



MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2014

The following management's discussion and analysis of financial condition and results of operations ("MD&A") for the six months ended June 30, 2014 prepared as of August 28, 2014, should be read in conjunction with the unaudited condensed interim consolidated financial statements for the three and six months ended June 30, 2014 and the related notes thereto of Santacruz Silver Mining Ltd. ("the Company" or "Santacruz") ("the 2014 Q2 Financial Statements"), together with the audited consolidated financial statements of the Company for the year ended December 31, 2013 as well as the accompanying MD&A for the year then ended.

The referenced consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts are expressed in US dollars unless otherwise indicated.

Forward-Looking Statements

This MD&A and the documents incorporated herein by reference contain "forward-looking information" within the meaning of applicable Canadian securities regulations and "forwarding-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 (collectively, "**forward-looking information**"). The forward-looking information contained in this MD&A is made as of the date hereof. Except as required under applicable securities legislation, the Company does not intend, and does not assume any obligation, to update forward-looking information.

Forward-looking information includes, but is not limited to, statements with respect to the future price of silver, gold and other metals and the effects thereof on the Company's mineral resources; statements relating to the potential mineralization and geological merits of the Company's Rosario mine (the "**Rosario Mine**"), San Felipe project (the "**San Felipe Project**") and Gavilanes property (the "**Gavilanes Property**" or "**Gavilanes Project**"), as described below; the Company's expected production and recoveries for its Rosario Mine; the expectations for the development of the main access ramp and the installation of a third ball to the milling facility at the Rosario Mine; expectations regarding the continuity of mineral deposits; the Company's goals regarding raising capital and developing its projects; the Company's proposed development and exploration plans for the San Felipe Project and the Gavilanes Property; timing of a preliminary economic assessment or a pre-feasibility study for the San Felipe Project; plans for drilling; expectations regarding environmental issues that may affect the exploration progress; project capital cost estimates; and the Company's other plans for development of its projects. Often, but not always, forward-looking information can be identified by the use of words such as "plans", "expects", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates", or "believes" or the negatives thereof or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved.

This forward-looking information is based on certain assumptions that the Company believes are reasonable, including that: the Company is able to obtain any required government or other regulatory approvals and adequate financing to complete its current and future exploration and development programs; current gold, silver and base metal prices will not materially decrease; the proposed development of the Company's mineral projects will be viable operationally and economically and

proceed as expected; the Company will not experience any material accident, labour dispute or failure of plant or equipment; any additional financing needed by the Company will be available on reasonable terms; that planned drilling at its mineral properties will be completed and that the results of such drilling will be sufficient to expand the existing resources at the Gavilanes Property consistent with management's expectations; that general business and economic conditions will not change in a material adverse manner; that the Company's exploration of its properties is not adversely affected by unexpected adverse weather conditions; that the estimates of the resources at the Rosario Mine, the San Felipe Project and the Gavilanes Project obtained by the Company are within reasonable bounds of accuracy (including with respect to size, grade and recovery); and that the Company's current exploration and development programs and objectives can be achieved.

Any financial outlook contained herein, as defined by applicable securities legislation, is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that reliance on such information may not be appropriate for other purposes.

Forward-looking information involves known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking information. Such factors include, among others, the risk that actual results of exploration activities will be different than anticipated, that cost of labour, equipment or materials increase more than expected, that the future price of silver, gold and base metals will decline, that mineral resources are not as estimated, that actual costs of reclamation activities are greater than expected; that changes in project parameters as plans continue to be refined result in increased costs, that lower rates of production are achieved than are expected, that unexpected variations in ore grade or recovery rates occur, that plant, equipment or processes fail to operate as anticipated, that accidents of labour disputes occur, that unanticipated delays occur in obtaining governmental approvals or financing or in the completion of development or construction activities, as well as those factors discussed in the section entitled "Risks and Uncertainties" in this MD&A, at pages 7 to 18 of the annual information form of the Company for the year ended December 31, 2012 dated November 19, 2013 (the "AIF"), filed on SEDAR on November 21, 2013. Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking information, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Readers are cautioned not to place undue reliance on forward-looking information due to the inherent uncertainty thereof.

General

Santacruz was incorporated pursuant to the Business Corporations Act of British Columbia on January 24, 2011. The Company's registered office is located at 10th Floor, 595 Howe Street, Vancouver, British Columbia, Canada V6C 2T5. The Company's shares are listed for trading on the TSX Venture Exchange under the symbol "SCZ". The Company also trades on the OTCQX under the trading symbol "SZSMF".

The Company is engaged in the acquisition, exploration and development of mineral properties in Mexico, with a primary focus on silver, but also including gold, zinc and lead. The Company is currently focused on meeting and maintaining its primary production objective of producing approximately 1.8 million silver equivalent ounces on a yearly basis commencing the beginning of the third quarter of 2014 at its producing property, the Rosario Mine. In addition, the Company is exploring three other mineral properties, being the San Felipe Project (an advanced stage project), the Gavilanes Project (an exploration project), and the El Gachi Property (an early stage exploration project).

The Company's strategic objective is to become a mid-tier silver producer in Mexico. As first steps to achieving this objective, the Company is focused in the near term (mid 2014), on the following:

- Continuing to increase production at the Rosario Mine;
- Initiating preliminary development activities at the San Felipe Project; and
- Continuing exploration on the Gavilanes Property.

Second Quarter 2014 Highlights

- Effective January 1, 2014, the Company began reporting the operating results of its Rosario Mine in its consolidated statement of loss and comprehensive loss. As 2014 is the first year the Company is reporting results from an operating mine in its consolidated statement of loss and comprehensive loss, it only has 2014 quarter over quarter comparative information available.
- Selected operating and financial information for the first and second quarter of 2014 is presented below:

	Q2	Q1	Six Months Ended June 30
Operating			
Ore Processed (tonnes milled) ⁽¹⁾	22,612	20,447	43,059
Silver Equivalent Produced (ounces) ⁽²⁾	168,300	160,600	328,900
Silver Equivalent Sold (payable ounces) ⁽³⁾	148,800	121,800	270,600
Production Cost per Tonne ⁽⁴⁾⁽⁷⁾	132.35	110.94	122.18
Cash Cost per Silver Equivalent (\$/oz.) ⁽⁴⁾⁽⁷⁾	22.72	25.04	23.77
All-in Sustaining Cost per Silver Equivalent (\$/oz.) ⁽⁴⁾⁽⁷⁾	25.39	35.49	29.94
Average Realized Silver Price per Ounce (\$/oz.) ⁽⁴⁾⁽⁷⁾	19.76	20.55	20.11
Financial			
Revenue (\$000's)	2,302	1,931	4,233
Mine Operations Loss (\$000's) ⁽⁵⁾⁽⁷⁾	(895)	(861)	(1,756)
Net Loss (\$000's) ⁽⁷⁾	(1,579)	(1,576)	(3,155)
Net Loss Per Share – Basic (\$) ⁽⁷⁾	(0.02)	(0.02)	(0.03)
Adjusted EBITDA (\$000's) ⁽⁵⁾⁽⁷⁾	(1,066)	(1,261)	(2,327)

⁽¹⁾ Ore processed includes 4,025 and 11,453 tonnes respectively in the second and first quarter arising from third party ore purchased by the Company and processed through the milling facility.

