

GROUP SIMEC SA DE CV  
Form F-1/A  
January 19, 2007

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**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**Amendment No. 3**  
**to**  
**FORM F-1**

**REGISTRATION STATEMENT**  
**UNDER**  
**THE SECURITIES ACT OF 1933**

**GRUPO SIMEC, S.A.B. de C.V.**  
(Exact name of Registrant as specified in its charter)

**GROUP SIMEC**  
(Translation of Registrant's name into English)

<b>United Mexican States</b> (State or other jurisdiction of incorporation or organization)	<b>3312</b> (Primary Standard Industrial Classification Code Number)	<b>None</b> (I.R.S. Employer Identification No.)
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**Approximate date of commencement of proposed sale of the securities to the public:** As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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SUBJECT TO COMPLETION, DATED JANUARY 19, 2007

**PROSPECTUS**

Grupo Simec, S.A.B. de C.V.

52,173,915 SERIES B COMMON SHARES

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

We are selling series B shares in the form of American depositary shares, or ADSs, in an international offering. Concurrently, we are selling series B shares in an offering in Mexico. Each ADS represents the right to receive three series B shares. The ADSs will be evidenced by American depositary receipts, or ADRs. The ADSs offered in the international offering may be delivered in the form of series B shares. The offering price and underwriting discounts and commissions in the international offering and the offering in Mexico will be substantially equivalent. We have granted the underwriters and the Mexican underwriters options to purchase up to an aggregate 7,826,085 additional series B shares, in each case, to cover over-allotments.

The ADSs are listed on the American Stock Exchange under the symbol "SIM", and the series B shares are listed on the Mexican Stock Exchange under the symbol "SIMEC.B". On January 16, 2007, the last reported sales price of the ADSs on the American Stock Exchange was \$13.84 per ADS, and the last reported sales price of the series B shares on the Mexican Stock Exchange was Ps. 51.02 per series B share.

**Investing in the ADSs and series B shares involves risks. See "Risk Factors" beginning on page 16.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per series B share	Per ADS	Total
Public Offering Price	Ps.	\$	\$
Underwriting Discount	Ps.	\$	\$
Proceeds to Grupo Simec, S.A.B. de C.V. (before expenses)	Ps.	\$	\$

The underwriters expect to deliver the ADSs and series B shares to purchasers on or about , 2007.

**Citigroup**

Co-Manager  
**Morgan Stanley**

, 2007

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**You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with different information. If anyone provides you with different information, you should not rely on it. We are not making an offer of these securities in any state where the offer is not permitted. The information in this prospectus is accurate only as of the date of this prospectus.**

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Grupo Simec, S.A.B. de C.V. is a corporation (*sociedad anónima bursatil de capital variable*) organized under the laws of the United Mexican States. Prior to October 24, 2006, our name was Grupo Simec, S.A. de C.V. (*sociedad anónima de capital variable*). Our name change resulted from the recent amendment to our by-laws incorporating the provisions required by the Mexican Securities Market Law.

We publish our financial statements in Mexican pesos and pursuant to accounting principles generally accepted in Mexico (“Mexican GAAP”), which differ in certain respects from accounting principles generally accepted in the United States (“U.S. GAAP”). Note 19 to our audited consolidated financial statements for the years ended December 31, 2005, 2004 and 2003 and Note 16 to our unaudited condensed consolidated financial statements for the six-month period ended June 30, 2006 provide a summary of the principal differences between Mexican GAAP and U.S. GAAP as they relate to our business, along with a reconciliation to U.S. GAAP of net income and stockholders’ equity, and statements of changes in stockholders’ equity and, for the unaudited condensed consolidated financial statements, of cash flows under U.S. GAAP.

Our audited financial statements and all other financial information contained herein with respect to the years ended December 31, 2005, 2004 and 2003 are presented in constant pesos with purchasing power as of June 30, 2006, unless otherwise noted. Our unaudited condensed consolidated interim financial statements for the six-month period ended June 30, 2006, which include comparative unaudited financial information for the six-month period ended June 30, 2005, and all other financial information presented herein with respect to the six-month periods ended June 30, 2006 and 2005 are presented in constant pesos with purchasing power as of June 30, 2006.

We have announced our unaudited results of operations for the nine months ended September 30, 2006. For a description of these unaudited results, see Exhibit I beginning on page I-1. Since we have presented the unaudited financial information set forth in Exhibit I in pesos of constant purchasing power as of September 30, 2006, it is not directly comparable to the financial information presented elsewhere in this prospectus, which unless otherwise stated, we have presented in pesos of constant purchasing power as of June 30, 2006. The financial information presented elsewhere in this prospectus stated in pesos of constant purchasing power as of June 30, 2006 would require the application of a restatement factor of 1.018 for such financial information to be comparable with the unaudited financial information presented in Exhibit I. We do not believe that the application of such factor represents a material change in the purchasing power of the Mexican peso during this period.

In August 2004, we and our subsidiary, Compañía Siderúrgica de California, S.A. de C.V. acquired certain of the Mexican assets of Industrias Ferricas del Norte, S.A. (Corporación Sidenor of Spain or “Grupo Sidenor”). These assets consisted of steel production facilities in Apizaco and Cholula (the “Atlax Acquisition”). The purchase price of these assets was approximately U.S.\$120 million. Our consolidated financial statements reflect the Atlax Acquisition as of August 1, 2004. We consummated the Atlax Acquisition on August 9, 2004. We have not included separate financial information relating to the Atlax Acquisition in this prospectus.

In July 2005, we and our controlling shareholder, Industrias CH, S.A.B. de C.V. (“Industrias CH”), acquired 100% of the stock of PAV Republic, Inc. (“Republic”), a producer of special bar quality (“SBQ”) steel in the United States. We acquired 50.2% of Republic’s stock through our majority owned subsidiary, SimRep Corporation (“SimRep”), and Industrias CH purchased the remaining 49.8% through its minority ownership interest in SimRep.

We have included in this prospectus the audited consolidated financial statements of Republic for the year ended December 31, 2004 and for the period from January 1, 2005 through July 22, 2005 prepared in accordance with U.S. GAAP. We also have included in this prospectus unaudited pro forma condensed combined statements of income reflecting our and Republic's combined accounts on a pro forma basis for the year ended December 31, 2005 and for the six-month period ended June 30, 2005. These pro forma financial statements are unaudited and may not be indicative of the results of operations that we actually would have achieved had we acquired Republic at the beginning of the periods presented and do not purport to be indicative of future results. We have prepared these unaudited pro forma condensed combined statements of income in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP and included a reconciliation to U.S. GAAP net income.

Certain market data and other statistical information used throughout this prospectus are based on third party sources, and other data is based on estimates, which are derived from our review of internal surveys, as well as independent sources. Although we believe that these sources are reliable, we have not independently verified the information and cannot guarantee its accuracy or completeness.

References in this prospectus to "dollars", "U.S. dollars", "\$" or "U.S.\$" are to the lawful currency of the United States. References in this prospectus to "pesos", "Pesos" or "Ps." are to the lawful currency of Mexico. References to "tons" in this prospectus refer to metric tons; a metric ton equals 1,000 kilograms or 2,204 pounds. We publish our financial statements in Pesos.

The terms "special bar quality steel" or "SBQ steel" refer to steel that is hot rolled or cold finished round square and hexagonal steel bars that generally contain higher proportions of alloys than lower quality grades of steel. SBQ steel is produced with precise chemical specifications and generally is made to order following client specifications.

This prospectus contains translations of certain peso amounts to U.S. dollars at specified rates solely for your convenience. These translations do not mean that the peso amounts actually represent such dollar amounts or could be converted into U.S. dollars at the rate indicated. Unless otherwise indicated, we have translated these U.S. dollar amounts from pesos at the exchange rate of Ps. 11.3973 per U.S.\$1.00, the interbank transactions rate in effect on June 30, 2006. On January 16, 2007, the interbank transactions rate for the Peso was Ps. 10.992 per U.S.\$1.00.

**EXCHANGE RATES**

The following table sets forth, for the periods indicated, the high, low, average and period-end, free-market exchange rate expressed in pesos per U.S. dollar. The average annual rates presented in the following table were calculated by using the average of the exchange rates on the last day of each month during the relevant period. The data provided in this table is based on noon buying rates published by the Federal Reserve Bank of New York for cable transfers in Mexican pesos. We have not restated the rates in constant currency units. All amounts are stated in pesos. We make no representation that the Mexican peso amounts referred to in this prospectus could have been or could be converted into U.S. dollars at any particular rate or at all.

**Exchange Rates**

<b>Year Ended December 31</b>	<b>High</b>	<b>Low</b>	<b>Average <sup>(1)</sup></b>	<b>Period End</b>
2002	10.43	9.00	9.66	10.43
2003	11.41	10.11	10.79	11.24
2004	11.64	10.81	11.29	11.15
2005	11.41	10.41	10.89	10.63
2006				
July 2006	11.18	10.87	10.98	10.92
August 2006	11.02	10.74	10.87	10.91
September 2006	11.10	10.84	10.99	10.98
October 2006	11.06	10.71	10.89	10.77
November 2006	11.05	10.75	10.91	11.01
December 2006	10.99	10.77	10.85	10.80
2007				
January 2007 <sup>(2)</sup>	11.02	10.77	10.93	10.99

<sup>(1)</sup> Average of month-end or period-end rates or daily rates, as applicable.

<sup>(2)</sup> Through January 16, 2007.

Except for the period from September through December 1982, during a liquidity crisis, the Mexican Central Bank has consistently made foreign currency available to Mexican private-sector entities (such as us) to meet their foreign currency obligations. Nevertheless, in the event of renewed shortages of foreign currency, there can be no assurance that foreign currency would continue to be available to private-sector companies or that foreign currency needed by us to service foreign currency obligations or to import goods could be purchased in the open market without substantial additional cost.

Fluctuations in the exchange rate between the peso and the U.S. dollar will affect the U.S. dollar value of securities traded on the Mexican Stock Exchange, including the series B shares and, as a result, will likely affect the market price of the ADSs. Such fluctuations will also affect the U.S. dollar conversion by the depository of any cash dividends paid in pesos on series B shares represented by ADSs.



## SUMMARY

*This section summarizes selected information contained elsewhere in this prospectus and is qualified in its entirety by the more detailed information and financial statements included elsewhere in this prospectus. This prospectus includes specific terms of the ADSs and the series B shares that we are offering, as well as information regarding our business and detailed financial information. You should carefully review the entire prospectus, including the risk factors, the financial statements and the notes related thereto and the other documents to which this prospectus refers, before making an investment decision.*

*Unless the context requires otherwise, when used in this prospectus, the terms “we”, “our” and “us” refer to Grupo Simec, S.A.B. de C.V., together with its consolidated subsidiaries.*

### **Our Company**

We are a diversified manufacturer, processor and distributor of special bar quality (“SBQ”) steel and structural steel products with production and commercial operations in the United States, Mexico and Canada.

We believe that we are the leading producer of SBQ products in North America, with leading market positions in both the United States and Mexico and that we offer the broadest SBQ product range in those markets today. We also believe that we are the leading producer of structural and light structural steel products in Mexico and have an increasing presence in the U.S. market. In the first half of 2006, almost all of our consolidated sales were in the North American market, 27.9% in Mexico, 71.9% in the United States and Canada. The remaining 0.2% of our consolidated sales were exports to other markets outside North America.

Our SBQ products are used across a broad range of highly engineered end-user applications, including axles, hubs and crankshafts for automobiles and light trucks, machine tools and off-highway equipment. Our structural steel products are mainly used in the non-residential construction market and other construction applications.

We focus on the Mexican and U.S. specialty steel markets by providing high value added products and services from our strategically located plants. The quality of our products and services, together with the cost advantage generated by our facility locations has allowed us to develop long standing relationships with most of our SBQ clients, which include U.S. and Mexico based automotive and industrial equipment manufacturers and their suppliers. In addition, our facilities located in the North West and Central parts of Mexico allow us to serve the structural steel and construction markets in those regions and southwest California with a significant advantage in the cost of freight.

In Mexico, the United States and Canada, we own and operate ten state of the art steel making, processing and/or finishing facilities with a combined annual crude steel installed production capacity of 3.4 million tons and a combined annual installed rolling capacity of 2.9 million tons. We operate both mini-mill and integrated steel making facilities, which gives us the flexibility to optimize our production and reduce production costs based on the relative prices of raw materials (e.g., scrap for our mini-mills and iron ore for our blast furnace).

In the first half of 2006, we had net sales of Ps. 11.9 billion, marginal profit of Ps. 2.2 billion and net income attributable to majority interest of Ps. 1.3 billion. In 2005, we had net sales of Ps. 13.0 billion, marginal profit of Ps. 2.6 billion and net income attributable to majority interest of Ps. 1.3 billion.

