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*OTC Bulletin Board: MMGG*

February 24, 2003

## **President's Letter to Metalline Mining Company Shareholders**

Metalline Mining Company's primary emphasis is to develop an ore reserve containing 2 million metric tons (mt) of zinc metal at its Sierra Mojada Project in Coahuila, Mexico. The reserve is being developed in one of the oxide zinc mineral systems (the Red Zinc Manto) by the project operator and partner Servicios Industriales Penoles. This reserve is enough to justify construction of a 5000 mt per day mine and Solvent Extraction Electrowinning plant producing 180,000 mt of zinc per year.

Metalline announced in a news release dated December 2, 2002 that Penoles will continue the Sierra Mojada Project and has purchased an additional 100,000 shares of Metalline Mining Company Common Stock, at a price of US\$2.00 per share, in accordance with the Earn In Agreement signed November 15, 2001 between Metalline Mining Company and Penoles. An aggressive program is planned for 2003 with a budget of US\$2 million and 10,000 meters of drilling planned.

The project is managed by a Technical Committee composed of two representatives from Metalline and two from Penoles. The Technical Committee met recently for an in-depth review of last years work and to plan and implement the work for this year's program. The work will consist of surface and underground drilling, channel sampling and driving raises and drifts to bulk sample the ore. Metallurgical studies and environmental baseline studies will also be performed. Last years work confirmed the quality and reliability of previous exploration work by Metalline and North Ltd. It also extended the known limits of mineralization and increased the average grade of all samples in the Red Zinc Manto. Penoles is an extremely competent operator and a very good working relationship has developed between Metalline and Penoles. Metalline has contracted to perform some of the underground drilling, sampling and development work for Penoles. Last year's program concentrated on the western portion of the Red Zinc Manto in the San Salvador and Encantada mines, work for 2003 will extend to the east into the Fronteriza Mine and to the west in the San Salvador and possibly into the La Esmeralda Mine. Work will also be conducted to follow up on the ore grade oxide zinc mineralization drilled by North Limited 2 kilometers to the west in the vicinity of the San Jose mine. This mineralization is the up-plunge projection of the Red Zinc Manto and was intersected only 10 meters below the surface and is amenable to open pit mining.

Current zinc inventories are moderate and zinc is at historic low prices. The market balance study by CHR Metals Limited of London predicts that 1.7 million mt (19% of current world consumption) of new production will need to be commissioned by 2007, with 900,000 mt required by 2005. Satisfying this requirement in the projected time frame is technically impossible. Management of both Metalline and Penoles are committed to developing Sierra Mojada on a timeline that will benefit from these expected developments. More on this subject follows.

Zinc is necessary to modern living, and, in tonnage produced, stands fourth among all metals in world production — exceeded only by iron, aluminum, and copper. Zinc uses range from metal products to rubber, chemicals and medicines. About three-fourths of zinc used is consumed as metal, mainly, about 54%, as a coating to protect iron and steel from corrosion (galvanized metal). Zinc metal is also used in alloys to make bronze, brass, other alloys and in zinc die casting. The remaining one-fourth is consumed as zinc compounds by the rubber, chemical, paint, and agricultural industries. Zinc is a necessary element for proper growth and development of humans, animals, and plants; it is the second most common trace metal, after iron, naturally found in the human body. Zinc deficiency is identified by the United Nations as among the 10 leading causes of disease in the world.

## **Advantages of being a Metalline shareholder**

**Profitability.** The recent development of Solvent Extraction Electrowinning (SXEW) for oxide zinc ores will allow refined zinc to be produced at a cost of \$0.25 per pound or less. Essentially all zinc is produced from sulfide ores by the smelting process at a cost of about \$0.35 per pound. The Red and White Zinc Manto ore bodies at Sierra Mojada are oxide zinc and SXEW will give Metalline a **30% cost of production advantage** over sulfide ore producing competitors.

**High Grade.** The average zinc content of all of Metalline's and Penoles' samples - raise bulk samples, drill and channel samples from the Red Zinc Manto is 11.8%. Data compiled by the International Zinc Association (IZA) show that mines with grades greater than 11% make up 18% of world zinc mines - less than 1 mine in 5 has grades higher than Sierra Mojada, and none produce from oxide ores.

