# ARIAN SILVER CORPORATION

# ANNUAL REPORT AND ACCOUNTS 2012

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|---|---|
| **DIRECTORS** | Anthony (Tony) J. Williams, *Chairman*<br>James (Jim) T. Williams, *Chief Executive Officer*<br>Thomas A. Bailey *Non-executive*<br>James S. Cable *Non-executive*<br>James A. Crombie *Non-executive* |
| **CORPORATE SECRETARY** | David H. Taylor |
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| **INVESTOR RELATIONS** | CHF Investor Relations<br>90 Adelaide Street West<br>Toronto<br>M5H 3V9<br>Canada |
| **AUDITOR** | PKF (UK) LLP<br>Farringdon Place<br>20 Farringdon Road<br>London, EC1M 3AP |
| **REGISTRAR** | Computershare Investor Services Inc<br>100 University Avenue<br>Toronto, Ontario, M5J 2Y1<br>Canada |
| **STOCK EXCHANGES** | AIM Market of the London Stock Exchange<br>TSX Venture Exchange<br>Frankfurt Stock Exchange |
| **TRADING SYMBOLS** | AIM: AGQ (stock is quoted in Pounds Sterling)<br>TSX-V: AGQ (stock is quoted in Canadian Dollars)<br>Frankfurt: I3A (stock is quoted in Euros) |

## INTRODUCTION

This Management's Discussion and Analysis ("MD&A") has been prepared based on information available to Arian Silver Corporation ("Arian" or the "Company") as at 27 February 2013 and compares its fourth quarter and consolidated 2012 financial results with the previous year. This document should be read in conjunction with the Company's audited Consolidated Financial Statements and the related notes which are available on SEDAR at www.sedar.com or the Company's website at www.ariansilver.com.

The audited Consolidated Financial Statements and related notes have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All dollar amounts referred to in this document are expressed in United States dollars, unless specifically stated otherwise.

Arian is a publicly quoted silver exploration, development and production company, operating in one of the richest silver-bearing districts in the world, Zacatecas State, Mexico. The Company is committed to mining existing silver areas, and to exploring new opportunities. Arian's current main project is in San José, Zacatecas State.

The Company's strategy is to:

- Obtain advanced and low-cost (acquisition cost) silver projects and rapidly build up resources in the ground. Arian is focusing its exploration efforts in one of the richest known silver-bearing districts in the world - the Zacatecas State of Mexico.
- Focus on projects with prior exploration and production history, thereby reducing risks and capital costs.
- Develop projects towards production through a combination of company development and/or Joint Venture (JV) and acquisition opportunities.
- Build shareholder value by expanding silver resources and reserves, and increasingly efficient production.

The Company is incorporated in the British Virgin Islands and its common shares are listed for trading on the TSX Venture Exchange and depository receipts are traded on the London Stock Exchange's AIM market. The Company's headquarters are on Berkeley Square, London.

### Forward-looking statements

Certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterised by words such as "plan", "expect", "forecast", "project", "intend", "believe", "anticipate", "expect", "outlook" and other similar words or statements that certain events or conditions "may" or "will" occur.

Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements.

These factors include the inherent risks involved in exploration and development, and mining of mineral properties, the uncertainties involved in interpreting drilling results and other geological data, fluctuating metal prices, the possibility of project cost overruns or unanticipated operating costs and expenses, uncertainties related to the necessity of financing, the availability of and costs of financing needed in the future, and other factors described in this document under the heading "Risk Management".

The Company undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change, other than as required by securities laws. The reader is cautioned not to place undue reliance on forward-looking statements (including, without limitation, statements relating to the mineral resource estimates, statements regarding the contract mining and milling operation at the San José Project (the "SJ Mining Operation"), the ability of the Company to achieve, maintain and possibly increase planned levels of production from the SJ Mining Operation, the ability of the Company to generate positive cash flow from the SJ Mining Operation, the ability to continue or implement proposed drilling programmes on the San Jose vein ("SJV") system and the Company's exploration, development and production plans and objectives).

These forward-looking statements reflect the current expectations or beliefs of the Company based on information currently available to the Company. Forward-looking statements are subject to a number of risks and uncertainties that may cause the actual results of the Company to differ materially from those discussed in the forward-looking statements, and even if such actual results are realised or substantially realised, there can be no assurance that they will have the expected consequences to, or effects on the Company. Factors that could cause actual results or events to differ materially from current expectations include, among other things, the performance of the contractors and plant and equipment engaged in relation to the SJ Mining Operation, failure to achieve anticipated production levels and mineral grades for ore from the SJ Mining Operation, failure to establish estimated mineral reserves, the possibility that future exploration results will not be consistent with the Company's expectations, uncertainties relating to the availability and costs of financing needed in the future, changes in the silver commodity price, changes in equity markets, political developments in Mexico, changes to regulations affecting the Company's activities, delays in obtaining or failures to obtain required regulatory approvals, the uncertainties involved in interpreting exploration results and other geological data, and the other risks involved in the mineral exploration and development industry. Any forward-looking statement speaks only as of the date on which it is made and, except as may be required by applicable securities laws, the Company disclaims any intent or obligation to update any forward-looking statement, whether as a result of new information, future events or results or otherwise. Although the Company believes that the assumptions inherent in the forward-looking statements are reasonable, forward-looking statements are not guarantees of future performance and accordingly undue reliance should not be put on such statements due to the inherent uncertainty therein.

The mineral resource figures disclosed in this MD&A are estimates and no assurances can be given that the indicated levels of minerals will be produced. Such estimates are expressions of judgment based on knowledge, mining experience, analysis of drilling results and industry practices. Valid estimates made at a given time may significantly change when new information becomes available. While the Company believes that the resource estimates included in this MD&A are well established, by their nature resource estimates are imprecise and depend, to a certain extent, upon statistical inferences, which may ultimately prove unreliable. If such estimates are inaccurate or are reduced in the future, this could have a material adverse impact on the Company.

Mineral resources are not mineral reserves and do not have demonstrated economic viability. There is no certainty that mineral resources can be upgraded to mineral reserves through continued exploration.

## Qualified persons

Mr Jim Williams, Eur Ing, Eur Geol, BSc, MSc, D.I.C., FIMMM, the Chief Executive Officer of Arian, a "Qualified Person" as defined in the AIM Rules of the London Stock Exchange, and a "Qualified Person" as such term is defined in Canadian National Instrument 43-101 ("NI 43-101"), has reviewed and approved the technical information in MD&A other than the mineral resource estimates referred to herein.

## OVERVIEW OF 2012

### *Financial*

| | Annual 2012 $000s | Annual 2011 $000s | Change $000s |
|---|---|---|---|
| Revenue | 4,588 | 7,467 | (2,879) |
| Gross (loss)/profit | (764) | 812 | (1,576) |
| Net (loss)/profit for the period | (4,031) | (10,970) | 6,939 |
| Cash and cash equivalents | 491 | 3,991 | (3,500) |
| Total assets | 14,119 | 16,250 | (2,131) |

The decrease in revenues and gross profits, and the net loss, was a result of the suspension of milling operations following a dispute with the mill owner.

The 2012 net loss of $4.0 million ("m") was $6.9m less than the 2011 loss of $10.97m. The latter included a charge of $8.5m in respect of share option expenses.

### *Operations*

Following a dispute with the third party mill owner, Contracuña SA de CV ("Contracuña"), the Company announced in July 2012 that production was suspended.

In November 2012 a contract was signed with an independent third party for toll milling a minimum 90,000 tonnes of run of mine ("ROM"). Milling commenced at this mill on 16 February 2013.

| | Annual 2012 * | Annual 2011 | Change % |
|---|---|---|---|
| Tonnes mined | 51,893 | 100,223 | (48%) |
| Tonnes milled | 53,297 | 83,959 | (37%) |
| Silver concentrate tonnes produced | 600 | 750 | (20%) |
| Silver ounces produced | 165,304 | 248,226 | (33%) |
| Silver ounces per concentrate tonne produced | 276 | 331 | (17%) |
| Silver ounces sold | 177,960 | 235,965 | (25%) |
| Silver concentrate tonnes sold | 648 | 706 | (8%) |

* Production in 2012 was suspended in July

### *Exploration*

- Phase 4 drilling programme indicated continuity of the vein thickness, silver mineralisation and grade along the San José Vein ("SJV").
- Results of the geophysical Induced Polarisation ("IP") survey identified the areas of probable vein displacements and provided targets for some of the last holes to be drilled in the Phase 4 drilling programme (see the Company's press release dated 16 January 2012 entitled "Arian Silver Reports Further Encouraging Exploration Progress at San José").
- On 12 March 2012, Arian reported a significant resource estimate upgrade (see the Company's press release entitled "Arian Silver Increases Contained Silver at San José by 32% to More Than 117 Million Ounces in Updated Mineral Resource Estimate").

### *Subsequent Events*

<u>Funding</u>

The Company is seeking additional finance to help achieve its strategy of increasing shareholder value by increasing production, productivity and mine capacity, and is actively discussing funding possibilities with interested parties.

<u>Mill operations</u>

Toll milling fully resumed on 16 February 2013 with a privately owned operator, Beneficiadora de Jales y Minerales Juan Reyes SA de CV ("Juan Reyes"). The contract with Juan Reyes gives exclusive use of the mill to Arian, is renewable by mutual consent and is initially for the processing of 90,000 tonnes of run-of-mine material from the San José mine. The mill operates with supervisory assistance from Arian personnel to help optimise processing to maximise material throughput and silver, lead and zinc recoveries.

Juan Reyes had indicated to Arian that the mill would be ready for operations in December 2012. Arian has been actively involved in project management to help ensure that the mill is properly commissioned.

The dispute with the owners of Contracuña caused toll milling operations to be suspended in July 2012. Although all amounts owed to Arian by Contracuña have now been repaid, Arian has submitted a claim for damages, which has been met by a counter-claim by Contracuña, which Arian believes, has been submitted solely to frustrate the legal process and is without merit.

## SUMMARY OPERATING PERFORMANCE 2012

| | Fourth Quarter 2012 | Fourth Quarter 2011 | Annual 2012 | Annual 2011 | Change % |
|---|---|---|---|---|---|
| Head grade - Ag grams per tonne | - | 201 | 177 | 190 | (7%) |
| Tonnes mined | - | 24,433 | 51,893 | 100,223 | (48%) |
| Tonnes milled | - | 22,971 | 53,297 | 83,959 | (37%) |
| | | | | | |
| Silver concentrate tonnes produced | - | 256 | 600 | 750 | (20%) |
| Silver ounces produced | - | 76,618 | 165,304 | 248,226 | (33%) |
| Silver ounces per concentrate tonne produced | - | 300 | 276 | 331 | (17%) |
| | | | | | |
| Silver ounces sold | - | 77,738 | 177,960 | 235,965 | (25%) |
| Silver concentrate tonnes sold | - | 242 | 648 | 706 | (8%) |

Production during 2012 was undertaken by Contracuña. In July 2012 Arian announced the suspension of production in July 2012 following a dispute with Contracuña. Arian has lodged court proceedings in Mexico to claim for damages.

Arian conducted further metallurgical testing during the year and announced in October 2012 recoveries in the order of 80% had been achieved using a "Leach-Ox" process (direct leaching of the ROM material). The test report further suggested there was significant upside potential to improve the recoveries of silver with the addition of flotation within the mill circuit to process the deeper seated, less oxidised/more sulphide rich material.

During November 2012 Arian agreed terms for toll milling of a minimum of 90,000 tonnes of run of mine ("ROM") ore at a cost of US$38 per tonne with a newly refurbished 500 tpd plant in Zacatecas. The plant is owned and controlled by an independent third party, Juan Reyes, and toll milling began on 16 February 2013.

## MINERAL RESOURCE ESTIMATE

On 12 March 2012, Arian reported a significant resource estimate upgrade (see the Company's press release entitled "Arian Silver Increases Contained Silver at San José by 32% to More Than 117 Million Ounces in Updated Mineral Resource Estimate").

The highlights of this announcement were:

- 29% increase in resource tonnage along the SJV from the July 2011 mineral resource estimate;
  - Contained ounces of silver have increased by 32%;
  - Contained pounds of lead have increased by 29%; and
  - Contained pounds of zinc have increased by 30%;
- Mineralisation remains open along the western and eastern strikes of the SJV and to depth; and
- Further drilling is planned to infill the current resources, step out along the remaining SJV structure in both directions, and to drill at depth on the SJV.

