



INDUSTRIAS PEÑOLES, S.A.B. DE C.V.

ANNUAL REPORT OF THE BOARD OF DIRECTORS TO THE SHAREHOLDERS' MEETING CORRESPONDING TO FISCAL YEAR 2013.

Dear shareholders:

As Chairman of the Board of Directors of Industrias Peñoles, S.A.B. de C.V., and on behalf of the Board, it is my honor to present you this report based on an analysis of the information provided by the Chief Executive Officer in his Annual Report on the Company's performance, the financial and operating results obtained in the 2013 fiscal year, the key developments from the period, and a report on the main activities of the Board of Directors.

The macroeconomic environment remained volatile and presented new challenges for Peñoles. The pace of growth decelerated across emerging markets and in Mexico in particular, while developed economies showed incipient recovery.

The sharp fall in precious metal prices signaled the end to a short era of exceptional prosperity for our industry. With the exception of lead, prices for the industrial metals in our portfolio also declined. It is, without doubt, an adverse time for our industry and we will have great challenges to overcome.

In Mexico, a number of reforms aimed at boosting the economic growth and development of our country were approved, including energy, financial

and educational reforms, as well as a fiscal package that includes new taxes for all businesses, with special duties for mining companies that will erode their competitiveness. This, coupled with security problems and land disputes, represents new challenges for the Company.

Our long history has taught us to address the inherent cyclical nature of the mining and metallurgical industry. Therefore, in both good times and bad we invest prudently and with a longterm view; we focus on maintaining the sustainability of our operations and organic growth, while consistently seeking to improve productivity through efficiency and cost controls in our operations. In years such as 2013, we redoubled our efforts to face new adverse conditions.

Peñoles has a solid and conservative financial position supported by the continuity of its strategy, which gives us flexibility and strength in difficult times. Our commitment to Mexico and value creation across the cycles is unwavering.

Nothing better exemplifies this commitment than the startup of new operations, the execution of our strategic growth projects as planned, and the investments made in exploration, technological development, sustainability, technology, training, safety and community development.

Specifically, we can highlight the successful startup of operations at the Velardeña mine in May, in the state of Durango, which contributed to the notable increase in annual zinc production. Velardeña required an investment of \$2,652 million and utilizes advanced technology.

The new dynamic leaching plant at Fresnillo plc's gold mine, Herradura, in the state of Sonora, at \$1,560 million, began startup testing in December to increase gold recoveries.

Construction advanced at the Rey de Plata polymetallic mine, in the state of Guerrero, with mine development, infrastructure preparation and the

placement of critical equipment orders. Production of zinc, copper, silver, lead and gold from this mine is expected for 2015, with an investment of \$3,484 million.

The \$507 million project to expand sodium sulfate production capacity by 150,000 tons per year at Química del Rey, in the state of Coahuila, advanced as planned.

At Fresnillo plc, two additional projects are under development: the San Julián silver-gold mine, in the state of Chihuahua, and Saucito II, in the state of Zacatecas, with \$6,500 million and \$3,055 million in investment, respectively.

As such, the investments made in 2013 in both fixed assets and exploration totaled \$14,404 million; while this figure is lower than in the previous year due to the difficult circumstances in the industry, it is in line with our strategy and vision of longterm sustainable growth.

The exploration group conducted an intensive program with more than 516,000 meters of drilling across 32 projects in Mexico and South America. The work undertaken allowed for a significant increase of resources at Rey de Plata, in the state of Guerrero. Resource estimates are conducted at Los Humos, a copper project in Sonora, and at Racaycocha, a coppermolybdenum project in Peru. Fresnillo plc made important findings at Noche Buena and San Ramón, as well as at the advanced projects of Centauro Deep and Juanicipio.

Our commitment to value creation includes actively supporting the economic development and self-sufficiency of the communities where we operate, aside from the benefit of creating decent and well-paying jobs. Peñoles actively participates in building roads, schools and infrastructure services, as well as promoting culture, athletics and recreational activities, among many other actions. This year our community investments totaled \$164 million.

These investments helped Peñoles to increase employment. In Velardeña, for example, in addition to our community support we created 800 direct and 1,600 indirect jobs, contributing significantly to regional and economic development in the state of Durango.

As for performance in 2013, mining operations exceeded production for all metal contents with the exception of gold, due to the temporary suspension of operations at the Herradura and Soledad-Dipolos mines as a result of an agrarian conflict. In the case of Herradura, a new explosives permit is being processed. Silver volumes grew with better ore grades and higher volumes treated at the Saucito, San Ramón and Ciénega mines. Zinc had the greatest increase, driven by the startup of Velardeña, while lead production benefited from better ore grades at Naica and Saucito. With regard to copper, including cathodes, production was nearly unchanged from the previous year.

In the metallurgical operations, refined gold and silver registered lower production volumes due to fewer inputs of doré from Penmont and reduced third party purchases of materials rich in precious metals. Production of refined lead declined due to lower lead contained in the concentrates received, and refined zinc declined slightly from the previous year.

