

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF FRESNILLO PLC

OPINION

In our opinion:

- Fresnillo plc's Group financial statements and Parent Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Fresnillo plc which comprise:

Group	Parent company
Consolidated balance sheet as at 31 December 2017	Parent Company balance sheet as at 31 December 2017
Consolidated income statement for the year then ended	Parent Company statement of changes in equity for the year then ended
Consolidated statement of comprehensive income for the year then ended	Parent Company statement of cash flows for the year then ended
Consolidated statement of changes in equity for the year then ended	Related notes 1 to 18 to the financial statements including a summary of significant accounting policies
Consolidated statement of cash flows for the year then ended	
Related notes 1 to 31 to the financial statements, including a summary of significant accounting policies	

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements (we include our consideration of a prohibited non-audit service provided to the Company below).

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

USE OF OUR REPORT

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

CONCLUSIONS RELATING TO PRINCIPAL RISKS, GOING CONCERN AND VIABILITY STATEMENT

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 34-47 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on pages 140 and 141 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 49 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 48 and 49 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

OVERVIEW OF OUR AUDIT APPROACH

Key audit matters	<ul style="list-style-type: none"> • Recognition of related party transactions, including revenue recognition • Valuation of the Silverstream contract • Disclosures, provisions and asset recoverability arising from the El Bajío ejido litigation and land disputes • Recoverable amount of mining assets • Potential tax uncertainties arising from tax authority inspections and changes in legislation • Recoverable amount of investments in subsidiaries (Parent Company Only)
Audit scope	<ul style="list-style-type: none"> • We performed an audit of the complete financial information of 5 components, being the 4 operating mining units and the Parent Company. These components accounted for: <ul style="list-style-type: none"> – 100% of Revenues; – 96% of Profit before tax, excluding Silverstream revaluation effects and gain on the sale of concessions; and, – 82% of Total assets. • In addition, we performed specified procedures on specific balances at a further 5 components. These components accounted for: <ul style="list-style-type: none"> – 100% of the Silverstream revaluation effects and gain on the sale of concessions; – 4% of Profit before tax excluding Silverstream revaluation effects and gain on the sale of concessions; and, – 16% of Total assets.
Materiality	<ul style="list-style-type: none"> • Overall Group materiality of US\$31.0m which represents 5% of forecast profit before tax, before Silverstream revaluation effects and gain on the sale of concessions.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

INDEPENDENT AUDITOR'S REPORT

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In the table below, each key audit matter is attributed an icon which is used to map these to our components in scope in the subsequent section below.

KEY AUDIT MATTER

RECOGNITION OF RELATED PARTY TRANSACTIONS, INCLUDING REVENUE RECOGNITION ◆

- All of the Group's current year revenue from the sale of goods, being concentrates, doré, slag and precipitates (US\$2,101.6 million; 2016: US\$1,905.5 million), and a significant amount of its expenses incurred (US\$111.6 million; 2016: US\$84.0 million), arise from transactions with related parties. These related parties are principally subsidiaries of the Group's direct parent, Industrias Peñoles ("Peñoles").
- Principal transactions include the sale of goods to the Met-Mex Peñoles refinery, administrative services received and the Silverstream contract.
- There is a risk that, if not at arm's length or not reflecting the goods or services provided in the period, such transactions could be used to manipulate earnings or to distribute profits to the Group's parent.
- There is also a risk that revenues are inappropriately recognised as a result of incorrect cut-off or inappropriate measurement of product sold.
- There is an ongoing focus by the Mexican tax authorities on transfer pricing as reflected by the current tax inspections. There is therefore the potential risk of tax exposures arising from related party transactions.

- ➔ Our judgment is that the level of risk in this area remains consistent with the prior year.

We have not made significant changes to our audit response compared to the prior year.

Related party transactions are disclosed in note 27 to the consolidated financial statements, Revenues in note 4 and relevant accounting policies in note 2.

OUR AUDIT RESPONSE

We performed full scope audit procedures over this risk area in 5 components, which covered 100% of the aggregate risk amount relating to revenue and 61% relating to related party expenses. In addition we performed specified procedures in 1 component which covered 38% of the aggregate risk amount relating to related party expenses. We also performed specified procedures over the Silverstream contract, which covered 100% of the risk amount.

Identification of related parties and related party transactions	<ul style="list-style-type: none"> • We evaluated the appropriateness of management's process for identifying, recording and reporting related party transactions. • We read contracts and agreements with related parties to understand the nature of the transactions. • Throughout the performance of our audit procedures, we remained alert for any related party transactions outside the normal course of business.
Revenue recognition	<ul style="list-style-type: none"> • On a sample basis we performed testing to verify physical deliveries of product in the year. • We performed revenue cut-off testing, by reference to shipment dates. • We evaluated the appropriateness of the accounting for embedded derivatives arising from the provisional pricing terms in sales contracts. • We obtained an understanding of the basis of the treatment and refining charges negotiated between the Group and Peñoles for the current year, these being deducted from revenue. • We compared actual revenues on a disaggregated basis to detailed expectations developed based on production in the year and market prices for relevant metals to identify and understand variances for further investigation.
Related party expenses	<ul style="list-style-type: none"> • On a sample basis we tested related party expenses against underlying contractual terms. • We utilised data analysis tools to interrogate entire data sets for potential related party transactions. • We compared actual results against detailed expectations of income statement line items impacted by related party transactions to corroborate that there was no evidence of manipulation.
Silverstream contract	<ul style="list-style-type: none"> • We tested a sample of cash receipts in respect of silver that is payable under the contract in the year. • The valuation of the Silverstream contract is discussed separately below.
Accuracy of disclosures	<ul style="list-style-type: none"> • We verified that related party disclosures in the financial statements are consistent with the results of our audit procedures.

KEY AUDIT MATTER

Transfer pricing considerations	<ul style="list-style-type: none"> We, along with our internal transfer pricing specialist, obtained and reviewed the most recent report (for 2016) to management from its transfer pricing specialists. We reviewed a letter provided by the specialist to management in February 2018 providing an update with respect to transfer pricing applied in 2017. We met with the specialist to further understand the content of the letter and to assess the conclusions reached. We assessed the specialist as a specialist engaged by management.
Management override	<ul style="list-style-type: none"> We developed detailed expectations for production volumes based on our interviews with management, published production reports and internal reporting to the Executive Committee. We performed analytical review procedures applying a low variance threshold, comparing revenue and production costs against the expectations we developed. We used EY's bespoke data analysis tools to search for terms indicating related parties and prepare a summary of transactions related to known related-party vendors and customers, which we compared to the schedule provided by management to the Audit Committee.

KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- Our procedures did not identify issues with the identification, recording or reporting of related party transactions.
- We concluded that revenue recognition in the year is appropriate, including the treatment of related provisional pricing terms.
- In respect of transfer pricing in transactions with related parties, we consider that the work undertaken by management's transfer pricing specialist is appropriate for Mexican tax law and also to support the appropriateness of the pricing applied to these transactions for financial reporting considerations.

KEY AUDIT MATTER**VALUATION OF THE SILVERSTREAM CONTRACT ■**

- The valuation of the Silverstream contract (US\$538.9 million at 31 December 2017; 2016: US\$467.5 million), a derivative financial instrument, is estimated by management using a discounted cash flow model.
- Key assumptions are the estimation of the reserves and resources and the related production profile of the Sabinas mine (owned and operated by Peñoles), future silver prices and the discount rate applied. These assumptions require management judgment and estimation.
- The resulting valuation is sensitive to changes in these assumptions which may result in material revaluation effects in the financial statements (US\$113.7 million pre-tax gain in 2017; 2016: US\$133.5 million pre-tax gain).

- ➡ Our judgment is that the level of risk in this area remains consistent with the prior year.

We adapted our procedures to consider the findings of a specialist engaged by Peñoles to assess its estimation process of the mineral reserves and resources of the Sabinas mine in the current year.

The nature of the Silverstream contract and related valuation considerations are disclosed in note 14 to the consolidated financial statements and the relevant accounting policies in note 2.

INDEPENDENT AUDITOR'S REPORT

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OUR AUDIT RESPONSE

We performed specified procedures over the valuation of the Silverstream contract at 31 December 2017 and related income statement revaluation effects. These procedures covered 100% of the risk amount.

Valuation model	<ul style="list-style-type: none"> In conjunction with our valuation specialists, we evaluated the appropriateness of the valuation approach and related model used by the Company to determine the fair value of the Silverstream contract under accounting standards.
Reserves and resources and production profile of the Sabinas mine	<ul style="list-style-type: none"> We interviewed the Sabinas mine geologist in order to understand the assumptions used in the estimation of reserves and resources and movements in the estimation in the year. We issued instructions to the auditor of Peñoles to perform procedures and report to us in respect of the reserves and resources estimate and mine plan of the Sabinas mine. These procedures included: <ul style="list-style-type: none"> conducting walkthroughs to confirm our understanding of Peñoles management's processes to estimate quantities of reserves and resources and to develop the Sabinas mine plan; testing of certain key Peñoles controls which address the risks associated with the estimation of reserves and resources quantities and accuracy of the resulting mine plan; gaining an understanding of reasons for changes in estimates of reserves and resources in the year; assessing the professional competence, objectivity, and capabilities of Peñoles' internal specialists involved in the estimation of reserves and resources quantities; and evaluating the reasonableness and appropriateness of inputs to the reserves and resources estimates and Sabinas mine plan as at 31 December 2017. In the current year Peñoles has engaged SRK Consulting ("SRK"), to perform certain procedures over its reserve and resource estimation process. We have therefore also instructed the auditor of Peñoles to: <ul style="list-style-type: none"> gain an understanding of the scope of these procedures; review the conclusions reached by the external specialist and assess whether there are any implications for the estimate of Sabinas reserves and resources and related mine plan as at 31 December 2017; and assess the professional competence, objectivity, and capabilities of the specialist. We discussed the results of the above procedures and reviewed key working papers. We performed sensitivity analysis on inferred resources included in the mine plan.
Key economic assumptions in the valuation	<ul style="list-style-type: none"> With assistance from our valuation specialists we corroborated key economic assumptions in the valuation, including future silver prices, foreign exchange rates and the discount rate applied. This included comparison to market data to consider the appropriateness of silver price and discount rate assumptions when considered together in the valuation model and analysis of the consistency of assumptions to other accounting estimates. We performed sensitivity analysis on the combination of silver price assumptions and discount rate.

KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- The valuation model is consistent with that used in prior periods and we consider this appropriate for the nature of this long term derivative contract.
- We highlighted the sensitivity of the valuation to economic input assumptions, most significantly silver price and discount rate. We consider that both management's long term silver price and discount rate assumptions are at the lower end of respective ranges considered appropriate by EY valuation specialists. We reported sensitivity analysis to demonstrate the financial impact of changing these assumptions.

KEY AUDIT MATTER**DISCLOSURES, PROVISIONS AND ASSET RECOVERABILITY ARISING FROM THE EL BAJÍO EJIDO LITIGATION AND LAND DISPUTES ●**

- The El Bajío litigation and land disputes may create uncertainty around the Group's ability to realise the carrying values of impacted assets in the Group's balance sheet and may give rise to further asset impairment.
- Related assets are capitalised mining costs and inventory held in leaching pads at the impacted mine site.
- The assessment of the recoverability of impacted assets and appropriate disclosure or provisions in the financial statements requires judgement about the future legal outcome of claims and land disputes and estimates of any related financial impacts.

- Our judgment is that the level of risk in this area remains consistent with the prior year.

We have not made significant changes to our audit response compared to the prior year.

Contingencies in respect of the El Bajío ejido litigation and land disputes are disclosed in note 26 to the consolidated financial statements and the relevant accounting policies in note 2.

KEY AUDIT MATTER**OUR AUDIT RESPONSE**

We performed full scope audit procedures over this risk area in 1 component, which covered 100% of the risk amount.

Recoverability of non-current assets	<ul style="list-style-type: none"> • We assessed management's conclusion that there is sufficient likelihood of future economic benefits flowing from the use of assets impacted by the El Bajío land disputes that continue to be carried on the Group's balance sheet. • We evaluated management's assessment of related indicators of impairment in respect of those assets.
Inventory valuation	<ul style="list-style-type: none"> • We assessed management's estimation of the recoverable value of inventory that is impacted by land disputes, including corroborating gold price assumptions to market data.
Future legal outcome of claims	<ul style="list-style-type: none"> • We evaluated management's assessment of the current status of the El Bajío ejido litigation and claims against the Group and considered whether there is a requirement for any provision or related disclosures under accounting standards. • We obtained and read independent legal confirmation letters from the Group's external lawyers advising on these issues, and assessed these for consistency with management's conclusions. We assessed these lawyers as specialists engaged by management. • We assessed the Group's internal legal counsel as a management specialist. • We reviewed related disclosures in the Annual Report and Accounts to consider their appropriateness and completeness.
Management override	<ul style="list-style-type: none"> • As the evaluation of related controls requires the evaluation of the assumptions used in, and the output of, that process, we do not seek to rely on these controls. As such, we did not specifically address the risk of management override of controls in this area but rather increased the level of challenge when performing our substantive procedures.

KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- We concluded that, based on the facts and circumstances of the El Bajío ejido litigation and land disputes, management's assessment that no provision is required and that the impacted assets are recoverable at 31 December 2017 is appropriate.
- The legal confirmations we received supported management's judgements in this area.
- We concluded that the carrying value of related assets is appropriate.
- We consider that the disclosure in note 26, Contingencies, is appropriate.

INDEPENDENT AUDITOR'S REPORT

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KEY AUDIT MATTER

RECOVERABLE AMOUNT OF MINING ASSETS ▲

- The identification of indicators of impairment is judgmental.
- When an impairment test is performed, the key assumptions underpinning management's assessment of the recoverable amount of mining assets are reserves and resources and related mine plans and production profiles, estimated future operating and capital expenditure, future commodity prices, exchange rates and the discount rates applied.
- The estimation of mineral reserves and resources quantities of the Group's mines requires significant judgment and estimation.
- The Group's reserves and resources are audited by SRK, a specialist engaged by management.
- Changes to assumptions could lead to material changes in estimated recoverable amounts, resulting in impairment of property plant and equipment (US\$2,448.6 million, 2016 US\$2,180.2 million). There is however no impairment taken prior years that may be reversed.

- ➡ Our judgment is that the level of risk in this area remains consistent with the prior year.

We have not made significant changes to our audit response compared to the prior year.

Management's assessment of the judgement and estimation required is set out in note 2 to the consolidated financial statements, with results of management's assessment for impairment in note 12. The reserves and resources tables are presented on pages 274-278, after the Parent Company notes.

OUR AUDIT RESPONSE

We performed full scope audit procedures over this risk area in 4 components, which covered 100% of the risk amount.

Indicators of impairment and methodology used to estimate recoverable values	<ul style="list-style-type: none"> • We reviewed management's identification of indicators of impairment under accounting standards. • We assessed the methodology used by management to estimate the recoverable value of each mining asset for which an impairment test was performed to ensure that this is consistent with accounting standards. • We have assessed the valuation models used by management to estimate the recoverable value of each asset.
Estimation process for reserves and resources	<ul style="list-style-type: none"> • We walked through the process of the estimation of the reserves and resources quantities. • We identified key controls in this process and obtained evidence of their implementation.
External specialists engaged by management	<ul style="list-style-type: none"> • We assessed SRK as a specialist engaged by management. • Through discussions with SRK, we have gained an understanding of the scope of their work to verify that this was appropriate. • We read the report of the external specialist and gained an understanding of the changes in reserves and resources estimates in the year.
Use of reserves and resources in financial statement calculations	<ul style="list-style-type: none"> • We tested that the audited reserves and resources estimates have been appropriately applied to relevant areas of the Group's financial statements, including in assessing the recoverable value of mining assets.
Key internal assumptions used in management's estimate of the recoverable values of mining assets	<ul style="list-style-type: none"> • We agreed related production profiles to the current mine plans for each mine and considered their consistency with our understanding of future plans at the mines obtained through interviews with both operating and senior management. • We assessed operating and capital costs included in the cash flow forecasts for consistency with current operating costs and forecast mine production.
Key external assumptions used in management's estimate of the recoverable values of mining assets	<ul style="list-style-type: none"> • Working with our valuation specialists we have assessed management's assumptions relating to future metals prices and discount rates, comparing these to market data and also for consistency with other estimates used in the financial statements. • We have performed sensitivity analysis on management's calculated recoverable values for alternative assumptions around silver and gold prices and the discount rate applied.

KEY AUDIT MATTER**KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE**

- We assessed SRK as an appropriate specialist engaged by management for the purposes of auditing the reserves and resources of the Group.
- We confirmed that the audited reserves and resources estimates have been appropriately used in relevant financial statement calculations.
- We consider the approach to determining the recoverable value of mining assets tested for impairment to be appropriate.
- Our procedures confirmed that the reserves and resources and related production profiles used in the impairment testing are consistent with the estimates audited by SRK and respective mine plans.
- Our procedures confirmed that the estimates of operating and capital costs are consistent with the production profiles of respective mines and related mine plans.
- We concluded that the carrying values of mining assets are recoverable at 31 December 2017.

KEY AUDIT MATTER**POTENTIAL TAX UNCERTAINTIES ARISING FROM TAX AUTHORITY INSPECTIONS AND CHANGES IN LEGISLATION ►**

This is an area on which the audit team, including senior members thereof, has spent considerable time during the year as these areas have developed. Constituent areas discussed below have not resulted in provisions at 31 December 2017 but are disclosed as contingent liabilities.

Tax authority inspections

- As disclosed in note 26, Contingencies, in the consolidated financial statements, in 2015 the tax authorities (SAT) initiated inspections of Minera Penmont for 2012 and 2013 which are ongoing.
- During the current year SAT initiated a number of further inspections at certain of the Group's subsidiaries.
- The Company has provided information to SAT with respect to the inspections initiated in the year. However, to date no findings have been raised by SAT.

Changes in legislation

- Effective 1 January 2017 there were changes in Mexican income tax and VAT requirements relating to contractors, a significant area of expenditure for Fresnillo. Fresnillo now has an obligation to ensure that contractors are compliant with their own tax obligations, including employment tax.
- If Fresnillo does not obtain and retain sufficient evidence of a contractors' compliance, the Company is at risk of not being permitted to deduct costs related to the contractor for income tax purposes or recover the related input VAT.
- The tax authorities committed to establish an online portal to facilitate compliance. This was only made available in December 2017. As such there has been a lack of clarity around the implementation of the requirements for 2017 until late in the year. In late 2017 the related legislation was updated, to clarify that registration by a contractor on the online portal by the end of 2018 was sufficient to discharge any 2017 compliance obligations for Fresnillo.

- ➡ Our judgment is that the level of risk in this area has increased compared with the prior year.

We have designed and executed specific audit responses to address the risk in the current year.

Contingencies in respect of taxation are disclosed in note 26 to the consolidated financial statements and the relevant accounting policies in note 2.

INDEPENDENT AUDITOR'S REPORT

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KEY AUDIT MATTER

OUR AUDIT RESPONSE

We performed full scope audit procedures over this risk area in all impacted components, which covered 100% of the risk amount.

Tax inspections	<ul style="list-style-type: none"> Throughout the year we maintained an understanding of the progress of inspections in order to understand the status of inspections started in 2015 as well as areas of information requested for new inspections and the status of subsequent correspondence with the tax authorities. We read the correspondence with tax authorities relating to the tax inspections and, where relevant, legal opinions supporting tax treatments. For elements of inspections that were progressed during the year, we critically inspected correspondence with the SAT to substantiate management's views on any remaining exposure at 31 December 2017. We evaluated management's process to determine any remaining exposure and likelihood of tax treatments being accepted by the tax authorities. We read the related disclosures in the financial statements assessing whether they accurately reflect our understanding of the status of the investigations and management's assessment of potential exposure.
Contractors' fiscal compliance	<ul style="list-style-type: none"> Using our tax specialists we assessed the implications of the new legislation and its implementation as this evolved during the year. We understood the Company's process for seeking compliance with the regulation and assessed its adequacy. We held meetings with management to understand its progress in obtaining evidence of contractor compliance throughout the year. On a sample basis we checked the evidence obtained by management in support of contractors' compliance during 2017. Following the clarification of legislation in late 2017 we assessed management's process to achieve contractor registration on the portal, and the subsequent extent of actual registration.
Management override	<ul style="list-style-type: none"> As the evaluation of related controls requires the evaluation of the assumptions used in, and the output of, that process, we do not seek to rely on these controls. As such, we did not specifically address the risk of management override of controls in this area but rather increased the level of challenge when performing our substantive procedures.

KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- We conclude that management's process for evaluating tax exposures is appropriate and that the conclusions reached are supportable.
- We conclude that the disclosure of contingent liabilities is appropriate at 31 December 2017.

