

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Financial statements

31 December 2019 and 2018
with independent auditor's report

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Financial statements

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INDEPENDENT AUDITOR'S REPORT

To the Board of Director and Shareholders of
PKC Group de Piedras Negras, S. de R.L. de C.V.

Qualified opinion

We have audited the accompanying financial statements of PKC Group de Piedras Negras, S. de R.L. de C.V. ("the Company"), which comprise the statement of financial position as at December 31, 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the issues described in the section "Basis for qualified opinion", the accompanying financial statements present fairly, in all material respects, the financial position of PKC Group de Piedras Negras, S. de R.L. de C.V. as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance with Mexican Financial Reporting Standards ("MFRS").

Basis for qualified opinion

As discussed in Note 1j) to the accompanying financial statements, as at December 31, 2019 and 2018, the Company did not record a provision for employee benefits in accordance with Mexican FRS D-3 "Employee benefits", instead, registered the liability, according to another financial reporting standard (IAS 19 "Employee benefits"). It was not practical to calculate the amount of employee benefits in accordance with MFRS D-3, at December 31, 2019 and 2018. The lack of recognition of such liability in accordance with MFRS D-3 is considered a material deviation for the accompanying financial statements.

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section of our report. We are independent of the Company in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) ("IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Mexico according with the "Código de Ética Profesional del Instituto Mexicano de Contadores Públicos" ("IMCP Code"), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the accompanying financial statements in accordance with MFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the [consolidated] [unconsolidated] financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The partner in charge of the audit resulting in this independent auditor's report, is who signs it.

Mancera, S.C.
A Member Practice of
Ernst & Young Global Limited



Aldo Villarreal Robledo

San Pedro Garza García, N.L., México.
June 25, 2020.

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Statements of financial position

(Amounts in Mexican pesos)

	As at December 31,	
	2019	2018
Assets		
Current assets:		
Cash	\$ 4,238,927	\$ 1,143,759
Related parties (Note 2)	41,173,428	39,682,530
Accounts receivable and other current assets (Note 3)	4,048,599	2,030,127
Total current assets	49,460,954	42,856,416
Non-current assets:		
Deferred income tax (Note 7)	6,753,878	5,435,977
Total assets	\$ 56,214,832	\$ 48,292,393
Liabilities and equity		
Current liabilities:		
Suppliers	\$ 1,774,159	\$ 1,419,654
Provisions and accrued liabilities (Note 4)	22,163,564	22,291,749
Total current liabilities	23,937,723	23,711,403
Employee benefits	8,762,559	5,074,917
Total liabilities	32,700,282	28,786,320
Equity (Note 5):		
Share capital	10,000	10,000
Subscribed capital not paid	(9,998)	(9,998)
Retained earnings	25,825,893	19,216,974
Other comprehensive income (Note 8)	(2,311,345)	289,097
Total equity	23,514,550	19,506,073
Total liabilities and equity	\$ 56,214,832	\$ 48,292,393

The accompanying notes are part of these financial statements.

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Statements of comprehensive income

(Amounts in Mexican pesos)

	For the year ended as at December 31,	
	2019	2018
Maquila revenues (Note 2)	\$ 260,290,899	\$ 234,647,825
Operating expenses:		
Maquila expenses (Note 6)	248,276,704	224,007,470
Income before Income tax	<u>12,014,195</u>	<u>10,640,355</u>
Income tax (Note 7)	5,405,276	2,128,636
Net income of the year	<u>6,608,919</u>	<u>8,511,719</u>
Other comprehensive income:		
Remeasurements of net defined Benefit liability (Note 8)	(2,600,442)	289,097
Comprehensive Income	<u>\$ 4,008,477</u>	<u>\$ 8,800,816</u>

The accompanying notes are part of these financial statements.