⁽²⁾ Silver equivalent ounces produced in 2014 are calculated using prices of US\$20.00/oz., US\$1,250/oz., US\$0.96/lb and US\$0.90/lb for silver, gold, lead and zinc respectively applied to the metal content of the lead and zinc concentrates produced by the Rosario Mine.

⁽³⁾ Silver equivalent sold ounces in the second and first quarters of 2014 were calculated using realized silver prices of US\$19.76/oz. and US\$20.58, respectively, applied to the payable metal content of the lead and zinc concentrates sold from the Rosario Mine.

⁽⁴⁾ The Company reports non-IFRS measures which include Production Cost per Tonne, Cash Cost per Silver Equivalent, All-in Sustaining Cost per Silver Equivalent and Average Realized Silver Price per Ounce. These measures are widely used in the mining industry as a benchmark for performance, but do not have a standardized meaning and may differ from methods used by other companies with similar descriptions. See "Non-IFRS Measures" section for definitions.

⁽⁵⁾ The Company reports additional non-IFRS measures which include Mine Operations Income (Loss) and Adjusted EBITDA. These additional financial disclosure measures are intended to provide additional information. Refer to the "Non-IFRS Measures – Additional Information" section for a reconciliation of Mine Operations Income (Loss) and Adjusted EBITDA to the 2014 Q1 and Q2 Financial Statements.

⁽⁶⁾ Average realized silver price per ounce is prior to all treatment, smelting and refining charges.

⁽⁷⁾ During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014. For the purposes of this comparison the referenced 2014 first quarter and second quarter figures have been adjusted to reflect this change.

- On April 10, 2014, the Company reported that Mr. Federico Villaseñor had been appointed to the Company's Board of Directors. Mr. Villaseñor holds a B.Sc. in Mining and Metallurgy from the University of Guanajuato, a M.S. of Mineral Economics from Columbia University and a Finance Degree from The Instituto Tecnológico Autónomo de Mexico. His career has spanned 40 years in the mining industry, including roles with Peñoles, Grupo Mexico, Goldcorp and as Director of Starcore International Mines Ltd. He has also participated as a Member of The Board in The Mexican Mining Chamber over several periods.
- On April 23, 2014, the Company reported that its common shares would commence trading on the OTCQX marketplace in the U.S. under the ticker SZSMF.
- On August 13, 2014, the Company announced the appointment of Mr. Robert Byrd to the position of Chief Operating Officer of the Company effective August 11, 2014. Mr. Byrd is a Mining Engineer with more than 30 years of experience in the mining industry and most recently served as the Country Manager for Mexico with Silver Standard Resources where he was responsible for the advancement and development of the Pitarrilla deposit in Durango, Mexico. Previously, Mr. Byrd served in senior management roles in mines in the US, Central and South America as well as in southern Europe. He is a graduate in Mining Engineering from the Colorado School of Mines.

Mr. Byrd replaces Mr. Francisco Ramos, who stepped down from his position as COO to pursue other opportunities in the mining industry. Mr. Ramos will be available to the Company as a consultant in order to ensure an orderly transfer of responsibilities of this operational role to Mr. Byrd.

Rosario Mine, Charcas, San Luis Potosi, Mexico

The Rosario Mine comprises the Rey David and San Rafael mining concessions located in the Municipality of Charcas in the State of San Luis Potosi, Mexico, 184 kilometres north of the capital city of San Luis Potosi. Details of the acquisition terms are contained in Note 8 of the 2014 Q2 Financial Statements. The property covers 500 hectares.

Production and Operating Results for the Second and First Quarter 2014

	Q2	Q1	% Change	Six Months Ended June 30
Ore Processed (tonnes milled) ⁽⁵⁾	22,612	20,447	10.6	43,059
Silver Equivalent Produced (ounces) ⁽¹⁾	168,300	160,600	4.8	328,900
Silver Equivalent Sold (payable ounces) ⁽²⁾	148,800	121,800	22.2	270,600
Production - Silver (ounces) ⁽⁵⁾	100,240	94,312	6.3	194,552
- Gold (ounces) ⁽⁵⁾	104	166	(37.3)	270
- Lead (tonnes) ⁽⁵⁾	171	186	(8.1)	357
- Zinc (tonnes) ⁽⁵⁾	437	367	19.1	804
Average Ore Grade – Silver (g/t)	153	167	(8.4)	160
- Gold (g/t)	0.21	0.33	(36.4)	0.27
- Lead (%)	0.86	1.02	(15.7)	0.93
- Zinc (%)	2.29	2.34	(2.1)	2.31
Metal Recovery – Silver (%)	89.9	85.7	4.9	87.9
- Gold (%)	70.4	77.3	(8.7)	73.7
- Lead (%)	88.2	89.7	(1.7)	88.9
- Zinc (%)	84.4	76.8	9.9	80.8
Cash Cost per Silver Equivalent (\$/oz.) ⁽³⁾⁽⁶⁾	22.72	25.04	(9.3)	23.77
All-in Sustaining Cash Cost per Silver Equivalent (\$/oz.) ⁽³⁾⁽⁶⁾	25.39	35.49	(28.5)	29.94
Cash Cost of Production per Tonne ⁽³⁾⁽⁶⁾	132.35	110.94	19.3	122.18

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- (1) Silver equivalent ounces produced in 2014 are calculated using prices of US\$20.00/oz., US\$1,250/oz., US\$0.96/lb and US\$0.90/lb for silver, gold, lead and zinc respectively applied to the metal content of the lead and zinc concentrates produced by the Rosario Mine.
 - (2) Silver equivalent sold ounces in the second and first quarters of 2014 were calculated using realized silver prices of US\$19.76/oz. and US\$20.58 respectively, applied to the payable metal content of the lead and zinc concentrates sold from the Rosario Mine.
 - (3) The Company reports non-IFRS measures which include Cash Cost per Silver Equivalent, All-in Sustaining Cash Cost per Silver Equivalent, Cash Cost of Production per Tonne, and Average Realized Silver Price per Ounce. These measures are widely used in the mining industry as a benchmark for performance, but do not have a standardized meaning and may differ from methods used by other companies with similar descriptions. See "Non-IFRS Measures" section for definitions.
 - (4) Average Realized Silver Price per Ounce is prior to all treatment, smelting and refining charges.
 - (5) The 2014 Q1 production figures include 11,453 tonnes of third party ore that produced 34,945 ounces Ag; 92 ounces Au; 83 tonnes Pb; and 200 tonnes Zn. The 2014 Q2 production figures include 4,025 tonnes of third party ore that produced 11,552 ounces Ag; 23 ounces Au; 22 tonnes Pb; and 85 tonnes Zn.
 - (6) During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014. For the purposes of this comparison the referenced 2014 first quarter and second quarter figures have been adjusted to reflect this change.

Mill throughput increased throughout the second quarter averaging approximately 270 tonnes per day (tpd) with average silver grade 153 g/t. Beginning in May all ore processed through the milling facility was sourced from the Rosario Mine and management is not planning on processing third party ore until the third ball mill is commissioned, which is now expected in early September and will bring milling capacity to 700 tpd. The production level by the end of the third quarter is expected to increase to approximately 450 tpd.

Mill recoveries in the quarter met or exceeded planned levels. Silver recoveries are expected to remain at approximately 90% over the duration of the Rosario Mine life as the silver grade of the ore feed increases.

