

## 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 2018 and of the Group's profit for the year then ended;
- the Group 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 2018	Parent Company balance sheet as at 31 December 2018
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 17 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 30 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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC CONTINUED

### 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 28 to 41 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on pages 125 and 126 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 43 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 pages 42 and 43 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"> <li>• Recognition of related party transactions, including revenue recognition.</li> <li>• Valuation of the Silverstream contract.</li> <li>• Recoverable amount of mining assets.</li> <li>• Recoverable amount of investments in subsidiaries (Parent Company only).</li> <li>• Re-estimation of quantities held in leaching pads at Herradura.</li> </ul>
Audit scope	<ul style="list-style-type: none"> <li>• We performed an audit of the complete financial information of 6 components, being the 5 operating mining units and the Parent Company. These components accounted for:               <ul style="list-style-type: none"> <li>– 100% of Revenues;</li> <li>– 92% of Profit before tax, excluding Silverstream revaluation effects and the gain from the part payment of an insurance claim; and,</li> <li>– 81% of Total assets.</li> </ul> </li> <li>• In addition, we performed specified procedures on specific balances at a further 4 components. These components accounted for:               <ul style="list-style-type: none"> <li>– 100% of the Silverstream revaluation effects;</li> <li>– 8% of Profit before tax excluding Silverstream revaluation effects and the gain from the part payment of an insurance claim; and,</li> <li>– 17% of Total assets.</li> </ul> </li> </ul>
Materiality	<ul style="list-style-type: none"> <li>• Overall Group materiality of US\$23.4 million which represents 5% of forecast profit before tax, prior to Silverstream revaluation effects and the gain from the part payment of an insurance claim of an insurance claim.</li> </ul>

### 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.

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\$2,102.7 million; 2017: US\$2,084.0 million), and a significant amount of its expenses incurred (US\$133.2 million; 2017: US\$111.6 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 26 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 6 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"> <li>• We evaluated the appropriateness of management's process for identifying, recording and reporting related party transactions and tested relevant controls.</li> <li>• We read contracts and agreements with related parties to understand the nature of the transactions.</li> <li>• Throughout the performance of our audit procedures, we remained alert for any related party transactions not already identified by management or that are outside the normal course of business.</li> </ul>
Revenue recognition	<ul style="list-style-type: none"> <li>• On a sample basis we performed testing to verify physical deliveries of product in the year.</li> <li>• We performed revenue cut-off testing, by reference to shipment dates.</li> <li>• We evaluated the appropriateness of the accounting for embedded derivatives arising from the provisional pricing terms in sales contracts.</li> <li>• 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 confirmed principal inputs to external benchmarks and confirmations received directly from the auditor of Peñoles.</li> <li>• We performed overall analytical procedures which consisted of comparing actual revenues on a disaggregated basis to detailed expectations developed based on production in the year and market prices for relevant metals and obtained explanations for any material variances.</li> </ul>
Related party expenses	<ul style="list-style-type: none"> <li>• On a sample basis we tested related party expenses against underlying contractual terms.</li> <li>• We utilised data analysis tools to interrogate entire data sets for potential related party transactions.</li> <li>• 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.</li> </ul>
Silverstream contract	<ul style="list-style-type: none"> <li>• We tested a sample of cash receipts in respect of silver that is payable under the contract in the year.</li> <li>• The valuation of the Silverstream contract is discussed separately below.</li> </ul>
Accuracy of disclosures	<ul style="list-style-type: none"> <li>• We verified that related party disclosures in the financial statements are consistent with the results of our audit procedures.</li> </ul>

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC

### CONTINUED

#### KEY AUDIT MATTER

Transfer pricing considerations	<ul style="list-style-type: none"> <li>We, along with our internal transfer pricing specialist, obtained and reviewed the most recent report (for 2017) to management from its transfer pricing specialists.</li> <li>We assessed the specialist as a specialist engaged by management.</li> <li>Our transfer pricing specialist inspected information to support transactions between Fresnillo and Peñoles.</li> </ul>
Management override	<ul style="list-style-type: none"> <li>We performed overall analytical review procedures applying a low variance threshold at a disaggregated level, comparing production quantities against the mine plans. We obtained explanations for variances through interviews with management and the Executive Committee, internal reporting to the Executive Committee and published production reports. Where relevant, we corroborated those explanations through EY's bespoke data analysis tools and external sources of information.</li> <li>We also used EY's data analysis tools to search for terms indicating related parties and prepared 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.</li> </ul>

#### 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 confirmed that the methodology for determining transfer pricing in respect of the transactions with other Peñoles companies has not changed during the year.

#### KEY AUDIT MATTER

##### VALUATION OF THE SILVERSTREAM CONTRACT ■

- The valuation of the Silverstream contract (US\$519.1 million at 31 December 2018; 2017: US\$538.9 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\$15.0 million pre-tax gain in 2018; 2017: US\$133.7 million pre-tax gain).

- 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.

The nature of the Silverstream contract and related valuation considerations are disclosed in note 13 to the consolidated financial statements and the relevant accounting policies in note 2.

#### OUR AUDIT RESPONSE

We performed specified procedures over the valuation of the Silverstream contract at 31 December 2018 and related income statement revaluation effects. These procedures covered 100% of the risk amount.

Valuation model	<ul style="list-style-type: none"> <li>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.</li> </ul>
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**KEY AUDIT MATTER**

Reserves and resources and production profile of the Sabinas mine	<ul style="list-style-type: none"> <li>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.</li> <li>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"> <li>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;</li> <li>testing of certain key Peñoles controls which address the risks associated with the estimation of reserves and resources quantities and the accuracy of the resulting mine plan;</li> <li>gaining an understanding of reasons for changes in estimates of reserves and resources in the year;</li> <li>assessing the professional competence, objectivity, and capabilities of Peñoles' internal specialists involved in the estimation of reserves and resources quantities; and</li> <li>evaluating the reasonableness and appropriateness of inputs to the reserves and resources estimates and Sabinas mine plan as at 31 December 2018.</li> </ul> </li> <li>We discussed the results of the above procedures with the auditor of Peñoles and reviewed key working papers.</li> </ul>
Key economic assumptions in the valuation	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> <li>We performed sensitivity analysis on the combination of silver price assumptions and discount rate.</li> </ul>

**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 concluded that the overall valuation of the contract is within a reasonable range.

**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 (net book value being US\$2,693.1 million, 2017 US\$2,448.6 million). There is no impairment taken in 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 245 to 247, after the Parent Company notes.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC

### CONTINUED

#### KEY AUDIT MATTER

##### OUR AUDIT RESPONSE

We performed full scope audit procedures over this risk area in 5 components, which covered 100% of the risk amount.

Indicators of impairment and methodology used to estimate recoverable values	<ul style="list-style-type: none"> <li>We reviewed management's identification of indicators of impairment under accounting standards.</li> <li>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.</li> <li>We have assessed the valuation models used by management to estimate the recoverable value of each asset.</li> </ul>
Estimation process for reserves and resources	<ul style="list-style-type: none"> <li>We walked through the process of the estimation of the reserves and resources quantities and tested relevant controls.</li> <li>We walked through the process of converting the estimation of the reserves and resources quantities to mine plans and tested relevant controls.</li> </ul>
External specialists engaged by management	<ul style="list-style-type: none"> <li>We assessed SRK as a specialist engaged by management.</li> <li>Through discussions with SRK, we have gained an understanding of the scope of their work to verify that this was appropriate.</li> <li>We engaged our own specialist (geologist) to evaluate the information provided by management's geologist.</li> <li>We read the report of the external specialist and gained an understanding of the changes in reserves and resources estimates in the year.</li> </ul>
Key internal assumptions used in management's estimate of the recoverable values of mining assets	<ul style="list-style-type: none"> <li>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.</li> <li>We assessed operating and capital costs included in the cash flow forecasts for consistency with current operating costs and forecast mine production.</li> </ul>
Key external assumptions used in management's estimate of the recoverable values of mining assets	<ul style="list-style-type: none"> <li>Working with our valuation specialists we 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.</li> <li>We have performed sensitivity analysis on management's calculated recoverable values for alternative assumptions around the discount rate applied.</li> </ul>

#### 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 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 2018.

#### KEY AUDIT MATTER

##### RECOVERABLE AMOUNT OF INVESTMENT IN SUBSIDIARIES (PARENT COMPANY ONLY) ▽

- Investments in subsidiaries (US\$7,141 million, 2017 US\$7,094 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 has increased as a result of performance at certain mines being below expectation in the 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	<ul style="list-style-type: none"> <li>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.</li> <li>Refer to the key audit matter above with respect to procedures performed relating to the recoverable value of mining assets.</li> <li>We have evaluated management's approach to valuing exploration prospects.</li> </ul>
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Key external assumptions used in management's estimate of the recoverable value	<ul style="list-style-type: none"> <li>Refer to the key audit matter above with respect to procedures performed relating to the recoverable value of mining assets.</li> <li>We have performed sensitivity analysis on management's calculated recoverable values for alternative assumptions around the discount rate applied.</li> </ul>
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#### 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 highlighted the sensitivity of the recoverable value, and therefore impairment charges or reversals, to economic input assumptions, most significantly silver and gold prices and the discount rate applied. We consider that management's discount rates applied are at the lower end of an acceptable range. We reported sensitivity analysis to demonstrate the financial impact of changing this assumption.

#### KEY AUDIT MATTER

##### RE-ESTIMATION OF QUANTITIES HELD IN LEACHING PADS AT HERRADURA ●

- The recoverable quantity of gold from leaching pads is an estimate requiring consideration of a number of variables and is likely to evolve over time as further information is obtained from ongoing leaching activities and analysis of the ore deposited.
- Following new information obtained in the year related to humidity and the grade of content in solution, management updated its estimate of the gold content in the Herradura leaching pads. This resulted in an increase in the estimated remaining gold content as at 1 January 2018 from 23 koz to 122 koz.
- Management has accounted for this increase prospectively, by increasing the number of ounces in inventory as at 1 January 2018, therefore reducing the weighted average unit cost of production. This impact reduced cost of sales in the year by US\$76.8 million.
- We consider that there is a risk of manipulation of the estimate as a result of management judgment involved in interpreting the results of the new analysis in the year in combination with ongoing recovery information from the pads. This includes the extent to which this new information is extrapolated across the full extent of the Herradura leaching pads. There is also judgment involved in the timing of the recognition of the change in estimate and the related effects on the financial statements.

This is a new risk for the year.

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

Inventories are disclosed in note 14 and cost of sales in note 5 to the consolidated financial statements. The relevant accounting policies are set out in note 2.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC

### CONTINUED

#### OUR AUDIT RESPONSE

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

Methodology applied to make estimate	<ul style="list-style-type: none"> <li>We assessed management's geologist involved in estimating the recoverable quantity of gold from leaching pads as a specialist.</li> <li>We engaged an external specialist (geologist) to evaluate the information provided by management's internal geologist.</li> <li>We, along with our specialist, <ul style="list-style-type: none"> <li>obtained an understanding of management's process and methodology to determine the revised estimate of quantities held in leaching pads;</li> <li>assessed the appropriateness of the methodology applied including changes as compared to prior periods;</li> <li>evaluated the basis for judgments applied, including the appropriateness of applying the new information to the entirety of the Herradura leaching pads;</li> <li>challenged whether the information obtained at Herradura suggests recovery rates for other mines in the mining district should be revised.</li> </ul> </li> </ul>
Calculation of estimate and related financial statement effects	<ul style="list-style-type: none"> <li>We assessed whether the adjustment represents a change in estimation or a prior year error.</li> <li>We recomputed the calculation of estimated gold content performed by management, agreeing inputs to prior year working papers where relevant.</li> <li>We performed sensitivity analysis on the primary inputs to the calculation, being humidity and gold content in solution.</li> <li>We reviewed the disclosures in the financial statements to confirm their accuracy and clarity.</li> </ul>
Management override	<ul style="list-style-type: none"> <li>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. We increased the level of challenge when performing our substantive procedures, including the engagement of a specialist as discussed above.</li> </ul>

#### KEY AUDIT MATTER

##### KEY OBSERVATIONS COMMUNICATED TO THE AUDIT COMMITTEE

- As heap leach recovery rates are an estimate that continues to be refined as new information is obtained, we consider it reasonable that management updated its estimate to reflect new information obtained in the current year.
- We therefore agree with management that it is appropriate for the adjustment to be accounted for prospectively in 2018.
- We highlighted the judgmental nature of the assumptions applied in the computation of the adjustment and demonstrated the potential range in the estimate of recoverable gold using sensitivity analysis.
- We concluded that there was a reasonable basis for the final assumptions used in the estimate and their application to the entire Herradura leaching pads.
- As such we concluded that there was adequate basis for the additional quantity and resulting accounting effects in the year.