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Statements of changes in equity

For the years ended December 31, 2019 and 2018

(Amounts in Mexican pesos)

	Share capital	Subscribe capital not paid	Retained earnings	Other comprehensive income	Total
Balance as at December 31, 2017	\$ 10,000	\$ (9,998)	\$ 10,705,255	\$ -	\$ 10,705,257
Comprehensive income			8,511,719	289,097	8,800,816
Balance as at December 31, 2018	10,000	(9,998)	19,216,974	289,097	19,506,073
Comprehensive income			6,608,919	(2,600,442)	4,008,477
Balance as at December 31, 2019	\$ 10,000	\$ (9,998)	\$ 25,825,893	\$ (2,311,345)	\$ 23,514,550

The accompanying notes are part of these financial statements.

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Statements of cash flows

(Amounts in Mexican pesos)

	For the year ended as at December 31,	
	2019	2018
Operating activities		
Profit before income tax	\$ 12,014,195	\$ 10,640,355
Employee benefits	2,787,286	1,628,921
	<u>14,801,481</u>	<u>12,269,276</u>
Changes in operating assets and liabilities:		
Accounts receivable and other current assets	(2,018,472)	(1,353,011)
Related parties	(1,490,898)	(11,874,109)
Suppliers	354,505	214,260
Income tax paid	(5,608,702)	(5,401,130)
Employee benefits	(2,814,561)	(398,236)
Provisions and accrued liabilities	(128,185)	6,260,662
Net cash flows provided by (used in) operating activities	<u>3,095,168</u>	<u>(282,288)</u>
Increase (decrease) in cash	3,095,168	(282,288)
Cash at beginning of year	1,143,759	1,426,047
Cash at end of year	<u>\$ 4,238,927</u>	<u>\$ 1,143,759</u>

The accompanying notes are part of these financial statements.

PKC GROUP DE PIEDRAS NEGRAS, S. DE R.L. DE C.V.

Notes to the financial statements

At December 2019 and 2018

(Amounts in Mexican pesos, unless otherwise indicated)

1. Nature of operations and summary of significant accounting policies

PKC Group de Piedras Negras, S. de R.L. de C.V. (The "Company") was founded in August 14, 2012, in accordance with Mexican law under the protection of the maquila program established by the Mexican Government. The company is a subsidiary of Project del Holding, S.A.R.L. and its main activity is to provide a maquila services to AEES Inc. (a related party).

October 27, 2015 the Ministry of Economy authorized AEES Manufacturera, S. de R.L. de C.V. (related party) to change the modality of its IMMEX Program from Industrial to a Holding Maquiladora Program.; this program includes the companies which provide personal services to AEES Manufacturera, S. de R.L. de C.V. With this authorization, AEES Manufacturera, S. de R.L. de C.V. acquired the quality of a controlling company with a singles IMMEX program in accordance with the Decree of the promotion of the manufacturing industry. The company celebrates a contract with AEES Inc (related party) to provide maquila services.

The Company's operating period and fiscal year is from January 1st, through December 31.

On June 25, 2020, the financial statements and these notes were authorized by the Shared-Service Manager, Fernando Parada, for their issue and subsequent approval by the Company's Board of Directors and Shareholders, who have the authority to modify the financial statements. Information on subsequent events covers the period from 1 January 2019 through the above-mentioned issue date of the financial statements.

Summary of significant accounting policies

a) Compliance with Mexican Financial Reporting Standards ("MFRS")

Except as mentioned in paragraph j), the financial statements as of 31 December 2019 and 2018 have been prepared in accordance with Mexican Financial Reporting Standards ("MFRS" or "Mexican FRS").

b) Basis of preparation

The financial statements as of 31 December 2019 and 2018 have been prepared on a historical cost basis, except for the non-monetary items that were acquired or recognized in the financial statements before 31 December 2007, as such items reflect the cumulative effects of inflation from their initial recognition date through 31 December 2007.

2.

From 1 January 2008 Mexico is considered to have a non-inflationary economic environment, as defined under Mexican FRS B-10 "Effects of inflation". As at 31 December 2019 and 2018, Mexico's cumulative inflation rate for the three prior years was 26% (annual average of 8%), which represents the necessary condition for considering Mexico as having a non-inflationary economic environment. Accordingly, the Company ceased restating its financial statements for inflation as of 1 January 2008.

