Hochschild Mining

(HOC)

BUY

14 October 2009

52-wk Range:	£0.65-3.38	Market Cap (M):	£1,035.3
12 month target	£3.41	EV (M):	£1,187.0

Mining

Initiating Coverage

Key Metrics

EV/EBITDA:	19.3
Shares Outstanding (M):	338.1
Current Price (GBP):	£3.06

Initiating Coverage

Summary

Moving to Fair Value: We initiate coverage of Hochschild with a Buy recommendation. In our opinion Hochschild just makes it as a Buy with the minimum 10% upside to the current share price to reach our target price of £3.41/share. However, we do expect good exploration results over the next 12 months and if current gold and silver prices are sustained then there is upside to our figures from higher commodity prices. However, since Hochschild presents its accounts in $US, the share price on the London Stock Exchange is most sensitive to the sterling-dollar exchange rate.

Strong Cash Position: Due to the recent fund raising, Hochschild has a strong cash position and we foresee no problems in repaying the $200m debt, funding the aggressive exploration programme, maintaining the existing dividend and maintaining its 40% ownership of Lake Shore. In arriving at this conclusion we have assumed little or no dividend from the two subsidiaries, Lake Shore Gold and Gold Resource Corporation over the next two years and we believe that any cash generated by these companies will be either used to expand their existing operations or reduce debt.

Exploration proceeding apace: Hochschild has a number of promising exploration opportunities but from the Fox-Davies perspective we do not believe that any of them will be sufficiently far advanced to develop into a mine before the end of 2010, suggesting that 2012 will be the year production growth resumes. Of course, any prominent news as to new mine development will be announced prior to this and incorporated into the share price, but we do not expect this to occur the short term.

FYE Dec	2008	2009E	2010E	2011E	2012E
Revenue (US$M):	452.5	561.4	731.3	738.6	603.9
EBITDA (US$M):	61.6	215.5	406.1	423.0	323.6
NPAT (inc significant items):	-19.0	73.4	164.4	177.8	128.1
EPS (USc):	-6.2	22.9	45.8	49.5	35.7
Cash Flow/Share (US$M):	21.3	66.9	91.6	91.2	69.9
Gold Price (US$/oz):	872.6	948.0	1087.5	1100.0	912.5
Silver Price (US$/oz)	15.0	14.3	17.1	17.3	15.6

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Executive Summary

The Hochschild Mining Group can trace back its history almost a century, when the Hochschild Group was founded in 1911 by Mauricio Hochschild. During the first few decades of the company's history, activities were concentrated in Bolivia and Peru, and were focused on mineral commercialisation. The first mines began operating in the 1940s, and in the 1960s, Hochschild opened the Arcata mine, which is still operational.

In 1984 the group sold its South American mining assets to Anglo American, who subsequently sold the Peruvian assets back to companies owned by Luis Hochschild. In 1995, an extensive exploration was begun, and the company continued to grow through project identification and joint venture agreements.

The company listed on the London Stock Exchange in November 2006, after placing 77.25M shares at a price of £3.50, the proceeds of which was used to pay off debt and fund ongoing projects.

Exhibit 1: Hochschild operations location map

Source: Hochschild

Hochschild may be seen as going through a major period of change. The Selene mine ceased operating in the June quarter of 2009, the Ares mine is expected to be mined out towards the end of 2011 and the Moris mine is expected to be mined out in mid 2010. Mining at Selene has been replaced by an increase in output from Pallancata, which will keep the Selene mill full. Although Ares will cease operations, the mill will continue to treat the concentrate from Arcata and process it through to doré. This will save significant selling expenses, expected to amount to around $12M per year.

However, this does beg the question as to why the conversion to doré will take place at Ares? Surely it would have been preferable to complete the processing through to doré on site at Arcata. If nothing else, it would have saved the transport charges. It was explained away as an expansion of an existing facility at Ares, but to our thinking it would have been better to move the existing doré production facility from Ares to Arcata. This way, Hochschild would have a surplus mill available which could readily be transported to a potential new mine, several of which beckon around 2011. On a similar vein of thought, one has to question why the Selene mill was expanded twice. It only commenced production in 2003 and within 6 years the mine had run out of ore. This is a very short mine life. Granted the mill was expanded to treat ore from Pallancata, but we now have the situation that Pallancata has been expanded to fill the mill. It is also doubtful whether the Pallancata mine can sustain a production rate of 3,000tpd unless new veins are developed. Exploration is proceeding apace to achieve this. At one point it may have been thought that the Pacapausa ore body would have filled this gap, but it has since been rolled into the joint venture with International Minerals and drilling fell victim to budget cuts for 2009.

In the short term, Hochschild's attributable production will be boosted by the start-up of the 40% associate Lake Shore Gold and the imminent production from its 24% share of Gold Resources El Aguila mine, where base metal production is expected to more then cover its operating costs. Both of these mines are essentially gold producers, so they will boost Hochschild's attributable gold production.

Table 1: Silver and Gold projection, past and projected

	2007	2008	2009F	2010F	2011F	2012F
Silver production (Moz)	13.58	16.73	18.93	21.38	21.40	20.49
Gold production (Koz)	200.6	194.0	158.9	162.3	138.3	96.6
Gold production including Lake Shore (Koz)	200.6	194.0	169.1	203.8	203.2	176.1

The above table of forecast gold and silver production includes no allowance for any production from Gold Resources Corporation and assumes that Hochschild maintains its ownership of Lake Shore at 40%. Under this scenario, it also shows that silver production peaks in 2011 with its own gold production having already peaked in 2008.

Elsewhere, Hochschild is basing its exploration on the "cluster principal." This means that exploration is primarily being focused around the existing mines, with the view that in all probability, new mines will feed into the existing centralised processing plants. This was the rationale behind buying the Liam Joint Venture from Newmont and Southwestern Resources.

The aggressive exploration programme is driven by the fact that the average mine life is quite short at 3.2 years. This is exacerbated since Gold Resources have started mining at El Aguila with NO ore reserves. Granted it is high grade ore, but this adds to the risk profile. Another salient point is that 34% of Hochschild's silver equivalent ounces are contained in its share of the ore at Pallancata, of which Hochschild only owns 60%.

When the ore reserves were last updated as at 31 December 2008, higher cut-off grades were used due to the cost inflation that occurred in 2008. This reduced the tonnages and exacerbated the mine life situation. With the cost reductions due to economies of scale, processing through to doré and general deflationary pressures in the mining industry, when combined with the improvements in the gold and silver prices, Fox-Davies anticipates that cut-off grades could conceivably be lowered when the ore reserves are next calculated.

On the positive side of the ledger, the balance sheet is in good order and the cash flows are strong. We believe, from our modelling, that prior to the recent raising, Hochschild would have had no problems developing a new mine from cash flow from mid 2010 onwards, but if dividends and debt repayments had adhered to schedule, then maintaining their 40% interest in Lake Shore Gold would have been difficult. Following the successful raising of $260M in a combination of shares and convertibles, maintaining the 40 % interest in Lake Shore is not a problem. But, spending the additional cash to maintain a 40% interest in Lake Shore Gold, only maintains restores the initial gold production profile, it does nothing to improve it until at least after 2011. In fact, the acquisition strategy appears odd. By announcing their intentions to the world, the Hochschild's board is making a rod for its own back. There are two aspects to this. Knowing that a bid is imminent as soon as the stand-still periods expire, the management of the associates can play a short term game, high grade their mines, pay big bonuses and dividends knowing they will not be around to pick up the pieces. From the investors' point of view, knowing bids for Lake Shore and Gold Resources are coming, they invest in these stocks, and wait to be taken out at a profit.

Perhaps Hochschild should have made hostile takeovers, with their expensive paper, and acquired 100% of these companies at an early stage. If this scenario had been followed, a bid for International Minerals should have been made. It would have solved many of the issues about mine life for the Selene mill and boosted attributable production. We understand that the Ecuadorian assets where a deterrent, but Hochschild could have done a similar deal to the one they did with Anglo American in 1984.

When the standstill agreement with Lake Shore Gold expires in November 2010, we believe that Hochschild will have sufficient cash to move to 100%. However, our calculations indicate that moving to 100% of Lake Shore, moving to 100% of Gold Resources and building a new mine are probably beyond the scope of Hochschild without resort to the debt market. The question is, which options management will choose. If a new mine features in the mix, will this be a new stand alone mill, or will it be a new mine feeding into an existing processing plant? Or, extensions to mine life versus production growth?

Excluding the associates, we believe that any growth in the company prior to 2012 will have to come from one of two sources. These are higher metal prices and cost reductions. The move to treat all the concentrate that Arcata produces into doré will have a significant impact and we anticipate that the new power lines will reduce electricity costs at the operations.

In summation, we see the next 12 months as a period of consolidation for Hochschild, during which time we anticipate that the exploration programme will deliver the next mine and enable growth to resume 2012.