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

This year we have included a new Key Audit Matter 'Re-estimation of quantities held in leaching pads at Herradura'. During 2017 and 2018, management assayed ore samples that were removed from an existing pad at Herradura in order to build a pathway to new leaching pads. The new information obtained from the assays resulted in a re-estimation of the remaining gold content of the leaching pads and a corresponding adjustment to inventory volumes. Given the judgment involved in this re-estimation and the size of the adjustment we consider this a new significant and fraud risk in the year.

In the prior year, our audit report included a key audit matters in relation to 'Disclosures, provisions and asset carrying value arising from the El Bajio Ejido conflict.' In light of a decrease in associated risk following favourable court rulings and a reduced possible financial statement impact, we no longer consider this a significant risk in the current year.

In the prior year, our audit report included a key audit matters in relation to 'Potential tax uncertainties arising from tax authority inspections and changes in legislation'. In light of no recent updates to legislation or significant new inspections, this area was not a key audit matter for this year's audit.



**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, the organisation of the group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity.

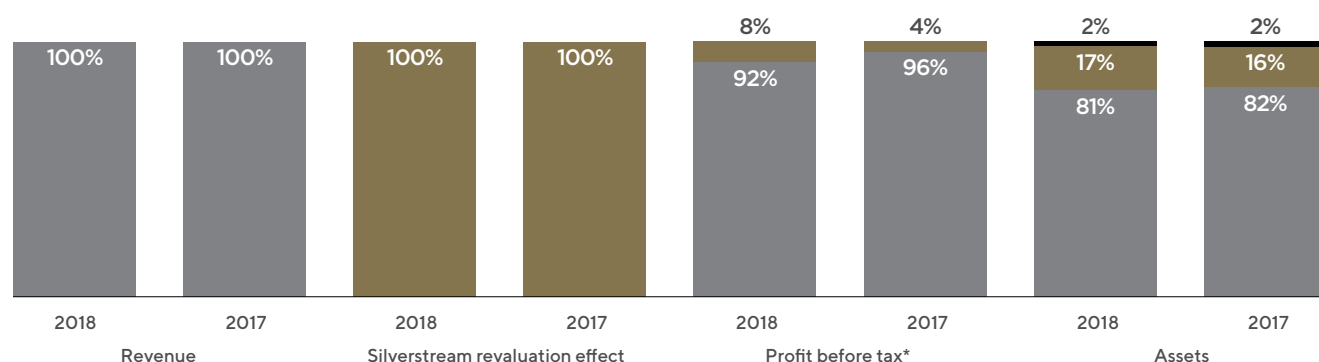
We performed an audit of the complete financial information of 6 components (2017: 5) ('full scope components') which were selected based on their size or risk characteristics. These components cover the operating mining units in Mexico and the Parent Company. In some instances operating mining units include more than one operating mine; the Penmont mining unit includes the Herradura, Noche Buena and Soledad & Dipolos mines (additionally in 2017 the Fresnillo mining unit included the Fresnillo and the San Julián mines).

We also performed specified audit procedures on specific account balances in a further 4 components (2017: 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 the receipt of a part payment received in respect of an insurance claim of less than 1% (2017: (1)%) and 2% of total assets (2017: 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**

In the current year, following the San Julián phase II mining unit coming on stream in summer 2017, we have separated the Fresnillo and San Julián mining units into two components, representing the individual operating mines. We have also removed Las Torres from our scope to reflect the stability in management's estimation of mine rehabilitation costs.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC CONTINUED

### 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 6 full scope components, audit procedures were performed on 1 of these directly by the primary audit team. For the 4 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 last two years 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.

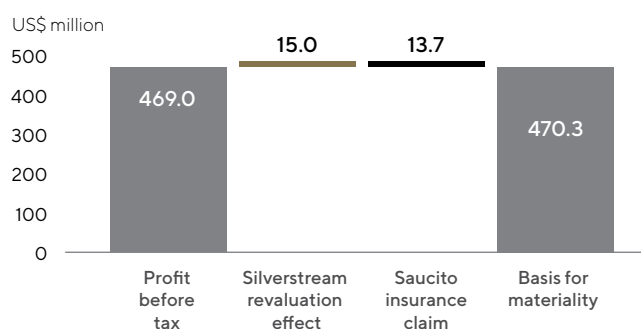
### OUR APPLICATION OF MATERIALITY

*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.

We determined materiality for the Group to be US\$23.4 million (2017: US\$31.0 million), which is 5% (2017: 5%) of profit before tax prior to Silverstream revaluation effects and the receipt of a part payment received in respect of an insurance claim, a one-off material item (subject to roundings). We believe 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 receipt of a part payment in respect of an insurance claim is a one off transaction. In the prior year an adjustment had been made to exclude the one-off gain on the sale of a concession.



During the course of our audit, we reassessed initial materiality and updated its calculation for the actual financial results of the year. This resulted in a decrease of materiality compared to that calculated at the planning stage of the audit, due to a decrease in precious metals prices in the last quarter of the year.

We determined materiality for the Parent Company to be US\$70.0 million (2017: US\$70.5 million), which is 1% (2017: 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.

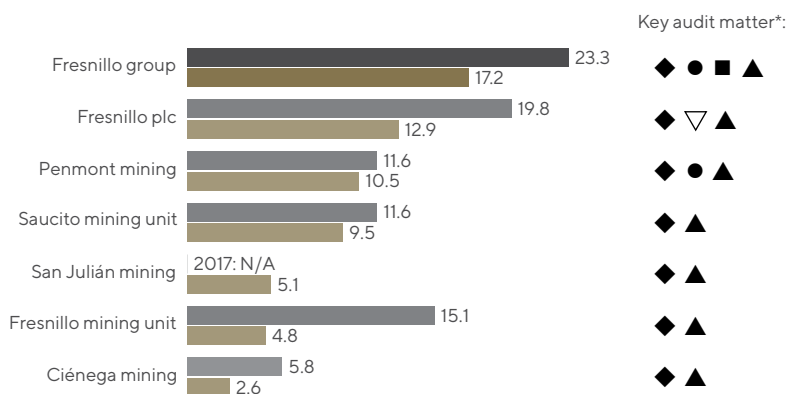
## PERFORMANCE MATERIALITY

*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% (2017: 75%) of our planning materiality, namely US\$17.5 million (2017: US\$23.2 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 decreased in respect of all components, reflecting the overall performance of the Group.



\* The icons correspond to the key audit matters set out above. Audit procedures in respect of the recoverable amount of investments in subsidiaries are performed at the performance materiality of the standalone parent financial statements.

## 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\$1.1 million (2017: US\$1.5 million), 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 financial 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 150** – 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 119 to 129** – 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 101** – 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.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRESNILLO PLC CONTINUED

### 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.

### 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 150, 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 to 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**

- We were appointed by the Company on 4 May 2016 to audit the financial statements for the year ending 31 December 2018 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 11 years, covering periods from our initial appointment in 2008 through to the year ended 31 December 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company and we remain independent of the Group and the Parent Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

**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.

**Daniel Trotman**

(Senior statutory auditor)

**FOR AND ON BEHALF OF ERNST & YOUNG LLP, STATUTORY AUDITOR**

London

26 February 2019

## FINANCIAL STATEMENTS

# CONSOLIDATED INCOME STATEMENT YEAR ENDED 31 DECEMBER

		Year ended 31 December 2018			Year ended 31 December 2017		
	Notes	US\$ thousands			US\$ thousands		
		Pre-Silverstream revaluation effect	Silverstream revaluation effect	Total	Pre-Silverstream revaluation effect	Silverstream revaluation effect	Total
<b>Continuing operations:</b>							
Revenues	4	2,103,785		2,103,785	2,093,308		2,093,308
Cost of sales	5	(1,323,057)		(1,323,057)	(1,167,903)		(1,167,903)
<b>Gross profit</b>		<b>780,728</b>		<b>780,728</b>	<b>925,405</b>		<b>925,405</b>
Administrative expenses		(83,339)		(83,339)	(72,710)		(72,710)
Exploration expenses	6	(172,799)		(172,799)	(141,108)		(141,108)
Selling expenses		(21,237)		(21,237)	(19,110)		(19,110)
Other operating income	8	11,703		11,703	28,203		28,203
Other operating expenses	8	(8,360)		(8,360)	(11,371)		(11,371)
<b>Profit from continuing operations before net finance costs and income tax</b>		<b>506,696</b>		<b>506,696</b>	<b>709,309</b>		<b>709,309</b>
Finance income	9	20,372		20,372	14,576		14,576
Finance costs	9	(50,010)		(50,010)	(89,653)		(89,653)
Revaluation effects of Silverstream contract	13	-	14,956	14,956	-	113,656	113,656
Foreign exchange loss		(8,084)		(8,084)	(6,399)		(6,399)
<b>Profit from continuing operations before income tax</b>		<b>468,974</b>	<b>14,956</b>	<b>483,930</b>	<b>627,833</b>	<b>113,656</b>	<b>741,489</b>
Corporate income tax	10	(116,162)	(4,487)	(120,649)	(119,365)	(34,097)	(153,462)
Special mining right	10	(13,315)		(13,315)	(27,220)		(27,220)
Income tax expense	10	(129,477)	(4,487)	(133,964)	(146,585)	(34,097)	(180,682)
<b>Profit for the year from continuing operations</b>		<b>339,497</b>	<b>10,469</b>	<b>349,966</b>	<b>481,248</b>	<b>79,559</b>	<b>560,807</b>
<b>Attributable to:</b>							
Equity shareholders of the Company		339,377	10,469	349,846	481,019	79,559	560,578
Non-controlling interest		120		120	229		229
		<b>339,497</b>	<b>10,469</b>	<b>349,966</b>	<b>481,248</b>	<b>79,559</b>	<b>560,807</b>
<b>Earnings per share: (US\$)</b>							
Basic and diluted earnings per Ordinary Share from continuing operations	11	-		0.475	-		0.761
<b>Adjusted earnings per share: (US\$)</b>							
Adjusted basic and diluted earnings per Ordinary Share from continuing operations	11		0.461	-	0.653		-

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

### YEAR ENDED 31 DECEMBER

	Notes	Year ended 31 December	
		2018 US\$ thousands	2017 US\$ thousands
<b>Profit for the year</b>		<b>349,966</b>	<b>560,807</b>
<b>Other comprehensive income/(expense)</b>			
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Gain on cash flow hedges recycled to income statement		1,582	-
Loss on cost of hedge recycled to income statement		(269)	-
Changes in the fair value of cost of hedges		14,353	-
Total effect of cash flow hedges		15,666	-
Changes in the fair value of available-for-sale financial assets		-	8,808
Impairment of available-for-sale financial assets taken to income during the year		-	36
Total effect of available-for-sale financial assets		-	8,844
Foreign currency translation		(185)	118
Income tax effect on items that may be reclassified subsequently to profit or loss:		(4,699)	(2,653)
<b>Net other comprehensive income that may be reclassified subsequently to profit or loss:</b>		<b>10,782</b>	<b>6,309</b>
<i>Items that will not be reclassified to profit or loss:</i>			
Changes in the fair value of cash flow hedges		-	-
Losses on cash flow hedges recycled to other assets		(233)	-
Changes in the fair value of cash flow hedges		(58)	-
Total effect of cash flow hedges		(291)	-
Changes in the fair value of equity investments at FVOCI		(46,579)	-
Remeasurement gains on defined benefit plans	21	2,610	933
Income tax effect on items that will not be reclassified to profit or loss	10	19,999	(148)
<b>Net other comprehensive (expense)/income that will not be reclassified to profit or loss</b>		<b>(24,261)</b>	<b>785</b>
<b>Other comprehensive (expense)/income, net of tax</b>		<b>(13,479)</b>	<b>7,094</b>
<b>Total comprehensive income for the year, net of tax</b>		<b>336,487</b>	<b>567,901</b>
<b>Attributable to:</b>			
Equity shareholders of the Company		336,377	567,672
Non-controlling interests		110	229
		<b>336,487</b>	<b>567,901</b>

