

# ANNUAL REPORT OF THE **BOARD OF DIRECTORS** TO THE SHAREHOLDERS' MEETING, CORRESPONDING TO FISCAL YEAR 2020

## Dear shareholders:

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

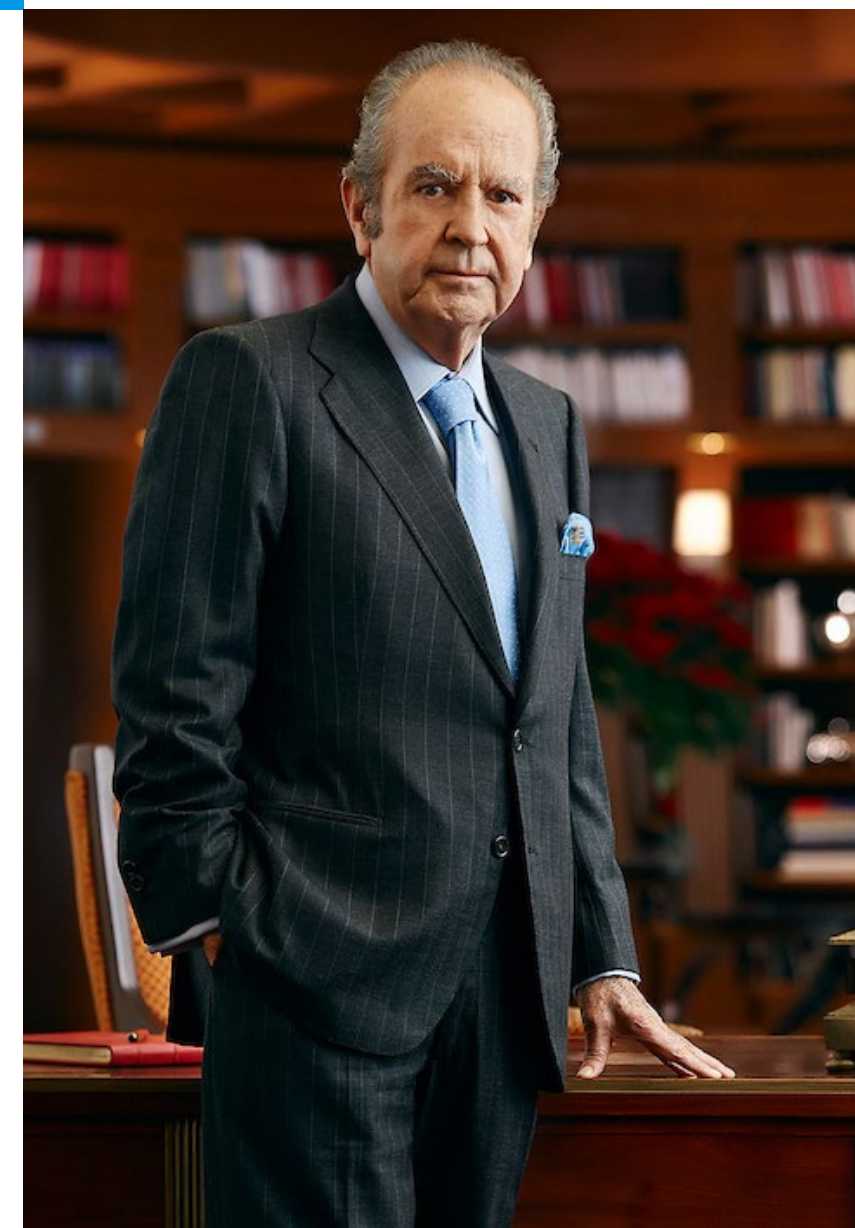
2020 was one of the most difficult years in contemporary history. The new coronavirus strain that spread around the world caused the tragic and painful loss of human lives, accompanied by the worst recession since the Great Depression. Life as we knew it was irrevocably changed, and lockdown measures seriously affected production, trade and supply chains for much of the year.