KEY AUDIT MATTER**RECOVERABLE AMOUNT OF INVESTMENT IN SUBSIDIARIES (PARENT COMPANY ONLY) ▼**

- Investments in subsidiaries (US\$7,094 million, 2016 US\$6,958 million) are more sensitive to changes in recoverable value than the Group's underlying mining assets because these investments were re-measured at fair value in 2008 when the Group was established ahead of its Initial Public Offering.
- The principal driver of the recoverable amount of investments in subsidiaries is the estimated value of underlying mining assets held by the Group's subsidiaries. Refer to related considerations in the related key audit matter above.
- In addition, management estimates the recoverable value of exploration projects in considering the recoverable value of subsidiaries.
- Changes to assumptions could lead to material changes in estimated recoverable amounts, resulting in either impairment or reversals of impairment taken in prior years.

- ➡ Our judgment is that the level of risk in this area remains consistent with the prior year.

We have not made significant changes to our audit response compared to the prior year.

Management's assessment of the judgement and estimation required is set out in note 2 to the Parent Company financial statements, with management's assessment of investments in subsidiaries included in note 5.

OUR AUDIT RESPONSE

We performed full scope audit procedures over this risk area in 1 component, which covered 100% of the risk amount.

Key internal assumptions used in management's estimate of the recoverable value

- We have assessed the methodology used by management to estimate the recoverable value of each investment for which an impairment test was performed to ensure that this is consistent with accounting standards.
- Refer to the key audit matter above with respect to procedures performed relating to the recoverable value of mining assets.
- We have evaluated management's approach to valuing exploration prospects.

Key external assumptions used in management's estimate of the recoverable value

- Refer to the key audit matter above with respect to procedures performed relating to the recoverable value of mining assets.
- We have performed sensitivity analysis on management's calculated recoverable values for alternative assumptions around silver and gold prices and the discount rate applied.

KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- We concluded that the carrying values of mining assets, the principal driver of the recoverable amount of investments in subsidiaries, are reasonable.
- We agree with management's assessment of the recoverable value of investments in subsidiaries and related income statement effects in the year.

INDEPENDENT AUDITOR'S REPORT

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PRINCIPAL CHANGES AS COMPARED TO THE PRIOR YEAR ARE DETAILED BELOW:

In the prior year we identified "Reserves and resources" as a separate key audit matter. In the current year we consider this as a component of a new Key Audit Matter: "The recoverable amount of mining assets" and as a component of "Recoverability of investment in subsidiaries."

In response to an increased number of tax inspections and changes to income tax and VAT in respect of contractors we identified a new Key Audit Matter: "Potential tax uncertainties arising from tax authority inspections and changes in legislation."

AN OVERVIEW OF THE SCOPE OF OUR AUDIT

TAILORING THE SCOPE

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile and the organisation of the Group and the effectiveness of group-wide controls and other factors such as the results of the work of Internal Audit when assessing the level of work to be performed at each entity.

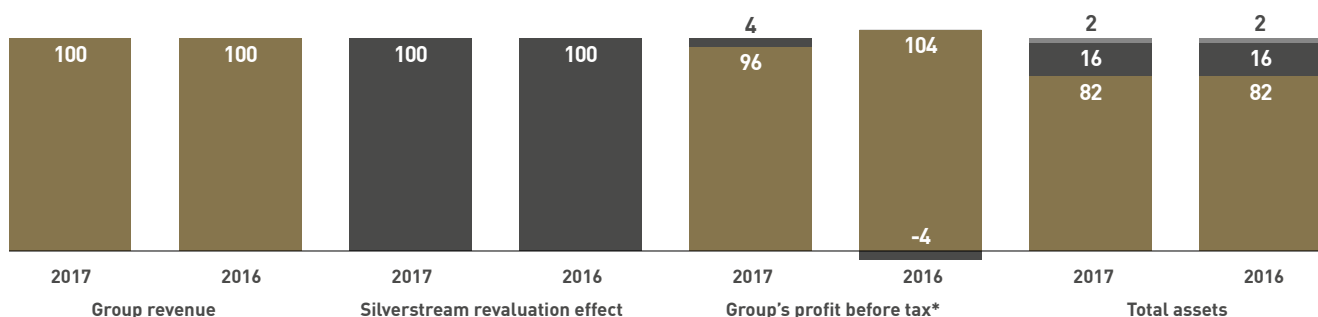
We performed an audit of the complete financial information of 5 components (2016: 5) ("full scope components") which were selected based on their size or risk characteristics. These components are the 4 operating mining units in Mexico and the Parent Company. In some instances operating mining units include more than one operating mine; the Fresnillo mining unit includes the Fresnillo and the San Julián mines and the Penmont mining unit includes the Herradura, Noche Buena and Soldada & Dipolos mines.

We also performed specified audit procedures on specific account balances in a further 5 components (2016: 5). The procedures were on those account balances within those components which we deemed to be significant either because of the size of these accounts or their risk profile. These accounts included taxation, mine closure provisions, property, plant and equipment and cash and cash equivalents and all balances relating to the Silverstream contract.

The reporting components where we performed audit procedures represented:

Key

■ Full scope ■ Specified procedures ■ Other procedures



* Excludes sales, Silverstream revaluation effects and gain on sale of concessions.

The audit scope of components at which we perform specified procedures may not include testing of all significant accounts of the component but will have contributed to the coverage reflected above.

The remaining components together represent an effect on the Group's Profit before tax excluding Silverstream revaluation effects and gain on disposal of concessions of less than 1% (2016: (1)%) and 2% of total assets (2016: 2%). For these components, we perform other procedures, including analytical review and testing of consolidation journals and intercompany eliminations to respond to any potential risks of material misstatement in the Group financial statements.

CHANGES FROM THE PRIOR YEAR

There were no significant changes in our scoping as compared to the prior year.

INVOLVEMENT WITH COMPONENT TEAMS

All of the Group's significant operations are in Mexico and are audited by one local team under our direct supervision.

	Work performed by	
	Primary team	One component team under our direct supervision
Full scope components	● (Parent Company)	●●●●
Components on which specified audit procedures are performed	● (Silverstream contract*)	●●●●

* In respect of the valuation of the Silverstream contract, we perform primary procedures directly. The component team performs certain supporting procedures regarding cash receipts, and the auditor of Peñoles provides support in respect of procedures on the estimation of reserve and resource quantities and the related mine plan at the Sabinas mine.

In establishing our overall approach to the Group audit, we determined the type of work that needed to be undertaken at each of the components by us, as the primary audit engagement team, or by the component auditor operating under our instruction. Of the 5 full scope components, audit procedures were performed on 1 of these directly by the primary audit team. For the 5 components at which specified procedures were performed, where the work was performed by component auditors, we determined the appropriate level of involvement to enable us to determine that sufficient audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

The primary engagement team, including the Senior Statutory Auditor, visited Mexico four times during the audit, during both the planning and execution phases, with members of the team working with and supervising the component team in Mexico for a number of weeks over several visits. These visits involved discussion and oversight of the component team audit approach, consideration of any accounting and auditing issues arising from their work, reviewing key audit working papers, meeting with management and attending closing meetings. In addition, in the current year members of the primary engagement team, including the Senior Statutory Auditor, visited three of the group's mining operations. This, together with the additional procedures performed at Group level, gave us appropriate evidence for our opinion on the Group financial statements.

Senior members of the component team attended a Global Team Planning Event in the planning phase of the audit, the Post Interim Event after hard close procedures and interacted regularly with the local team between visits to Mexico as appropriate. The primary engagement team is predominantly composed of Spanish speakers in order to further enhance our interactions with both the component team and management.

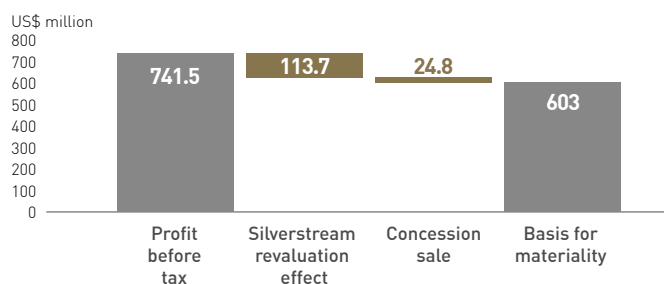
The primary team was responsible for the scope and direction of the audit process. For certain procedures, in particular areas involving significant judgement and heightened audit risk, we performed work ourselves with support where required from the component team. In other cases, we reviewed key working papers including, but not limited to, the risk areas described above.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

MATERIALITY

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.



INDEPENDENT AUDITOR'S REPORT

CONTINUED

We determined materiality for the Group to be US\$31.0 million (2016: US\$29.2 million), which is 5% (2016: 5%) of profit before tax prior to Silverstream revaluation effects and gain on sale of concessions, a one-off material item (subject to roundings). This is a consistent basis to 2016 (there being no gain on sale of concessions in 2016). We believe that this measure of profit represents one of the principal considerations for members of the Group, particularly as the Silverstream revaluation effects are principally non-cash in nature and the gain on sale of concession is a one off transaction.

During the course of our audit, we reassessed initial materiality and updated its calculation for the actual financial results of the year. This did not result in any changes to materiality.

We determined materiality for the Parent Company to be US\$70.5 million (2016: US\$59.3 million), which is 1% of equity. The materiality of the Parent Company is higher than that of the Group, reflective of the Parent Company's primary role being that of a holding company.

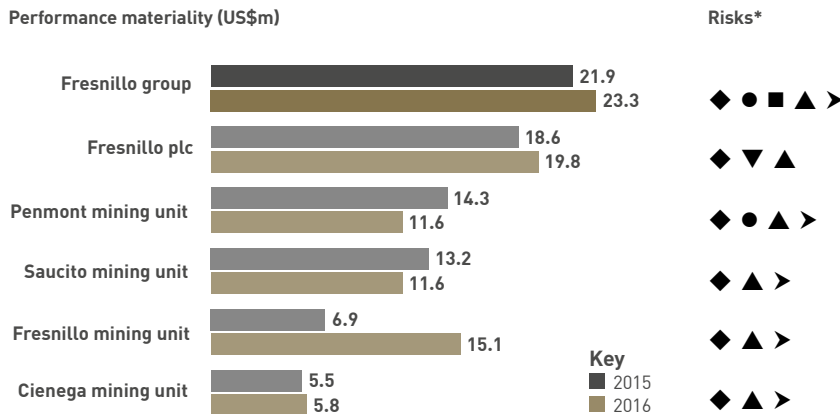
PERFORMANCE MATERIALITY

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2016: 75%) of our planning materiality, namely US\$23.2 million (2016: US\$21.9 million). We based this judgement on factors including the past history of misstatements, our ability to assess the likelihood of misstatements and the effectiveness of the internal control environment.

Audit work at component locations for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of total performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. The performance materiality allocated to full-scope components in the current year is set out in the graph to the right.

Allocated performance materiality increased in respect of all components, reflecting the overall performance of the Group and the individual contributions of the components to that performance. Specifically in respect of the Fresnillo mining unit, we note that the increase in performance materiality reflects the San Julián mine becoming fully operational during 2017.



REPORTING THRESHOLD

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of US\$1.5m (2016: US\$1.5m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

OTHER INFORMATION

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 169** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting set out on pages 134-146** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 122** – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R (2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

OPINIONS ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

INDEPENDENT AUDITOR'S REPORT

CONTINUED

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

RESPONSIBILITIES OF DIRECTORS

As explained more fully in the directors' responsibilities statement set out on page 169, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

The objectives of our audit, in respect of fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the group. We determined that the most significant which are directly relevant to specific assertions in the financial statements are those related to the reporting framework (IFRS, the Companies Act 2006 and UK Corporate Governance Code), regulations impacting mining operations including mining laws, environmental and labour regulations and tax and employee profit sharing requirements in Mexico.
- We understood how Fresnillo plc is complying with those legal and regulatory frameworks by making enquiries to management, internal audit, those responsible for legal and compliance procedures and the company secretary. We corroborated our enquiries through our review of board minutes and papers provided to the Audit Committee.
- We assessed the susceptibility of the group's financial statements to material misstatement, including how fraud might occur by meeting with management from various parts of the business to understand where it is considered there was a susceptibility of fraud. We also considered performance targets and their propensity to influence on efforts made by management to manage earnings. We considered the programs and controls that the group has established to address risks identified, or that otherwise prevent, deter and detect fraud; and how senior management monitors those programs and controls. Where the risk was considered to be higher, we performed audit procedures to address each identified fraud risk. These procedures included testing manual journals and were designed to provide reasonable assurance that the financial statements were free of fraud or error.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

OTHER MATTERS WE ARE REQUIRED TO ADDRESS

- Following a competitive tender process and the recommendation of the audit committee, we were appointed as auditors by the shareholders and signed an engagement letter on 28 July 2017. We were appointed by the company at the AGM on 4 May 2016 to audit the financial statements for the year ending 31 December 2017 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 10 years, covering periods from our initial appointment in 2008 through to the year ended 31 December 2017.
- In January 2017, we identified that non-audit services related to December 2016 prohibited under the new FRC Ethical Standard had been undertaken. These related to less than 10 hours of tax services related to payroll tax for an immaterial subsidiary of the group. No amounts related to these services have been recognised in the financial statements for the year ended 31 December 2017. We, therefore, consider this to be a minor breach of the Ethical Standard and we do not consider our independence to be impaired. We notified the Audit Committee of this breach in February 2017. The Audit Committee agreed with our conclusion that the breach is minor and that our independence is not impaired. The Committee's discussion of this breach is set out on page 139. The evaluation of whether our independence was impaired included consideration of the safeguards to independence in connection with the service specifically that the work was undertaken by a separate team from the audit team and responsibility for the related tax calculation was taken by a competent member of the group's management.
- The audit opinion is consistent with the additional report to the Audit Committee.

Daniel Trotman (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

27 February 2018

Notes:

- 1 The maintenance and integrity of the Fresnillo plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- 2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

CONSOLIDATED INCOME STATEMENT

YEAR ENDED 31 DECEMBER

		Year ended 31 December 2017			Year ended 31 December 2016		
	Notes	US\$ thousands			US\$ thousands		
		Pre-Silverstream revaluation effect	Silverstream revaluation effect	Total	Pre-Silverstream revaluation effect	Silverstream revaluation effect	Total
Continuing operations:							
Revenues	4	2,093,308		2,093,308	1,905,503		1,905,503
Cost of sales	5	(1,167,903)		(1,167,903)	(1,023,388)		(1,023,388)
Gross profit		925,405		925,405	882,115		882,115
Administrative expenses		(72,710)		(72,710)	(59,157)		(59,157)
Exploration expenses	6	(141,108)		(141,108)	(121,182)		(121,182)
Selling expenses		(19,110)		(19,110)	(16,277)		(16,277)
Other operating income	8	28,203		28,203	1,398		1,398
Other operating expenses	8	(11,371)		(11,371)	(10,442)		(10,442)
Profit from continuing operations before net finance costs and income tax		709,309		709,309	676,455		676,455
Finance income	9	14,576		14,576	6,958		6,958
Finance costs	9	(89,653)		(89,653)	(80,323)		(80,323)
Revaluation effects of Silverstream contract	14	–	113,656	113,656	–	133,528	133,528
Foreign exchange loss		(6,399)		(6,399)	(18,378)		(18,378)
Profit from continuing operations before income tax		627,833	113,656	741,489	584,712	133,528	718,240
Corporate income tax	10	(119,365)	(34,097)	(153,462)	(219,808)	(40,058)	(259,866)
Special mining right	10	(27,220)		(27,220)	(33,412)		(33,412)
Income tax expense	10	(146,585)	(34,097)	(180,682)	(253,220)	(40,058)	(293,278)
Profit for the year from continuing operations		481,248	79,559	560,807	331,492	93,470	424,962
Attributable to:							
Equity shareholders of the Company		481,019	79,559	560,578	333,516	93,470	426,986
Non-controlling interest		229		229	(2,024)		(2,024)
		481,248	79,559	560,807	331,492	93,470	424,962
Earnings per share: (US\$)							
Basic and diluted earnings per Ordinary Share from continuing operations	11	–		0.761	–		0.579
Adjusted earnings per share: (US\$)							
Adjusted basic and diluted earnings per Ordinary Share from continuing operations	11	0.653		–	0.453		–

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED 31 DECEMBER

	Notes	Year ended 31 December	
		2017 US\$ thousands	2016 US\$ thousands
Profit for the year		560,807	424,962
Other comprehensive income/(expense)			
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Losses on cash flow hedges recycled to income statement		-	1,184
Income tax effect	10	-	(355)
Changes in the fair value of cash flow hedges		-	(52,918)
Income tax effect	10	-	15,875
<i>Net effect of cash flow hedges</i>		-	(36,214)
Changes in the fair value of available-for-sale financial assets	13	8,808	44,729
Income tax effect	13	(2,642)	(13,418)
Impairment of available-for-sale financial assets taken to income during the year		36	-
Income tax effect	10	(11)	-
<i>Net effect of available-for-sale financial assets</i>		6,191	31,311
<i>Foreign currency translation</i>		118	3
Net other comprehensive income/(expense) that may be reclassified subsequently to profit or loss:		6,309	(4,900)
<i>Items that will not be reclassified to profit or loss:</i>			
Remeasurement gains on defined benefit plans	22	933	2,443
Income tax effect	10	(148)	(388)
Net other comprehensive income that will not be reclassified to profit or loss		785	2,055
Other comprehensive income/(expense), net of tax		7,094	(2,845)
Total comprehensive income for the year, net of tax		567,901	422,117
Attributable to:			
Equity shareholders of the Company		567,672	424,141
Non-controlling interests		229	(2,024)
		567,901	422,117

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER

	Notes	As at 31 December	
		2017 US\$ thousands	2016 US\$ thousands
ASSETS			
Non-current assets			
Property, plant and equipment	12	2,448,596	2,180,217
Available-for-sale financial assets	13	144,856	116,171
Silverstream contract	14	506,569	438,811
Derivative financial instruments	30	–	16,532
Deferred tax asset	10	48,950	20,023
Inventories	15	91,620	89,351
Other receivables	16	129	990
Other assets		3,389	3,385
		3,244,109	2,865,480
Current assets			
Inventories	15	179,485	187,499
Trade and other receivables	16	342,506	286,678
Income tax recoverable		59,588	–
Prepayments		3,543	2,839
Derivative financial instruments	30	382	6,618
Silverstream contract	14	32,318	28,718
Short-term investments	17	–	200,000
Cash and cash equivalents	17	876,034	711,954
		1,493,856	1,424,306
Total assets		4,737,965	4,289,786
EQUITY AND LIABILITIES			
Capital and reserves attributable to shareholders of the Company			
Share capital	18	368,546	368,546
Share premium	18	1,153,817	1,153,817
Capital reserve	18	(526,910)	(526,910)
Available-for-sale financial assets reserve	18	53,799	47,608
Foreign currency translation reserve	18	(610)	(728)
Retained earnings	18	1,962,708	1,637,888
		3,011,350	2,680,221
Non-controlling interests		55,245	36,147
Total equity		3,066,595	2,716,368
Non-current liabilities			
Interest-bearing loans	20	799,046	798,027
Derivative financial instruments	30	14,224	16
Provision for mine closure cost	21	184,775	149,109
Provision for pensions and other post-employment benefit plans	22	9,217	9,095
Deferred tax liability	10	491,677	463,050
		1,498,939	1,419,297

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER

CONTINUED

	Notes	As at 31 December	
		2017 US\$ thousands	2016 US\$ thousands
Current liabilities			
Trade and other payables	23	134,949	121,633
Income tax payable		18,328	18,842
Derivative financial instruments	30	4,992	630
Employee profit sharing		14,162	13,016
		172,431	154,121
Total liabilities		1,671,370	1,573,418
Total equity and liabilities		4,737,965	4,289,786

These financial statements were approved by the Board of Directors on 26 February 2018 and signed on its behalf by:

Mr Arturo Fernández
Non-executive Director
26 February 2018

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED 31 DECEMBER

	Notes	Year ended 31 December	
		2017 US\$ thousands	2016 US\$ thousands
Net cash from operating activities	29	761,471	897,958
Cash flows from investing activities			
Purchase of property, plant and equipment		(604,751)	(434,050)
Proceeds from the sale of property, plant and equipment and other assets	8	26,078	277
Repayments of loans granted to contractors		925	2,626
Short-term investments	17	200,000	(81,282)
Silverstream contract	14	43,349	47,565
Purchase of available-for-sale financial assets		(19,877)	–
Interest received		14,535	6,958
Net cash used in investing activities		(339,741)	(457,906)
Cash flows from financing activities			
Dividends paid to shareholders of the Company	19	(236,560)	(88,219)
Capital contribution		18,869	7,361
Interest paid ¹	20	(35,503)	(28,028)
Net cash used in financing activities		(253,194)	(108,886)
Net increase in cash and cash equivalents during the year		168,536	331,166
Effect of exchange rate on cash and cash equivalents		(4,456)	(632)
Cash and cash equivalents at 1 January		711,954	381,420
Cash and cash equivalents at 31 December	17	876,034	711,954

1 Total interest paid during the year ended 31 December 2017 less amounts capitalised totalling US\$11.4 million (31 December 2016: US\$18.2 million) which were included within the caption Purchase of property, plant and equipment.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

YEAR ENDED 31 DECEMBER

Attributable to the equity holders of the Company

											US\$ thousands
	Notes	Share capital	Share premium	Capital reserve	Hedging reserve	Available-for-sale financial assets reserve	Foreign currency translation reserve	Retained earnings	Total	Non-controlling interests	Total equity
Balance at 1 January 2016		368,546	1,153,817	(526,910)	36,214	16,297	(731)	1,296,906	2,344,139	30,202	2,374,341
Profit/(Loss) for the year		–	–	–	–	–	–	426,986	426,986	(2,024)	424,962
Other comprehensive income, net of tax		–	–	–	(36,214)	31,311	3	2,055	(2,845)	–	(2,845)
Total comprehensive income for the year		–	–	–	(36,214)	31,311	3	429,041	424,141	(2,024)	422,117
Capital contribution		–	–	–	–	–	–	–	–	7,969	7,969
Dividends declared and paid	19	–	–	–	–	–	–	(88,059)	(88,059)	–	(88,059)
Balance at 31 December 2016		368,546	1,153,817	(526,910)	–	47,608	(728)	1,637,888	2,680,221	36,147	2,716,368
Profit/(Loss) for the year		–	–	–	–	–	–	560,578	560,578	229	560,807
Other comprehensive income, net of tax		–	–	–	–	6,191	118	785	7,094	–	7,094
Total comprehensive income for the year		–	–	–	–	6,191	118	561,363	567,672	229	567,901
Capital contribution		–	–	–	–	–	–	–	–	18,869	18,869
Dividends declared and paid	19	–	–	–	–	–	–	(236,543)	(236,543)	–	(236,543)
Balance at 31 December 2017		368,546	1,153,817	(526,910)	–	53,799	(610)	1,962,708	3,011,350	55,245	3,066,595

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. CORPORATE INFORMATION

Fresnillo plc. (the 'Company') is a public limited company and registered in England and Wales with registered number 6344120 and is the holding company for the Fresnillo subsidiaries detailed in note 5 of the Parent Company accounts (the 'Group').