Arian's resource estimate includes all drilling programmes from 2006 along the SJV which has a delineated NI 43-101 and a JORC-compliant resource estimate of approximately 30.61 million ounces of silver, 67.02 million pounds of lead and 149.91 million pounds of zinc in the "indicated" mineral resource category, and 88.65 million ounces of silver, 205.25 million pounds of lead and 410.50 million pounds of zinc in the "inferred" mineral resource category. These NI 43-101 and JORC-compliant mineral resources are summarised in the table below:

| Resource Category | Tonnes | Average Grade | | | Contained Metal | | |
|---|---|---|---|---|---|---|---|
| | | Ag | Pb | Zn | Ag | Pb | Zn |
| | (t) | (g/t) | % | % | (Moz) | (Mlb) | (Mlb) |
| Indicated | 8,000,000 | 119 | 0.38 | 0.85 | 30.61 | 67.02 | 149.91 |
| Inferred | 24,500,000 | 110 | 0.38 | 0.76 | 86.65 | 205.25 | 410.50 |

1. *Geological characteristics and +30 ppm grade envelopes used to define resource volumes.*
2. *Each mineral resource estimate is in accordance with CIM standards.*
3. *The effective date of each mineral resource estimate is 12 March 2012.*
4. *The estimates are based on geological, statistical and geostatistical data assessment and computerised IDW3, Ag grade wireframe restricted, linear block modelling.*
5. *The resource was estimated using 188 drill holes and more than 38,000 metres.*
6. *Resource figures were prepared under the supervision of Malcolm Titley who is a Qualified Person (as defined in Canadian National Instrument 43-101).*
7. *Tonnage figures have been rounded to reflect this as an estimate.*
8. *Ag (silver) ounces have been calculated using 31.1035 g = 1 oz.*
9. *Pb (lead) and Zn (zinc) tonnes have been calculated using 2204.622 lbs = 1 tonne.*
10. *The mineral resource is 100% owned by Arian.*

The following reports prepared by A.C.A. Howe International Limited relating to the San José project are available on the Company's website www.ariansilver.com or on SEDAR at www.sedar.com :-

a) Report dated 22 September 2009 and entitled "Preliminary Economic Assessment Report (PEAR) on the San José Silver-Lead-Zinc Deposit, Zacatecas, Mexico"; and

b) Report dated 15 August 2008 and entitled "Resource Estimation Update for the San José Silver-Lead-Zinc Deposit, Zacatecas, Mexico".

Readers are reminded that mineral "resources" are not mineral "reserves" as they have not yet demonstrated economic viability. There is no certainty that mineral resources can be upgraded to mineral reserves through continued exploration.

## REVIEW OF OPERATIONS

The Company owns 31 mineral concessions in Mexico totalling approximately 7,900 hectares as set out below.

| Project Name | No. of Concessions | Area in hectares ("ha") |
|---|---|---|
| San José | 11 | 6,279.57 |
| Calicanto | 7 | 83.97 |
| Others | 13 | 1,536.47 |
| **Total** | **31** | **7,900.01** |

### San José project, Zacatecas State

***Overview***

The 100%-owned San José property lies 55 kilometres to the southeast of Zacatecas City and covers 11 mining concessions totalling approximately 6,300ha. The property has significant infrastructure, including a 4x5 metre main haulage ramp extending more than 4.0 kilometres along the footwall of the SJV system, and a 350 metres deep, 500 tpd vertical shaft with operational hoist. In addition, a number of shallower vertical shafts are located in a westerly direction along the SJV.

The continuation of ramp development at the San José mine enabled the mine to remain fully prepared and ready to recommence immediately to accommodate the resumption of milling.

| | | | 2012 | | |
|---|---|---|---|---|---|
| Production information summary for San Jose mine: | **Full Year** | **Q4** | **Q3** | **Q2** | **Q1** |
| Head grade (mill): Ag grams per tonne (g/t) | **177** | - | - | 181 | 173 |
| Tonnes mined | **51,893** | - | 4,072 | 26,268 | 21,553 |
| Tonnes milled | **53,297** | - | - | 28,903 | 24,394 |
| Ag concentrate tonnes produced | **600** | - | - | 298 | 302 |
| Recovery % | **53.88** | - | - | 58.74 | 49.01 |
| Ag ounces produced | **165,304** | - | - | 98,616 | 66,688 |
| Ag ounces per concentrate tonne produced | **276** | - | - | 331 | 221 |
| Ag ounces sold | **177,960** | - | 8,937 | 93,112 | 75,911 |
| Ag concentrate tonnes sold | **648** | - | 32 | 286 | 330 |
| Quarter end inventory balances | | | | | |
| Mined tonnes stockpile | **18,192** | 18,192 | 18,204 | 15,003 | 17,637 |
| Ag concentrate inventory tonnes | - | - | - | 36 | 24 |
| Ag ounces included in concentrate inventory | - | - | - | 11,276 | 5,772 |

| | | | 2011 | | |
|---|---|---|---|---|---|
| Production information summary for San Jose mine: | **Full Year** | **Q4** | **Q3** | **Q2** | **Q1** |
| Head grade (mill): Ag grams per tonne (g/t) | **190** | 201 | 199 | 178 | 178 |
| Tonnes mined | **100,223** | 24,433 | 33,941 | 22,387 | 19,462 |
| Tonnes milled | **83,959** | 22,971 | 21,512 | 18,348 | 21,128 |
| Ag concentrate tonnes produced | **750** | 256 | 204 | 144 | 146 |
| Recovery % | **48.43** | 51.68 | 47.76 | 56.66 | 38.08 |
| Ag ounces produced | **248,226** | 76,618 | 65,804 | 59,568 | 46,236 |
| Ag ounces per concentrate tonne produced | **331** | 300 | 323 | 412 | 316 |
| Ag ounces sold | **235,965** | 77,738 | 77,587 | 41,868 | 38,772 |
| Ag concentrate tonnes sold | **706** | 242 | 221 | 117 | 126 |
| Quarter end inventory balances | | | | | |
| Mined tonnes stockpile | **20,478** | 20,478 | 19,016 | 9,972 | 2,549 |
| Ag concentrate inventory tonnes | **52** | 52 | 39 | 57 | 29 |
| Ag ounces included in concentrate inventory | **14,995** | 14,995 | 14,118 | 23,075 | 10,195 |

Tonnes mined

No tonnes were mined in Q4 2012. The decrease in tonnes mined from Q4 2011 to Q4 2012 of 24,433 tonnes (100%) and decrease in tonnes mined from Q3 2012 to Q4 2012 of 4,072 tonnes (100%) was due to the suspension of production.

Tonnes milled
No tonnes were milled in Q4 2012 due to the suspension of production.

Mined tonnes stockpile
The stockpile of mined ore was 18,192 tonnes at the end of Q4 2012 compared to 20,478 tonnes at the end of Q4 2011.

Silver concentrate inventory tonnes
Silver concentrate inventory balance at the end of Q4 2012 was nil compared to 52 tonnes at the end of Q4 2011. This follows the suspension of production and the sale of all remaining silver concentrate.

***Mining Operations***
The initial mining operation that commenced in 2010 focussed on the Ramal Norte/Sur, San José 75m Level Central Zone and Santa Ana resource blocks. These were selected by Arian, from several delineated resource blocks, to support an initial pilot scale mining operation, which when added to the Soledad resource block increases the potential mine rate to 1,500 tpd subject to available milling capacity.

During 2012, Arian continued preparing and exploring mining blocks to verify continuity of mineralisation to ensure production to the plant, ready for the increase in milling capacity due to the operation of the 4th ball mill which commenced operation in May 2012.

| All figures in this table are quoted in metres | 2012 | | | | |
|---|---|---|---|---|---|
| | **Full Year** | **Q4** | **Q3** | **Q2** | **Q1** |
| Exploration Drilling | **253** | - | 12 | 121 | 120 |
| Ramp development | **489** | 81 | 68 | 242 | 98 |
| Preparation | **338** | - | 8 | 151 | 179 |
| Raises | **96** | - | 33 | 31 | 32 |

Ramp development in the Santa Ana area provided access to blocks indicated by diamond drilling on level 70, enabling further verification of resource for further exploitation and extraction below this level. The ramp continues development below level 120 to explore continuity of blocks as there is evidence of mineralisation at 300 metres depth.

Contract mining was minimised during the second half of 2012 to avoid excessive stockpiling; ramp development continued.

Looking forward to the planned resumption of mining at 500 tpd, mining costs are expected to be $32/tonne including transport between the mine and mill.

***Milling Operations***
During Q1 and Q2 2012 Arian contracted its milling operations on a fixed monthly fee basis with Contracuña. However, a dispute was announced on 16 July 2012 which resulted in the suspension of milling operations. On 7 August 2012 Arian filed a claim against Contracuña to recover all losses and damages for breach of contract.

The Contracuña mill had a maximum rating of 400 tpd but it was not designed for the hardness and abrasiveness of the San José ROM material. Significant improvement had been made to this mill that allowed it to increase to over 400 tpd during May 2012, following the installation of the 4th in-line ball mill and other modifications.

On 9 August 2012 Arian announced that it had signed a letter of intent, for the exclusive use of a newly refurbished and soon to be re-commissioned 500 tpd mill. This mill, which is located nearby on the outskirts of the city of Zacatecas, began toll milling on 16 February 2013.

Arian believes that the use of this re-commissioned mill will increase recoveries and further test the potential for a larger scale commercial operation.

A 2% net smelter royalty ("NSR") on SJV revenue is payable to the vendor of the San José property. The vendor of the San José property also owns the newly refurbished toll mill being commissioned. It is therefore in the interests of the vendor to ensure the toll mill maximises recoveries.

***Laboratory***
Since April 2011 Arian has had a sample preparation and analytical laboratory on site at San José operated on behalf of Arian by the Stewart Group, which is now a subsidiary of the ALS Chemex Group. This is a valuable asset for Arian because it allows for the rapid turnaround of samples and provides vital information to our operational personnel to ensure that operating decisions are in a timely manner. In addition the laboratory provides an invaluable tool during drilling programmes which has significantly decreased the turnaround times for analysis of Arian's drill samples.

The laboratory comprises a comprehensive sample preparation facility, wet chemistry facility, atomic absorption spectrometry ("AAS") and fire-assay ("FA"), for final determinations of silver, lead and zinc. The laboratory is fully compliant with Arian's quality assurance and quality control (QA/QC) programme.

***Exploration Information***
In January 2012, Arian released interim drill results relating to the Phase 4 drilling programme which indicated continuity of the vein thickness, silver mineralisation and grade along the SJV. Also announced were the results of the geophysical Induced Polarisation ("IP") survey which identified the areas of probable vein displacements and provided targets for some of the last holes to be drilled in the Phase 4 drilling programme (see the Company's press release dated 16 January 2012 entitled "Arian Silver Reports Further Encouraging Exploration Progress at San José").

On 12 March 2012 the Company announced the conclusions of an independent resource update by CSA Global (UK) Limited which took into account all the Phase 1, 2, 3 and 4 drilling programmes; the Technical Report is available on the Company's website and was filed on SEDAR on 25 April 2012 at www.sedar.com.

***Mineral Resource***
Arian's resource estimate includes all drilling programmes from 2006 along the SJV which has a delineated NI 43-101 and a JORC-compliant resource estimate of approximately 30.61 million ounces of silver, 67.02 million pounds of lead and 149.91 million pounds of zinc in the "indicated" mineral resource category, and 88.65 million ounces of silver, 205.25 million pounds of lead and 410.50 million pounds of zinc in the "inferred" mineral resource category. These NI 43-101 and JORC-compliant mineral resources are summarised in the table on page 8.

## Calicanto and other projects

***Overview***
Arian owns 100% of the Calicanto Project which consists of seven adjacent mining concessions totalling 84ha, namely: Calicanto, Vicochea I, Vicochea II, Misie 1 and Misie 2, and Missie 1 and Missie 2 properties, collectively known as the "Calicanto Group". The concessions are located in the historic mining district of Zacatecas. The Calicanto Group of concessions comprises at least four main mineralised vein systems.

There has been no significant expenditure on the Calicanto Project during the past two years.

Additional information in respect of the Calicanto Project is contained in a technical report prepared by A.C.A. Howe International Limited dated 20 March 2006 and entitled "Technical Report on the Calicanto and San Celso Projects, Zacatecas, Mexico". A copy of this report is available on the Company's website www.ariansilver.com or on SEDAR at www.sedar.com.

## REVIEW OF FINANCIAL RESULTS

### Selected Annual Information

Mining and production commenced at the San José mine in October 2010 and the first delivery and sale of approximately 14 tonnes of silver in concentrate took place in December 2010.

2011 reflected Arian's first year in production, but was followed in July 2012 with the announcement that milling had been suspended.

Exploration continued throughout 2010 up to Q1 2012.

The foregoing factors have a significant impact on the comparability of the year-on-year figures set out below.

| | Annual 2012 $'000 | Annual 2011 $'000 | Annual 2010 $'000 | Change 2012-11 $'000 | Change 2012-11 % |
|---|---|---|---|---|---|
| Revenue | 4,588 | 7,467 | 184 | (2,879) | (39%) |
| Cost of sales | 5,352 | 6,655 | 175 | 1,303 | (20%) |
| Gross (loss) / profit | (764) | 812 | 9 | (1,576) | (194%) |
| Operating (loss)/profit | (3,958) | (10,510) | (2,086) | 6,552 | (62%) |
| Net investment (loss) / profit | (73) | (460) | 380 | 387 | (84%) |
| Net (loss) / profit for the period | (4,031) | (10,970) | (1,902) | 6,939 | (63%) |
| | | | | | |
| Basic and diluted (loss)/profit per share $ | ($0.01) | ($0.04) | $0.01 | $0.03 | (75%) |
| | | | | | |
| Intangible assets | 1,176 | 1,093 | 1,241 | 83 | 8% |
| Property, plant and equipment | 10,405 | 8,082 | 5,423 | 2,323 | 29% |
| Trade and other receivables | 1,206 | 1,890 | 934 | (684) | (36%) |
| Cash | 491 | 3,991 | 8,255 | (3,500) | (88%) |
| Inventories | 644 | 922 | 139 | (278) | (30%) |
| Non current assets held for sale | - | - | 2,884 | - | - |
| Financial assets held for sale | 197 | 272 | - | (75) | (28%) |
| Total assets | 14,119 | 16,250 | 18,876 | (2,131) | (13%) |
| Total non-current financial liabilities | 177 | 170 | 161 | 7 | 4% |
| Shareholders' equity | 13,003 | 14,909 | 16,744 | (1,906) | (13%) |

#### *Revenue*

Revenues comprised sales of silver concentrate, which decreased by 39% to $4.6m (2011: $7.5m) on account of the suspension of production in the second half of the year. The reduced revenues were compounded by silver spot prices being lower than average during the first half of the year, and increased smelter charges.