**Low Cost Producer.** The median cash cost of mine production of zinc is about \$0.50 per pound. High grade and SXEW technology will give us a minimum \$0.25 per pound advantage over the median zinc mine. Sierra Mojada will be profitable at cyclic low metal prices and highly profitable at cyclic high metal prices.

**Sierra Mojada is a Silver District.** Historic production from mines in the Sierra Mojada district produced about ten million metric tons of ore containing a minimum of 500 grams silver per metric ton, and probably averaged about 1000 grams per ton (31 grams equals 1 troy ounce), in addition to copper, lead and zinc. Sierra Mojada ores were selectively mined and direct shipped to the smelter. These high-grade workings provide excellent access for the reserve definition currently being conducted in the Red Zinc Manto in the San Salvador, Encantada and Fronteriza mines.

**The Red Zinc Manto contains Silver.** Silver values in the Red Zinc Manto oxide zinc ore body range from lows of 5 to 10 grams per metric ton to highs of 300-400 grams and could average 60 to 100 grams or more. The silver possibly occurs as native metal and would be amenable to a gravity separation before leaching.

**Focused, Disciplined Development Program.** Our strategy is to take advantage of the convergence of the SXEW technology and the large and high-grade oxide zinc deposits at Sierra Mojada to create a project that has World Class economics. We are concentrating our efforts on developing the required reserve (2 million metric tons of contained zinc metal) to justify the construction of a SXEW plant. In addition to silver, the Red Zinc Manto and other District ores

contain germanium and cobalt. These valuable by-products are expected to be recovered and to enhance project economics. Sierra Mojada District ores consist of both oxide and sulfide ore and both become exploitable after the SXEW plant is constructed. However, our initial focus is on the multibillion-dollar opportunity presented by the oxide zinc deposits.

**Project Partner.** Metalline signed an Earn In Agreement on the Sierra Mojada Project with Penoles November 15, 2001 and Penoles become the project operator. Penoles, a \$1.9 billion company, the second largest Mexican mining company and the World's largest silver refiner, is a progressive mining company with an excellent track record of successful new project development. There are numerous synergies between the Sierra Mojada project and Penoles' business objectives. This technically and financially strong partner assures the skills required to bring the project to completion.

## **Skorpion**

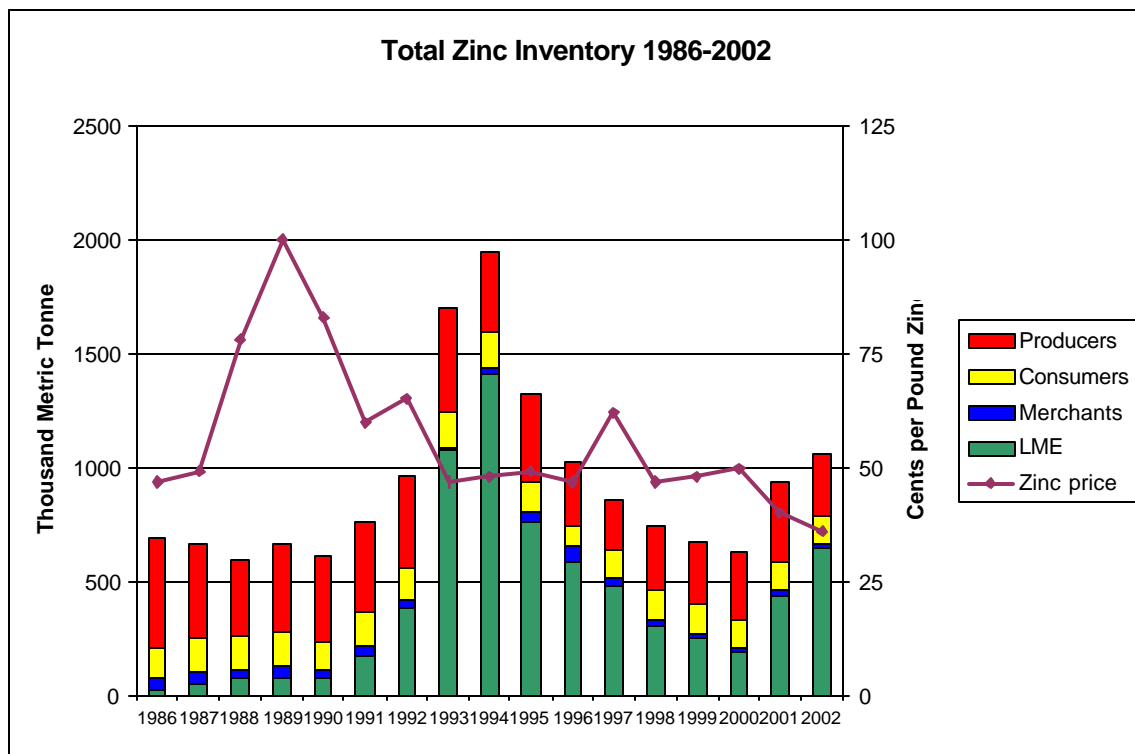
The first zinc SXEW production will be from the Skorpion Mine, owned by Anglo American plc, in Namibia, Africa. The Skorpion Mine is operated by Skorpion Zinc and the mine and SXEW plant is, at present, being commissioned – undergoing start up and ramping up to full production of 4000 mt per day and 150,000 mt zinc per year. The first zinc is due to be produced in mid-April (Reuters, Feb., 19).



