $75.0 million revolving credit facility, including a $5.0 million sub-limit for letters of credit, and a $75.0 million term loan, and also provided us with the ability to incur additional incremental term loans of up to $50.0 million, provided that certain conditions were met, including compliance with certain covenants. On June 29, 2015, we repaid all outstanding borrowings under the February 2015 Wells Fargo Credit Facility and terminated such facility in connection with the refinancing discussed below.

Total interest expense incurred in the thirteen weeks ended December 26, 2015 on the February 2015 Wells Fargo Credit Facility was $0.8 million.

June 2015 Wells Fargo Revolver and Golub Term Loan

On June 29, 2015, we, as guarantor, and our wholly-owned primary operating subsidiary, Boot Barn, Inc., refinanced our $150 million February 2015 Wells Fargo Credit Facility with the $125 million June 2015 Wells Fargo Revolver and $200 million 2015 Golub Term Loan. Borrowings under the credit agreements were initially used to pay costs and expenses related to the Sheplers Acquisition and the closing of the new credit agreements, and may be used for working capital and other general corporate purposes.

Borrowings under the June 2015 Wells Fargo Revolver bear interest at per annum rates equal to, at our option, either (i) the London Interbank Offered Rate (“LIBOR”) plus an applicable margin for LIBOR loans, or (ii) the base rate plus an applicable margin for base rate loans. The base rate is calculated as the highest of (a) the federal funds rate plus 0.5%, (b) the Wells Fargo prime rate and (c) one-month LIBOR plus 1.0%. The applicable margin is calculated based on a pricing grid that in each case is linked to quarterly average excess availability. For LIBOR Loans, the applicable margin ranges from 1.00% to 1.25%, and for base rate loans it ranges from 0.00% to 0.25%. We also pay a commitment fee of 0.25% per annum of the actual daily amount of the unutilized revolving loans. The interest on the June 2015 Wells Fargo Revolver is payable in quarterly installments ending on June 29, 2020, the maturity date. The amount outstanding under the June 2015 Wells Fargo Revolver as of December 24, 2016 and March 26, 2016 was $23.0 million and $48.8 million, respectively. Total interest expense incurred in the thirteen and thirty-nine weeks ended December 24, 2016 on the June 2015 Wells Fargo Revolver was $0.4 million and $1.1 million, respectively, and the weighted average interest rate for the thirteen weeks ended December 24, 2016 was 2.0%.

Borrowings under the 2015 Golub Term Loan bear interest at per annum rates equal to, at our option, either (a) LIBOR plus an applicable margin for LIBOR loans with a LIBOR floor of 1.0%, or (b) the base rate plus an applicable margin for base rate loans. The base rate is calculated as the greater of (i) the higher of (x) the prime rate and (y) the federal funds rate plus 0.5% and (ii) the sum of one-month LIBOR plus 1.00%. The applicable margin is 4.5% for LIBOR Loans and 3.5% for base rate loans. The principal and interest on the 2015 Golub Term Loan will be payable in quarterly installments ending on June 29, 2021, the maturity date. Quarterly principal payments of $500,000 are due for each quarter. Total interest expense incurred in the thirteen and thirty-nine weeks ended December 24, 2016 on the 2015 Golub Term Loan was $2.7 million and $8.2 million, respectively, and the weighted average interest rate for the thirteen weeks ended December 24, 2016 was 5.5%.

All obligations under each of the 2015 Golub Term Loan and the June 2015 Wells Fargo Revolver are unconditionally guaranteed by us and each of our direct and indirect domestic subsidiaries (other than certain immaterial subsidiaries) which are not named as borrowers under the 2015 Golub Term Loan or the June 2015 Wells Fargo Revolver, as applicable.

The priority with respect to collateral under each of the 2015 Golub Term Loan and the June 2015 Wells Fargo Revolver is subject to the terms of an intercreditor agreement among the lenders under the 2015 Golub Term Loan and the June 2015 Wells Fargo Revolver.

Each of the June 2015 Wells Fargo Revolver and the 2015 Golub Term Loan contains customary provisions relating to mandatory prepayments, restricted payments, voluntary payments, affirmative and negative covenants, and events of default. In addition, the terms of the June 2015 Wells Fargo Revolver require the Company to maintain, on a consolidated basis, a Consolidated Fixed Charge Coverage Ratio of at least 1.00:1.00 during such times as a covenant trigger event shall exist. The terms of the 2015 Golub Term Loan require the Company to maintain, on a consolidated basis, a maximum Consolidated Total Net Leverage Ratio as of December 24, 2016 of 4.50:1.00. As provided for in the 2015 Golub Term Loan, this ratio steps down to 4.25:1.00 as of April 1, 2017 and 4.00:1:00 as of September 30, 2017 and for all subsequent periods. The June 2015 Wells Fargo Revolver and 2015 Golub Term Loan also require us to pay additional interest of 2% per annum upon triggering certain specified events of default as set forth therein. For financial accounting purposes, the requirement for us to pay a higher interest rate upon an event of default is an embedded derivative. As of December 24, 2016, the fair value of these embedded derivatives was estimated and was not significant.

As of December 24, 2016, we were in compliance with the June 2015 Wells Fargo Revolver and the 2015 Golub Term Loan debt covenants.

Cash Position and Cash Flow

Cash and cash equivalents were $31.2 million as of December 24, 2016 compared to $7.2 million as of March 26, 2016.