As determined based on the National Consumer Price Index (NCPI) published by the National Statistical and Geographical Information Agency (INEGI), Mexico's annual inflation rate for 2019 and 2018 is as follows:

	Cumulative inflation for 2018	Cumulative inflation for 2019	Inflation for the year
	(sum of inflation rates for 2016, 2017 and 2018)	(sum of inflation rates for 2017, 2018 and 2019)	(inflation for 2019)
Inflation rates	15.25%	13.17%	2.83%

In accordance with FRS, it corresponds to a non-inflationary economic environment, and require that the financial statements continue been preparing under a historical cost basis.

Current versus non-current classification

The Company presents assets and liabilities in the statement of financial position based on current/non-current classification.

An asset is current when it is:

- Expected to be realized or intended to be sold or consumed in the normal operating cycle;
- expected to be realized within twelve months after the reporting period;
- held primarily for the purpose of trading, or
- cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets are classified as non-current.

A liability is current when:

- It is expected to be settled in the normal operating cycle;
- it is held primarily for the purpose of trading;
- it is due to be settled within twelve months after the reporting period, or
- There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

The terms of the liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

The Company classifies all other liabilities as non-current.

c) Revenue from contracts with customers

The Company is primarily engaged to render maquila services based on a contract with its related party AEES, Inc.

Maquila revenues are recognized at the moment in which the maquila service is rendered in accordance with the contract with their related party AEES, Inc. For the determination of revenues, the company uses a factor of 4.75% profit on the costs and expenses incurred in the maquila process, This factor may be modified at the end of the fiscal year to comply with the transfer pricing requirements in accordance with Articles 179, 180, 181 and 182 of the current Mexican Income Tax Law (MITL).

d) Use of estimates

The preparation of the Company's financial statements in accordance with Mexican FRS requires management to make judgements, estimates and significant assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. The Company based its estimates on the available information at the time the financial statements were prepared. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

Judgements

In the process of applying the Company's accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognized in the financial statements:

Retirement benefits

The net cost of defined benefits and the present value of these labor obligations are determined using actuarial valuations. An actuarial valuation involves making various assumptions. These include the determination of the discount rate, future salary increases, and mortality, disability, employee turnover rates, as well as certain financial and demographic assumptions. Due to the complexities involved in the valuation, the underlying assumptions, and the long-term nature of the valuation, a defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of marketable securities in currencies consistent with the currencies of the post-employment benefit obligation by reference to market yields on high-quality corporate bonds or when no such information is available, by reference to market yields on government bonds. When a corporate bond rate is used, the underlying bonds are further assessed for quality, and those having excessive credit spreads are excluded from the analysis of bonds on which the discount rate is based due to their low quality.

4.

The mortality rate is based on Mexico's publicly available mortality tables.

Future salary increases are based on expected future inflation rates for Mexico considering a growth rate in the expected benefits.

e) Cash

Cash principally consist of bank deposits.

f) Trade receivables and other accounts receivable

Accounts receivable represent the consideration to which an entity is entitled in exchange for satisfaction of a performance obligation through the transfer of a promised good or service to a customer.

Trade receivables are considered to be financial assets (IFC as are known in Spanish), as they arise from a contract that establishes the contractual obligations of the parties.

Accounts receivable are recognized upon accrual of the transaction giving rise to them, which occurs when control over the promised good or service is transferred to the customer in execution of the terms of the related contract. Accounts receivable are only recognized when they meet the conditions for recognition of the corresponding revenue in accordance with Mexican FRS D-1 Revenue from contracts with customers.

The amount of a receivable can vary because of rebates, discounts or refunds, and the corresponding changes to the consideration amount are recognized at the time the customer becomes entitled to such rebate, discount or refund.