As a result, metal prices dropped sharply, particularly in the first quarter of the year. The prices of industrial metals recovered gradually but could not regain the level at which they had begun 2020. Precious metal prices also dropped initially, but returned to levels higher than in the recent past.

To mitigate the impacts of this contingency, Peñoles introduced an emergency plan to avoid propagation of the virus and protect the life and health of its employees, to safeguard its assets, protect liquidity, control costs, expenses and investments, and

preserve employment. Strict sanitary protocols were applied in all of our facilities, and medical and psychological support and follow-up were provided to all employees. Administrative staff and personnel with specific vulnerabilities were assigned to work from home. Meanwhile, to stand beside the rest of the nation as it dealt with the emergency, we made substantial donations of medical and personal protection equipment to hospitals and health clinics, and basic supplies and masks to the communities where we operate. We have conducted both PCR and rapid testing and carried out an extensive informational campaign regarding sanitary measures, prevention and self-care, among many other actions. Our social investment in the period, in addition to the payment of mining rights to the nation, totaled US\$ 8 million. I would like to extend special thanks to our senior management and board members who voluntarily agreed to reduce their pay as an expression of solidarity with the company during the pandemic.

Clearly, the restrictions imposed to deal with the pandemic affected the pace of project execution. Startup of the Capela polymetallic mine in Guerrero was slower than planned and the unit could not reach its nameplate milling capacity until the end of the year. Construction of the tailings flotation plant at Fresnillo was completed, and will begin work of recovering silver and gold content in the third quarter of 2021. Work also continued on developing the Juanicipio project in Zacatecas, whose extracted ore was processed at Fresnillo's plant to begin producing gold



and silver in concentrates while its own processing plant is targeted for completion by mid-2021. Investment in capital expenditures during the year totaled US\$ 561 million, 38.5% less than in 2019.

In our exploration activities, field work was postponed at a number of projects and tasks were redirected to analyzing information on the existing portfolio and investigating new prospects. Drilling was conducted primarily at operating mines and their areas of influence, focused on strengthening our reserves. The investment in these activities totaled US\$ 141 million, 32.2% less than in 2019.

Because of the sharp drop in the prices of industrial metals, low grades and high operating costs, operations at the Madero zinc mine in Zacatecas, and the Milpillas copper mine in Sonora, were suspended indefinitely. In the latter, the ore deposited at the leaching pads will continue to be processed to produce copper cathodes until its depletion. Operations at the Bismark unit were closed down definitely as planned, due to depletion of its reserves. Twelve percent of Bismark's employees were relocated to other operations and the remainder received their severance pay according to law and the respective collective bargaining agreements.

Gold mining production yielded 824,087 ounces, below production in 2019 due to a lower amount of ore deposited in the leaching pads at Herradura and Noche Buena, in turn because of the shutdowns ordered by the authorities as a result of the pandemic. Silver production totaled 62.6 million ounces, similar to the previous year, thanks to the contributions of Juanicipio and Capela. Lead grew slightly to 86,420 metric tons, thanks to production by Capela and Saucito, while zinc totaled 288,072 metric tons, slightly lower than the year before because production at Saucito and Velardeña offset the decline in production caused by closures at Madero and Bismark.

In the metals business, production of refined metal was lower than in 2019, particularly gold, where production was off by 14.0% to 957,209 ounces, attributed to lower receipts of dorés. Stabilization of processes at the newly-expanded zinc refinery continued, producing 260,943 metric tons of refined zinc. Demand for our main chemical products meanwhile ebbed amid difficult market conditions.

We devised an emergency plan to protect our people's health and safety, preserve liquidity and employment.