The chart outlines our corporate structure:

Chart below

- 
- (1) Includes the following non-operating subsidiaries: Compañía Siderúrgica del Pacífico, S.A. de C.V. (99.99%), Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V. (100%), Administradora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V. (99.99%), Industrias del Acero y del Alambre, S.A. de C.V. (99.99%), Procesadora Mexicali, S.A. de C.V. (99.99%), Servicios Simec, S.A. de C.V. (100%), Sistemas de Transporte de Baja California, S.A. de C.V. (100%), Operadora de Metales, S.A. de C.V. (100%), Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V. (100%), Administradora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V. (100%), Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V. (100%), Arrendadora Simec S.A. de C.V. (100%), Controladora Simec S.A. de C.V. (100%) and Compañía Siderúrgica de Guadalajara S.A. de C.V. (100%).
  - (2) Our principal Mexican facilities consist of steel-making facilities in Guadalajara, Jalisco, Mexicali, Baja California, and Apizaco, Tlaxcala, and a cold finishing facility in Cholula, Puebla.
  - (3) The remaining 49.8% of SimRep Corporation is owned by our controlling shareholder, Industrias CH, S.A.B. de C.V.
  - (4) SimRep owns 100% of Republic Engineered Products through its 100% interest in PAV Republic Inc. Our principal U.S. and Canadian facilities consist of a steel-making facility in Canton, Ohio, a steel-making and hot-rolling facility in Lorain, Ohio, a hot-rolling facility in Lackawanna, New York, and cold finishing facilities in Massillon, Ohio, Gary, Indiana, and Hamilton, Ontario, Canada.

## **Our Competitive Strengths**

We believe the following are our principal competitive strengths:

### ***Leading SBQ producer in North America.***

We believe we have been the leading market producer and supplier of SBQ steel in Mexico since August 2004 and in the United States since July 2005. In 2005, we supplied approximately 28% of the Mexican market and 20% of the U.S. market.

### ***Higher value-added product mix.***

To maximize operating margins, we focus our production on higher value-added SBQ products, which represented 79% of our total sales in the first six months of 2006.

### ***Long-standing customer relationships.***

Our SBQ products are highly engineered and tailored to specific client needs. We continuously work with our clients on design engineering and new product development to meet the requirements of their evolving platforms. We believe that the quality of our products and services allows us to develop long lasting direct relationships with the largest end-users of SBQ products in North America, which, we believe, increases switching costs and improves our competitive position.

### ***Reduced price volatility.***

The quality requirements of the majority of our SBQ clients and the nature of our relationships have allowed us to implement favorable pricing policies that include annual price revisions and price adjustments based on the price of key inputs such as scrap, iron ore, energy, alloys and other key raw materials. These contribute to maintaining operating margins against raw material price fluctuations relatively stable.

### ***Competitive cost structure.***

We believe our cost structure is highly favorable due to our:

- *Competitive cost of raw materials.* We believe our centralized purchasing strategy and strong financial position allow us to obtain favorable terms from our raw materials suppliers.
- *Low freight expenses.* We believe the strategic location of our facilities allows us to serve our SBQ steel and other clients with lower distribution and freight costs than most of our competitors.
- *Relatively low cost of labor in Mexico.* Our Mexican operations benefit from the relatively lower cost of labor in the Mexican market compared to the United States. In addition, our Mexican, U.S. and Canadian operations do not currently have any significant legacy liabilities or their associated costs.
- *Favorable labor agreement in the United States.* The labor agreement in place in our U.S. operations has eliminated legacy costs and enhances our ability to maximize workforce flexibility, allowing us to reduce production costs.

· *Lean operational structure and overhead cost.* We maintain non-operating costs at low levels by relying on a lean and cost efficient overhead structure.

***State-of-the-art production facilities.***

We have recently completed the revamping of our mini-mill steel-making facility in Canton, Ohio including the installation of a new continuous caster. We believe that our remaining steel making and processing facilities in Mexico and the United States are among the most modern and well maintained in North America.

***Extensive track record of profitable growth.***

Over the last two years we have significantly increased our installed capacity through the acquisition of Republic and of plants in Tlaxcala and Cholula, Mexico. As a result of these acquisitions, organic growth and operational improvements, we have increased our installed capacity from 0.7 million tons as of December 31, 2003 to 3.4 million tons of crude steel as of June 30, 2006.

***Significant organic growth opportunities.***

Our liquid steel making capacity exceeds our rolling and finished steel capacity, which allows us to continue increasing our finished product capacity through comparatively low levels of capital investments. We intend to pursue this option and plan to invest approximately U.S.\$250 million in a rolling mill with an annual capacity of 600,000 tons in our facilities. We also intend to explore expanding our liquid steel-making facilities in Lorain, Ohio by bringing an existing second blast furnace online at a cost significantly lower than that of purchasing a new blast furnace with the same capacity.

***Solid financial position.***

We seek to maintain a conservative capital structure and prudent leverage levels. We currently have no significant financial debt or significant legacy liabilities. We believe that these factors, combined with our strong cash flow generation, provide us with the financial flexibility and resources to continue to pursue growth enhancing initiatives.

***Experienced and committed management team.***

Our management team has extensive experience in, and knowledge of, the North American steel industry and in evaluating, pursuing and completing both strategic and organic growth opportunities as well as a track-record of increasing productivity and reducing costs.

## **Our Business Strategy**

We intend to consolidate further our position as a leading producer, processor and distributor of SBQ steel in North America and structural steel in Mexico. We also intend to expand our overall presence in the steel industry by identifying and pursuing growth opportunities and value enhancing initiatives. Our strategy includes:

### ***Further integrating our operations.***

We intend to continue the integration of our Mexican, U.S. and Canadian operations to capitalize on the commercial and cost related synergies contemplated at the time of the Atlax Acquisition in 2004 and the acquisition of Republic in 2005.

### ***Improving our cost structure.***

We have substantially reduced our operating cost and non-operating expenses and plan to continue to do so by reducing overhead expenses and operating costs through sharing best practices among our operating facilities and maintaining a conservative capital structure.

### ***Focusing on high margin and value-added products.***

We prioritize the production of high margin steel products over volume and utilization levels. We plan to continue to base our production decisions on achieving relatively high margins.

### ***Building on our strong customer relationships.***

We intend to strengthen our long-standing customer relationships by maintaining strong customer service and proactively responding to changing customer needs.

### ***Pursuing strategic growth opportunities.***

We have successfully grown our business by acquiring, integrating and improving under-performing operations. In addition, we intend to continue in pursuit of acquisition opportunities that will allow for disciplined growth of our business and value creation for our shareholders. We also intend to pursue organic growth by reinvesting the cash that our operating activities generate to expand the capacity and increase the efficiency of our existing facilities.

### ***Risks Related to Our Business***

Our business is subject to certain risks that could impact our competitive position and strengths, as well as our ability to execute our business strategy. Many of these risks are beyond our control, such as factors affecting the global demand for steel products, our exposure to the fluctuations in the cost of raw materials, our dependence on a limited number of key suppliers of raw materials and the cyclical nature of the industries and markets that we serve. Furthermore, these risks include those generally associated with being a producer of steel products in Mexico, the United States and Canada, including foreign exchange exposure and political risk. Intense competition from other steel producers could reduce our market share in the countries where we operate, and the capital intensive nature of the steel industry. Our dependence on the availability of capital resources to continue to modernize and upgrade our facilities and to expand our operations could affect the implementation of our strategy. For additional risks relating to our business and this offering, see “Risk Factors” beginning on page 16 of this prospectus.

**The Offering**

Issuer	Grupo Simec, S.A.B. de C.V.
Securities offered	A total of 52,173,914 series B shares which include series B shares in the form of ADSs in an international offering and series B shares in an offering in Mexico.
Public offering price per series B share	Ps.
Public offering price per ADS	\$
International offering	The underwriters are offering an aggregate amount of series B shares in the form of ADSs in the United States and other countries outside of Mexico.
Mexican offering	Simultaneously with the international offering, the Mexican underwriters are offering an aggregate amount of series B shares in a public offering in Mexico.
ADSs	Each ADS represents three series B shares. The ADSs will be evidenced by American depositary receipts, or ADRs, issued under the deposit agreement. ADRs are certificates that evidence ADSs, just as share certificates evidence a holding of shares in a company. See “Description of American Depositary Receipts”.
Trading market for series B shares	The series B shares are listed on the Mexican Stock Exchange under the symbol “SIMEC.B”.
Trading market for ADSs	The ADSs are listed on the American Stock Exchange under the symbol “SIM”.
Use of proceeds	We expect to use the net proceeds from the sale of the ADSs and series B shares for general corporate purposes, including investments in fixed assets aimed at increasing our installed capacity in our core business as well as potential acquisitions intended to increase our market share and complement our business strategy.
Depositary	The Bank of New York
Expected offering timetable	Expected pricing date: February , 2007 Expected closing date: February , 2007

Settlement	Settlement of the series B shares will be made through the book-entry system of S.D. Indeval, S.A. de C.V., <i>Institución para el Depósito de Valores</i> (“INDEVAL”). Settlement of the ADSs will be made through the book-entry system of The Depository Trust Company, or DTC.
Lock-up provision	We, our officers and directors and our principal shareholders have agreed that, for a period of 180 days from the date of this prospectus, we and they will not, without the prior written consent of the representative of the underwriters, dispose of or hedge any series B shares or any securities convertible into or exchangeable for our series B shares. The representative of the underwriters, in its sole discretion, may release any of the securities subject to these lock-up agreements at any time without notice. See “Underwriting”.
Voting rights	Each series B share will entitle the holder to one vote at any shareholders’ meeting. ADS holders may instruct the depository how to exercise the voting rights of the shares represented by the ADSs. For the benefit of ADS holders, we have agreed to notify the depository of any shareholders’ meetings, and the depository has agreed to mail notices of these meetings to ADS holders and explain the procedures necessary to exercise voting rights. See “Description of American Depositary Receipts” and “Description of Capital Stock” for a discussion of the depository’s role, our agreement with the depository and your voting rights.
Dividend policy	We have not paid dividends in the past and currently do not intend to pay dividends in the near future. See “Dividends and Dividend Policy”.
Taxation	Under current Mexican law, dividends paid to holders who are not residents of Mexico for tax purposes, and sales of ADSs by ADS holders who are not residents of Mexico for tax purposes, are not subject to any Mexican withholding or other similar tax. See “Taxation” for a discussion of Mexican tax issues related to payment of dividends and disposition of the series B shares or the ADSs.
Risk Factors	Investing in the ADSs and series B shares involves a high degree of risk. You should carefully read and consider the information set forth under the heading “Risk Factors” and all other information set forth in this prospectus before investing in the series B shares or the ADSs.

### **Summary Consolidated Financial Information**

The following tables present our summary consolidated financial information for each of the periods indicated. This information should be read in conjunction with, and is qualified in its entirety by reference to, our financial statements, including the notes thereto, as well as “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included elsewhere in this prospectus. Our financial statements are prepared in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP. Note 19 to our audited consolidated financial statements for the years ended December 31, 2005, 2004 and 2003 and Note 16 to our unaudited condensed consolidated financial statements for the six-month period ended June 30, 2006 provide a summary of the principal differences between Mexican GAAP and U.S. GAAP as they relate to our business, along with a reconciliation to U.S. GAAP of net income and stockholders’ equity, a statement of changes in stockholders’ equity and, for the unaudited condensed consolidated financial statements, a statement of cash flows under U.S. GAAP.

Mexican GAAP provides for the recognition of certain effects of inflation by restating non-monetary assets and non-monetary liabilities using the Mexican National Consumer Price Index, restating the components of stockholders’ equity using the Mexican National Consumer Price Index and recording gains or losses in purchasing power from holding monetary liabilities or assets. Mexican GAAP also requires the restatement of all financial statements to constant Mexican pesos as of the date of the most recent balance sheet presented. Our audited financial statements and all other financial information contained herein with respect to the years ended December 31, 2001, 2002, 2003, 2004 and 2005 are accordingly presented in constant pesos with purchasing power as of June 30, 2006, unless otherwise noted. Our unaudited condensed interim financial statements for the six-month period ended June 30, 2006, which include comparative unaudited financial information for the six-month period ended June 30, 2005, and all other financial information presented herein with respect to the six-month periods ended June 30, 2006 and 2005 are presented in constant pesos with purchasing power as of June 30, 2006. Our results of operations for the six-month period ended June 30, 2006 are not necessarily indicative of our expected results of operations for the year ended December 31, 2006 and should not be construed as such.