#### *Cost of sales*

Cost of sales decreased by 20% to $5.4m (2011: $6.7m) primarily on account of lower sales volumes.

#### *Gross (loss)/profit*

A gross loss of $0.8m (2011: $0.8m gross profit) was incurred primarily on account of reduced revenues.

#### *Operating loss*

The operating loss decreased by $6.6m or 62% to $4.0m (2011: $10.5m), primarily on account of the reduction in gross profit of $1.6m and a much lower share option expense of $0.3m (2011: $8.5m) . Other administrative expenses remained in line with 2011.

#### *Net loss*

Net loss decreased by $6.9m, or 63% to $4.0m (2011: $11.0m) on account of the reduction in the operating loss together with revaluation of Geologix Explorations, Inc. ("Geologix") shares, which were received as part payment for the final instalment for the sale of the Tepal concession.

***Total assets***
Total assets decreased by 13% to $14.1m (2011: $16.3m) primarily due to an investment of $2.4m in the San José mine, offset by a $3.5m reduction in cash, a $0.7m reduction in trade receivables, a $0.3m reduction in inventories and a $0.1m reduction in financial assets held for re-sale.

***Total non-current financial liabilities***
Total non-current financial liabilities increased by 4% to $177,000 (2011: $170,000). This amount would only be payable if the mine were closed; it covers decommissioning, reclamation and rehabilitation at the end of the initial mining period of approximately 4 years and is based on an estimated cost of $206,000 and discount rate of 5%.

***Shareholders' equity***
Shareholders' equity decreased by $1.9m or 13% to $13.0m (2011: $14.9m). This reduction reflects the $4m net loss for the year, offset by a $1.0m increase in foreign exchange reserves, $0.9m increase in share capital and $0.2m charge for the fair value of options issued.

## Quarterly results

| | 2012 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| **Unaudited** | **Q4** | **Q3** | **Q2** | **Q1** | **Q4** | **Q3** | **Q2** | **Q1** |
| | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** |
| Revenue | 34 | 136 | 2,104 | 2,314 | 2,367 | 2,434 | 1,529 | 1,137 |
| Cost of sales | 256 | 475 | 2,242 | 2,379 | 1,921 | 1,914 | 1,470 | 1,350 |
| Gross (loss) / profit | (222) | (339) | (138) | (65) | 446 | 520 | 59 | (213) |
| Operating (loss) / profit | (1,072) | (1,025) | (1,006) | (855) | (393) | (486) | (1,356) | (8,275) |
| Net investment (loss)/profit | (84) | 57 | (127) | 81 | (50) | (116) | (179) | (115) |
| Net (loss)/profit for the period | (1,156) | (968) | (1,133) | (774) | (443) | (602) | (1,535) | (8,390) |
| Basic and diluted loss per share | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.01 | $0.03 |
| Total assets | 14,119 | 14,409 | 15,021 | 16,732 | 16,250 | 16,894 | 18,843 | 19,631 |
| Total non-current financial liabilities | 177 | 175 | 172 | 171 | 170 | 168 | 166 | 163 |
| Shareholders' equity | 13,003 | 13,464 | 13,647 | 15,370 | 14,909 | 15,806 | 17,764 | 18,342 |

***Q4 2012 v Q3 2012***
Revenue during Q4 and Q3 was generated from the sale of silver concentrate from the San José mining operation.

The gross loss reduced on account of reduced expenditure on mining operations; the net loss increased in Q4 compared to Q3 following the revaluation of Geologix shares.

Total assets decreased by $0.3m to $14.1m; cash decreased by $0.4m to $0.5m and financial assets held for sale relating to the Geologix shares reduced by $0.1m. This was offset by an increase of $0.2m investment in development of the San José mine.

Shareholders' equity reduced $0.5m on account of the $1.2m net loss and $0.1m increase in foreign exchange translation reserves, offset by the increase of $0.8m share capital raised through the Standby Equity Distribution Agreement ("SEDA").

***Q3 2012 v Q2 2012***
A gross loss of $0.3m was reported in the third quarter, $0.2m higher than the second quarter, mainly as a result of lower revenues resulting from the suspension of processing of mined ore. The net loss in the period of $1m was $0.1m less than for the previous quarter due to the increase in value of the Geologix shares received as partial payment for the disposal of the Tepal property.

Cash decreased by $0.5m to $0.9m largely as a result of investment in the development of the San José mine. The decrease in shareholders' equity of $0.2m was largely attributable to the movement in the foreign exchange reserve and the loss for the period.

***Q2 2012 v Q1 2012***
A gross loss of $0.1m was reported in the second quarter broadly in line with the first quarter. The net loss of $1.1m in the period was $0.3m higher than for the previous quarter mainly due to a $0.1m

non-cash charge for the fair value of share options vesting that were issued in the quarter, and $0.2m for the reduction in value of the Geologix shares received as partial consideration for the disposal of the Tepal property.

Cash decreased by $1.4m to $1.4m largely as a result of investment in the development of the San José mine. The decrease in shareholders' equity of $1.7m was largely attributable to the net loss (of $1.1m) and movement in the foreign exchange reserve for the period.

***Q1 2012 v Q4 2011***
Revenue in Q1 was in line with Q4. Although there was a significant increase in concentrate tonnes sold of 330t, this was off-set by the lower head grade at 173 grams per tonne sold compared to 201 grams per tonne in Q4 2011. The cost of sales was $0.5m higher mainly due to $0.6m additional cost of the increased tonnes sold in the period, offset by a $0.1m benefit from a reduction in the cost per tonne sold. The net loss in the period of $0.8m was $0.4m higher than for the previous quarter's loss of $0.4m mainly due $0.3m charge for the fair value of share purchase options vesting that vested in the period.

Cash decreased by $1.2m to $2.8m largely as a result of investment in the development of the San José mine. Property, plant and equipment increased by $1.1m was a result of the development of the San José mine. The increase in shareholders' equity was largely attributable to the movement in the foreign exchange reserve.

***Q4 2011 v Q3 2011***
Revenues of $2.4m mainly comprise revenues from the sale of silver concentrate from the San José mining operation. The net loss in the period of $0.4m was $0.2m lower than the previous quarter. Due largely to a $0.1m drop in gross profit, offset by a gain on Geologix shares, and a $0.2m foreign exchange gain.

Total assets decreased by $0.6m to $16.3m. A result of a decrease in cash by $1.5m to $4.0m, which was offset by increased investment of $0.7m in development of the San José mine and an inventory increase of $0.2m; a $0.1m increase in stockpiled ore and $0.1m increase in silver concentrate produced in relation to the San José mine. The decrease in shareholders' equity is largely attributable to the net loss for the period and the increase in foreign exchange translation reserves.

***Q3 2011 v Q2 2011***
Revenues increased by $0.9 to $2.4m. The net loss in the period was $0.9m lower than for the previous quarter: $0.3m of this difference relates to the expensing of the fair value of options, $0.5m relates to the increased profitability of the San José mine, and $0.1m to the investment loss on the Geologix shares.

Total assets decreased by $1.9m; cash decreased by $1.7m to $5.5m, and financial assets valued at fair value relating to the Geologix shares decreased by $0.2m. This was offset by investment in the San José property of $2.5m, as well as a $0.1m increase in trade and other receivables and $0.1m increase in inventories. The decrease in shareholders' equity is largely attributable to the loss incurred in the period.

***Q2 2011 v Q1 2011***
Revenues of $1.5m comprised $1.5m from the sale of silver concentrate from the San José mining operation and $13,000 interest income. The net loss in the period was $6.9m lower than for the previous quarter: $6.7m of this improvement relates to the expensing of the fair value of options that occurred in Q1 and $0.2m relates to the increased profitability of the San José mine.

Total assets decreased by $0.8m; cash decreased by $1.7m to $7.2m and financial assets valued at fair value relating to the Geologix shares decreased by $0.3m. This was offset by investment in the San José property of $0.7m, as well as a $0.2m increase in trade and other receivables and $0.2m increase in inventories. The decrease in shareholders' equity is largely attributable to the loss incurred in the period.

***Q1 2011 v Q4 2010***
Revenues of $1.1m comprised $1.1m from the sale of silver concentrate from the San José mining operation and $11,000 interest income. The net loss in the period was $7.4m higher than the previous quarter, largely due to $7.3m for the fair value of options vested.

Total assets increased by $0.8m; non-current assets increased by $1.4m due to investment in mine development and exploration costs at the San José mine. Trade and other receivables increased by $0.6m, and inventories by $0.2m relating to working capital of the San José mine. Cash increased by $0.7m, and other financial assets held for sale increased by $0.7m (relating to the Geologix shares held as part payment for the sale of Tepal), offset by $2.8m reduction in assets held for sale relating to the funds received for the sale of Tepal. The increase in shareholders' equity is largely attributable to the fair value of the share options issued, the exercise of share purchase warrants and options offset by the loss incurred in the period.

## Subsequent events

***Mill operations update***
Toll milling fully resumed on 16 February 2013 with a privately owned operator, Beneficiadora de Jales y Minerales Juan Reyes SA de CV ("Juan Reyes"). The contract with Juan Reyes gives exclusive use of the mill to Arian, is renewable by mutual consent and is initially for the processing of 90,000 tonnes of run-of-mine material from the San José mine. The mill operates with supervisory assistance from Arian personnel to help optimise processing to maximise material throughput and silver, lead and zinc recoveries.

***Legal action against Contracuña***
The dispute with the owners of the Contracuña Mill caused toll milling operations to be suspended in July 2012. Although all amounts owed to Arian by the owner of the Contracuña Mill have now been repaid, Arian has submitted a claim for damages, which has been met by a counter-claim by Contracuña, which Arian believes, has been submitted solely to frustrate the legal process and is without merit.

## Liquidity, working capital and capital resources

***Liquidity***
At 31 December 2012 the Company had cash and cash equivalents of $0.5m (2011: $4.0m) and working capital of $1.6m (2011: $5.9m).

Cash and cash equivalents decreased by $3.5m during 2012 as a result of $2.6m used in operating activities and $1.8m investment in the development of the San José mine, offset by $0.9m from proceeds raised from the drawdowns made against the SEDA facility and the exercise of share purchase options.

***Working capital***

Current assets

- Cash and cash equivalents of $0.5m (2011: $4.0m) decreased by $3.5m as a result of investment in the development of and working capital requirements of the San José mine, offset by funds from the issue of shares and in connection with the SEDA drawdown and the exercise of share purchase options.
- Trade and other receivables of $1.2m (2011: $1.9m) decreased by $0.7m owing to a $1.2m decrease in monies owed for the sale of silver concentrate, offset by an increase for monies owed by the Mexican authorities in respect of IVA (Mexican sales tax) of $0.5m.
- Inventories of $0.6m (2011: $0.9m) reflected reduced mining operations to avoid excessive stockpiling.
- Other financial assets held at fair value through the profit and loss account of $0.2m (2011: $0.3m) related to the Geologix shares held.

Current liabilities
Trade payables $0.9m (2011: $1.2m) decreased by $0.3m owing to reduced business activity resulting from the suspension of milling activities.

***Capital resources***

Standby Equity Distribution Agreement
The Company announced on 27 September 2012 it had signed a 3 year £5m standby equity distribution agreement with YA Global Master SPV Ltd ("Yorkville"), an investment fund managed by

Yorkville Advisors Global, L.P. The SEDA allows the company to draw down funds in exchange for the issue of shares in the Company.

Under the terms of the SEDA, equity is issued at 95 per cent of the prevailing market price over a pricing period of between 5 and 20 days. The amount of each drawdown may not exceed 400 per cent of the average daily trading volume of shares multiplied by the volume weighted average price on AIM for the five trading days prior to the drawdown request.

Use of the facility is entirely at the discretion of the Company and there are no penalties for not drawing down on the facility.

During the year, the Company share capital increased following:
- The exercise of 525,000 share purchase options, which generated £61,375
- The issue of 975,067 shares under the terms of the SEDA, for £154,000
- The issue of 2,209,390 shares under the terms of the SEDA, for £360,000

Since the year end the Company has received £371,000 under the terms of the SEDA in exchange for 2,677,689 shares.

An application has been made to the London Stock Exchange for 2,198,279 common shares to be admitted to trading on AIM and it is expected that admission will occur at 8.00 a.m. on 6 March 2013. The new common shares will rank pari passu in all respects with the existing common shares.

Following this share issue the Company has in issue 309,774,537 common shares with voting rights.

Funds received in respect of the SEDA during 2012 have been utilised for continued development and mining work at the San José mine and as a contribution to working capital.

Share options
The following share purchase options are currently outstanding, each entitling the holder to acquire one common share of the Company:

15,960,000 share purchase options with exercise prices ranging from £0.055 to £0.4925 or Cdn$0.10 to Cdn$0.79 expiring on various dates up to May 2017.