Industrias Peñoles S.A.B. de C.V. ('Peñoles') currently owns 75% of the shares of the Company and the ultimate controlling party of the Company is the Baillères family, whose beneficial interest is held through Peñoles. The registered address of Peñoles is Calzada Legaria 549, Mexico City 11250. Copies of Peñoles' accounts can be obtained from www.penoles.com.mx. Further information on related party balances and transactions with Peñoles' group companies is disclosed in note 27.

The consolidated financial statements of the Group for the year ended 31 December 2017 were authorised for issue by the Board of Directors of Fresnillo plc on 26 February 2018.

The Group's principal business is the mining and beneficiation of non-ferrous minerals, and the sale of related production. The primary contents of this production are silver, gold, lead and zinc. Further information about the Group operating mines and its principal activities is disclosed in note 3.

2. SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PREPARATION AND CONSOLIDATION, AND STATEMENT OF COMPLIANCE

BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union as they apply to the financial statements of the Group for the years ended 31 December 2017 and 2016, and in accordance with the provisions of the Companies Act 2006.

The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments, available-for-sale financial assets and defined benefit pension scheme assets which have been measured at fair value.

The consolidated financial statements are presented in dollars of the United States of America (US dollars or US\$) and all values are rounded to the nearest thousand (\$'000) except when otherwise indicated.

BASIS OF CONSOLIDATION

The consolidated financial statements set out the Group's financial position as of 31 December 2017 and 2016, and the results of operations and cash flows for the years then ended.

Entities that constitute the Group are those enterprises controlled by the Group regardless of the number of shares owned by the Group. The Group controls an entity when the Group is exposed to, or has the right to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Entities are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. The Group applies the acquisition method to account for business combinations in accordance with IFRS 3.

All intra-Group balances, transactions, income and expenses and profits and losses, including unrealised profits arising from intra-Group transactions, have been eliminated on consolidation. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. The interest of non-controlling shareholders may be initially measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The choice of measurement basis is made on an acquisition-by-acquisition basis. Subsequent to acquisition, non-controlling interests consist of the amount attributed to such interests at initial recognition and the non-controlling interest's share of changes in equity since the date of the combination. Any losses of a subsidiary are attributed to the non-controlling interests even if that results in a deficit balance.

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions – that is, a transaction with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interest are also recorded in equity.

(B) CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

The accounting policies applied are consistent with those applied in the preparation of the consolidated financial statements for the year ended 31 December 2016. During 2017, there were no amendments to existing accounting policies.

NEW STANDARDS, INTERPRETATIONS AND AMENDMENTS (NEW STANDARDS) ADOPTED BY THE GROUP

The Group has adopted from 1 January 2017 Amendments to IAS 7. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The Group also has adopted Amendments to IAS 12. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. These amendments had no impact in the financial information of the Group.

Other than the above mentioned amendments there were no significant new standards that the Group was required to adopt effective from 1 January 2017.

STANDARDS, INTERPRETATIONS AND AMENDMENTS ISSUED BUT NOT YET EFFECTIVE

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, as applicable to the Group's financial statements, when they become effective, except where indicated.

IFRS 9 FINANCIAL INSTRUMENTS

IFRS 9 Financial Instruments addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. The Group has decided not to adopt IFRS 9 until it becomes mandatory on 1 January 2018. The Group does not expect the new guidance to have a significant impact on the classification and measurement of its financial assets for the following reasons:

CLASSIFICATION AND MEASUREMENT

The equity instruments that are currently classified as available-for-sale financial assets satisfy the conditions for classification as at fair value through other comprehensive income (FVOCI). Under IFRS 9, gains and losses accumulated in OCI are not recycled to the income statement. There are no other significant changes to the accounting for these assets. Also, embedded derivatives resulting from the sales of goods as described in note 2(p) will be no longer separated from the host contract. Instead, the entire receivable will be measured at fair value through profit or loss. Management does not expect this to result in a significant impact on the measurement of the receivable.

There will be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities.

DERECOGNITION

The derecognition rules have been transferred from IAS 39 Financial Instruments: Recognition and Measurement and have not been changed.

HEDGE ACCOUNTING

The new hedge accounting rules will align the accounting for hedging instruments more closely with the Group's risk management practices. At this stage the Group does not expect to designate any new hedge relationships except for the derivatives corresponding to purchase of property, plant and equipment. The Group's existing hedge relationships qualify as continuing hedges upon the adoption of IFRS 9. As a consequence, the Group does not expect an impact on the accounting for its hedging relationships.

IFRS 9 changes the accounting requirements for the time value of purchased options where only the intrinsic value of such options has been designated as the hedging instrument. In such cases, changes in the time value of options are initially recognised in OCI. Where the hedged item is transaction related, amounts initially recognised in OCI related to the change in the time value of options are reclassified to profit or loss or as a basis adjustment to non-financial assets or liabilities upon maturity of the hedged item, or, in the case of a hedged item that realises over time, the amounts initially recognised in OCI are amortised to profit or loss on a systematic and rational basis over the life of the hedged item. Under IAS 39, the change in time value of options is recorded in the income statement. The initial credit adjustment from retained earnings to hedging reserve as at 1 January 2017 would be US\$23.0 million and the adjustment decreasing financial cost for the year ended 31 December 2017 US\$42.1 million.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(B) CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES CONTINUED

IMPAIRMENT

IFRS 9 requires the Group to now use an expected credit loss model for its trade receivables measured at amortised cost, either on a 12-month or lifetime basis. Given the short-term nature of these receivables, the Group does not expect these changes will have a significant impact.

PRESENTATION AND DISCLOSURE

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

The IASB has issued a new standard for the recognition of revenue arising from contracts with customers. The new revenue standard will supersede all current revenue recognition requirements under IFRS.

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer. The Group has evaluated recognition and measurement of revenue based on the five-step model in IFRS 15 and has not identified any financial impacts, hence no adjustments are expected to result from the adoption of IFRS 15. The Group has elected to adopt the new standard from 1 January 2018 applying the modified retrospective adoption method.

Certain disclosures will change as a result of the requirements of IFRS 15. The Group expects this to include a breakdown of revenue from customers and revenue from other sources, including the movement in the value of embedded derivatives in sales contracts.

IFRS 16 LEASES

IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. These amendments are effective for annual periods beginning on or after 1 January 2019 and earlier application is permitted. However, as there are several interactions between IFRS 16 and IFRS 15 Revenue from contracts with customers, early application is restricted to entities that also early adopt IFRS 15. The Group has decided to adopt the standard when it becomes effective.

IFRIC 22 FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION

IFRIC 22 clarifies which exchange rate to use in reporting foreign currency transactions when payment is made or received in advance. The interpretation requires the company to determine a 'date of transaction' for the purposes of selecting an exchange rate to use on initial recognition of the related asset, expense or income. In the case that there are multiple payments or receipts in advance, the entity should determine a date of the transaction for each flow of advance consideration. IFRIC 22 is applicable for annual periods beginning on or after 1 January 2018 and earlier adoption is permitted. The interpretation is not expected to have any impact in the financial information of the Group.

IFRIC 23 UNCERTAINTY OVER INCOME TAX TREATMENTS

This Interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. The interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments. Application of tax law can be complex and requires judgement to assess risk and estimate outcomes where the amount of tax payable or recoverable is uncertain. The Group is working to identify potential uncertainties based on previous resolutions of tax authorities. IFRIC 23 is applicable for annual periods beginning on or after 1 January 2019 and earlier adoption is permitted.

The Group has not early adopted any standard, interpretation or amendment that was issued but is not yet effective.

(C) SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Group's consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. These judgements and estimates are based on management's best knowledge of the relevant facts and circumstances, with regard to prior experience, but actual results may differ from the amounts included in the consolidated financial statements. Information about such judgements and estimates is contained in the accounting policies and/or the notes to the consolidated financial statements.

JUDGEMENTS

Areas of judgement, apart from those involving estimations, that have the most significant effect on the amounts recognised in the consolidated financial statements are:

- **Determination of functional currency (note 2(d)):**
The determination of functional currency requires management judgement, particularly where there may be more than one currency in which transactions are undertaken and which impact the economic environment in which the entity operates.
- **Evaluation of the status of projects (note 2(e)):**
The evaluation of project status impacts the accounting for costs incurred and requires management judgement. This includes the assessment of whether there is sufficient evidence of the probability of the existence of economically recoverable minerals to justify the commencement of capitalisation of costs, the timing of the end of the exploration phase and the start of the development phase and the commencement of the production phase. These judgements directly impact the treatment of costs incurred and proceeds from the sale of metals from ore produced.
- **Stripping costs (note 2(e)):**
The Group incurs waste removal costs (stripping costs) during the development and production phases of its surface mining operations. During the production phase, stripping costs (production stripping costs) can be incurred both in relation to the production of inventory in that period and the creation of improved access and mining flexibility in relation to ore to be mined in the future. The former are included as part of the costs of inventory, while the latter are capitalised as a stripping activity asset, where certain criteria are met.

Once the Group has identified production stripping for a surface mining operation, judgement is required in identifying the separate components of the ore bodies for that operation, to which stripping costs should be allocated. Generally a component is a specific volume of the ore body that is made more accessible by the stripping activity. In identifying components of the ore body, the Group works closely with the mining operations personnel to analyse each of the mine plans. The mine plans and, therefore, the identification of components, will vary between mines for a number of reasons. These include, but are not limited to, the type of commodity, the geological characteristics of the ore body, the geographical location and/or financial considerations. The Group reassesses the components of ore bodies annually in line with the preparation of mine plans. In the current year, this reassessment did not give rise to any changes in the identification of components.

Once production stripping costs have been identified, judgement is also required to identify a suitable production measure to be used to allocate production stripping costs between inventory and any stripping activity asset(s) for each component. The Group considers that the ratio of the expected tonnes of waste to be stripped for an expected tonnes of ore to be mined for a specific component of the ore body is the most suitable production measure.

Furthermore, judgements and estimates are also used to apply the units of production method in determining the depreciable lives of the stripping activity asset(s).

- **Qualifying assets (note 2(e)):**
All interest-bearing loans are held by the parent company and were not obtained for any specific asset's acquisition, construction, or production. Funds from these loans are transferred to subsidiaries to meet the strategic objectives of the Group or are otherwise held centrally. Due to this financing structure, judgement is required in determining whether those borrowings are attributable to the acquisition, construction or production of a qualifying asset. Therefore, management determines whether borrowings are attributable to an asset or group of assets based on whether the investment in an operating or development stage project is classified as contributing to achieving the strategic growth of the Group.
- **Contingencies (note 26).**
By their nature, contingencies will be resolved only when one or more uncertain future events occur or fail to occur. The assessment of the existence and potential quantum of contingencies inherently involves the exercise of significant judgement and the use of estimates regarding the outcome of future events.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(C) SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS CONTINUED ESTIMATES AND ASSUMPTIONS

Significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements include:

- Estimated recoverable ore reserves and mineral resources, note 2(e):
Ore reserves are estimates of the amount of ore that can be economically and legally extracted from the Group's mining properties; mineral resources are an identified mineral occurrence with reasonable prospects for eventual economic extraction. The Group estimates its ore reserves and mineral resources based on information compiled by appropriately qualified persons relating to the geological and technical data on the size, depth, shape and grade of the ore body and suitable production techniques and recovery rates, in conformity with the Joint Ore Reserves Committee (JORC) code 2012. Such an analysis requires complex geological judgements to interpret the data. The estimation of recoverable ore reserves and mineral resources is based upon factors such as geological assumptions and judgements made in estimating the size and grade of the ore body, estimates of commodity prices, foreign exchange rates, future capital requirements and production costs.
- As additional geological information is produced during the operation of a mine, the economic assumptions used and the estimates of ore reserves and mineral resources may change. Such changes may impact the Group's reported balance sheet and income statement including:
 - The carrying value of property, plant and equipment and mining properties may be affected due to changes in estimated future cash flows, which consider both ore reserves and mineral resources;
 - Depreciation and amortisation charges in the income statement may change where such charges are determined using the unit-of-production method based on ore reserves;
 - Stripping costs capitalised in the balance sheet, either as part of mine properties or inventory, or charged to profit or loss may change due to changes in stripping ratios;
 - Provisions for mine closure costs may change where changes to the ore reserve and resources estimates affect expectations about when such activities will occur; and
 - The recognition and carrying value of deferred income tax assets may change due to changes regarding the existence of such assets and in estimates of the likely recovery of such assets.
- Determination of useful lives of assets for depreciation and amortisation purposes, notes 2(e) and 12:
Estimates are required to be made by management as to the useful lives of assets. For depreciation calculated under the unit-of-production method, estimated recoverable reserves are used in determining the depreciation and/or amortisation of mine-specific assets. The depreciation/amortisation charge is proportional to the depletion of the estimated remaining life of mine of production. Estimated useful lives of other assets are based on the expected usage of the asset. Each item's life, which is assessed annually, has regard to both its physical life limitations and to expectations of the use of the asset by the Group, including with reference to present assessments of economically recoverable reserves of the mine property at which the asset is used.
- Silverstream, note 14:
The valuation of the Silverstream contract as a derivative financial instrument requires estimation by management. The term of the derivative is based on Sabinas life of mine and the value of this derivative is determined using a number of estimates, including the estimated recoverable ore reserves and mineral resources and future production profile of the Sabinas mine, the estimated recoveries of silver from ore mined, estimates of the future price of silver and the discount rate used to discount future cash flows. For further details on the inputs that have a significant effect on the fair value of this derivative, see note 30. The impact of changes in silver price assumptions, foreign exchange, inflation and the discount rate is included in note 31.
- Assessment of recoverability of property plant and equipment and impairment charges, note 2(f):
The recoverability of an asset requires the use of estimates and assumptions such as long-term commodity prices, reserves and resources and the associated production profiles, discount rates, future capital requirements, exploration potential and operating performance. Changes in these assumptions will affect the recoverable amount of the property, plant and equipment.
- Estimation of the mine closure costs, notes 2(l) and 21:
Significant estimates and assumptions are made in determining the provision for mine closure cost as there are numerous factors that will affect the ultimate liability payable. These factors include estimates of the extent and costs of rehabilitation activities, the currency in which the cost will be incurred, technological changes, regulatory changes, cost increases, mine life and changes in discount rates. Those uncertainties may result in future actual expenditure differing from the amounts currently provided. The provision at the balance sheet date represents management's best estimate of the present value of the future closure costs required.

- Income tax, notes 2(r) and 10:

The recognition of deferred tax assets, including those arising from un-utilised tax losses require management to assess the likelihood that the Group will generate taxable earnings in future periods, in order to utilise recognised deferred tax assets. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Group to realise the net deferred tax assets recorded at the balance sheet date could be impacted.

(D) FOREIGN CURRENCY TRANSLATION

The Group's consolidated financial statements are presented in US dollars, which is the parent company's functional currency. The functional currency for each entity in the Group is determined by the currency of the primary economic environment in which it operates. For all operating entities, this is US dollars.

Transactions denominated in currencies other than the functional currency of the entity are translated at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate of exchange ruling at the balance sheet date. All differences that arise are recorded in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated into US dollars using the exchange rate at the date when the fair value is determined.

For entities with functional currencies other than US dollars as at the reporting date, assets and liabilities are translated into the reporting currency of the Group by applying the exchange rate at the balance sheet date and the income statement is translated at the average exchange rate for the year. The resulting difference on exchange is included as a cumulative translation adjustment in other comprehensive income. On disposal of an entity, the deferred cumulative amount recognised in other comprehensive income relating to that operation is recognised in the income statement.

(E) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost comprises the purchase price and any costs directly attributable to bringing the asset into working condition for its intended use. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

The cost less the residual value of each item of property, plant and equipment is depreciated over its useful life. Each item's estimated useful life has been assessed with regard to both its own physical life limitations and the present assessment of economically recoverable reserves of the mine property at which the item is located. Estimates of remaining useful lives are made on a regular basis for all mine buildings, machinery and equipment, with annual reassessments for major items. Depreciation is charged to cost of sales on a unit-of-production (UOP) basis for mine buildings and installations, plant and equipment used in the mine production process or on a straight line basis over the estimated useful life of the individual asset when not related to the mine production process. Changes in estimates, which mainly affect unit-of-production calculations, are accounted for prospectively. Depreciation commences when assets are available for use. Land is not depreciated.

The expected useful lives are as follows:

	Years
Buildings	6
Plant and equipment	4
Mining properties and development costs ¹	16
Other assets	3

¹ Depreciation of mining properties and development cost are determined using the unit-of-production method.

An item of property, plant and equipment is de-recognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising at de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year that the asset is de-recognised.

Non-current assets or disposal groups are classified as held for sale when it is expected that the carrying amount of the asset will be recovered principally through sale rather than through continuing use. Assets are not depreciated when classified as held for sale.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(D) FOREIGN CURRENCY TRANSLATION CONTINUED

DISPOSAL OF ASSETS

Gains or losses from the disposal of assets are recognised in the income statement when all significant risks and rewards of ownership are transferred to the customer, usually when title has been passed.

MINING PROPERTIES AND DEVELOPMENT COSTS

Payments for mining concessions are expensed during the exploration phase of a prospect and capitalised during the development of the project when incurred.

Purchased rights to ore reserves and mineral resources are recognised as assets at their cost of acquisition or at fair value if purchased as part of a business combination.

Mining concessions, when capitalised, are amortised on a straight line basis over the period of time in which benefits are expected to be obtained from that specific concession.

Mine development costs are capitalised as part of property, plant and equipment. Mine development activities commence once a feasibility study has been performed for the specific project. When an exploration prospect has entered into the advanced exploration phase and sufficient evidence of the probability of the existence of economically recoverable minerals has been obtained pre-operative expenses relating to mine preparation works are also capitalised as a mine development cost.

The initial cost of a mining property comprises its construction cost, any costs directly attributable to bringing the mining property into operation, the initial estimate of the provision for mine closure cost, and, for qualifying assets, borrowing costs. The Group ceases the capitalisation of borrowing cost when the physical construction of the asset is complete and is ready for its intended use.

Revenues from metals recovered from ore mined in the mine development phase, prior to commercial production, are credited to mining properties and development costs. Upon commencement of production, capitalised expenditure is depreciated using the unit-of-production method based on the estimated economically proven and probable reserves to which they relate.

