

ENDURING CONFIDENCE

Annual report of the Board of Directors to the Shareholders' Meeting, corresponding to the 2019 fiscal year

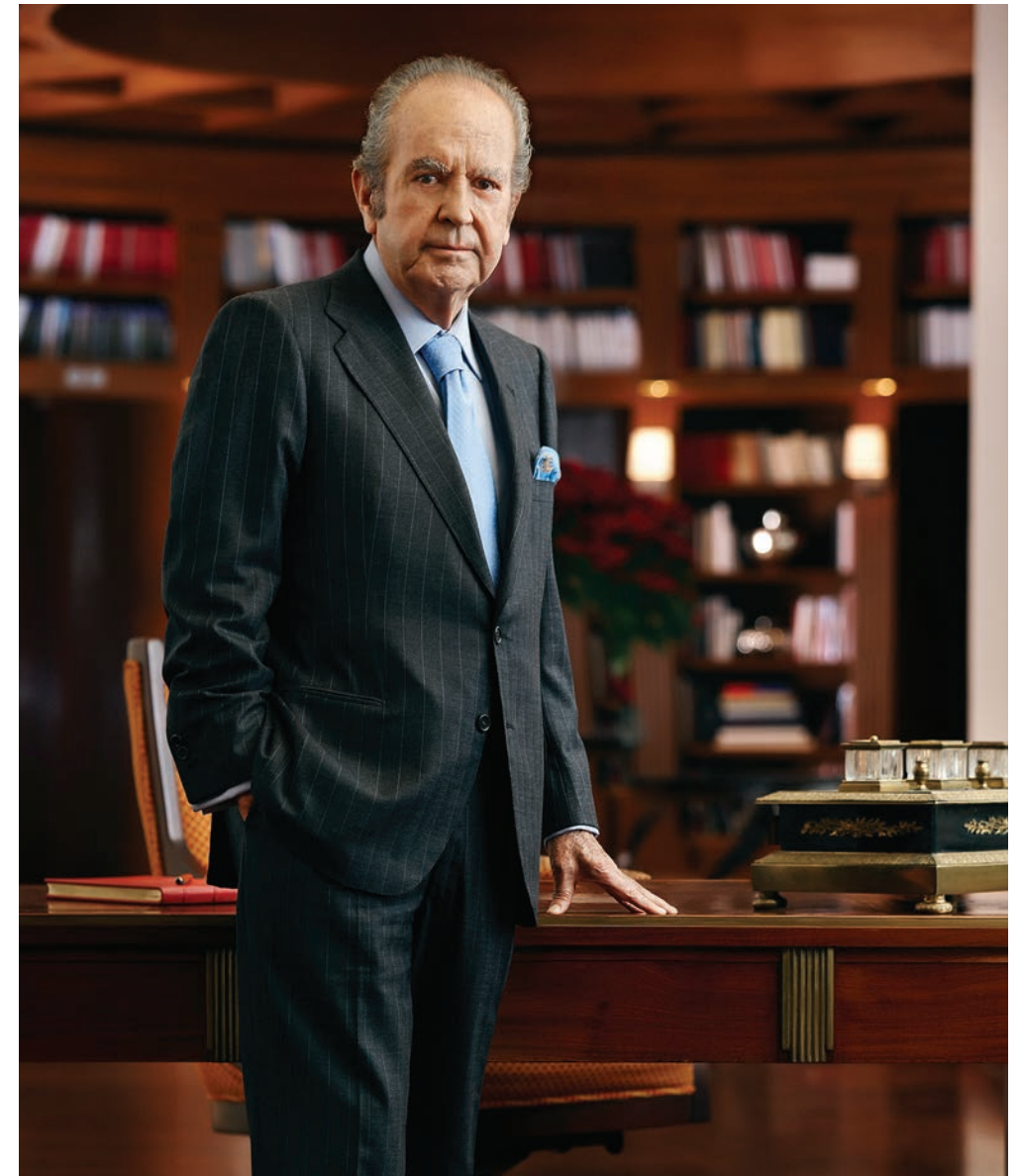
Dear shareholders:

As Chairman of the Board of Directors of Industrias Peñoles, S.A.B. de C.V., and on behalf of the Board, I present you this report based on an analysis of the information provided by the Chief Executive Officer in his Annual Report on the company's performance, the financial and operating results obtained in 2019, and key developments in the period, as well as a report on the main activities of the Board of Directors.

The company faced great challenges in 2019. In the international sphere, prolonged trade tensions and geopolitical conflicts fueled uncertainty and economic slowdown. This dragged down metal prices, particularly zinc and lead. Gold and silver quoted lower in the first half of the year but recovered in the second half.

Our confidence in Mexico's potential remains firm; we reiterate our commitment to its development and feel proud to share our mining history of more than 130 years. Peñoles has a long-term vision that is embodied in ongoing investment to improve working conditions and safety for our employees, expand operations and incorporate new technologies, replenish reserves and enhance our processes.

In 2019, two of the most widely recognized firms in the world conducted major audits of the company's tailings dams, reviewing their structural stability, the quality of their management, and their operation and governance. As a result, we have strengthened operating standards and the solidity of our governance.



We recognize the effort and talent of our employees. We offer them well-paid jobs and encourage their personal and professional advancement. We promote safe working conditions and an ethical, harmonious workplace that supports productivity.