Future commitments
The following table discloses the contractual obligations for the Company as at 31 December 2012:

| | **Less than 1 year** | **1 – 2 years** | **Total** |
|---|---|---|---|
| | **2012<br>$'000** | **2012<br>$'000** | **2012<br>$'000** |
| Building lease | 15 | - | 15 |
| Milling Contract | 3,420 | - | 3,420 |
| **Total** | **3,435** | **-** | **3,435** |

## Off-balance sheet arrangements
The Company has no off-balance sheet arrangements.

## Transactions between related parties
Dragon Group Limited, of which A.J. Williams is a director and beneficial owner, charged the Company a total of $123,803 (2011: $124,574) in respect of A.J. Williams' remuneration. At 31 December, 2012 $20,910 (2011: $10,002) was outstanding.

## Proposed transactions

Mill expansion
The Company has identified a second-hand processing plant which appears to be suitable for treating the San José ore. The Company will provide an update on these discussions as they progress.

## Future outlook

The commencement of processing at the Juan Reyes toll mill once again puts Arian back into the ranks of silver producers after frustrating delays since mid 2012. However, this new toll mill arrangement, while providing useful cash flow, should be regarded as only a stepping-stone towards the Company acquiring its own processing plant. A plant has been identified and the Company is in discussions regarding its acquisition, which if successful will eventually allow greater daily ore throughput from the San José mine with increased efficiencies all round.

The Company has already established very significant resources of silver, lead and zinc at San José and the proposed acquisition of a plant will accelerate the aim of becoming a significant silver producer in the medium term.

## Critical accounting estimates

The preparation of financial statements in conformity with IFRS requires the Company to select from possible alternative accounting principles and to make estimates and assumptions that determine the reported amount of assets and liabilities at the balance sheet date and reported costs and expenditures during the reporting period. Estimates and assumptions may be revised as new information is obtained and are subject to change. The Company's accounting policies are considered appropriate in the circumstances, but are subject to judgements and uncertainties inherent in the financial reporting process.

The following section discusses the critical accounting estimates and assumptions that management has made and how they affect the amounts reported in the consolidated financial statements. We consider these estimates to be an important part of understanding our consolidated financial statements.

***Going concern***

The Financial Statements have been prepared on a going concern basis.

The directors regularly review cash flow forecasts to determine whether the Company and its subsidiaries (together referred to as the "Group") have sufficient cash reserves to meet future working capital requirements and to fund future exploration projects and business opportunities. Exchange rates and the price of silver have a significant impact on the Group's cash flow.

Toll milling fully resumed on 16 February 2013 at a mill operated by Beneficiadora de Jales y Minerales Juan Reyes SA de CV, and under present market conditions and prices for the sale of silver concentrate, the directors believe that the sale of concentrate from the continued mining and processing of 500 tpd should provide sufficient cash flow to cover operational cash flow expenditure.

In September 2012, the Group entered into a £5 million Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd ("Yorkville"). This facility was to provide working capital funding to initiate the P5 drilling programme, milling and mining studies. The SEDA entitles the Group to drawdown funds in exchange for the issue of shares at a price based on the Company's market price over the previous 5 to 20 days period. At the year end, the Group had drawn down an amount of £514,000 against this facility.

This facility has been utilised for continued development and mining work at the San José mine and as a contribution to working capital.

The Group is also considering a number of funding options including the issue of new equity, project and debt finance to provide additional funding for future growth and expansion.

In the past the Group has been successful at raising equity funds, however there can be no assurance that the Group will be able to raise funds for future development.

The directors currently believe that the Group has adequate financial resources or access to such resources in order to continue in operational existence for the foreseeable future and to meet its currently projected working capital and project expenditure requirements for the next 12 months. They therefore believe it appropriate to prepare the Company's financial statements on a going concern basis

***Resource Properties, Deferred Exploration and Development Costs***
All costs related to the exploration of mineral properties are capitalised until either the properties are brought into production, at which time they are amortised over the estimated life of the project, or until the properties are sold, or title rights allowed to lapse, or are abandoned or determined not to be commercially viable, at which time they are charged to the income statement.

The amounts capitalised at any time represent costs to be charged to operations in future and do not necessarily reflect the present or future values of particular properties. The recoverability of the carrying values of exploration properties is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete development and future profitable production therefrom, or alternatively, upon the Company's ability to dispose of its interests on an advantageous basis.

Management is of the view that the current policy is appropriate for the Company at this time and is consistent with many other public mineral exploration and development companies in the UK and Canada. Shareholders are advised that carrying values are not necessarily indicative of present or future values. The Company assesses whether impairment exists in any of its exploration projects and writes down that project to its estimated recoverable value when such impairment is found to exist. Any write down is recorded as an expense in the Company's income statement in the financial statements for the relevant period.

***Share based payments***
The share option programme allows Company directors, officers, employees and consultants to acquire shares of the Company. The fair value of share purchase options granted is recognised as an expense with a corresponding increase in equity. The fair value is measured at the grant date and spread over the period until the share purchase options vest unconditionally. The fair value of the share purchase options granted is measured using the Black-Scholes model, taking into account the terms and conditions upon which the share purchase options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share purchase options that vest, except if the change is due to market based conditions not being satisfied.

***Revenue recognition***
Revenue from sales of metal concentrate is recognised when title transfers and the rights and obligations of ownership pass to the customer. The Company's sales of concentrate are made under pricing arrangements where final sales prices are determined by quoted market prices in a period subsequent to the date of sale. In these circumstances, revenue from sales is recorded at the time of the sale based on forward prices for the expected date of final settlement. Subsequent variations in prices are recognised as revenue adjustments as they occur.

In a period of extreme and unusual price volatility, the effect of mark-to-market price adjustments related to the quantity of metal which remains to be settled with independent smelters could be significant.

***Inventories***
Concentrates and stockpile ore are valued at the lower of the average production costs or net realisable value. The assumptions used in the valuation of those inventories included estimates of metal contained in stockpiled ore, assumptions of the amount of metal that is expected to be recovered, assumptions of the smelting terms as well as assumptions of the metal prices and exchange rates expected to be realised when the metals are recovered. If these estimates or assumptions prove to be inaccurate the Company could be required to write-down the recorded value of its inventories, which would reduce the Company's earnings and working capital. Net realisable value is determined with reference to market prices.

## Changes in accounting policies including initial adoption

There have been no changes in accounting policies. The Group has not adopted any standards or interpretations in advance of the required implementation dates. It is not expected that adoption of the standards or interpretations which have been issued by the International Accounting Standards Board but have not been adopted will have a material impact on the financial information.

## RISK MANAGEMENT

## Financial Risks

***Market risk***

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk for Arian comprises two types of risk: currency risk and price risk.

***Price risk***

The price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments in the market. As at 31 December 2012, the Company held other financial assets at fair value of $197,000 (2011 – $272,000) relating to the Geologix shares, a fluctuation of 50% would affect other financial assets at fair value through profit and loss and profit by $102,000.

***Currency risk***

The Company's exploration expenditure is made in Mexico in Mexican Peso and head office expenses are predominantly made in the UK in Pounds Sterling, United States dollars and Canadian dollars. The Company is therefore exposed to the movement in exchange rates for these currencies.

The Company does not currently hedge foreign exchange risk.

At the year end the majority of the Company's cash resources were held in Pounds Sterling. The Company therefore also has downside exposure to any strengthening of the United States dollar, Canadian Dollar or the Mexican Peso against the Pounds Sterling as this would increase expenses in Pounds Sterling terms and accelerate the depletion of the Company's cash resources. Any weakening of the United States dollar, Canadian Dollar or the Mexican Peso against the Pounds Sterling would, however, result in a reduction in expenses in Pounds Sterling terms and preserve the Company's cash resources.

In addition, any movements in Pounds Sterling or Mexican Peso would affect the presentation of the consolidated statement of financial position when the net assets of the Mexican subsidiary and parent company in the UK are translated from their functional currencies into United States dollars.

***Liquidity risk***

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at 31 December 2012, the Company had cash of $491,000 to settle accounts payable of $939,000. The Company's accounts payable have contractual maturities of less than 30 days and are subject to normal trade terms. Management expects that the Company will generate sufficient cash from the sale of concentrates and funds raised from investors to settle operating accounts payable.

***Credit risk***

Credit risk is the risk of loss associated with a counterparty's inability to fulfil its payment obligations. The Company's credit risk is attributable to cash and trade receivables. The credit risk on cash is limited because the Company invests its cash in deposits with well capitalised financial institutions with strong credit ratings. Credit risk attributable to trade receivables is managed in off take agreements.

## Other risk factors

The financing, exploration, development and exploitation of the Company's properties and the operations of the Company' business are subject to a number of factors, including metal prices, laws

and regulations, political conditions, currency fluctuations, hiring qualified people and obtaining necessary services in jurisdictions where the Company operates.

The Company is subject to a number of risk factors due to the nature of the mining business in which it is engaged, not least are adverse movements in commodity prices, which are impossible to forecast. The Company seeks to counter this risk, as far as possible, by selecting exploration areas on the basis of their recognised geological potential to host economic deposits.

The following is a brief discussion of those distinctive or special characteristics of the Company's operations and industry that may have a material impact on, or constitute risk factors in respect of the Company's future financial performance.

***Mining concessions and title***

In relation to mining concessions over which the Company holds legal rights, if the Company fails to fulfil the specific terms of any of its concessions or operates in the concession areas in a manner that violates Mexican law, regulators may impose fines, suspend or revoke the concessions, any of which could have a material adverse effect on the Company's operations and proposed operations.

Whilst the Company has received legal opinions in respect of title to its properties there is no guarantee that title to such properties will not be challenged or impugned by third parties. The Company's concessions may be subject to prior unregistered agreements, transfers or other claims and title may be affected by unidentified or unknown defects or government actions.

***Nature of mineral exploration and mining***

Any exploration programme entails risks relating to the location of economic ore bodies, the development of appropriate metallurgical processes, the receipt of necessary governmental permits and the construction of mining and processing facilities. Save in respect of the San José project, the Company's projects are not in production and no assurance can be given that any exploration programme will result in any new commercial mining operation or in the discovery of new resources.

The exploration and development of mineral deposits involves significant financial risks over a prolonged period of time, which even a combination of careful evaluation, experience and knowledge may not eliminate. While discovery of a mineral structure may result in substantial rewards, few concessions which are explored are ultimately developed into producing mines. Major expenditure may be required to establish reserves by drilling and to construct mining and processing facilities at a site. It is impossible to ensure that preliminary feasibility studies or full feasibility studies on the Company's projects or the current or proposed exploration programmes on any of the concessions in which the Company has rights or is negotiating rights will result in a profitable commercial mining operation.

The Company's operations are subject to all of the hazards and risks normally incidental to exploration, development and the production of minerals. These could result in damage to or destruction of the Company's facilities, damage to life or property, environmental damage or pollution and possibly legal liability for any or all damage which could have a material adverse impact on the business, operations and financial performance of the Company. The Company's activities may be subject to prolonged disruptions due to weather conditions depending on the location of operations in which the Company has interests. Hazards, such as unusual or unexpected geological formations, rock falls, flooding or other climatic conditions may be encountered in the drilling and removal of material. Although precautions to minimise risk will be taken, even a combination of careful evaluation, experience and knowledge may not eliminate all of the hazards and risks.

Whether a mineral deposit will be or will continue to be commercially viable depends on a number of factors, some of which are the particular attributes of the deposit, such as its size and grade, proximity to infrastructure, financing costs and governmental regulations, including regulations relating to prices, taxes, royalties, infrastructure, land use, importing and exporting of silver, changes in the silver price and environmental protection. The effect of these factors cannot be accurately predicted, but the combination of these factors may result in the Company not receiving an adequate return on invested capital.

The Company is transitioning from an exploration company to a producer. In the mining industry such a transition is sometimes a difficult and challenging exercise due to operational issues and risks.

***Volatility of metal prices***
The value of the Company's resources and financial results of operations will be affected by fluctuations in metal prices over which the Company has no control. A reduction in the metal prices may prevent the Company's properties from being economically mined or result in curtailment of existing production activities or result in the impairment and write-off of assets.

The price of silver, which is affected by numerous factors including inflation levels, fluctuations in the US dollar and other currencies, supply and demand and political and economic conditions, may have a significant influence on the market price of the Company's common shares.

***Requirement for additional financing***
The exploration and development of the Company's concessions, including continuing exploration projects, and the construction of mining facilities and development of mining operations, will require substantial additional financing. The Company currently has sufficient funds to finance its projected working capital and project expenditures for the next 12 months but will require further funding in the future to continue to explore and develop its concessions and to maintain its interest in all its projects. No assurance can be given that the Company will be able to raise the additional financing necessary to continue its production activities or to explore and/or develop its concessions. Failure to obtain sufficient financing for any projects will result in a delay or indefinite postponement of exploration, development or production on properties covered by the Company's concessions or even the loss of a concession. The only sources of funds currently available to the Company are through the sale of product from production activities, the issue of equity capital, the sale of concessions or other assets, royalty interests or the entering into of joint ventures. In addition, the Company's ability to obtain further financing will depend in part on the price of silver and the industry's perception of its future price and other factors outside the Company's control. Additional financing may not be available when needed, or if available, the terms of such financing might not be favourable to the Company and might involve substantial dilution to shareholders. In the absence of adequate funding the Company may not be able to continue as a going concern in which event the carrying value of the Company's projects would be impaired.

***Limited operating history***
The Company has a limited history of producing revenue and its ultimate success will depend on its ability to generate cash flow from its concessions in the future. The Company has not earned any material profits to date and there is no assurance that it will do so in the future. A major portion of the Company's activities will be directed to the development of the SJV as well as the search for and the development of new silver deposits. Significant capital investment will be required for exploration at the concessions and to achieve commercial production from the Company's existing projects and from successful exploration efforts. There is no assurance that the Company will be able to raise the required funds to continue these activities.