Mining properties and mine development are stated at cost, less accumulated depreciation and impairment in value, if any.

CONSTRUCTION IN PROGRESS

Assets in the course of construction are capitalised as a separate component of property, plant and equipment. On completion, the cost of construction is transferred to the appropriate category of property, plant and equipment. The cost of construction in progress is not depreciated.

SUBSEQUENT EXPENDITURES

All subsequent expenditure on property, plant and equipment is capitalised if it meets the recognition criteria, and the carrying amount of those parts that are replaced, is de-recognised. All other expenditure including repairs and maintenance expenditure is recognised in the income statement as incurred.

STRIPPING COSTS

In a surface mine operation, it is necessary to remove overburden and other waste material in order to gain access to the ore bodies (stripping activity). During development and pre-production phases, the stripping activity costs are capitalised as part of the initial cost of development and construction of the mine (the stripping activity asset) and charged as depreciation or depletion to cost of sales, in the income statement, based on the mine's units of production once commercial operations begin.

Removal of waste material normally continues throughout the life of a surface mine. At the time that saleable material begins to be extracted from the surface mine the activity is referred to as production stripping.

Production stripping cost is capitalised only if the following criteria is met:

- It is probable that the future economic benefits (improved access to an ore body) associated with the stripping activity will flow to the Group;
- The Group can identify the component of an ore body for which access has been improved; and
- The costs relating to the improved access to that component can be measured reliably.

If not all of the criteria are met, the production stripping costs are charged to the income statement as operating costs as they are incurred.

Stripping activity costs associated with such development activities are capitalised into existing mining development assets, as mining properties and development cost, within property, plant and equipment, using a measure that considers the volume of waste extracted compared with expected volume, for a given volume of ore production. This measure is known as 'component stripping ratio', which is revised annually in accordance with the mine plan. The amount capitalised is subsequently depreciated over the expected useful life of the identified component of the ore body related to the stripping activity asset, by using the units of production method. The identification of components and the expected useful lives of those components are evaluated annually. Depreciation is recognised as cost of sales in the income statement.

The capitalised stripping activity asset is carried at cost less accumulated depletion/depreciation, less impairment, if any. Cost includes the accumulation of costs directly incurred to perform the stripping activity that improves access to the identified component of ore, plus an allocation of directly attributable overhead costs. The costs associated with incidental operations are excluded from the cost of the stripping activity asset.

In identifying components of the ore body, the Group works closely with the mining operations personnel for each mining operation to analyse each of the mine plans. Generally, a component will be a subset of the total ore body and a mine may have several components that are identified based on the mine plan. The mine plans and therefore the identification of components can vary between mines for a number of reasons including but not limited to, the type of commodity, the geological characteristics of the ore body, the geographical location and/or financial considerations.

(F) IMPAIRMENT OF NON-FINANCIAL ASSETS

The carrying amounts of non-financial assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may not be recoverable. At each reporting date, an assessment is made to determine whether there are any indications of impairment. If there are indicators of impairment, an exercise is undertaken to determine whether carrying values are in excess of their recoverable amount. Such reviews are undertaken on an asset by asset basis, except where such assets do not generate cash flows independent of those from other assets or groups of assets, and then the review is undertaken at the cash generating unit level.

If the carrying amount of an asset or its cash generating unit exceeds the recoverable amount, a provision is recorded to reflect the asset at the recoverable amount in the balance sheet. Impairment losses are recognised in the income statement.

THE RECOVERABLE AMOUNT OF AN ASSET

The recoverable amount of an asset is the greater of its value in use and fair value less costs of disposal. In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Fair value less cost of disposal is based on an estimate of the amount that the Group may obtain in an orderly sale transaction between market participants. For an asset that does not generate cash inflows largely independently of those from other assets, or groups of assets, the recoverable amount is determined for the cash generating unit to which the asset belongs. The Group's cash generating units are the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

REVERSAL OF IMPAIRMENT

An assessment is made each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the Group makes an estimate of the recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in estimates used to determine the asset's recoverable amount since the impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to the recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised in previous years. Such impairment loss reversal is recognised in the income statement.

(G) FINANCIAL ASSETS AND LIABILITIES

Financial assets are recognised when the Group becomes party to contracts that give rise to them and are classified as financial assets at fair value through profit or loss; held to maturity investments; available-for-sale financial assets; or loans and receivables or derivatives designated as hedging instruments, as appropriate. The Group determines the classification of its financial assets at initial recognition and re-evaluates this designation at each balance sheet date. When financial assets are recognised initially, they are measured at fair value, plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

The Group recognises financial liabilities on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument. Financial liabilities are classified at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial liabilities are initially recognised at the fair value of the consideration received, including any transaction costs incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(G) FINANCIAL ASSETS AND LIABILITIES CONTINUED

FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial assets and liabilities classified as held-for-trading and other assets or liabilities designated as fair value through profit or loss at inception are included in this category. Financial assets or liabilities are classified as held-for-trading if they are acquired or incurred for the purpose of selling or repurchasing in the short term. Derivatives, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments as defined by IAS 39. Financial assets or liabilities at fair value through profit or loss are carried in the balance sheet at fair value with gains or losses arising from changes in fair value, presented as finance costs or finance income in the income statement.

LOANS AND RECEIVABLES

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available-for-sale.

After initial measurement, such assets are subsequently carried at amortised cost using the effective interest method less any allowance for impairment. Gains or losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Current trade receivables are carried at the original invoice amount less provision made for impairment of these receivables. Non-current receivables are stated at amortised cost. Loans and receivables from contractors are carried at amortised cost.

LOANS AND BORROWINGS

After initial recognition at fair value, net of directly attributable transaction costs, interest-bearing loans are subsequently measured at amortised cost using the effective interest rate (EIR) method. The EIR amortisation is included as finance costs in the income statement. Gains and losses are recognised in profit or loss, in the income statement, when the liabilities are derecognised as well as through the EIR amortisation process.

The Group adjusts the carrying amount of the financial liability to reflect actual and revised estimated cash flows. The carrying amount is recalculated by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate. Any adjustment is recognised in profit or loss as income or expense.

This category generally applies to interest-bearing loans and borrowings. For more information, refer to note 20.

AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets are those non-derivative financial assets that are designated as such or are not classified in any of the preceding categories and are not held to maturity investments.

Available-for-sale financial assets represent equity investments that have a quoted market price in an active market; therefore, a fair value can be reliably measured. After initial measurement, available-for-sale financial assets are measured at fair value with mark-to-market unrealised gains or losses recognised as other comprehensive income in the available-for-sale reserve until the financial asset is de-recognised.

Financial assets classified as available-for-sale are de-recognised when they are sold, and all the risks and rewards of ownership have been transferred. When financial assets are sold, the accumulated fair value adjustments recognised in other comprehensive income are included in the income statement within other operating income or expense.

DE-RECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

A financial asset or liability is generally de-recognised when the contract that gives rise to it is settled, sold, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in profit or loss.

The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in the income statement.

(H) IMPAIRMENT OF FINANCIAL ASSETS

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

ASSETS CARRIED AT AMORTISED COST

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired receivables are recognised when they are assessed as uncollectible.

AVAILABLE-FOR-SALE FINANCIAL ASSETS

If an available-for-sale financial asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. In assessing whether there is an impairment, the Group considers whether a decline in fair value is either significant or prolonged, by considering the size of the decline in this value, the historic volatility in changes in fair value and the duration of the sustained decline. Reversals in respect of equity instruments classified as available-for-sale are not recognised in the income statement.

(I) INVENTORIES

Finished goods, work in progress and ore stockpile inventories are measured at the lower of cost and net realisable value. Cost is determined using the weighted average cost method based on cost of production which excludes borrowing costs.

For this purpose, the costs of production include:

- personnel expenses, which include employee profit sharing, materials and contractor expenses which are directly attributable to the extraction and processing of ore;
- the depreciation of property, plant and equipment used in the extraction and processing of ore; and
- related production overheads (based on normal operating capacity).

Operating materials and spare parts are valued at the lower of cost or net realisable value. An allowance for obsolete and slow-moving inventories is determined by reference to specific items of stock. A regular review is undertaken by management to determine the extent of such an allowance.

Net realisable value is the estimated selling price in the ordinary course of business less any further costs expected to be incurred to completion and disposal.

(J) SHORT-TERM INVESTMENTS

Where the Group invests in short-term instruments which are either not readily convertible into known amounts of cash or are subject to risk of changes in value that are not insignificant, these instruments are classified as short-term investments. Short-term investments are classified as loans and receivables.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(K) CASH AND CASH EQUIVALENTS

For the purposes of the balance sheet, cash and cash equivalents comprise cash at bank, cash on hand and short-term deposits held with banks that are readily convertible into known amounts of cash and which are subject to insignificant risk of changes in value. Short-term deposits earn interest at the respective short-term deposit rates between one day and four months. For the purposes of the cash flow statement, cash and cash equivalents as defined above are shown net of outstanding bank overdrafts.

(L) PROVISIONS

MINE CLOSURE COST

A provision for mine closure cost is made in respect of the estimated future costs of closure, restoration and for environmental rehabilitation costs (which include the dismantling and demolition of infrastructure, removal of residual materials and remediation of disturbed areas) based on a mine closure plan, in the accounting period when the related environmental disturbance occurs. The provision is discounted and the unwinding of the discount is included within finance costs. At the time of establishing the provision, a corresponding asset is capitalised where it gives rise to a future economic benefit and is depreciated over future production from the mine to which it relates. The provision is reviewed on an annual basis by the Group for changes in cost estimates, discount rates or life of operations. Changes to estimated future costs are recognised in the balance sheet by adjusting the mine closure cost liability and the related asset originally recognised. If, for mature mines, the revised mine assets net of mine closure cost provisions exceed the recoverable value, the portion of the increase is charged directly as an expense. For closed sites, changes to estimated costs are recognised immediately in profit or loss.

(M) EMPLOYEE BENEFITS

The Group operates the following plans:

DEFINED BENEFIT PENSION PLAN

This funded plan is based on each employee's earnings and years of service. This plan was open to all employees in Mexico until it was closed to new entrants on 1 July 2007. The plan is denominated in Mexican Pesos. For members as at 30 June 2007, benefits were frozen at that date subject to indexation with reference to the Mexican National Consumer Price Index (NCPI).

The cost of providing benefits under the defined benefit plan is determined using the projected unit credit actuarial valuation method and prepared by an external actuarial firm as at each year-end balance sheet date. The discount rate is the yield on bonds that have maturity dates approximating the terms of the Group's obligations and that are denominated in the same currency in which the benefits are expected to be paid. Actuarial gains or losses are recognised in OCI and permanently excluded from profit or loss.

Past service costs are recognised as an expense on a straight line basis over the average period until the benefits become vested. If the benefits have already vested following the introduction of, or changes to, a pension plan, the past service cost is recognised immediately.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Net interest cost is recognised in finance cost and return on plan assets (other than amounts reflected in net interest cost) is recognised in OCI and permanently excluded from profit or loss.

DEFINED CONTRIBUTION PENSION PLAN

A defined contribution plan is a post-employment benefit plan under which the Group pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in profit or loss when they are due. The contributions are based on the employee's salary.

This plan started on 1 July 2007 and it is voluntary for all employees to join this scheme.

SENIORITY PREMIUM FOR VOLUNTARY SEPARATION

This unfunded plan corresponds to an additional payment over the legal seniority premium equivalent to approximately 12 days of salary per year for those unionised workers who have more than 15 years of service. Non-unionised employees with more than 15 years of service have the right to a payment equivalent to 12 days for each year of service. For both cases, the payment is based on the legal current minimum salary.

The cost of providing benefits for the seniority premium for voluntary separation is determined using the projected unit credit actuarial valuation method and prepared by an external actuarial firm as at each year-end balance sheet date. Actuarial gains or losses are recognised as income or expense in the period in which they occur.

OTHER

Benefits for death and disability are covered through insurance policies.

Termination payments for involuntary retirement (dismissals) are charged to the income statement, when incurred.

(N) EMPLOYEE PROFIT SHARING

In accordance with the Mexican legislation, companies in Mexico are subject to pay for employee profit sharing (PTU) equivalent to 10% of the taxable income of each fiscal year.

PTU is accounted for as employee benefits and is calculated based on the services rendered by employees during the year, considering their most recent salaries. The liability is recognised as it accrues and is charged to the income statement. PTU, paid in each fiscal year, is considered deductible for income tax purposes.

(O) LEASES

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date including whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
- b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
- c) There is a change in the determination of whether fulfilment is dependent on a specified asset; or
- d) There is a substantial change to the asset.

GROUP AS A LESSEE

Finance leases which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased asset, or if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are reflected in the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

GROUP AS A LESSOR

Leases where the Group does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

Where a reassessment is made, lease accounting commences or ceases from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b) above.

For arrangements entered into prior to 1 January 2005, the date of inception is deemed to be 1 January 2007, in accordance with the transitional requirements of IFRIC 4.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(P) REVENUE RECOGNITION

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of consideration received excluding discounts, rebates and other sales taxes.

SALE OF GOODS

Revenue is recognised in the income statement when all significant risks and rewards of ownership are transferred to the customer, usually when title has been passed. Revenue excludes any applicable sales taxes.

The Group recognises revenue on a provisional basis at the time concentrates, precipitates and doré bars are delivered to the customer's smelter or refinery, using the Group's best estimate of contained metal. Revenue is subject to adjustment once the analysis of the product samples is completed, contract conditions have been fulfilled and final settlement terms are agreed. Any subsequent adjustments to the initial estimate of metal content are recorded in revenue once they have been determined.

In addition, sales of concentrates and precipitates throughout each calendar month, as well as doré bars that are delivered after the 20th day of each month, are 'provisionally priced' subject to a final adjustment based on the average price for the month following the delivery to the customer, based on the market price at the relevant quotation point stipulated in the contract. Doré bars that are delivered in the first 20 days of each month are finally priced in the month of delivery.

For sales of goods that are subject to provisional pricing, revenue is initially recognised when the conditions set out above have been met using the provisional price. The price exposure is considered to be an embedded derivative and hence separated from the sales contract. At each reporting date, the provisionally priced metal is revalued based on the forward selling price for the quotation period stipulated in the contract until the quotation period ends. The selling price of the metals can be reliably measured as these are actively traded on international exchanges. The revaluing of provisionally priced contracts is recorded as an adjustment to revenue.

The customer deducts treatment and refining charges before settlement. Therefore, the fair value of consideration received for the sale of goods is net of those charges.

The Group recognises in selling expenses a levy in respect of the Extraordinary Mining Right as sales of gold and silver are recognised. The Extraordinary Mining Right consists of a 0.5% rate, applicable to the owners of mining titles. The payment must be calculated over the total sales of all mining concessions. The payment of this mining right must be remitted no later than the last business day of March of the following year and can be credited against corporate income tax.

The Group also recognises in selling expenses a discovery premium royalty equivalent to 1% of the value of the mineral extracted and sold during the year from certain mining titles granted by the Mexican Geological Survey (SGM) in the San Julián mine. The premium is settled to SGM on a quarterly basis.

OTHER INCOME

Other income is recognised in the income statement when all significant risks and rewards of ownership are transferred to the customer, usually when title has been passed.

(Q) EXPLORATION EXPENSES

Exploration activity involves the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of an identified resource.

Exploration expenses are charged to the income statement as incurred and are recorded in the following captions:

- Cost of sales: costs relating to in-mine exploration, that ensure continuous extraction quality and extend mine life; and
- Exploration expenses:
 - Costs incurred in geographical proximity to existing mines in order to replenish or increase reserves; and
 - Costs incurred in regional exploration with the objective of locating new ore deposits in Mexico and Latin America and which are identified by project. Costs incurred are charged to the income statement until there is sufficient probability of the existence of economically recoverable minerals and a feasibility study has been performed for the specific project.

(R) TAXATION**CURRENT INCOME TAX**

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the country the Group operates.

DEFERRED INCOME TAX

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- Where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of transaction, affects neither the accounting profit nor taxable profit loss; and
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except:

- Where the deferred income tax asset relating to deductible temporary differences arise from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax relating to items recognised directly in other comprehensive income is recognised in equity and not in the income statement.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

MINING RIGHTS

The Special Mining Right is considered an income tax under IFRS and states that the owners of mining titles and concessions are subject to pay an annual mining right of 7.5% of the profit derived from the extractive activities. The Group recognises deferred tax assets and liabilities on temporary differences arising in the determination of the Special Mining Right (see note 10).

SALES TAX

Expenses and assets are recognised net of the amount of sales tax, except:

- When the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognised as part of the cost of acquisition of the asset or as part of the expense item, as applicable; and
- When receivables and payables are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(S) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

The Group uses derivatives to reduce certain market risks derived from changes in foreign exchange and commodities price which impact its financial and business transactions. Hedges are designed to protect the value of expected production against the dynamic market conditions.

Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The full fair value of a derivative is classified as non-current asset or liability if the remaining maturity of the item is more than 12 months.

Any gains or losses arising from changes in fair value on derivatives during the year that do not qualify for hedge accounting are taken directly to the income statement.

Derivatives are valued using valuation approaches and methodologies (such as Black Scholes and Net Present Value) applicable to the specific type of derivative instrument. The fair value of forward currency and commodity contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles, European foreign exchange options are valued using the Black Scholes model. The Silverstream contract is valued using a Net Present Value valuation approach.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for the undertaken hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

CASH FLOW HEDGES

For derivatives that are designated and qualify as cash flow hedges, the effective portion of changes in the fair value of derivative instruments are recorded as in other comprehensive income and are transferred to the income statement when the hedged transaction affects profit or loss, such as when a forecast sale or purchase occurs. For gains or losses related to the hedging of foreign exchange risk these are included, in the line item in which the hedged costs are reflected. Where the hedged item is the cost of a non-financial asset or liability, the amounts recognised in other comprehensive income are transferred to the initial carrying amount of the non-financial asset or liability. The ineffective portion of changes in the fair value of cash flow hedges is recognised directly as finance costs, in the income statement of the related period.

If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, any cumulative gain or loss recognised directly in other comprehensive income from the period that the hedge was effective remains separately in other comprehensive income until the forecast transaction occurs, when it is recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

When hedging with options, the Group designates only the intrinsic value movement of the hedging option within the hedge relationship. The time value of the option contracts is therefore excluded from the hedge designation. Changes in fair value of time value is recognised in the income statement in finance costs.

EMBEDDED DERIVATIVES

Contracts are assessed for the existence of embedded derivatives at the date that the Group first becomes party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. Embedded derivatives which are not clearly and closely related to the underlying asset, liability or transaction are separated and accounted for as stand-alone derivatives.

(T) BORROWING COSTS

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes 12 or more months to get ready for its intended use or sale (a qualifying asset) are capitalised as part of the cost of the respective asset. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Where funds are borrowed specifically to finance a project, the amount capitalised represents the actual borrowing costs incurred. Where surplus funds are available for a short term from funds borrowed specifically to finance a project, the income generated from the temporary investment of such amounts is also capitalised and deducted from the total capitalised borrowing cost. Where the funds used to finance a project form part of general borrowings, the amount capitalised is calculated using a weighted average of rates applicable to relevant general borrowings of the Group during the period.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

(U) FAIR VALUE MEASUREMENT

The Group measures financial instruments at fair value at each balance sheet date. Fair values of financial instruments measured at amortised cost are disclosed in notes 30 and 31.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities.

Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.

Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above. Further information on fair values is described in note 30.

(V) DIVIDEND DISTRIBUTION

Dividends payable to the Company's shareholders are recognised as a liability when these are approved by the Company's shareholders or Board as appropriate. Dividends payable to minority shareholders are recognised as a liability when these are approved by the Company's subsidiaries.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

3. SEGMENT REPORTING

For management purposes, the Group is organised into operating segments based on producing mines.

At 31 December 2017, the Group has seven reportable operating segments as follows:

- The Fresnillo mine, located in the state of Zacatecas, an underground silver mine;
- The Saucito mine, located in the state of Zacatecas, an underground silver mine;
- The Ciénega mine, located in the state of Durango, an underground gold mine; including the San Ramón satellite mine;
- The Herradura mine, located in the state of Sonora, a surface gold mine;
- The Soledad-Dipolos mine, located in the state of Sonora, a surface gold mine;
- The Noche Buena mine, located in state of Sonora, a surface gold mine; and
- The San Julián mine, located on the border of Chihuahua/Durango states, an underground silver-gold mine. Phase one of San Julián mine commenced commercial production in the third quarter of 2016 and phase two in the third quarter of 2017.

The operating performance and financial results for each of these mines are reviewed by management. As the Group's chief operating decision-maker does not review segment assets and liabilities, the Group has not disclosed this information.

