



INDUSTRIAS PEÑOLES, S.A.B. DE C.V.

ANNUAL REPORT OF THE BOARD OF DIRECTORS TO THE SHAREHOLDERS' MEETING CORRESPONDING TO FISCAL YEAR 2014.

Dear shareholders:

As Chairman of the Board of Directors of Industrias Peñoles, S.A.B. de C.V., and on behalf of the Board, I 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 2014, and key developments in the period, as well as a report on the main activities of the Board of Directors.

As had been expected, 2014 was a year of great challenges, as economic conditions were adverse. Precious metal prices saw a sharp decline and reached their lowest levels of the past four years: within our industrial metals portfolio, only zinc had a moderate price increase.

Along with the unfavorable international metals market, the domestic industry has had to face the pressures generated by a rise in energy costs –when in contrast, international prices are declining–, difficulties arising from organized crime activity, conflicts linked to insecurity in land ownership, and of course, the new mining rights. The company will pay \$500.2 million pesos (hereafter “million”) in mining rights –surface, special and extraordinary– corresponding to 2014, representing 41.7% of net income. In terms of fuel, high overhead costs are being paid for diesel, the main input for open pit mines, compared to the international price. Clearly, the domestic mining industry has lost much of its competitiveness.

With more than a century of history, Peñoles has successfully weathered many difficulties and has overcome great challenges. The consistency of our strategy of prudent investment and long-term organic growth is essential to addressing the inherent cyclicity of the industry in a

changing environment. We recognize, however, that our greatness lies in our people, whose talent, effort and dedication empower us to face difficult circumstances.

The context of 2014 required us to take particular care of liquidity; for that reason we put special focus on controlling costs and expenses and rationalizing our investments. Thus, with a view beyond the annual cycle, we carefully allocated capital resources to sustain and achieve operational productivity, develop strategic projects and acquisitions, as well as to vital exploration, technological development, sustainability, training, safety and community development activities.

Among our growth projects, a highlight was the completion of construction of the new sodium sulfate plant at Química del Rey, in the state of Coahuila, which will expand production capacity by 150,000 tons per year and will enable us to consolidate leadership in the domestic market for this product. The investment was \$571.9 million, equivalent to \$43 million dollars (hereafter "US\$ million").

At Fresnillo plc, the new dynamic leaching plant to increase gold recovery from the Herradura mine in Sonora started up operations, as did Saucito II, a silver-gold mine in the state of Zacatecas. Investment in these projects totaled \$1,596.0 million (US\$120 million) and \$3,125.5 million (US\$235 million), respectively.

At the Rey de Plata project, a polymetallic mine in the state of Guerrero whose total investment will be \$3,564.4 million (US\$268 million), development and infrastructure work continued and critical equipment was received. Operations are expected to commence in 2017 for the production of zinc, silver, copper and gold. Construction also advanced according to schedule at Fresnillo plc's San Julián gold-silver mine, in the state of Chihuahua, where operations will start up in 2015.

Fresnillo plc's financial position enabled it to acquire the 44% stake held by Newmont USA, Ltd. in the Penmont joint venture, which includes the Herradura, Soledad-Dipolos and Noche Buena gold mines in the state of Sonora, as well as advanced exploration projects. Through this US\$450 million transaction, Penmont became 100% Fresnillo plc owned. The change strengthens its position and improves its outlook for sustained growth in gold production.

As such, investments in fixed assets and exploration totaled \$11,964.1 million (16.9% less than in the prior year); while this amount was lower due to difficult circumstances, it was sufficient for the disciplined

execution of projects and the proper maintenance of operations, and was in line with our vision of sustained long-term growth.

At Peñoles we seek to establish harmonious and mutually beneficial relationships with the communities where we operate, and want to ensure a proactive approach. Therefore our community investment is also a priority: we continued and will continue to actively support community development through the creation of good jobs, construction of schools, roads and infrastructure, and promotion of sports, health and recreational activities. Investment in social support this year was \$104.7 million.

In exploration activities, important findings were made in the portfolio of projects located in Mexico and South America. At the Los Humos copper project (Sonora), and the Racaycocha copper-molybdenum project (Peru), resource estimates were conducted, and in the latter, surrounding concessions were acquired, expanding the potential of the project. Work on areas surrounding the Velardeña zincmine (Durango) and the Milpillas copper mine (Sonora) helped identify resources with the potential to increase reserves for these operating units. Fresnillo plc obtained important findings that increased resources at San Ramón (Durango), Cardones (Guanajuato) and Pilarica (Peru), and encouraging results at Herradura (Sonora).