The financial information includes the consolidation of Republic from July 22, 2005 and the consolidation of the Atlax Acquisition from August 1, 2004. Period to period comparison of our results of operations and financial condition is made more difficult as a result of the inclusion of financial information relating to the acquisition of Republic only from July 22, 2005 and of financial information relating to the Atlax Acquisition only from August 1, 2004.

We have derived the selected financial and operating information set forth below in part from our consolidated financial statements, which have been reported on by KPMG Cárdenas, Dosal, S.C. for the fiscal years ended December 31, 2001, 2002, 2003 and 2004 and by Mancera S.C., a Member Practice of Ernst & Young Global, an independent registered public accounting firm for the fiscal year ended December 31, 2005. In so doing, Mancera, S.C. has relied on the audited consolidated financial statements of our subsidiary SimRep and its subsidiaries, reported on by BDO Hernández Marrón y Cía., S.C., a member firm of BDO International.

For unaudited selected consolidated financial information as of September 30, 2006 and for the nine month periods ended September 30, 2005 and 2006, and a discussion of our unaudited financial results for the nine month periods ended September 30, 2005 and 2006, which are presented in pesos of constant purchasing power as of September 30, 2006, see Exhibit I to this prospectus. Since the unaudited financial information set forth in Exhibit I is presented in pesos of constant purchasing power as of September 30, 2006, it is not directly comparable to the financial information presented elsewhere in this prospectus, which unless otherwise stated, is presented in pesos of constant purchasing power as of



June 30, 2005. The financial information presented elsewhere in this prospectus stated in pesos of constant purchasing power as of June 30, 2006 would require the application of a restatement factor of 1.018 for such financial information to be comparable with the unaudited financial information presented in Exhibit I. We do not believe that the application of such factor represents a material change in the purchasing power of the Mexican peso during this period.

2001	Year Ended December 31,					Six Months Ended June 30,			
	2002	2003	2004	2005	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>	
	(Millions of constant June 30, 2006 pesos)					(Millions of constant June 30, 2006 pesos)	(Millions of constant June 30, 2006 pesos)		
						(Millions of constant June 30, 2006 pesos)			
	(except per share and per ADS data)								

**Income Statement****Data:***Mexican GAAP:*

Net sales	2,288	2,403	3,047	5,910	12,967	1,138	3,574	11,912	1,045
Direct cost of sales	1,536	1,608	2,002	3,435	10,371	910	2,327	9,682	849
Marginal profit	752	795	1,045	2,475	2,596	228	1,247	2,230	196
Indirect manufacturing, selling, general and administrative expenses	376	327	308	371	692	61	244	462	41
Depreciation and amortization	160	177	199	222	326	29	131	202	18
Operating income	216	291	538	1,882	1,578	138	872	1,566	137
Financial income (expense)	6	(141)	(27)	(38)	(145)	(13)	(35)	45	4
Other income (expense), net	73	(41)	(32)	(38)	55	5	8	33	3
Income before taxes, employee profit sharing and minority interest	295	109	479	1,806	1,488	131	845	1,644	144
Income tax expense and employee profit sharing	19	(25)	159	344	191	17	98	105	9
Net income (loss)	276	134	320	1,462	1,297	114	747	1,539	135
Minority interest	0	0	0	0	17	2	0	193	17
Majority interest	276	134	320	1,462	1,280	112	747	1,346	118
Net income per share	2	0.4	1	4	3	0.27	2	3	0.28
Net income per ADS <sup>(2)</sup>	5	1	3	11	9	0.81	6	10	0.84
Weighted average shares outstanding (thousands) <sup>(5)</sup>	164,448	299,901	357,159	398,916	413,790		405,209	419,451	
Weighted average ADSs outstanding (thousands)	54,816	99,967	119,053	132,972	137,930		135,070	139,817	

*U.S. GAAP**including effects of inflation:*

Net sales	2,288	2,403	3,048	5,911	12,967	1,138	3,573	11,912	1,045
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Direct cost of sales	1,530	1,612	2,007	3,429	10,375	910	2,329	9,594	842
Marginal profit	758	791	1,041	2,482	2,592	228	1,244	2,318	203
Operating income <sup>(4)</sup>	200	255	544	1,865	1,544	135	875	1,660	146
Financial income (expense)	7	(141)	(27)	(38)	(145)	(13)	(35)	45	4
Other income (expense), net	657	(74)	(32)	(4)	93	8	8	33	3
Income before taxes, employee profit sharing and minority interest	864	40	485	1,823	1,492	130	848	1,737	152
Income tax expense (income)	69	(182)	207	389	197	17	102	118	10
Income before minority interest	795	222	278	1,434	1,295	113	746	1,619	142
Minority interest	0	0	0	0	17	1	0	193	17
U.S. GAAP Adjustment on minority interest	0	0	0	0	0	0	0	40	3
Net Income	795	222	278	1,434	1,278	112	746	1,386	125
Income per share <sup>(5)</sup>	5	1	1	4	3	0.27	2	3.3	0.30
Income per ADS	14	2	2	11	9	0.81	6	10	0.89

**Balance Sheet**

**Data:**

*Mexican GAAP:*

Total assets	5,557	5,035	6,570	9,306	14,588	1,280	9,531	16,439	1,442
Total long-term liabilities <sup>(3)</sup>	803	881	1,153	1,513	2,244	197	1,439	2,003	176
Total stockholders' equity	3,338	4,089	5,062	6,848	9,628	845	7,368	11,902	1,044

	Year Ended December 31,					Six Months Ended June 30,				
	2001	2002	2003	2004	2005	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>	
	(Millions of constant June 30, 2006 pesos)					(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)	
	(except per share and per ADS data)									

*U.S. GAAP including effects of inflation:*

Total assets	6,507	6,228	6,497	9,173	14,796	1,298	9,548	16,421	1,441
Total long-term liabilities <sup>(3)</sup>	803	914	1,097	1,476	2,303	202	1,426	1,974	173
Total stockholders' equity	3,949	4,338	5,045	6,752	7,969	699	7,442	9,613	843

**Other Data:**

*Mexican GAAP:*

Capital expenditures	46	10	65	1,285	503	44	6	167	15
Adjusted EBITDA <sup>(6)</sup>	376	468	737	2,104	1,904	167	1,003	1,768	155
Depreciation and amortization from continuing operations	160	177	199	222	326	29	131	202	18
Working capital	(560)	(11)	1,023	1,968	4,063	356	2,907	5,854	514

**Operational information:**

Annual installed capacity (thousands of tons)	730	730	730	1,210	2,847	1,210	2,902		
Tons shipped	561	609	628	773	1,708	524	1,369		
Mexico	512	529	547	676	899	449	461		
United States, Canada and others	49	80	81	97	809	75	908		
SBQ steel	78	78	63	168	923	170	997		
Structural and other steel products	483	531	565	605	785	352	372		
Per ton:									
Net sales per ton	4,080	3,943	4,851	7,644	7,591	666	6,825	8,699	763
Cost of sales per ton	2,740	2,639	3,187	4,442	6,072	533	4,443	7,070	620
Operating income per ton	385	476	857	2,435	924	81	1,666	1,144	100
Adjusted EBITDA per ton	670	767	1,174	2,722	1,115	98	1,916	1,291	113
Number of employees	1,386	1,333	1,288	2,018	4,360	1,975		4,340	

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 11.3973 per \$1.00, the interbank transactions rate in effect on June 30, 2006.

(2) Following our stock split effective May 30, 2006, one ADS represents three series B shares; previously one ADS represented one series B share.

(3) Total long-term liabilities include amounts relating to deferred taxes.

(4) Reflects a reclassification in 2005 from other expenses under Mexican GAAP to operating expenses under U.S. GAAP of Ps. 38 million due to the cancellation of technical assistance.

(5) For U.S. GAAP and Mexican GAAP purposes, the weighted average shares outstanding were calculated to give effect to the stock split described in Note 13(a) to the audited financial statements.

(6) Adjusted EBITDA is not a financial measure computed under Mexican or U.S. GAAP. Adjusted EBITDA derived from our Mexican GAAP financial information means Mexican GAAP net income (loss) excluding (i) depreciation and amortization, (ii) financial income (expense), net (which is composed of net interest expense, foreign exchange gain or loss and monetary position gain or loss), (iii) other income (expense) and (iv) income tax expense and employee statutory profit-sharing expense.

Adjusted EBITDA does not represent, and should not be considered as, an alternative to net income, as an indicator of our operating performance, or as an alternative to cash flow as an indicator of liquidity. In making such comparisons, however, you should bear in mind that adjusted EBITDA is not defined and is not a recognized financial measure under Mexican GAAP or U.S. GAAP and that it may be calculated differently by different companies and must be read in conjunction with the explanations that accompany it. Adjusted EBITDA as presented in this table does not take into account our working capital requirements, debt service requirements and other commitments.

We believe that adjusted EBITDA can be useful to facilitate comparisons of operating performance between periods and with other companies in our industry because it excludes the effect of (i) depreciation and amortization, which represents a non-cash charge to earnings, (ii) certain financing costs, which are significantly affected by external factors, including interest rates, foreign currency exchange rates, and inflation rates, which have little or no bearing on our operating performance, (iii) other income (expense) that are not constant operations and (iv) income tax expense and employee statutory profit-sharing expense. However, adjusted EBITDA has certain material limitations, including that (i) it does not include taxes, which are a necessary and recurring part of our operations; (ii) it does not include depreciation and amortization, which, because we must utilize property, equipment and other assets in order to generate revenues in our operations, is a necessary and recurring part of our costs; (iii) it does not include comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenue; and (iv) it does not include

other income and expenses that are part of our net income. Therefore, any measure that excludes any or all of taxes, depreciation and amortization, comprehensive cost of financing and other income and expenses has material limitations.

Adjusted EBITDA should not be considered in isolation or as a substitute for net income, net cash flow from operating activities or net cash flow from investing and financing activities. Reconciliation of net income to adjusted EBITDA is as follows:

	<b>Year Ended December 31,</b>					<b>Six Months Ended June 30,</b>				
<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2005<sup>(1)</sup></b>	<b>2005</b>	<b>2006</b>	<b>2006<sup>(1)</sup></b>		
	(Millions of constant June 30, 2006 pesos)					(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)	
	(except per share and per ADS data)									
<i>Mexican GAAP:</i>										
Net income	276	134	320	1,462	1,297	114	747	1,539	135	
Depreciation and amortization	160	177	199	222	326	28	131	202	18	
Financial income (expense)	6	(141)	(27)	(38)	(145)	(13)	(35)	45	4	
Income tax expense and employee profit sharing	19	(25)	159	344	191	17	98	105	9	
Other income (expense)	73	(41)	(32)	(38)	55	5	8	33	3	
Adjusted EBITDA	376	468	737	2,104	1,904	167	1,003	1,768	155	

**SUMMARY PRO FORMA COMBINED FINANCIAL INFORMATION**

The following tables present our and Republic's unaudited pro forma condensed combined pro forma financial information reflecting our and Republic's combined accounts on a pro forma basis as of and for the periods indicated.

Also included in this prospectus, beginning on Page F-153, are unaudited pro forma condensed combined statements of income reflecting our and Republic's combined accounts on a pro forma basis for the year ended December 31, 2005 and for the six-month period ended June 30, 2005.

All pro forma financial information included in this prospectus is unaudited and may not be indicative of the results of operations that actually would have been achieved had we acquired Republic at the beginning of the periods presented and do not purport to be indicative of future results. The information in the following tables should also be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations".

The unaudited pro forma condensed combined financial information is prepared in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP.

For additional information regarding financial information presented in this prospectus, see "Presentation of Financial and Other Information".