Management monitors the results of its operating segments separately for the purpose of performance assessment and making decisions about resource allocation. Segment performance is evaluated without taking into account certain adjustments included in revenue as reported in the consolidated income statement, and certain costs included within cost of sales and gross profit which are considered to be outside of the control of the operating management of the mines. The table below provides a reconciliation from segment profit to gross profit as per the consolidated income statement. Other income and expenses included in the consolidated income statement are not allocated to operating segments. Transactions between reportable segments are accounted for on an arm's length basis similar to transactions with third parties.

In 2017 and 2016, substantially all revenue was derived from customers based in Mexico.

OPERATING SEGMENTS

The following tables present revenue and profit information regarding the Group's operating segments for the year ended 31 December 2017 and 2016, respectively:

Year ended 31 December 2017										
US\$ thousands	Fresnillo	Herradura	Ciénega	Soledad-Dipolos ⁴	Saucito	Noche Buena	San Julián	Other ⁵	Adjustments and eliminations	Total
Revenues:										
Third party ¹	368,286	605,823	183,689	–	446,008	214,998	274,504	–	–	2,093,308
Inter-segment								79,907	(79,907)	–
Segment revenues	368,286	605,823	183,689	–	446,008	214,998	274,504	79,907	(79,907)	2,093,308
Segment profit²	252,249	355,570	97,098	2,269	315,196	75,496	174,712	59,878	(22,966)	1,309,502
Depreciation and amortisation										(367,609)
Employee profit sharing										(16,488)
Gross profit as per the income statement										925,405
Capital expenditure ³	111,724	153,200	46,461	–	133,679	18,748	79,069	61,870	–	604,751

1 Total third party revenues include treatment and refining charges amounting US\$139.9 million.

2 Segment profit excluding depreciation and amortisation and employee profit sharing. During 2017 there were no foreign exchange hedging losses included in gross profit.

3 Capital expenditure represents the cash outflow in respect of additions to property, plant and equipment, including mine development, construction of leaching pads, purchase of mine equipment and capitalised stripping activity, excluding additions relating to changes in the mine closure provision. Significant additions the construction of facilities at San Julián phase II, the second dynamic leaching plant at Herradura and the construction of the Pyrites plant at Saucito.

4 During 2017, this segment did not operate due to the Bajío conflict (note 26). Segment profit is derived from the changes in the net realisable value allowance against inventory (note 15).

5 Other inter-segment revenue corresponds to leasing services provided by Minera Bermejil, S.A. de C.V.; capital expenditure corresponds to Minera Juanicipio S.A de C.V.

Year ended 31 December 2016										
US\$ thousands	Fresnillo	Herradura	Ciénega	Soledad-Dípolos ⁴	Saucito	Noche Buena	San Julián ⁵	Other ⁶	Adjustments and eliminations	Total
Revenues:										
Third party ¹	327,957	655,025	169,530	–	459,590	225,374	66,441	–	1,586	1,905,503
Inter-segment								77,385	(77,385)	–
Segment revenues	327,957	655,025	169,530	–	459,590	225,374	66,441	77,385	(75,799)	1,905,503
Segment profit²	224,163	369,896	100,105	12,977	363,780	83,852	45,833	63,379	(17,854)	1,246,131
Foreign exchange hedging losses										(2,770)
Depreciation and amortisation										(346,502)
Employee profit sharing										(14,744)
Gross profit as per the income statement										882,115
Capital expenditure ³	52,794	78,825	32,745	–	102,398	8,620	144,468	14,200	–	434,050

1 Total third party revenues include treatment and refining charges amounting US\$141.1 million.

2 Segment profit excluding foreign exchange hedging losses, depreciation and amortisation and employee profit sharing.

3 Capital expenditure represents the cash outflow in respect of additions to property, plant and equipment, including mine development, construction of leaching pads, purchase of mine equipment and capitalised stripping activity, excluding additions relating to changes in the mine closure provision. Significant additions include the construction of second beneficiation plant (Merrill Crowe) at Herradura and the expansion of the flotation plant and the construction of the Pyrites plant at Saucito.

4 During 2016, this segment did not operate due to the Bajío conflict (note 26). Segment profit is derived from the changes in the net realisable value allowance against inventory (note 15).

5 Due to its size this segment was presented within Other in the financial statements for the year ended as at 31 December 2016.

6 Other includes inter-segment revenue corresponds to leasing services provided by Minera Bermejal, S.A. de C.V.; capital expenditure corresponds to Minera Juanicipio S.A. de C.V. The presentation of capital expenditure has been changed by presenting San Julián separately to be consistent with the presentation in the 2017 table above.

4. REVENUES

Revenues reflect the sale of goods, being concentrates, doré, slag and precipitates of which the primary contents are silver, gold, lead and zinc.

(A) REVENUES BY PRODUCT SOLD

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Lead concentrates (containing silver, gold, lead and by-products)	832,039	792,770
Doré and slag (containing gold, silver and by-products)	820,821	880,447
Zinc concentrates (containing zinc, silver and by-products)	195,837	120,889
Precipitates (containing gold and silver)	244,611	111,397
	2,093,308	1,905,503

Substantially all lead concentrates, precipitates, doré and slag, were sold to Peñoles' metallurgical complex, Met-Mex, for smelting and refining.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

4. REVENUES CONTINUED

(B) VALUE OF METAL CONTENT IN PRODUCTS SOLD

For products other than refined silver and gold, invoiced revenues are derived from the value of metal content adjusted by treatment and refining charges incurred by the metallurgical complex of the customer. The value of the metal content of the products sold, before treatment and refining charges is as follows:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Silver	844,815	724,024
Gold	1,125,290	1,133,067
Zinc	161,305	106,461
Lead	101,826	83,070
Value of metal content in products sold	2,233,236	2,046,622
Adjustment for treatment and refining charges	(139,928)	(141,119)
Total revenues ¹	2,093,308	1,905,503

¹ Includes provisional price adjustments which represent changes in the fair value of embedded derivatives resulting in a gain of US\$9.2 million (2016: loss of US\$(2.2) million). During 2017 there were no hedging transactions impacting revenues (2016: gain of US\$ 1.6 million). For further detail, refer to note 2(p).

The average realised prices for the gold and silver content of products sold, prior to the deduction of treatment and refining charges, were:

	Year ended 31 December	
	2017 US\$ per ounce	2016 US\$ per ounce
Gold ²	1,267.4	1,246.5
Silver ²	16.9	17.2

² Realised prices do not include the results of hedging.

5. COST OF SALES

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Depreciation and amortisation (notes 2(e) and 12)	367,609	346,502
Personnel expenses (note 7)	89,629	80,360
Maintenance and repairs	115,670	90,650
Operating materials	153,221	131,786
Energy	144,298	117,995
Contractors	233,909	174,167
Freight	10,545	7,921
Insurance	4,786	4,990
Mining concession rights and contributions	11,589	10,347
Other	22,043	14,721
Cost of production	1,153,299	979,439
Losses on foreign currency hedges	–	2,770
Change in work in progress and finished goods (ore inventories)	16,873	61,488
Change in net realisable value allowance against inventory (note 15)	(2,269)	(20,309)
	1,167,903	1,023,388

6. EXPLORATION EXPENSES

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Contractors	105,778	88,822
Administrative services	6,818	6,243
Mining concession rights and contributions	13,872	14,027
Personnel expenses (note 7)	6,749	5,521
Assays	2,850	2,982
Rentals	2,329	1,524
Other	2,712	2,063
	141,108	121,182

These exploration expenses were mainly incurred in areas of the Fresnillo, Herradura, La Ciénega, Saucito and San Julián mines, the San Ramón satellite mine and Orysivo, Guanajuato, Centauro Deep and Valles projects. In addition, exploration expenses of US\$8.3 million (2016: US\$7.9 million) were incurred in the year on projects located in Peru.

The following table sets forth liabilities (generally trade payables) corresponding to exploration activities of the Group companies engaged only in exploration, principally Exploraciones Mineras Parreña, S.A. de C.V.

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Liabilities related to exploration activities	1,947	1,643

The liabilities related to exploration activities recognised by the Group operating companies are not included since it is not possible to separate the liabilities related to exploration activities of these companies from their operating liabilities.

Cash flows relating to exploration activities are as follows:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Operating cash out flows related to exploration activities	140,804	120,457

7. PERSONNEL EXPENSES

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Employees' profit sharing	17,150	15,145
Salaries and wages	39,448	36,296
Bonuses	12,112	10,233
Statutory healthcare and housing contributions	14,258	12,979
Other benefits	8,704	8,035
Vacations and vacations bonus	2,636	1,634
Social security	7,112	4,459
Post-employment benefits ¹	4,224	3,567
Other	10,843	8,686
	116,487	101,034

1 Post-employment benefits include US\$0.4 million associated to benefits corresponding to the defined contribution plan (2016: US\$1.5 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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7. PERSONNEL EXPENSES CONTINUED

(A) PERSONNEL EXPENSES ARE REFLECTED IN THE FOLLOWING LINE ITEMS:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Cost of sales (note 5)	89,629	80,360
Administrative expenses	20,109	15,153
Exploration expenses (note 6)	6,749	5,521
	116,487	101,034

(B) THE MONTHLY AVERAGE NUMBER OF EMPLOYEES DURING THE YEAR WAS AS FOLLOWS:

	Year ended 31 December	
	2017 No.	2016 No.
Mining	1,994	1,881
Plant concentration	602	550
Exploration	501	454
Maintenance	865	894
Administration and other	936	791
Total	4,898	4,570

8. OTHER OPERATING INCOME AND EXPENSES

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Other income:		
Gain on sale of property, plant and equipment ¹	25,333	–
Rentals	–	3
Selling of scrap	1,444	610
Other	1,426	785
	28,203	1,398

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Other expenses:		
Rentals	229	–
Maintenance ²	1,858	926
Donations	2,540	317
Environmental activities	1,790	1,005
Loss on sale of property, plant and equipment	–	1,103
Consumption tax expensed	1,031	940
Write-off of property, plant and equipment	–	3,005
Impairment available-for-sale financial assets	36	–
Other	3,887	3,146
	11,371	10,442

1 Mainly corresponds to the sale of certain mining concession from the Fresnillo district to a third party for a consideration of US\$26.0 million, resulting in a gain of US\$24.8 million.

2 Costs relating to the rehabilitation of the facilities of Compañía Minera Las Torres, S.A. de C.V. (closed mine).

9. FINANCE INCOME AND FINANCE COSTS

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Finance income:		
Interest on short-term deposits and investments	11,368	4,542
Other	3,208	2,416
	14,576	6,958

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Finance costs:		
Interest on interest-bearing loans	35,808	29,006
Fair value movement on derivatives ¹	41,389	40,294
Unwinding of discount on provisions	11,703	10,476
Other	753	547
	89,653	80,323

¹ Principally relates to the time value associated with gold commodity options (see note 30 for further details).

10. INCOME TAX EXPENSE

(A) MAJOR COMPONENTS OF INCOME TAX EXPENSE:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Consolidated income statement:		
Corporate income tax		
Current:		
Income tax charge	155,692	167,873
Amounts under/(over) provided in previous years	8,676	(1,646)
	164,368	166,227
Deferred:		
Origination and reversal of temporary differences	(45,003)	53,581
Revaluation effects of Silverstream contract	34,097	40,058
	(10,906)	93,639
Corporate income tax	153,462	259,866
Special mining right		
Current:		
Special mining right charge ¹	19,415	24,502
	19,415	24,502
Deferred:		
Origination and reversal of temporary differences	7,805	8,910
Special mining right	27,220	33,412
Income tax expense reported in the income statement	180,682	293,278

¹ The special mining right 'SMR' allows the deduction of payments of mining concessions rights up to the amount of SMR payable within the same legal entity. During the fiscal year ended 31 December 2017, the Group credited US\$15.7 million (2016: US\$12.4 million) of mining concession rights against the SMR. Total mining concessions rights paid during the year were US\$16.3 million (2016: US\$15.4 million) and have been recognised in the income statement within cost of sales and exploration expenses. Mining concessions rights paid in excess of the SMR cannot be credited to SMR in future fiscal periods, and therefore no deferred tax asset has been recognised in relation to the excess. Without regards to credits permitted under the SMR regime, the current special mining right charge would have been US\$35.1 million (2016: US\$36.9 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

10. INCOME TAX EXPENSE CONTINUED

(A) MAJOR COMPONENTS OF INCOME TAX EXPENSE: CONTINUED

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Consolidated statement of comprehensive income:		
Deferred income tax credit/(charge) related to items recognised directly in other comprehensive income:		
Losses on cash flow hedges recycled to income statement	–	(355)
Changes in fair value of cash flow hedges	–	15,875
Changes in fair value of available-for-sale financial assets	(2,653)	(13,418)
Remeasurement losses on defined benefit plans	(148)	(388)
Income tax effect reported in other comprehensive income	(2,801)	1,714

(B) RECONCILIATION OF THE INCOME TAX EXPENSE AT THE GROUP'S STATUTORY INCOME RATE TO INCOME TAX EXPENSE AT THE GROUP'S EFFECTIVE INCOME TAX RATE:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Accounting profit before income tax	741,489	718,240
Tax at the Group's statutory corporate income tax rate 30.0%	222,446	215,472
Expenses not deductible for tax purposes	2,562	2,016
Inflationary uplift of the tax base of assets and liabilities	(20,011)	(8,933)
Current income tax (over)/underprovided in previous years	472	(1,303)
Exchange rate effect on tax value of assets and liabilities ¹	(9,934)	90,035
Non-taxable/Non-deductible foreign exchange losses	(4,242)	(2,157)
Inflationary uplift of tax losses	(5,084)	(2,891)
IEPS tax credit (note 10(e))	(26,181)	(24,020)
Deferred tax asset not recognised	4,461	3,360
Special mining right deductible for corporate income tax	(8,165)	(10,024)
Other	(2,862)	(1,689)
Corporate income tax at the effective tax rate of 20.7% (2016: 36.2%)	153,462	259,866
Special mining right	27,220	33,412
Tax at the effective income tax rate of 24.4% (2016: 40.8%)	180,682	293,278

1 Mainly derived from the tax value of property, plant and equipment.

(C) MOVEMENTS IN DEFERRED INCOME TAX LIABILITIES AND ASSETS:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Opening net liability	(443,027)	(342,195)
Income statement credit/(charge) arising on corporate income tax	10,906	(93,639)
Income statement charge arising on special mining right	(7,805)	(8,910)
Exchange difference	–	3
Net (charge)/ credit related to items directly charged to other comprehensive income	(2,801)	1,714
Closing net liability	(442,727)	(443,027)

The amounts of deferred income tax assets and liabilities as at 31 December 2017 and 2016, considering the nature of the related temporary differences, are as follows:

	Consolidated balance sheet		Consolidated income statement	
	2017 US\$ thousands	2016 US\$ thousands	2017 US\$ thousands	2016 US\$ thousands
Related party receivables	(221,451)	(199,181)	22,270	72,799
Other receivables	(2,171)	(3,725)	(1,554)	3,256
Inventories	162,842	163,113	271	(43,868)
Prepayments	(898)	(1,803)	(923)	(10,727)
Derivative financial instruments including Silverstream contract	(147,535)	(134,984)	12,551	4,469
Property, plant and equipment arising from corporate income tax	(341,774)	(351,325)	(9,551)	36,358
Exploration expenses and operating liabilities	44,121	24,303	(19,818)	4,083
Other payables and provisions	55,379	44,733	(10,646)	13,910
Losses carried forward	68,213	66,343	(1,870)	22,250
Post-employment benefits	1,465	1,685	220	364
Deductible profit sharing	4,249	3,905	(344)	(226)
Special mining right deductible for corporate income tax	30,661	29,100	(1,561)	(8,034)
Available-for-sale financial assets	(16,818)	(14,175)	2,643	13,419
Other	(3,772)	(3,581)	(2,594)	(14,414)
Net deferred tax liability related to corporate income tax	(367,489)	(375,592)	-	-
Deferred tax credit related to corporate income tax	-	-	(10,906)	93,639
Related party receivables arising from special mining right	(21,379)	(18,764)	2,616	3,557
Inventories arising from special mining right	11,107	8,274	(2,831)	1,341
Property plant and equipment arising from special mining right	(64,966)	(56,945)	8,020	4,012
Net deferred tax liability	(442,727)	(443,027)	-	-
Deferred tax (credit)/charge	-	-	(3,101)	102,549
Reflected in the statement of financial position as follows:				
Deferred tax assets	48,950	20,023	-	-
Deferred tax liabilities-continuing operations	(491,677)	(463,050)	-	-
Net deferred tax liability	(442,727)	(443,027)	-	-

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to the same fiscal authority.

On the basis of management's internal forecast, a deferred tax asset has been recognised in respect of tax losses amounting to US\$227.4 million (2016: US\$221.1 million). If not utilised, US\$13.7 million (2016: US\$10.7 million) will expire within five years and US\$213.6 million (2016: US\$210.4 million) will expire between six and ten years.

The Group has further tax losses and other similar attributes carried forward of US\$37.4 million (2016: US\$29.1 million) on which no deferred tax is recognised due to insufficient certainty regarding the availability of appropriate future taxable profits.

(D) UNRECOGNISED DEFERRED TAX ON INVESTMENTS IN SUBSIDIARIES

The Group has not recognised all of the deferred tax liability in respect of distributable reserves of its subsidiaries because it controls them and only part of the temporary differences are expected to reverse in the foreseeable future. The temporary differences for which a deferred tax liability has not been recognised aggregate to US\$1,723 million (2016: US\$1,949 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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10. INCOME TAX EXPENSE CONTINUED

(E) CORPORATE INCOME TAX ('IMPUESTO SOBRE LA RENTA' OR 'ISR') AND SPECIAL MINING RIGHT ('SMR')

The Group's principal operating subsidiaries are Mexican residents for taxation purposes. The rate of current corporate income tax is 30%.

During 2016 the Mexican Internal Revenue Law granted to taxpayers a credit in respect of an excise tax (Special Tax on Production and Services, or IEPS for its acronym in Spanish) paid when purchasing diesel used for general machinery and certain mining vehicles. The credit can be applied against either the Group's own corporate income tax or the income tax withheld from third parties. The credit is calculated on an entity-by-entity basis and expires one year after the purchase of the diesel. In the year ended 31 December 2017, the Group applied a credit of US\$23.2 million (2016: US\$19.1 million) in respect of the year and recognised a deferred tax asset of US\$2.9 million (2016: US\$4.8 million) in respect of the IEPS incurred in 2017 and expected to be applied during 2018. As the IEPS deduction is itself taxable, the deferred tax asset is recognised at 70% of the IEPS carried forward. The net amount applied by the Group is presented in the reconciliation of the effective tax rate in note 10(b).

The SMR states that the owners of mining titles and concessions are subject to pay an annual mining right of 7.5% of the profit derived from the extractive activities and is considered as income tax under IFRS. The SMR allows as a credit the payment of mining concessions rights up to the amount of SMR payable. The 7.5% tax applies to a base of income before interest, annual inflation adjustment, taxes paid on the regular activity, depreciation and amortisation, as defined by the new ISR. This SMR can be credited against the corporate income tax of the same fiscal year and its payment must be remitted no later than the last business day of March of the following year.

11. EARNINGS PER SHARE

Earnings per share (EPS) is calculated by dividing profit for the year attributable to equity shareholders of the Company by the weighted average number of Ordinary Shares in issue during the period.

The Company has no dilutive potential Ordinary Shares.

As of 31 December 2017 and 2016, earnings per share have been calculated as follows:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Earnings:		
Profit from continuing operations attributable to equity holders of the Company	560,578	426,986
Adjusted profit from continuing operations attributable to equity holders of the Company	481,019	333,516

Adjusted profit is profit as disclosed in the Consolidated Income Statement adjusted to exclude revaluation effects of the Silverstream contract of US\$113.6 million gain (US\$79.5 million net of tax) (2016: US\$133.5 million gain (US\$93.5 million net of tax)).

Adjusted earnings per share have been provided in order to provide a measure of the underlying performance of the Group, prior to the revaluation effects of the Silverstream contract, a derivative financial instrument.