**Skorpion Mine and SXEW Plant, January 2003**

## Zinc Price Outlook

Zinc price is a paradox when fundamentals and historic price are considered. During 2000 London Metal Exchange (LME) inventories fell to a low of 190,000 mt and the zinc price was \$0.50 per pound. World zinc consumption is 24,000 mt per day; 190,000 mt is an 8 day world supply. Fundamentally, a much higher zinc price would be expected. LME inventories had not been that low since 1991. LME inventory has increased to 674,000 metric tons and the price is \$0.35 per pound. From 1986 to 1991, total zinc inventories ranged between 550,000 and 1,000,000 mt the zinc price ranged between \$0.50 and \$1.00 per pound and the zinc price has averaged \$0.61 over the past 40 years (constant 1999 dollars). One would expect a zinc price well above \$0.50, not a decline to the present \$0.35 per pound or an August, 2002 low of \$0.329 per pound. LME inventory is well below the 1993 to 1995 highs when the price was just below \$0.50, the current price is at historic lows, **a paradox – but the case.**



During the past two decades annual increase in Western World zinc production has been 2.4%, increased consumption in Asia over this period has averaged 8.4%. Macquarie Bank forecasts an increase in world demand from 0.9% in 2002 to 5.4% in 2003.

According to the International Lead Zinc Study Group (ILZSG) zinc production for 2001 and 2002, in metric tons, was:

	2002	2001
World Mine production	8,729,000	8,899,000
Western World Mine Production	6,503,000	6,594,000
World Metal Production	9,502,000	9,235,000
Western World Metal Production	6,530,000	6,293,000
World Consumption	8,936,000	8,798,000
Western World Consumption	6,877,000	6,785,000

In 2002, consumption exceeded mine production, but refined metal output exceeded both. Consumption increased from 2001 to 2002, despite global economic conditions. Mine production declined during this period, due to reduction in capacity because of the unprofitable market price, reserve depletion and closure of mines. Metal production exceeded consumption by 437,000 mt for 2001 and by 566,000 mt for 2002, this oversupply of refined metal in the market resulted in lower prices. The problem of excess of smelter capacity and the eventual solution is reduction in output, closure of smelters, **or increased consumption that will utilize the available smelter capacity.** The smelter capacity additions were completed by China and others with the expectation of increased future world consumption. It has created the current oversupply, anticipated to be short term. Since mine production is lower than metal production, the excess metal production has had to come from drawdown of zinc concentrate inventories at the smelters. This has resulted in bidding up the price of concentrate despite the low market price of refined metal, which further squeezes the smelters and concentrate supply. This is an unsustainable situation, mine production will have to increase over the long term and smelter output will have to decrease in the short term until zinc price rises sufficiently for mines to produce at a profit and remain in production and eventually increase production if anticipated smelter capacity and increased consumption are to be satisfied.