	<b>Pro Forma</b>		<b>Actual</b>		
	<b>Year Ended December 31, 2005</b>	<b>2005<sup>(1)</sup></b>	<b>Six Months Ended June 30,</b>		<b>2006<sup>(1)</sup></b>
(Millions of constant June 30, 2006 pesos)	(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)	
		(except per share and per ADS data)			
<b>Income Statement Data:</b>					
<i>Mexican GAAP:</i>					
Net sales	22,380	1,964	12,388	11,912	1,045
Direct cost of sales	18,556	1,628	9,987	9,682	849
Marginal profit	3,824	336	2,401	2,230	196
Indirect manufacturing, selling, general and administrative expenses	1,246	109	707	462	41
Depreciation and amortization	339	30	144	202	18
Operating income	2,239	196	1,550	1,566	137
Financial income (expense)	(234)	(21)	(120)	45	4
Other income (expense), net	45	4	34	33	3
Income before taxes, employee profit sharing and minority interest	2,050	180	1,464	1,644	144
Income tax expense and employee profit sharing	390	34	323	105	9
Net income (loss)	1,660	146	1,141	1,539	135
Minority interest	198	17	196	193	17
Majority interest	1,462	128	945	1,346	118
Net income per share	4	0.31	2	3	0.28
Net income per ADS <sup>(2)</sup>	11	0.93	7	10	0.84
Weighted average shares outstanding (thousands) <sup>(5)</sup>	413,790		405,209	419,451	





	Pro Forma		Actual		
	Year Ended December		Six Months Ended June 30,		
	31,		2005	2006	2006 <sup>(1)</sup>
	2005	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>
(Millions of constant June 30, 2006 pesos)	(Millions of dollars)	(Millions of constant June 30, 2006 pesos)	(Millions of constant June 30, 2006 pesos)	(Millions of constant June 30, 2006 pesos)	(Millions of dollars)
		(except per share and per ADS data)			
Weighted average ADSs outstanding (thousands)	137,930		135,070	139,817	
<i>U.S. GAAP including effects of inflation:</i>					
Net sales	22,380	1,964	12,388	11,912	1,045
Operating income <sup>(4)</sup>	2,239	196	1,550	1,660	146
Minority interest	198	17	196	193	17
Net Income	1,462	128	945	1,386	122
Income per share <sup>(5)</sup>	4	0.37	2	3	0.29
Income per ADS	11	0.93	7	10	0.87

**Other Data:***Mexican GAAP:*

Capital expenditures	503	5	6	167	15
Adjusted EBITDA <sup>(6)</sup>	2,578	226	1,694	1,768	155
Depreciation and amortization from continuing operations	339	30	144	202	18

**Operational information:**

Annual installed capacity (thousands of tons)	2,847		2,847	2,902	
Tons shipped	2,683		1,400	1,369	
Mexico	910		449	461	
United States, Canada and others	1,773		951	908	
SBQ steel	1,936		1,047	997	
Structural and other steel products	747		352	372	
Per ton:					
Net sales per ton	8,341	732	8,849	8,699	763
Cost of sales per ton	6,916	607	7,134	7,070	620
Operating income per ton	835	73	1,107	1,144	100
Adjusted EBITDA per ton	961	84	1,210	1,291	113
Number of employees	4,360		1,975	4,340	

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 11.3973 per \$1.00, the interbank transactions rate in effect on June 30, 2006.

(2) Following our a stock split effective May 30, 2006, one ADS represents three series B shares; previously, one ADS represented one series B share.

(3) Long-term debt includes amounts relating to deferred taxes.

(4) Reflects a reclassification in 2005 from other expenses under Mexican GAAP to operating expenses under U.S. GAAP of Ps. 38 million due to the cancellation of technical assistance.

(5) For U.S. GAAP and Mexican GAAP purposes, the weighted average shares outstanding were calculated to give effect to the stock split described in Note 13(a) to the Consolidated Financial Statements.

(6) Adjusted EBITDA is not a financial measure computed under Mexican or U.S. GAAP. Adjusted EBITDA derived from our Mexican GAAP financial information means Mexican GAAP net income (loss) excluding (i) depreciation and amortization, (ii) financial income (expense), net (which is composed of net interest expense, foreign exchange gain or loss and monetary position gain or loss), (iii) other income (expense) and (iv) income tax expense and employee statutory profit-sharing expense.

Adjusted EBITDA does not represent, and should not be considered as, an alternative to net income, as an indicator of our operating performance, or as an alternative to cash flow as an indicator of liquidity. In making such comparisons, however, you should bear in mind that adjusted EBITDA is not defined and is not a recognized financial measure under Mexican GAAP or U.S. GAAP and that it may be calculated differently by different companies and must be read in conjunction with the explanations that accompany it. Adjusted EBITDA as presented in this table does not take into account our working capital requirements, debt service requirements and other commitments.

We believe that adjusted EBITDA can be useful to facilitate comparisons of operating performance between periods and with other companies in our industry because it excludes the effect of (i) depreciation and amortization, which represents a non-cash charge to earnings, (ii) certain financing costs, which are significantly affected by external factors, including interest rates, foreign currency exchange rates, and inflation rates, which have little or no bearing on our operating performance, (iii) other income (expense) that are not constant operations and (iv) income tax expense and employee statutory profit-sharing expense. However, adjusted EBITDA has certain material limitations, including that (i) it does not include taxes, which are a necessary and recurring part of our operations; (ii) it does not include depreciation and amortization, which, because we must utilize property, equipment and other assets in order to generate revenues in our operations, is a necessary and recurring part of our costs; (iii) it does not include comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenue; and (iv) it does not include other income and expenses that are part of our net income. Therefore, any measure that excludes any or all of taxes, depreciation and amortization, comprehensive cost of financing and other income and expenses has material limitations.

Adjusted EBITDA should not be considered in isolation or as a substitute for net income, net cash flow from operating activities or net cash flow from investing and financing activities. Reconciliation of net income to adjusted EBITDA is as follows:

	Pro Forma			Actual	
	Year Ended December 31,		2005 (Millions of constant June 30, 2006 pesos)	Six Months Ended June 30,	
	2005 (Millions of constant June 30, 2006 pesos)	2005 (Millions of dollars)		2006	2006 (Millions of dollars)
<i>Mexican GAAP:</i>					
Net income	1,660	146	1,141	1,539	135
Depreciation and amortization	339	30	144	202	18
Financial income (expense)	(234)	(20)	(120)	45	4
Income tax expense and employee profit sharing	390	34	323	105	9
Other income (expense)	45	4	34	33	3
Adjusted EBITDA	2,578	226	1,694	1,768	155

## **RISK FACTORS**

*Investing in the series B shares and the ADSs involves a high degree of risk. You should consider carefully the following risks, as well as all the other information presented in this prospectus, before making an investment decision. Any of the following risks, if they were to occur, could materially and adversely affect our business, results of operations, prospects and financial condition. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also materially and adversely affect our business, results of operations, prospects and financial condition. In either event, the market price of our series B shares and ADSs could decline, and you could lose all or part of your investment.*

### **Risks Related to Our Business**

*We may not be able to pass along price increases for raw materials to our customers to compensate for fluctuations in price and supply.*

Prices for raw materials necessary for production have fluctuated significantly in the past and significant increases could adversely affect our margins. During periods when prices for scrap metal, iron ore, alloys, coke and other important raw materials have increased, our industry historically has sought to maintain profit margins and pass along increased raw materials costs to customers by means of price increases.

We may not be able to pass along these and other possible cost increases in the future and, therefore, our margins and profitability may be adversely affected. Even when we can successfully apply surcharges, interim reductions in profit margins frequently occur due to a time lag between the increase in raw material prices and the market acceptance of higher selling prices for finished steel products. We cannot assure you that any of our future customers will agree to pay increased prices based on surcharges or that any of our current customers will continue to pay such surcharges.

*Implementing our growth strategy, which may include acquisitions, may adversely affect our operations.*

As part of our growth strategy, we may need to expand our existing facilities, build additional plants, acquire other steel assets, enter into joint ventures or form strategic alliances that we expect will expand or complement our existing business. If any of these transactions occur, they will likely involve some or all of the following risks:

- disruption of our ongoing business;
- diversion of our resources and of management's time;
- decreased ability to maintain uniform standards, controls, procedures and policies;
- difficulty managing the operations of a larger company;
- increased likelihood of involvement in labor, commercial or regulatory disputes or litigation related to the new enterprise;
- potential liability to joint venture participants or to third parties;

- difficulty competing for acquisitions and other growth opportunities with companies having greater financial resources; and
- difficulty integrating the acquired operations and personnel into our existing business.

Our operations are capital intensive. We require capital for, among other purposes, acquiring new equipment, maintaining existing equipment and complying with environmental laws and regulations. We may not be able to fund our capital expenditures from operating cash flow or from borrowings. If we are unable to fund our capital requirements we may not be able to implement our business plan.

We intend to continue to pursue a growth strategy, the success of which will depend in part on our ability to acquire and integrate additional facilities. Some of these acquisitions may be outside of Mexico. Acquisitions involve a number of special risks that could adversely affect our business, financial condition and results of operations, including the diversion of management's attention, the assimilation of the operations and personnel of the acquired facilities, the assumption of legacy liabilities and the potential loss of key employees. We cannot assure you that any acquisition we make will not materially and adversely affect us or that any such acquisition will enhance our business. We are unable to predict the likelihood of any additional acquisitions being proposed or completed in the near future or the terms of any such acquisitions. If we determine to make any significant acquisition, we may be required to sell additional equity or debt securities or obtain additional credit facilities, which could result in additional dilution to our stockholders. There can be no assurance that adequate equity or debt financing would be available to us for any such acquisitions.

***We may not be able to integrate successfully our recently acquired steel facilities into our operations.***

In 2005, we and our controlling shareholder, Industrias CH, acquired 100% of the stock of Republic, a U.S. producer of SBQ steel. We acquired 50.2% of Republic's stock through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% through SimRep. Our future success will depend in part on our ability to integrate the operations of Republic successfully into our historic operations. Furthermore, while we have not yet encountered any material problems related to the assets acquired, there can be no assurance that problems will not arise in the future and that the costs associated with those problems, should they arise, will not be significant.

***We face significant price and industry competition from other steel producers, which may adversely affect our profitability and market share.***

Competition in the steel industry is significant. Continuous advances in materials sciences and resulting technologies have given rise to products such as plastics, aluminum, ceramics and glass, all of which compete with steel products. Competition in the steel industry exerts a downward pressure on prices, and, due to high start-up costs, the economics of operating a steel mill on a continuous basis may encourage mill operators to establish and maintain high levels of output even in times of low demand, which further decreases prices and profit margins. The recent trend of consolidation in the global steel industry may increase competitive pressures on independent producers of our size if large steel producers formed through consolidations adopt predatory pricing strategies that decrease prices and profit margins even further. If we are unable to remain competitive with these producers, our market share and financial performance may be adversely affected.

Approximately 27.9% of our sales for the six-months ended June 30, 2006 were in Mexico, where we face strong competition from other Mexican steel producers. A number of our Mexican competitors have undertaken modernization and expansion plans, including the installation of production facilities and



manufacturing capacity for certain products that will compete with our products. As these producers become more efficient, we may experience increased competition from them and a loss of market share. In addition, we face competition from international steel producers. Increased international competition, especially when combined with excess production capacity, could force us to lower our prices or to offer increased services at a higher cost to us, which could reduce our gross margins and net income.

Since most of our sales are in the United States and Canada, we also face strong competition from other steel producers. A number of our competitors have undertaken modernization and expansion plans, including the installation of production facilities and manufacturing capacity for certain products that will compete with our products. As these producers become more efficient, we may experience increased competition from them and a loss of market share. In addition, we face competition from international steel producers. Increased international competition, especially when combined with excess production capacity, could force us to lower our prices or to offer increased services at a higher cost to us, which could reduce our gross margins and net income.

***We depend on distributions from our operating subsidiaries to finance our operations.***

We need to receive sufficient funds from our subsidiaries for a substantial portion of our internal cash flow, including cash flow to fund any future investment plans and to service our future financial obligations. As a result, our cash flow will be adversely affected if we do not receive dividends and other income from our subsidiaries. The ability of most of our subsidiaries to pay dividends and make other transfers to us may be restricted by any indebtedness that we may incur or by Mexican law. Any such reduction in cash flow could materially adversely affect us.

***The operation of our facilities depends on good labor relations with our employees.***

At September 30, 2006, approximately 83% of our non-Mexican and 59% of our Mexican employees were members of unions. Collective bargaining agreements are typically negotiated on a facility by facility basis for our Mexican facilities. The compensation terms of our labor contracts are adjusted on an annual basis, and all other terms of the labor contracts are renegotiated every two years. Any failure to reach an agreement on new labor contracts or to negotiate these labor contracts might result in strikes, boycotts or other labor disruptions. These potential labor disruptions could have a material adverse effect on our results of operations and financial condition. There have been no labor disruptions in the past five years in our Mexicali and Guadalajara facilities, and there have been no labor disruptions in the Apizaco and Cholula facilities or our U.S. and Canadian facilities since we acquired them in 2004 and 2005, respectively. Labor disruptions, strikes or significant negotiated wage increases could reduce our sales or increase our cost, and accordingly could have a material adverse effect on our business.