Accounts receivable are initially recognized at the transaction price determined in accordance with Mexican FRS D-1 and subsequently adjusted to the amount of the transaction price that has not been collected from the customer.

Receivables denominated in foreign currency or in another medium of exchange are translated to the Company's functional currency using the rate of exchange prevailing at the reporting date. Changes in the amount of trade receivables arising from exchange rate fluctuations are recognized as part of net financing cost.

Accounts receivable are classified as either short-term or long-term depending on the length of their terms. Accounts receivable that are due within one year of the reporting date (or within the entity's normal business cycle if it exceeds one year) are classified as short-term. All other accounts receivable are classified as long-term.

The Company records an allowance for expected credit losses in profit or loss upon initial recognition of its trade receivables, based on an assessment of their recoverability, and then recognizes the changes to the allowance that arise in each subsequent period.

Related party receivables arising from the sale of goods or services are presented and disclosed separately, since these receivables have special characteristics with respect to their collectability.

Other accounts receivable are initially recognized as they accrue and represent amounts owed to an entity arising from transactions that are unrelated to its normal operations (loans to shareholders, officers and employees, insurance claims, recoverable taxes when the Company is entitled in accordance with the corresponding tax law), and which the entity expects to receive within one year of the reporting date (or within the entity's normal business cycle if it exceeds one year). Other accounts receivable are presented as part of current assets.

Other accounts receivable are measured at the amount of the consideration to which the Company is entitled, which is generally the nominal amount of the receivable at initial recognition, and the uncollected nominal amount upon subsequent recognition.

g) Allowance for expected credit losses

The Company recognizes an allowance for expected credit losses and exercises its judgement to determine the expected credit losses of its trade receivables, taking into consideration its historical credit loss experience, current circumstances, and reasonable and sustainable forecasts of different future quantifiable events that could reduce the future cash flows earned from the Company's receivables.

The Company recognizes the allowance for expected credit losses related to accounts receivable in accordance with Mexican FRS C-16 Impairment of financial assets.

h) Prepaid expenses

Prepaid expenses are initially recognized as assets as of the date the payment is made, provided that it is probable that the future economic benefits associated with the asset will flow to the Company. At the time the goods or services are received, prepaid expenses are either capitalized or recognized in profit or loss as an expense, depending on whether there is certainty that the acquired goods or services will generate future economic benefits.

The Company periodically evaluates the ability of prepaid expenses lose their ability to generate future economic benefits and the recoverability thereof, the amount deemed as unrecoverable is recognized as an impairment loss in income for the period.

i) Provisions, contingent and commitments

Provisions are recognized when (i) the Company has a present obligation (legal or constructive) as a result of a past event, (ii) it is probable (more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation and (iii) a reliable estimate can be made of the amount of the obligation.

When the effect of the value of money over time is significant, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. The discount rate applied in these cases is pretax and reflects market conditions at the date of statement of financial position and, where appropriate, the risks specific to the liability. In these cases, the increase in the provision is recognized as an interest expense.

6.

Contingent liabilities are recognized only when it is probable they will give rise to a future cash disbursement for their settlement.

Contingent assets are recognized when the realization of income is virtually certain.

j) Net employee defined benefit liabilities

Seniority premiums are paid to workers as required by Mexican labor law. Under Mexican labor law, the Company is also obligated to make certain payments to workers who leave the Company or are dismissed in certain circumstances.

The premium costs seniority and termination benefits are recognized annually based on calculations by independent actuaries using the projected unit credit method using financial assumptions in nominal terms.