Low zinc price has caused producers to reduce or close production and few mines and smelters are making a profit at current prices. Two of China's largest smelters, Zhuzhou Zinc Smelter and Baiyin Non-ferrous Metals Co. recently announced 2003 export and production reduction. Zhuzhou Zinc, China's second largest zinc producer, will cut exports by half to 35,000 mt this year and plans to produce 200,000 mt of zinc, down from 220,000 in 2002. Baiyin, one of China's top five zinc producers will cut exports, the level to be determined on world prices latter this year. Baiyin exported 46,000 mt of zinc in 2002. Baiyin expects its zinc output this year to be only 120,000 mt, compared with 150,000 mt in 2002, due to unfavorable world prices. "The prices are not good and we are not in a hurry to export. We can't make any money at such price levels" stated a Baiyin representative. The price levels referred to being \$805 to \$870 per mt, \$0.37 to \$0.40 per pound (Reuters, Jan 17, 2003). Reduction in mine and smelter production will continue until prices improve.

Recent reports and news articles indicate that some of the world's economies, China, India and Asia, are recovering. Trends in the US are uncertain with weakness in the US dollar, increase in oil, gas and energy costs, and the potential for war with Iraq.

The CHR Metals Limited's market balance study (July, 2001), forecasts 900,000 metric tons of additional annual capacity will need to be commissioned by 2005, with the total rising to 1,700,000 metric tons by 2007 to meet forecast growth in demand and **to compensate for losses in mine output due to reserve depletion and attrition of output.** As noted above, these requirements are technically not possible to fulfill in the required time frame; since discovery through development of a mine is a 5 to 10 year process at best. This would require that the equivalent of two of the largest recent discoveries Century (600,000 mt) and Antamina (280,000 mt) be discovered and put into production in each of the two year periods. If CHR Limited's projections are only 50% correct the requirements could not be fulfilled. Consequently, low supply and increasing demand will force zinc prices higher over the coming 5 to 10 years.

For sulfide producers and smelters it is not a good time to "be in" the zinc business, I believe it is however, a good time to be "getting into" the zinc business, particularly with production from oxide

zinc and Solvent Extraction Electrowinning (SXEW). It is possible to reach production at Sierra Mojada between 2005 and 2007 and be able to fill part of the projected shortage in production and benefit from a rising zinc price. For oxide production by SXEW (Skorpion and Sierra Mojada), and its cost of production advantage, even at current prices, it would be a profitable time to be in the business, producing zinc at \$0.20 to \$0.25 per pound. Zinc price cannot go below or remain below the smelter cost of production for any significant time or smelters will close. A profit is required to remain in business. The smelter cost of production puts a floor on the price of zinc. The same argument holds for oxide copper solvent extraction at \$0.45 to \$0.50 per pound and smelter production costs at about \$0.65 per pound, the floor for copper price, as 80% of copper production is from smelting of sulfide ore.

Zinc prices are marginally improving and zinc inventories on the LME are holding in the 650,000 to 675,000 mt range. Zinc warrant cancellations are at record highs, indicating a shift from short to long positions. The future of zinc metal price is intricately tied to the world economies. The rate of growth of World Zinc Consumption is projected to continue to increase. Zinc consumption in the U.S. and Europe may be approaching a plateau; the areas of strong growth in zinc consumption appear to be China, India and Asia.

### **China's Impact on Metal Demand**

China's 1997 zinc mine production was 1,120,000 mt and its consumption was 850,000 mt. Smelter production was increased from 1,430,000 in 1997 to 1,920,000 for 2000, with net exports of 550,000 mt in 2000. China was a zinc concentrate exporter until late 2001, Q3/Q4, when it became an importer of concentrate. China produced 2,040,000 mt in 2001 and estimated exports for 2002 are 1,084,000 mt. China's increase in refined zinc production and exportation had a negative effect on the zinc market and resulted in lower zinc prices.

**A major shift now appears to be the making.** Zinc exports from smelters in China are down 14% in the first seven months of 2002 to 760,000 tonnes. The decline is due to inadequate concentrate supply from mines in China and offshore, plus current market prices. Exports for 2002 are forecast to be 17.8% lower at 891,230 tonnes (Macquarie Bank, Aug. 15, 2002).