Besides generating jobs—many of them in remote regions—we support the self-development of communities where we operate with training actions. Through cultural and sports activities, we help strengthen the social fabric. Furthermore, each year we offer health care days. Our social investment this year, not including the payment of mining rights, totaled US\$ 11 million.

us\$ 1.1 billion

bonds were placed on international debts markets.
Investors' confidence was again demonstrated.

During the year we completed construction of the Capela polymetallic mine in Guerrero, which is slated for startup in February 2020. We invested a total of US\$ 334 million in this project, which will provide direct jobs to 650 people. We also continued development of a tailings flotation plant to recover silver and gold content at Fresnillo, which will add to the content recovered at Saucito. Furthermore, we began development of the Juanicipio mine in Zacatecas, 56% owned by Fresnillo plc. In the metallurgical business we continued stabilizing the recent expansions at the zinc refinery and moved forward on development of a project to recover silver in high-grade zinc concentrates, which will begin operations in the second half of 2020.

In our exploration activity, the work focused mainly on strengthening reserves of operating mines, with a total investment of US\$ 208 million. In the Bismark mine's area of influence, we intensified deep drilling, but the results were not favorable.

Our investment in capital expenditures and explorations during the fiscal year totaled US\$ 1.12 billion (11.2% less than the year before).

In mining operations, gold production totaled 910,900 ounces, less than in 2018. The Noche Buena open-pit mine is approaching the end of its operating life, as expected. Silver production—a total volume of 62.3 million ounces—declined in the year because of lower grades and thickness of the veins at the Saucito and Fresnillo mines. Zinc production reached a new record of 292,300 metric tons, as did lead, rising to 84,300 metric tons.

In the metallurgical business, the biggest challenges have been in the startup of the refined zinc expansion, which will carry annual production capacity from 120,000 to 350,000 metric tons. Output in 2019 reached a record 283,600 metric tons of zinc. Silver and lead production also increased, while gold had a slight decrease.

One highlight of the year was the successful placement of bonds totaling US\$ 1.1 billion on international debt markets, in two tranches of US\$ 550 million each, at terms of 10 and 30 years. Investor confidence in the company was amply demonstrated by a bid-to-cover ratio of more than six times. Some of the proceeds of this placement were used to make advance payment of debt certificates (*certificados bursátiles*) for US\$ 400 million and US\$ 200 million, set to expire in 2020 and 2022, respectively. The rest was used for general corporate purposes. In an earlier transaction, we arranged a syndicated bank loan for US\$ 300 million at a term of five years, to cover working capital needs, mainly relating to the zinc expansion.

The financial results of the fiscal year were unsatisfactory, and were affected by higher costs, largely because of the need for additional work on mine development, increased consumption in operations and the startup of the zinc plant, as well as the effects of a change in the accounting treatment of mining work and write-downs of assets at the Bismark and Madero mines (heavily impacted by low zinc prices). In million dollars, sales totaled US\$ 4,472 (an increase of 1.9%). Gross profit came to US\$ 871 (-32.4%), EBITDA US\$ 969 (-24.6%) and operating income US\$ 275 (-61.1%). Thus, net income for 2019 was US\$ 36 (89.0% lower than the year before). The company declared dividends totaling Ps. 3.0 billion.

We are confident that the new operations and improvements in existing processes will help strengthen our margins and financial performance indicators going forward. The company's financial position remains solid, and we maintain investment-grade credit ratings with a stable outlook.

The Board of Directors adheres to solid corporate governance practices. In the discharge of its duties, the Board relies on the support of committees that have been created as recommended in the Code of Best Principles and Practices for Corporate

284

thousand tons of refined zinc in 2019,
a record production volume.

Governance. The Board met four times during the 2019 fiscal year. Among the topics discussed and approved during those sessions, the most important were the following:

- › Reinforcement of workplace and environmental safety programs.
- › Strategic Plan review.
- › Metal hedging and exchange rate program.
- › Analysis and approval of the investment program.
- › Review and authorization of the financing program.
- › Authorization for the issuance of long-term bonds by the company.
- › Review and approval of the budget for the 2019 fiscal year.

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

The company's Financial Statements were prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board. The foregoing comments were made on the basis of the financial statements, as well as the main accounting policies and criteria followed in preparation of the financial information, examined by the external auditors and included in this Report.

Submitted herein for the consideration of this Shareholders' Meeting is a report on the main accounting policies and criteria that serve as the basis of preparation for the Financial Statements, and which include, among others: the basis of presentation and consolidation, significant accounting policies, and new accounting pronouncements, which were audited by the external auditors and made part of this Report.

In the opinion of the Board of Directors, the Report presented to this Shareholders' Meeting by the Chief Executive Officer reasonably reflects the financial position and results of the company, as well as the key developments of the business during 2019.

In accordance with policies, the performance of senior executives is reviewed annually. The Nomination, Evaluation and Compensation Committee must authorize any increase in salary and benefits. Salary increases and bonuses are determined based on the results of performance evaluations. The remuneration package of senior executives is comprised of a base salary, and legal and other benefits common to the national industry.

The international metal market looks complex and volatile for the year ahead. In Peñoles we will continue managing the business responsibly and prudently, and with our confidence in Mexico: an enduring confidence.

I want to express my gratitude to the members of the Board of Directors for their dedication, commitment and valuable contributions. I would also like to thank our employees for their hard work and dedication. I also extend my appreciation to you, our shareholders, for your continued confidence in us.

Alberto Baillères
Chairman of the Board of Directors