Financial Forecasts

Hochschild

Current: £3.06 | Recommendation: BUY (Target: £3.41)

HOC(AIM)

December year-end	2008	2009F	2010F	2011F	2012F	2013F	2014F
PROFIT & LOSS (US$ M)							
Sales revenue	433.8	518.8	724.5	725.7	587.8	519.2	459.0
Dividends received	0.0	0.0	0.0	1.3	1.1	0.9	0.7
Other revenue	9.2	36.7	0.0	0.0	0.0	0.0	0.0
Operating costs	281.3	285.4	302.3	288.0	253.3	246.8	238.1
Exploration write off	23.9	17.8	16.0	16.0	12.0	0.0	0.0
Depreciation/amortisation	42.5	61.0	60.7	56.3	54.6	50.5	49.5
Other expenses	76.2	36.9	0.0	0.0	0.0	0.0	0.0
EBIT	19.1	154.5	345.4	366.6	269.0	222.8	172.0
Net interest expense	9.7	6.2	(3.0)	(8.1)	(12.2)	(13.8)	(16.7)
Pre-tax profit	9.4	148.3	348.4	374.8	281.2	236.5	188.7
Income tax expense	22.9	38.5	104.5	112.4	84.3	71.0	56.6
Minorities, pref divs	5.5	36.4	79.4	84.5	68.7	56.6	45.3
NPAT (inc significant items)	(19.0)	73.4	164.4	177.8	128.1	109.0	86.8
NPAT (equity)	(19.0)	73.4	164.4	177.8	128.1	109.0	86.8
Significant Items (post tax)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT (exc significant items)	(19)	73	164	178	128	109	87
DIVISIONAL EBIT (US$ M)							
Arcata	81	79	115	128	109	87	72
Ares	65	25	43	35	0	0	0
Selene	(26)	(3)	0	0	0	0	0
Pallancata	21	68	122	137	114	97	78
San Jose	15	68	132	134	107	86	68
Total Divisional EBIT	19	154	345	367	269	223	172
CASHFLOW (US$ M)							
EBITDA	61.6	215.5	406.1	423.0	323.6	273.3	221.5
Exploration write off	23.9	17.8	16.0	16.0	12.0	0.0	0.0
Tax paid	(25.3)	(19.0)	(94.2)	(114.2)	(88.5)	(75.1)	(60.7)
Working capital / other	33.4	1.3	(15.1)	(13.5)	(8.2)	4.4	5.4
Gross operating cash flow	93.6	215.6	312.8	311.3	238.9	202.5	166.2
Capex / exploration	(316.2)	(160.5)	(64.9)	(54.0)	(47.1)	(25.0)	(25.0)
Net investments	(183.5)	(56.7)	0.0	0.0	0.0	0.0	0.0
Other investing	(0.0)	2.8	0.0	0.0	0.0	0.0	0.0
Free cash flows	(406.0)	1.1	247.9	257.3	191.8	177.6	141.2
Net borrowings	411.2	(155.2)	(251.6)	(255.3)	(188.5)	(163.3)	(123.9)
Equity raised	0.0	145.0	0.0	0.0	0.0	0.0	0.0
Dividends paid	(28.5)	(13.8)	(14.4)	(23.7)	(23.7)	(23.7)	(28.7)
Other financing	(0.4)	5.1	2.1	5.6	8.4	9.4	11.4
Financing cash flows	382.2	(18.9)	(263.9)	(273.3)	(203.8)	(177.6)	(141.2)
BALANCE SHEET (US$ M)							
Cash & deposits	116.1	269.2	520.8	747.6	879.1	1,028.1	1,052.1
Trade debtors	123.7	117.6	146.3	83.1	72.5	64.2	55.4
PPE	489.0	555.8	528.0	493.7	461.1	432.6	405.0
Exploration	0.0	9.4	25.4	41.4	54.4	57.4	60.4
Other assets	285.6	324.9	324.4	318.6	318.0	317.6	289.6
Total assets	1,014.5	1,276.9	1,544.9	1,684.4	1,785.2	1,899.9	1,862.5
Current borrowings	98.1	100.2	14.3	14.3	14.3	0.0	0.0
Non-current borrowings	231.7	231.4	231.4	202.9	145.9	131.6	31.6
Other liabilities	0.0	188.6	392.5	406.4	507.0	541.3	417.0
Total liabilities	471.5	520.2	638.1	623.5	667.1	672.9	448.6
Total shareholders' equity	543.0	756.7	906.7	1,060.9	1,118.0	1,227.0	1,413.8

		2008	2009F	2010F	2011F	2012F	2013F	2014F
EQUITY PRODUCTION (GOLD)								
Arcata	(koz)	24.1	29.0	26.5	26.5	25.8	23.6	23.6
Ares	(koz)	64.2	47.5	54.6	41.0	0.0	0.0	0.0
Selene	(koz)	8.5	3.0	0.0	0.0	0.0	0.0	0.0
Pallancata	(koz)	9.7	18.4	21.8	25.0	25.0	25.0	25.0
San Jose	(koz)	27.7	39.6	48.8	48.8	48.8	43.6	41.9
Total production	(koz)	194.0	171.0	206.0	206.2	179.3	171.8	90.5
CASH COSTS								
Arcata	(US$/oz)	2.8	2.6	2.2	1.9	2.5	2.8	2.8
Ares	(US$/oz)	(22.5)	343.6	216.4	212.8	0.0	0.0	0.0
Selene	(US$/oz)	5.7	10.1	0.0	0.0	0.0	0.0	0.0
Pallancata	(US$/oz)	6.1	4.7	4.0	3.4	3.9	4.0	4.1
San Jose	(US$/oz)	30.2	(182.2)	(576.8)	(589.4)	(489.3)	(442.2)	(357.6)
Total cash costs	(US$/oz)	55.3	147.7	(49.6)	(141.1)	(238.2)	(207.2)	(163.5)
ASSUMPTIONS		2008	2009F	2010F	2011F	2012F	2013F	2014F
Gold	(US$/oz)	872.6	948.0	1,087.5	1,100.0	912.5	800.0	762.5
Silver	(US$/oz)	15.0	14.3	17.1	17.3	15.6	14.1	12.5
British Pound	USDGBP	1.85	1.56	1.62	1.64	1.67	1.67	1.67

SHARE PRICE PERFORMANCE

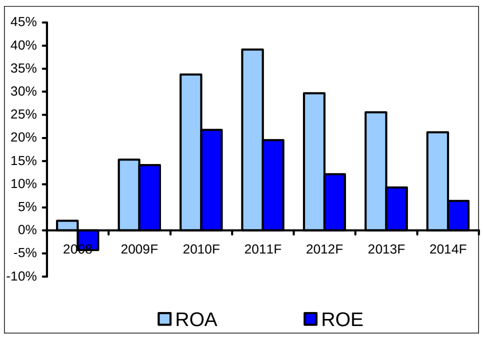
52-week low/high	US¢	104 / 586
Market value	(US$ M)	1656.4

NET PRESENT VALUE		HJ10	% total
Arcata	(US$ M)	509.6	27%
Ares	(US$ M)	57.9	3%
Selene	(US$ M)	0.0	0%
Pallancata	(US$ M)	324.5	0.2
San Jose	(US$ M)	250.5	0.1
Hedging	(US$ M)	0.0	0.0
Exploration	(US$ M)	100.0	0.1
Corporate/Other	(US$ M)	311.5	0.2
Total	(US$ M)	1883.7	1.0
Less net debt (cash)	(US$ M)	62.3	
Valuation	(US$ M)	1821.3	
Total diluted shares	(M)	338.1	
Valuation per share	(US¢)	5.39	

SENSITIVITY	-10%	-5%	+5%	+10%
valuation (GBp) for % change in				
Capex	1.0%	0.5%	-0.5%	0.9%
Operating costs	1.3%	0.6%	-0.7%	-1.3%
Gold	-4.1%	-2.0%	2.1%	4.2%
Silver	-12.0%	-6.1%	6.2%	12.7%
British Pound	11.1%	5.3%	-4.8%	-9.1%

	2008	2009F	2010F	2011F
Diluted shares on issue	307.4	320.2	358.9	358.9
EPS pre amortisation (c)	(6.2)	22.9	45.8	49.5
EPS growth (%)	NA	(4.7)	1.0	0.1
PER (x)	(71.4)	21.5	10.8	10.0
Enterprise value (US$ M) *	213.6	62.3	(275.2)	(530.5)
EV*/EBITDA (x)	0.7	0.3	(1.6)	(4.3)
ROA (%)	2.1%	15.3%	33.7%	39.1%
ROE (%)	-4.3%	14.2%	21.8%	19.5%
Effective tax rate (%)	30.0%	30.0%	30.0%	30.0%
Net debt/equity (%)	39.3%	8.2%	-30.3%	-50.0%
Net debt/net debt+equity (%)	28.2%	7.6%	-43.6%	-100.0%
Net interest cover (x)	2.0	25.1	-115.8	-45.0

* forecasts based on current market cap



Arcata

Location

Hochschild's 100% owned Arcata Mine is located in the district of Cayarani in southern Peru, around 300km to the northeast of the city of Arequipa, at an altitude of 4,630m above sea level.