As at December 31, 2019 and 2018, the Company did not record a provision for its obligation related to termination benefits, which should be calculated using the projected unit credit method in accordance with Mexican FRS D-3 "Employee benefits". The Company recognize only the seniority premium provision based on the actuarial calculation in accordance with IAS 19 as of December 31, 2019.

k) Compensated absences

The Company creates a provision for the costs of compensated absences, such as paid annual leave, which is recognized using the accrual method.

l) Employee Profit Sharing (EPS)

Current employee profit sharing is presented as part of costs or expenses in the statement of comprehensive income.

m) Comprehensive income

Comprehensive income represents the increase or decrease in earned capital from net income or loss for the year and components of Other Comprehensive Income (OCI). Other Comprehensive Income (OCI) consists of income, cost and expense items recognized in equity that are expected to be realized in the medium (long) term and whose amounts may change due to changes in the fair value of the assets and liabilities that gave rise to them, making their realization uncertain. OCI includes net defined benefit liability (asset) remeasurement gains and losses related to the labor obligations.

n) Income tax

Current income tax

Current income tax is recognized as a current liability, net of prepayments made during the year. Current income tax is recognized as an expense in profit or loss, except to the extent that it arises from transactions or other events recognized outside profit or loss, either in comprehensive income or directly in equity.

Deferred income tax

Deferred income tax is calculated using the asset and liability method. Under this method, deferred taxes are recognized on all temporary differences between financial reporting and tax values of assets and liabilities, applying the income tax rate as of the date of the statement of financial position, or the enacted rate at the date of the statement of financial position that will be in effect when the temporary differences giving rise to deferred tax assets and liabilities are expected to be recovered or settled.

The Company periodically evaluates the possibility of recovering deferred tax assets and if necessary, creates a valuation allowance for those assets that do not have a high probability of being realized.

o) Statement of comprehensive income presentation

Costs and expenses shown in the statement of comprehensive income are analyzed by their function, since such classification allows for a more accurate evaluation of the Company's operating and gross profit margins. Although not required to do so under Mexican FRS, the Company includes operating income in the income statement, since this item is an important indicator for evaluating the Company's operating results.

p) Concentration of risk

As at December 31, 2019 and 2018, the Company provides its maquila services exclusively to its related party AEES, Inc. under a maquila program. Accordingly, in the event that the related party no longer requires these services, the Company's operating results could be adversely affected.

q) New accounting pronouncements

1) Standards and Improvements to Mexican FRS issued but not yet effective

The standards that are issued but not yet effective up to the date of issue of the Company's financial statements are disclosed below.

The Company intends to adopt these standards, if applicable, when they become effective.

Mexican FRS B-11 Disposal of long-lived assets and discontinued operations (effective for annual periods beginning on or after 1 January 2020)

In November 2018, the CINIF issued Mexican FRS B-11 Disposal of long-lived assets and discontinued operations, the purpose of which is to separate the requirements for presentation and disclosure of disposals of long-lived assets (or disposal groups) classified as held for sale, as well as discontinued operations, from the requirements for measurement of long-lived assets established in Bulletin C-15 Accounting for the impairment or disposal of long-lived assets.

8.

The new standard establishes that long-lived assets and certain assets that an entity would normally regard as non-current that are acquired exclusively with the view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with Mexican FRS B-11. In addition, for assets classified according to a liquidity presentation of the statement of financial position, under Mexican FRS B-11, non-current assets are those assets expected to be recovered more than twelve months after the reporting date (or within the entity's normal business cycle if it exceeds twelve months).

Mexican FRS B-11 is effective for annual periods beginning on or after 1 January 2020. Early adoption is not permitted.

It is important to note that first-time adoption of Mexican FRS B-11 does not give rise to accounting changes in the financial statements.

Improvements to Mexican FRS for 2020

The improvements with accounting changes related to valuation, disclosures or presentation in the financial statements are as follows:

(i) Mexican FRS D-4 Income taxes and Mexican FRS D-3 Employee benefits

Entities are now required to account for the effects of uncertain tax treatments on their income tax and employee profit sharing. The improvements address matters such as: whether an entity should consider uncertain tax treatments separate or combined basis, the assumptions an entity must make when determining whether the tax treatment will be reviewed by the tax authorities, how an entity should determine its taxable profit, tax base, unused tax losses, unused tax credits and tax rates, methods for estimating the uncertainty, and how an entity should evaluate changes in facts and circumstances.