***Mineral resource estimates***
The mineral resource figures disclosed in this MD&A are estimates and no assurances can be given that the indicated levels of minerals will be produced. Such estimates are expressions of judgment based on knowledge, mining experience, analysis of drilling results and industry practices. Valid estimates made at a given time may significantly change when new information becomes available. While the Company believes that the resource estimates included in this MD&A are well established, by their nature resource estimates are imprecise and depend, to a certain extent, upon statistical inferences, which may ultimately prove unreliable. If such estimates are inaccurate or are reduced in the future, this could have a material adverse impact on the Company.

Mineral resources are not mineral reserves and do not have demonstrated economic viability. There is no certainty that mineral resources can be upgraded to mineral reserves through continued exploration.

***No reserves***
The Company does not hold any concessions in respect of which mineral reserves estimates have been established that comply with CIM Standards and Guidelines or other similar recognised industry standards.

***Insurance and uninsured risks***
The mining industry is subject to significant risks that could result in damage to, or destruction of, mineral properties or producing facilities, personal injury or death, environmental damage, delays in mining or monetary losses and possible legal liability.

The Company's insurance policies may not provide adequate coverage for losses related to these or other risks. The Company's insurance policies do not cover all possible risks that may arise in relation to the Company's exploration activities and production facilities and as a result the Company may incur losses or damages that could have a material and adverse effect on the Company's operations and finances.

In the course of the Company's activities certain risks or unexpected or unusual geological conditions both underground and on surface may occur. It is not always possible to insure against such risks due to the absence of available cover or the Company may decide not to insure due to costs considerations of available cover. As a result the Company could incur losses or damages that could have a material and adverse effect on the Company's operations and finances.

***Reliance on contractors in Mexico***

The Company relies on contractors to implement the Company's exploration and development programmes as well as its current mining operation at the San José project. The failure of a contractor to perform properly its services to the Company could delay or inconvenience the Company's operations, and have a materially adverse effect on the Company.

***Key personnel***

The Company's business is dependent on retaining the services of a small number of key personnel of the appropriate calibre as the business develops. The Company has entered into employment agreements with certain key managers. The success of the Company is, and will continue to be to a significant extent, dependent on the expertise and experience of the directors and senior management. The loss of one or more of these individuals could have a materially adverse effect on the Company. The Company does not currently have any insurance in place with respect to key personnel.

***Environmental factors***

The Company's operations are subject to environmental regulation in the jurisdictions in which the Company operates. Such regulation covers a wide variety of matters, including, without limitation, prevention of waste, pollution and protection of the environment, labour regulations and health and safety. The Company may also be subject under such regulations to clean-up costs and liability for toxic or hazardous substances, which may exist on or under any of the properties covered by its concessions, or which may be produced as a result of its operations.

If the Company does not comply with environmental regulations or does not file environmental impact statements in relation to each of its concessions, it may be subject to penalties, its operations may be suspended, closed and/or its concessions may be revoked.

Environmental legislation and permit requirements are likely to evolve in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their directors and employees.

***Political risk***

The Company is conducting its exploration activities in the Republic of Mexico. The Company may be adversely affected by changes in economic, political, judicial, administrative or other regulatory factors such as taxation in the Republic of Mexico, where the Company will operate and holds its major assets. The Republic of Mexico may have a more volatile political environment and/or more challenging trading conditions than in some other parts of the world. The Directors believe the Government of Mexico supports the development of natural resources by foreign operators. There is no assurance that future political and economic conditions in Mexico will not result in the Government of Mexico adopting different policies in respect of foreign development and ownership of mineral resources. Any such changes in policy may result in changes in laws affecting ownership of assets, taxation, rates of exchange, environmental protection, labour relations, repatriation of income and return of capital. These changes may affect both the Company's ability to undertake exploration and development activities in respect of future properties in the manner currently contemplated, as well as its ability to continue to explore and develop those properties, in respect of which it has obtained exploration and development rights to date.

***Payment obligations***
Under the mineral property concessions and certain other contractual agreements to which a member of the Group is, or may in the future become, a party, any such company is, or may become, subject to payment and other obligations. If such obligations are not complied with when due, in addition to any other remedies which may be available to other parties, this could result in dilution or forfeiture of interests held by such companies. The Company may not have, or be able to obtain, financing for all such obligations as they arise.

***Regulatory approvals***
The operations of the Company require approvals, licenses and permits from various regulatory authorities, governmental and otherwise. The Board believes that the Company holds or will obtain all necessary approvals, licenses and permits under applicable laws and regulations in respect of its current projects. There can be no guarantee that the Company will be able to obtain or maintain all necessary approvals, licenses and permits that may be required to explore and develop its various projects and/or commence construction or operation of mining facilities that economically justify the cost.

***Competition***
The Company competes with numerous other companies and individuals in the search for and acquisition of mineral claims, leases and other mineral interests, as well as for the recruitment and retention of qualified employees. There is significant competition for the silver opportunities available and, as a result, the Company may be unable to acquire further silver concessions on terms it considers acceptable.

***Conflicts of interest***
Certain directors and officers of the Company also serve as directors and/or officers of other companies involved in mineral exploration and development and consequently there is the potential for conflicts of interest. The Company expects that any such director or officer shall disclose such interest in accordance with its articles of association or his contractual obligations to the Company and any decision made by any of such directors and officers involving the Company will be made in accordance with their duties and obligations to deal fairly and in good faith with a view to the best interests of the Company and its shareholders.

## Availability of documents on SEDAR
Additional information relating to the Company may be accessed through SEDAR on the internet at www.sedar.com or the Company's website on www.ariansilver.com.

## Disclosure of outstanding share data
The following table sets out the outstanding securities of the Company as at 27 February, 2013:-

| | **Number in issue** |
|---|---|
| Common shares of no par value | 307,576,258 |
| Share purchase options | 15,960,000 |

Each share option entitles the holder thereof to purchase one common share of the Company.

# Audited Consolidated Financial Statements

**Year Ended 31 December 2011**
**(In thousands of U.S. dollars)**

## Directors' responsibilities statement

The directors are responsible for preparing the financial statements and have, as required by the AIM Rules of the London Stock Exchange, elected to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union in order to give a true and fair view of the state of affairs of the Group and of its profit and loss for that period. In preparing these financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The directors are responsible for keeping records that are sufficient to show and explain the Company's transactions and will, at any time, enable the financial position of the Company to be determined with reasonable accuracy. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the British Virgin Islands governing the preparation and dissemination of the Company financial statements and other information included in the annual reports may differ from legislation in other jurisdictions.

## Independent auditor's report to the members of Arian Silver Corporation

We have audited the financial statements ('the financial statements') of Arian Silver Corporation for the year ended 31 December 2012 which comprise the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of cash flows, the consolidated statement of changes in equity and the related notes. 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.

This report is made solely to the Company's members, as a body in accordance with the terms of our engagement. 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.

### Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the financial statements:
- give a true and fair view of the state of the Group's affairs as at 31 December 2012 and of its loss for the year then ended; and
- have been properly prepared in accordance with IFRSs as adopted by the European Union.

### Separate opinion in relation to IFRSs as issued by the IASB

As explained in Note 2(a) to the Group financial statements the Group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

**PKF (UK) LLP**
London, UK
28 February 2013

## Consolidated statement of comprehensive income

(Expressed in United States dollars)

**For the year ended 31 December 2012**

| | Note | 2012 $'000 | 2011 $'000 |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue | | 4,588 | 7,467 |
| Cost of sales | | (5,352) | (6,655) |
| **Gross (loss)/profit** | | (764) | 812 |
| Administrative expenses | | (3,194) | (11,322) |
| **Operating loss** | 5 | (3,958) | (10,510) |
| Net investment loss | 7 | (73) | (460) |
| Income tax | 8 | - | - |
| **Loss for the year attributable to equity shareholders of the parent** | | (4,031) | (10,970) |
| **Other comprehensive income** | | | |
| Foreign exchange translation differences recognised directly in equity | 16 | 981 | (1,317) |
| **Other comprehensive income for the year** | | 981 | (1,317) |
| **Total comprehensive income for the year attributable to equity shareholders of the parent** | | (3,050) | (12,287) |
| Basic and diluted loss per share ($) | 9 | (0.01) | (0.04) |

*The accompanying notes are an integral part of these consolidated financial statements.*

## Consolidated statement of financial position
(Expressed in United States dollars)

**As at 31 December 2012**

| | Note | 2012 $'000 | 2011 $'000 |
|---|---|---|---|
| **Assets** | | | |
| Intangible assets | 10 | 1,176 | 1,093 |
| Property, plant and equipment | 11 | 10,405 | 8,082 |
| **Total non-current assets** | | 11,581 | 9,175 |
| Trade and other receivables | 12 | 1,206 | 1,890 |
| Cash and cash equivalents | 13 | 491 | 3,991 |
| Inventories | 14 | 644 | 922 |
| Financial assets held at fair value through profit or loss | 15 | 197 | 272 |
| **Total current assets** | | 2,538 | 7,075 |
| **Total assets** | | 14,119 | 16,250 |
| **Equity attributable to equity shareholders of the parent** | | | |
| Share capital | 16 | 48,223 | 47,326 |
| Share-based payment reserve | 16 | 7,885 | 9,359 |
| Foreign exchange translation reserve | 16 | (1,570) | (2,551) |
| Accumulated losses | 16 | (41,535) | (39,225) |
| **Total equity** | | 13,003 | 14,909 |
| **Liabilities** | | | |
| Trade and other payables | 19 | 939 | 1,171 |
| **Total current liabilities** | | 939 | 1,171 |
| Provision for mine closure | 20 | 177 | 170 |
| **Total non-current liabilities** | | 177 | 170 |
| **Total liabilities** | | 1,116 | 1,341 |
| **Total equity and liabilities** | | 14,119 | 16,250 |

*The accompanying notes are an integral part of these consolidated financial statements.*

***The financial statements were approved and authorised for issue by the Board of Directors on 27 February 2013 and were signed on its behalf by:***

*"J T Williams"*
J T Williams
Chief Executive Officer

*"J Mayfield"*
J Mayfield
Chief Financial Officer

## Consolidated statement of cash flows

(Expressed in United States dollars)

**For the year ended 31 December 2012**

| | *Note* | 2012 $'000 | 2011 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Loss before tax | | (4,031) | (10,970) |
| Adjustments for: | | | |
| Depreciation and amortisation | | 158 | 218 |
| Loss on disposal of fixture & fittings | | - | 1 |
| Exchange difference | | 146 | (961) |
| Net investment loss | | 73 | 442 |
| Equity-settled share-based payment transactions | | 247 | 8,546 |
| | | (3,407) | (2,724) |
| Decrease/(increase) in trade and other receivables | | 732 | (992) |
| (Decrease)/increase in trade and other payables | | (264) | 700 |
| Decrease/(increase) in inventories | | 303 | (786) |
| **Net cash used in operating activities** | | (2,636) | (3,802) |
| **Cash flows from investing activities** | | | |
| Interest received | | 12 | 44 |
| Proceeds from disposal of Tepal project | | - | 775 |
| Acquisition of property, plant and equipment | | (1,879) | (3,482) |
| **Net cash used in investing activities** | | (1,867) | (2,663) |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of share capital | | 897 | 1,906 |
| **Net cash from financing activities** | | 897 | 1,906 |
| **Net decrease in cash and cash equivalents** | | (3,606) | (4,559) |
| Cash and cash equivalents at 1 January | | 3,991 | 8,255 |
| Effect of exchange rate fluctuations on cash held | | 106 | 295 |
| **Cash and cash equivalents at 31 December** | *13* | 491 | 3,991 |

*The accompanying notes are an integral part of these consolidated financial statements.*

## Consolidated statement of changes in equity
(Expressed in United States dollars)

**For the year ended 31 December 2012**

| | Share Capital $'000 | Share based payment Reserve $'000 | Foreign exchange translation reserve $'000 | Accumulated Losses $'000 | Total $'000 |
|---|---|---|---|---|---|
| Balance – 1 January 2011 | 45,420 | 813 | (1,234) | (28,255) | 16,744 |
| Loss for the year | - | - | - | (10,970) | (10,970) |
| Foreign exchange | - | - | (1,317) | - | (1,317) |
| **Total comprehensive income for the year** | **-** | **-** | **(1,317)** | **(10,970)** | **(12,287)** |
| Exercise of warrants | 143 | - | - | - | 143 |
| Exercise of share options | 1,763 | - | - | - | 1,763 |
| Fair value of share options | - | 8,546 | - | - | 8,546 |
| **Balance – 31 December 2011** | **47,326** | **9,359** | **(2,551)** | **(39,225)** | **14,909** |
| Loss for the year | - | - | - | (4,031) | (4,031) |
| Foreign exchange | - | - | 981 | - | 981 |
| **Total comprehensive income for the year** | **-** | **-** | **981** | **(4,031)** | **(3,050)** |
| Exercise of share options | 94 | **-** | **-** | **-** | **94** |
| Fair value of share options | - | 247 | - | - | **247** |
| Shares issued for cash | 823 | - | - | - | **823** |
| Share issue costs | (20) | - | - | - | **(20)** |
| Lapse of share options | - | (1,721) | - | 1,721 | **-** |
| **Balance – 31 December 2012** | **48,223** | **7,885** | **(1,570)** | **(41,535)** | **13,003** |

*The accompanying notes are an integral part of these consolidated financial statements.*

## 1. Reporting entity

Arian Silver Corporation (the "Company") is a company domiciled in the British Virgin Islands. The consolidated financial statements for the year ended 31 December 2012 comprise the Company and its subsidiaries (together referred to as the "Group").