History

Arcata is Hochschild's flagship mine, which began producing silver in 1964 and has produced around 240Moz silver since operations began. The southern part of the district was mined until 2005, and since then three vein systems, Mariana, Ramal 2 and Macarena have been mined, with Mariana accounting for two thirds of the mine's production. The mine and mill have been expanded several times since 1964 when production commenced at 50tpd.

Operations at Arcata are underground, and ore is mined using conventional and mechanised cut-and-fill overhand stoping methods, using timber as support. Currently, a concentrator at the mine produces silver/gold bulk concentrate through flotation with a current capacity of 1,750ktpa. Over the past decade, grades at the mine have averaged over 700g/t silver, and since 2003, production has averaged 4.3Moz silver and 16.5Koz gold per year. In September 2008, plant expansion at Arcata was completed, increasing capacity from 424ktpa to 618ktpa, an increase of 46%.

Reserves

At December 31st 2008, Arcata had reserves of 1.61Mt at 541g/t silver and 1.62g/t of gold, equating to 28Moz of silver and 84Koz of gold. Resources stand at 3.94Mt at 583g/t silver and 1.75g/t gold, equating to 73.9Moz and 221Koz of gold.

Table 1: Reserves at Arcata as of 31st December 2008

	Tonnes (Mt)	Silver grade (g/t)	Gold grade (g/t)
Proved	0.93	575	1.80
Probable	0.68	495	1.38
Total	**1.61**	**541**	**1.62**

Source: Hochschild

Production

Silver production at Arcata increased 38% in 2008, yielding 9Moz at an average head grade of 571.4g/t. Gold production increased by 46% in the year, with 24Koz produced at an average grade of 1.53g/t. The higher levels of production were due to plant expansion during the year, as grades and recovery rates remained constant. Production is expected to increase in 2009, as the impact of a full year of production with the expanded plant is felt.

Exploration at Arcata continues, with the intention of replacing ore that is removed. In 2008, 1.03Mt of ore at 517g/t silver and 1.4g/t gold were added to the mine's reserves, and 1.1Mt of ore at 525g/t silver and 1.4g/t gold were added to indicated resources. In 2009, exploration will continue around the current vein structures, and new targets to the north of the existing structure will also be explored.

Table 2: Historic Production at Arcata as at 7th October 2009

	2005	2006	2007	2008	Q32009
Ore Production (kt)	282.2	313.7	415.4	557.9	480.2
Average head grade silver (g/t)	539	536	560	571	524.3
Average head grade gold (g/t)	1.19	1.39	1.43	1.53	1.63
Silver produced (koz)	4,271	4,754	6,553	9,032	7445
Gold produced (koz)	7.2	11.9	16.5	24.0	22.4

Source: Hochschild

In the first-half 2009 results presentation it was announced that two new structures had been identified. They are 400m and 800m north of the Mariana vein respectively. They are typical of the Arcata structures, with gold grades running between 1.7 and 4.6g/t and silver grades of between 113 and 539g/t. It is expected that the ore mined in 2009 will be replaced in the reserves by exploration. This was followed by news in the September quarterly report containing grades and intercepts of the three veins. Whilst the reported vein intercepts were all narrow at under one meter,

In June 2009 it was announced that Hochschild would make an investment of between $25M and $30M to increase operational efficiency by converting Arcata's production to doré, rather than the concentrate that is currently produced. The facilities and equipment necessary to convert Arcata's concentrate to doré will be installed at Hochschild's Ares operation, which already produces doré and is located approximately 16 miles from Arcata. This will enable the Company to leverage the existing infrastructure at Ares and therefore reduce operational risk. The capital expenditure required to complete the project is expected to be in the region of $25 - $30 million with an approximate 2 year pay-back. The conversion is scheduled to be completed in the second half of 2010. The advantages of this move are that it will maximise revenues by reducing commercial discounts, lowers working capital and selling expenses, provides more stable commercial terms and supports the Hochschild strategy of producing profitable ounces.

A new 22km 66kV power line has been installed at the mine which has raised the available energy supply at the mine following the plant expansion undertaken in 2008.

Ares

Location

The 100% owned Ares Mine is located in the state of Arequipa in southern Peru, around 275km to the northeast of the city of Arequipa, at an altitude of 4,900m above sea level.

History

Exploration began at Ares in 1993, after the site was discovered in the late 1980s by aerial photography. The mine came into production in 1997, with the plant starting up in 1998, and since then has produced almost 27Moz of silver and 2Moz of gold. Currently, between 80% and 90% of the production comes from the Victoria vein and surrounding structures.

Hochschild operates an underground mine at Ares, and ore is mined using conventional and mechanised cut-and-fill overhand stoping methods, using rockbolts and timber as support. Ore is delivered to a cyanide leaching plant at the mine, and solution is then fed to a Merrill Crowe plant to produce doré. The mine currently has a processing capacity of 325Kt per day, and after processing, the doré is transported to Salt Lake City where it is refined by Johnson Matthey.

Reserves

Ares has a total of 0.65Mt of ore in reserves at grades of 120g/t silver and 4.86g/t gold, which equates to 2.5Moz of silver and 101.5Koz of gold. Resources at Ares stand at 1.02Mt of ore at grades of 183g/t silver and 5.89g/t gold, equating to 6Moz silver and 192.6Koz gold.

Table 3: Reserves at Ares at December 31st 2008

	Tonnes (Mt)	Silver grade (g/t)	Gold grade (g/t)
Proved	0.46	124	5.01
Probable	0.19	112	4.49
Total	**0.65**	**120**	**4.86**

Source: Hochschild

Production

Production at Ares has decreased significantly over the past five years due to rapidly decreasing grades at the mine. Silver production was down 43% in the year to 1.57Moz from 2.7Moz, and the head grade decreased significantly to 157g/t from 279g/t. Gold production also decreased significantly, going down 57% to 64.2Koz from 150Koz, and the grade dropped to 6.06g/t from 14.6g/t gold. To help offset the falling grades, the mill was expanded from 280ktpa to 325ktpa in 2006.

Currently, the average ore grades at the Ares mine are declining due to the geological nature of the ore body and the age of the mine. We believe mining operations at Ares will cease by the end of 2010. It is currently converting 10% of the concentrate produced at Arcata into doré and it is planned to move to 100% by 2010. This said, the future of Ares would appear to be as a metallurgical processing centre, father than as a mine.

Table 4: Historic Production at Ares as at 7th October 2009

	2005	2006	2007	2008	Q32009
Ore Production (kt)	281.1	289.1	333.8	347.9	250.9
Average head grade silver (g/t)	355.3	311	279	157	96
Average head grade gold (g/t)	22.8	17.4	14.6	6.06	4.57
Silver produced (koz)	2,944	2,688	2,701	1,538	661
Gold produced (koz)	199	156	150	64.2	34.1

Source: Hochschild

Selene

Location

The Selene mine is situated in the district of Cotaruse, in the department of Apurimac in southern Peru. The nearest town, Izahuaca is approximately 40 minutes by road, and the mine is 180km from Hochschild's Ares mine. The operation lies at an altitude of 4,600m above sea level.

History

Development at the 100% owned Selene Mine commenced in 1998, and first production was achieved in 2003. Since then, the mine has produced 19Moz of silver and 144Koz of gold. Ore was mined underground from two vein systems, using conventional and mechanised cut-and-fill overhand stoping methods. Due to the low grade and thin nature of the veins, mining at Selene was halted in the second quarter of 2009. From this time, all the ore is sourced from Pallancata.

A concentrator at the mine processes the ore in to gold and silver bulk concentrate, operating at a current capacity of 3,000tpd, following expansion during 2008.

Reserves

At December 31st 2008, reserves at Selene stood at 127.3Kt at grades of 268g/t silver and 2g/t gold, which equates to 1.1Moz of silver and 8.2Koz of gold. There is 1.2Mt of ore in resources at Selene, at grades of 245g/t silver and 1.33g/t of gold, equating to 9.6Moz of silver and 52.3Koz of gold, but we understand the mine has been allowed to flood and it is unlikely it will be reopened in the foreseeable future.

Table 5: Reserves at Selene at December 31st 2008

	Tonnes (Kt)	Silver grade (g/t)	Gold grade (g/t)
Proved	75.7	275	2.04
Probable	51.7	257	1.94
Total	**127.3**	**268**	**2.00**

Source: Hochschild

Production

As a result of decreasing grades at Selene due to the ageing of the deposit and its geological nature, production has been declining in the past few years. In 2008, the mine produced 1.6Moz of silver and 8.5Koz of gold, which was a 54% and 61% decrease respectively on 2007 levels. Mining ended at Selene in May 2009.