Cash cost per silver equivalent ounce sold (see Non-IFRS Measures for definition) during the second quarter (\$22.72) was approximately 9% less than in the first quarter. This variance arose largely from increased production of silver and zinc which in turn resulted from increased recoveries in the milling facility. Operating expenses amounted to \$2,256,465 (as reported). During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014.

Cash cost of production per tonne (see Non-IFRS Measures for definition) during the second quarter (\$132.35) was approximately 19% greater than in the first quarter, after giving effect to the above referenced capitalization of Ramp development costs. During the second quarter the Company used extensively the services of a contract mining consultant to assist in implementing a revised mine plan. The cost of these services was approximately \$450,000 (\$19.90/t). The contract was completed by the end of June, and as such management expects that this fact, combined with an increase in the production rate during the third and fourth quarter of 2014 and beyond, the cash cost of production per tonne will significantly decrease.

Resource Expansion

In connection with the Main Access Ramp development, underground drill stations are planned for Levels 3 and 4 and a 4,000 metre underground drilling program to test the Rosario Mine to depth is planned for the fourth quarter. Currently the Rosario Mine has only been drilled to a depth of approximately 200 metres.

Resource and Exploration Update***San Felipe Project, Sonora, Mexico***

The San Felipe Project consists of 15 concessions and is a late stage exploration project, located in the State of Sonora, approximately 130 kilometers north-west of Hermosillo City, the state capital of Sonora. Santacruz acquired exploration rights with the right to purchase the project from Minera Hochschild Mexico, S.A. de C.V. ("Hochschild") pursuant to the terms of a mining exploration and promissory sale agreement dated August 3, 2011, as amended December 9, 2011, October 8, 2012 and August 13, 2013 (the "San Felipe Agreement"). Details of the acquisition terms are included in note 9(b) to the 2014 Q2 Financial Statements.

Seven mineralized structures are known to exist within the San Felipe Project area: the Santa Rosa, La Ventana, Transversales, San Felipe, Artemisa, Cornucopia, and Las Lamas. In most cases, the mineralized structures are silicified and form resistant, high-relief ridges.

Exploration Summary

Hochschild explored and developed the project from 2001 to 2008, with more than 18,500 meters of diamond drilling and significant development work completed on the project at the La Ventana, San Felipe and Las Lamas veins. A copy of the most recent and updated NI43-101 Technical Report dated December 19, 2012 for the San Felipe Project is available on the Company's website at www.santacruzsilver.com and on SEDAR. The Report was prepared by Donald E. Hulse, P.E. and SME-RM of Gustavson, who is an independent "qualified person" under NI 43-101. The Report disclosed the measured, indicated, and inferred mineral resources estimated within the San Felipe Project, with an effective date of April 5, 2012, and remains current. A mineral reserves estimate was not prepared. Mineral Resources are not Mineral Reserves and do not demonstrate economic viability. There is no certainty that all or any part of the Mineral Resource will be converted to Mineral Reserves. The Report indicates that the San Felipe Project contains a mineral resource of 3 million metric tons of measured and 900 thousand metric tons of indicated mineralization, containing 31 million and 8 million troy ounces of silver equivalent, respectively, above a cutoff grade of 75g AgEq/t. The report estimates that there is an additional 1.5 million metric tons of inferred mineral resource above the 75g AgEq/t cutoff containing 11 million troy ounces of silver equivalent.

All Veins Total								
Measured								
Ag Eq Cutoff	Tonnes (x1000)	Ounces Ag (x1000)	Equivalent Ounces Ag (x1000)	Ag gpt	Equivalent Ag gpt	Cu %	Pb %	Zn %
50	4,314	8,919	37,718	64.30	271.94	0.25	2.56	4.51
75	3,133	7,313	30,887	72.60	306.64	0.29	2.83	5.11
100	2,420	6,193	25,970	79.59	333.76	0.32	3.02	5.58
150	1,524	4,519	18,913	92.21	385.95	0.38	3.40	6.52
Indicated								
Ag Eq Cutoff	Tonnes (x1000)	Ounces Ag (x1000)	Equivalent Ounces Ag (x1000)	Ag gpt	Equivalent Ag gpt	Cu %	Pb %	Zn %
50	1,546	2,663	11,679	53.58	235.05	0.20	2.29	3.96
75	936	1,876	8,188	62.33	272.09	0.24	2.56	4.63
100	621	1,408	6,116	70.50	306.13	0.27	2.81	5.26
150	329	860	3,869	81.35	366.05	0.34	3.38	6.32
Measured + Indicated								
Ag Eq Cutoff	Tonnes (x1000)	Ounces Ag (x1000)	Equivalent Ounces Ag (x1000)	Ag gpt	Equivalent Ag gpt	Cu %	Pb %	Zn %
50	5,860	11,582	49,397	61.48	262.21	0.23	2.49	4.37
75	4,069	9,188	39,074	70.24	298.69	0.28	2.77	5.00
100	3,042	7,601	32,086	77.73	328.12	0.31	2.98	5.51
150	1,853	5,378	22,782	90.28	382.42	0.37	3.39	6.49
Inferred								
Ag Eq Cutoff	Tonnes (x1000)	Ounces Ag (x1000)	Equivalent Ounces Ag (x1000)	Ag gpt	Equivalent Ag gpt	Cu %	Pb %	Zn %
50	3,084	4,140	19,913	41.75	200.80	0.16	2.17	3.35
75	1,495	2,149	11,347	44.70	236.08	0.20	2.68	3.92
100	750	1,281	6,742	53.16	279.68	0.25	3.02	4.74
150	317	651	3,533	63.82	346.58	0.33	3.63	6.01

*Ag Eq is the silver equivalent used to calculate the cutoff. The silver equivalent was calculated with the following equation:

$$\text{AgEq} = \frac{(\text{Ag} * P_{\text{ag}} / 31.1035) + (\text{Pb} * P_{\text{pb}} * 22.05) + (\text{Cu} * P_{\text{cu}} * 22.05) + (\text{Zn} * P_{\text{zn}} * 22.05) + (\text{Au} * P_{\text{au}} / 31.1035)}{(P_{\text{ag}})}$$

Where:

Metal	Symbol	Grade Units	Price	Price Symbol
Silver Eq	AgEq	g/t		
Silver	Ag	g/t	26.28 \$/tOz	<u>P_{ag}</u>
Copper	Cu	%	3.491 \$/lb	<u>P_{cu}</u>
Lead	Pb	%	0.9988 \$/lb	<u>P_{pb}</u>
Zinc	Zn	%	0.9531 \$/lb	<u>P_{zn}</u>

* The calculation assumes equal recoveries in all metals pending further metallurgical work.

- The grades for copper, lead, and zinc are multiplied by each metal's 3 year trailing average price.
- The quantity and grade or quality is an estimate and is rounded to reflect the fact that it is an approximation.

More detailed information regarding the San Felipe Project is available on the Company's website, www.santacruzsilver.com.

The Company is currently preparing a preliminary economic assessment (PEA) that is expected to be completed during the third quarter of 2014.

Exploration and Acquisition Costs

During the six months ended June 30, 2014, Santacruz incurred mineral property acquisition costs and exploration expenditures of \$1,000,000 and \$2,869,716 respectively at the San Felipe Project.