Sodium sulfate volumes broke production and sales records for the second consecutive year, and as a result of commercial efforts, the remaining products performed well, with record production of magnesium sulfate. These products diversify our revenues and markets.

In order to focus on core businesses, we decided to sell our indirect participation, through Bal-Ondeo, S.A. de C.V., of Desarrollos Hidráulicos de Cancún, S. de R.L. de C.V., a concession holder for the extraction, treatment and distribution of water in the municipalities of Cancún and Isla Mujeres in the state of Quintana Roo. The transaction was completed in December.

In addition, we continue to take firm steps towards energy self-sufficiency with the search for renewable sources, as part of our dual commitment to sustainability and cost reduction. Of particular note is the signing of a memorandum of understanding to develop a wind farm in the state of Coahuila, with the potential to generate between 150 and 200 MW, which could start operations in 2016 to complement our wind farm in Oaxaca.

Gross sales in 2013, excluding hedging results, totaled \$65,393 million, a -32.9% decline from 2012 primarily due to lower metal prices and lower volumes sold, as well as a lower average exchange rate for the peso against the dollar. Results from metal prices and exchange rate hedgings were favorable, at \$1,158 million. Gross profit was \$18,464 million (-35.6%), EBITDA was \$16,243 million and operating income totaled \$10,748 million (37.8% and 47.6% lower, respectively). Net income in 2013 was \$4,761 million (-52.5%) and \$6,610 million in dividends were declared in 2013. The debt to EBITDA ratio was 1.2 times at the close of the year, with sufficient cash to cover operating, strategic and financial needs for the medium term.

In a difficult year, Peñoles' financial position remains solid and the balance sheet is strong and conservative. This is reflected in the Company's credit ratings, in which a stable outlook prevails.

The confidence of the financial markets was demonstrated by Fresnillo plc's successful placement of USD\$800 million 10- year bonds in the international market. Fresnillo also completed USD\$346 million in a new share issue and placement on the London Stock Exchange. The proceeds from both transactions will enable Fresnillo to continue funding its strategic growth projects.

We recognize that employees are the life force of the Company. Thus the commitment to promote their development in an atmosphere of respect and recognition, and in a safe working environment, is fundamental. As such,

we have continued and will continue to significantly strengthen training and safety programs for our employees and contractors, and will further strengthen the safety culture throughout the Organization.

In 2013, implementation began on a Comprehensive Risk and Compliance Program for the prevention of fraud, corruption and money laundering, with the aim of strengthening internal controls, complying with legal requirements and promoting a culture of ethics and living our organizational values.

The Board of Directors has adhered to sound corporate governance practices throughout the year. To perform its functions, the Board is supported by the Committees recommended in the Code of Best Corporate Practices. The Board met four times during 2013 fiscal year. Among the topics discussed and approved at these meetings are the following:

- Reinforcement of safety programs.
- Labor-management relations.
- The metals hedging program.
- Review of the 2013 budget.
- The basis of the 2014 budget.
- Adjustments to the organizational structure.
- Internal corporate restructuring.
- The sale of non-core assets.

Pursuant to the provisions of the Securities Market Law, the Audit and Corporate Governance Committee has submitted its Annual Report, which is presented to the Shareholders' Meeting.

The financial statements from which comments herein are derived, as well as the main accounting policies and criteria used in the preparation of the financial information, were audited by the external auditors and included in the Annual Report. The Company's financial statements were prepared in

accordance with International Financial Reporting Standards, issued by the International Accounting Standards Board.

It is also submitted herein for the consideration of the Shareholders' Meeting a report on the main accounting policies and criteria used for the preparation of the financial statements that comprise, among others: the basis of presentation, consolidation, significant accounting policies and new accounting pronouncements, which were audited by the external auditors and made part of this report.

In the opinion of the Board of Directors, the report presented to this Shareholders' Meeting by the Chief Executive Officer reasonably reflects the financial position and results of the Company, as well as the key highlights of the business during 2013.

In accordance with policy, the performance of senior executives is evaluated annually. Any increase in salary and benefits must be authorized by the Nomination, Evaluation and Compensations Committee. Salary increases are made annually and bonuses are determined based on the results of performance evaluations. The remuneration package of senior executives is comprised of a base salary, legal and other benefits common to the industry domestically.

In 2014, we will face an environment of low metal prices and new taxes for this industry. Therefore, we must strive to maintain our competitiveness, increasing productivity and controlling costs. We remain firmly committed to maintaining prudent management practices and to adopting timely and effective actions to mitigate potential adverse effects. An internal corporate restructuring was undertaken to better protect the Company's assets and ensure more flexibility.

I would like to thank the members of the Board of Directors for their dedication, commitment and valuable contributions. I also want to thank our employees for their hard work. Thank you also to you, dear shareholders,

for the continued trust you have placed in us. We continue to have confidence about future growth and our commitment to you is unwavering.

Alberto Baillères
Chairman of the Board of Directors