In 2008, 290Kt at 189g/t silver 1.5g/t gold were converted to reserves, and other exploration continues at the mine. However, in the last annual report Hochschild it was announced that due to the high capex of extracting existing resources at the mine, production is likely to decrease in the coming year and could possibly come to an end if the operation ceases to be profitable. This prediction came true in mid 2009. Currently, geological information at the site is being re-interpreted in order to identify possible drilling targets for the future.

Table 6: Historic Production at Selene as at 7th October 2009

	2005	2006	2007	2008	Q32009
Ore Production (kt)	288.9	359.7	413.6	269.2	109.9
Average head grade silver (g/t)	399	398	296	210	217
Average head grade gold (g/t)	3.43	2.85	2.01	1.21	1.09
Silver produced (koz)	3,335	4,162	3,414	1,579	628
Gold produced (koz)	27.5	28.3	21.6	8.5	3.0

Source: Hochschild

Pallancata

Location

The Pallancata mine is located approximately 22km to the northeast of Hochschild's Selene Mine in the department of Apurimac in southern Peru. It is 60% owned by Hochschild and is run by Minera Ares, a wholly-owned subsidiary of the company. The remaining 40% owned by International Minerals, a TSX-listed silver-gold company.

History

The property was acquired by International Minerals in 2002 following an initial sampling programme at the site. In 2003, the first drilling programme of 17 holes was completed, with the assays confirming high-grade mineralisation at the Pallancata vein, and in the West Breccia zone which contained a higher gold content. Further drilling in 2004 and 2005 indicated possible further high-grade mineralisation at the site.

Hochschild signed a joint-venture (JV) agreement with International Minerals in 2006, and construction permits were granted in August that year. Production began in the third quarter of 2007 at an initial rate of 180Kt per year. Ore is currently processed at the Selene mine, 22km away, and is sold as a gold/silver concentrate.

Reserves

At December 31st 2008, attributable reserves at the mine stood at 2.58Mt in reserves, at average grades of 366g/t of silver and 1.51g/t of gold. This equates to 30.3Moz of silver and 125Koz of gold. Resources at the mine total 3.32Mt of ore at 410g/t of silver and 1.68g/t of gold, equating to 43.8Moz of silver and 179.5Koz of gold.

Table 7: Attributable reserves at Pallancata at December 31st 2008

	Tonnes (Kt)	Silver grade (g/t)	Gold grade (g/t)
Proved	1.18	380	1.60
Probable	1.40	354	1.43
Total	**2.58**	**366**	**1.51**

Source: Hochschild

Production

2008 was Pallancata's first full year of production, with the mine yielding a total of 4.2Moz of silver and 16.2Koz of gold. Exploration at the mine yielded good results, with 3.1Mt of ore at 396g/t of silver and 1.6g/t of gold converted into reserves from underground workings. Additionally, other exploration of the mine added a further 0.7Mt of ore at 368g/t of silver and 1.4g/t of gold to the inferred resource category. With the cessation of mining at Selene, the production rate at Pallancata is being ramped up to 3,000tpd, a rate that is expected to be achieved towards the end of 2009.

Table 8: Historic Total Production at Pallancata as at 7th October 2009 (60% net to Hochschild)

	2007	2008	Q32009
Ore Production (kt)	78.3	468.1	645.0
375.8Average head grade silver (g/t)	310	312	316
Average head grade gold (g/t)	1.49	1.49	1.40
Silver produced (koz)	704	4,188	5689
Gold produced (koz)	2.76	16.2	21.7

Source: Hochschild

Hochschild is currently undertaking a near-mine exploration programme within 3km of the mine. The programme calls for 56 drill holes and a total meterage of around 16,428m. In the 2009 half yearly results it was announced that eleven holes had been drilled to date for a total length of 3,638m in the Virgen del Carmen area. The results were consistent with the current ore reserve grades. Drilling is also being conducted in the Pallancata east area and the Rina vein. Assays of four holes drilled so far were released in the third quarter production update. All four reported intercepts were broadly in line with the existing ore reserve grades. The exploration programme for 2009 has been extended by an additional 4 holes totalling approximately 1,300m.

San Jose

Location

The San Jose mine is situated in the province of Santa Cruz in Argentina, 1,750km south-west of Buenos Aires. The operation is a joint venture between Hochschild and Minera Andes. Hochschild owns 51% of the project and is the sole operator of the mine.

History

San Jose was discovered by Minera Andes in 1998 following a reconnaissance drilling programme in the area. Hochschild acquired a 51% interest in the project in 2001, and under the agreement paid $400,000 per year to Minera Andes until production was reached. The company also agreed to spend a total of $3M in the three years, and a minimum of $100,000 per year on exploration.

The mine came into production in June 2007, and plant capacity was increased in 2008 from 750 to 1,500 tonnes per day. Silver and gold concentrate and doré are produced at the mine. In 2008, Hochschild made an offer for the remaining stake in the project in order to ensure that the project was fully financed. However, the offer was not accepted, and Minera Andes met its obligations at the mine.

Reserves

At December 31st 2008, Hochschild's attributable reserves at the San Jose mine stood at 0.83Mt of ore at grades of 522g/t of silver and 7.9g/t of gold, equating to almost 14Moz of silver and 211Koz of gold. In resources, Hochschild had 1.68Mt of ore at grades of 467g/t of silver and 7.3g/t of gold, equating to 25.3Moz of gold and 395Koz of gold.

Table 9: Reserves at San Jose as at December 31st 2008

	Tonnes (Kt)	Silver grade (g/t)	Gold grade (g/t)
Proved	246.5	508	7.92
Probable	568.0	529	7.90
Total	**832.4**	**522**	**7.90**

Source: Hochschild

New exploration is underway at San Jose, with 22,000 meters of drilling planned for 2009. San Jose is in a part of northwest Santa Cruz province that is revealing itself to be a new mineral frontier. The San Jose project area has the potential to evolve into a mining district -- that is, an area that hosts multiple mines. Currently, about 40 kilometres of vein strike length have been drill-tested, and less than 10 percent of that length accounts for the reserve base that supports the San Jose mine. Multiple discoveries have been made that warrant further exploration. In addition, drilling by the operating partner in the last three years has located four new veins. Geophysical work has located five kilometres of new targets. Follow-up drilling on the new targets has had a 100 percent success rate. The first drill results of this follow-up drilling were released in the September quarter production report, with two intercepts on the Ramal Kospi vein and two on the Ramal Ayelen vein. All intercepts were one metre wide or better with good gold and silver grades.

Production

As production began in the second half of 2007, this year was San Jose's first in full production. Total ore production stood at 296Kt, at grades of 559g/t of silver and 6.69g/t of gold, which equates to almost 4.4Moz of silver and 54Koz of gold. The expansion of plant capacity at the mine means that almost 550Kt a year could be processed at the facility.

Exploration around the mine has discovered a new mineralised structure 845m from the Huevos Verdes vein where an intercept of 1m grading 8.9g/t gold and 517g/t silver was made. Two surface holes intercepted the structure 40m in each direction but did not confirm economic mineralisation; the target is open to the north and west and will be drilled from underground once preparations are complete.

A new 130km 132kV power line and transformer station have been installed which connects the San Jose operations to the national grid, eliminating the need to use onsite generations as the primary source of energy.

In 2008 the cash costs were $6.42/oz for silver and $375/oz for gold and had decreased in the first quarter of 2009 to $4.99 and $357 respectively. These figures are expected to drop further with the connection to the national grid and the mill expansion to 1,500tpd.

Table 10: Historic Total Production at San Jose at 7th October 2009 (51% net to Hochschild)

	2007	2008	Q32009
Ore Production (kt)	93.0	296.0	360.5
Average head grade silver (g/t)	538	559	411
Average head grade gold (g/t)	7.08	6.69	5.87
Silver produced (koz)	958	4,381	3,966
Gold produced (koz)	15.0	54.3	57.1

Source: Hochschild

Moris

Location

The Moris mine is located in the Chihuahua district of Mexico, around 300km west from the city Chihuahua, the district's capital. Until recently, the project was 70% owned by Hochschild and 30% owned by Exmin, but on the 29th May 2009 Hochschild acquired full ownership of the project for a cash consideration of $1.5M.

History

The Moris mine was operated by Minera Manhatten from 1996-1999 and produced 50Koz of gold and 150Koz of silver. In August 2006, a joint venture was agreed between Hochschild and the owner at the time, Exmin, for Hochschild to acquire a 70% interest in the property for $4.2M.

Production commenced in August 2007, using open pit methods with 5m benches at a strip ratio of 1:3.6. Ore is mined at around 1Mt per year, and the material is heap leached and processed at a previously existing plant 2km away into gold and silver doré.

Reserves

At December 31st 2008, reserves at Moris stood at 1.24Mt at 4.6g/t of silver and 1.44g/t gold, which equates to 0.18Moz of silver and 57.4Koz of gold. Total resources at the mine stand at 2.1Mt at grades of 4.59g/t of silver and 1.26g/t of gold, equating to 0.31Moz of silver and 85.4Koz of gold.