	2017 thousands	2016 thousands
	2017 US\$	2016 US\$
Number of shares:		
Weighted average number of Ordinary Shares in issue	736,894	736,894
Earnings per share:		
Basic and diluted earnings per share	0.761	0.579
Adjusted basic and diluted earnings per Ordinary Share from continuing operations	0.653	0.453

12. PROPERTY, PLANT AND EQUIPMENT

Year ended 31 December 2016						
	Land and buildings	Plant and equipment	Mining properties and development costs	Other assets	Construction in progress	Total
	US\$ thousands					
Cost						
At 1 January 2016	173,201	1,447,939	1,289,406	217,979	561,623	3,690,148
Additions	459	11,423	4,168	(50,304) ²	441,649	407,395
Disposals	–	(12,409)	(4,206)	(161)	–	(16,776)
Transfers and other movements	70,315	188,633	218,648	26,391	(503,987)	–
At 31 December 2016	243,975	1,635,586	1,508,016	193,905	499,285	4,080,767
Accumulated depreciation						
At 1 January 2016	(74,170)	(725,762)	(678,417)	(73,211)	–	(1,551,560)
Depreciation for the year ¹	(16,412)	(177,744)	(148,223)	(18,961)	–	(361,340)
Write-off of property, plant and equipment	(4)	(2,909)	–	(92)	–	(3,005)
Disposals	–	11,048	4,206	101	–	15,355
At 31 December 2016	(90,586)	(895,367)	(822,434)	(92,163)	–	(1,900,550)
Net Book amount at 31 December 2016	153,389	740,219	685,582	101,742	499,285	2,180,217

Year ended 31 December 2017						
	Land and buildings	Plant and equipment	Mining properties and development costs	Other assets	Construction in progress	Total
	US\$ thousands					
Cost						
At 1 January 2017	243,975	1,635,586	1,508,016	193,905	499,285	4,080,767
Additions	3,079	5,464	46,558	27,187 ²	567,856	650,144
Disposals	–	(9,584)	(4,415)	(1,611)	–	(15,610)
Transfers and other movements	14,751	186,125	359,226	35,984	(596,086)	–
At 31 December 2017	261,805	1,817,591	1,909,385	255,465	471,055	4,715,301
Accumulated depreciation						
At 1 January 2017	(90,586)	(895,367)	(822,434)	(92,163)	–	(1,900,550)
Depreciation for the year ¹	(21,462)	(165,502)	(179,891)	(14,061)	–	(380,916)
Disposals	–	9,410	4,412	939	–	14,761
At 31 December 2017	(112,048)	(1,051,459)	(997,913)	(105,285)	–	(2,266,705)
Net Book amount at 31 December 2017	149,757	766,132	911,472	150,180	471,055	2,448,596

¹ Depreciation for the year includes US\$367.7 million (2016: US\$346.5 million) recognised as an expense in the cost of sales in the income statement and US\$13.3 million (2016: US\$14.8 million), capitalised as part of construction in progress.

² From the additions in 'other assets' category US\$24.1 million (2016: US\$(54.9) million) corresponds to the reassessment of mine closure rehabilitations costs (see note 21).

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12. PROPERTY, PLANT AND EQUIPMENT CONTINUED

The table below details construction in progress by operating mine

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Saucito	101,885	45,197
Herradura	98,401	37,740
Noche Buena	12,028	15,985
Ciénega	29,039	17,348
Fresnillo	30,641	32,703
San Julián	53,383	270,154
Other ¹	145,678	80,158
	471,055	499,285

¹ Manly corresponds to Juanicipio development project and Minera Bermejil, S.A. de C.V. (2016: Juanicipio development project).

During the year ended 31 December 2017, the Group capitalised US\$11.4 million of borrowing costs within construction in progress (2016: US\$18.2 million). Borrowing costs were capitalised at the rate of 5.78% (2016: 5.78%).

SENSITIVITY ANALYSIS

As at 31 December 2017 and 2016, the carrying amount of mining assets was fully supported by the higher of value in use and fair value less cost of disposal (FVLCD) computation of their recoverable amount. Value in use and FVLCD was determined based on the net present value of the future estimated cash flows expected to be generated from the continued use of the CGUs. For both valuation approaches management used price assumptions of US\$1,300/ounce and US\$19/ounce (2016: US\$1,250/ounce and US\$18/ounce) for gold and silver, respectively. Management considers that the models supporting the carrying amounts are most sensitive to commodity price assumptions and have therefore performed a sensitivity analysis for those CGUs, where a reasonable possible change in prices could lead to impairment. Management has considered a low sensitivity by decreasing gold and silver prices by 5% (2016: gold and silver 10%) and a high sensitivity by decreasing gold and silver prices by 10% (2016: gold 15% and silver 20%). As at 31 December 2017 no impairment resulted in those CGU tested (2016: San Julián US\$84.3 million under high sensitivity; US\$nil under low sensitivity and Herradura US\$109.6 million under high sensitivity; US\$nil under low sensitivity).

13. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Beginning balance	116,171	71,442
Purchase of available-for-sale financial assets ¹	19,877	–
Fair value change	8,808	44,729
Ending balance	144,856	116,171
Of which relates to investments in funds	19,877	–

¹ Corresponds to the Company's investment in an investment fund held to obtain a financial return.

At 31 December 2017, several investments in quoted shares were valued below the cost paid by the Group. This decrease has continued throughout the past 12-month period, which is considered to be prolonged, therefore an impairment of US\$0.04 million was recognised as other expenses in the income statement. During 2016 no impairment arose on the investment in quoted shares.

The fair value of the available-for-sale financial assets is determined by reference to published price quotations in an active market.

14. SILVERSTREAM CONTRACT

On 31 December 2007, the Group entered into an agreement with Peñoles through which it is entitled to receive the proceeds received by the Peñoles Group in respect of the refined silver sold from the Sabinas Mine ('Sabinas'), a base metals mine owned and operated by the Peñoles Group, for an upfront payment of US\$350 million. In addition, a per ounce cash payment of US\$2.00 in years one to five and US\$5.00 thereafter (subject to an inflationary adjustment that commenced from 31 December 2013) is payable to Peñoles. The cash payment per ounce for the year ended 31 December 2017 was US\$5.20 per ounce (2016: US\$5.15 per ounce). Under the contract, the Group has the option to receive a net cash settlement from Peñoles attributable to the silver produced and sold from Sabinas, to take delivery of an equivalent amount of refined silver or to receive settlement in the form of both cash and silver. If, by 31 December 2032, the amount of silver produced by Sabinas is less than 60 million ounces, a further payment is due from Peñoles of US\$1 per ounce of shortfall.

The Silverstream contract represents a derivative financial instrument which has been recorded at fair value and classified within non-current and current assets as appropriate. The term of the derivative is based on Sabinas life of mine which is currently 38 years. Changes in the contract's fair value, other than those represented by the realisation of the asset through the receipt of either cash or refined silver, are charged or credited to the income statement. In the year ended 31 December 2017 total proceeds received in cash were US\$43.3 million (2016: US\$47.5 million) of which, US\$5.9 million was in respect of proceeds receivable as at 31 December 2016 (2015: US\$2.8 million). Cash received in respect of the year of US\$37.3 million (2016: US\$44.8 million) corresponds to 3.6 million ounces of payable silver (2016: 3.8 million ounces). As at 31 December 2017, a further US\$4.9 million (2016: US\$5.9 million) of cash receivable corresponding to 422,375 ounces of silver is due (2016: 538,756 ounces).

The US\$113.6 million unrealised gain recorded in the income statement (2016: US\$133.5 million gain) resulted from the updating of assumptions used to value the Silverstream contract. The most significant of these were the increase in the Sabinas mine silver reserves and resources, the unwinding of the discount, an increase in the forward price of silver, and the difference between the payments already received during the year ended 31 December 2017 and payments estimated in the valuation model as of 31 December 2016.

A reconciliation of the beginning balance to the ending balance is shown below:

	2017 US\$ thousands	2016 US\$ thousands
Balance at 1 January:	467,529	384,771
Cash received in respect of the year	(37,373)	(44,796)
Cash receivable	(4,925)	(5,974)
Remeasurement gains recognised in profit and loss	113,656	133,528
Balance at 31 December	538,887	467,529
Less – Current portion	32,318	28,718
Non-current portion	506,569	438,811

See note 30 for further information on the inputs that have a significant effect on the fair value of this derivative, see note 31 for further information relating to market and credit risks associated with the Silverstream asset.

15. INVENTORIES

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Finished goods ¹	10,957	5,736
Work in progress ²	175,016	189,047
Ore stockpile ³	15,115	18,253
Operating materials and spare parts	75,331	70,348
	276,419	283,384
Accumulated write-down of work in progress inventory ⁴	–	(2,269)
Allowance for obsolete and slow-moving inventories	(5,314)	(4,265)
Balance as 31 December at lower of cost and net realisable value	271,105	276,850
Less – Current portion	179,485	187,499
Non-current portion ⁵	91,620	89,351

1 Finished goods include metals contained in concentrates and doré bars, and concentrates on hand or in transit to a smelter or refinery.

2 Work in progress includes metals contained in ores on leaching pads.

3 Ore stockpile includes ore mineral obtained during the development phase at San Julián.

4 Corresponds to ore inventory of the Soledad-Dipolos mine resulting from net realisable value calculations.

5 The non-current inventories are expected to be processed more than 12 months from the reporting date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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15. INVENTORIES CONTINUED

Concentrates are a product containing sulphides with variable content of precious and base metals and are sold to smelters and/or refineries. Doré is an alloy containing a variable mixture of gold and silver that is delivered in bar form to refineries. This content once processed by the smelter and refinery is sold to customers in the form of refined products.

The amount of inventories recognised as an expense in the year was US\$1,170.1 million (2016: US\$1,042.4 million) before changes to the net realisable value of inventory. The adjustment to the net realisable value allowance against work-in-progress inventory decreased US\$2.2 million during the year (2016: US\$20.3 million decrease). The adjustment to the allowance for obsolete and slow-moving inventory recognised as an expense was US\$1.04 million (2016: US\$0.7 million).

16. TRADE AND OTHER RECEIVABLES

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Trade and other receivables from related parties (note 27) ¹	226,134	189,619
Value Added Tax receivable	85,979	70,426
Advances and other receivables from contractors	19,832	14,651
Other receivables from related parties (note 27)	4,925	5,973
Loans granted to contractors	1,403	1,401
Other receivables arising on the sale of fixed assets	57	386
Other receivables	4,612	4,693
	342,942	287,149
Provision for impairment of 'other receivables'	(436)	(471)
Trade and other receivables classified as current assets	342,506	286,678
Other receivables classified as non-current assets:		
Loans granted to contractors	129	990
	129	990
	342,635	287,668

¹ Trade receivables from related parties includes the fair value of embedded derivatives arising due to provisional pricing in sales contracts of US\$6.5 million as at 31 December 2017 (2016: US\$(2.8) million).

Trade receivables are shown net of any corresponding advances, are non-interest-bearing and generally have payment terms of 46 to 60 days.

Loans granted to contractors bear interest of between LIBOR plus 1.5% to LIBOR plus 3% and mature over two years.

The total receivables denominated in US dollars were US\$242.3 million (2016: US\$206.8 million), and in pesos US\$100.3 million (2016: US\$80.9 million).

As of 31 December for each year presented, with the exception of 'other receivables' in the table above, all trade and other receivables were neither past due nor impaired. The amount past due and considered as impaired as of 31 December 2017 is US\$0.4 million (2016: US\$0.5 million).

In determining the recoverability of receivables, the Group performs a risk analysis considering the type and age of the outstanding receivable and the credit worthiness of the counterparty, see note 31(b).

17. CASH AND CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

The Group considers cash and cash equivalents and short-term investments when planning its operations and in order to achieve its treasury objectives.

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Cash at bank and on hand	4,265	2,592
Short-term deposits	871,769	709,362
Cash and cash equivalents	876,034	711,954

Cash at bank earns interest at floating rates based on daily bank deposits. Short-term deposits are made for varying periods of between one day and four months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. Short-term deposits can be withdrawn at short notice without any penalty or loss in value.

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Short-term investments	–	200,000

Short-term investments are made for fixed periods no longer than four months and earn interest at fixed rates without an option for early withdrawal. As at 31 December 2017 there were no short-term investments (31 December 2016: US\$200,000 held in fixed-term bank deposits).

18. EQUITY**SHARE CAPITAL AND SHARE PREMIUM**

Authorised share capital of the Company is as follows:

Class of share	As at 31 December			
	2017		2016	
	Number	Amount	Number	Amount
Ordinary Shares each of US\$0.50	1,000,000,000	\$500,000,000	1,000,000,000	\$500,000,000
Sterling Deferred Ordinary Shares each of £1.00	50,000	£50,000	50,000	£50,000

Issued share capital of the Company is as follows:

	Ordinary Shares		Sterling Deferred Ordinary Shares	
	Number	US\$	Number	£
At 1 January 2016	736,893,589	\$368,545,586	50,000	£50,000
At 31 December 2016	736,893,589	\$368,545,586	50,000	£50,000
At 31 December 2017	736,893,589	\$368,545,586	50,000	£50,000

As at 31 December 2017 and 2016, all issued shares with a par value of US\$0.50 each are fully paid. The rights and obligations attached to these shares are governed by law and the Company's Articles of Association. Ordinary shareholders are entitled to receive notice and to attend and speak at any general meeting of the Company. There are no restrictions on the transfer of the Ordinary Shares.

The Sterling Deferred Ordinary Shares only entitle the shareholder on winding up or on a return of capital to payment of the amount paid up after repayment to Ordinary Shareholders. The Sterling Deferred Ordinary Shares do not entitle the holder to payment of any dividend, or to receive notice or to attend and speak at any general meeting of the Company. The Company may also at its option redeem the Sterling Deferred Ordinary Shares at a price of £1.00 or, as custodian, purchase or cancel the Sterling Deferred Ordinary Shares or require the holder to transfer the Sterling Deferred Ordinary Shares. Except at the option of the Company, the Sterling Deferred Ordinary Shares are not transferrable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

18. EQUITY CONTINUED

RESERVES

SHARE PREMIUM

This reserve records the consideration premium for shares issued at a value that exceeds their nominal value.

CAPITAL RESERVE

The capital reserve arose as a consequence of the Pre-IPO Reorganisation as a result of using the pooling of interest method.

HEDGING RESERVE

This reserve records the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge, net of tax. When the hedged transaction occurs, the gain or the loss is transferred out of equity to the income statement or the value of other assets.

AVAILABLE-FOR-SALE FINANCIAL ASSETS RESERVE

This reserve records fair value changes on available-for-sale investments, net of tax. On disposal or on impairment, the cumulative changes in fair value are recycled to the income statement.

FOREIGN CURRENCY TRANSLATION RESERVE

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial information of entities with a functional currency different to that of the presentational currency of the Group.

RETAINED EARNINGS/ACCUMULATED LOSSES

This reserve records the accumulated results of the Group, less any distributions and dividends paid.

19. DIVIDENDS DECLARED AND PAID

The dividends declared and paid during the years ended 31 December 2017 and 2016 are as follows:

	US cents per Ordinary Share	Amount US\$ thousands
Year ended 31 December 2017		
Final dividend for 2016 declared and paid during the year ¹	21.5	158,432
Interim dividend for 2017 declared and paid during the year ²	10.6	78,111
	32.1	236,543
Year ended 31 December 2016		
Final dividend for 2015 declared and paid during the year ³	3.3	24,686
Interim dividend for 2016 declared and paid during the year ⁴	8.6	63,373
	11.9	88,059

¹ This dividend was approved by the Board of Directors on 23 May 2017 and paid on 26 May 2017.

² This dividend was approved by the Board of Directors on 31 July 2017 and paid on 8 September 2017.

³ This dividend was approved by the Board of Directors on 3 May 2016 and paid on 9 May 2016.

⁴ This dividend was approved by the Board of Directors on 1 August 2016 and paid on 9 September 2016.

20. INTEREST-BEARING LOANS**SENIOR NOTES**

On 13 November 2013, the Group completed its offering of US\$800 million aggregate principal amount of 5.500% Senior Notes due 2023 (the 'Notes').

Movements in the year in the debt recognised in the balance sheet are as follows:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Opening balance	798,027	797,032
Accrued interest	46,267	46,267
Interest paid ¹	(46,267)	(46,267)
Amortisation of discount and transaction costs	1,019	995
Closing balance	799,046	798,027

1 Accrued interest is payable semi-annually on 13 May and 13 November.

The Group has the following restrictions derived from the issuance of the Senior Notes (the 'Notes'):

CHANGE OF CONTROL:

Should the rating of the Senior Notes be downgraded as a result of a change of control (defined as the sale or transfer of 35% or more of the common shares; the transfer of all or substantially all the assets of the Group; starting a dissolution or liquidation process; or the loss of the majority in the Board of Directors) the Group is obligated to repurchase the Notes at an equivalent price of 101% of their nominal value plus the interest earned at the repurchase date, if requested to do so by any creditor.

PLEDGE ON ASSETS:

The Group shall not pledge or allow a pledge on any property that may have a material impact on business performance (key assets). Nevertheless, the Group may pledge the aforementioned properties provided that the repayment of the Notes keeps the same level of priority as the pledge on those assets.

21. PROVISION FOR MINE CLOSURE COST

The provision represents the discounted values of the estimated cost to decommission and rehabilitate the mines at the estimated date of depletion of mine deposits. Uncertainties in estimating these costs include potential changes in regulatory requirements, decommissioning, dismantling, reclamation alternatives, timing, and the discount, foreign exchange and inflation rates applied.

During the year, the Group refined its estimation of costs by further analysing the currency in which costs will be incurred. The Group has performed separate calculations of the provision by currency, discounting at corresponding rates. As at 31 December 2017, the discount rates used in the calculation of the parts of the provision that relate to Mexican pesos range from 6.27% to 7.97% (2016: range of 6.61% to 7.74%). The range for the current year parts that relate to US dollars range from 1.37% to 2.22% (2016: not applicable).

Mexican regulations regarding the decommissioning and rehabilitation of mines are limited and less developed in comparison to regulations in many other jurisdictions. It is the Group's intention to rehabilitate the mines beyond the requirements of Mexican law, and estimated costs reflect this level of expense. The Group intends to fully rehabilitate the affected areas at the end of the life of the mines.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

21. PROVISION FOR MINE CLOSURE COST CONTINUED

The provision is expected to become payable at the end of the production life of each mine, based on the reserves and resources, which ranges from three to 27 years from 31 December 2017 (three to 27 years from 31 December 2016).

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Opening balance	149,109	195,476
Increase/(Decrease) to existing provision	1,024	(21,745)
Effect of change in estimation	19,678	–
Effect of changes in discount rate	(281)	(13,570)
Unwinding of discount	11,729	10,476
Payments	(131)	(472)
Foreign exchange	3,647	(21,056)
Closing balance	184,775	149,109

22. PENSIONS AND OTHER POST-EMPLOYMENT BENEFIT PLANS

The Group has a defined contribution plan and a defined benefit plan.

The defined contribution plan was established as from 1 July 2007 and consists of periodic contributions made by each non-unionised worker and contributions made by the Group to the fund matching workers' contributions, capped at 8% of the employee's annual salary.

The defined benefit plan provides pension benefits based on each worker's earnings and years of services provided by personnel hired through 30 June 2007 as well as statutory seniority premiums for both unionised and non-unionised workers.

The overall investment policy and strategy for the Group's defined benefit plan is guided by the objective of achieving an investment return which, together with contributions, ensures that there will be sufficient assets to pay pension benefits and statutory seniority premiums for non-unionised workers as they fall due while also mitigating the various risks of the plan. However, the portion of the plan related to statutory seniority premiums for unionised workers is not funded. The investment strategies for the plan are generally managed under local laws and regulations. The actual asset allocation is determined by current and expected economic and market conditions and in consideration of specific asset class risk in the risk profile. Within this framework, the Group ensures that the trustees consider how the asset investment strategy correlates with the maturity profile of the plan liabilities and the respective potential impact on the funded status of the plan, including potential short-term liquidity requirements.

Death and disability benefits are covered through insurance policies.

The following tables provide information relating to changes in the defined benefit obligation and the fair value of plan assets:

	Pension cost charge to income statement					Remeasurement gains/(losses) in OCI									Balance at 31 December 2017
	Balance at 1 January 2017	Service cost	Net Interest	Foreign exchange	Sub-total recognised in the year	Benefits paid	Return on plan assets (excluding amounts included in net interest)	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Experience adjustments	Foreign exchange	Sub-total included in OCI	Contributions by employer	Defined benefit increase due to personnel transfer	
	US\$ thousands														
Defined benefit obligation	(25,377)	(956)	(1,729)	(1,146)	(3,831)	883	–	–	515	498	–	1,013	–	(15)	(27,327)
Fair value of plan assets	16,282	–	1,031	731	1,762	(413)	(80)	–	–	–	–	(80)	422	137	18,110
Net benefit liability	(9,095)	(956)	(698)	(415)	(2,069)	470	(80)	–	515	498	–	933	422	122	(9,217)

	Pension cost charge to income statement					Remeasurement gains/(losses) in OCI									Balance at 31 December 2016
	Balance at 1 January 2016	Service cost	Net Interest	Foreign exchange	Sub-total recognised in the year	Benefits paid	Return on plan assets (excluding amounts included in net interest)	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Experience adjustments	Foreign exchange	Sub-total included in OCI	Contributions by employer	Defined benefit increase due to personnel transfer	
	US\$ thousands														
Defined benefit obligation	(32,165)	(649)	(1,803)	5,573	3,121	816	–	(744)	2,636	1,103	–	2,995	–	(144)	(25,377)
Fair value of plan assets	17,631	–	927	(3,003)	(2,076)	(432)	(552)	–	–	–	–	(552)	1,570	141	16,282
Net benefit liability	(14,534)	(649)	(876)	2,570	1,045	384	(552)	(744)	2,636	1,103	–	2,443	1,570	(3)	(9,095)

Of the total defined benefit obligation, US\$7.5 million (2016: US\$6.7 million) relates to statutory seniority premiums for unionised workers which are not funded. The expected contributions to the plan for the next annual reporting period are US\$nil.