With the support of the company's solid financial profile and investor confidence, we were able to successfully place new bond issues on international markets totaling US\$ 1.45 billion. Part of the proceeds were used to restructure debt under more favorable conditions. Peñoles issued US\$ 600 million in two tranches: US\$ 100 million through the reopening of a bond placed last year (for US\$ 550 million expiring in 2029) and another for US\$ 500 million at 30 years. Of these proceeds, US\$ 300 million were used to prepay a syndicated loan (originally set to expire in 2024). Fresnillo plc meanwhile placed a US\$ 850 million bond issue at 30 years and bought back US\$ 481.7 million of a US\$ 800 million issue expiring in 2023. The credit ratings of both issuers remained at investment grade with a stable outlook. This not only improved our long-term maturity profile but strengthened our liquidity with the additional resources—at lower cost—and the company's balance sheet maintains a prudent amount of leverage and a more comfortable maturity profile.

In our financial results for the year, sales benefited from the rise in gold and silver prices, while costs and expenses were down both because of austerity measures and because of less consumption by our operations. These benefits were offset by an increase in financial expenses relating to the bond issuance and debt prepayment, as well as impairment of assets at the Bismark, Madero and Milpillas units, where

We have undertaken a transcendental transformation to be better prepared in an ever complex and changing environment.

operations, as we mentioned above, were suspended. We also registered a correction to the tax treatment of mining work which, together with the rise in deferred taxes because of the peso's devaluation against the dollar, meant a higher tax provision for the period. In billions of dollars, sales totaled US\$ 4.67, a 4.5% increase; gross income was US\$ 1.25 (+43.4%), EBITDA grew to US\$ 1.46 (+50.4%) and operating income was US\$ 743 million (+170.0%). All this resulted in a net loss of the controlling interest of US\$ 34 million for the fiscal year.

To focus on becoming more resilient amid growing uncertainty, to improve our operating and administrative efficiency and enhance the company's performance and results, we have undertaken a transcendental transformation, sustained by three pillars: 1) enriching the strategy of our mining and metallurgical businesses; 2) restructuring the organization, and 3) bringing about a change in culture. These pillars constitute the foundation to pursue our goals, both as a business and as an employer concerned about the welfare of our people and their families, and to continue contributing to the development of our beloved Mexico.

As part of the organizational restructuring, a new unit was created within Peñoles called Baluarte Minero, which will group together and reorganize the functions and structures

that provide shared services (administrative and technical) to Peñoles and Fresnillo plc, to make them more effective and take advantage of all possible synergies without affecting the autonomy that each company's management should have. This restructuring does not imply additional costs; in fact, it aims at a gradual and sustainable reduction. Starting January 1, 2021, the date on which this new structure took effect, Fernando Alanís will lead the new task as CEO of Baluarte Minero, and Rafael Rebollar was appointed CEO of Industrias Peñoles. We are grateful to Fernando for his hard work, dedication and achievements as Chief Executive Officer for more than 12 years.

With this transformation, we are confident that we will be optimally prepared to face the challenges that arise in an increasingly complex, changing environment.

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 Principles and Best Practices for Corporate Governance. The Board met five times during the 2020 fiscal year. Among the topics covered and approved during those sessions, the most important were the following:

- Implementation and follow-up of the coronavirus emergency plan.
- Reinforcement of workplace and environmental safety programs.
- Strategic Plan review and update of the risk matrix.
- Metal hedging and exchange rate program.
- Analysis and adjustments to the investment and financing program.
- Authorization for the issuance of long-term bonds by the company.
- Review of the budget for the 2020 and 2021 fiscal years.

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 are an integral 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 2020.

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 industry in Mexico. This Committee analyzed and recommended approval of the restructuring and the new appointments.

We know that every challenge brings an opportunity; this is why we continuously prepare and adjust to circumstances, and this past year has been no exception. The changes imposed by the "new normal" compel us to be flexible—without straying from our course—and to strengthen and accelerate our ability to adapt. In this complex and changing environment, this will be our greatest strength as we look toward the future.

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. And I extend my appreciation to you, our shareholders, for your continued confidence in us.

**Alberto Baillères**

Chairman of the Board of Directors