Gavilanes Property, San Dimas, Durango, Mexico

The Gavilanes Property comprises 10 mining concessions located in the rugged Sierra Madre Occidental mountain range in the municipality of San Dimas in the State of Durango, Mexico, approximately 110 kilometres west-north-west of Durango City. The Gavilanes Property covers a total area of 8,832.28 hectares. Details of the acquisition terms are contained in Note 9(a) of the 2014 Q2 Financial Statements.

Current Exploration Activities

On January 23, 2014, the Company filed a technical report in respect of its previously announced independent NI 43-101 Mineral Resource estimate on the Gavilanes Property. The Mineral Resource estimate was prepared by Gary Giroux, P.Eng. of Giroux Consultants Ltd. and utilized a geological model completed by Hans Smit, P.Geo and Fletcher Bourke, P.Geo. The effective date of this mineral resource estimate is November 13, 2013. No work has been performed on the property since then.

The Gavilanes Property is an intermediate sulphidation (silver-base metal-gold) vein system, with veining identified within a 2.2 km² area. The present resource estimate covers only an approximately 0.2 km² surface area. Three domain types were used for the resource estimate – Vein, Hangingwall (HW) / Footwall (FW) and Stockwork (stx). Based upon a 75 gram per tonne (“g/t”) silver equivalent (“AgEq”) cut-off, the resources on three of seven known veins, Guadalupe, Descubridora and San Nicolas, as well as the El Hundido stockwork are as follows:

	(tonnes)	Ag (g/t)	Au (g/t)	Cu (%)	Pb (%)	Zn (%)	AgEq (g/t)	AgEq Oz
Indicated	953,000	164.6	0.09	0.06	0.42	0.41	200.5	6,143,000
Inferred	5,399,000	124.6	0.12	0.09	0.40	0.34	163.0	28,294,000

*AgEq is the silver equivalent in ppm used to calculate the cutoff. The silver equivalent was calculated with the following equation:

$$AgEq = \frac{(Cu\% \times 71.65) + (Pb\% \times 21.38) + (Auppm \times 42.37) + (Agppm \times 0.69) + (Zn\% \times 19.18)}{0.69}$$

The metal prices used in the silver equivalent estimate are listed below.

		Factor
Ag	US\$ 21.55 per ounce	0.69 \$/gm
Au	US\$ 1318.00 per ounce	42.37 \$/gm
Cu	US\$ 3.25 per pound	71.65 \$/%
Pb	US\$ 0.97 per pound	21.38 \$/%
Zn	US\$ 0.87 per pound	19.18 \$/%

100% recovery has been assumed for all metals in this silver equivalent estimate. At this stage of the project no metallurgy has been completed and the reader is cautioned that 100% recoveries are never achieved.

Highlights of the mineral resource estimate are as follows:

- Indicated mineral resources of 6,143,000 AgEq ounces grading 200 g/t AgEq;
- Inferred mineral resource of 28,294,000 AgEq ounces grading 163 g/t AgEq;
- Veins remain open along strike and to depth with intermittent surface exposures indicating an untested strike length;
- The El Hundido stockwork zone is open down-dip and to the south; and
- Four unexplored veins offer additional potential.

The identified indicated and inferred resource is significant, however engineering and economic studies have not been completed and thus no statement can be made about the project's potential economic viability. Recommended work at Gavilanes includes drilling in the area of current resources with the intent of upgrading resources to Indicated and Measured, drilling the open extent of the area with resources, testing other targets on the property and undertaking preliminary metallurgy, engineering and environmental studies.

Exploration and Acquisition Costs

During the six months ended June 30, 2014, mineral property acquisition costs and exploration costs were \$1,500,000 and \$67,297 respectively for the Gavilanes Property.

El Gachi Property, Sonora, Mexico

The El Gachi Property covers approximately 48,057 hectares and is located approximately 30 kilometres from the San Felipe Project. To date the Company has not completed any exploration work on the property.

Non-IFRS Measures

The Company has included certain non-IFRS performance measures throughout this MD&A, including cash cost per silver ounce, production cost per tonne, and average realized silver price per ounce, each as defined in this section. These performance measures are employed by the Company to measure its operating and financial performance internally, to assist in business decision-making, and provide key performance information to senior management. The Company believes that, in addition to conventional measures prepared in accordance with IFRS, certain investors and other stakeholders also use these non-IFRS measures as information to evaluate the Company's operating and financial performance. As there are no standardized methods of calculating these non-IFRS measures, the Company's methods may differ from those used by others and, accordingly, the Company's use of these measures may not be directly comparable to similarly titled measures used by others. Accordingly, these non-IFRS measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Cash Cost per Silver Equivalent Ounce and Production Cost per Tonne

The non-IFRS measures of cash cost per silver equivalent ounce and cash cost of production per tonne are used by the Company to manage and evaluate operating performance at the Rosario Mine and are widely reported in the silver mining industry as benchmarks for performance, but do not have a standardized meaning. Cash costs are calculated based on the cash operating costs at the Rosario Mine and, in the case of cash cost per silver ounce, also include the third party concentrate treatment, smelting and refining cost.

Management of the Company believes that the Company's ability to control the cash cost per silver equivalent ounce produced and cash cost of production per tonne are two of its key performance drivers impacting both the Company's financial condition and results of operations. Having a low cash cost of production per tonne, when taken in connection with effective management of mining dilution, will improve the cost per silver equivalent ounce produced. Having a low cost base per silver equivalent ounce of production allows the Company to remain profitable even during times of declining commodity prices and provides more flexibility in responding to changing market conditions. In addition, a profitable operation results in the generation of positive cash-flows, which then improves the Company's financial condition. The Company believes these measures provide investors and analysts with useful information about the Company's underlying cash costs of operations and are relevant metrics used to understand the Company's operating profitability and ability to generate cash-flow.

To facilitate a better understanding of these measures as calculated by the Company, the following table provides a detailed reconciliation between the cash cost of production per tonne, cash cost per silver equivalent ounce, and the Company's operating expenses as reported in the Company's Consolidated Statements of Loss and Comprehensive Loss.

(Expressed in US Dollars except ounces, tonnes, per ounce and per tonne)	Q2 2014	Q1 2014	Six Months Ended June 30, 2014
Operating expenses (as reported)	2,256,465	2,965,608	5,222,073
Add (Deduct) Capitalized Q1 2014 Ramp Expenditures ⁽¹⁾	486,514	(486,514)	-
Add (Deduct): Inventory change	249,724	(210,701)	39,023
Cash Cost of Production (A)	2,992,703	2,268,393	5,261,096
Operating expenses (as reported)	2,256,465	2,965,608	5,222,073
Add (Deduct) 2014 Q1 Capitalized Ramp Expenditures ⁽¹⁾	486,514	(486,514)	-
Concentrate treatment, smelting and refining cost	638,005	571,178	1,209,183
Cash Cost of Silver Equivalent Sold (B)	3,380,984	3,050,272	6,431,256
Ore processed (tonnes milled) (C)	22,612	20,447	43,059
Cash Cost of Production per Tonne⁽²⁾ (A/C)	132.35	110.94	122.18

Silver Equivalent Sold (payable ounces) (D)	148,800	121,800	270,600
Cash Cost per Silver Equivalent Ounce (B/D)	22.72	25.04	23.77

⁽¹⁾ During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014.