The principal assumptions used in determining pension and other post-employment benefit obligations for the Group's plans are shown below:

	As at 31 December	
	2017 %	2016 %
Discount rate	7.67	7.52
Future salary increases (NCPI)	5.0	5.0

The life expectancy of current and future pensioners, men and women aged 65 and older will live on average for a further 23.1 and 26.3 years respectively (2016: 22.3 years for men and 25.5 for women). The weighted average duration of the defined benefit obligation is 11 years (2016: 12.1 years).

The fair values of the plan assets were as follows:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Government debt	556	746
State-owned companies	4,559	3,914
Mutual funds (fixed rates)	12,995	11,622
	18,110	16,282

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

22. PENSIONS AND OTHER POST-EMPLOYMENT BENEFIT PLANS CONTINUED

The pension plan has not invested in any of the Group's own financial instruments nor in properties or assets used by the Group.

A quantitative sensitivity analysis for significant assumptions as at 31 December 2017 is as shown below:

Assumptions	Discount rate		Future salary increases (NCPI)		Life expectancy of pensioners
	0.5% increase	0.5% decrease	0.5% increase	0.5% decrease	+ 1 Increase
Sensitivity level					
(Decrease)/Increase to the net defined benefit obligation (US\$ thousands)	(1,381)	1,516	164	(158)	440

The sensitivity analysis above has been determined based on a method that extrapolates the impact on net defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period. The pension plan is not sensitive to future changes in salaries other than in respect of inflation.

23. TRADE AND OTHER PAYABLES

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Trade payables	93,664	68,216
Other payables to related parties (note 27)	9,057	3,173
Accrued expenses	18,600	16,797
Other taxes and contributions	13,628	33,447
	134,949	121,633

Trade payables are mainly for the acquisition of materials, supplies and contractor services. These payables do not accrue interest and no guarantees have been granted. The fair value of trade and other payables approximate their book values.

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 31.

24. COMMITMENTS

A summary of capital expenditure commitments by operating mine is as follows:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Saucito	64,511	32,933
Herradura	28,813	29,544
Noche Buena	1,643	3,677
Ciénega	16,688	6,454
Fresnillo	19,570	12,079
San Julián	27,403	39,895
Other ¹	83,729	20,133
	242,357	144,715

¹ Other includes commitments of Minera Bermejal, S. de R.L. de C.V. and Minera Juanicipio, S.A. de C.V. (2016: Minera Bermejal, S. de R.L. de C.V. and Minera Juanicipio, S.A. de C.V.).

25. OPERATING LEASES**(A) OPERATING LEASES AS LESSOR**

Future minimum rentals receivable under non-cancellable operating leases are as follows:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Within one year	491	1,095
After one year but not more than five years	108	1,875
	599	2,970

(B) OPERATING LEASES AS LESSEE

The Group has financial commitments in respect of non-cancellable operating leases for land, offices and equipment. These leases have renewal terms at the option of the lessee with future lease payments based on market prices at the time of renewal. There are no restrictions placed upon the Group by entering into these leases.

The Group has put in place several arrangements to finance mine equipment through loans and the sale of mine equipment to contractors. In both cases, contractors are obligated to use these assets in rendering services to the Group as part of the mining work contract, during the term of financing or credit, which ranges from two to six years. The Group considers that the related mining work contracts contain embedded operating leases.

The future minimum rental commitments under these leases are as follows:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Within one year	3,424	6,790
After one year but not more than five years	1,538	3,399
	4,962	10,189

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Minimum lease payments expensed in the year	4,916	4,142

26. CONTINGENCIES

As of 31 December 2017, the Group has the following contingencies:

- The Group is subject to various laws and regulations which, if not observed, could give rise to penalties.
- Tax periods remain open to review by the Mexican tax authorities (SAT, by its Spanish acronym) in respect of income taxes for five years following the date of the filing of corporate income tax returns, during which time the authorities have the right to raise additional tax assessments including penalties and interest. Under certain circumstances, the reviews may cover longer periods.

As such, there is a risk that transactions, and in particular related party transactions, that have not been challenged in the past by the authorities, may be challenged by them in the future.

- There are currently a number of ongoing tax inspections that have been initiated by the SAT. No findings or claims have been communicated to the Company in respect of these, other than relating to Penmont as discussed below. It is not practical to determine the amount of any potential claims or the likelihood of any unfavourable outcome arising from these or any future inspections that may be initiated. However, management believes that its interpretation of the relevant legislation is appropriate and that the Group has complied with all regulations and paid or accrued all taxes and withholdings that are applicable.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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26. CONTINGENCIES CONTINUED

- With regards to Penmont tax audits, which commenced during 2015, the Company considers it completed the provision of all documentation required in order to demonstrate that all the 2012-2013 non-taxable income and tax deductions which are being challenged, are appropriate. Penmont formally filed a writ before the Mexican Taxpayers Ombudsman (PRODECON, per its Spanish acronym) requesting a conclusive agreement in the matter. SAT's first, second and third response to the request detailed that, while the documentation provided was sufficient to demonstrate that all of non-taxable income and the majority of the tax deductions are correct, there are still two tax deductions to be approved. In this sense, discussion with the SAT continue, and as long as the conclusive agreement is still in progress, the current auditing process is suspended and the tax authorities cannot determine a tax deficiency until PRODECON issues the final agreement under the terms agreed between Penmont and the SAT.
- On 8 May 2008, the Company and Peñoles entered into the Separation Agreement (the 'Separation Agreement'). This agreement relates to the separation of the Group and the Peñoles Group and governs certain aspects of the relationship between the Fresnillo Group and the Peñoles Group following the initial public offering in May 2008 ('Admission'). The Separation Agreement provides for cross-indemnities between the Company and Peñoles so that, in the case of Peñoles, it is held harmless against losses, claims and liabilities (including tax liabilities) properly attributable to the precious metals business of the Group and, in the case of the Company, it is held harmless by Peñoles against losses, claims and liabilities which are not properly attributable to the precious metals business. Save for any liability arising in connection with tax, the aggregate liability of either party under the indemnities shall not exceed US\$250 million in aggregate.
- Peñoles has agreed to indemnify the Fresnillo Group in relation to: (i) any tax charge, subject to certain exceptions, the Company may incur as a result of the Pre-IPO Reorganisation (including as a result of a transaction following Admission of a member of the Fresnillo Group, provided that Peñoles has confirmed that the proposed transaction will not give rise to a tax charge, or as a result of a transaction of a member of the Peñoles Group on or after Admission), the Global Offer or Admission; and (ii) certain tax aspects of certain other pre-Admission transactions. Peñoles' liability under these indemnities and in respect of general tax liabilities arising pre-Admission which are not properly attributable to the precious metals business of the Fresnillo Group shall not exceed US\$500 million. If a member of the Fresnillo Group forming part of Peñoles' tax consolidation pays an intra-Group dividend in excess of its net income tax account ('Cuenta de Utilidad Fiscal Neta' or 'CUFIN') account after Admission and is relieved of tax as a result of the consolidation, it is required to pay Peñoles an amount in respect of that tax.
- On 30 November 2012, the Mexican government enacted a new federal labour law. During 2014 management implemented certain actions as a part of an ongoing process in order to manage the exposure resulting from the issuance of the new labour law including any potential impacts on the operations and financial position of the Group, however, management does not expect any potential contingency or significant effect on the Group's financial statements as at 31 December 2017 and going forward.
- New income tax and VAT legislation in respect of contractors came into effect on 1 January 2017, requiring management to ensure that contractors are compliant with their own tax obligations, including employment tax. This has created a new obligation for Fresnillo to obtain and retain sufficient evidence of contractors' fiscal compliance in order to deduct costs related to the contractors for income tax purposes and to recover input VAT. In late 2017, the 2018 Federal Revenue Law clarified that if the online portal (established by the tax authorities to facilitate compliance) is used in 2018, it would be sufficient to discharge any 2017 compliance obligations. Management considers that it is well progressed in meeting its obligations for 2017 and does not consider that any significant economic exposure will arise as a result of this new legislation with respect to the current year.
- In regard to the ejido El Bajío matter previously reported by the Company:
 - In 2009 five members of the El Bajío agrarian community in the state of Sonora, who claimed rights over certain surface land in the proximity of the operations of Minera Penmont ('Penmont'), submitted a legal claim before the Unitarian Agrarian Court (Tribunal Unitario Agrario) of Hermosillo, Sonora, to have Penmont vacate an area of this surface land. The land in dispute encompassed a portion of surface area where part of the operations of the Soledad-Dipolos mine are located. The litigation resulted in a definitive court order, pursuant to which Penmont was ordered to vacate 1,824 hectares of land. The disputed land was returned in July 2013, resulting in the suspension of operations at Soledad-Dipolos.
 - The Agrarian Court noted in that same year that certain remediation activities were necessary to comply with the relevant regulatory requirements and requested the guidance of the Federal Environmental Agency (SEMARNAT) in this respect. The Agrarian Court further issued a procedural order in execution of his ruling determining, amongst other aspects, that Penmont must remediate the lands to the state they were in before Penmont's occupation.
 - In the opinion of the Company, this procedural order was excessive since this level of remediation was not part of the original agrarian ruling and also because the procedural order appeared not to consider the fact that Penmont conducted its activities pursuant to valid mining concessions and environmental impact permits. In December 2016, the Agrarian Court issued a subsequent procedural order in which the Court recognised that Penmont complied with the agrarian ruling by having returned the land in dispute and, furthermore, that remediation activities are to be conducted in accordance with Federal environmental guidelines and regulations, as supervised by the competent Federal authorities. Remediation activities in this respect are pending as the agrarian members have not yet permitted Penmont physical access to the lands. Penmont has already presented a conceptual mine closure and remediation plan before the Agrarian Court in respect of the approximately 300 hectares where Penmont conducted mining activities. The agrarian community Ejido El Bajío appealed this procedural order from the Agrarian Court and a Federal District Court denied this appeal. The agrarian community has presented in the month of August 2017 a further and last recourse against this ruling by the Federal District Court and the final result is pending.

- In addition, and as also previously reported by the Company, claimants in the El Bajío matter presented other claims against occupation agreements they entered into with Penmont, covering land parcels separate from the land described above. Penmont has no significant mining operations or specific geological interest in the affected parcels and these lands are therefore not considered strategic for Penmont. As previously reported, the Agrarian Court issued rulings declaring such occupation agreements over those land parcels to be null and void and that Penmont must remediate such lands to the state that they were in before Penmont's occupation as well as returning any minerals extracted from this area. Given that Penmont has not conducted significant mining operations or has specific geological interest in these land parcels, any contingency relating to such land parcels is not considered material by the Company. The case relating to the claims over these land parcels remains subject to finalisation.
- Various claims and counterclaims have been made between the relevant parties in the El Bajío matter. There remains significant uncertainty as to the finalisation and ultimate outcome of these legal proceedings.

27. RELATED PARTY BALANCES AND TRANSACTIONS

The Group had the following related party transactions during the years ended 31 December 2017 and 2016 and balances as at 31 December 2017 and 2016.

Related parties are those entities owned or controlled by the ultimate controlling party, as well as those who have a minority participation in Group companies and key management personnel of the Group.

(A) RELATED PARTY BALANCES

	Accounts receivable		Accounts payable	
	As at 31 December		As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands	2017 US\$ thousands	2016 US\$ thousands
Trade:				
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	225,741	189,584	397	301
Other:				
Industrias Peñoles, S.A.B. de C.V.	4,925	5,974	-	-
Servicios Administrativos Peñoles, S.A. de C.V.	-	-	2,434	1,612
Servicios Especializados Peñoles, S.A. de C.V.	-	-	1,786	36
Termoeléctrica Peñoles, S. de R.L. de C.V.	-	-	1,650	908
Eólica de Coahuila S.A. de C.V.	-	-	1,926	-
Other	392	34	864	316
Sub-total	231,058	195,592	9,057	3,173
Less-current portion	231,058	195,592	9,057	3,173
Non-current portion	-	-	-	-

Related party accounts receivable and payable will be settled in cash.

Other balances with related parties:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
<i>Silverstream contract:</i>		
Industrias Peñoles, S.A.B. de C.V.	538,887	467,529

The Silverstream contract can be settled in either silver or cash. Details of the Silverstream contract are provided in note 14.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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27. RELATED PARTY BALANCES AND TRANSACTIONS CONTINUED

(B) PRINCIPAL TRANSACTIONS WITH AFFILIATES, INCLUDING INDUSTRIAS PEÑOLES S.A.B DE C.V., THE COMPANY'S PARENT, ARE AS FOLLOWS:

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Income:		
<i>Sales:</i> ¹		
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	2,101,579	1,905,503
<i>Other income</i>	3,173	2,381
Total income	2,104,752	1,907,884

1 Figures do not include hedging gains as the derivative transactions are not undertaken with related parties. Figures are net of the adjustment for treatment and refining charges of US\$139.9 million (2016: US\$141.1 million) and include sales credited to development projects of US\$8.3 million (2016: US\$1.6 million).

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Expenses:		
<i>Administrative services</i> ² :		
Servicios Administrativos Peñoles, S.A. de C.V. ³	26,323	24,309
Servicios Especializados Peñoles, S.A. de C.V.	18,239	16,015
	44,562	40,324
<i>Energy:</i>		
Termoelectrica Peñoles, S. de R.L. de C.V.	20,415	16,011
Fuerza Eólica del Istmo S.A. de C.V.	1,678	1,794
Eólica de Coahuila S.A. de C.V.	13,666	–
	35,759	17,805
<i>Operating materials and spare parts:</i>		
Wideco Inc	4,534	5,254
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	6,420	3,140
	10,954	8,394
<i>Equipment repair and administrative services:</i>		
Serviminas, S.A. de C.V.	8,406	8,268
<i>Insurance premiums:</i>		
Grupo Nacional Provincial, S.A. B. de C.V.	8,157	7,155
<i>Other expenses:</i>	3,795	2,085
Total expenses	111,633	84,031

2 Includes US\$6.4 million (2016: US\$4.7 million) corresponding to expenses reimbursed.

3 Includes US\$7.5 million (2016: US\$9.5 million) relating to engineering costs that were capitalised.

(C) COMPENSATION OF KEY MANAGEMENT PERSONNEL OF THE GROUP

Key management personnel include the members of the Board of Directors and the Executive Committee who receive remuneration.

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Salaries and bonuses	2,689	2,416
Post-employment benefits	235	208
Other benefits	373	345
Total compensation paid in respect of key management personnel	3,297	2,969

	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Accumulated accrued defined pension entitlement	4,433	4,237

This compensation includes amounts paid to Directors disclosed in the Directors' Remuneration Report.

The accumulated accrued defined pension entitlement represents benefits accrued at the time the benefits were frozen. There are no further benefits accruing under the defined benefit scheme in respect of current services.

28. AUDITOR'S REMUNERATION

Fees due by the Group to its auditor during the year ended 31 December 2017 and 2016 are as follows:

Class of services	Year ended 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Fees payable to the Group's auditor for the audit of the Group's annual accounts	1,187	1,149
Fees payable to the Group's auditor and its associates for other services as follows:		
The audit of the Company's subsidiaries pursuant to legislation	226	222
Audit-related assurance services	308	350
Tax compliance services	19	21
Other non-audit services	27	–
Total	1,767	1,742

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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29. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2017 US\$ thousands	2016 US\$ thousands
Reconciliation of profit for the year to net cash generated from operating activities			
Profit for the year		560,807	424,962
Adjustments to reconcile profit for the period to net cash inflows from operating activities:			
Depreciation and amortisation	5	367,609	346,502
Employee profit sharing	7	17,150	15,145
Deferred income tax	10	(3,101)	102,549
Current income tax expense	10	183,783	190,729
(Gain)/Loss on the sale of property, plant and equipment and other assets	8	(25,333)	1,103
Other losses		–	981
Write-off of property, plant and equipment		–	3,005
Impairment of available-for-sale financial assets	8	36	–
Net finance costs		33,674	33,019
Foreign exchange loss/(gain)		11,434	(539)
Difference between pension contributions paid and amounts recognised in the income statement		(58)	(944)
Non-cash movement on derivatives		41,389	40,345
Changes in fair value of Silverstream	14	(113,656)	(133,528)
Working capital adjustments			
(Increase) in trade and other receivables		(44,381)	(39,526)
(Increase)/Decrease in prepayments and other assets		(708)	113
Decrease in inventories		5,745	23,725
Increase in trade and other payables		36,426	5,133
Cash generated from operations		1,070,816	1,012,774
Income tax paid		(292,063)	(102,255)
Employee profit sharing paid		(17,282)	(12,561)
Net cash from operating activities		761,471	897,958

30. FINANCIAL INSTRUMENTS

(A) FAIR VALUE CATEGORY

As at 31 December 2017				
US\$ thousands				
Financial assets:	At fair value through profit or loss	Available-for-sale investments at fair value through OCI	Loans and receivables	At fair value through OCI (cash flow hedges)
Trade and other receivables ¹ (note 16)	–	–	236,859	–
Available-for-sale financial assets (note 13)	–	144,856	–	–
Silverstream contract (note 14)	538,887	–	–	–
Embedded derivatives within sales contracts ¹ (note 4)	6,511	–	–	–
Derivative financial instruments (note 30(c))	311	–	–	71
Financial liabilities:	At fair value through profit or loss	At amortised cost	At fair value through OCI (cash flow hedges)	
Interest-bearing loans (note 20)	–	799,046	–	
Trade and other payables (note 23)	–	102,721	–	
Derivative financial instruments (note 30(c))	37	–	19,179	

1 Trade and other receivables and embedded derivative within sales contracts are presented net in trade and other receivables in the balance sheet.

As at 31 December 2016				
US\$ thousands				
	At fair value through profit or loss	Available-for-sale investments at fair value through OCI	Loans and receivables	At fair value through OCI (cash flow hedges)
Financial assets:				
Trade and other receivables ¹ (note 16)	–	–	213,750	–
Available-for-sale financial assets (note 13)	–	116,171	–	–
Silverstream contract (note 14)	467,529	–	–	–
Derivative financial instruments (note 30(c))	145	–	–	23,005
Financial liabilities:				
	At fair value through profit or loss	At amortised cost	At fair value through OCI (cash flow hedges)	
Interest-bearing loans (note 20)	–	798,027	–	
Trade and other payables (note 23)	–	70,442	–	
Embedded derivatives within sales contracts ¹ (note 4)	–	2,750	–	
Derivative financial instruments (note 30(c))	–	–	646	

1 Trade and other receivables and embedded derivative within sales contracts are presented net in trade and other receivables in the balance sheet.