***Operations at our Lackawanna, New York facility depend on our right to use certain property and assets of an adjoining facility that the Mittal Steel Company N.V. ("Mittal Steel") owns. The termination of any such rights could interrupt our operations and have a material adverse effect on our results of operations and financial condition.***

The operations at our Lackawanna facility depend on certain easements and other recorded agreements that the International Steel Group Inc. made in our favor relating to, among other things, use of certain oxygen pipelines, engine rooms, water pipelines, natural gas and compressed air distribution systems and electrical equipment. Currently we and Mittal Steel are negotiating to extend these services and utility arrangements for a period of three years. Our respective rights under these agreements may be terminated in the event of force majeure or plant closures by either party. In the event that a plant closure occurs and affects the supply of utilities or services, either party, upon notice, has the right of ingress, egress and regress to enter the other party's premises for the sole purpose of continuing the supply of the





utility affected. All of these rights are assignable in the event of a sale of either of the parties. These rights are essential to the use and operation of the Lackawanna facility. In the event of a termination of any of these rights, we could be required to cease some or all of our operations at the Lackawanna facility. Because we produced certain types of products in the Lackawanna facility that we do not produce in our other facilities, an interruption of production at the Lackawanna facility could result in a substantial loss of revenue and could damage our relationships with customers.

***Our sales are highly concentrated and could be significantly reduced if one of our major customers reduced its purchases of our products or was unable to fulfill its financial obligations to us.***

Our sales are concentrated among a relatively small number of customers. Any of our major customers can stop purchasing our products or significantly reduce their purchases at any time. For the six-months ended June 30, 2006, direct sales of our products to two of our customers, United States Steel Corporation (“U.S. Steel”) and American Axle & Manufacturing Holdings, Inc. (“American Axle”) accounted for approximately 18.7% of our revenue. A disruption in sales to either of these customers could adversely effect our cash flow and results of operations.

There can be no assurance that we will be able to maintain our current level of sales to these customers or that we will be able to sell our products to other customers on terms that will be favorable. The loss of, or substantial decrease in the amount of purchases by, or a write-off of any significant receivables from, any of our major customers would adversely affect our business, results of operations, liquidity and financial condition.

***Unanticipated problems with our manufacturing equipment and facilities could have an adverse impact on our business.***

Our capacity to manufacture steel products depends on the suitable operation of our manufacturing equipment, including blast furnaces, electric arc furnaces, continuous casters, reheating furnaces and rolling mills. Although we perform maintenance to our equipment on a continuous basis, breakdowns requiring significant time and/or resources to repair, as well as the occurrence of adverse events such as fires, explosions or adverse meteorological conditions, could cause temporary production interruptions that could adversely affect our results of operations.

We have not obtained insurance against all risks, and do not maintain insurance covering losses resulting from catastrophes or business interruptions. In the event we are not able to quickly and cost-effectively remedy problems creating any significant interruption of our manufacturing capabilities, our operations could be adversely affected. In addition, in the event any of our plants were destroyed or significantly damaged or its production capabilities otherwise significantly decreased, we would likely suffer significant losses; furthermore, the capital investments necessary to repair any destroyed or damaged facilities or machinery would adversely affect our cash flows and our profitability.

***Because a significant portion of our sales are to the automotive industry, a decrease in automotive manufacturing could reduce our cash flows and adversely affect our results of operations.***

Direct sales of products to automotive assemblers and manufacturers accounted for approximately 45% of our total net sales in 2005. Demand for our products is affected by, among other things, the relative strength or weakness of the U.S. automotive industry. U.S. automotive manufacturers have experienced significant reductions in market share to mostly Asian companies and have announced planned reduction in working capacity. Many large original equipment manufacturers such as Dana Corporation, Delphi Corporation (“Delphi”) and others, have sought bankruptcy protection. A reduction in vehicles manufactured in North America, the principal

market for Republic's SBQ steel products, would have an adverse effect on our results of operations. In addition, the U.S. automotive industry is significantly unionized and subject to unanticipated and extended work slowdowns and stoppages resulting from labor disputes. We also sell to independent forgers, components suppliers and steel service centers, all of which sell to the automotive market as well as other markets. Developments affecting the U.S. automotive industry may adversely affect us.

***If we are unable to obtain or maintain quality and environmental management certifications for our facilities, we may lose existing customers and fail to attract new customers.***

Most of our automotive parts customers in Mexico and the United States require that we have ISO 9001 or 14001 certification. All of the U.S. facilities that sell to automotive parts customers are currently ISO 9001 or 14001 certified, as required.

If the foregoing certifications are canceled, if approvals are withdrawn or if necessary additional standards are not obtained in a timely fashion, our ability to continue to serve our targeted market, retain our customers or attract new customers may be impaired. For example, our failure to maintain these certifications could cause customers to refuse shipments, which could materially affect our revenues and results of operations.

In order to continue to serve the premium part of the SBQ products market, our U.S. facilities will need to be ISO/TS 16949 certified as of December 15, 2006. We currently are in compliance with this new standard but cannot assure you of our future compliance.

In the SBQ market, all participants must satisfy quality audits and obtain certifications in order to obtain the status of "approved supplier". The automotive industry has put these stringent conditions in place for the production of auto parts to assure a vehicle's quality and safety. We currently are an approved supplier for our automotive parts customers. Maintaining these certifications is crucial in preserving and increasing our market share because these conditions can be a barrier to entry in the SBQ market and we cannot assure you that we will do so.

***In the event of environmental violations at our facilities we may incur significant liabilities.***

Our operations are subject to a broad range of environmental laws and regulations regulating our impact on air, water, soil and groundwater and exposure to hazardous substances. We cannot assure you that we will at all times operate in compliance with environmental laws and regulations. If we fail to comply with these laws and regulations, we may be assessed fines or penalties, be required to make large expenditures to comply with such laws and regulations and/or be forced to shut down noncompliant operations. You should also consider that environmental laws and regulations are becoming increasingly stringent and it is possible that future laws and regulations may require us to incur material environmental compliance liabilities and costs. In addition, we need to maintain existing and obtain future environmental permits in order to operate our facilities. The failure to obtain necessary permits or consents or the loss of any permits could result in significant fines or penalties or prevent us from operating our facilities. We may also be subject, from time to time, to legal proceedings brought by private parties or governmental agencies with respect to environmental matters, including matters involving alleged property damage or personal injury that could result in significant liability. Certain of our facilities in the United States have been the subject of administrative action by state and local environmental authorities. See "Business—Legal Matters and Regulations—Legal Proceedings—Environmental Claims."

***If we are required to remediate contamination at our facilities we may incur significant liabilities.***

We may be required to remediate contamination at certain of our facilities and have established a reserve to deal with such liabilities. However, we cannot assure you that our environmental reserves will be adequate to cover such liabilities or that our environmental expenditures will not differ significantly from our estimates or materially increase in the future. Failure to comply with any legal obligations requiring remediation of contamination could result in liabilities, imposition of cleanup liens and fines, and we could incur large expenditures to bring our facilities into compliance.

***We could incur losses due to product liability claims and may be unable to maintain product liability insurance on acceptable terms, if at all.***

We could experience losses from defects or alleged defects in our steel products that subject us to claims for monetary damages. For example, many of our products are used in automobiles and light trucks and it is possible that a defect in one of these vehicles could result in product liability claims against us. In accordance with normal commercial sales, some of our products include implied warranties that they are free from defects, are suitable for their intended purposes and meet certain agreed upon manufacturing specifications. We cannot assure you that future product liability claims will not be brought against us, that we will not incur liability in excess of our insurance coverage, or that we will be able to maintain product liability insurance with adequate coverage levels and on acceptable terms, if at all.

***Our controlling shareholder, Industrias CH, is able to exert significant influence on our business and policies and its interests may differ from those of other shareholders.***

As of June 30, 2006, Industrias CH, which the chairman of our board of directors, Rufino Vigil González, controls, owned approximately 85% of our shares. Industrias CH nominated and elected all of the current members of our board of directors, and Industrias CH continues and, after this offering, will continue to be in a position to elect our future directors and to exercise substantial influence and control over our business and policies, including the timing and payment of dividends. The interests of Industrias CH may differ significantly from those of other shareholders. Furthermore, as a result of the significant equity position of Industrias CH, there is currently limited liquidity in our series B shares and ADSs, and we cannot assure you liquidity will increase significantly as a result of this offering.

***We have had a number of transactions with our affiliates.***

Historically, we have engaged in a significant number and variety of transactions on market terms with affiliates, including entities that Industrias CH owns or controls. We expect that in the future we will continue to enter into transactions with our affiliates, and some of these transactions may be significant.

***We depend on our senior management and their unique knowledge of our business and of the SBQ industry, and we may not be able to replace key executives if they leave.***

We depend on the performance of our executive officers and key employees. Our senior management has significant experience in the steel industry, and the loss of any member of senior management or our inability to attract, retain additional senior management could adversely affect our business, results of operations, prospects and financial condition. We believe that the SBQ steel market is a niche market where specific industry experience is key to success. We depend on the knowledge of our business and the SBQ industry of our senior management team, including Luis Garcia Limon, our chief executive officer. See "Management". In addition, we attribute much of the success of our growth strategy to our ability to retain most of the key senior management personnel of the companies and



businesses that we have acquired. Competition for qualified personnel is significant, and we may not be able to find replacements with sufficient knowledge of, and experience in, the SBQ industry for our existing senior management or any of these individuals if their services are no longer available. Our business could be adversely affected if we cannot attract or retain senior management or other necessary personnel.

### **Risks Related to the Steel Industry**

*Our results of operations are significantly influenced by the cyclical nature of steel industry.*

The steel industry is cyclical in nature and sensitive to national and international macroeconomic conditions. Global demand for steel as well as overall supply levels significantly influence prices for our products. Changes in these two factors likely will impact our operating results. Although global steel prices increased significantly during 2004, they fell in 2005 over 2004 levels, increasing again in the first nine months of 2006 but showing signs of weakening in the last quarter. We cannot predict or give you any assurances as to prices of steel in the future.

The costs of ferrous scrap and iron ore, the principal raw materials used in our steel operations, are subject to price fluctuations. Although our wholly-owned scrap collection and processing operations furnish a material portion of our scrap requirements, we must acquire the remainder of our scrap from other sources. Because increases in the prices we are able to charge for our finished steel products may lag increases in ferrous scrap prices, such increases in scrap prices can adversely affect our operating results. In 2004, the price of scrap increased significantly. However, scrap prices decreased significantly in 2005 over 2004 levels. In the first four months of 2006, scrap prices remained similar to 2005 levels. There can be no assurance that scrap prices will not increase and, if so, there can be no assurance that we will be able to pass all or a portion of these increases on through higher finished product prices.

U.S. Steel supplies the majority of our iron ore and a portion of our coke requirements. We purchase the balance of our requirements in the open market. We expect to purchase increasing amounts of our iron ore requirements in the open market in the future. In 2004, U.S. Steel supplied essentially all of Republic's iron ore and coke requirements under terms of a supply agreement that was beneficial to us. In 2005, the prices of these materials increased when we negotiated new contracts with U.S. Steel, and, therefore, we purchased more of the material in the open market. In the first six months of 2006, iron ore and coke prices decreased from 2005 levels. We cannot guarantee that we will be able to continue to find suppliers of these raw materials in the open market or that the prices of these materials will not increase or that the quality will remain the same. There is no assurance we will be able to pass all or a portion of higher raw material prices on through finished product prices.

*The energy costs involved in our production processes are subject to fluctuations that are beyond our control and could significantly increase our costs of production.*

Energy costs constitute a significant component of our costs of operations. Energy cost as a percentage of net sales was 13% for the year ended December 31, 2005. Our manufacturing processes are dependent on adequate supplies of electricity and natural gas. A substantial increase in the cost of natural gas or electricity could have a material adverse effect on our margins. In addition, a disruption or curtailment in supply could have a material adverse effect on our production and sales levels.

The Mexican government is currently the only supplier of energy in Mexico and has, in some cases, increased prices above international levels. We, like all other high volume users of electricity in Mexico, pay special rates to the Mexican federal electricity commission (*Comisión Federal de Electricidad* or "CFE") for electricity. We also pay special rates to Pemex, Gas y Petroquímica Básica, ("PEMEX"), the national oil company, for gas used at the Guadalajara facility. There can be no



assurance these special rates will continue to be available to us or that these rates may not increase significantly in the future. We enter into futures contracts to fix and reduce volatility of natural gas prices. We have not always been able to pass the effect of these increases on to our customers and there is no assurance that we will be able to pass the effect of these increases on to our customers in the future or to maintain futures contracts to reduce volatility in natural gas prices. Changes in the price or supply of natural gas would materially and adversely affect our business and results of operations.

## **Risks Related to Mexico**

### ***Mexican governmental, political and economic factors may adversely impact our business.***

The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy. Accordingly, Mexican governmental actions concerning the economy and state-owned enterprises could have a significant impact on Mexican private sector entities in general and us, in particular, and on market conditions, prices and returns on Mexican securities, including ours.