Since employee profit sharing is determined based on the same tax laws and using practically the same tax base as income tax, the abovementioned considerations related to the effects of uncertainty are also applicable to current and deferred employee profit sharing.

These improvements are effective for annual periods beginning on or after 1 January 2020, with early adoption permitted for annual periods beginning on or after 1 January 2019.

The adoption of these improvements are being analyzed by the Company.

(ii) Mexican FRS D-4 Income taxes

Entities are now required to recognize the tax effects of distributions of dividends in equity, so when an entity recognizes a liability for distribution of dividends, it must also recognize the corresponding income tax liability, if applicable.

This improvement is effective for annual periods beginning on or after 1 January 2020, with early adoption recommended for annual periods beginning on or after 1 January 2019.

2) New standards, interpretations and Improvements to Mexican FRS effective as at 1 January 2019

Improvements to Mexican FRS for 2019

(i) Mexican FRS B-9 Interim financial reporting

Mexican FRS B-9 Interim financial reporting introduces new disclosure requirements for condensed financial statements for an interim period related to the fair value of the Company's financial instruments and revenue from contracts with customers, such as changes in economic and business circumstances that affect the fair value of financial assets and liabilities, transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments, changes in the classification of financial assets as a result of a change in the purpose or use of those assets or changes in contingent liabilities or contingent assets, regardless of the date of the most recent annual financial report.

These improvements are effective for annual periods beginning on or after 1 January 2019. Any accounting changes arising from the adoption of these improvements are to be recognized prospectively.

The adoption of these new accounting standards had no effect on the Company's financial statements.

Improvements to Mexican FRS for 2018

The improvements with accounting changes related to valuation, disclosures or presentation in the financial statements are as follows:

(i) Mexican FRS B-2 Statement of cash flows

Mexican FRS B-2 introduces a new requirement that entities must now include in the notes to the financial statements, disclosures related to relevant changes in liabilities reported within financing activities that may or may not have required the use of cash or cash equivalents. In addition to the required disclosures, entities also need to include a reconciliation of beginning and ending balances for these items.

These improvements are effective for annual periods beginning on or after 1 January 2018, with early adoption permitted for annual periods beginning on or after 1 January 2017.

(ii) Mexican FRS B-10 Effects of inflation

Mexican FRS B-10 introduces a new requirement that the notes to the financial statements (whether restated for inflation or not) should, in addition to the cumulative inflation rate for the three prior years and the inflation rate used to determine whether the entity operates in an inflationary or not inflationary economic environment, state the following rates:

10.

- The cumulative inflation rate for three years that includes the two prior years and the current year, which shall be the basis for determining whether the entity will operate in an inflationary economic environment in the following year.
- The inflation rate considered for purposes of preparing the financial statements.

These improvements are effective for annual periods beginning on or after 1 January 2018, with early adoption permitted for annual periods beginning on or after 1 January 2017. The adoption of this standard had no effects on the Company's financial statements.

2. Related parties

An analysis of balances due from and to related parties as at 31 December 2019 and 2018 is as follows:

	2019	2018
Receivable:		
AEES, Inc. ⁽¹⁾	\$ 41,173,428	\$ 39,682,530
	<u>\$ 41,173,428</u>	<u>\$ 39,682,530</u>

⁽¹⁾ Accounts receivable from related parties is originated by the maquila services derived from the modality of the IMMEX program of its affiliate such as described in Note 1. As of November 1st, 2015, the company provides maquila services to AEES Inc, which previously they were provided to AEES Manufacturera, S. de R.L. de C.V.