(B) FAIR VALUE MEASUREMENT

The fair value of financial assets and liabilities, together with the carrying amounts shown in the balance sheet are as follows:

		As at 31 December			
		Carrying amount		Fair value	
	2017 US\$ thousands	2016 US\$ thousands	2017 US\$ thousands	2016 US\$ thousands	
Financial assets:					
Available-for-sale financial assets	144,856	116,171	144,856	116,171	
Silverstream contract (note 14)	538,887	467,529	538,887	467,529	
Embedded derivatives within sales contracts	6,511	–	6,511	–	
Derivative financial instruments	382	23,150	382	23,150	
Financial liabilities:					
Interest-bearing loans ² (note 20)	799,046	798,027	878,864	840,904	
Embedded derivatives within sales contracts	–	2,750	–	2,750	
Derivative financial instruments	19,216	646	19,216	646	

2 Interest-bearing loans are categorised in Level 1 of the fair value hierarchy.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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30. FINANCIAL INSTRUMENTS CONTINUED

(B) FAIR VALUE MEASUREMENT CONTINUED

The financial assets and liabilities measured at fair value are categorised into the fair value hierarchy as at 31 December as follows:

As of 31 December 2017				
Fair value measure using				
	Quoted prices in active markets Level 1 US\$ thousands	Significant observable Level 2 US\$ thousands	Significant unobservable Level 3 US\$ thousands	Total US\$ thousands
Financial assets:				
Derivative financial instruments:				
Embedded derivatives within sales contracts	-	-	6,511	6,511
Options commodity contracts	-	71	-	71
Options and forward foreign exchange contracts	-	311	-	311
Silverstream contract	-	-	538,887	538,887
	-	382	538,887	539,269
Financial investments available-for-sale:				
Quoted investments	144,856	-	-	144,856
	144,856	382	-	145,238
Financial liabilities:				
Derivative financial instruments:				
Options commodity contracts	-	19,179	-	19,179
Options and forward foreign exchange contracts	-	37	-	37
	-	19,216	6,511	25,727
As of 31 December 2016				
Fair value measure using				
	Quoted prices in active markets Level 1 US\$ thousands	Significant observable Level 2 US\$ thousands	Significant unobservable Level 3 US\$ thousands	Total US\$ thousands
Financial assets:				
Derivative financial instruments:				
Options commodity contracts	-	23,005	-	23,005
Option and forward foreign exchange contracts	-	145	-	145
Silverstream contract	-	-	467,529	467,529
	-	23,150	467,529	490,679
Financial investments available-for-sale:				
Quoted investments	116,171	-	-	116,171
	116,171	23,150	467,529	606,850
Financial liabilities:				
Derivative financial instruments:				
Embedded derivatives within sales contracts	-	-	2,750	2,750
Options commodity contracts	-	66	-	66
Options and forward foreign exchange contracts	-	580	-	580
	-	646	2,750	3,396

There have been no significant transfers between Level 1 and Level 2 of the fair value hierarchy, and no transfers into and out of Level 3 fair value measurements. A reconciliation of the opening balance to the closing balance for Level 3 financial instruments other than Silverstream (which is disclosed in note 14) is shown below:

	2017 US\$ thousands	2016 US\$ thousands
Balance at 1 January:	(2,750)	(532)
Changes in fair value	15,068	(1,718)
Realised embedded derivatives during the year	(5,807)	(500)
Balance at 31 December	6,511	(2,750)

The fair value of the financial assets and liabilities is included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The following valuation techniques were used to estimate the fair values:

OPTION AND FORWARD FOREIGN EXCHANGE CONTRACTS

The Group enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The foreign currency forward (Level 2) contracts are measured based on observable spot exchange rates, the yield curves of the respective currencies as well as the currency basis spreads between the respective currencies. The foreign currency option contracts are valued using the Black Scholes model, the significant inputs to which include observable spot exchange rates, interest rates and the volatility of the currency.

OPTION COMMODITY CONTRACTS

The Group enters into derivative financial instruments with various counterparties, principally financial institutions with investment grade credit ratings. The option commodity (Level 2) contracts are measured based on observable spot commodity prices, the yield curves of the respective commodity as well as the commodity basis spreads between the respective commodities. The option contracts are valued using the Black Scholes model, the significant inputs to which include observable spot commodities price, interest rates and the volatility of the commodity.

SILVERSTREAM CONTRACT

The fair value of the Silverstream contract is determined using a valuation model including unobservable inputs (Level 3). This derivative has a term of over 20 years and the valuation model utilises a number of inputs that are not based on observable market data due to the nature of these inputs and/or the duration of the contract. Inputs that have a significant effect on the recorded fair value are the volume of silver that will be produced and sold from the Sabinas mine over the contract life, the future price of silver, future foreign exchange rates between the Mexican peso and US dollar, future inflation and the discount rate used to discount future cash flows.

The estimate of the volume of silver that will be produced and sold from the Sabinas mine requires estimates of the recoverable silver reserves and resources, the related production profile based on the Sabinas mine plan and the expected recovery of silver from ore mined. The estimation of these inputs is subject to a range of operating assumptions and may change over time. Estimates of reserves and resources are updated annually by Peñoles, the operator and sole interest holder in the Sabinas mine and provided to the Company. The production profile and estimated payable silver that will be recovered from ore mined is based on the latest plan and estimates, also provided to the Company by Peñoles. The inputs assume no interruption in production over the life of the Silverstream contract and production levels which are consistent with those achieved in recent years

Management regularly assesses a range of reasonably possible alternatives for those significant unobservable inputs described above, and determines their impact on the total fair value. The significant unobservable inputs are not interrelated. The fair value of the Silverstream is not significantly sensitive to a reasonable change in future exchange rates, however, it is to a reasonable change in future silver price, future inflation and the discount rate used to discount future cash flows.

For further information relating to the Silverstream contract see note 14. The sensitivity of the valuation to the inputs relating to market risks, being the price of silver, foreign exchange rates, inflation and the discount rate is disclosed in note 31.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

30. FINANCIAL INSTRUMENTS CONTINUED

(B) FAIR VALUE MEASUREMENT CONTINUED

QUOTED INVESTMENTS:

The fair value of available-for-sale financial assets is derived from quoted market prices in active markets. (Level 1)

INTEREST-BEARING LOANS

The fair value of the Group's interest-bearing loan, is derived from quoted market prices in active markets. (Level 1)

EMBEDDED DERIVATIVES WITHIN SALES CONTRACTS:

Sales of concentrates, precipitates and doré bars are 'provisionally priced' and revenue is initially recognised using this provisional price and the Group's best estimate of the contained metal. Revenue is subject to final price and metal content adjustments subsequent to the date of delivery (see note 2(p)). This price exposure is considered to be an embedded derivative and is separated from the sales contract.

At each reporting date, the provisionally priced metal content is revalued based on the forward selling price for the quotational period stipulated in the relevant sales contract. The selling price of metals can be reliably measured as these metals are actively traded on international exchanges but the estimated metal content is a non-observable input to this valuation (Level 3).

At 31 December 2017 the fair value of embedded derivatives within sales contracts was US\$6.5 million (2016: US\$(2.7) million). The revaluation effects of embedded derivatives arising from these sales contracts are recorded as an adjustment to revenues.

(C) DERIVATIVE FINANCIAL INSTRUMENTS

The Group enters into certain forward and option contracts in order to manage its exposure to foreign exchange risk associated with costs incurred in Mexican pesos and other currencies. The Group also enters into option contracts to manage its exposure to commodity price risk as described in note 2(s).

The following tables summarise the fair value of derivative financial instruments held as of 31 December 2017 and 2016.

Financial assets	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Currency contracts		
Forward contracts:		
Euro	193	145
Swedish krona	104	–
Canadian dollar	14	–
Commodity contracts		
Option contracts ¹ :		
Gold	–	23,005
Lead	71	–
Total derivative related assets	382	23,150
Less-current portion	382	6,618
Non-current portion²	–	16,532

1 Option contracts operate as zero cost collars.

2 Non-current portion corresponds to Gold option contracts that mature in a period over one year from the reporting date until 30 December 2019.

Financial liabilities	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Currency contracts		
Forward contracts:		
Euro	12	570
Canadian dollar	-	10
Swedish krona	25	-
Commodity contracts		
Option contracts ¹ :		
Gold	18,096	16
Lead	-	2
Zinc	1,083	48
Total derivative related liabilities	19,216	646
Less-current portion	4,992	630
Non-current portion²	14,224	16

1 Option contracts operate as zero cost collars.

2 Non-current portion corresponds to Gold option contracts that mature in a period over one year from the reporting date until 30 December 2019.

The following table summarises the movements in deferred gains or losses on foreign exchange and price commodity derivative instruments qualifying for hedge accounting, net of tax effects, recorded in other comprehensive income for the year:

	As at 31 December	
	2017 US\$ thousands	2016 US\$ thousands
Beginning balance	-	36,214
Gains recycled to revenue during the year	-	(1,586)
Losses recycled to cost of sales during the year	-	2,770
Unrealised losses before tax arising during the year	-	(52,918)
Deferred tax effect recorded in other comprehensive income during the year	-	15,520
Ending balance	-	-

During the year ended 31 December 2017 all the contracted hedging position were out of the money and therefore all the mark-to-market valuation has been taken to income within financial income/(expense).

31. FINANCIAL RISK MANAGEMENT

OVERVIEW

The Group's principal financial assets and liabilities, other than derivatives, comprise trade receivables, cash, available-for-sale financial assets, interest-bearing loans and trade payables.

The Group has exposure to the following risks from its use of financial instruments:

- Market risk, including foreign currency, commodity price, interest rate, inflation rate and equity price risks;
- Credit risk; and
- Liquidity risk.

This note presents information about the Group's exposure to each of the above risks and the Group's objectives, policies and processes for assessing and managing risk. Further quantitative disclosures are included throughout the financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Fresnillo Audit Committee has responsibility for overseeing how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Audit Committee is assisted in its oversight role by Internal Audit, which undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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31. FINANCIAL RISK MANAGEMENT CONTINUED

OVERVIEW CONTINUED

(A) MARKET RISK

Market risk is the risk that changes in market factors, such as foreign exchange rates, commodity prices or interest rates will affect the Group's income or the value of its financial instruments.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

In the following tables, the effect on equity excludes the changes in retained earnings as a direct result of changes in profit before tax.

FOREIGN CURRENCY RISK

The Group has financial instruments that are denominated in Mexican peso, euro and Swedish krona which are exposed to foreign currency risk. Transactions in currencies other than the US dollar include the purchase of services, fixed assets, spare parts and the payment of dividends. As a result, the Group has financial assets and liabilities denominated in currencies other than functional currency, and holds cash and cash equivalents in Mexican peso.

In order to manage the Group's exposure to foreign currency risk on expenditure denominated in currencies other than the US dollar, the Group has entered into certain forward and option derivative contracts with maturity dates from 2018 (see note 30 for additional detail).

The following table demonstrates the sensitivity of financial assets and financial liabilities (excluding Silverstream) to a reasonably possible change in the US dollar exchange rate compared to the Mexican peso, reflecting the impact on the Group's profit before tax and equity, with all other variables held constant. It is assumed that the same percentage change in exchange rates is applied to all applicable periods for the purposes of calculating the sensitivity with relation to derivative financial instruments.

Year ended 31 December	Strengthening/ (Weakening) of US dollar	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	20% (10%)	– –
2016	15% (10%)	78 (67)

The following table demonstrates the sensitivity of financial assets and financial liabilities to a reasonably possible change in the US dollar exchange rate compared to the Swedish krona on the Group's profit before tax and equity, with all other variables held constant. It is assumed that the same percentage change in exchange rates is applied to all applicable periods.

Year ended 31 December	Strengthening/ (Weakening) of US dollar	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	10% (10%)	(3,783) 1,365
2016	10% (10%)	(63) 94

The following table demonstrates the sensitivity of financial assets and financial liabilities (excluding Silverstream) to a reasonably possible change in the US dollar exchange rate compared to the euro on the Group's profit before tax and equity, with all other variables held constant. It is assumed that the same percentage change in exchange rates is applied to all applicable periods.

Year ended 31 December	Strengthening/ (Weakening) of US dollar	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	10% (10%)	1,058 (1,056)
2016	5% (10%)	459 (1,024)

FOREIGN CURRENCY RISK – SILVERSTREAM

Future foreign exchange rates are one of the inputs to the Silverstream valuation model. The following table demonstrates the sensitivity of the Silverstream contract valuation to a reasonably possible change in the Mexican peso as compared to the US dollar, with all other inputs to the Silverstream valuation model held constant. It is assumed that the same percentage change in exchange rates is applied to all applicable periods in the valuation model.

Year ended 31 December	Strengthening/ (Weakening) of US dollar	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	20% (10%)	(781) 521
2016	15% (10%)	(1,436) 1,223

COMMODITY RISK

The Group has exposure to changes in metals prices (specifically silver, gold, lead and zinc) which have a significant effect on the Group's results. These prices are subject to global economic conditions and industry-related cycles.

The Group uses derivative instruments to hedge against an element of gold, zinc and lead price.

The table below reflects the aggregate sensitivity of financial assets and liabilities (excluding Silverstream) to a reasonably possible change in commodities prices, reflecting the impact on the Group's profit before tax with all other variables held constant.

The sensitivity shown in the table below relates to changes in fair value of commodity derivatives financial instruments contracts and embedded derivatives in sales.

Year ended 31 December	Increase/(Decrease) in commodity prices				Effect on profit before tax: increase/ (decrease) US\$ thousands	Effect on equity: increase/ (decrease) US\$ thousands
	Gold	Silver	Zinc	Lead		
2017	10% (10%)	10% (10%)	20% (20%)	15% (15%)	83,433 5,105	(19,164) 1,818
2016	10% (15%)	25% (20%)	40% (30%)	40% (15%)	(28,516) (36,031)	– 120,715

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CONTINUED

31. FINANCIAL RISK MANAGEMENT CONTINUED

OVERVIEW CONTINUED

COMMODITY PRICE RISK – SILVERSTREAM

Future silver price is one of the inputs to the Silverstream valuation model. The following table demonstrates the sensitivity of the Silverstream contract valuation to a reasonably possible change in future silver prices, with all other inputs to the Silverstream valuation model held constant. It is assumed that the same percentage change in silver price is applied to all applicable periods in the valuation model. There is no impact on the Group's equity, other than the equivalent change in retained earnings.

Year ended 31 December	Increase/ (Decrease) in silver price	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	10% (10%)	72,779 (72,779)
2016	25% (20%)	157,406 (125,925)

INTEREST RATE RISK

The Group is exposed to interest rate risk from the possibility that changes in interest rates will affect future cash flows or the fair values of its financial instruments, principally relating to the cash balances and the Silverstream contract held at the balance sheet date. Interest-bearing loans are at a fixed rate, therefore the possibility of a change in interest rate only impacts its fair value but not its carrying amount. Therefore, interest-bearing loans and loans from related parties are excluded from the table below.

The following table demonstrates the sensitivity of financial assets and financial liabilities (excluding Silverstream) to a reasonably possible change in interest rate applied to a full year from the balance sheet date. There is no impact on the Group's equity other than the equivalent change in retained earnings.

Year ended 31 December	Basis point increase/ (decrease) in interest rate	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	90 (50)	7,898 (4,388)
2016	65 (20)	5,943 (1,829)

The sensitivity shown in the table above primarily relates to the full year of interest on cash balances held as at the year end.

INTEREST RATE RISK – SILVERSTREAM

Future interest rates are one of the inputs to the Silverstream valuation model. The following table demonstrates the sensitivity of the Silverstream contract valuation to a reasonably possible change in interest rates, with all other inputs to the Silverstream valuation model held constant. It is assumed that the same change in interest rate is applied to all applicable periods in the valuation model. There is no impact on the Group's equity, other than the equivalent change in retained earnings.

Year ended 31 December	Basis point increase/ (decrease) in interest rate	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	90 (50)	(58,798) 37,935
2016	65 (20)	(35,908) 12,051

INFLATION RATE RISK

INFLATION RATE RISK – SILVERSTREAM

Future inflation rates are one of the inputs to the Silverstream valuation model. The following table demonstrates the sensitivity of the Silverstream contract to a reasonably possible change in the inflation rate, with all other inputs to the Silverstream valuation model held constant. It is assumed that the same change in inflation is applied to all applicable periods in the valuation model. There is no impact on the Group's equity, other than the equivalent change in retained earnings.

Year ended 31 December	Basis point (increase/ (decrease) in inflation rate	Effect on profit before tax: increase/ (decrease) US\$ thousands
2017	100 (100)	88 (83)
2016	100 (100)	190 (188)

EQUITY PRICE RISK

The Group has exposure to changes in the price of equity instruments that it holds as available-for-sale financial assets.

The following table demonstrates the sensitivity of available-for-sale financial assets to a reasonably possible change in market price of these equity instruments, reflecting the effect on the Group's profit before tax and equity:

Year ended 31 December	Increase/ (Decrease) in equity price	Effect on profit before tax: increase/ (decrease) (US\$ thousands)	Effect on equity: increase/ (decrease) US\$ thousands
2017	40% (65%)	– –	28,972 (65,408)
2016	100% (50%)	– –	116,171 (58,086)

(B) CREDIT RISK

Exposure to credit risk arises as a result of transactions in the Group's ordinary course of business and is applicable to all financial assets and derivative financial instruments. The financial assets are trade and other receivables, cash and cash equivalents, short-term investments, the Silverstream contract and available-for-sale financial assets.

The Group's policies are aimed at minimising losses as a result of counterparties' failure to honour their obligations. Individual exposures are monitored with customers subject to credit limits to ensure that the Group's exposure to bad debts is not significant. The Group's exposure to credit risk is influenced mainly by the individual characteristics of each counter-party. The Group's financial assets are with counterparties with what the Group considers to have an appropriate credit rating. As disclosed in note 27, the counterparties to a significant proportion of these financial assets are related parties. At each balance sheet date, the Group's financial assets were neither impaired nor past due, other than 'Other receivables' as disclosed in note 16. The Group's policies are aimed at minimising losses from foreign currency hedging contracts. The Company's foreign currency hedging contracts are entered into with large financial institutions with strong credit ratings.

The Group has a high concentration of trade receivables with one counterparty Met-Mex Peñoles, the Group's primary customer throughout 2017 and 2016. A further concentration of credit risk arises from the Silverstream contract. Both Met-Mex and the counterparty to the Silverstream contract are subsidiaries in the Peñoles group which currently owns 75% of the shares of the Company and is considered by management to be of appropriate credit rating.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONTINUED

31. FINANCIAL RISK MANAGEMENT CONTINUED

OVERVIEW CONTINUED

(B) CREDIT RISK CONTINUED

The Group's surplus funds are managed by Servicios Administrativos Fresnillo, S.A. de C.V., which manages cash and cash equivalents, including short-term investments investing in a number of financial institutions. Accordingly, on an ongoing basis the Group deposits surplus funds with a range of financial institutions, depending on market conditions. In order to minimise exposure to credit risk, the Group only deposits surplus funds with financial institutions with a credit rating of MX-1 (Moody's) and mA-1+ (Standard and Poor's) and above. As at 31 December 2017, the Group had concentrations of credit risk as 23% of surplus funds were deposited with one financial institution of which 17% was held in short-term Mexican government paper.

The maximum credit exposure at the reporting date of each category of financial asset above is the carrying value as detailed in the relevant notes. See note 13 for the maximum credit exposure to available-for-sale financial assets, note 17 for short-term investments and cash and cash equivalents and note 27 for related party balances with Met-Mex. The maximum credit exposure with relation to the Silverstream contract is the value of the derivative as at 31 December 2017, being US\$538.9 million (2016: US\$467.5 million).

(C) LIQUIDITY RISK

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due.

The Group monitors its risk of a shortage of funds using projected cash flows from operations and by monitoring the maturity of both its financial assets and liabilities.

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments.

	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
As at 31 December 2017					
Interest-bearing loans (note 20)	46,267	92,534	92,534	846,267	1,077,602
Trade and other payables	102,311	–	–	–	102,311
Derivative financial instruments – liabilities	4,992	14,224	–	–	19,216
Embedded derivatives within sales contracts – liability	6,511	–	–	–	6,511
	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
As at 31 December 2016					
Interest-bearing loans (note 20)	46,267	92,534	92,534	892,534	1,123,869
Trade and other payables	71,389	–	–	–	71,389
Derivative financial instruments – liabilities	630	16	–	–	646
Embedded derivatives within sales contracts – liability	2,750	–	–	–	2,750

The payments disclosed for financial derivative instruments in the above table are the gross undiscounted cash flows. However, those amounts may be settled gross or net. The following table shows the corresponding estimated inflows based on the contractual terms:

	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
As at 31 December 2017					
Inflows	15,174	-	-	-	15,174
Outflows	(14,884)	-	-	-	(14,884)
Net	290	-	-	-	290

	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
As at 31 December 2016					
Inflows	10,932	-	-	-	10,932
Outflows	(11,229)	-	-	-	(11,229)
Net	(297)	-	-	-	(297)

The above liquidity tables include expected inflows and outflows from currency option contracts which the Group expects to be exercised during 2018 as at 31 December 2017 and during 2017 as at 31 December 2016, either by the Group or counterparty.

Management considers that the Group has adequate current assets and forecast cash from operations to manage liquidity risks arising from current liabilities and non-current liabilities.

CAPITAL MANAGEMENT

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios that support its business and maximise shareholder value. Management considers capital to consist of equity and certain interest-bearing loans, including loans from related parties, as disclosed in the balance sheet, excluding net unrealised gains or losses on revaluation of cash flow hedges and available-for-sale financial assets. In order to ensure an appropriate return for shareholder's capital invested in the Group management thoroughly evaluates all material projects and potential acquisitions and approves them at its Executive Committee before submission to the Board for ultimate approval, where applicable. The Group's dividend policy is based on the profitability of the business and underlying growth in earnings of the Group, as well as its capital requirements and cash flows, including cash flows from the Silverstream.

In managing its capital, the Group considers its cash and other liquid asset position, as set out below:

	2017 US\$ thousands	2016 US\$ thousands
Cash and cash equivalents (note 17)	876,034	711,954
Short-term investments (note 17)	-	200,000
Available-for-sale financial instruments held in funds (note 13)	19,877	-
Cash and other liquid assets position	895,911	911,954