Table 11: Reserves at Moris as at December 31st 2008

	Tonnes (Kt)	Silver grade (g/t)	Gold grade (g/t)
Proved	1.13	4.60	1.44
Probable	0.11	4.69	1.31
Total	**1.24**	**4.60**	**1.44**

Source: Hochschild

Production

Production began at Moris in August 2007, and this year was the mine's first full year in production. A total of 876Kt of ore was extracted at average grades of 5.71g/t of silver and 1.57g/t of gold. Production is expected to increase in 2009 due to a more stable plant process. There is currently less that two years supply of ore in the open pit, at which time the mine is expected to close.

Table 12: Historic Total Production at Moris as at 7th October 2009

	2007	2008	Q32009
Ore Production (kt)	338.3	876.1	949.2
Average head grade silver (g/t)	4.69	5.71	5.02
Average head grade gold (g/t)	1.65	1.57	1.39
Silver produced (koz)	12.6	65.1	71
Gold produced (koz)	5.6	26.9	21.8

Source: Hochschild

Projects

San Felipe

The San Felipe project is located in Northern Sonora in Mexico, and consists of six underground mining concessions. The project is 100% owned by Hochschild, and contains both precious and base metals. Due to the fall in zinc prices in 2008, project development is currently delayed, but the company is positive about the future potential of the site.

Drilling during 2008 yielded total resources of 4Mt at grades of 6.5% zinc, 2.2%, lead 0.3% copper, 78.5g /t silver and 0.04g /t gold. San Felipe is much more of a base metal project and does not appear to fit well within the Hochschild strategy of being a precious metal producer. It is not planned to conduct much work at San Felipe until the zinc price improves.

Table 13: Resources at San Felipe as at December 31st 2008

	Tonnes (Mt)	Zn (%)	Pb (%)	Cu (%)	Ag (g/t)	Au (g/t)
Measured	1.39	7.12	3.10	0.39	69	0.02
Indicated	1.35	6.14	2.73	0.31	82	0.06
Inferred	1.26	6.18	2.26	0.19	84	0.05
Total	**4.00**	**6.5**	**2.2**	**0.3**	**78.5**	**0.04**

Source: Hochschild

Liam JV

In August 2008, Hochschild completed a deal with Newmont to buy their 50% of the Liam property in Peru for $33.3M. Liam consists of a 282,000 hectare land package with 38 identified exploration projects. In March 2009, Hochschild acquired the outstanding shares in the JV by purchasing 100% of Southwestern Resources, the JV partner, to gain 100% control of the property and other properties owned by Southwestern, such as the 30% JV with Yamana Mining at Millo. Millo is located adjacent to the 100% owned Azuca project. It also took ownership of the Pacapausa prospect to 80%. This is important as it is located very close to the Pallancata/Selene operations and it could provide ore for the Selene mill

Azuca

Azuca is a 100% owned gold and silver exploration project in Peru, near to Hochschild's existing operations. Drilling of around 15,000m in 53 holes has been conducted at the site, and yielded a resource estimate in the inferred category of 1.78Mt at 327g/t of silver and 1.34g/t of gold, equating to 18.7Moz of silver and 76.4Koz of gold. Work continues on expanding resources at the site. Hochschild plans to have an initial economic assessment completed by the end of 2009. The drill hole intercept for the Azuca Oeste vein was 12.1m wide, and graded 2.4g/t and 350g/t silver, an excellent result. The two intercepts reported for the Yanamayo vein were considerably narrower but of significantly higher grade being 0.9m grading 4.6g/t gold and 1,442g/t silver and 1.6m grading 6.4g/t gold and 1,442g/t silver

Millo

Milo is located adjacent to Hochschild's 100% owned Azuca project. It was originally drilled by Southwestern and returned intercepts of 20.3m grading 37g/t silver and 2.7g/t gold, 17.3m grading 162g/t silver and 1.8g/t gold. There is also a narrower but higher grade intercept of 0.7m grading 814/t silver and 27.1g/t gold. Yamana is earning a 70% interest in the project by conducting a prefeasibility study.

Crespo

Crespo is located in Peru, within the Liam Joint Venture. The previous operators drilling suggested a potential open pitable gold and silver deposit with indications of higher grade zones. Drilling to date has indicated a mineralised potential of 12.5Mt grading 0.77g/t gold and 39.4g/t gold. A later drilling programme of six holes totalling 352m found two wide intercepts around 328/g/t silver equivalent. A tunnel is planned which will allow Hochschild to test the continuity of high grade structures and confirm grades obtained by previous drilling. The Company aims to determine a first resource estimation of this project in 2010.

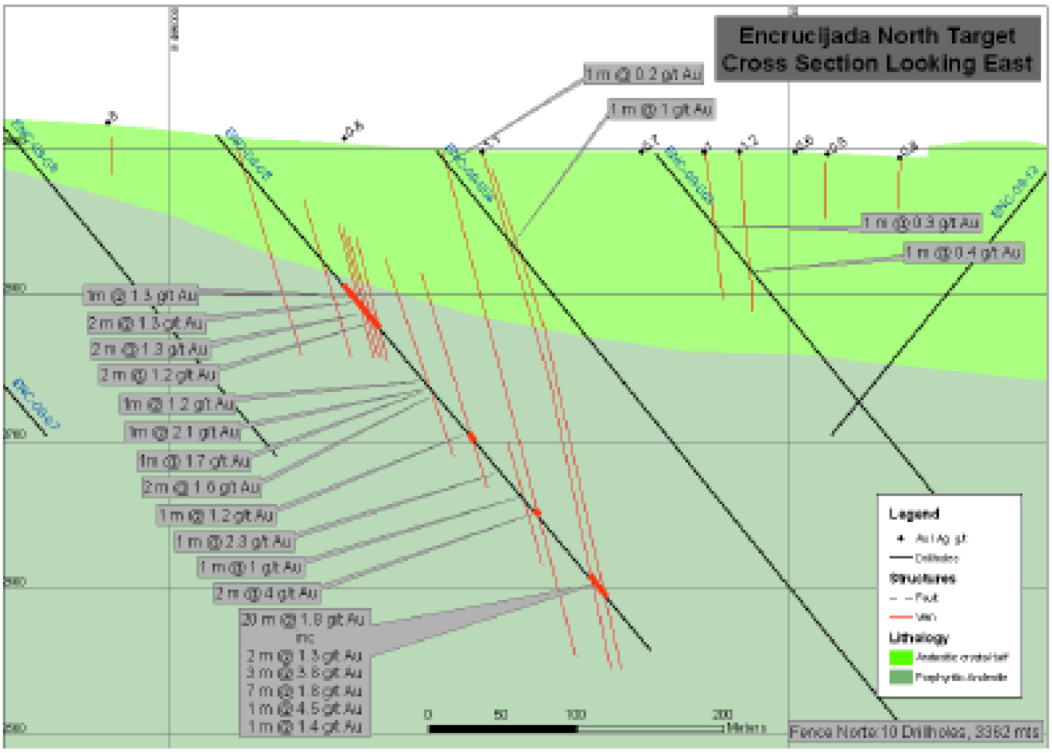
Inmaculada

Inmaculada is part of a JV agreement with TSX-listed company Ventura Gold, in which Hochschild has a 49% interest. The project is located southwest of Cuzco in southern Peru, and is around 40km south of the Pallancata mine. In January, Ventura Gold announced a maiden resource for the project, standing at 3.7Mt at grades of 4.0g/t of gold and 139g/t of silver in the inferred category, which equates to 483Koz of gold and 16.6Moz of silver. This resource is based on the Angela Vein, where 13,149m of drilling was conducted in 2007-8 and the ore body remains open at depth. Drilling to increase the resource is in progress and 5,000m of drilling is planned for 2009, and the results of seven drill holes announced in late August 2009, extended the strike length of the vein to greater than 1.1km. The Martha Vein, not included in the resource figure, was intercepted in 2007. The best intercepts were 0.65m grading 17.8g/t gold and 263g/t silver and 0.6m grading 2.6g/t gold and 1,218g/t silver. A further 1,000m of drilling on this vein is planned for 2009. Should an ore reserve be proven up on the Inmaculada lease then the probability is that the ore would be trucked to the Selene mill. The Peruvian government is in the process of building a road that would shorten the trucking distance to the Selene mill significantly.

Encrucijada

Encrucijada is located in Region II in Chile, approximately 210 kilometres north of Copiapo, and is in the same geological district as the El Peñon mine which produced 0.4 million ounces of gold equivalent in 2008. It is a joint venture with Andina Minerals where Hochschild is earning a 51% stake by spending $3 million on exploration. Hochschild is committed to spending US$800,000 on exploration within the first 12 months of the agreement and, in order to attain their 51% interest, is required to spend a further US$1.0 million prior to the second anniversary and US$1.2 million prior to the third anniversary of signing the agreement. Upon completion of the exploration expenditures, the two companies may form a partnership to continue exploring the property with Hochschild owning a 51% interest and Andina having a 49% interest.