All-in Sustaining Cost per Ounce

All-in Sustaining Cost (“AISC”) is a non-IFRS measure and was calculated based on guidance provided by the World Gold Council (“WGC”) in June 2013. WGC is not a regulatory industry organization and does not have the authority to develop accounting standards for disclosure requirements. Other mining companies may calculate AISC differently as a result of differences in underlying accounting principles and policies applied, as well as differences in definitions of sustaining versus development capital expenditures.

AISC is a more comprehensive measure than cash cost per ounce for the Company’s operating performance by providing greater visibility, comparability and representation of the total costs associated with producing silver from its Rosario Mine.

The Company defines sustaining capital expenditures as, “costs incurred to sustain and maintain existing assets at current productive capacity and constant planned levels of productive output without resulting in an increase in the life of assets, future earnings, or improvements in recovery or grade. Sustaining capital includes costs required to improve/enhance assets to minimum standards for reliability, environmental or safety requirements. Sustaining capital expenditures excludes all expenditures at the Company’s new projects and certain expenditures at the Rosario Mine which are deemed expansionary in nature.”

AISC includes total production cash costs incurred at the Company’s mining operations, which forms the basis of the Company’s total cash costs. Additionally, the Company includes sustaining capital expenditures, corporate general and administrative expense, exploration and evaluation costs, share-based payments and reclamation cost accretion. The Company believes that this measure represents the total sustainable costs of producing silver from current operations, and provides the Company and other stakeholders of the Company with additional information of the Company’s operational performance and ability to generate cash flows. As the measure seeks to reflect the full cost of silver production from current operations, new project capital and expansionary capital at current operations are not included. Certain other cash expenditures, including tax payments, dividends and financing costs are also not included.

The following tables provide a detailed reconciliation of these measures to our operating expenses, as reported in our consolidated financial statements.

(Expressed in US Dollars except ounces and per ounce)	Q2 2014	Q1 2014	Six Months Ended June 30, 2014
Operating expenses (as reported)	2,256,465	2,965,608	5,222,073
Concentrate treatment, smelting and refining cost	638,005	571,178	1,209,183
Sustaining capital expenditures	248,582	62,085	310,667
General and administrative expenses	625,178	713,117	1,338,295
Accretion of decommissioning and restoration provision	10,487	10,296	20,783
All-in Sustaining Cost	3,778,717	4,322,284	8,101,001
Silver Equivalent Sold (payable ounces)	148,800	121,800	270,600
All-in Sustaining Cost per Silver Equivalent Ounce Sold	25.39	35.49	29.94

Average Realized Silver Price per Ounce

Revenues are presented as the sum of invoiced revenues related to delivered shipments of lead and zinc concentrates, after having deducted treatment, smelting and refining charges.

The following is an analysis of the gross revenues prior to treatment, smelting and refining charges, and shows deducted treatment, smelting and refining charges to arrive at the net reportable revenue for the period per IFRS. Gross revenues are divided by silver equivalent ounces sold to calculate the average realized price per ounce of silver equivalents sold.

(Expressed in US Dollars except ounces, tonnes, per equivalent ounce and per tonne)	Q2 2014	Q1 2014	Six Months Ended June 30, 2014
Revenues (as reported)	2,302,056	1,931,567	4,233,623
Add back: Treatment, smelting and refining charges	638,005	571,178	1,209,183
Gross Revenues	2,940,061	2,502,745	5,442,806
Silver Equivalent Sold (ounces)	148,800	121,800	270,600
Average Realized Price per Ounce of Silver Equivalent Sold⁽¹⁾	19.76	20.55	20.11
Average Market Price per Ounce of Silver per London Silver Fix	19.62	20.49	20.06

⁽¹⁾ Average realized price per ounce of silver sold in each reporting period is affected by mark-to-market adjustments and final settlements on concentrate shipments in prior periods. Concentrates sold to third-party smelters are provisionally priced and the price is not settled until a predetermined future date, typically one to four months after delivery to the customer, based on the market price at that time.

Non-IFRS Measures – Additional Information

The Company uses additional non-IFRS measures which include Mine Operations Income (Loss) and EBITDA. These additional financial disclosure measures are intended to provide additional information.

Mine Operations Income (Loss)

Mine operations income (loss) represents the difference between revenues and mine operating expenses, less depletion, depreciation and amortization expenses. Management believes that mine operations income (loss) provides useful information to investors for evaluating the Company's mining performance.

EBITDA and Adjusted EBITDA

EBITDA is a non-IFRS measure that provides an indication of whether the Company's operations are generating sufficient operating cash flow to fund working capital needs and to fund capital expenditures. EBITDA comprises revenue less operating expenses before interest expense, interest income, amortization and depletion, impairment charges, and income taxes.

Adjusted EBITDA is a non-IFRS measure in which standard EBITDA (earnings before interest expense, interest income, taxes, amortization and depletion, and impairment charges) is adjusted for share-based payments expense, foreign exchange gains or losses, and non-recurring items. Foreign exchange gains or losses may consist of both realized and unrealized losses. Under IFRS, entities must reflect in compensation expense the cost of share-based payments. In the Company's circumstances, share-based payments can involve a significant accrual of amounts that will not be settled in cash but are settled by the issuance of shares in exchange. The Company discloses adjusted EBITDA to aid in understanding of the results of the Company and is meant to provide further information about the Company's financial results to investors.

The following table provides a reconciliation of EBITDA and Adjusted EBITDA to the 2014 Q1 and Q2 Financial Statements:

(Expressed in US 000's Dollars)	Q2 2014	Q1 2014	Six Months Ended June 30, 2014
Net loss for the period as reported	\$ (1,092)	\$ (2,062)	\$ (3,154)
Add (Deduct) Capitalized Q1 2014 Ramp Expenditures ⁽¹⁾	(487)	487	-
Income tax expense (recovery)	30	(41)	(11)
Interest income	(54)	(39)	(93)
Interest expense	11	10	21
Amortization and depletion of mineral properties, plant and equipment	456	315	771
EBITDA	(1,136)	(1,330)	(2,466)
Foreign exchange	(71)	61	(10)
Share-based payments	141	8	149
Adjusted EBITDA	<u>\$ 1,066</u>	<u>\$ (1,261)</u>	<u>\$ (2,327)</u>

⁽¹⁾ During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014.

Review of Operations

Six months ended June 30, 2014

The Company recorded a net loss of \$3,154,104 (\$0.03 per share) for the six months ended June 30, 2014, compared to the net loss of \$1,307,998 (\$0.02 per share) for the six months ended June 30, 2013.

The Company recorded revenues of \$4,233,623, operating expenses of \$5,222,073 and amortization and depletion expenses of \$766,805 for the six months ended June 30, 2014. No such revenues and expenses were reported for the six months ended June 30, 2013, since the Company declared its Rosario Mine to be in commercial production effective January 1, 2014 and this is the first year the Company is reporting the operating results of its Rosario Mine in its consolidated statement of loss and comprehensive loss. The operations resulted in a mine operating loss of \$1,755,255, primarily because payable silver production was less than projected. Management expects to remedy this matter and recoup some of the production shortfall in the coming months.

As reported elsewhere, during the second quarter the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter.

Also included in minesite operating expenses were \$551,332 of fees paid to a consulting firm that management engaged at the beginning of the year to assist in optimizing the mine operations. Substantially all of these fees were incurred from January 1 to May 31 inclusive and the contract was completed by end of June.