## FINANCIAL STATEMENTS

# CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER

	Notes	As at 31 December	
		2018 US\$ thousands	2017 US\$ thousands
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	12	2,693,104	2,448,596
Equity instruments at FVOCI	2(b), 29	78,219	–
Available-for-sale financial assets	2(b)	–	144,856
Silverstream contract	13	498,274	506,569
Derivative financial instruments	29	20	–
Deferred tax asset	10	88,883	48,950
Inventories	14	91,620	91,620
Other receivables	15	–	129
Other assets		3,199	3,389
		<b>3,453,319</b>	<b>3,244,109</b>
<b>Current assets</b>			
Inventories	14	243,404	179,485
Trade and other receivables	15	411,157	342,506
Income tax recoverable		50,871	59,588
Prepayments		15,488	3,543
Derivative financial instruments	29	294	382
Silverstream contract	13	20,819	32,318
Cash and cash equivalents	16	560,785	876,034
		<b>1,302,818</b>	<b>1,493,856</b>
<b>Total assets</b>		<b>4,756,137</b>	<b>4,737,965</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Capital and reserves attributable to shareholders of the Company</b>			
Share capital	17	368,546	368,546
Share premium	17	1,153,817	1,153,817
Capital reserve	17	(526,910)	(526,910)
Hedging reserve	17	(229)	–
Cost of hedging reserve	17	(2,374)	–
Available-for-sale financial assets reserve	17	–	53,799
Fair value reserve of financial assets at FVOCI	17	23,370	–
Foreign currency translation reserve	17	(795)	(610)
Retained earnings	17	2,033,860	1,962,708
		<b>3,049,285</b>	<b>3,011,350</b>
Non-controlling interests		78,968	55,245
<b>Total equity</b>		<b>3,128,253</b>	<b>3,066,595</b>
<b>Non-current liabilities</b>			
Interest-bearing loans	19	800,127	799,046
Derivative financial instruments	29	–	14,224
Provision for mine closure cost	20	189,842	184,775
Provision for pensions and other post-employment benefit plans	21	6,393	9,217
Deferred tax liability	10	470,925	491,677
		<b>1,467,287</b>	<b>1,498,939</b>



	Notes	As at 31 December	
		2018 US\$ thousands	2017 US\$ thousands
Current liabilities			
Trade and other payables	22	133,140	134,949
Income tax payable		10,960	18,328
Derivative financial instruments	29	3,807	4,992
Employee profit sharing		12,690	14,162
		160,597	172,431
Total liabilities		1,627,884	1,671,370
Total equity and liabilities		4,756,137	4,737,965

These financial statements were approved by the Board of Directors on 25 February 2019 and signed on its behalf by:

**Mr Arturo Fernández**  
**Non-executive Director**  
 25 February 2019

## FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENT OF CASH FLOWS

### YEAR ENDED 31 DECEMBER

	Notes	Year ended 31 December	
		2018 US\$ thousands	2017 US\$ thousands
<b>Net cash from operating activities</b>	28	<b>588,359</b>	761,471
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment		(668,669)	(604,751)
Proceeds from the sale of property, plant and equipment and other assets	8	78	26,078
Repayments of loans granted to contractors		1,327	925
Short-term investments		–	200,000
Silverstream contract	13	36,303	43,349
Purchase of available-for-sale financial assets		–	(19,877)
Proceeds from the sale of debt investments		20,087	–
Interest received		19,520	14,535
<b>Net cash used in investing activities</b>		<b>(591,354)</b>	(339,741)
<b>Cash flows from financing activities</b>			
Dividends paid to shareholders of the Company	18	(298,068)	(236,560)
Capital contribution		23,613	18,869
Interest paid <sup>1</sup>	19	(35,177)	(35,503)
<b>Net cash used in financing activities</b>		<b>(309,632)</b>	(253,194)
Net (decrease)/increase in cash and cash equivalents during the year		(312,627)	168,536
Effect of exchange rate on cash and cash equivalents		(2,622)	(4,456)
Cash and cash equivalents at 1 January		876,034	711,954
<b>Cash and cash equivalents at 31 December</b>	16	<b>560,785</b>	876,034

1 Total interest paid during the year ended 31 December 2018 less amounts capitalised totalling US\$11.1 million (31 December 2017: US\$11.4 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	Cost of hedging reserve	Available-for-sale financial assets reserve	Fair value reserve of financial assets at FVOCI	Foreign currency translation reserve	Retained earnings	Total	Non-controlling interests	Total equity
<b>Balance at 1 January 2017</b>		368,546	1,153,817	(526,910)	-	-	47,608	-	(728)	1,637,888	2,680,221	36,147	2,716,368
Profit 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	18	-	-	-	-	-	-	-	-	(236,543)	(236,543)	-	(236,543)
<b>Balance at 31 December 2017</b>		<b>368,546</b>	<b>1,153,817</b>	<b>(526,910)</b>	<b>-</b>	<b>-</b>	<b>53,799</b>	<b>-</b>	<b>(610)</b>	<b>1,962,708</b>	<b>3,011,350</b>	<b>55,245</b>	<b>3,066,595</b>
Adjustments for initial application of IFRS 9	2(b)	-	-	-	-	(13,376)	(53,799)	49,622	-	17,553	-	-	-
Profit for the year		-	-	-	-	-	-	-	-	349,846	349,846	120	349,966
Other comprehensive expense, net of tax		-	-	-	(229)	11,002	-	(26,252)	(185)	2,195	(13,469)	(10)	(13,479)
Total comprehensive income for the year		-	-	-	(229)	11,002	-	(26,252)	(185)	352,041	336,377	110	336,487
Capital contribution		-	-	-	-	-	-	-	-	-	-	23,613	23,613
Dividends declared and paid	18	-	-	-	-	-	-	-	-	(298,442)	(298,442)	-	(298,442)
<b>Balance at 31 December 2018</b>		<b>368,546</b>	<b>1,153,817</b>	<b>(526,910)</b>	<b>(229)</b>	<b>(2,374)</b>	<b>-</b>	<b>23,370</b>	<b>(795)</b>	<b>2,033,860</b>	<b>3,049,285</b>	<b>78,968</b>	<b>3,128,253</b>

## 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 percent 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](http://www.penoles.com.mx). Further information on related party balances and transactions with Peñoles' Group companies is disclosed in note 26.

The consolidated financial statements of the Group for the year ended 31 December 2018 were authorised for issue by the Board of Directors of Fresnillo plc on 25 February 2019.

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 2018 and 2017, 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 trade receivables, derivative financial instruments, equity securities, investment in funds 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 2018 and 2017, 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 adopted in the preparation of the consolidated financial statements are consistent with those applied in the preparation of the consolidated financial statements for the year ended 31 December 2017, except for the following:

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

On January 1, 2018, the Company adopted IFRS 9, Financial Instruments which replaced IAS 39, Financial Instruments: Recognition and Measurement using the modified retrospective approach, hence, the Group does not restate prior periods. Differences between previous carrying amounts using accounting policies as disclosed in the 2017 ARA and those determined under IFRS 9 at the date of initial application have been included in opening retained earnings.

IFRS 9 provides a revised model for classification and measurement of financial instruments; a single, forward-looking expected loss impairment model; and changes to hedge accounting.

The classification and measurement model for financial assets in IFRS 9 is based on the Group's business models for managing its financial assets and whether the contractual cash flows represent solely payments for principal and interest. Generally, equity instruments are classified and measured as fair value through profit or loss (FVPL). However, in respect of equity instruments that the Group intends to hold for the foreseeable future, IFRS 9 permits the Group to irrevocably elect upon initial recognition or transition to classify those assets as fair value through other comprehensive income (FVOCI). Changes in the fair value of equity instruments elected to be classified as FVOCI are not reclassified to profit or loss in future periods. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9.

**LONG-TERM FINANCIAL ASSETS**

The adoption of IFRS 9 resulted in certain changes to the classification of financial assets previously classified as available-for-sale financial assets (AFS). The Company designated its investments in quoted equity investments as FVOCI and classified investments in funds as FVPL:

	(in thousands of US dollars)	
	1 January 2018	31 December 2017
Available-for-sale financial assets	–	144,856
Debt instruments at fair value through profit or loss	19,877	–
Equity instruments at fair value through other comprehensive income	124,979	–
	<b>144,856</b>	<b>144,856</b>

Upon transition, the balance in the AFS reserve relating to investments in funds was reclassified from accumulated other comprehensive income (OCI) to retained earnings in the amount of US\$53.8 million. In addition, the amounts previously recognised in retained earnings related to historical impairment of AFS that are now classified as FVOCI have been reclassified to the FVOCI reserve in the amount of US\$6.0 million.

**TRADE RECEIVABLES**

Under IFRS 9, embedded derivatives are no longer separated from their host contracts. Instead, where embedded derivatives are present, the entire host contract is classified as fair value through profit or loss. For the Group, this change affects the trade receivables that include provisional pricing adjustments. However, it did not result in any change in the carrying amount of those trade receivables.

**IMPAIRMENT**

The adoption of the new 'expected credit loss' impairment model under IFRS 9, as opposed to an incurred credit loss model under IAS 39, had a negligible impact on the carrying amounts of the Group's financial assets on the transition date given the Group transacts exclusively with organisations with strong credit ratings, has had a negligible historical level of counterparty default and only has a short term period of exposure to credit risk.

**HEDGING**

The new general hedge accounting requirements retain the three types of hedge accounting mechanisms previously available under IAS 39. Under IFRS 9, however, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been replaced with the principle of an 'economic relationship' and retrospective assessment of hedge effectiveness is no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

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 as a cost of hedging. 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 was recorded in the income statement. As at 1 January 2018, the adjustment to reflect the changes in accounting for the time value of such options increased retained earnings and decreased the cost of hedging reserve by US\$19.1 million (US\$13.4 million net of tax).

### REVENUE RECOGNITION

On January 1, 2018, the Group adopted IFRS 15, Revenue from Contracts with Customers which supersedes IAS 18, Revenue. IFRS 15 establishes a single five-step model framework for determining the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. IFRS 15 requires entities to recognise revenue when control of goods or services transfers to the customer whereas the previous standard, IAS 18, required entities to recognise revenue when the risks and rewards of the goods or services transfer to the customer. The Company concluded there is no change in the timing of revenue recognition of its doré, precipitates and concentrate sales under IFRS 15 compared to the previous standard as the point of transfer of risks and rewards of goods and services and transfer of control occur at the same time. Therefore, no adjustment was required to the Group's financial statements.

Revenue associated with the sale of concentrates, precipitates and doré bars is recognised when control of the asset sold is transferred to the customer. Indicators of control transferring include an unconditional obligation to pay, legal title, physical possession, transfer of risk and rewards and customer acceptance. This generally occurs when the goods are delivered to the customer's smelter or refinery agreed with the buyer; at which point the buyer controls the goods.

The Group's sales contracts, in general, provide for a provisional payment based upon provisional assays and quoted metal prices. Revenues are recorded under these contracts at the time control passes to the buyer and measured at the fair value of the consideration receivable based on forward market prices set on specified quotational periods applied to the Group's best estimate of contained metal quantities.