During the years ended 31 December 2019 and 2018, the Company had the following transactions with its related parties:

	2019	2018
Revenue for maquila service	\$ 260,290,899	\$ 234,647,825

3. Accounts receivable and other current assets

At December 31, 2019 and 2018, the accounts receivable and other current assets are as follows:

	2019	2018
Recoverable value added tax	\$ 3,804,969	\$ 808,821
Prepaid insurance	177,275	106,224
Other accounts receivable	66,355	1,115,082
	<u>\$ 4,048,599</u>	<u>\$ 2,030,127</u>

4. Provisions and accrued liabilities

At December 31, 2019 and 2018, the provisions and accrued liabilities are as follows:

	2019	2018
Employee Profit Sharing (EPS)	\$ 1,909,636	\$ 2,089,798
Taxes and contributions payable	4,908,957	6,400,036
Liability provisions	14,569,701	13,230,170
Income tax	775,270	571,745
	<u>\$ 22,163,564</u>	<u>\$ 22,291,749</u>

5. Equity

a) At December 31, 2019 and 2018, the share capital authorized is \$10,000 which has not been fully paid, share capital is unlimited. Both the fixed and the variable portion of capital are represented by shares of Series "B" with nominal value of one peso each and are fully subscribed by foreign investors.

b) In accordance with the Mexican Corporations Act, the Company is required to appropriate at least 5% of the net income of each year to increase the legal reserve. This practice must be continued each year until the legal reserve reaches 20% of the value of the Company's share capital. As at 31 December 2019 and 2018, the company has not created the legal reserve.

c) Earnings distributed in excess of the Net Reinvested Taxed Profits Account (CUFINRE by its acronym in Spanish) and Net Taxed Profits Account (CUFIN by its acronym in Spanish) balances will be subject to the payment of corporate income tax at the statutory rate at that time. The payment of this tax may be credited against the Company's current income tax.

Dividends paid to individuals and foreign corporations from earnings generated as of 1 January 2014, shall be subject to an additional 10% withholding tax.

6. Maquila expenses

At December 31, 2019 and 2018, the maquila expenses are as follows:

	2019	2018
Wages and salaries	\$ 183,935,238	\$ 166,730,160
Social security and payroll tax	36,472,279	31,840,751
Transportation expenses	14,474,204	12,009,733
Other expenses	12,008,858	11,756,686
Travel expenses	927,232	1,024,897
Profesional fees and services	458,893	645,243
	<u>\$ 248,276,704</u>	<u>\$ 224,007,470</u>

12.

7. Income tax

Income Tax (IT)

The Mexican Income Tax Law (MITL) establishes a corporate income tax rate of 30% for fiscal years 2019 and 2018.

For the fiscal year 2019 it is important to mention that in order to comply with the MITL in Articles 179, 180 and 181, the company opted to determine its taxable income in conformity with the Article 182 section II of the MITL and a result of this applied the 6.9 on a fixed assets value, and 6.5% on a cost and expenses incurred on the maquila operation respectively.

The MITL establishes requirements and limits regarding certain deductions, including restrictions on the deductibility of payroll-related expenses that are considered tax-exempt for employees, contributions to create or increase pension fund reserves, and Mexican Social Security Institute dues that are paid by the Company but that should be paid by the employees. The MITL also establishes that certain payments made to related parties shall not be deductible if they do not meet certain requirements

On August 29, 2019 the Company received a resolution by the Mexican Tax Authorities (hereinafter "SHCP" as are known in Spanish) for the operation of maquila services carried out its related party abroad AEES, Inc. for the year ended 2015 through notification 900-06-01-00-00-2019-000622 with regard to the inquiries made by the Company in the terms of Article 34-A of the Código Fiscal de la Federación within the Transfer Price Agreement Promotion (APA) submitted to the SHCP, in order to comply with the articles 179 and 180 of the Law on Income tax, pursuant to the third paragraph of article 182 of the statutory provision in comment, the SHCP considers that the Company develop the methodology proposed in that file so that they determine that the transactional margin method of operating income set out in the first paragraph of Article 180, fraction VI of the Law on Income tax is applied for the purpose of determining the price or amount of the operation subject to the APA. Based on the above, the Company has carried out the corresponding calculations for that year in accordance with the time limits granted in such resolution and recorded the corresponding provision in the amount of \$193,678. In addition, based on the above, considering the new factor (mark up) for the determination of revenue, the Company submitted additional statements for the years 2016, 2017 and 2018 and recorded the corresponding income tax paid for previous years of \$222,908.