Our financial condition, results of operations and prospects may also be affected by currency fluctuations, inflation, interest rates, regulation, taxation, social instability and other political, social and economic developments in or affecting Mexico. There can be no assurance that future developments in the Mexican political, economic or social environment, over which we have no control, will not have a material adverse effect on our business, results of operations, financial condition or prospects or adversely affect the market price of the ADSs and the series B shares.

The Mexican economy has in the past experienced balance of payment deficits and shortages in foreign exchange reserves. While the Mexican government does not currently restrict the ability of Mexican or foreign persons or entities to convert pesos to foreign currencies generally, and to U.S. dollars in particular, it has done so in the past and no assurance can be given that the Mexican government will not institute a restrictive exchange control policy in the future. The effect of any exchange control measures adopted by the Mexican government on the Mexican economy cannot be predicted.

In the Mexican national elections held on July 2, 2000, Vicente Fox of the *Partido Accion Nacional* (the National Action Party) or PAN, won the presidency. His victory ended more than 70 years of presidential rule by the *Partido Revolucionario Institucional* (the Institutional Revolutionary Party) or PRI. Neither the PRI nor the PAN succeeded in securing a majority in either house of the Mexican Congress. Further, elections held in 2003 and 2004, resulted in a reduction in the number of seats held by the PAN in the Mexican Congress and state governorships. The resulting gridlock impeded the progress of structural reforms in Mexico.

On July 2, 2006, Mexico held presidential and federal congressional elections, and Felipe Calderón Hinojosa, the PAN candidate, won by a very narrow margin. However, the *Partido de la Revolución Democrática* (the Revolutionary Democratic Party or PRD), the leading opposition party, has contested the results of the election. On September 6, 2006, the *Tribunal Electoral del Poder Judicial de la Federación* (the Federal Electoral Chamber) unanimously declared Mr. Calderón to be the president-elect whose term as president will run from December 1, 2006 until November 30, 2012. We cannot predict whether the PRD will continue to generate political unrest in the country or whether any such unrest would affect our financial condition results of operations or prospects.

***High levels of inflation and interest rates in Mexico, and weakness in the Mexican economy, could adversely impact our financial condition and results of operation.***

In the past, Mexico has experienced high levels of inflation and high domestic interest rates. If the Mexican economy falls into a recession, or if inflation and interest rates increase, consumer purchasing power may decrease, and as a result, demand for steel products may decrease. In addition, a recession could affect our operations to the extent we are unable to reduce our costs and expenses in response to falling demand. Furthermore, our growth strategy of acquiring other companies and assets may be impaired in the future if interest rates increase, and we are not able to obtain acquisition financing on favorable terms. These events could adversely affect our business, results of operations, financial condition or prospects.

***Devaluation or depreciation of the peso against the U.S. dollar may adversely affect the dollar value of an investment in the ADSs and the series B shares, as well as the dollar value of any dividend or other distributions that we may make.***

Fluctuations in the exchange rate between the peso and the U.S. dollar, particularly peso depreciations, may adversely affect the U.S. dollar equivalent of the peso price of the Series B shares on the Mexican Stock Exchange. As a result, such peso depreciations will likely affect our revenues and earnings in U.S. dollar terms and the market price of the ADSs. Exchange rate fluctuations could also affect the depositary's ability to convert into U.S. dollars, and make timely payment of, any peso cash dividends and other distributions paid in respect of the Series B shares.

***Our financial statements are prepared in accordance with Mexican GAAP, and therefore may not be directly comparable to financial statements of other companies prepared under U.S. GAAP or other accounting principles.***

All Mexican companies must prepare their financial statements in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP. Among other differences, Mexican companies are required to incorporate the effects of inflation directly in their accounting records and in their published financial statements. Accordingly, Mexican financial statements and reported earnings may differ from those of companies in other countries in this and other respects. See Note 19 to our 2005 consolidated financial statements for a description of the principal differences between Mexican GAAP and U.S. GAAP as they relate to us.

***Tariffs, anti-dumping and countervailing duty claims imposed in the future could harm our ability to export our products.***

A substantial part of our operations are outside the United States, and we export products from those facilities to the United States. In recent years, the U.S. government has imposed anti-dumping and countervailing duties against Mexican and other foreign steel producers, but has not imposed any such penalties against us or our products. In the first quarter of 2002, the U.S. government imposed tariffs of 15% on rebar and 30% on hot rolled bar and cold finish bar against imports of steel from all the countries with the exception of Mexico, Canada, Argentina, Thailand and Turkey; in the first quarter of 2003, the tariffs were reduced to 12% on rebar and 24% on hot rolled bar and cold finish bar, and these tariffs were eliminated in late 2003, prior to their originally scheduled termination date. There can be no assurance that anti-dumping or countervailing duties suits will not be initiated against us or that the U.S. government will not impose tariffs on steel imports from Mexico or that existing tariffs on U.S. steel imports from other countries, will not be lifted in the future.



In September 2001, the Mexican government imposed tariffs of 25% against imports for all products that we produce from all countries with the exception of those which have a free trade agreement with Mexico, which includes the United States. In April 2002, the Mexican government increased these tariffs to 35%. These tariffs have subsequently been reduced over time and are currently 7% for steel products. There can be no assurances that these tariffs will not be further reduced or that countries seeking to export steel products to Mexico will not impose similar tariffs on Mexican exports to those countries.

***We are subject to different corporate disclosure and accounting standards than U.S. companies.***

A principal objective of the securities laws of the United States, Mexico and other countries is to promote full and fair disclosure of all material corporate information. However, there may be less publicly available information about non-U.S. issuers of securities listed in the United States than is regularly published by or about U.S. issuers of listed securities. In addition, we prepare our financial statements in accordance with Mexican GAAP, which differs from U.S. GAAP in a number of respects. For example, under Mexican GAAP we must incorporate the effects of inflation directly in our accounting records and published financial statements. While we are required to reconcile our net income and stockholders' equity to those amounts that would be derived under U.S. GAAP, the effects of inflation accounting under Mexican GAAP are not eliminated in such reconciliation. For this and other reasons, the presentation of Mexican financial statements and reported earnings may differ from that of U.S. companies in this and other important respects. Please see Note 19 to our audited consolidated financial statements for the years ended December 31, 2005, 2004 and 2003 beginning on page F-41 of this prospectus and Note 16 to our unaudited condensed consolidated financial statements for the six-month period ended June 30, 2006 beginning on page F-73 of this prospectus.

### **Risks Related to the Global Offering**

***As a result of the lower level of liquidity and the higher level of volatility of the Mexican securities market, the market price of our series B shares, and as a result, our ADSs, may experience extreme price and trading volume fluctuations.***

The Mexican Stock Exchange is one of Latin America's largest exchanges in terms of market capitalization, but it remains relatively small, illiquid and volatile compared to other major world markets. Although the public participates in the trading of securities on the Mexican Stock Exchange, a substantial portion of such activity consists of transactions by or on behalf of institutional investors. These market characteristics may limit the ability of a holder of series B shares to sell its shares and may also adversely affect the market price of the series B shares and, as a result, the market price of the ADSs. The trading volume for securities issued by emerging market companies tends to be lower than the trading volume of securities issued by companies in more developed countries.

***You may not be entitled to participate in future preemptive rights offerings.***

Under Mexican law, if we issue new shares for cash as part of a capital increase, other than in a public offering, we must grant our stockholders the right to purchase a sufficient number of shares to maintain their existing ownership percentage in our company. Rights to purchase shares in these circumstances are known as preemptive rights. We may not legally be permitted to allow holders of ADSs or holders of series B shares in the United States to exercise any preemptive rights in any future capital increase unless: (1) we file a registration statement with the U.S. Securities and Exchange Commission, or the SEC, with respect to that future issuance of shares; or (2) the offering qualifies for an exemption from the registration requirements of the Securities Act. At the time of any future capital

increase, we will evaluate the costs and potential liabilities associated with filing a registration statement with the SEC and any other factors that we consider important to determine whether we will file such a registration statement.

We cannot assure you that we will file a registration statement with the SEC to allow holders of ADSs or holders of series B shares in the United States to participate in a preemptive rights offering. In addition, under current Mexican law, sales by the depositary of preemptive rights and distribution of the proceeds from such sales to you, the ADS holders, is not possible. As a result, your equity interest in us may be diluted proportionately.

***ADS holders may only vote through the depositary and are not entitled to attend shareholders' meetings.***

Under the terms of the ADSs, you have a right to instruct the depositary, The Bank of New York, to vote the shares underlying our ADSs. If we provide the depositary with notice of shareholders' meetings, the depositary will notify you of shareholders' meetings. Otherwise, you will not be able to exercise your right to vote unless you withdraw the series B shares underlying the ADSs. We will use our best efforts to request that the depositary notify you of upcoming votes and ask for your instructions. However, you may not receive voting materials in time to ensure that you are able to instruct the depositary to vote your shares or otherwise learn of shareholders' meetings to withdraw your series B shares to allow you to cast your vote with respect to any specific matter. In addition, the depositary and its agents may not be able to send out your voting instructions on time or carry them out in the manner you have instructed. As a result, you may not be able to exercise your right to vote and you may lack recourse if the series B shares underlying your ADSs are not voted as you requested.

In addition, Mexican law and our by-laws require shareholders to deposit their shares with our secretary or with a Mexican custodian or provide evidence of their status as shareholders in order to attend shareholders' meetings. ADS holders will not be able to meet this requirement and accordingly are not entitled to attend shareholders' meetings. ADS holders will also not be permitted to vote the series B shares underlying the ADSs directly at a shareholders' meeting or to appoint a proxy to do so without withdrawing the series B shares. Please see "Description of American Depositary Receipts" for further discussion regarding the deposit agreement and your voting rights.

***It may be difficult to enforce civil liabilities against us or our directors, officers and controlling persons.***

We are organized under the laws of Mexico, and most of our directors, officers and controlling persons reside in Mexico. In addition, a substantial portion of our assets and their assets are located in Mexico. As a result, it may be difficult for investors to effect service of process on such persons within the United States or elsewhere outside of Mexico or to enforce judgments against us or them, including in any action based on civil liabilities under U.S. federal securities laws. There is doubt as to the enforceability in Mexico, whether in original actions or in actions to enforce judgments of U.S. courts or other courts outside of Mexico, of liabilities based solely on U.S. federal securities laws.

***Future sales of shares may depress the price of our series B shares and ADSs.***

As of June 30, 2006, we had 421,214,706 series B shares outstanding. After this offering, the series B shares and ADSs sold in this offering will be freely tradable, without restriction, under the Securities Act, except for any shares purchased by our "affiliates", as defined in the Securities Act. Sales of substantial amounts of any remaining series B shares may depress our stock price and, as a result, the

price of our ADSs, and we cannot assure you that our stock price would recover from any such loss in value.

This discussion assumes the effectiveness of certain lock-up arrangements with the underwriters under which we have agreed not to issue, sell or otherwise dispose of shares. We cannot assure you that these lock-up arrangements will not be terminated prior to 180 days after the global offering without prior notice to you by the underwriters.

***We may issue additional series B shares or ADSs in the future which may dilute the interest of the public investors.***

We may offer additional series B shares or ADSs in the future, although we have no current intention to do so. Any such offering or the market perception that such an offering could occur may result in a decrease in the market price of the series B shares and ADSs.

## FORWARD LOOKING STATEMENTS

This prospectus contains certain statements regarding our business that may constitute “forward looking statements” within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. When used in this prospectus, the words “anticipates”, “plans”, “believes”, “estimates”, “intends”, “expects”, “projects” and similar expressions are intended to identify forward looking statements, although not all forward looking statements contain those words. These statements, including but not limited to our statements regarding our strategy for raw material acquisition, products and markets, production processes and facilities, sales and distribution and exports, growth and other trends in the steel industry and various markets, operations and liquidity and capital resources are based on management’s beliefs, as well as on assumptions made by, and information currently available to, management, and involve various risks and uncertainties, some of which are beyond our control. Our actual results could differ materially from those expressed in any forward looking statement. In light of these risks and uncertainties there can be no assurance that forward looking statements will prove to be accurate. Factors that might cause actual results to differ from forward looking statements include, but are not limited to,

- factors relating to the steel industry (including the cyclical nature of the industry, finished product prices, worldwide production capacity, the high degree of competition from Mexican and foreign producers and the price of ferrous scrap, iron ore and other raw materials);
  - our ability to operate at high capacity levels;
  - the costs of compliance with U.S. and Mexican environmental laws;
- the integration of the Mexican steel manufacturing facilities located in Apizaco and Cholula, as well as the recently acquired Republic in the United States;
  - future capital expenditures and acquisitions;
  - future devaluations of the peso;
  - the imposition by Mexico of foreign exchange controls and price controls;
- the influence of economic and market conditions in other countries on Mexican securities; and
  - the factors discussed in “Risk Factors” beginning on page 16.