At each reporting date, provisionally priced metal is marked to market based on the forward selling price for the quotational period stipulated in the contract, changes in fair value of provisionally priced metal is recognised in revenue adjusting the value of sales. The transaction price can be measured reliably as an active and freely traded commodity market such as the London Metals Exchange exists for silver, gold, zinc and lead and the value of product sold by the Company is directly linked to the form in which it is traded on that market. Variations between the price recorded at the date when control is transferred to the buyer and the actual final price set under the smelting contracts are caused by changes in metal prices resulting in the receivable being recorded at FVPL.

Final settlement is based on quantities adjusted as required following the inspection of the product by the customer as well as applicable commodity prices. IFRS 15 requires that variable consideration should only be recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The Group concluded that the adjustments relating to the final assay results for the quantity and quality of concentrate sold are not significant and do not constrain the recognition of revenue.

Refining and treatment charges under the sales contracts continue to be deducted from revenue from sales of concentrates as these are not related to a distinct good or service.

### OTHER NARROW SCOPE AMENDMENTS

The Group has adopted IFRIC 22 – Foreign Currency Transactions and Advance Considerations, which did not have a material impact on the Group's consolidated financial statements.

Other than the amendment mentioned above, there were no significant new standards that the Group was required to adopt effective from 1 January 2018.

### 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 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. The Group has elected to adopt the new standard from 1 January 2019 applying the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets will be measured at the amount of the lease liability on adoption. The Group has set up a project team which has reviewed all of the Group's leasing arrangements over the last year in light of the new lease accounting rules in IFRS 16. As at the reporting date, the Group has non-cancellable operating lease commitments of \$16.1 million, see note 24. Of these commitments, approximately \$0.2 million relate to short-term leases and \$2.7 million to low value leases which will both be recognised on a straight-line basis as expense in profit or loss.

**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 evaluated potential uncertain tax positions under the requirements of the Interpretation and has not identified any impact on the Group's financial statements. IFRIC 23 is applicable for annual periods beginning on or after 1 January 2019.

The IASB and IFRS Interpretation committee have issued other amendments resulting from improvements to IFRSs that management considers do not have any impact on the accounting policies, financial position or performance of the Group. 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 for the year ended 31 December 2018 are:

- 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, judgment is required in identifying the separate components of the ore bodies for that operation, to which stripping costs should be allocated. Generally, a component will be a subset of the total ore body that is made more accessible as a result of 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 since components are usually identified during the mine planning stage. The Group reassesses the components of ore bodies in line with the preparation and update of mine plans which usually depend on newest information of reserves and resources.

In the current year, this reassessment did not give rise to any changes in the identification of components except for those existing at Centauro pit at Herradura mine.

Following the results of reserves and resources studies in the prior year, significant additional gold reserves were identified at Centauro pit. The mining operations worked on assessing the impact of these new reserves on the design of the mine and proposed a new mine plan which was approved in July 2018. The new design significantly expands the size of the Centauro pit and results in areas which were previously going to be mined as two separate components being accessed and mined as a single component. Based on the new mine plan, effective 1 July 2018 the Group has changed the components identified at Centauro pit and therefore the measurement of the corresponding stripping costs.

This change was incorporated prospectively from 1 July 2018. Had the determination of components not changed, capitalised stripping cost during the six-month period ended 31 December 2018 would have been US\$28.6 million higher, with an offsetting impact against the work-in-progress inventory balance as of 31 December 2018.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

- Contingencies, note 25:  
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.

### 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.
- Estimate of recoverable ore on leaching pads:  
In the Group's open pit mines, certain mined ore is placed on leaching pads where a solution is applied to the surface of the heap to dissolve the gold and enable extraction. The determination of the amount of recoverable gold requires estimation with consideration of the quantities of ore placed on the pads and the grade of that ore (based on assay data) and the estimated recovery percentage (based on metallurgical studies and current technology).

The grades of ore placed on pads are regularly compared to the quantities of metal recovered through the leaching process to evaluate the appropriateness of the estimated recovery (metallurgical balancing). The Group monitors the results of the metallurgical balancing process and recovery estimates are refined based on actual results over time and when new information becomes available.

In 2017, the Group decided that it would construct a new leaching pad in a separate area of the Herradura mine. To reduce the hauling distance from the pit to the new pad, the Group constructed an access route through certain existing leaching pads, removing and redepositing the ore in the process. These works allowed the Group to perform assays and verify certain characteristics of the ore, including the humidity of the ore deposited and the grade of gold in solution. The Group finalised the evaluation of those assays during first half of 2018.

As a result of this new information, the Group updated its estimate of the remaining gold content in leaching pads resulting in an increase of 98.9 thousand ounces of gold as at 1 January 2018. This represents 1.7% of the total gold content deposited from the inception of the mine to 31 December 2017.

This change in estimation was incorporated prospectively in inventory from 1 January 2018. The increase in the number of ounces reduced the weighted average cost of inventory. Had the estimation not changed, production cost during the year ended 31 December 2018 would have been US\$71.9 million higher, with an offsetting impact against the work-in-progress inventory balance as of 31 December 2018.

- Silverstream, note 13:  
The valuation of the Silverstream contract as a derivative financial instrument requires estimation by management. The term of the derivative is based on the 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 detail 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.



- Estimation of the mine closure costs, notes 2 (j) and 19:  
Significant estimates and assumptions are made in determining the provision for mine closure cost as there are numerous factors that will affect the ultimate amounts 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 (q) 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. 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. 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 <sup>1</sup>	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

#### 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 as new information of reserves and resources is available. 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.

#### **(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**

From 1 January 2018, the Group classifies its financial assets in the following measurement categories:

- those to be measured at amortised cost;
- those to be measured subsequently at fair value through OCI; and
- those to be measured subsequently at fair value through profit or loss.

The classification depends on the Group's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or OCI. For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI).

The Group reclassifies debt investments when and only when its business model for managing those assets changes.

Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset.

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Subsequent measurement of debt instruments depends on the Group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Group classifies its debt instruments:

#### AMORTISED COST

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

The Group's financial assets at amortised cost include receivables (other than trade receivables which are measured at fair value through profit and loss).

#### FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

At transition to IFRS 9, the Group had certain financial asset that were accounted for as debt instruments at fair value through other comprehensive income; however, at the reporting date, no such assets existed.

#### EQUITY INSTRUMENTS DESIGNATED AS FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Upon initial recognition, the Group can elect to classify irrevocably its equity investments as equity instruments designated at fair value through OCI when they meet the definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. The classification is determined on an instrument-by-instrument basis.

Gains and losses on these financial assets are never recycled to profit or loss. Dividends are recognised as other income in the statement of profit or loss when the right of payment has been established, except when the Group benefits from such proceeds as a recovery of part of the cost of the financial asset, in which case, such gains are recorded in OCI. Equity instruments designated at fair value through OCI are not subject to impairment assessment.

The Group elected to classify irrevocably its listed equity investments under this category.

#### FAIR VALUE THROUGH PROFIT OR LOSS

Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

Changes in the fair value of financial assets at FVPL are recognised in other gains/(losses) in the statement of profit or loss as applicable.

The Group's trade receivables and derivative financial instruments, including the Silverstream contract, are classified as fair value through profit or loss.

#### DE-RECOGNITION OF FINANCIAL ASSETS

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

#### IMPAIRMENT OF FINANCIAL ASSETS

From 1 January 2018, the Group assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

For receivables (other than trade receivables which are measured at FVPL), the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

**(H) 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.

**(I) 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.

**(J) 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.

**(K) 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

#### 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.

#### (L) EMPLOYEE PROFIT SHARING

In accordance with the Mexican legislation, companies in Mexico are subject to pay for employee profit sharing ('PTU') equivalent to ten percent 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.

#### (M) 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.

**(N) REVENUE FROM CONTRACTS WITH CUSTOMERS**

Revenue is recognised when control of goods or services transfers to the customer based on the performance obligations settle in the contracts with customers.

**SALE OF GOODS**

Revenue associated with the sale of concentrates, precipitates and doré bars is recognised when control of the asset sold is transferred to the customer. Indicators of control transferring include an unconditional obligation to pay, legal title, physical possession, transfer of risk and rewards and customer acceptance. This generally occurs when the goods are delivered to the customer's smelter or refinery agreed with the buyer; at which point the buyer controls the goods.

The Group's sales contracts, in general, provide for a provisional payment based upon provisional assays and quoted metal prices. Revenues are recorded under these contracts at the time control passes to the buyer and measured at the fair value of the consideration receivable based on forward market prices set on specified quotational periods applied to the Group's best estimate of contained metal quantities.

Final settlement is based on quantities adjusted as required following the inspection of the product by the customer as well as applicable commodity prices. IFRS 15 requires that variable consideration should only be recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. As the adjustments relating to the final assay results for the quantity and quality of concentrate sold are not significant, they do not constrain the recognition of revenue.

Refining and treatment charges under the sales contracts are deducted from revenue from sales of concentrates as these are not related to a distinct good or service.

**(O) 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.

**(P) SELLING EXPENSES**

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.

**(Q) 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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

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 (See note 10 (e)). 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.

### (R) 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.



Beginning 1 January 2018, the documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the Group will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge ineffectiveness and how the hedge ratio is determined). A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- There is 'an economic relationship' between the hedged item and the hedging instrument.
- The effect of credit risk does not 'dominate the value changes' that result from that economic relationship.
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

Hedges which meet the 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. This is not a reclassification adjustment and will not be recognised in OCI for the period. 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. In such cases, changes in the time value of options are initially recognised in OCI as a cost of hedging. 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.

#### **(S) 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.

#### **(T) 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 29 and 30.

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 2. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

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 29.

### (U) 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.

### 3. SEGMENT REPORTING

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

At 31 December 2018, 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.
- The San Julián mine, located on the border of Chihuahua/Durango states, an underground silver-gold mine.

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 2018 and 2017, 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 2018 and 2017, respectively. Revenues for the year ended 31 December 2018 include those derived from contracts with costumers and other revenues, as showed in note 4.

Year ended 31 December 2018										
US\$ thousands	Fresnillo	Herradura	Ciénega	Soledad-Dipolos <sup>4</sup>	Saucito	Noche Buena	San Julián	Other <sup>5</sup>	Adjustments and eliminations	Total
Revenues:										
Third party <sup>1</sup>	333,009	607,073	172,922	–	436,491	210,994	341,714	–	1,582	2,103,785
Inter-Segment								85,101	(85,101)	–
Segment revenues	333,009	607,073	172,922	–	436,491	210,994	341,714	85,101	(83,519)	2,103,785
Segment Profit <sup>2</sup>	211,530	322,985	79,154	–	274,505	85,903	176,518	65,690	(11,281)	1,205,004
Depreciation and amortisation										(411,764)
Employee profit sharing										(12,512)
Gross profit as per the income statement										780,728
Capital expenditure <sup>3</sup>	121,146	116,002	72,895	–	148,440	50,209	83,129	76,848	–	668,669

1 Total third party revenues include treatment and refining charges amounting US\$141.2 million. Adjustments and eliminations correspond to hedging gains (note 4).

2 Segment profit excluding foreign exchange hedging gains, 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 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 2018, this segment did not operate due to the Bajío conflict (note 25).

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

									Year ended 31 December 2017	
US\$ thousands	Fresnillo	Herradura	Ciénega	Soledad-Dipolos <sup>4</sup>	Saucito	Noche Buena	San Julián	Other <sup>5</sup>	Adjustments and eliminations	Total
<b>Revenues:</b>										
Third party <sup>1</sup>	368,286	605,823	183,689	–	446,008	214,998	274,504	–	–	2,093,308
Inter-Segment								79,907	(79,907)	–
<b>Segment revenues</b>	<b>368,286</b>	<b>605,823</b>	<b>183,689</b>	<b>–</b>	<b>446,008</b>	<b>214,998</b>	<b>274,504</b>	<b>79,907</b>	<b>(79,907)</b>	<b>2,093,308</b>
<b>Segment Profit<sup>2</sup></b>	<b>252,249</b>	<b>355,570</b>	<b>97,098</b>	<b>2,269</b>	<b>315,196</b>	<b>75,496</b>	<b>174,712</b>	<b>59,878</b>	<b>(22,966)</b>	<b>1,309,502</b>
Depreciation and amortisation										(367,609)
Employee profit sharing										(16,488)
<b>Gross profit as per the income statement</b>										<b>925,405</b>
Capital expenditure <sup>3</sup>	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 25). Segment profit is derived from the changes in the net realisable value allowance against inventory (note 14).