For 2003, China has issued export quotas of 600,000 mt to individual zinc companies, but it is unlikely that this quota will be reached if the LME price remains below \$900 per metric ton (\$0.41 per pound). The export quota for 2002 was set at 650,000 mt but the actual exports may be well below this amount. Based on the first 9 months, only slightly over 500,000 mt of zinc and zinc products were exported. According to China Minmetals Group, the Chinese state-owned metals trading group, the Chinese producers are facing difficulties in obtaining zinc concentrate for their smelters. Zinc production is expected to drop to 1.94 million mt in 2002, from 2.04 million mt in 2001. For 2003, China's zinc output may fall below 2002's (Platts Metals Week, 2002). This declining output is occurring at the time when Chinese demand for galvanized metal is increasing. China's car sales exceeded one million units in the first 11 months of 2002, a 54% increase in sales compared with the same period in 2001. Because only about one-third of all cars sold in China are produced by domestic producers and because some of the galvanized steel for these cars must be imported, increased car sales in China will help foreign producers of zinc and galvanized steel (Metal Pages, 2002). Shortage of zinc concentrate on the Chinese market may restrain other companies, but it was not an issue for at least one company – Yunnan Chihong Zinc & Germanium Co. The company submitted a proposal to the Chinese Government and, at the

same time, began construction of a 100,000 mt/year addition to its existing 60,000 mt/year capacity zinc smelter, which it hopes to finish by year end 2004. The company currently operates two zinc mines nearby capable of producing a combined 400,000 mt of concentrates annually (zinc concentrate ranges 50% to 55% zinc). For those smelters that lack an adequate and steady source of concentrate, the outlook, at least for the immediate future, is not very promising. For example, China's second largest zinc producer, the Zhuzhou smelter, has decided to continue production in 2003 at the reduced 2002 level, which was about 50,000 mt below the 2001 output (USGS Mineral Industry Survey for zinc in November 2002).

China is a major player in the metal markets, particularly steel and iron ore – and consequently, the galvanized metal industry – and is shaping the future of these markets as it expands its smelting capacity and increases its imports of raw materials and exports of refined metal and manufactured products. One of the reasons for this dramatic growth is the outcome of acceptance as a member of the World Trade Organization in 2001. China is experiencing an economic boom with 11.8% growth in industrial output in the first 7 months of 2002. Other reasons for this economic boom are the result of massive government and foreign investment spending, rapid growth of exports, and strong consumer spending by its new middle class. Domestic motor vehicle sales are forecast to rise 50% in 2002. Construction is up 14.4% and household appliances are up 23.3% in the first half of 2002. The creation of a middle class in China is having a dramatic effect on growth of consumer goods and construction. The major use of zinc, about 54%, is corrosion protection in the automobile and construction industries, galvanized steel. (Harlan Meade, Expatriate Resources, September 19, 2002)

The remarkable growth in demand for metals in China is not unique to zinc. In 2002, China will overtake USA as the world's largest importer of steel. It has also been the single positive factor in re-balancing copper markets with imports of copper cathode up 90% during the first 8 months of 2002. China's search for raw materials is highlighted by the recent formation of a new state copper company consisting of several of the major copper smelters. The mandate of China Non-ferrous Metal International Mining Co. is to promote and invest in foreign mine copper projects to secure adequate supply of copper concentrates. Korea Resources is doing the same thing in the zinc sector. (Harlan Meade, Expatriate Resources, September 19, 2002).

In closing, I would like to thank all of our shareholders for their support and loyalty through these difficult market times. While the current zinc market has slowed in its rate of increase, consumption of zinc is still increasing and is projected to strongly increase, up to 5% annually, while mine supply is decreasing. I predict that mine production will continue to decrease due to reserve depletion in excess of new reserve discovery, unless the discovery of new reserves accelerates markedly. The strong reduction in exploration funding by the industry currently and in the past several years, decreases the probability that new reserve discovery will outpace reserve depletion in the next 5 to 10 year time frame. Noranda, one of the largest zinc producers, has ceased zinc exploration world wide (Metal Bulletin February 10, 2003). Admittedly, zinc has been the most difficult base metal to make a profit at in the last 10 years, I maintain that in the next 10 years zinc will be one of the most profitable metals, and **highly profitable for those producing from oxide ores by Solvent Extraction Electrowinning.**

With Best Regards and looking forward to the next few years!

**Merlin Bingham**  
**President**