Forward looking statements speak only as of the date they were made, and we undertake no obligation to update publicly or to revise any forward looking statements after we distribute this prospectus because of new information, future events or other factors. In light of the risks and uncertainties described above, the forward looking events and circumstances discussed in this prospectus might not occur.

## USE OF PROCEEDS

We estimate that the proceeds from the combined offering will be approximately Ps. (U.S.\$ million) (or approximately Ps. (U.S.\$ million) if the over-allotment options are exercised in full) based upon an estimated public offering price per series B share of approximately Ps. and after deducting underwriting discounts and commissions but before the estimated expenses associated with the combined offering.

We intend to use the proceeds that we obtain from the combined offering for general corporate purposes, including approximately U.S.\$110 million for investments in fixed assets aimed at increasing our installed capacity in our various facilities in the U.S., Canada and Mexico. We expect that these investments will include an increase in our melt shop capacity (approximately U.S.\$15 million), a new oxygen plant (approximately U.S.\$10 million), new roll mills (approximately U.S.\$27 million), a project to increase production of new SBQ products (approximately U.S.\$20 million), investments to increase stainless steel production (approximately U.S.\$20 million) and a new inspection system for finished products (approximately U.S.\$8 million), as well as possibly potential acquisitions intended to improve our market share and complement our business strategy.

**CAPITALIZATION**

The following table sets forth our unaudited short-term debt and capitalization under Mexican GAAP as of November 30, 2006 and as adjusted to give effect to our receipt of the net proceeds of the sale of our series B shares in the combined offering (assuming no exercise of the over-allotment options).

You should read this table together with our audited financial statements and our unaudited financial statements included in this prospectus. Information in the following table is presented in constant pesos as of November 30, 2006 and dollar amounts are translated at the rate of Ps. 11.0454 per U.S.\$1.00, the interbank transactions rate on November 30, 2006.

	<b>As of November 30, 2006</b>			
	<b>Actual</b>	<b>Actual</b>	<b>As Adjusted <sup>(1)</sup></b>	<b>As Adjusted <sup>(1)</sup></b>
	<b>(\$ Millions)</b>	<b>(Ps. Millions)</b>	<b>(\$ Millions)</b>	<b>(Ps. Millions)</b>
Short-term debt	17	181		
Long-term debt	0	0		
Total stockholders' equity	1,148	12,684		
Total Capitalization	1,165	12,865		

(1) Adjusted values have been calculated based on an assumed offering price of Ps. \_\_\_\_\_ per series B share.

For every \_\_\_\_\_ increase or decrease in the price per series B share in this combined offering, our total stockholders' equity will increase or decrease by approximately Ps. \_\_\_\_\_ (U.S.\$ \_\_\_\_\_).

## MARKET INFORMATION

We have prepared the information concerning the Mexican securities market set forth below based on materials obtained from public sources, including the Mexican National Banking and Securities Commission, the Mexican Stock Exchange, the Mexican Central Bank, and publications by market participants.

Our ADSs are listed on the American Stock Exchange under the symbol “SIM”, and our series B shares are listed on the Mexican Stock Exchange under the symbol “SIMEC.B”.

We cannot predict the extent to which investors will choose to take delivery of series B shares in the form of ADSs as compared to series B shares, or the extent to which investors will be interested in our ADSs. We also cannot predict the liquidity of any such market. If the trading volume of our ADSs or series B shares in any such market falls below certain levels, our shares or ADSs could be delisted or deregistered in that market.

### Trading on the Mexican Stock Exchange

#### *Overview*

The Mexican Stock Exchange, located in Mexico City, is the only stock exchange in Mexico. Operating continuously since 1907, the Mexican Stock Exchange is organized as a corporation (*sociedad anonima de capital variable*). Securities trading on the Mexican Stock Exchange occurs each business day from 8:30 a.m. to 3:00 p.m., Mexico City time.

Since January 1999, all trading on the Mexican Stock Exchange has been effected electronically. The Mexican Stock Exchange may impose a number of measures to promote an orderly and transparent trading price of securities, including the operation of a system of automatic suspension of trading in shares of a particular issuer when price fluctuation exceeds certain limits. The Mexican Stock Exchange may also suspend trading in shares of a particular issuer as a result of:

- non-disclosure of material events; or
- changes in the offer or demand, volume traded, or prevailing share price that are inconsistent with the shares' historical performance and cannot be explained through publicly available information.

The Mexican Stock Exchange may reinstate trading in suspended shares when it deems that the material events have been adequately disclosed to public investors or when it deems that the issuer has adequately explained the reasons for the changes in offer and demand, volume traded, or prevailing share price. Under current regulations, the Mexican Stock Exchange may consider the measures adopted by the other stock exchanges in order to suspend and/or resume trading in an issuer's shares in cases where the relevant securities are simultaneously traded on a stock exchange outside of Mexico.

Settlement on the Mexican Stock Exchange is effected two business days after a share transaction. Deferred settlement is not permitted without the approval of the Mexican National Banking and Securities Commission, even where mutually agreed. Most securities traded on the Mexican Stock Exchange are on deposit with the INDEVAL, a privately owned securities depository that acts as a clearinghouse, depository, and custodian, as well as a settlement, transfer, and registration agent for Mexican Stock Exchange transactions, eliminating the need for physical transfer of securities.

Although the Mexican Securities Market Law (*Ley del Mercado de Valores*) provides for the existence of an over-the-counter market, no such market for securities in Mexico has developed.

### Market Regulation

In 1925, the Mexican National Banking Commission (*Comisión Nacional Bancaria*) was established to regulate banking activity and in 1946, the Mexican Securities Commission (*Comisión Nacional de Valores*) was established to regulate stock market activity. In 1995, these two entities were merged to form the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*). The Mexican Securities Market Law, which took effect in 1975, introduced important structural changes to the Mexican financial system, including the organization of brokerage firms as corporations (*sociedades anónimas*). The Mexican Securities Market Law sets standards for authorizing companies to operate as brokerage firms, which authorization is granted at the discretion of the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*), upon the recommendation of the National Banking and Securities Commission. In addition to setting standards for brokerage firms, the Mexican Securities Market Law authorizes the National Banking and Securities Commission, among other things, to regulate the public offering and trading of securities, corporate governance, disclosure and reporting standards and to impose sanctions for the illegal use of insider information and other violations of the Mexican Securities Market Law. The National Banking and Securities Commission regulates and supervises the Mexican securities market, the Mexican Stock Exchange, INDEVAL and brokerage firms through a board of governors composed of 13 members.

On December 30, 2005, a new Mexican Securities Market Law was enacted and published in the Official Gazette. The new Securities Market Law became effective on June 28, 2006, however, in some cases an additional period of 180 days (until late December 2006) will be available for issuers to incorporate the new corporate governance and other requirements derived from the new law into their by-laws. The new Mexican Securities Market Law changed the Mexican securities regulation in various material respects. The reforms were intended to update the Mexican regulatory framework applicable to the securities market and publicly traded companies in accordance with international standards.

In particular, the new Mexican Securities Market Law (i) establishes that public entities and the entities controlled by them will be considered a single economic unit, (ii) clarifies the rules for tender offers, dividing them into voluntary and mandatory categories, (iii) clarifies standards for disclosure of holdings of shareholders of public companies, (iv) expands and strengthens the role of the board of directors of public companies, (v) defines the standards applicable to the board of directors and the duties of the board, each director, its secretary, the general director and executive officers (introducing concepts such as the duty of care, duty of loyalty and safe harbors), (vi) replaces the statutory auditor (*comisario*) and its duties with an audit committee, a corporate practices committee and external auditors, (vii) clearly defines the roles and responsibilities of executive officers, (viii) improves the rights of minority shareholders relating to legal remedies and access to company information, (ix) introduces concepts such as consortiums, groups of related persons or entities, control, related parties and decision-making power, (x) sets out three new types of companies different to the ones which are set out by the Mexican Companies Law, the (a) *sociedad anónima promotora de inversión*, by which the investment of national and foreigner investors shall be promoted, (b) *sociedad anónima promotora de inversión bursátil* and (c) *sociedad anónima bursátil*, and (xi) expands the definition of applicable sanctions for violations of the Mexican Securities Market Law, including the punitive damages and criminal penalties.

In March 2003, the National Banking and Securities Commission issued certain general regulations applicable to issuers and other securities market participants. The general regulations, which repealed several previously enacted National Banking and Securities Commission regulations (*circulares*), now provide a single set of rules governing issuers and issuer activity, among other things.





In September 2006, these general regulations were amended to give effect to the provisions of the Mexican Securities Market Law.

In addition, in September 2004, the National Banking and Securities Commission issued general rules applicable to brokerage firms, the National Banking and Securities Commission Rules for Brokerage Firms (*circulares aplicables a casas de bolsa*). These rules now provide a single set of rules governing participation of Mexican underwriters in public offerings, among other things.

#### *Registration and Listing Standards*

To offer securities to the public in Mexico, an issuer must meet specific qualitative and quantitative requirements. In addition, only securities that have been registered with the Mexican National Securities Registry as authorized by National Banking and Securities Commission approval may be listed on the Mexican Stock Exchange. The authorization of the National Banking and Securities Commission with respect to the registration does not imply any kind of certification or assurance related to the investment quality of the securities, the solvency of the issuer, or the accuracy or completeness of any information delivered to the National Banking and Securities Commission. The general regulations state that the Mexican Stock Exchange must adopt minimum requirements for issuers to list their securities in Mexico. These requirements relate to matters such as operating history, financial and capital structure, minimum trading volumes and minimum public floats, among others. The general regulations also state that the Mexican Stock Exchange must implement minimum requirements for issuers to maintain their listing in Mexico. These requirements relate to matters such as financial condition, trading minimums, capital structure and minimum public floats, among others. The National Banking and Securities Commission may waive some of these requirements in certain circumstances. In addition, some of the requirements are applicable to each series of shares of the relevant issuer.

The Mexican Stock Exchange will review compliance with the foregoing requirements and other requirements on an annual, semi-annual and quarterly basis, and may also do it at any other time. The Mexican Stock Exchange must inform the National Banking and Securities Commission of the results of its review and this information must, in turn, be disclosed to investors. If an issuer fails to comply with any of the foregoing requirements, the Mexican Stock Exchange will request that the issuer propose a plan to cure the violation. If the issuer fails to propose a plan, if the plan is not satisfactory to the Mexican Stock Exchange or if an issuer does not make substantial progress with respect to the corrective measures, trading of the relevant series of shares on the Mexican Stock Exchange will be temporarily suspended. In addition, if an issuer fails to propose a plan or ceases to follow the plan once proposed, the National Banking and Securities Commission may suspend or cancel the registration of the shares, in which case the majority shareholder or any controlling group must carry out a tender offer to acquire 100% of the outstanding shares of the issuer in accordance with the tender offer rules discussed below.

#### *Reporting Obligations*

Issuers of listed securities are required to file unaudited quarterly financial statements and audited annual financial statements as well as various periodic reports with the National Banking and Securities Commission and the Mexican Stock Exchange. Mexican issuers must file the following reports with the National Banking and Securities Commission:

- an annual report prepared in accordance with the National Banking and Securities Commission general regulations by no later than June 30 of each year;
- quarterly reports, within 20 business days following the end of each of the first three quarters and 40 business days following the end of the fourth quarter; and



- reports disclosing material events promptly upon their occurrence.

Pursuant to the National Banking and Securities Commission's general regulations, the internal rules of the Mexican Stock Exchange were amended to implement an automated electronic information transfer system, or SEDI (*Sistema Electrónico de Envío y Difusión de Información*), for information required to be filed with the Mexican Stock Exchange. Issuers of listed securities must prepare and disclose their financial information via a Mexican Stock Exchange-approved electronic financial information system, or SIFIC (*Sistema de Información Financiera Computarizada*). Immediately upon its receipt, the Mexican Stock Exchange makes the financial information submitted via SIFIC available to the public.

The National Banking and Securities Commission's general regulations and the rules of the Mexican Stock Exchange require issuers of listed securities to file information through SEDI that relates to any act, event or circumstance that could influence issuers' share price. If listed securities experience unusual price volatility, the Mexican Stock Exchange must immediately request that an issuer inform the public as to the causes of the volatility or, if the issuer is unaware of the causes, that an issuer make a statement to that effect. In addition, the Mexican Stock Exchange must immediately request that issuers disclose any information relating to relevant material events, when it deems the information currently disclosed to be insufficient, as well as instruct issuers to clarify the information when necessary. The Mexican Stock Exchange may request that issuers confirm or deny any material events that have been disclosed to the public by third parties when it deems that the material event may affect or influence the securities being traded. The Mexican Stock Exchange must immediately inform the National Banking and Securities Commission of any such requests.