5 Other 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 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 SOURCE

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Revenues from contracts with customers	2,102,694	2,084,048
Revenues from other sources:		
Provisional pricing adjustment on products sold	(491)	9,260
Hedging gain on sales	1,582	-
	2,103,785	2,093,308

## (B) REVENUES BY PRODUCT SOLD

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Lead concentrates (containing silver, gold, lead and by-products)	804,882	832,039
Doré and slag (containing gold, silver and by-products)	818,067	820,821
Zinc concentrates (containing zinc, silver and by-products)	249,182	195,837
Precipitates (containing gold and silver)	231,654	244,611
	2,103,785	2,093,308

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

## (C) 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	
	2018 US\$ thousands	2017 US\$ thousands
Silver	815,837	844,815
Gold	1,118,087	1,125,290
Zinc	204,499	161,305
Lead	106,536	101,826
Value of metal content in products sold	2,244,959	2,233,236
Adjustment for treatment and refining charges	(141,174)	(139,928)
Total revenues <sup>1</sup>	2,103,785	2,093,308

<sup>1</sup> Includes provisional price adjustments which represent changes in the fair value of trade receivables resulting in a loss of US\$0.5 million (2017: gain of US\$9.2 million due to changes in the fair value of embedded derivatives arising on provisional pricing in sales contracts) and hedging gain of US\$1.6 million (2017: nil). For further detail, refer to note 2(n).

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	
	2018 US\$ per ounce	2017 US\$ per ounce
Gold <sup>2</sup>	1,269.1	1,267.4
Silver <sup>2</sup>	15.5	16.9

<sup>2</sup> For the purpose of the calculation, revenue by content of products sold does not include the results from hedging.

**5. COST OF SALES**

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Depreciation and amortisation (notes 2 (e) and 12)	411,764	367,609
Personnel expenses (note 7)	94,653	89,629
Maintenance and repairs	150,021	115,670
Operating materials	191,954	153,221
Energy	176,333	144,298
Contractors	291,970	233,909
Freight	11,633	10,545
Insurance	4,956	4,786
Mining concession rights and contributions	13,271	11,589
Other	29,680	22,043
Cost of production	1,376,235	1,153,299
Change in work in progress and finished goods (ore inventories) <sup>1</sup>	(53,178)	16,873
Change in net realisable value allowance against inventory (note 14)	-	(2,269)
	<b>1,323,057</b>	<b>1,167,903</b>

1 Refer to note 2 (c) for more detail related to change in work in progress inventories for the year ended 31 December 2018 following a change in estimations.

**6. EXPLORATION EXPENSES**

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Contractors	127,734	105,778
Administrative services	6,734	6,818
Mining concession rights and contributions	23,441	15,056
Personnel expenses (note 7)	4,137	4,260
Assays	3,615	2,850
Rentals	1,378	2,329
Other	5,760	4,017
	<b>172,799</b>	<b>141,108</b>

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, San Javier and Carina projects. In addition, exploration expenses of US\$6.3 million (2017: US\$8.3 million) were incurred in the year on projects located in Peru and Chile.

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	
	2018 US\$ thousands	2017 US\$ thousands
Liabilities related to exploration activities	112	1,947

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	
	2018 US\$ thousands	2017 US\$ thousands
Operating cash out flows related to exploration activities	174,634	140,804

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 7. PERSONNEL EXPENSES

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Salaries and wages	46,542	39,448
Employees' profit sharing	13,003	17,150
Bonuses	12,367	12,112
Statutory healthcare and housing contributions	17,976	16,057
Other benefits	10,682	8,704
Vacations and vacations bonus	2,870	2,636
Social security	2,369	1,862
Post-employment benefits <sup>1</sup>	4,026	4,224
Legal contributions	2,190	1,608
Training	3,033	3,834
Other	7,404	8,852
	122,462	116,487

1 Post-employment benefits include US\$0.6 million associated to benefits corresponding to the defined contribution plan (2017: US\$0.4 million).

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

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Cost of sales (note 5)	94,653	89,629
Administrative expenses	23,672	20,109
Exploration expenses (note 6)	4,137	6,749
	122,462	116,487

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

	Year ended 31 December	
	2018 No.	2017 No.
Mining	2,236	1,994
Plant concentration	752	602
Exploration	480	501
Maintenance	1,035	865
Administration and other	658	936
Total	5,161	4,898

**8. OTHER OPERATING INCOME AND EXPENSES**

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Other income:</b>		
Gain on sale of property, plant and equipment <sup>1</sup>	-	25,333
Insurance recovery <sup>2</sup>	9,245	-
Other	2,458	2,870
	<b>11,703</b>	<b>28,203</b>

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Other expenses:</b>		
Rentals	184	229
Maintenance <sup>3</sup>	1,278	1,858
Donations	1,313	2,540
Environmental activities	1,216	1,790
Loss on sale of property, plant and equipment	999	-
Consumption tax expensed	655	1,031
Impairment available-for-sale financial assets	-	36
Other	2,715	3,887
	<b>8,360</b>	<b>11,371</b>

1 Mainly corresponds to a sale of a 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 Corresponds to a partial reimbursement for the insurance claim relating to Saucito's flood see note 26 for further detail.

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

**9. FINANCE INCOME AND FINANCE COSTS**

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Finance income:</b>		
Interest on short-term deposits and investments	15,584	11,368
Other	4,788	3,208
	<b>20,372</b>	<b>14,576</b>

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Finance costs:</b>		
Interest on interest-bearing loans	36,258	35,808
Fair value movement on derivatives <sup>1</sup>	274	41,389
Unwinding of discount on provisions	10,044	11,703
Other	3,434	753
	<b>50,010</b>	<b>89,653</b>

1 The 2017 figure principally relates to the time value associated with gold commodity options (see note 29 for further detail). During 2018 this effect was recognised within other comprehensive income (see note 2 (b)).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 10. INCOME TAX EXPENSE

## A) MAJOR COMPONENTS OF INCOME TAX EXPENSE:

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Consolidated income statement:</b>		
<b>Corporate income tax</b>		
<b>Current:</b>		
Income tax charge	156,715	155,692
Amounts under provided in previous years	11,774	8,676
	<b>168,489</b>	<b>164,368</b>
<b>Deferred:</b>		
Origination and reversal of temporary differences	(52,327)	(45,003)
Revaluation effects of Silverstream contract	4,487	34,097
	<b>(47,840)</b>	<b>(10,906)</b>
<b>Corporate income tax</b>	<b>120,649</b>	<b>153,462</b>
<b>Special mining right</b>		
<b>Current:</b>		
Special mining right charge <sup>1</sup>	10,860	19,415
	<b>10,860</b>	<b>19,415</b>
<b>Deferred:</b>		
Origination and reversal of temporary differences	2,455	7,805
<b>Special mining right</b>	<b>13,315</b>	<b>27,220</b>
<b>Income tax expense reported in the income statement</b>	<b>133,964</b>	<b>180,682</b>

<sup>1</sup> 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 2018, the Group credited US\$17.3 million (2017: US\$15.7 million) of mining concession rights against the SMR. Total mining concessions rights paid during the year were US\$22.2 million (2017: US\$16.3 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\$28.1 million (2017: US\$35.1 million).

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Consolidated statement of comprehensive income:</b>		
<b>Deferred income tax credit/(charge) related to items recognised directly in other comprehensive income:</b>		
Gain on cash flow hedges recycled to income statement	(388)	–
Changes in fair value of cash flow hedges	(4,224)	–
Changes in fair value of available-for-sale financial assets	20,327	(2,653)
Remeasurement losses on defined benefit plans	(415)	(148)
<b>Income tax effect reported in other comprehensive income</b>	<b>15,300</b>	<b>(2,801)</b>



**(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	
	2018 US\$ thousands	2017 US\$ thousands
<b>Accounting profit before income tax</b>	<b>483,930</b>	<b>741,489</b>
Tax at the Group's statutory corporate income tax rate 30.0%	145,179	222,446
Expenses not deductible for tax purposes	2,454	2,562
Inflationary uplift of the tax base of assets and liabilities	(16,599)	(20,011)
Current income tax (over)/underprovided in previous years	(4,807)	472
Exchange rate effect on tax value of assets and liabilities <sup>1</sup>	(778)	(9,934)
Non-taxable/non-deductible foreign exchange losses	1,255	(4,242)
Inflationary uplift of tax losses	(2,909)	(5,084)
IEPS tax credit (note 10 (e))	(7,012)	(26,181)
Deferred tax asset not recognised	6,571	4,461
Special mining right deductible for corporate income tax	(3,992)	(8,165)
Other	1,287	(2,862)
<b>Corporate income tax at the effective tax rate of 24.9% (2017: 20.7%)</b>	<b>120,649</b>	<b>153,462</b>
Special mining right	13,315	27,220
<b>Tax at the effective income tax rate of 27.6% (2017: 24.4%)</b>	<b>133,964</b>	<b>180,682</b>

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	
	2018 US\$ thousands	2017 US\$ thousands
Opening net liability	(442,727)	(443,027)
Income statement credit arising on corporate income tax	47,840	10,906
Income statement charge arising on special mining right	(2,455)	(7,805)
Exchange difference	-	-
Net credit/(charge) related to items directly charged to other comprehensive income	15,300	(2,801)
<b>Closing net liability</b>	<b>(382,042)</b>	<b>(442,727)</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 10. INCOME TAX EXPENSE CONTINUED

The amounts of deferred income tax assets and liabilities as at 31 December 2018 and 2017, considering the nature of the related temporary differences, are as follows:

	Consolidated balance sheet		Consolidated income statement	
	2018 US\$ thousands	2017 US\$ thousands	2018 US\$ thousands	2017 US\$ thousands
Related party receivables	(220,131)	(221,451)	(1,320)	22,270
Other receivables	1,315	(2,171)	(3,486)	(1,554)
Inventories	188,119	162,842	(25,277)	271
Prepayments	(1,035)	(898)	137	(923)
Derivative financial instruments including Silverstream contract	(150,205)	(147,535)	(1,942)	12,551
Property, plant and equipment arising from corporate income tax	(330,722)	(341,774)	(11,052)	(9,551)
Exploration expenses and operating liabilities	50,691	44,121	(6,570)	(19,818)
Other payables and provisions	57,303	55,379	(1,924)	(10,646)
Losses carried forward	67,059	68,213	1,154	(1,870)
Post-employment benefits	1,016	1,465	34	220
Deductible profit sharing	3,807	4,249	442	(344)
Special mining right deductible for corporate income tax	29,321	30,661	1,340	(1,561)
Equity investments at FVOCI	3,510	-	-	-
Available-for-sale financial assets	-	(16,818)	-	2,643
Other	(4,396)	(3,772)	624	(2,594)
Net deferred tax liability related to corporate income tax	(304,348)	(367,489)	-	-
Deferred tax credit related to corporate income tax	-	-	(47,840)	(10,906)
Related party receivables arising from special mining right	(20,161)	(21,379)	(1,218)	2,616
Inventories arising from special mining right	13,746	11,107	(2,639)	(2,831)
Property plant and equipment arising from special mining right	(71,279)	(64,966)	6,312	8,020
<b>Net deferred tax liability</b>	<b>(382,042)</b>	<b>(442,727)</b>	<b>-</b>	<b>-</b>
<b>Deferred tax credit</b>	<b>-</b>	<b>-</b>	<b>(45,385)</b>	<b>(3,101)</b>
Reflected in the statement of financial position as follows:				
Deferred tax assets	88,883	48,950	-	-
Deferred tax liabilities-continuing operations	(470,925)	(491,677)	-	-
<b>Net deferred tax liability</b>	<b>(382,042)</b>	<b>(442,727)</b>	<b>-</b>	<b>-</b>

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\$223.5 million (2017: US\$227.4 million). If not utilised, US\$37.6 million (2017: US\$13.7 million) will expire within five years and US\$185.9 million (2017: US\$213.6 million) will expire between six and ten years.