The performance of mining operations in 2014 was solid. Production of metal contents in the mines exceeded the previous year, with the exception of gold whose volume was slightly lower due to the stoppage of operations at Soledad-Dipolos and the temporary suspension at Herradura, which resumed its activities at the end of the first quarter of the year. This decline was partially offset by higher volumes at Noche Buena and Saucito. A new annual silver production record was set of 54.4 million ounces, thanks to higher volumes processed at Saucito and Herradura, and better ore grades at Sabinas. Lead production increased due to higher volumes and better ore grades and recoveries at Velardeña and Saucito, while zinc production had the most growth, driven by Velardeña, which in just over a year since starting up, is producing above its original design capacity. As for copper, production rose due to better ore grade and recovery at Milpillas.

In the metallurgical operations, production volume of refined silver rose due to better ore grades in the concentrates and materials received, while gold rose slightly due to higher content of rich materials; lead volume was lower due to a decline in contents in the concentrates treated, and zinc increased with the higher volume of concentrates received and better ore grades.

Production volume of sodium sulfate was similar to the previous year; however, lower demand from the domestic market due the economic situation affected sales of this product. Nonetheless, among the other

chemicals, certain varieties of magnesium oxide registered new production and sales records. Similarly, magnesium sulfate also attained a new production and sales record thanks to increased demand in the agricultural market.

In addition, we advanced our strategy of self-sufficiency in electricity generated from renewable sources. A 25-year energy supply agreement was signed with the Portuguese company Electricidad de Portugal Renovables (EDPR), for the development of a wind farm with 180 MW of installed capacity to be built in 2016 in the state of Coahuila. This will ensure the supply of clean energy generated by this park at very competitive costs.

After a thorough analysis, the Executive Committee approved the project to expand refined zinc production capacity by 100,000 tons per year at the metallurgical complex in Torreón, Coahuila. This project, expected for 2017, will have new technology and require an investment of \$4,309.2 (US\$324 million), and will consolidate our position as the leading Latin American producer of refined zinc.

As for financial results, expressed in millions, gross sales in 2014, excluding hedging results, totaled \$61,022.0, a change of -6.7% compared to 2013. This situation was primarily due to lower metal prices, with the exception of zinc, which was partially offset by the higher average exchange rate of the peso against the dollar. Results from metal price and exchange rate hedging were lower, totaling \$533.6. Gross profit was \$16,071.8 (-13.0%), EBITDA was \$15,082.4 and operating income totaled \$8,546.0 (7.1% and 20.5% lower, respectively). Net income for 2014 was \$1,199.1 (-74.8%), and \$755.2 in dividends were declared in 2014. The debt to EBITDA ratio was 1.4 times at year end, with sufficient cash to cover operational, strategic and financial needs for the medium term.

Thanks to efforts to control costs and expenses, and despite lower sales and inflation for several of our inputs, EBITDA margin on sales remained stable (24.5%) compared to the previous year (24.4%).

However, due to certain differences in the interpretation of tax provisions, the Metalúrgica Met-Mex-Peñoles subsidiary recorded an extraordinary expense of \$1,106.8, after signing a conclusive agreement with the Tax Administration Service through the Office of Taxpayer Defense (PRODECON, for its Spanish acronym), which terminated the tax audits for the years 2009-2012.

Because our people are our most important asset, we remain committed to promoting their development in an atmosphere of respect, recognition and in a safe environment. We have continued, and will not cease, to strengthen training and safety programs for our employees and contractors. Furthermore, we

have added the ethical performance of our businesses to our Vision, and we are strengthening the culture of ethics and living these values throughout the entire organization.

The Board of Directors has adhered to sound corporate governance practices. To perform its functions, the Board is supported by the committees recommended in the Code of Best Corporate Practices. The Board met four times in 2014. The following are among the topics discussed and approved at those meetings:

- reinforcement of workplace safety and environmental programs;
- labor-management relations;
- the metals hedging program;
- review of the 2014 budget;
- the basis of the 2015 budget;
- finalizing contracts for the supply of electricity; and
- policies for the acquisition and sale of company stock.

Pursuant to the provisions of the Securities Market Law, the Audit and Corporate Governance Committee prepared its Annual Report, which is presented to this 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.

Submitted herein for the consideration of this Shareholders' Meeting is a report on the main accounting policies and criteria that serve as the basis of preparation for the Financial Statements, and which include, 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 developments of the business during 2014.

In accordance with policies, the performance of senior executives is evaluated annually. The Nomination, Evaluation and Compensation Committee must authorize any increase in salary and benefits. 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 and legal and other benefits common to the industry domestically.

In 2015, in the face of new challenges and the expectation that difficult market conditions will continue, we must work harder to remain competitive, increase productivity and control costs. We remain firmly committed to maintaining sound, prudent management practices.

Our confidence in the future is based on the greatness of our people, in their ability to innovate and give the best of themselves, especially in the face of adversity: I thank them for their dedication and hard work. I would also like to thank the members of the Board of Directors for their commitment and valuable contributions, and you, dear shareholders, for continuing to place your confidence in us.

Alberto Baillères
Chairman of the Board of Directors