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The following table presents summary cash flow information for the periods indicated (in thousands):

	Thirty-Nine Weeks Ended	
	December 24,	December 26,
(in thousands)	2016	2015
Net cash provided by/(used in):		
Operating activities	$ 68,163	$ 55,668
Investing activities	(17,698)	(176,635)
Financing activities	(26,451)	137,359
Net increase in cash	$ 24,014	$ 16,392

Operating Activities

Net cash provided by operating activities was $68.2 million for the thirty-nine weeks ended December 24, 2016. The significant components of cash flows provided by operating activities were net income of $11.6 million, the add-back of non-cash depreciation and amortization expense of $12.3 million, stock-based compensation expense of $2.3 million, and amortization of debt issuance fees and debt discount of $0.8 million. Other liabilities, accounts payable and accrued expenses and other current liabilities increased by $40.5 million due to the timing of payments. These increases were partially offset by an increase in inventories of $3.7 million due to the growth of the company.

Net cash provided by operating activities was $55.7 million for the thirty-nine weeks ended December 26, 2015. The significant components of cash flows provided by operating activities were net income of $8.9 million, the add-back of non-cash depreciation and amortization expense of $9.5 million, stock-based compensation expense of $2.1 million, amortization of deferred loan fees and debt discount of $2.0 million and the excess tax benefit related to the exercise of stock options of $3.7 million. Accounts payable and accrued expenses and other current liabilities increased by $40.1 million due to increases in acquisition-related integration accruals and Holiday seasonality. Prepaid expenses and other current assets decreased by $9.1 million primarily due to a decrease in prepaid rent as a result of the timing of rent payments. The above was offset by an increase in inventories of $13.9 million due to the growth of the company.

Investing Activities

Net cash used in investing activities was $17.7 million for the thirty-nine weeks ended December 24, 2016, which was attributable to purchases of property and equipment during the period.

Net cash used in investing activities was $176.6 million for the thirty-nine weeks ended December 26, 2015, which was attributable to the Sheplers Acquisition, net of cash acquired for $146.5 million and purchases of property and equipment during the period for $30.1 million.

Financing Activities

Net cash used in financing activities was $26.5 million for the thirty-nine weeks ended December 24, 2016. We reduced our line of credit borrowings by $25.8 million and repaid $1.8 million on our debt and capital lease obligations during the period. We also received $1.2 million from the exercise of stock options.

Net cash provided by financing activities was $137.4 million for the thirty-nine weeks ended December 26, 2015. We increased our loan borrowings by $200.9 million and our line of credit borrowings by $13.8 million. We paid $6.5 million of debt issuance fees related to these borrowings and repaid $77.3 million on our debt and capital lease obligations during the period. We also received $2.7 million from the exercise of stock options, and $3.7 million excess tax benefit from the exercise of those options.

Contractual Obligations

During the thirteen and thirty-nine weeks ended December 24, 2016, there were no significant changes to our contractual obligations described in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Fiscal 2016 10-K, other than those which occur in the normal course of business.

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Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements, except for operating leases and purchase obligations.

Implications of Being an Emerging Growth Company

We are an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012, which we refer to as the JOBS Act. We will remain an emerging growth company until the earlier of (1) the last day of our fiscal year (a) following the fifth anniversary of the completion of our IPO, (b) in which we have total annual gross revenue of at least $1.0 billion, or (c) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds $700.0 million as of the last business day of our most recently completed second fiscal quarter, and (2) the date on which we have issued more than $1.0 billion in non-convertible debt securities during the prior three-year period. An emerging growth company may take advantage of specified reduced reporting and other burdens that are otherwise generally applicable to public companies.

Item 3. Quantitative and Qualitative Disclosure of Market Risk

We are subject to interest rate risk in connection with borrowings under our credit facilities, which bear interest at variable rates. As of December 24, 2016, we had $23.0 million in outstanding borrowings under the June 2015 Wells Fargo Revolver and $197.0 million under the 2015 Golub Term Loan. The annual impact of a 1.0% rate change on the outstanding total debt balance as of December 24, 2016 would be approximately $2.2 million.

As of December 24, 2016, there were no other material changes in the market risks described in the “Quantitative and Qualitative Disclosure of Market Risks” section of the Fiscal 2016 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, including our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 24, 2016. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of December 24, 2016, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

During the quarter ended December 24, 2016, no changes occurred with respect to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Part II. Other Information

Item 1. Legal Proceedings

For information on legal proceedings, see Note 7, “Commitments and Contingencies”, to our unaudited financial statements included in this Quarterly Report, which information is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes to our risk factors as set forth in “Item 1A—Risk Factors” in our Fiscal 2016 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit No.	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files from Boot Barn Holdings, Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 24, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statement of Stockholders' Equity; (iv) the Condensed Consolidated Statements of Cash Flows and (v) Notes to the Condensed Consolidated Financial Statements.

*These certifications are furnished to the SEC pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURES

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

	Boot Barn Holdings, Inc.
Date: February 1, 2017	/s/ James G. Conroy James G. Conroy President and Chief Executive Officer (Principal Executive Officer)
Date: February 1, 2017	/s/ Gregory V. Hackman Gregory V. Hackman Chief Financial Officer and Secretary (Principal Financial Officer and Principal Accounting Officer)

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EXHIBIT INDEX

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