The Group is primarily involved in the acquisition and development of mineral resource assets.

## 2. Basis of preparation

### (a) Statement of compliance

The consolidated financial statements for the year ended 31 December 2012 have been prepared in accordance with both International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board and IFRSs and Interpretations adopted by the EU in force at the reporting date.

The Group has adopted all of the new and revised Standards and Interpretations that are relevant to its operations and effective for accounting periods beginning 1 January 2012. The adoption of these new and revised Standards and Interpretations had no material effect on the profit or loss or financial position of the Group.

The Group has not adopted any standards or interpretations in advance of the required implementation dates. It is not expected that adoption of the standards or interpretations which have been issued by the International Accounting Standards Board but have not been adopted will have a material impact on the financial statements.

The accounts were approved by the board and authorised for issue on 27 February 2013.

### (b) Going concern and adequacy of project finance

The Financial Statements have been prepared on a going concern basis.

The directors regularly review cash flow forecasts to determine whether the Group has sufficient cash reserves to meet future working capital requirements and to fund future exploration projects and business opportunities. Exchange rates and the price of silver have a significant impact on the Group's cash flow.

Toll milling fully resumed on 16 February 2013 at a mill operated by Beneficiadora de Jales y Minerales Juan Reyes SA de CV, and under present market conditions and prices for the sale of silver concentrate, the directors believe that the sale of concentrate from the continued mining and processing of 500 tpd should provide sufficient cash flow to cover operational cash flow expenditure.

In September 2012, the Group entered into a £5 million Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd ("Yorkville"). This facility was to provide working capital funding to initiate the P5 drilling programme, milling and mining studies. The SEDA entitles the Group to drawdown funds in exchange for the issue of shares at a price based on the Company's market price over the previous 5 to 20 days period. At the year end, the Group had drawn down an amount of £514,000 against this facility.

This facility has been used to cover some operational costs since November 2012 owing to the delay in re-commencement of processing.

The Group is also considering a number of funding options including the issue of new equity, project and debt finance to provide additional funding for future growth and expansion.

## 2. Basis of preparation (continued)

### (b) Going concern and adequacy of project finance (continued)

In the past the Group has been successful at raising equity funds, however there can be no assurance that the Group will be able to raise funds for future development.

The directors currently believe that the Group has adequate financial resources or access to such resources in order to continue in operational existence for the foreseeable future and to meet its currently projected working capital and project expenditure requirements for the next 12 months. They therefore believe it appropriate to prepare the Company's financial statements on a going concern basis.

### (c) Use of estimates and judgement

The preparation of financial statements in conformity with International Financial Reporting Standards ("IFRSs") requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Information about such judgements and estimates is contained in the accounting policies and/or the notes to the consolidated financial statements. Areas of judgement that have the most significant effect on the amounts recognised in the consolidated financial statements:

- Going concern and adequacy of project finance – Note 2b
- Capitalisation and impairment of exploration and evaluation costs – Notes 3h, 3j, 10
- Estimation of share based payment costs – Notes 3p, 18
- Depreciation on property, plant and equipment – Note 3i
- Revenue – Note 3c
- Inventories – Note 3k

### (d) Functional and presentation currency

These consolidated financial statements are presented in United States dollars as the Company believes it to be the most appropriate and meaningful currency for investors. The functional currencies of the Company and its subsidiary are Pounds Sterling and Mexican Peso respectively.

## 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by Group entities.

### (a) Basis of consolidation

***(i) Subsidiaries***

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control is obtained.

***(ii) Transactions eliminated on consolidation***

Intra-group balances and any unrealised gains, losses, income or expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

## 3. Significant accounting policies *(continued)*

### (b) Foreign currency

#### *(i) Foreign currency transactions*

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the date of the consolidated statement of financial position are translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates the fair value was determined.

The functional currency of the parent company is Pounds Sterling. The reason for presenting the financial statements in United States dollars is because this is the trading currency of silver and it is therefore considered to be the most useful currency to the users of the accounts.

#### *(ii) Financial statements of operations*

The assets and liabilities of operations, including goodwill and fair value adjustments arising on consolidation, are translated to United States dollars at exchange rates ruling at the date of the consolidated statement of financial position. The revenues and expenses of operations and net investments in subsidiaries are translated to United States dollars at rates approximating to the exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on retranslation are recognised in other comprehensive income. They are reclassified to profit or loss upon disposal.

### (c) Revenue recognition

Revenue from sales of metal concentrate is recognised when title transfers and the rights and obligations of ownership pass to the customer. The Group's sales of concentrate are made under pricing arrangements where final sales prices are determined by quoted market prices in a period subsequent to the date of sale. In these circumstances, revenue from sales is recorded at the time of the sale based on forward prices for the expected date of final settlement. Subsequent variations in prices are recognised as revenue adjustments as they occur.

In a period of extreme and unusual price volatility, the effect of mark-to-market price adjustments related to the quantity of metal which remains to be settled with independent smelters, could be significant.

### (d) Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

All other leases are classified as operating leases. Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

### (e) Finance income and expenses

Finance income comprises interest income on funds invested and related foreign currency gains. Interest income is recognised as it accrues, using the effective interest method.

Finance expenses comprise interest expense on borrowings and related foreign currency losses. All borrowing costs are recognised in profit or loss using the effective interest method.

## 3. Significant accounting policies *(continued)*

### (f) Income tax expense

Income tax expense comprises current and deferred tax.

Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

### (f) Income tax expense (continued)

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is not recognised for the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries that will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### (g) Earnings per share

The Group presents basic and diluted earnings per share (“EPS”) data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all potentially dilutive common shares, which comprise warrants and share options.

### (h) Intangible assets

*(i) Goodwill*

All business combinations are accounted for by applying the purchase method. Goodwill arises on the acquisition of subsidiaries. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (see accounting policy j). Goodwill arising on acquisition is capitalised and shown within fixed assets. The excess of net assets over consideration paid on an acquisition is recognised directly in profit or loss.

*(ii) Deferred exploration and evaluation costs*

These comprise costs directly incurred in exploration and evaluation as well as the cost of mineral licences. They are capitalised as intangible assets pending the determination of the feasibility of the project. When the decision is taken to develop a mine the related intangible assets are transferred to property, plant and equipment and the exploration and evaluation costs are amortised over the estimated life of the project. Where a project is abandoned or is determined not economically viable, the related costs are written off.

The recoverability of deferred exploration and evaluation costs is dependent upon a number of factors common to the natural resource sector. These include the extent to which a Company can establish mineral reserves on its properties, the ability of the Company to obtain necessary financing to complete the development of such reserves and future profitable production or proceeds from the disposition thereof.

## 3. Significant accounting policies *(continued)*

### (i) Property, plant and equipment

***Mine development costs***

Mine development costs include appropriate deferred exploration and evaluation costs reclassified on commencing development of an exploration property. Before reclassification, such costs are assessed for impairment, with any impairment recognised in profit or loss for the period.

All subsequent development costs are capitalised, including all costs incurred as commissioning costs. When the mine is capable of operating in the manner intended by management, the mining assets are amortised over the estimated life of the reserves on a unit of production basis.

***Other property, plant and equipment***

*(i) Recognition and measurement*

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the estimated costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

*(ii) Subsequent costs*

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

*(iii) Depreciation*

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

- office equipment 3 years
- fixtures and fittings 3 years
- plant and equipment 5 years
- motor vehicles 4 years

The residual value, if not insignificant, is reassessed annually.

### (j) Impairment

The carrying amounts of the Group's assets are reviewed at the date of each consolidated statement of financial position to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

## 3. Significant accounting policies *(continued)*

### (k) Inventories

Concentrate and stockpiled ore are valued at the lower of the average production costs and net realisable value. The assumptions used in the valuation of those inventories include estimates of metal contained in stockpiled ore, assumptions of the amount of metal that is expected to be recovered, assumptions of the smelting terms as well as assumptions of the metal prices and exchange rates expected to be realised when the metals are recovered. If these estimates or assumptions prove to be inaccurate, the Group could be required to write-down the recorded value of its inventories, which would reduce the Group's earnings and working capital. Net realisable value is determined with reference to market prices.

### (l) Financial instruments

*(i) Non-derivative financial instruments*

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, trade and other payables, available for sale financial assets and financial assets at fair value through profit or loss.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular purchases and sales of financial assets are accounted for at trade date, i.e. the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

*(ii) Trade and other receivables*

Trade and other receivables that are short term in nature are stated at cost less any impairment provision.

*(iii) Financial liabilities*

Financial liabilities include current borrowings and trade and other payables that are short term in nature and are stated at amortised cost.

*(iv) Cash and cash equivalents*

Cash and cash equivalents represent bank balances and call deposits.

*(v) Other financial assets at fair value through profit or loss*

Financial assets at fair value through profit and loss comprise investments acquired principally for the purpose of selling. Subsequent to initial recognition financial assets at fair value through profit and loss are stated at fair value. Movements in fair values are recognised in profit or loss as finance income or expenditure.

### (m) Non-current assets held for sale

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than continuing use. This is the case when the asset is available for immediate sale in its present condition and the sale is highly probable.

Non-current assets held for sale are measured at the lower of its carrying amount or fair value less costs to sell.

## 3. Significant accounting policies *(continued)*

A sale is considered to be highly probable if the appropriate level of management is committed to a plan to sell the asset and the active plan to complete the sale has been initiated, the sale has been actively marketed at a price that is reasonable in relation to its fair value and the sale is expected to qualify for recognition as a completed sale within one year from the date it is classified as held for sale.

### (n) Provisions

A provision is recognised in the consolidated statement of financial position when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

***Provisions for decommissioning and site restoration costs***

An obligation to incur decommissioning and site rehabilitation costs occurs when environmental disturbance is caused by the development or on-going production of a mining property. Costs are estimated on the basis of a closure plan and are subject to regular review.

Such costs arising from the installation of plant and other site preparation work, discounted to their net present value, are provided and capitalised within mine development costs at the start of each project, as soon as the obligation to incur such cost arises. These decommissioning costs are charged against profits over the life of the mine, through depreciation of the asset and unwinding or amortisation of the discount on the provision. Depreciation is included in operating costs while the unwinding of the discount is included in financing costs. Changes in the measurement of a liability relating to the decommissioning of plant or other site preparation work are added to, or deducted from, the cost of the related asset in the current period.

### (o) Share capital – Common shares

Incremental costs directly attributable to the issue of common shares and share options are recognised as a deduction from equity.

### (p) Share-based payment transactions

The share option programme allows Group directors, officers, employees and consultants to acquire shares of the Company. The fair value of options granted is recognised as an expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period until the options vest unconditionally. The fair value of the options granted is measured using the Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest, except if the change is due to market based conditions not being satisfied.

## 4. Segment reporting

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Board in order to allocate resources to the segments and to assess their performance.

The operating segments included in internal reports are determined on the basis of their significance to the Group. In particular, operating mines are reported as separate segments together with exploration projects that have significant capitalised expenditure. An analysis of the Group's business segments is set out below.

## 4. Segment reporting *(continued)*

### (i) Segment information

| | San José | | All other segments | | Total | |
|---|---|---|---|---|---|---|
| | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 |
| Revenue | 4,588 | 7,467 | - | - | 4,588 | 7,467 |
| (Loss)/profit before tax | (764) | 812 | (3,267) | (11,782) | (4,031) | (10,970) |
| Capital Expenditure | 1,828 | 3,463 | 51 | 19 | 1,879 | 3,482 |
| Depreciation and amortisation | 142 | 201 | 16 | 17 | 158 | 218 |
| Total assets | 10,866 | 8,927 | 3,253 | 7,323 | 14,119 | 16,250 |
| Total liabilities | 177 | 170 | 939 | 1,171 | 1,116 | 1,341 |

San Jose revenue relates to transactions from two customers during the year, each customer accounting for 67% and 33% respectively, (2011 100% and 0%)

### (ii) Geographical information

| | Mexico | | UK | | Total | |
|---|---|---|---|---|---|---|
| | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 |
| Non current assets excluding investments | 11,525 | 9,167 | 56 | 8 | 11,581 | 9,175 |
| Revenue | 4,588 | 7,467 | - | - | 4,588 | 7,467 |

## 5. Operating loss is stated after charging:

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Auditor's remuneration | | |
| Audit – Remuneration for audit of Arian Silver Corporation | 47 | 48 |
| Audit – Remuneration for audit of Arian Silver de Mexico S.A. de C.V. | 18 | 15 |
| Taxation | 9 | 24 |
| Depreciation and amortisation | 158 | 218 |
| Gain on disposal of non-current assets held for sale | - | 112 |
| Exchange loss | 106 | 295 |

## 6. Staff numbers and costs

The average number of persons employed by the Group (including Directors) during the year, analysed by category, was as follows:

| | Number of Employees 2012 | Number of Employees 2011 |
|---|---|---|
| Finance and administration | 16 | 15 |
| Technical | 42 | 36 |
| | **58** | **51** |

The aggregate staff costs of these persons were as follows:

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Wages and salaries | 1,101 | 1,008 |
| Social security costs | 108 | 137 |
| Share based payments | 232 | 7,960 |
| | **1,441** | **9,105** |

**Remuneration of key management personnel**

Key management personnel remuneration is detailed below:

| | 2012 | | | 2011 |
|---|---|---|---|---|
| | Salary | Fees | Total | Total |
| **Executive Directors** | $'000 | $'000 | $'000 | $'000 |
| A J Williams | 114 | - | 114 | 115 |
| J T Williams | 254 | - | 254 | 257 |
| **Non-executive Directors** | | | | |
| T A Bailey | 24 | - | 24 | 24 |
| J S Cable | 24 | - | 24 | 24 |
| J A Crombie | 24 | - | 24 | 24 |
| **Other key management** | | | | |
| Country Manager – Mexico | - | 60 | 60 | 60 |
| Former Chief Financial Officer (appointed 9 May 2011, resigned 15th January 2013) | 158 | - | 158 | 107 |
| Company Secretary (appointed 13 October 2011) | 111 | - | 111 | 28 |
| Former Company Secretary (retired 13 October 2011) | - | - | - | 104 |
| | **709** | **60** | **769** | **743** |

The above remuneration excludes social security costs incurred by the Group. Including these social security costs, the total short-term employee benefits for the year in respect of key management personnel amounted to $839,000 (2011 - $1,003,000).