Variances of note in general and administrative expenses are detailed below:

- Administrative expenses of \$284,639 (2013 – \$247,230), management and consulting fees of \$319,242 (2013 – \$175,259), other expenses of \$102,847 (2013 – \$385), professional fees of \$296,849 (2013 – \$194,557). These expenses were higher during 2014 primarily due to increased activities at the Company's Mexican office in connection with the commencement of commercial production of the Rosario Mine and development of the San Felipe Project.
- Share-based payments of \$149,957 (2013 – \$427,809). 400,000 stock options were granted during the 2014 fiscal period as compared to 400,000 stock options granted in 2013. However, the fair value of the options granted in 2013 was higher due to a higher exercise price and share price at grant date.

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- Shareholder communications of \$97,008 (2013 – \$269,490). These expenses decreased primarily as the result of decreased costs related to investor awareness initiatives.
 - Travel expenses of \$71,964 (2013 – \$88,465). Travel expenses decreased due to a decrease in management’s travel between the Company’s Canadian and Mexican offices.

Three months ended June 30, 2014

The Company recorded a net loss of \$1,091,827 (\$0.01 per share) for the three months ended June 30, 2014, compared to the net loss of \$565,244 (\$0.01 per share) for the three months ended June 30, 2013.

The Company recorded revenues of \$2,302,056, operating expenses of \$2,256,465 and amortization and depletion expenses of \$453,735 for the three months ended June 30, 2014. No such revenues and expenses were reported for the three months ended June 30, 2013, since the Company declared its Rosario Mine to be in commercial production effective January 1, 2014 and this is the first fiscal year the Company is reporting the operating results of its Rosario Mine in its consolidated statement of loss and comprehensive loss. The operations resulted in a mine operating loss of \$408,144 primarily because payable silver production was less than projected. Management expects to remedy this matter and recoup some of the production shortfall in the coming months.

As reported elsewhere, during the second quarter the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter, of which \$486,514 related to first quarter expenditures.

Included in minesite operating expenses were approximately \$450,000 of fees paid to a consulting firm that management engaged at the beginning of the year to assist in optimizing the mine operations. Substantially all of these fees were incurred in April and May and the contract was completed by end of June.

Variances of note in general and administrative expenses are detailed below:

- Management and consulting fees of \$140,727 (2013 – \$102,322), other expenses of \$50,647 (2013 – \$nil), professional fees of \$166,330 (2013 – \$124,546). These expenses were higher during 2014 primarily due to increased activities at the Company’s Mexican office in connection with the commencement of commercial production of the Rosario Mine and development of the San Felipe Project.
- Share-based payments of \$141,465 (2013 – \$56,838). 400,000 stock options were granted during the three months ended June 30, 2014 as compared to no stock options granted during the three months ended June 30, 2013. The share-based payments recorded during the three months ended June 30, 2013 were due to the vesting of previously granted stock options.
- Shareholder communications of \$51,612 (2013 – \$136,592). These expenses decreased primarily as the result of decreased costs related to investor awareness initiatives.

Summary of Quarterly Results

	THREE MONTHS ENDED			
	Jun 30, 2014	Mar 31, 2014	Dec 31, 2013	Sep 30, 2013
	\$	\$	\$	\$
Revenues	2,302,056	1,931,567	Nil	Nil
Operating expenses ⁽²⁾	2,256,465	2,965,608	Nil	Nil
Administrative expenses	768,544	723,506	520,005	691,827
Deferred exploration and development costs, and option payments (cash portion)	3,008,677	2,641,936	776,179	3,810,981
Net loss ⁽²⁾	(1,091,827)	(2,062,277)	(4,507,829)	(503,505)
Net loss per share ⁽¹⁾⁽²⁾	(0.01)	(0.02)	(0.05)	(0.00)
	THREE MONTHS ENDED			
	Jun 30, 2014	Mar 31, 2013	Dec 31, 2012	Sep 30, 2012
	Nil	Nil	Nil	Nil
Revenues	Nil	Nil	Nil	Nil
Operating expenses	Nil	Nil	Nil	Nil
Administrative expenses	687,315	903,644	645,510	760,827
Deferred exploration and development costs, and option payments (cash portion)	4,044,722	18,057,101	4,900,203	2,170,450
Net loss	(565,244)	(742,754)	(583,307)	(763,841)
Net loss per share ⁽¹⁾	(0.01)	(0.01)	(0.04)	(0.01)

⁽¹⁾ The basic and fully diluted calculations result in the same value due to the anti-dilutive effect of outstanding stock options and warrants for all quarters.

⁽²⁾ Operating expenses are as reported. During the second quarter of 2014 the Company took the decision to capitalize the expenditures incurred subsequent to December 31, 2013 to develop the Ramp. Accordingly, \$735,096 was capitalized to Plant and Equipment during the second quarter. Included in this amount was \$486,514 relating to the first quarter of 2014. This adjustment has not been reflected in the first or second quarter operating expenses, net loss or net loss per share reported in this table.

During the three months ended December 31, 2013, the Company recorded deferred income tax expense of \$3,974,151 as a result of the Mexican tax reform enacted in December 2013.

Effective January 1, 2014, the Company began reporting the operating results of its Rosario Mine and accordingly began reporting revenues and operating expenses for the quarters ended March 31 and June 30, 2014 in its consolidated statement of loss and comprehensive loss.

Mexican Tax Reform

In late 2013, a new income tax law was enacted in Mexico (“Mexican Tax Reform”) which became effective January 1, 2014. Key provisions of the Mexican Tax Reform consist of:

- Imposes a new 7.5% mining royalty. This royalty is deductible for corporate income tax purposes and is calculated as 7.5% of a royalty base which is computed as taxable revenues (except interest and inflationary adjustment), less allowable deductions for income tax purposes (except interest, inflationary adjustment, depreciation and mining fees), less prospecting and exploration expenses of the year;
- Imposes a new environmental duty of 0.5% of gross income arising from the sale of gold and silver;

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- Corporate income tax rate to remain at 30%, eliminating the scheduled reduction to 29% in 2014 and to 28% in 2015;
 - Elimination of the Business Flat Tax (“IETU”);
 - Elimination of the option for depreciation of capital assets on an accelerated basis;
 - Elimination of 100% deduction on exploration expenses for locating and quantifying new deposits in pre-operating periods. These exploration costs will be amortized on a straight-line basis over 10 years;
 - Reduction of deductibility for various employee fringe benefits; and
 - Imposes a 10% withholding tax on dividends distributed to resident individuals or foreign residents (including foreign corporations). According to the Mexico-Canada tax treaty, this dividend withholding tax rate may be reduced to 5%.

The Company has taken the position that the new 7.5% mining royalty is an income tax in accordance with IFRS for financial reporting purpose, as it is based on a measure of revenue less certain specified costs.

Financing Activities

Details of financing activities in the year ended December 31, 2013 are as follows:

- On February 19, 2013, the Company closed a prospectus offering through a syndicate of underwriters (the “Underwriters”). The Company issued 21,850,000 common shares at a price of CDN\$1.85 per share for gross proceeds of \$39,949,557 (CDN\$40,422,500). The Underwriters received a cash fee of \$2,396,973, as well as 1,311,000 warrants, each of which is exercisable to purchase one common share for a price of CDN\$1.85 for a period of 24 months. The Company also issued 60,000 common shares as corporate finance fee and incurred additional issue costs of \$508,894.
- On August 16, 2013, the Company issued 1,250,000 common shares at a deemed issue price of CDN\$1.07 per share as an option payment pursuant to the San Felipe Agreement.
- During the year ended December 31, 2013, the Company issued 324,545 common shares pursuant to exercise of warrants for total gross proceeds of \$231,849.