For the years ended at December 31, 2019 and 2018, the Company reported a taxable income of \$17,310,069 and \$15,121,201, respectively, on which correspond income tax of \$5,192,116 and \$4,536,360, respectively.

a) An analysis of income tax recognized in profit and loss for the years ended 31 December 2019 and 2018 is as follows:

	2019	2018
Current income tax	\$ 5,192,116	\$ 4,536,360
Prior year income tax	416,586	-
Deferred income tax	(203,426)	(2,407,724)
	<u>\$ 5,405,276</u>	<u>\$ 2,128,636</u>

b) Other Comprehensive Income (OCI):

	2019	2018
Deferred taxes related to items recognized in other comprehensive income during the year		
Remeasurements of net defined benefit liability	\$ 1,114,475	\$ (123,899)
Deferred tax recognized in OCI	<u>\$ 1,114,475</u>	<u>\$ (123,899)</u>

c) An analysis of deferred taxes shown in the statement of financial position is as follows:

	2019	2018
Deferred tax assets:		
Provisions and accrued liabilities	\$ 3,731,064	\$ 3,081,900
Accounts payable	447,228	734,280
Employee benefits	2,628,768	1,646,374
Total deferred tax assets	<u>6,807,060</u>	<u>5,462,554</u>
Deferred tax liabilities:		
Prepaid expenses	(53,182)	(26,577)
Total deferred tax liabilities	<u>(53,182)</u>	<u>(26,577)</u>
Deferred tax asset, net	<u>\$ 6,753,878</u>	<u>\$ 5,435,977</u>

A reconciliation of the statutory income tax rate to the effective income tax rate recognized by the Company for financial reporting purposes is as follows:

	2019	2018
Income before income tax	\$ 12,014,195	\$ 10,640,355
Plus (less):		
Annual inflation adjustment	(109,163)	(616,745)
Non-deductible expenses	1,799,923	1,046,431
APA Adjustment	1,316,585	
APA and Safe Harbor adjustment from previous years	1,388,621	(3,977,088)
Others	1,607,424	2,500
Income before income tax	<u>18,017,585</u>	<u>7,095,453</u>
Statutory income tax rate	30%	30%
Total income tax	<u>\$ 5,405,276</u>	<u>\$ 2,128,636</u>
Effective income tax rate	<u>45%</u>	<u>20%</u>

14.

8. Other Comprehensive Income (OCI)

The effects of the income tax derived from the movements of the OCI of the period are shown below:

	Beginning balance OCI	OCI before taxes	Income taxes at 30%	OCI, net
Remeasurements of net defined benefit liability (*)	\$ 289,097	\$ (3,714,917)	\$ 1,114,475	\$ (2,311,345)
Other comprehensive income	\$ 289,097	\$ (3,714,917)	\$ 1,114,475	\$ (2,311,345)

(*) Deferred income tax is calculated on a 100% basis deduction.

9. Contingencies and commitments

I. Commitments

The company had celebrated a contract with his related party to provide maquila services. This contract is for an indefinite period. Total revenue from this concept was \$260,290,899 in 2019 and \$234,647,825 in 2018.

II. Contingencies

At December 31, 2019, the company has the following contingencies:

- a) There is a contingent liability derived to labor obligations mentioned in Note 1j).
- b) In accordance with current tax legislation, the authorities are entitled to examine the five fiscal years prior to the last statement filed income tax.
- c) According to the Law on Income tax, companies that conduct transactions with related parties are subject to certain limitations and requirements, as to the determination of the agreed prices, as these must be comparable to those that would be used with arm's-length transactions. In the event that the tax authorities will review prices and reject the certain amounts may require, in addition to the collection of the tax, accessories corresponding (updating and surcharges), and penalties on unpaid taxes, which could become even 100% of the amount of contributions updated. The Company's policy is to conduct a transfer pricing study to evaluate the operations carried out with related parties.