Key management personnel also participate in the Group's share option programme as disclosed in note 18.

## 7. Net investment loss

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Revaluation of financial assets held at fair value through profit or loss | (78) | (495) |
| Unwinding of provision for mine closure | (7) | (9) |
| Interest income | 12 | 44 |
| | **(73)** | **(460)** |

## 8. Income tax recognised in the income statement

| | 2012 | 2011 |
|---|---|---|
| **Current tax** | **$'000** | **$'000** |
| Current year | - | - |

**Reconciliation of effective tax rate**

| | 2012<br>$'000 | 2011<br>$'000 |
|---|---|---|
| Loss before tax | (4,031) | (10,970) |
| Income tax using the domestic corporation tax rate of 24.49% (2011 – 26.49%) | (987) | (2,906) |
| Non-deductible expenses | 313 | 584 |
| Share options disallowed | 61 | 2,264 |
| Share options relief | (8) | - |
| Losses utilised | - | (88) |
| Exchange rate differences | 345 | (566) |
| Depreciation in excess of capital allowances | 9 | 12 |
| Short term timing differences not recognised in a deferred tax asset | (580) | (482) |
| Tax losses carried forward | 847 | 1,182 |
| Total tax expense/(credit) | - | - |

**Unrecognised deferred tax asset**

| | 2012<br>$'000 | 2011<br>$'000 |
|---|---|---|
| Mexican short term timing differences (at 29%) | (3,647) | (2,960) |
| Mexican tax losses (at 29%) | 3,643 | 2,883 |
| UK tax losses (at 23%) | 3,465 | 3,256 |
| Total | 3,461 | 3,179 |

A net deferred tax asset has not been recognised in respect of the above items because it is not probable that future taxable profit will be available against which the Group can utilise the benefits there from. This substantially comprises losses of $15,047,670.

## 9. Loss per share

**Basic loss per share**

The calculation of basic loss per share at 31 December 2012 was based on the loss attributable to common shareholders of $4,031,000 (2011 – $10,970,000) and a weighted average number of common shares outstanding during the year ended 31 December 2012 of 302,059,015 (2011 – 300,252,683). See Note 26 for a description of subsequent transactions giving rise to changes in the number of issued and outstanding common shares.

**Diluted Loss per share**

The potential increase in common shares from the exercise of any outstanding share purchase warrants or share options would be anti-dilutive as the Group has a net loss. These potential common shares are therefore excluded from the calculation and the diluted loss per share figure reported is the same as the basic earnings per share.

## 10. Intangible assets

| Cost | Goodwill $'000 | Deferred exploration costs $'000 | Total $'000 |
|---|---|---|---|
| Balance – 1 January 2011 | 13,446 | 1,426 | **14,872** |
| Foreign exchange | - | (148) | **(148)** |
| **Balance – 31 December 2011** | 13,446 | 1,278 | **14,724** |
| Balance – 1 January 2012 | 13,446 | 1,278 | **14,724** |
| Foreign exchange | - | 83 | **83** |
| **Balance – 31 December 2012** | 13,446 | 1,361 | **14,807** |
| **Impairment losses and amortisation** | | | |
| Balance – 1 January 2011 | (13,446) | (185) | **(13,631)** |
| **Balance – 31 December 2011** | (13,446) | (185) | **(13,631)** |
| Balance – 1 January 2012 | (13,446) | (185) | **(13,631)** |
| **Balance – 31 December 2012** | (13,446) | (185) | **(13,631)** |
| **Carrying amounts** | | | |
| **At 31 December 2012** | - | 1,176 | **1,176** |
| At 31 December 2011 | - | 1,093 | **1,093** |
| At 1 January 2011 | - | 1,241 | 1,241 |

The goodwill recognised in the table above is a combination of the goodwill arising on the merger with Arian Silver Corporation Limited in 2006 and the goodwill on the acquisition of Arian Silver Corporation (UK) Ltd in 2006.

Deferred exploration costs as at 31 December 2012 consisted mainly of costs relating to Calicanto $803,000 (2011 - $746,000), San Celso $94,000 (2011 - $88,000) and Los Compos $85,000 (2011 - $79,000).

## 11. Property, plant and equipment

| | Mine Development costs $'000 | Plant and equipment $'000 | Fixtures & fittings $'000 | Vehicles $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance – 1 January 2011 | 5,334 | 125 | 47 | 105 | **5,611** |
| Additions | 3,463 | 19 | - | - | **3,482** |
| Disposals | - | - | (15) | - | **(15)** |
| Foreign exchange movement | (591) | (12) | (4) | (12) | **(619)** |
| **Balance – 31 December 2011** | 8,206 | 132 | 28 | 93 | **8,459** |
| Balance – 1 January 2012 | 8,206 | 132 | 28 | 93 | **8,459** |
| Additions | 1,760 | 119 | - | - | **1,879** |
| Foreign exchange movement | 610 | 9 | 2 | 7 | **628** |
| **Balance – 31 December 2012** | 10,576 | 260 | 30 | 100 | **10,966** |
| **Depreciation and impairment losses** | | | | | |
| Balance – 1 January 2011 | (7) | (67) | (25) | (89) | **(188)** |
| Depreciation and amortisation charge for the year | (195) | (14) | (3) | (6) | **(218)** |
| Disposals | - | - | 14 | - | **14** |
| Foreign exchange movement | 1 | 6 | 1 | 7 | **15** |
| **Balance – 31 December 2011** | (201) | (75) | (13) | (88) | **(377)** |
| Balance – 1 January 2012 | (201) | (75) | (13) | (88) | **(377)** |
| Depreciation and amortisation charge for the year | (141) | (12) | (3) | (2) | **(158)** |
| Foreign exchange movement | (13) | (5) | (1) | (7) | **(26)** |
| **Balance – 31 December 2012** | (355) | (92) | (17) | (97) | **(561)** |
| **Carrying amounts** | | | | | |
| **At 31 December 2012** | 10,221 | 168 | 13 | 3 | **10,405** |
| At 31 December 2011 | 8,005 | 57 | 15 | 5 | **8,082** |
| At 1 January 2011 | 5,327 | 58 | 22 | 16 | **5,423** |

The mine development costs at 31 December 2012, relate to the 100% owned San José property in Zacatecas State, Mexico.

## 12. Trade and other receivables

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Other receivables | 1,077 | 1,789 |
| Prepayments | 129 | 101 |
| | **1,206** | **1,890** |

Included within other receivables is $998,000 (2011 - $544,000) of Mexican IVA (sales goods tax) which is recoverable from the Mexican authorities. The Group have previously been successful recovering IVA and management are confident that this amount will be recovered.

## 13. Cash and cash equivalents

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Bank balances | 491 | 3,991 |
| Cash and cash equivalents in the statement of cash flows | **491** | **3,991** |

## 14. Inventories

| | 2012 | 2011 |
|---|---|---|
| | $'000 | $'000 |
| Consumables | 13 | 28 |
| Stockpiled ore | 631 | 576 |
| Silver concentrate produced | - | 318 |
| | **644** | **922** |

## 15. Financial assets held for sale at fair value through profit or loss

Following the completion in 2011 of the disposal of the Group's Tepal Gold-Copper Project to Geologix Explorations Inc ("Geologix"), the Group holds 1,089,318 Geologix shares. The Group did not dispose of any Geologix shares during the year ended 31 December 2012. However, the shares held were acquired with the principal intent to be disposed of in the near future and as such, have been classified as financial assets held at fair value through profit and loss. At 31 December 2012, these shares have a fair value of $197,000 (2011- $272,000), with a corresponding loss of $78,000 (2011- $495,000).

## 16. Share capital and reserves

**Authorised**
The Company is authorised to issue an unlimited number of common shares of no par value.

**Issued and outstanding common shares**
Changes for the years ended 31 December 2012 and 2011 are detailed in the following table:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Number of Shares 000's | Amount $000's | Number of Shares 000's | Amount $000's |
| Balance – 1 January | 301,190 | 47,326 | 282,448 | 45,420 |
| Shares issued for cash | 3,184 | 823 | - | - |
| Issue costs of share issuance | - | (20) | - | - |
| Exercise of warrants | - | - | 17,342 | 1,763 |
| Exercise of share options | 525 | 94 | 1,400 | 143 |
| **Balance – 31 December** | 304,899 | 48,223 | **301,190** | **47,326** |

During the years ended 31 December 2012 and 2011, the Company made the following share issues:

**2012**

- 975,067 common shares issued at £0.157938 per share to provide additional working capital of £154,000 drawdown of the SEDA.
- 2,209,390 common shares issued at £0.162941 per share to provide additional working capital of £360,000 drawdown of the SEDA.
- 500,000 common shares issued at £0.12 per share to provide additional working capital of £60,000 in connection with share options exercised.
- 25,000 common shares issued at £0.055 per share to provide additional working capital of £1,375 in connection with share options exercised.

## 16. Share capital and reserves (*continued*)

**2011**

- 17,341,370 common shares issued at Cdn$0.10 per share to provide additional working capital of Cdn$1,734,200 in connection with warrants exercised.
- 1,200,000 common shares issued at £0.055 per share to provide additional working capital of £66,000 in connection with share options exercised.
- 200,000 common shares issued at £0.12 per share to provide additional working capital of £24,000 in connection with share options exercised.

**Share-based payment reserve**

The share based payment reserve arises on the grant of share options to directors, employees and other eligible persons under the share option plan.

**Foreign exchange translation reserve**

The translation reserve comprises both foreign exchange differences arising on the translation of amounts relating to overseas operations.

**Accumulated losses**

Accumulated losses contain losses in the current and prior years.

## 17. Warrants

A summary of the changes in the Company's share purchase warrants for the years ended 31 December 2012 and 2011 is set out below:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Warrants outstanding (000's) | Weighted average exercise price ($) | Warrants outstanding (000's) | Weighted average exercise price ($) |
| Balance – 1 January | - | - | 17,342 | 0.10 |
| Exercised | - | - | (17,342) | (0.10) |
| **Balance – 31 December** | **-** | **-** | **-** | **-** |

## 18. Share-based payment transactions

On 31 May 2012, the board approved the rolling share option plan to be converted to a fixed plan under which 30,000,000 common shares of the Company with no part value would be reserved for issuance representing approximately 9.94% of the currently issued and outstanding common shares. All subsisting options granted under the previous option plan would form part of the 30,000,000 share limit.

The number and weighted average exercise prices of share options for the years ended 31 December 2012 and 2011 is set out below:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Outstanding (000's) | Weighted average exercise price ($) | Outstanding (000's) | Weighted average exercise price ($) |
| Balance – 1 January | 18,485 | 0.67 | 4,725 | 0.13 |
| Issued | 1,000 | 0.31 | 14,860 | 0.79 |
| Issued | - | - | 300 | 0.48 |
| Exercised | (500) | (0.19) | (1,200) | (0.09) |
| Exercised | (25) | (0.09) | (200) | (0.25) |
| Lapsed | (3,000) | (0.79) | - | - |
| **Balance – 31 December** | **15,960** | **0.62** | **18,485** | **0.67** |

## 18. Share-based payment transactions *(continued)*

Share options in issue at 31 December 2012:

| Outstanding shares | Exercise price | Expiry |
|---:|---:|---:|
| 1,500,000 | £0.12/Cdn$0.25 | 4 June 2013 |
| 1,300,000 | £0.055/Cdn$0.10 | 16 July 2014 |
| 11,860,000 | £0.4925/Cdn$0.79 | 18 January 2016 |
| 300,000 | £0.30/Cdn$0.48 | 6 June 2016 |
| 1,000,000 | £0.20/Cdn$0.32 | 29 May 2017 |

The weighted average remaining contractual life of share options as at 31 December 2012 was 1,012 days.