Details of financing activities in the six months ended June 30, 2014 are as follows:

- On March 11, 2014, the Company closed a prospectus offering, pursuant to which 12,062,500 common shares were issued at a price of CDN\$1.00 per share for gross proceeds of \$10,864,694 (CDN\$12,062,500). The underwriters received a cash fee of \$651,882 (CDN\$723,750), as well as 723,750 warrants, each of which is exercisable to purchase one common share for a price of CDN\$1.00 until March 11, 2016 for 645,000 warrants and March 20, 2016 for 78,750 warrants. The Company also issued 100,000 common shares as corporate finance fee and incurred additional issue costs of \$318,653.

Capital Expenditures

The Company spent \$5,650,613 on its mineral properties during the six months ended June 30, 2014 (2013 – \$22,101,823). The Company also spent \$1,855,226 on acquisitions of plant and equipment during the six months ended June 30, 2014 (2013 – \$3,011,360). The Company has made no dividend payments, and currently has no plans to declare any dividends.

Use of Proceeds from Previous Financings

During the 2013 fiscal year, the Company used the net proceeds of CDN\$37,997,150 from the 2013 financing (which included net proceeds from the exercise of the over-allotment option) as follows:

Use of Proceeds as stated in the short form prospectus from the 2013 Financing	Original Estimated Expenditure (Cdn\$)	Approximate Actual Expenditure (Cdn\$)
San Felipe Project		
Property payments	\$15,977,631	\$16,677,000
Surface and underground mapping and permitting	\$420,000	\$50,000
Drilling and related infrastructure	\$6,000,000	\$2,550,000
Development of ramps for bulk samples and underground drilling	\$1,600,000	-
Annual mining taxes, ejidal fees and sundry project costs	-	\$761,000
Pre-feasibility study	\$350,000	-
Subtotal:	\$24,347,631	\$20,038,000
Gavilanes Property		
Property payments	\$3,195,526	\$1,797,000
Mapping and sampling and staffing and site costs	\$400,000	\$260,000
Drilling and sample analysis	\$650,000	\$797,000
Updated resource estimate	\$150,000	\$50,000
Subtotal:	\$4,395,526	\$2,904,000
Rosario Mine		
Mill construction costs	-	\$1,997,000
Pre-production costs	-	\$6,267,000
Subtotal:	-	\$8,264,000
General		
Estimated offering costs	\$500,000	\$520,000
Administration expenses, including corporate and financial reporting, legal and compliance and accounting costs	\$900,000	\$862,000
General corporate communication and corporate development	\$500,000	-
Value added taxes paid on property payments, exploration and pre-production costs	-	\$5,409,150
General working capital ⁽¹⁾	\$7,353,993 ⁽¹⁾	-
Subtotal:	\$9,253,993	\$6,791,150
Total	\$37,997,150	\$37,997,150

⁽¹⁾ Net proceeds from the exercise of the over-allotment option were added to general working capital, as disclosed in the short form prospectus from the 2013 financing.

As noted in the table above, the Company used approximately \$8.3 million of the funds from the 2013 financing to fund ongoing pre-production and mill construction costs at the Rosario Mine. These expenditures were not included in the original estimate of use of proceeds and arose due to unforeseen delays in getting the Rosario Mine underground development sufficiently advanced to consistently supply the milling facility with ore at expected production rates. The Company delayed exploration drilling and other underground development work on the San Felipe Project as a result of the unexpected production delay at the Rosario Mine.

Liquidity and Capital Resources

As at June 30, 2014, the Company had cash and cash equivalents of \$1,852,987 (December 31, 2013 – \$1,618,472) and working capital of \$7,167,501 (December 31, 2013 – \$6,979,805). During the six months ended June 30, 2014, net cash used in operating activities was \$2,223,702, net cash used in investing activities was \$7,505,839 primarily for acquisitions of mineral property interests, plant and equipment, and costs relating to the exploration activities on its mineral properties; and net cash provided by issuance of common shares as part of financing activities was \$9,894,159.

Pursuant to the terms of the underlying mineral property agreements to the Rosario Mine (Note 8 to the 2014 Q2 Financial Statements), in order to maintain and exercise the option the Company must make aggregate cash payments of \$525,000 on or before February 22, 2016. Subsequent to June 30, 2014, the Company made payments of \$20,000 in accordance with the terms of these agreements.

Pursuant to the terms of the Gavilanes property agreement (Note 9(a) to the 2014 Q2 Financial Statements), in order to maintain and exercise the option the Company must make aggregate cash payments of \$1,150,000 on or before December 17, 2014.

Pursuant to the terms of the San Felipe Agreement (Note 9(b) to the 2014 Q2 Financial Statements), in addition to cash payments of \$23,700,000 made to June 30, 2014, in order to maintain and exercise the option, the Company must make further aggregate cash payments of approximately \$20,000,000 on or before October 31, 2015. An additional \$1,000,000 must be paid for restructuring fees which is due on October 31, 2015, payable in cash or in that number of the Company's common shares having a value of \$1,500,000 at the date of issue, subject to a minimum issue price of CDN\$1.07 per share.

During the six months ended June 30, 2014, the Company's operations did not generate positive cashflow. Until such time as the Rosario Mine begins generating positive cash flow the Company is reliant on its internal cash reserves and the resource capital markets in order to fund its activities. In order to fund the further development of the San Felipe Project and the Gavilanes Property, on March 11, 2014, the Company closed a prospectus offering and issued 12,062,500 common shares for gross proceeds of CDN\$12,062,500.

During the six months ended June 30, 2014, the Company used the net proceeds of CDN\$11,338,750 from the March 2014 financing (which included net proceeds from the exercise of the over-allotment option) as follows:

Use of Proceeds as stated in the short form prospectus from the 2014 Financing	Original Estimated Expenditure (Cdn\$)	Approximate Actual Expenditure (Cdn\$)
San Felipe Project		
Property payments	-	\$1,067,000
Drilling and related infrastructure	\$500,000	\$500,000
Development of access ramps and preliminary tailings impoundment study	\$2,250,000	\$1,900,000
Pre-feasibility study	\$400,000	-
Subtotal:	\$3,150,000	\$3,467,000
Gavilanes Property		
Property payments	-	\$1,600,000
Mapping, drilling, sample analysis, metallurgy and related infrastructure	\$3,000,000	-
Subtotal:	\$3,000,000	\$1,600,000

Use of Proceeds as stated in the short form prospectus from the 2014 Financing	Original Estimated Expenditure (Cdn\$)	Approximate Actual Expenditure (Cdn\$)
Rosario Property		
Development of access ramps and plant expansion	-	\$1,200,000
Subtotal:	-	\$1,200,000
General		
Estimated offering costs	\$350,000	\$350,000
Administration expenses, including corporate and financial reporting, legal and compliance, accounting costs, general corporate communication and corporate development, and general working capital ⁽¹⁾	\$4,838,750	\$4,721,750
Subtotal:	\$5,188,750	\$5,071,750
Total	\$11,338,750	\$11,338,750

⁽¹⁾ Net proceeds from the exercise of the over-allotment option were added to general working capital, as disclosed in the short form prospectus from the 2014 financing.