The Group has further tax losses and other similar attributes carried forward of US\$42.2 million (2017: US\$37.4 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\$1,430 million (2017: US\$1,723 million).

**(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 2018, the Group applied a credit of US\$14.9 million in respect of the year (2017: US\$23.2 million), which was offset by an adjustment in respect of prior years of US\$7.8 million (2017: nil). Additionally, as at 31 December 2017 the Group recognised a deferred tax asset US\$2.9 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 2018 and 2017, earnings per share have been calculated as follows:

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Earnings:</b>		
Profit from continuing operations attributable to equity holders of the Company	349,846	560,578
Adjusted profit from continuing operations attributable to equity holders of the Company	339,377	481,019

Adjusted profit is profit as disclosed in the Consolidated Income Statement adjusted to exclude revaluation effects of the Silverstream contract of US\$14.9 million gain (US\$10.4 million net of tax) (2017: US\$113.6 million gain (US\$79.5 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.

	2018 thousands	2017 thousands
<b>Number of shares:</b>		
Weighted average number of Ordinary Shares in issue	736,984	736,894

	2018 US\$	2017 US\$
<b>Earnings per share:</b>		
Basic and diluted earnings per share	0.475	0.761
Adjusted basic and diluted earnings per Ordinary Share from continuing operations	0.461	0.653

## FINANCIAL STATEMENTS

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 12. PROPERTY, PLANT AND EQUIPMENT

Year ended 31 December 2017

	Land and buildings	Plant and Equipment	Mining properties and development costs	Other assets	Construction in Progress	Total
	US\$ thousands					
<b>Cost</b>						
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 <sup>2</sup>	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
<b>Accumulated depreciation</b>						
At 1 January 2017	(90,586)	(895,367)	(822,434)	(92,163)	–	(1,900,550)
Depreciation for the year <sup>1</sup>	(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)
<b>Net Book amount at 31 December 2017</b>	<b>149,757</b>	<b>766,132</b>	<b>911,472</b>	<b>150,180</b>	<b>471,055</b>	<b>2,448,596</b>

Year ended 31 December 2018

	Land and buildings	Plant and Equipment	Mining properties and development costs	Other assets	Construction in Progress	Total
	US\$ thousands					
<b>Cost</b>						
At 1 January 2018	261,805	1,817,591	1,909,385	255,465	471,055	4,715,301
Additions	1,928	76,424	69	546	586,840	665,807
Disposals	–	(9,768)	(2,386)	(1,749)	–	(13,903)
Transfers and other movements	19,566	248,356	269,336	22,469	(559,727)	–
At 31 December 2018	283,299	2,132,603	2,176,404	276,731	498,168	5,367,205
<b>Accumulated depreciation</b>						
At 1 January 2018	(112,048)	(1,051,459)	(997,913)	(105,285)	–	(2,266,705)
Depreciation for the year <sup>1</sup>	(24,130)	(166,204)	(208,807)	(20,878)	–	(420,019)
Disposals	–	9,159	1,881	1,583	–	12,623
At 31 December 2018	(136,178)	(1,208,504)	(1,204,839)	(124,580)	–	(2,674,101)
<b>Net Book amount at 31 December 2018</b>	<b>147,121</b>	<b>924,099</b>	<b>971,565</b>	<b>152,151</b>	<b>498,168</b>	<b>2,693,104</b>

1 Depreciation for the year includes US\$411.8 million (2017: US\$367.7 million) recognised as an expense in cost of sales in the income statement and US\$8.3 million (2017: US\$13.3 million), capitalised as part of construction in progress.

2 From the additions in 'other assets' category US\$4.5 million (2017: US\$24.1 million) corresponds to the reassessment of mine closure rehabilitations costs, see note 20.

The table below details construction in progress by operating mine

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Saucito	88,916	101,885
Herradura	70,536	98,401
Noche Buena	20,834	12,028
Ciénega	47,838	29,039
Fresnillo	48,671	30,641
San Julián	64,236	53,383
Other <sup>3</sup>	157,137	145,678
	<b>498,168</b>	<b>471,055</b>

3 Mainly corresponds to Juanicipio development project (2017: Juanicipio development project and Minera Bermejil, S.A. de C.V.).

During the year ended 31 December 2018, the Group capitalised US\$11.1 million of borrowing costs within construction in progress (2017: US\$11.4). Borrowing costs were capitalised at the rate of 5.78% (2017: 5.78%).

**SENSITIVITY ANALYSIS**

As at 31 December 2018 and 2017, 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 long-term price assumptions of US\$1,310/ounce and US\$19.25/ounce (2017: US\$1,300/ounce and US\$19/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% (2017: gold and silver 5%) and a high sensitivity by decreasing gold and silver prices by 10% and 15% respectively (2017: gold and silver 10%). As at 31 December 2018 the analysis resulted in an impairment on Herradura of US\$302.7 million under high sensitivity; US\$72.3 million under low sensitivity and San Julián US\$159.3 million under high sensitivity; US\$45.4 million under low sensitivity (2017: nil for Herradura and San Julián).

**13. 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 \$2.00 in years one to five and \$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 2018 was \$5.26 per ounce (2017: \$5.20 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 FVPL 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 35 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 2018 total proceeds received in cash were US\$36.3 million (2017: US\$43.3 million) of which, US\$4.9 million was in respect of proceeds receivable as at 31 December 2017 (2016: US\$5.9 million). Cash received in respect of the year of US\$31.3 million (2017: US\$37.3 million) corresponds to 3.4 million ounces of payable silver (2017: 3.6 million ounces). As at 31 December 2018, a further US\$3.4 million (2017: US\$4.9 million) of cash receivable corresponding to 335,914 ounces of silver is due (2017: 422,375 ounces).

The US\$15.0 million unrealised gain recorded in the income statement (31 December 2017: US\$113.6 million gain) resulted mainly from the unwinding of the discount and the updating of the Sabinas long-term mine plan, which were partially compensated by the increase in the LIBOR reference rate and the decrease in the forward silver price.

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

	2018 US\$ thousands	2017 US\$ thousands
Balance at 1 January:	538,887	467,529
Cash received in respect of the year	(31,379)	(37,373)
Cash receivable	(3,371)	(4,925)
Remeasurement gains recognised in profit and loss	14,956	113,656
Balance at 31 December	519,093	538,887
Less – Current portion	20,819	32,318
Non-current portion	498,274	506,569

See note 29 for further information on the inputs that have a significant effect on the fair value of this derivative, see note 30 for further information relating to market and credit risks associated with the Silverstream asset.

## FINANCIAL STATEMENTS

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 14. INVENTORIES

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Finished goods <sup>1</sup>	15,052	10,957
Work in progress <sup>2</sup>	235,094	175,016
Ore stockpile <sup>3</sup>	3,799	15,115
Operating materials and spare parts	87,180	75,331
	341,125	276,419
Allowance for obsolete and slow-moving inventories	(6,101)	(5,314)
Balance as 31 December at lower of cost and net realisable value	335,024	271,105
Less – Current portion	243,404	179,485
Non-current portion <sup>4</sup>	91,620	91,620

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 (note 2(c)).

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

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

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\$1,323.1 million (2017: US\$1,170.1 million) before changes to the net realisable value of inventory. During the year there was no adjustment to net realisable value allowance against work-in-progress inventory (2017: US\$2.2 million decrease). The adjustment to the allowance for obsolete and slow-moving inventory recognised as an expense was US\$0.8 million (2017: US\$1.04 million).

## 15. TRADE AND OTHER RECEIVABLES

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Trade and other receivables from related parties (note 26) <sup>5</sup>	213,292	226,134
Value Added Tax receivable	182,290	85,979
Other receivables from related parties (note 26)	3,371	4,925
Other receivables from contractors	2,755	21,292
Other receivables	10,306	4,612
	412,014	342,942
Provision for impairment of 'other receivables'	(857)	(436)
Trade and other receivables classified as current assets	411,157	342,506
Other receivables classified as non-current assets:		
Loans granted to contractors	–	129
	–	129
	411,157	342,635

5 As of 31 December 2017 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.

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

The total receivables denominated in US\$ were US\$223.1 million (2017: US\$242.3 million), and in Mexican pesos US\$187.2 million (2017: US\$100.3 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 2018 is US\$0.9 million (2017: US\$0.4 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 30(b).

**16. CASH AND CASH EQUIVALENTS**

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

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Cash at bank and on hand	2,125	4,265
Short-term deposits	558,660	871,769
Cash and cash equivalents	560,785	876,034

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.

**17. EQUITY****SHARE CAPITAL AND SHARE PREMIUM**

Authorised share capital of the Company is as follows:

Class of share	As at 31 December			
	2018		2017	
	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 2017	736,893,589	\$368,545,586	50,000	£50,000
At 31 December 2017	736,893,589	\$368,545,586	50,000	£50,000
At 31 December 2018	736,893,589	\$368,545,586	50,000	£50,000

As at 31 December 2018 and 2017, 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 transferable.

**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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

**17. EQUITY CONTINUED****COST OF HEDGING RESERVE**

The changes in the time value of option contracts are accumulated in the costs of hedging reserve. These deferred costs of hedging are either reclassified to profit or loss or recognised as a basis adjustment to non-financial assets or liabilities upon maturity of the hedged item, or, in the case of a hedge item that realises over time, amortised on a systematic and rational basis over the life of the hedged item.

**AVAILABLE-FOR-SALE FINANCIAL ASSETS RESERVE**

As at 31 December 2017 this reserve recorded fair value changes on available-for-sale investments, net of tax. On disposal or on impairment, the cumulative changes in fair value were recycled to the income statement. These assets were reclassified upon adoption of IFRS 9, for further detail see note 2 (b).

**FAIR VALUE RESERVE OF FINANCIAL ASSETS AT FVOCI**

The Group has elected to recognise changes in the fair value of certain investments in equity securities in OCI, as explained in note 2(b). These changes are accumulated within the FVOCI reserve within equity. The Group transfers amounts from this reserve to retained earnings when the relevant equity securities are derecognised.

**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.

**18. DIVIDENDS DECLARED AND PAID**

The dividends declared and paid during the years ended 31 December 2018 and 2017 are as follows:

	US cents per Ordinary Share	Amount US\$ thousands
<b>Year ended 31 December 2018</b>		
Final dividend for 2017 declared and paid during the year <sup>1</sup>	29.8	219,594
Interim dividend for 2018 declared and paid during the year <sup>2</sup>	10.7	78,848
	<b>40.5</b>	<b>298,442</b>
<b>Year ended 31 December 2017</b>		
Final dividend for 2016 declared and paid during the year <sup>3</sup>	21.5	158,432
Interim dividend for 2017 declared and paid during the year <sup>4</sup>	10.6	78,111
	<b>32.1</b>	<b>236,543</b>

1 This dividend was approved by the Board of Directors on 30 May 2018 and paid on 4 June 2018.

2 This dividend was approved by the Board of Directors on 3 September 2018 and paid on 7 September 2018.

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

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

**19. 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	
	2018 US\$ thousands	2017 US\$ thousands
Opening balance	799,046	798,027
Accrued interest	46,267	46,267
Interest paid <sup>5</sup>	(46,267)	(46,267)
Amortisation of discount and transaction costs	1,081	1,019
Closing balance	<b>800,127</b>	<b>799,046</b>

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



The Group has the following restrictions derived from the issuance of 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.

#### 20. 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.

The Group has performed separate calculations of the provision by currency, discounting at corresponding rates. As at 31 December 2018, the discount rates used in the calculation of the parts of the provision that relate to Mexican pesos range from 7.12% to 8.55% (2017: range of 6.27% to 7.97%). The range for the current year parts that relate to US dollars range from 2.05% to 2.70% (2017: range of 1.37% to 2.22%). 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.

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 3 to 25 years from 31 December 2018 (3 to 27 years from 31 December 2017). As at 31 December 2018 the weighted average term of the provision is 12 years (2017: 13 years).