Share options held by directors and senior management at 31 December 2012:

| Holder | Shares '000s | Exercise price | Grant Date | Vesting Date | Expiry[1] |
|---|---:|---:|---:|---:|---:|
| A Williams | 3,500 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 April 2011 | 18 January 2016 |
| | 750 | £0.12/Cdn$0.25 | 5 June 2008 | 5 October 2008 | 4 June 2013 |
| J Williams | 3,500 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 April 2011 | 18 January 2016 |
| | 750 | £0.12/Cdn$0.25 | 5 June 2008 | 5 October 2008 | 4 June 2013 |
| J Cable | 650 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 April 2011 | 18 January 2016 |
| | 200 | £0.055/Cdn$0.10 | 17 July 2009 | 17 July 2009 | 16 July 2014 |
| T Bailey | 650 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 April 2011 | 18 January 2016 |
| | 200 | £0.055/Cdn$0.10 | 17 July 2009 | 17 July 2009 | 16 July 2014 |
| J Crombie | 650 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 April 2011 | 18 January 2016 |
| | 550 | £0.055/Cdn$0.10 | 17 July 2009 | 17 July 2009 | 16 July 2014 |
| Senior | 800 | £0.20/Cdn$0.32 | 30 May 2012 | 30 May 2012 | 29 May 2017 |
| Management | 150 | £0.30/Cdn$0.48 | 7 June 2011 | 7 June 2012 | 6 June 2016 |
| | 150 | £0.30/Cdn$0.48 | 7 June 2011 | 7 June 2013 | 6 June 2016 |
| | 600 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 July 2011 | 18 January 2016 |
| | 600 | £0.4925/Cdn$0.79 | 19 January 2011 | 19 January 2012 | 18 January 2016 |
| | 250 | £0.055/Cdn$0.10 | 17 July 2009 | 17 January 2010 | 16 July 2014 |

[1] The expiry date is subject to the option holder holding office on the expiry date and not having previously exercised the share option. Share options may lapse at an earlier date in accordance with the rules of the share option plan, for example, should an option holder cease to hold office.

## 18. Share-based payment transactions *(continued)*

Changes to share options held by directors and senior management in the year ended 31 December 2012:

| Holder | At 1 January 2012 '000s | Granted '000s | Lapsed '000s | Exercised '000s | At 31 December 2012 '000s |
|---|---|---|---|---|---|
| A Williams | 4,250 | - | - | - | 4,250 |
| J Williams | 4,250 | - | - | - | 4,250 |
| J Cable | 850 | - | - | - | 850 |
| T Bailey | 850 | - | - | - | 850 |
| J Crombie | 1,200 | - | - | - | 1,200 |
| Senior Management | 5,250 | 800 | (3,000) | (500) | 2,550 |
| **Total** | **16,650** | **800** | **(3,000)** | **(500)** | **13,950** |

During the year 800,000 share options were issued to senior management at an exercise price of £0.20/Cdn$0.32. In addition 500,000 share options were exercised by senior management at an exercise price of £0.12/Cdn$0.25 and 3,000,000 lapsed in January 2012 at an exercise price of £0.492/Cdn$0.79. The aggregate gains made by directors and senior management on these share sales for the year ended 31 December 2012 was $23,000 (2011 - $481,000).

**Fair value of share options and assumptions**

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model. The following inputs were used in the calculation of the fair value of the share options granted.

| | 2012 | 2011 |
|---|---|---|
| Fair value | $167,000 | $8,626,000 |
| Share price 31 December 2011 | | $0.24 |
| Share price 31 December 2012 | $0.24 | |
| Exercise price (expressed as weighted average) | $0.32 | $0.76 |
| Expected volatility (expressed as weighted average volatility used in the modelling under Black-Scholes model) | 90% | 90% |
| Option life (expressed as weighted average life used in the modelling under Black-Scholes model) | 5yrs | 5yrs |
| Expected dividends | - | - |
| Risk-free interest rate (based on national government bonds) | 0.72% | 2.18% |

The expected volatility is based on the historical share price of the Company. There are no market conditions associated with the share option grants.

The total expense relating to the fair value of the share options recognised in administrative expenses was $247,000 (2011 - $8,546,000) during the year ended 31 December 2012; of these expenses $183,000 (2011 - $7,373,000) relate to share options issued to key management personnel.

## 19. Trade and other payables

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Payables due to related parties | 21 | 10 |
| Trade payables | 785 | 1,039 |
| Other payables | 133 | 122 |
| | **939** | **1,171** |

## 20. Provision for mine closure

| | 2012 $'000 | 2011 $'000 |
|---|---|---|
| Opening balance | 170 | 161 |
| Unwinding of discount | 7 | **9** |
| Closing balance | **177** | **170** |

The provision has been made to cover projected closure costs at the San José mine for the initial mining period of approximately 4 years, should the Company fail to extend the operations beyond the initial period. Closure costs are estimated to be $206,000 (2011 - $206,000) at the end of the 4 years and has been discounted to its present value using a discount rate of 5%. Closure activities include decommissioning, reclamation and rehabilitation.

## 21. Group entities

| Significant Subsidiaries | Country of incorporation and operation | Principal activity | Arian Silver Corporation effective interest | |
|---|---|---|---|---|
| | | | 2012 | 2011 |
| Arian Silver de Mexico S.A. de C.V. | Mexico | Exploration and Production of Silver | 100% | 100% |

## 22. Financial instruments and financial risk management

| Categories of financial instruments | Loans and receivables | | Financial liabilities measured at amortised cost | | Financial assets at fair value through profit or loss | |
|---|---|---|---|---|---|---|
| | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 | 2012 $'000 | 2011 $'000 |
| Cash and cash equivalents | 491 | 3,991 | - | - | - | - |
| Shares | - | - | - | - | 197 | 272 |
| Trade and other receivables | 79 | 1,245 | - | - | - | - |
| Trade and other payables | - | - | 939 | 1,171 | - | - |
| | 570 | 5,236 | 939 | 1,171 | 197 | 272 |

Exposure to interest rate and currency risks arises in the normal course of the Group's business. Derivative financial instruments are not used to hedge exposure to fluctuations in foreign exchange rates and interest rates.

The Group's policy is to retain its surplus funds on short term deposits, usually between one week and four weeks duration, at prevailing market rates. Credit risk is managed by ensuring that surplus funds are only deposited with well established financial institutions of high quality credit standing.

### Valuation hierarchy

The carrying amount of the financial assets at fair value through profit or loss stated above is based on unadjusted quoted prices in active markets for identical assets i.e. Level 1.

### Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk for Arian comprises two types of risk: currency risk and price risk.

## 22. Financial instruments and financial risk management *(continued)*

**Price risk**
The price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments in the market. As at at 31 December 2012, the Group held other financial assets at fair value of $197,000 (2011 – $272,000) relating to the Geologix shares (see Note 15), a fluctuation of 50% would affect other financial assets at fair value through profit and loss and profit by $102,000.

**Foreign currency risk**
The Group's exploration expenditure is made in Mexico in Mexican Peso and head office expenses are predominantly made in the UK in Pounds Sterling, United States dollars and Canadian dollars. The Group is therefore exposed to the movement in exchange rates for these currencies. The Group does not currently hedge foreign exchange risk.

At the year end the majority of the Group's cash resources were held in Pounds sterling. The Group therefore also has downside exposure to any strengthening of the United States dollar, Canadian dollar or the Mexican Peso against Pounds sterling as this would increase expenses in Pounds sterling terms and accelerate the depletion of the Group's cash resources. Any weakening of the United States dollar, Canadian Dollar or the Mexican Peso against Pounds sterling would, however, result in a reduction in expenses in Pounds sterling terms terms and preserve the Group's cash resources.

There is not considered to be any material exposure in respect of other monetary assets and liabilities of the Group as these are of a short-term nature. The table below shows an analysis of cash and cash equivalents denominated by currency.

| | Cash Held 2012 $'000 | Cash Held 2011 $'000 |
|---|---|---|
| Pounds Sterling | 383 | 663 |
| United States Dollars | 60 | 345 |
| Canadian Dollars | 44 | 2,375 |
| Mexican Pesos | 4 | 608 |
| | **491** | **3,991** |

**Interest rate risk**
Interest rate risk is the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. Interest rate risk arises from interest bearing financial assets and liabilities that the Group uses. Treasury activities take place under procedures and policies approved and monitored by the Board to minimise the financial risk faced by the Group. Interest bearing assets comprise cash and cash equivalents which are considered to be short-term liquid assets. The Group is not exposed to any significant interest rate risk as the amount of interest receivable is insignificant.

**Liquidity risk**
The Group's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at 31 December 2012, the Group had cash of $491,000 to settle accounts payable of $939,000. The Group's accounts payable have contractual maturities of less than 30 days and are subject to normal trade terms. Management expects that the Group will generate sufficient cash from the sale of concentrates and funds raised from investors and the SEDA facility to settle operating accounts payable.

## 22. Financial instruments and financial risk management *(continued)*

**Credit risk**
Credit risk is the risk of loss associated with a counterparty's inability to fulfil its payment obligations. The Group's credit risk is attributable to cash and trade receivables. The credit risk on cash is limited because the Group invests its cash in deposits with well capitalised financial institutions with strong credit ratings. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the consolidated statement of financial position which at the year end amounted to $570,000 (2011- $5,236,000)

**Fair values**
It is the Board's opinion that the carrying values of the cash and cash equivalents, the other receivables, all trade and other payables, current borrowings and investments in the consolidated statement of financial position represent their fair values. The basis of assessing the fair value of the financial assets held at fair value through profit or loss is set out in the valuation hierarchy section of this note.

**Capital Management**
The Group's objective when managing capital is to safeguard the Group's ability to continue as a going concern and have access to adequate funding for its exploration and development projects, so that it can provide returns for shareholders and benefits for other stakeholders. The Group manages the capital structure and makes adjustments in the light of changes in economic conditions and risk characteristics of the underlying assets. In order to maintain or adjust the capital structure the Group may issue new shares, acquire debt, or sell assets. Management regularly review cash flow forecasts to determine whether the Group has sufficient cash reserves to meet future working capital requirements and to take advantage of business opportunities.

**Sensitivity Analysis**
The Group holds cash in Pounds Sterling arising from fund raising. The main risk is through foreign exchange fluctuations and how this moves in companies where the cash balances are held in a currency that is different to the functional currency.

Exposure to foreign currency risk sensitivity analysis:

| | Profit/Loss | | Equity | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | $'000 | $'000 | $'000 | $'000 |
| If there was a 10% weakening of Pounds sterling against US Dollar with all other variables held constant – increase/(decrease) | (38) | (66) | (38) | (66) |
| If there was a 10% strengthening of Pounds sterling against US Dollar with all other variables held constant – increase/(decrease) | 38 | 66 | 38 | 66 |

A 10% variation is considered an appropriate level of sensitivity given recent levels of foreign exchange volatility.

## 23. Future commitments

The Group is committed to make the following payments under non-cancellable operating lease arrangements:

| | Milling contract | | Buildings | | Total | |
|---|---|---|---|---|---|---|
| | 2012<br>$'000 | 2011<br>$'000 | 2012<br>$'000 | 2011<br>$'000 | 2012<br>$'000 | 2011<br>$'000 |
| Payable in less than one year | 3,420 | 5,153 | 15 | 167 | 3,435 | 5,320 |
| Payable in one to two years | - | 2,147 | - | 14 | - | 2,161 |
| | 3,420 | 7,300 | 15 | 181 | 3,435 | 7,481 |

## 24. Related parties

**Control of the Company**
In the opinion of the Board, at 31 December 2012 there was no ultimate controlling party of the Company.

**Identity of related parties**
The Company and its subsidiaries have a related party relationship, with its Directors and executive officers.

**Transactions with key management personnel**
At 31 December 2012 the Directors of the Company and their immediate relatives controlled approximately 2.8% per cent of the voting shares of the Company.

During the year ended 31 December 2012 the Company entered into the following transactions involving key management personnel:

Companies in the Dragon Group charged the Company a total of $123,083 (2011 – $124,574). This relates to the reimbursement of Tony Williams' remuneration paid on behalf of the Company. Tony Williams, Chairman and a director of the Company, beneficially owns the Dragon Group. At 31 December 2012 $20,910 (2011 - $10,002) was outstanding.

Key management personnel also participate in the Group's share option programme as disclosed in note 18.

Key management personnel compensation is disclosed in note 6.

Directors' interests in the common shares of the Company as at 31 December 2012 and 2011 were:

| | 2012 | 2011 |
|---|---|---|
| A J Williams | 2,200,000 | 2,200,000 |
| J T Williams | 4,800,000 | 4,800,000 |
| J A Crombie | 1,500,000 | 1,500,000 |
| T A Bailey | 2,000 | 2,000 |

## 25. Contracuña

The dispute with the owners of Contracuña SA de CV ("Contracuña") caused toll milling operations to be suspended in July 2012. Although all amounts owed to Arian by Contracuña have now been repaid, Arian has submitted a claim for damages, which has been met by a counter-claim by Contracuña, which Arian believes, has been submitted solely to frustrate the legal process and is without merit.

## 26. Post balance sheet events

**Issue of shares**

Since 31 December 2012, the Company has issued 1,019,894 common shares at £0.142172 and a further 1,657,795 common shares at £0.136326 in relation to the drawdown of the SEDA, generating funding of £145,000 and £226,000 respectively.

An application has been made to the London Stock Exchange for 2,198,279 common shares to be admitted to trading on AIM and it is expected that admission will occur at 8.00 a.m. on 6 March 2013. The new common shares will rank pari passu in all respects with the existing common shares.

Following this share issue the Company has in issue 309,774,537 common shares with voting rights.

**Operation of toll mill commenced**

On 16 February 2013, Arian Silver Mexico recommenced operations at the newly refurbished Juan Reyes toll mill. The mill has a maximum capacity of 500 tonnes per day and benefits from two separate flotation streams to extract zinc in addition to lead and silver concentrate. The contract with Juan Reyes gives exclusive use of the mill to Arian, is renewable by mutual consent and is initially for the processing of 90,000 tonnes of run-of-mine material from the San Jose mine at $38 per tonne; this should take approximately six months once the daily throughput is achieved and maintained.