Exhibit 2: Cross section of Encrucijada drilling



Source: Hochschild

Hochschild can further increase its ownership to 60% by investing an additional $3.5 million towards a feasibility study in a single project. A 10 hole (3,362m) fence was drilled at the north target of the property to evaluate concealed vein structures and a structural zone with various veins was identified. Drill highlights include multiple intercepts in hole ENC-09-005 (see map above) of which the best are 2.0m with 4.0 g/t Au (336 to 338m in depth) and 3.0m with 3.7 g/t Au (391 to 394m), 1.0m with 4.5 g/t Au (404 to 405m); the latter two intercepts are included in a 20m interval at 1.8 g/t Au. The discovery of this significant structural corridor with multiple veins in the same geological context as the El Peñon mine is very encouraging. From September 2009, drilling will focus on other targets in this project as well as to follow-up on the north target.

Victoria

The Vaquillas project covers approximately 51,400 hectares located in the porphyry copper belt of northern Chile. Vaquillas is located near the Domeyko Fault Zone, a controlling feature to many of the world's largest copper deposits, making the property prospective for copper and precious metal mineralization.

A joint venture letter of intent with Iron Creek Capital Corp. to explore the precious metal properties within their Vaquillas project was signed in September 2008. Under the terms of the agreement Hochschild can earn-in a 60% interest in the Vaquillas project by contributing $6.75M over a 5 year period. Field work started during the first week in October on the Inti claims followed by a 2,100 metre reverse circulation drill program (9 holes) that was completed in December. Sample results from the drilling program show no significant mineralization, with the exception of drill hole 3 which intersected 1m of 326 g/t Ag. The remaining targets will be explored during 2009.

In the September quarterly production update, it was announced that significant precious metal mineralisation has been identified at the Vaquillas target where 4,000m was drilled in 14 holes. Partial results from 9 holes confirm a broad zone of highly anomalous gold and silver over an area of 1km by 1 km, with high-grade discrete veins (open in all directions). Significant results include: 12m at 1,8 g/t Au & 208 g/t Ag; 8m at 5.5 g/t Au & 15 g/t Ag (includes 1m at 37.7 g/t Au & 60 g/t Ag).

Investments

Lake Shore Gold (Hochschild 40%)

Hochschild Mining acquired 19.9% of TSX-listed Lake Shore Gold Corp in February 2008 for a total consideration of C$64.6M, which was to be used to fund development and exploration at Lake Shore's properties. In June 2008, Hochschild increased its stake to 35%, and then 40%, by way of a private placement and the purchasing of shares from Aurora Platinum. The total consideration for Hochschild's 40% stake stands at $182M. Lake Shore has a number of properties in the Timmins gold mining district in Northern Ontario and Quebec. Production at the Timmins project began in the first quarter of 2009, and is expected to be at 500tpd by the end of the year yielding around 30,000oz of gold. Production levels are then expected to increase to 1,500tpd by the end of 2010 yielding 100,000oz of gold and the target for 2011 is 200,000oz of gold. The company also has several gold exploration properties in the area.

In August 2009, Lake Shore Gold announced it would acquire all of the outstanding common shares of West Timmins Mining Inc. ("WTM"), and Hochschild Mining is fully supportive of the transaction. Under terms of the agreement, which is subject to shareholder approval, WTM shareholders are to receive 0.73 Lake Shore Gold shares per WTM share, valuing WTM at approximately C$319 million.

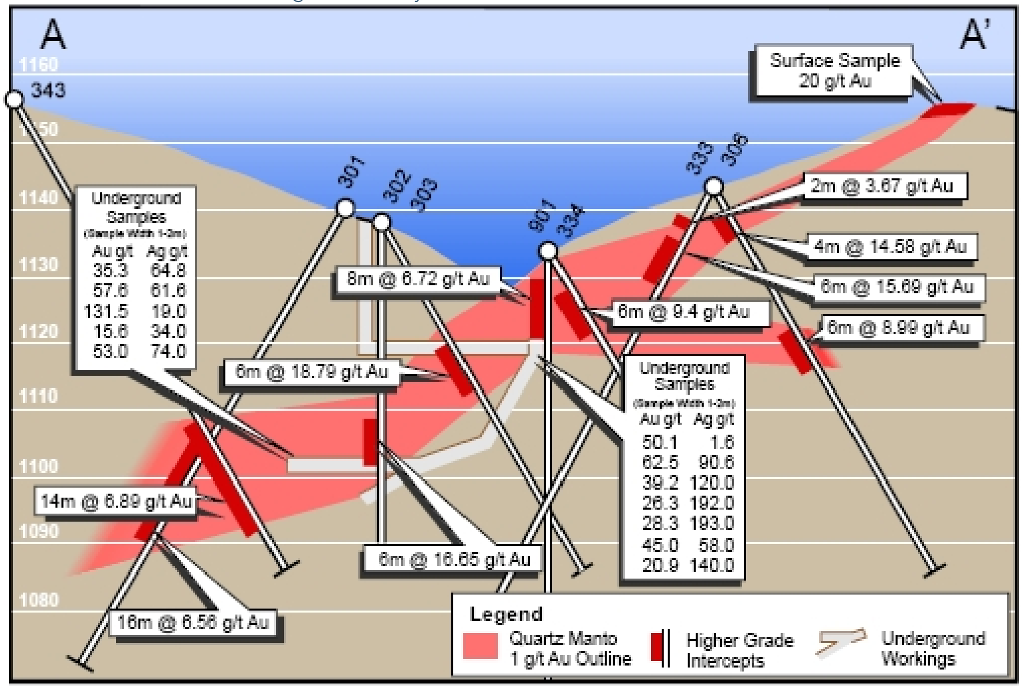
The transaction will create the new large-scale, wholly-owned Timmins West Gold Mine Complex on the western Timmins mining trend, an extension of the world class Timmins mining trend where approximately 70 million ounces of gold have been produced over the last century. The Timmins West Gold Mine Complex will consist of Lake Shore Gold's adjacent 100%-owned Timmins Mine, with existing mine infrastructure, the Thunder Creek Joint Venture, where high-grade intercepts have been reported within 800 metres of the Timmins shaft, and an extensive land package of adjacent exploration properties, giving Lake Shore Gold a dominant position in this highly prospective area. It is believed that this acquisition will unlock significant synergies in developing the Thunder Creek properties and potentially expedite development by 3 years.
Hochschild currently owns 40% of Lake Shore Gold, but will be diluted to about 26% once the transaction proceeds. The Board of Lake Shore Gold has committed to look at ways in which Hochschild can return to a 40% shareholding in the enlarged company.

Gold Resources Corporation (Hochschild 24%)

Hochschild increased its stake in Gold Resources Corporation (GRC) from 5% to 17% on February 26, 2009 for a total consideration of $18M. This was followed on July 20, 2009 by the investment of a further $15.0M, taking the stake to 24%. Hochschild has the ability to increase its stake in Gold resources to 40% with the full support of the Gold Resources board. There is a standstill period which extends until February 2011 at which time Hochschild can buy shares in Gold Resources without restriction.

Gold Resources Corporation is exploring in the State of Oaxaca, Mexico. It is aiming to emerge as an elite peer group producer in 2009, with the start of production from its flagship project, El Aguila which it owns 100%. Although this project will commence operations as a high grade open pit, and from year two onwards it plans to be an underground mine. Currently construction is well under way. Gold production is due to commence in late 2009 subject to equipment delivery and construction schedules, but we note that the large grinding mill has been set on its foundations. In the first full year of production the target is to produce 70,000oz of gold at a price of $100oz after by-product credits through a 300,000tpa plant. The mill has been designed to be very flexible and is capable of producing gold doré plus floatation concentrates, the ore body containing payable quantities of copper, lead and zinc.

Exhibit 3: Cross section of El Aguila orebody



Source: Gold Resources Corp

The projects two other deposits, the Arista underground vein deposit and El Aire, an underground vein deposit, are high-grade polymetallic vein systems with high-grade gold, silver, copper, lead and zinc. 75% of the values of the Arista deposit come from the precious metals gold and silver with the remaining 25% of the values coming from the base metals copper, lead and zinc. Depending on the base metal prices at the time of Arista production, all nominal production costs of the precious metals may potentially be paid for by base metal revenue applied as production credits. Continued exploration at El Aguila, in Mexico has outlined a new, high grade vein system, La Arista. The Arista vein system appears to be a series of parallel, en echelon veins which extends over 585 metres of strike length and 400 metres of vertical extent.