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Opening balance</b>	<b>184,775</b>	149,109
Increase to existing provision	<b>9,758</b>	1,024
Effect of change in estimation	<b>-</b>	19,678
Effect of changes in discount rate	<b>(14,279)</b>	(281)
Unwinding of discount	<b>10,065</b>	11,729
Payments	<b>(545)</b>	(131)
Foreign exchange	<b>68</b>	3,647
<b>Closing balance</b>	<b>189,842</b>	184,775

#### 21. 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.

## FINANCIAL STATEMENTS

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 21. PENSIONS AND OTHER POST-EMPLOYMENT BENEFIT PLANS CONTINUED

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 2018
	Balance at 1 January 2018	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	
Defined benefit obligation	(27,327)	(62)	(1,791)	5	(1,848)	884	-	-	1,749	821	-	2,570	-	-	(25,721)
Fair value of plan assets	18,110	-	1,110	27	1,137	(630)	40	-	-	-	-	40	614	57	19,328
Net benefit liability	(9,217)	(62)	(681)	32	(711)	254	40	-	1,749	821	-	2,610	614	57	(6,393)

US\$ thousands

	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	
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)

US\$ thousands

Of the total defined benefit obligation, US\$7.4 million (2017: US\$7.5 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 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	
	2018 %	2017 %
Discount rate	8.42	7.67
Future salary increases (NCPI)	5.15	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 26.6 years respectively (2017: 23.1 years for men and 26.3 for women). The weighted average duration of the defined benefit obligation is 10.8 years (2017: 11 years).

The fair values of the plan assets were as follows:

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Government debt	351	556
State owned companies	5,132	4,559
Mutual funds (fixed rates)	13,845	12,995
	19,328	18,110

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 2018 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)	(1,256)	1,374	179	(173)	76

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.

## 22. TRADE AND OTHER PAYABLES

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Trade payables	91,734	93,664
Other payables to related parties (note 26)	12,321	9,057
Accrued expenses	13,163	18,600
Other taxes and contributions	15,922	13,628
	133,140	134,949

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 30.

## 23. COMMITMENTS

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

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Saucito	52,288	64,511
Herradura	17,701	28,813
Noche Buena	3,346	1,643
Ciénega	13,779	16,688
Fresnillo	90,181	19,570
San Julián	8,781	27,403
Other <sup>1</sup>	142,111	83,729
	328,187	242,357

<sup>1</sup> Other includes commitments of Minera Juanicipio, S.A. de C.V. (2017: Minera Bermejil, S. de R.L. de C.V. and Minera Juanicipio, S.A. de C.V.)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

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

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

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Within one year	–	491
After one year but not more than five years	–	108
	–	599

**(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<sup>1</sup>:

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Within one year	6,374	3,424
After one year but not more than five years	9,756	2,926
	16,130	6,350

	As at 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Minimum lease payments expensed in the year	7,193	4,916

<sup>1</sup> During the Group's IFRS 16 implementation activities, a limited number of highly certain extensions to operating lease commitments were identified. The 2017 commitments have been restated to reflect those judgements in a consistent manner.

**25. CONTINGENCIES**

As of 31 December 2018, 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.
- Other than discussed below, tax inspections that had been initiated by the SAT in previous years, were either closed or resolved through a Conclusive Agreement in 2018 or in early 2019. According to article 69-H of the Mexican Tax Code, settlements reached and executed by taxpayers and the authority may not be challenged in any way. Such settlements shall only be effective between the parties; and they shall not constitute a precedent in any case.
- With respect to Minera Penmont's 2012 and 2013 tax inspections, on 11 July, 2018 the Company filed before tax authorities a substance administrative appeal against the tax assessment, and on 3 September 2018, it filed additional documentation before tax authorities and is waiting for its response.
- On 22 October 2018 we were notified of the SAT's findings in respect of Minera Penmont's 2015 & 2016 tax inspections. The Company considers it completed the provision of all documentation required to demonstrate that the tax deductions which are being challenged, are appropriate and is waiting for the SAT's response.
- On 1 February 2019 we were notified that the SAT will conduct an inspection of Minera Saucito's 2013 tax certificate.
- 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.

- 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' o '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 2018 and going forward.
- 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 its 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 nor 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.
- In 2011, flooding occurred in the Saucito mine, following which the Group filed an insurance claim in respect of the damage caused (and in respect of business interruption). In early 2018, the insurance provider notified the Group that the claim had been accepted; however, there is disagreement about the appropriate amount to be paid. In October the Group received US\$13.6 million in respect of the insurance claim, however this does not constitute a final settlement and management continues to pursue a higher insurance reimbursement. Due to the fact that negotiations are on-going and there is uncertainty regarding the timing of reaching an agreement with the insurer, the amount expected to be recovered is currently not practicable to determine.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

**25. CONTINGENCIES** CONTINUED

- On 11 February 2019, the Supreme Court of Mexico issued a ruling regarding a specific constitutional issue presented by the former administration of the Federal Government, who challenged the ability of the State of Zacatecas to impose environmental taxes on aspects such as (i) extraction of rocks; (ii) emissions into the air; (iii) discharges of industrial residues, and (iv) disposal of industrial waste.

The ruling of the Supreme Court establishes that, from a constitutional point of view, there is no express limitation granting the Mexican State at a Federal level the sole power to impose such taxes; therefore, the State of Zacatecas has a joint right to create these taxes. Notwithstanding the foregoing, the Court did not exhaust the analysis of the legality of each particular tax created by the State of Zacatecas.

The Company had previously challenged the legality of such taxes and in 2017 obtained an injunction from a Federal court. The State of Zacatecas has appealed this ruling and the final result is pending.

**26. RELATED PARTY BALANCES AND TRANSACTIONS**

The Group had the following related party transactions during the years ended 31 December 2018 and 2017 and balances as at 31 December 2018 and 2017.

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	
	2018 US\$ thousands	2017 US\$ thousands	2018 US\$ thousands	2017 US\$ thousands
<b>Trade:</b>				
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	213,202	225,741	408	397
<b>Other:</b>				
Industrias Peñoles, S.A.B. de C.V.	3,371	4,925	-	-
Servicios Administrativos Peñoles, S.A. de C.V.	-	-	3,249	2,434
Servicios Especializados Peñoles, S.A. de C.V.	-	-	1,556	1,786
Fuentes de Energía Peñoles, S.A. de C.V.	-	-	1,138	-
Termoeléctrica Peñoles, S. de R.L. de C.V.	-	-	988	1,650
Eólica de Coahuila S.A. de C.V.	-	-	3,459	1,926
Other	90	392	1,523	864
Sub-total	216,663	231,058	12,321	9,057
Less-current portion	216,663	231,058	12,321	9,057
Non-current portion	-	-	-	-

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

Other balances with related parties:

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<i>Silverstream contract:</i>		
Industrias Peñoles, S.A.B. de C.V.	519,093	538,887

The Silverstream contract can be settled in either silver or cash. Details of the Silverstream contract are provided in note 13.

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

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Income:</b>		
<i>Sales:</i> <sup>1</sup>		
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	2,119,758	2,101,579
<i>Insurance recovery</i>		
Grupo Nacional Provincial, S.A. B. de C.V. <sup>2</sup>	13,652	-
<i>Other income</i>	4,419	3,173
<b>Total income</b>	<b>2,137,829</b>	<b>2,104,752</b>

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\$141.2 million (2017: US\$139.9 million) and include sales credited to development projects of US\$17.6 million (2017: US\$8.3 million).

2 Includes a time value element of US\$ 3.1 million which has been recognised in finance income within the income statement.

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
<b>Expenses:</b>		
<i>Administrative services:</i> <sup>3</sup>		
Servicios Administrativos Peñoles, S.A. de C.V. <sup>4</sup>	28,625	26,323
Servicios Especializados Peñoles, S.A. de C.V.	15,830	18,239
	<b>44,455</b>	<b>44,562</b>
<i>Energy:</i>		
Termoeléctrica Peñoles, S. de R.L. de C.V.	17,383	20,415
Fuerza Eólica del Istmo S.A. de C.V.	2,187	1,678
Fuentes de Energía Peñoles, S.A. de C.V.	3,872	-
Eólica de Coahuila S.A. de C.V.	34,147	13,666
	<b>57,589</b>	<b>35,759</b>
<i>Operating materials and spare parts:</i>		
Wideco Inc	5,783	4,534
Metalúrgica Met-Mex Peñoles, S.A. de C.V.	8,329	6,420
	<b>14,112</b>	<b>10,954</b>
<i>Equipment repair and administrative services:</i>		
Serviminas, S.A. de C.V.	9,733	8,406
<i>Insurance premiums:</i>		
Grupo Nacional Provincial, S.A. B. de C.V.	8,603	8,157
<i>Other expenses:</i>	2,561	3,795
<b>Total expenses</b>	<b>137,053</b>	<b>111,633</b>

3 Includes US\$1.7 million (2017: US\$6.4 million) corresponding to expenses reimbursed.

4 Includes US\$4.2 million (2017: US\$7.5 million) relating to engineering costs that were capitalised.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

**26. RELATED PARTY BALANCES AND TRANSACTIONS** CONTINUED**(C) COMPENSATION OF KEY MANAGEMENT PERSONNEL OF THE GROUP**

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

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Salaries and bonuses	3,260	3,385
Post-employment benefits	245	235
Other benefits	249	373
Total compensation paid in respect of key management personnel	3,754	3,993

	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Accumulated accrued defined pension entitlement	4,001	4,433

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.

**27. AUDITOR'S REMUNERATION**

Fees due by the Group to its auditor during the year ended 31 December 2018 and 2017 are as follows:

Class of services	Year ended 31 December	
	2018 US\$ thousands	2017 US\$ thousands
Fees payable to the Group's auditor for the audit of the Group's annual accounts	1,306	1,214
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	176	226
Audit-related assurance services	347	308
Tax compliance services	4	19
Total	1,833	1,767



## 28. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

	Notes	2018 US\$ thousands	2017 US\$ thousands
Reconciliation of profit for the year to net cash generated from operating activities			
Profit for the year		349,966	560,807
<b>Adjustments to reconcile profit for the period to net cash inflows from operating activities:</b>			
Depreciation and amortisation	5	411,764	367,609
Employee profit sharing	7	13,003	17,150
Deferred income tax	10	(45,385)	(3,101)
Current income tax expense	10	179,349	183,783
Loss/(gain) on the sale of property, plant and equipment and other assets	8	999	(25,333)
Impairment of available-for-sale financial assets	8	-	36
Net finance costs		27,433	33,674
Foreign exchange loss		8,382	11,434
Difference between pension contributions paid and amounts recognised in the income statement		62	(58)
Non-cash movement on derivatives		34	41,389
Changes in fair value of Silverstream	14	(14,956)	(113,656)
<b>Working capital adjustments</b>			
(Increase) in trade and other receivables		(60,384)	(44,381)
(Increase) in prepayments and other assets		(11,753)	(708)
(Increase)/decrease in inventories		(63,918)	5,745
Increase in trade and other payables		8,174	36,426
<b>Cash generated from operations</b>		802,770	1,070,816
Income tax paid		(200,088)	(292,063)
Employee profit sharing paid		(14,323)	(17,282)
<b>Net cash from operating activities</b>		588,359	761,471

## 29. FINANCIAL INSTRUMENTS

## (A) FAIR VALUE CATEGORY

As at 31 December 2018				
US\$ thousands				
	Amortised cost	Fair value through OCI	Fair value (hedging instruments)	Fair value through profit or loss
<b>Financial assets:</b>				
Trade and other receivables (note 15)	1,986	-	-	216,573
Equity instruments at FVOCI	-	78,219	-	-
Silverstream contract (note 13)	-	-	-	519,093
Derivative financial instruments	-	-	314	-
<b>Financial liabilities:</b>				
Interest-bearing loans (note 19)	800,127	-	-	-
Trade and other payables (note 22)	97,169	-	-	-
Derivative financial instruments	-	-	3,807	-

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 29. FINANCIAL INSTRUMENTS CONTINUED