Transactions with Related Parties

The Company's related parties consist of the Company's directors, officers and companies associated with them including the following:

- Malaspina Consultants Inc., a company owned by Robert McMorran, the Chief Financial Officer
- Pref-Ex Geological Inc., a company owned by Marc Prefontaine, a director of the Company

During the three and six months ended June 30, 2014 and 2013, the Company incurred the following charges by directors and officers of the Company and by companies controlled by directors and officers of the Company:

	Three months ended		Six months ended	
	2014	June 30, 2013	2014	June 30, 2013
	\$	\$	\$	\$
Accounting and corporate secretarial fees ⁽¹⁾	66,147	37,035	98,739	70,749
Directors' fees ⁽²⁾	26,804	41,455	48,958	60,947
Management fees and salaries and benefits capitalized in mine property ⁽³⁾	148,490	54,467	251,550	147,685
Share-based payments	138,495	-	138,495	333,519

⁽¹⁾ The charge includes accounting and corporate secretarial fees paid to Malaspina Consultants Inc.

⁽²⁾ The charge includes geological consulting fees paid to Pref-Ex Geological Inc. and directors' fees paid to Marc Prefontaine, James Hutton, and Craig Angus.

⁽³⁾ The charge includes management fees paid to Arturo Préstamo Elizondo, the Chief Executive Officer, and salaries and benefits paid to Francisco Ramos, the Chief Operating Officer, which were capitalized in mine property during the 2013 fiscal year.

At June 30, 2014, accounts payable and accrued liabilities include an amount of \$54,974 (December 31, 2013 – \$28,333), due to Malaspina Consultants Inc. for accounting services, and Marc Prefontaine, James Hutton, and Craig Angus for directors' fees.

Key management includes directors and executive officers of the Company. Other than the amounts disclosed above, there was no other compensation paid or payable to key management for employee services for the reported periods.

Financial Instruments

Fair Value and Classification of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, trade receivables, other receivables, and accounts payable and accrued liabilities. Cash and cash equivalents, trade receivables and other receivables are designated as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are designated as other financial liabilities, which are measured at amortized cost. The carrying values of the Company's financial instruments approximate their fair values due to the short-term nature of these instruments.

Off-balance Sheet Arrangements

The Company has not entered into any material off-balance sheet arrangements such as guarantee contracts, contingent interests in assets transferred to unconsolidated entities, derivative financial obligations, or with respect to any obligations under a variable interest equity arrangement.

Subsequent Event

Stock Options

On August 12, 2014, the Company granted 600,000 incentive stock options to an officer having an exercise price of CDN\$0.94 each expiring August 12, 2019.

Outstanding Share Data

Authorized share capital: Unlimited number of Common Shares

All share information is reported as of August 28, 2014 in the following table.

Issued and Outstanding Common Shares			103,493,484
	Expiry Date	Exercise Price (CDN\$)	
Options	May 10, 2015	\$0.90	300,000
	April 12, 2017	\$0.90	4,806,666
	July 24, 2017	\$0.90	800,000
	February 28, 2018	\$1.85	400,000
	July 29, 2018	\$1.22	300,000
	April 10, 2019	\$1.00	400,000
	August 12, 2019	\$0.94	600,000
Warrants	February 19, 2015	\$1.85	1,311,000
	March 11, 2016	\$1.00	645,000
	March 20, 2016	\$1.00	78,750
Fully Diluted			113,134,900

6,325,856 of the outstanding common shares are held in escrow.

Disclosure Controls and Procedures

In connection with National Instrument 52-109 (Certificate of Disclosure in Issuer's Annual and Interim Filings) ("NI 52-109"), the Chief Executive Officer and Chief Financial Officer of the Company have filed a Venture Issuer Basic Certificate with respect to the financial information contained in the

unaudited condensed interim consolidated financial statements for the six months ended June 30, 2014 and this accompanying MD&A.

In contrast to the full certificate under NI 52-109, the Venture Issuer Basic Certificate does not include representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in NI 52-109. For further information the reader should refer to the Venture Issuer Basic Certificates filed by the Company on SEDAR at www.sedar.com.

Risks and Uncertainties

Natural resources exploration, development, production and processing involve a number of business risks, some of which are beyond the Company's control. These can be categorized as operational, financial and regulatory risks.

Operational risks include: the Company may not be able to find and develop resources economically, the Company cannot guarantee title to its properties, the Company may have difficulty in marketing production and services, the Company must manage changing governmental laws and regulations, the Company may have difficulty in hiring and retaining skilled employees and contractors, environmental hazards (including discharge of pollutants or hazardous chemicals), industrial accidents and occupational and health hazards, mechanical failures, the unavailability of materials and equipment, pit slope failures, unusual or unexpected rock formations, poor or unexpected geological or metallurgical conditions, poor or inadequate ventilation, failure of mine communication systems, poor water condition, interruptions to gas and electricity supplies, human error and adverse weather conditions, there is no assurance that the Company will acquire additional mineral properties and any acquisitions may expose the Company to new risks, and the mining industry is intensely competitive for the acquisition of new properties, access to capital and hiring of skilled personnel. The Company continuously monitors and responds to changes in these factors and seeks to adhere to all regulations governing its operations.

Financial risks include commodity prices, interest rates and fluctuating foreign exchange rates, all of which are beyond the Company's control. Additional financial risks are the Company's ability to raise capital to continue funding its operations.

Regulatory risks include the possible delays in getting regulatory approval to, and permits for, the transactions that the Board of Directors believe to be in the best interest of the Company, and include increased fees for filings, the introduction of ever more complex reporting requirements the cost of which the Company must meet in order to maintain its exchange listing.

Outlook

During the second quarter of 2014 the Rosario Mine continued to steadily ramp up production and is approaching positive cash flow from operations. The near term focus of the Company is to continue increasing the production throughput at the Rosario Mine. To this end the Company has nearly completed the installation of an additional ball mill to the milling facility needing only to install the ball mill motor which is expected to be delivered in early September. Once online, this third ball mill will increase milling capacity to 700 tonnes per day. Once this significant upgrade to milling capacity is completed, management is confident that production levels at the Rosario Mine will increase in line with expectations. In addition to adding the third ball mill, management will continue with the optimization processes underway at the Rosario Mine as part of an ongoing effort to lower the production costs.

With respect to the San Felipe Project, the preparation of a preliminary economic assessment ("the PEA") is nearly complete and delivery of the report is expected within the next two weeks. Based on the results of this study, and assuming a positive result, the Company expects to hold discussions with respect to

finding an acceptable financing proposal for developing the project. Such discussions will be undertaken in consideration of current capital markets.

Once positive cash flow is established at the Rosario Mine the Company expects to recommence exploration activities at the Gavilanes Property.

Additional Disclosure for Venture Issuers without Significant Revenue

The Company provides disclosure related to capitalized or expensed exploration and development costs in the notes to the financial statements and disclosure related to general and administration expenses in the statements of loss and comprehensive loss. The Company has no expensed research and development costs nor deferred development costs.

Qualified Persons

All technical information which is included in this statement has been reviewed and approved by Donald E. Hulse P.E. of Gustavson and is consistent with work published by Gustavson.

Other Information

Additional information related to the Company is available on SEDAR at www.sedar.com and on the Company's website, www.santacruzsilver.com.