GRC has 100% interest in three additional properties located strategically within trucking distance to El Aguila: the El Rey high-grade gold property, the Las Margaritas high-grade silver property, and the Solaga high-grade silver property. Collectively, they provide the Company with a pipeline of potential projects that would expand and diversify the Company's precious metal production profile. The Company plans to have four high-grade properties feeding one mill.

Zincore

Zincore is a TSX listed zinc company with a $9M market capitalisation. It became a subsidiary when Hochschild acquired Southwestern Resources. We do not believe that it is a core asset.

Financials

The Balance Sheet

On the balance sheet as at 30 June 2009, the total debt was US$301.594M. This comprised US$201.382M of non-current debt and US$100.212M of current debt. This was offset by the US$58.9M of cash.

On 7 October, 2009 Hochschild announced a proposed equity placing and Convertible Bond offering to raise up to $250M. This is expected to be achieved by the placing of up to 30.735M share of 25p each to raise approximately $150M accompanied by a convertible bond offering of approximately $100M. The expected combined gross proceeds of up to $250M will provide Hochschild with the financial resources to:

- Pursue further acquisition opportunities in key mining districts
- Allow further investments in Lake Shore Gold and Gold Resource Corporation
- Fund value-added investment in existing operations and exploration projects
- Pre-pay $85M of the companies $200M syndicated loan facility

The actual funds raised amounted to $260M. We calculate that as at 31December 2009, there will be approximately $269M of cash on the balance sheet assuming no acquisition in the next three months. This gives net debt to equity of 8.2% and net debt to net debt plus equity of 7.6%. The long term portion of the debt is scheduled to commence repayments at the rate of approximately $57M per year commencing in 2010. Fox-Davies has assumed an immediate pre-payment of $85m and then no further payments until after $85M of scheduled payments have accrued. This is a low cost facility fixed at 2.75%. In order to ensure an ongoing level of cash flow stability Hochschild implemented a hedging strategy for 2010 which is particularly related to the funding of its debt repayments. On our modelling we have assumed that the convertible bonds all convert in 2104. Up until that date we have treated the bonds as debt with an interest rate of 5.75%. This is the top end of the interest rate band as mentioned in the press release. The one point not included in our modelling is that following the Lake Shore acquisition of West Timmins, Hochschild's ownership drops to approximately 26%, but the two companies are committed at ways to keep Hochschild at 40%. This could require an expenditure of around C$127M, and Hochschild now have the funds to maintain their 40% holding if so desired.

Hochschild has secured a "zero cost collar" for 5.5M oz of silver, with an average floor of US$12.7/oz and a cap of $19.7/oz and these apply for 2010 only.

Cashflow Statement

The cashflows are very strong over the next few years as this coincides with the period of highest metal prices, and as we stated above there are no problems expected in repaying the loan, whilst maintaining the current dividend. The period 2009 to 2011 is expected to see the closure of three of Hochschild's mines, Selene, Moris and Ares, and as a result we anticipate that silver production will drop from the second half of 2011. However, Hochschild has many exploration options, where there are currently small resources and exploration is in train to expand these. Whilst some of these potential new mines are expected to feed into existing mills utilising the "cluster technique" some are too far away from existing mills and others may be proven to be large enough to support stand alone operations. Development of potential new mines should be low cost for Hochschild due to the fact that it has spare milling capacity. This has two benefits Firstly, if the ore is treated through an existing mill, no new mill will be needed and the costs are minimised. Secondly, if the new mine is to be a stand alone operation, one of the existing spare mills could be moved to the new mine site. Not only would this minimise the costs, but it would considerably reduce the time taken to commission the mine as no delivery times from manufacturers would be required.

On our cashflow analysis, we believed that commencing in the third quarter of 2010, Hochschild could easily afford the development of a new mine from internal cashflows. In the current lending environment, this puts the company in a very strong position. Following the proposed equity placing and convertible bond offering, Hochschild have no problems with cash should they wish to address the issue of a lack of production growth over the next two years.

Valuation & Risks

Valuation technique

We have valued the producing mines that are owned or managed by Hochschild by modelling them individually, on a quarterly basis for the life of the mine as determined by their reserves. This poses two problems. Firstly, Hochschild raised the cut-off grade at each of its mines at the end on 2008, and this had the impact of shortening mine lives. Hochschild's mines are relatively small and high grade, mining silver-gold veins. A characteristic of this type of mine is that they tend not to have large reserves and the mine lives appear short. Another characteristic is that owners of such deposits tend to start mining as soon as they have sufficient ore for a few years. Part of the theory behind this is that it is often cheaper to explore from underground, than drill from the surface. Consequently, mine lives tend to be much longer than one would think on first appearance. We have therefore assumed that all the resources will also be mined and processed and when stated by the company that depletion will be replaced by exploration, added another year to mine life.

Another important aspect of Hochschild's strategy is the cluster concept. This was the reason for acquiring the land around the Ares and Arcata mines through the purchase of the Liam JV and Southwestern Resources. There are also exploration JVs. Through these strategies, relatively small ore bodies may be processed through Hochschild's mills, effectively extending the mine life significantly. Therefore, in our valuation we have assessed what Fox-Davies thinks will be the mine life and used this figure.

Where Hochschild has an interest in another mining company, mainly its 40% interest in Lake Shore Gold and the 24% interest in Gold Resources, we have taken the market value of the shareholding as the value for the net present value calculation.

We then take the net present value of the head office costs, then total the net present value and subtract the net debt and add an assessed value of the exploration acreage. The net present value is then quoted as the value 12 months forward from the last half yearly reporting date.

The discount rate used in our calculations is 7.5%. This is below the 10% we use for AIM listed stocks and well below the figure we use for companies operating in more risky environments. We believe the lower discount rate used in our calculations is justified by the increased liquidity of being a main board company and the solid operating history of the company.

Since Hochschild reports its earning in US dollars, that is our modelling currency. To convert the valuation to our target price, we divide the US$ NPV by the prevailing exchange rate.

Valuation Base Case

Our base case valuation is $1,833M. However, we have added an additional mine life at Arcata and Pallancata, extending both mine lives until 2020. We did this as historically Hochschild has managed to extend the lives of its operations with on going discoveries and the fact that there are known vein systems waiting to be explored. Under this scenario, the two mines not included are Selene and Ares, although the metallurgical plant at each site is assumed to continue in operation. For the two investments, we have assumed a flow of dividends.

Risks

With Hochschild having been a successful mining company for a number of years, we consider it to be a low risk company. However, potential investors should be aware of the short mine lives, typically much shorter than the price to earnings ratio. Historically Hochschild has always discovered more ore and kept the mines operating but there is no guarantee of this going forward.

Hochschild has diversified its country risks. Although the core mines are located in Peru, which we consider a mining friendly country, it diversified its operations into Mexico and Argentina some time ago. It is now taking this a step further by diversifying into Canada and is exploring in Chile.
There are risks in the exposure to gold and silver. Our forecasts are based on the Fox-Davies metal price forecasts and there is no guarantee that these will eventuate. There is also a significant exposure to the currencies of the countries that

the company operates in. This is principally the Neuvo Sole. Lastly, depending upon how metal prices perform, Hochschild may change its cut-off grades for the ore reserves again. Such a move could impact either way on mine lives.

There is approximately $200M of long term debt on the Hochschild balance sheet that is due for repayment commencing in 2010. Pending any major capital expenditures, that have yet to be announced, we believe that the repayment of this debt should not pose any problems. Our analysis of cash flows indicate that the dividend can re maintained, the debt paid down, the interest in Lake Shore Gold maintained at 40% and plenty left over to take advantage of any other opportunities that may be present.

Hochschild had a modest hedged position at the start of 2009. It was composed of 8.9M oz of silver hedged at a price of $12.09/oz and 30,00oz of gold hedged at $972/oz. A small portion of these commitments are open ended, but we believe that all positions will be closed by the end of 2009. As at 30 June 2009, the position was 4.6M oz of silver hedged at a price of $12.0/oz and 18,000 oz of gold hedged at $971.8/oz. There are currently no plans to hedge in 2010, other than the existing cap and collar, but the situation will be reassessed if silver and gold prices drop to $9/oz and $750/oz respectively.

Directors & Senior Management

Eduardo Hochschild, Executive Chairman – Eduardo Hochschild joined the Hochschild Mining Group in 1987 as Safety Assistant at the Arcata unit, becoming Head of the Hochschild Mining Group in 1998 and Chairman in 2006. He graduated from Tufts University in Boston with a BSc in Physics and Mechanical Engineering. He holds numerous directorships with Cementos Pacasmayo S.A.A., COMEX Peru, the Banco de Crédito del Perú, the Sociedad Nacional de Minería y Petróleo, the Asian Pacific Economic Council Business Advisory Committee, the Conferencia Episcopal Peruana, Pacífico Peruano Suiza, TECSUP and the Universidad Nacional de Ingeniería.