	As at 31 December 2017			
	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)
<b>Financial assets:</b>				
Trade and other receivables <sup>1</sup> (note 15)	–	–	236,859	–
Available-for-sale financial assets	–	144,856	–	–
Silverstream contract (note 13)	538,887	–	–	–
Embedded derivatives within sales contracts <sup>1</sup> (note 4)	6,511	–	–	–
Derivative financial instruments	311	–	–	71
<b>Financial liabilities:</b>		At fair value through profit or loss	At amortised Cost	At fair value through OCI (cash flow hedges)
Interest-bearing loans (note 19)		–	799,046	–
Trade and other payables (note 22)		–	102,721	–
Derivative financial instruments		37	–	19,179

<sup>1</sup> 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:

	Carrying amount		As at 31 December	
	2018	2017	2018	2017
	US\$ thousands	US\$ thousands	US\$ thousands	US\$ thousands
<b>Financial assets:</b>				
Trade receivables	216,573	236,859	216,573	236,859
Equity instruments at FVOCI	78,219	–	78,219	–
Available-for-sale financial assets	–	144,856	–	144,856
Silverstream contract (note 13)	519,093	538,887	519,093	538,887
Embedded derivatives within sales contracts	–	6,511	–	6,511
Derivative financial instruments	74	382	74	382
<b>Financial liabilities:</b>				
Interest-bearing loans <sup>2</sup> (note 19)	800,127	799,046	817,936	878,864
Derivative financial instruments	3,807	19,216	3,807	19,216

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

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 2018				
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
<b>Financial assets:</b>				
Trade receivables	-	-	216,573	216,573
Derivative financial instruments:				
Option commodity contracts (note 29 (c))	-	240	-	240
Option and forward foreign exchange contracts	-	74	-	74
Silverstream contract	-	-	519,093	519,093
Other financial assets:				
Equity instruments at FVOCI	78,219	-	-	78,219
	78,219	314	735,666	814,199
<b>Financial liabilities:</b>				
Derivative financial instruments:				
Option commodity contracts (note 29 (c))	-	3,660	-	3,660
Option and forward foreign exchange contracts	-	147	-	147
	-	3,807	-	3,807

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
<b>Financial assets:</b>				
Derivative financial instruments:				
Embedded derivatives within sales contracts	-	-	6,511	6,511
Option commodity contracts (note 29 (c))	-	71	-	71
Option and forward foreign exchange contracts	-	311	-	311
Silverstream contract	-	-	538,887	538,887
Financial investments available-for-sale:				
Quoted investments	144,856	-	-	144,856
	144,856	382	545,398	690,636
<b>Financial liabilities:</b>				
Derivative financial instruments:				
Option commodity contracts (note 29 (c))	-	19,179	-	19,179
Option and forward foreign exchange contracts	-	37	-	37
	-	19,216	-	19,216

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

**29. FINANCIAL INSTRUMENTS CONTINUED**

A reconciliation of the opening balance to the closing balance for Level 3 financial instruments other than Silverstream (which is disclosed in note 13) is shown below<sup>1</sup>:

	2018 US\$ thousands	2017 US\$ thousands
Balance at 1 January:	225,741	(2,750)
Net change in trade receivable from goods sold	(12,048)	-
Changes in fair value	(4,016)	15,068
Realised embedded derivatives during the year	3,525	(5,807)
Balance at 31 December	213,202	6,511

1 Balance as at 31 December 2017 corresponds to the embedded derivative included in trade receivable for sales subject to provisional pricing; from 1 January 2018 onwards as a result of the adoption of IFRS 9 as explained in note 2 (b) the balance corresponds the whole trade receivable for sales subject to provisional pricing.

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 13. 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 30.

**EQUITY INVESTMENTS:**

The fair value of equity investments 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).

**TRADE RECEIVABLES:**

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 (n)). This price exposure is considered to be an embedded derivative and therefore the entire related trade receivable is measured at fair value.

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.

**(C) DERIVATIVE FINANCIAL INSTRUMENTS**

The Group enters into certain option contracts to manage its exposure to commodity price risk as described in note 2 (r).

The Group sells gold as the primary product of the Group's open-pit mines. Upon the acquisition of the remaining 46% interest in the Penmont mines in 2014, the Group entered into commodity option contracts to protect the value of future sales related to that previous non-controlling interest over a period of five years. The Group also sells lead and zinc as a by-product in certain of its mines. Except in relation to the acquisition of the remaining interest in the Penmont mines described above, the Group's risk management strategy is to not hedge primary metal prices and hedge by-product metals in certain market conditions. The Group monitors metal price volatility in order to determine when to enter into new hedging contracts related to by-products. New contracts were entered into in 2017 but not in 2018. These contracts are expected to reduce the volatility attributable to metals price fluctuations. Hedging the price volatility of forecast metals sales is in accordance with the risk management strategy outlined by the Board of Directors.

There is an economic relationship between the hedged items and the hedging instruments as the terms of the commodity option contracts match the terms of the expected highly probable forecast sales (i.e., notional amount and expected payment date). The Group has established a hedge ratio of 1:1 for the hedging relationships as the underlying risks of the commodity option contracts are identical to the hedged risk components. To test the hedge effectiveness, the Group uses the hypothetical derivative method and compares the changes in the fair value of the hedging instruments against the changes in fair value of the hedged items attributable to the hedged risks.

Due to the terms of the Group's hedge relationships, the change in the fair value of both the hedging instrument and hedged items equalled the amounts recognised in other comprehensive income in the following paragraphs. The amounts recycled to the income statement in respect of these contracts are recognised in revenue; ineffectiveness is recognised in finance cost.

**GOLD OPTION CONTRACTS**

As at 31 December 2018, the outstanding collar derivative instruments mature over the period from 31 January 2019 to 30 December 2019 and hedge cash proceeds for the sales of gold production amounting 346,152 ounces (2017: 712,584 ounces) with a floor price of US\$1,100:1 ounce, a range of capped prices from US\$1,375 to US\$1,495:1 ounce (2017: US\$1,375 to US\$1,495:1 ounce) and weighted average capped price of US\$1,424:1 ounce (2017: US\$1,423:1 ounce). The fair value of the put options as at 31 December 2018 was an asset of US\$0.9 million (2017: US\$3.7 million), and the fair value of the call options at 31 December 2018 was a liability of US\$4.6 million (2017: US\$21.8 million). In 2018 the changes in the fair value of the option contracts corresponding to the time value amounted to US\$14.4 million and was recorded in other comprehensive income; in 2017 fair value amounted of US\$41.1 million was recorded in the income statement.

**LEAD OPTION CONTRACTS**

As at 31 December 2018 there were no outstanding options related to lead contracts. As at 31 December 2017, lead collar derivative instruments hedge lead production amounting 21,168 tonnes with a floor price of US\$2,370:1 tonne, a range of capped prices from US\$2,730 to US\$2,740:1 tonne and weighted average cap price of US\$2,735:1 tonne. The fair value of the put options at 31 December 2017 was an asset of US\$0.5 million, and the fair value of the call options at 31 December 2017 was a liability of US\$0.5 million. The gain recycled to the income statement in the period was US\$1.0 million (2017: nil).

**ZINC OPTION CONTRACTS**

As at 31 December 2018 there were no outstanding options related to zinc contracts. As at 31 December 2017, zinc collar derivative instruments hedge lead production amounting 5,760 tonnes with a range of floor prices of US\$2,500 to 2,756:1 tonne and weighted average floor price of US\$2,591:1 tonne, a range of capped prices from US\$3,650 to US\$3,800:1 tonne and weighted average cap price of US\$3,716:1 tonne. The fair value of the put options at 31 December 2017 was an asset of US\$0.5 million, and the fair value of the call options at 31 December 2017 was a liability of US\$1.5 million. The gain recycled to the income statement in the period was US\$0.6 million (2017: nil).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

### 30. FINANCIAL RISK MANAGEMENT

#### OVERVIEW

The Group's principal financial assets and liabilities, other than derivatives, comprise trade receivables, cash, equity instruments at FVOCI, 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.
- 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.

#### (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 29 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
2018	10% (10%)	(380) 464
2017	20% (10%)	(3,783) 1,365

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
<b>2018</b>	<b>10%</b>	<b>19</b>
	<b>(10%)</b>	<b>20</b>
2017	10%	(335)
	(10%)	500

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
<b>2018</b>	<b>10%</b>	<b>53</b>
	<b>(10%)</b>	<b>52</b>
2017	10%	1058
	(10%)	(1,056)

#### 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
<b>2018</b>	<b>10%</b>	<b>(46)</b>
	<b>(10%)</b>	<b>56</b>
2017	20%	(781)
	(10%)	521

#### 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		
<b>2018</b>	<b>10%</b>	<b>15%</b>	<b>25%</b>	<b>20%</b>	<b>22,330</b>	<b>(14,910)</b>
	<b>(10%)</b>	<b>(15%)</b>	<b>(20%)</b>	<b>(15%)</b>	<b>(21,204)</b>	<b>8,703</b>
2017	10%	10%	20%	15%	83,433	(19,164)
	(10%)	(10%)	(20%)	(15%)	5,105	1,818

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 30. FINANCIAL RISK MANAGEMENT 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
2018	15% (15%)	106,879 (106,879)
2017	10% (10%)	72,779 (72,779)

## 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
2018	75 (75)	4,206 (4,206)
2017	90 (50)	7,898 (4,388)

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
2018	75 (75)	(47,151) 54,775
2017	90 (50)	(58,798) 37,935



**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
<b>2018</b>	<b>100</b>	<b>56</b>
	<b>(100)</b>	<b>(51)</b>
2017	100	88
	(100)	(83)

**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
<b>2018</b>	<b>40%</b>	<b>-</b>	<b>31,288</b>
	<b>(40%)</b>	<b>-</b>	<b>(31,288)</b>
2017	40%	-	28,972
	(65%)	-	(65,408)

**(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 counterparty. The Group's financial assets are with counterparties with what the Group considers to have an appropriate credit rating. As disclosed in note 26, 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 2018 and 2017. 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 per cent of the shares of the Company and is considered by management to be of appropriate credit rating.

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 mxA-1+ (Standard and Poor's) and above. As at 31 December 2018, the Group had concentrations of credit risk as 19 percent of surplus funds were deposited with one financial institution of which the total investment 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 16 for the maximum credit exposure to cash and cash equivalents, note 27 for related party balances with Met-Mex and note 29 for equity instruments at FVOCI. The maximum credit exposure with relation to the Silverstream contract is the value of the derivative as at 31 December 2018, being US\$519.1 million (2017: US\$538.9 million).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

## 30. FINANCIAL RISK MANAGEMENT CONTINUED

## (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
<b>As at 31 December 2018</b>					
Interest-bearing loans (note 19)	46,267	92,534	92,534	800,000	1,031,335
Trade and other payables	97,169	-	-	-	97,169
Derivative financial instruments - liabilities	3,807	-	-	-	3,807
	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
<b>As at 31 December 2017</b>					
Interest-bearing loans (note 19)	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

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
<b>As at 31 December 2018</b>					
Inflows	12,608	4,310	-	-	16,918
Outflows	(12,688)	(4,290)	-	-	(16,977)
<b>Net</b>	<b>(80)</b>	<b>20</b>	<b>-</b>	<b>-</b>	<b>(60)</b>
	US\$ thousands				
	Within 1 year	2-3 years	3-5 years	> 5 years	Total
<b>As at 31 December 2017</b>					
Inflows	15,174	-	-	-	15,174
Outflows	(14,884)	-	-	-	(14,884)
<b>Net</b>	<b>290</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>290</b>

The above liquidity tables include expected inflows and outflows from currency option contracts which the Group expects to be exercised during 2019 as at 31 December 2018 and during 2018 as at 31 December 2017, 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:

	2018 US\$ thousands	2017 US\$ thousands
Cash and cash equivalents (note 16)	560,785	876,034
Available-for-sale financial instruments held in funds	–	19,877
<b>Cash and other liquid assets position</b>	<b>560,785</b>	<b>895,911</b>