Roberto Dañino, Deputy Chairman and Executive Director – Roberto Dañino joined the Hochschild Mining Group in 1995, where he remained until 2001 when he left to serve in the Peruvian Government as Prime Minister and later as Peru's Ambassador to the United States. From 2003 to 2006 he was Senior Vice President and General Counsel of the World Bank Group and Secretary General of ICSID. Previously, he was a partner of Wilmer, Cutler & Pickering in Washington DC. He was also founding General Counsel of the Inter-American Investment Corporation. He holds Law degrees from Harvard Law School and the Pontificia Universidad Católica del Perú.

Miguel Aramburú, Chief Executive Officer – Miguel Aramburú joined Hochschild in 1995 when he was appointed General Manager of Compañia Minera Pativilca. He was appointed Chief Financial Officer in 2002 and subsequently served as General Manager of the Mining Division and, most recently, as Chief Operating Officer. He assumed his current role of Chief Executive Officer in January 2008. Miguel serves as a director of TECSUP and Pacifico Peruano Suiza, CIa. de Seguros y Reaseguros. He graduated from the Pontificia Universidad Católica del Peru in 1987 in Industrial Engineering and holds an MBA from Stanford University. Miguel was appointed to the Board from 1 January 2009.

Ignacio Rosado, Chief Financial Officer – Ignacio Rosado has been the Chief Financial Officer of the Group since 2005. Previously, he was Senior Engagement Manager for Latin America for McKinsey & Company from 2000 to 2005. Ignacio began his career in banking, having worked for Banco Wiese Sudameris in Peru (1992-1994) at Banco de Crédito del Perú. He holds an MBA from the University of Michigan Business School and a BSc in Economics from the Universidad del Pacífico in Peru. Ignacio was appointed to the Board from 1 January 2009. He is also one of Hochschild's representatives on the Board of Lake Shore Gold Corp., a Toronto listed gold company, in which Hochschild has a 40% interest.

Sir Malcolm Field, Senior Non-Executive Director – Sir Malcolm Field is currently the Senior Non-Executive Director of Aricom plc and a Non-Executive Director of both Odgers Ray & Berndtson. From 2002 to 2006, Sir Malcolm served as Chairman of Tube Lines Limited, one of the London Underground consortia, and from 2001 to 2006, was an external policy adviser to the Department of Transport in the United Kingdom. From 1982 to 1993, he was Group Managing Director of WH Smith plc and from 1993 to 1996 he served as Chief Executive. From 1996 to 2001, Sir Malcolm was Chairman of the Civil Aviation Authority and he has also held appointments as a Non-Executive Director in a number of companies, including Scottish and Newcastle plc, MEPC, The Stationery Office and Evolution Beeson Gregory.

Jorge Born Jr., Non-Executive Director – Jorge Born Jr. joined Bomagra S.A. in 1997 as Chief Executive Officer, and since 2001 has been President and Chief Executive Officer of the same organisation. Jorge is also a Director of Caldenes S.A., a subsidiary of Bomagra S.A. Prior to joining Bomagra S.A. in 1997, he served as Head of Bunge Limited's European operations from 1992 to 1997 and as Head of Bunge Limited's UK operations from 1989 to 1992. He has been a Director and Deputy Chairman of Bunge Limited since 2001 and director of Mutual Investment Limited since 1997 and its Deputy Chairman since 2001. Jorge has also been a Director of Dufry South America S.A. of Rio de Janeiro since 2006. Jorge received a BSc in Economics from the Wharton School of the University of Pennsylvania in 1983.

Nigel Moore, Non-Executive Director – Nigel Moore is a Chartered Accountant. Since 2003, he has been Chairman of TEG Environmental plc. He is currently a Non-Executive Director of The Vitec Group plc, JKX Oil & Gas plc, Ascent Resources plc and Production Services Network Ltd. From 1973 to 2003, Nigel was a Partner at Ernst & Young and was the Managing Partner of Ernst & Young's London office from 1985 to 1987, a Senior Partner attached to the Chairman's Office (Europe) from 1987 to 1989 and the Regional Managing Partner for Eastern Europe and Russia from 1989 to 1996. From 1996 to 2003, he was a Client Service Partner for the oil and gas sector.

Dionisio Romero, Non-Executive Director – Dionisio Romero is Chairman and Chief Executive Officer of the financial services holding company, Credicorp Ltd. He is Chairman of Banco de Crédito del Peru, Banco de Crédito de Bolivia, Atlantic Security Bank and Pacífico Peruano Suiza, Cia. de Seguros y Reaseguros. He graduated with a BA degree in Economics from Pomona College, California in 1957, and earned an MBA from Stanford University in 1959.

Fred Vinton, Non-Executive Director – Mr Vinton is currently Chairman of EP Private Equity Ltd, a position he has held since 2006. Prior to this he served as Chairman/Chief Executive Officer of Electra Partners Limited for over 10 years and as Chief Executive of Quilvest Ltd between 1992 and 1995. Formerly, Mr Vinton spent 25 years at JP Morgan, where he was responsible for the bank's business in Latin America, the UK and Scandinavia before joining N M Rothschild & Sons Ltd as Chief Operating Officer in 1988. He currently holds directorships in companies including Unipart Group of Companies UK, Emergent Asset Management Ltd, MBA Latin America Opportunity Fund, GP Investments Ltd, Dinamia SCR S.A., EQMC Europe Development Capital Fund plc and MBA Multistrategy Investment Fund.

Corporate Structure & Shareholders

Hochschild have a total of 307,350,226 shares on issue, with approximately 32% in public hands.

Table 14: Major shareholders in Hochschild

Shareholder Name	(%) held
Directors & Related	53.64
Vanguard Group	6.07
M&G Investment Management	5.64
Blackrock Inv Management UK	4.52
Blackrock Group	3.99
Altima Partners	3.55
Altima Partners LLP	3.36
Deutsche Bank AG	3.00
Alberto Beeck	1.51
Blackrock Investment Management	1.40

Source: Bloomberg

Research Disclosures

Peter Rose

Peter Rose has had 21 years experience in equities as a resources analyst, most recently having spent 11 years with Deutsche Bank in Australia, with previous positions including three years with Prudential Bache and five years with James Capel. Peter's industry experience includes 16 years as a metallurgist, three years with De Beers in South Africa, and eight years in the uranium industry, five of which were spent at the Ranger Uranium mine. Peter has a Bachelor of Science in Applied Mineral Science from Leeds University UK, and a Bachelor of Commerce from the University of South Africa. Peter is a member of the Institute of Mining & Metallurgy and a chartered engineer.

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Ian Lucas

Ian Lucas joined the Fox-Davies Capital research team in December 2007. Prior to this, Ian gained a Bachelor of Arts (Hons) in Archaeology from University College London, and worked on a number of research excavations around Europe. He has passed the Securities and Investment Institute Certificate in Securities and is currently a Level 1 CFA candidate.

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Research disclosure as of 14 October 2009

Company Name	Disclosure
Hochschild (HOC)	

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Trading Buy	Recommendation implies that the analysts' expected total return over the short term compared against the target price is positive.
Hold	Recommendation implies that expected total return of between 15% and zero is expected over 12 months between current and analysts' target price.
Trading Sell	Recommendation implies that the analysts' expected total return over the short term compared against the target price is negative.
Sell	Recommendation implies that expected total return expected over 12 months between current and analysts' target price is negative.

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Fox-Davies Capital Coverage

Fox-Davies corporate client & coverage universe as of 14 October 2009:

Company	Ticker	Recommendation	Date	Target Price	Last Price
Mining					
Angel Mining	ANGM LN Equity	BUY	12.10.09	£0.08	£0.04
Atlantic Coal	ATC LN equity	BUY	06.10.09	£0.02	£0.007
Discovery Metals	DME LN Equity	BUY	08.10.09	£0.50	£0.29
EMED Mining	EMED LN Equity	BUY	12.10.09	£0.45	£0.12
Exco Resources	EXS AU Equity	BUY	06.10.09	A$0.65	A$0.27
Gippsland Limited	GIP LN Equity	BUY	06.10.09	£0.02	NA
Hambledon Mining	HMB LN Equity	HOLD	09.10.09	£0.13	£0.07
Highland Gold	HGM LN Equity	BUY	12.10.09	£1.06	£0.97
Hochschild Mining	HOC LN Equity	BUY	14.10.09	£3.41	£3.16
KEFI Minerals	KEFI LN Equity	Spec. BUY	06.10.09	NA	£0.03
Kryso Resources	KYS LN Equity	BUY	06.10.09	£0.25	£0.08
Lydian International	LYD CN Equity	BUY	14.10.09	C$1.39	C$0.63
Minera IRL	MIRL LN Equity	HOLD	06.10.09	£0.65	£0.75
Oxus Gold	OXS LN Equity	BUY	06.10.09	£0.41	£0.13
Stratex International	STI LN Equity	BUY	06.10.09	£0.06	£0.04

Recommendation Summary

Date	Recommendation	Target Price (£)
	Initiation of coverage	
14 Oct 09	Set target price (BUY)	£3.41

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