An issuer may defer the disclosure of material events under some circumstances, as long as:

- the issuer implements adequate confidentiality measures (including maintaining records of persons or entities in possession of confidential information);
  - the information is related to incomplete transactions;
  - there is no misleading public information relating to the material event; and
    - no unusual price or volume fluctuation occurs.

Similarly, if an issuer's securities are traded on both the Mexican Stock Exchange and a foreign securities exchange, the issuer must simultaneously file the information that it is required to file pursuant to the laws and regulations of the foreign jurisdiction with the National Banking and Securities Commission and the Mexican Stock Exchange.

The new Mexican Securities Market Law has not substantially modified the reporting obligations of issuers of equity securities listed on the Mexican Stock Exchange.

#### *Suspension of Trading*

In addition to the authority of the Mexican Stock Exchange under its internal regulations as described above, pursuant to the rules of National Banking and Securities Commission, the National Banking and Securities Commission and the Mexican Stock Exchange may suspend trading in an issuer's securities:

- if the issuer does not disclose a material event; or

- upon price or volume volatility or changes in the offer or demand in respect of the relevant securities that are not consistent with the historic performance of the securities and cannot be explained solely through information made publicly available pursuant to the National Banking and Securities Commission's general regulations.

The Mexican Stock Exchange must immediately inform the National Banking and Securities Commission and the general public of any such suspension. An issuer may request that the National Banking and Securities Commission or the Mexican Stock Exchange resume trading, provided it demonstrates that the causes triggering the suspension have been resolved and that it is in full compliance with the periodic reporting requirements under applicable law. If an issuer's request has been granted, the Mexican Stock Exchange will determine the appropriate mechanism to resume trading. If trading in an issuer's securities is suspended for more than 20 business days and the issuer is authorized to resume trading without conducting a public offering, the issuer must disclose via SEDI a description of the causes that resulted in the suspension and reasons why it is now authorized to resume trading before trading may resume.

*Insider Trading, Trading Restrictions and Tender Offers*

The Mexican Securities Market Law contains specific regulations regarding insider trading, including, (i) the requirement that persons in possession of information deemed privileged abstain (x) from trading in the relevant issuer's securities, (y) from making recommendations to third parties to trade in such securities and (z) from trading in options and derivatives of the underlying security issued by such entity, and (ii) providing a counterparty not privy to insider information with a right of indemnification from the party possessing privileged information.

In addition, if an issuer's securities are traded on both the Mexican Stock Exchange and a foreign securities exchange, the issuer must simultaneously file with the National Banking and Securities Commission the information that it is required to file pursuant to the rules and regulations of the foreign securities exchange.

Pursuant to the Mexican Securities Market Law, the following persons must notify the National Banking and Securities Commission of any transactions undertaken by a listed issuer:

- members of a listed issuer's board of directors;
- shareholders controlling 10% or more of a listed issuer's outstanding share capital;
- advisors;
- groups controlling 10% or more of a listed issuer's outstanding share capital; and
- other insiders.

In addition, under the Mexican Securities Market Law insiders must abstain from purchasing or selling securities of the issuer within 90 days from the last sale or purchase, respectively.

Shareholders of issuers listed on the Mexican Stock Exchange must notify the National Banking and Securities Commission before effecting transactions outside of the Mexican Stock Exchange that result in a transfer of 10% or more of an issuer's share capital. Transferring shareholders must also inform the National Banking and Securities Commission of the effect of the transactions within three days following their completion, or, alternatively, that the transactions have not been consummated. The

National Banking and Securities Commission will notify the Mexican Stock Exchange of these transactions on a no-name basis.

The Mexican Securities Market Law also provides that, for purposes of determining any of the foregoing percentages, convertible securities, warrants and derivatives must be taken into account.

Subject to certain exceptions, any acquisition of a public company's shares that results in the acquiror owning 10% or more, but less than 30%, of an issuer's outstanding share capital must be publicly disclosed to the National Banking and Securities Commission and the Mexican Stock Exchange by no later than one business day following the acquisition. Any acquisition by an insider that results in the insider holding an additional 5% or more of a public company's outstanding share capital must also be publicly disclosed to the National Banking and Securities Commission and the Mexican Stock Exchange no later than the day following the acquisition. Some insiders must also notify the National Banking and Securities Commission of share purchases or sales that occur within a three-month or five-day term and that exceed certain value thresholds. The Mexican Securities Market Law requires that convertible securities, warrants and derivatives to be settled in kind be taken into account in the calculation of share ownership percentages.

The Mexican Securities Market Law contains provisions relating to public tender offers and certain other share acquisitions occurring in Mexico. Under the law, tender offers may be voluntary or mandatory. Voluntary tender offers, or offers where there is no requirement that they be initiated or completed, are required to be made *pro rata*. Any intended acquisition of a public company's shares that results in the acquiror owning 30% or more, but less than a percentage that would result in the acquiror obtaining control, of a company's voting shares requires the acquiror to make a mandatory tender offer for (i) the greater of the percentage of the share capital intended to be acquired or (ii) 10% of the company's outstanding share capital stock. Finally, any intended acquisition of a public company's shares that is aimed at obtaining voting control requires the potential acquiror to make a mandatory tender offer for 100% of the company's outstanding share capital (however, under certain circumstances the National Banking and Securities Commission may permit an offer for less than 100%). The tender offer must be made at the same price to all shareholders and classes of shares. The board of directors, with the advice of the audit committee, must issue its opinion of any tender offer resulting in a change of control, which opinion must take minority shareholder rights into account and which may be accompanied by an independent fairness opinion.

Under the Mexican Securities Market Law, all tender offers must be open for at least 20 business days and not 15 business days as required by the general rules and purchases thereunder are required to be made *pro rata* to all tendering shareholders. The Mexican Securities Market Law also permits the payment of certain amounts to controlling shareholders over and above the offering price if these amounts are (i) fully disclosed, (ii) approved by the board of directors and (iii) paid in connection with non-compete or similar obligations. The law also provides exceptions to the mandatory tender offer requirements and specifically sets forth remedies for non-compliance with these tender offer rules (e.g., suspension of voting rights, possible annulment of purchases, etc.) and other rights available to prior shareholders of the issuer.

#### *Anti-Takeover Protections*

The Mexican Securities Market Law provides that public companies may include anti-takeover provisions in their by-laws if such provisions (i) are approved by a majority of the shareholders, with no more than 5% of the outstanding capital shares voting against such provisions, (ii) do not exclude any shareholder(s) or group of shareholder(s) and (iii) do not restrict, in an absolute manner, a change of control.

**Market Price of Series B shares**

Our series B shares are traded on the Mexican Stock Exchange under the symbol “SIMEC.B”. As of October 24, 2006, the date of our annual shareholders meeting, there were 421,214,706 series B shares issued and outstanding. As of such date, 13,735,221 shares were held in the United States in the form of ADSs by 22 record holders, and 407,479,485 shares were held in Mexico by approximately 46 record holders. The ADSs are evidenced by ADRs issued by The Bank of New York (the “Depository”), as depository under a Deposit Agreement, dated as of July 8, 1993, as amended, among us, the Depository and the holders from time to time of ADRs. Because certain of the shares are held by nominees, the number of record holders may not be representative of the number of beneficial owners.

**Share Price Information**

The following table sets forth for the periods indicated the high and low sales prices expressed in historical pesos of a series B shares on the Mexican Stock Exchange and the high and low sales price expressed in dollars of the ADSs on the American Stock Exchange. (Table adjusted to reflect May 30, 2006 3 for 1 stock split.)

	Mexican Stock Exchange		American Stock Exchange	
	High	Low	High	Low
<b>2002</b>	0.89	0.50	1.75	0.80
<b>2003</b>	37.50	10.20	5.34	0.85
<b>2004</b>	95.99	22.40	8.75	2.10
<b>2005</b>	95.00	40.75	8.70	3.63
<b>2006</b>	84.00	22.00	21.64	3.96
<b>2005</b>				
First Quarter	95.00	49.99	8.70	4.24
Second Quarter	54.00	40.75	4.80	3.63
Third Quarter	56.60	42.30	5.45	3.91
Fourth Quarter	49.00	42.50	4.80	3.77
<b>2006</b>				
First Quarter	80.00	43.28	7.48	3.96
Second Quarter	84.00	22.00	9.49	5.55
Third Quarter	57.50	25.00	15.90	6.60
Fourth Quarter	79.40	50.00	21.64	13.50
<b>2006</b>				
July	37.10	25.00	10.34	6.60
August	45.50	34.50	12.66	9.47
September	57.50	43.09	15.90	11.77
October	67.41	50.32	19.03	13.50
November	79.40	62.00	21.64	17.00
December	77.50	50.00	21.00	13.57
<b>2007</b>				
January (through January 16)	53.01	45.95	14.40	12.42

On February 20, 2003, we effected a 1 for 20 reverse stock split. On May 30, 2006, we effected a 3 for 1 stock split. Following the May 30 split, we adjusted the ADS to share ratio from one ADS representing one share to one ADS representing three shares.

## **DIVIDENDS AND DIVIDEND POLICY**

A vote by the majority of our shareholders present at a shareholders' meeting, generally upon a recommendation of our board of directors, determines the declaration, amount and payment of dividends. The declaration and payment of dividends is subject to limitations under Mexican law and in case of the existence of debt instruments, to any covenants contained in any of such instruments. Our controlling shareholder, Industrias CH, currently has the power and, after giving effect to the combined offering, will continue to have the power to determine our dividend policy. See "Risk Factors - Our controlling shareholder, Industrias CH, is able to exert significant influence on our business and policies and its interests may differ from those of other shareholders" and "Major Shareholders".

We have not paid dividends in the past. Because we intend to devote a substantial portion of our future cash flows to funding our expansion plan and working capital requirements, we do not currently expect to pay dividends in the near future. We may consider paying dividends in the future based on a number of factors, including our results of operations, financial condition, cash requirements, tax considerations, future prospects and other factors that our board of directors and our shareholders may deem relevant, including the terms and conditions of any future debt instruments that might limit our ability to pay dividends.



**UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION**

The following tables present our and Republic's unaudited pro forma condensed combined pro forma financial information reflecting our and Republic's combined accounts on a pro forma basis as of and for the periods indicated.

Also included in this prospectus, beginning on Page F-136, are our unaudited combined consolidated pro forma statements of income reflecting our and Republic's combined accounts on a pro forma basis for the year ended December 31, 2005 and as of and for the six-month period ended June 30, 2005.

All pro forma financial information included in this prospectus is unaudited and may not be indicative of the results of operations that actually would have been achieved and we acquired Republic at the beginning of the periods presented and do not purport to be indicative of future results. The information in the following tables should also be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations".

The unaudited pro forma condensed combined financial information is prepared in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP.

For additional information regarding financial information presented in this prospectus, see "Presentation of Financial and Other Information".

	<b>Pro Forma</b>		<b>Actual</b>		
	<b>Year Ended December</b>		<b>Six Months Ended June 30,</b>		
	<b>31,</b>		<b>2005</b>	<b>2006</b>	<b>2006<sup>(1)</sup></b>
	<b>2005</b>	<b>2005<sup>(1)</sup></b>			
	(Millions		(Millions of constant		(Millions
	of		June 30, 2006		of dollars)
	constant		pesos)	(Millions of constant	of dollars)
	June 30,	(Millions	June 30, 2006 pesos)	(Millions of constant	of dollars)
	2006	of dollars)	(except per share and per ADS data)		
	(pesos)	(except per share and per ADS data)			
<b>Income Statement Data:</b>					
<i>Mexican GAAP:</i>					
Net sales	22,380	1,964	12,388	11,912	1,045
Direct cost of sales	18,556	1,628	9,987	9,682	849
Marginal profit	3,824	336	2,401	2,230	196
Indirect manufacturing, selling, general and administrative expenses	1,246	109	707	462	41
Depreciation and amortization	339	30	144	202	18
Operating income	2,239	196	1,550	1,566	137
Financial income (expense)	(234)	(21)	(120)	45	4
Other income (expense), net	45	4	34	33	3
Income before taxes, employee profit sharing and minority interest	2,050	180	1,464	1,644	144
Income tax expense and employee profit sharing	390	34	323	105	9
Net income (loss)	1,660	146	1,141	1,539	135
Minority interest	198	17	196	193	17
Majority interest	1,462	128	945	1,346	118

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Net income per share	4	0.31	2	3	0.28
Net income per ADS <sup>(2)</sup>	11	0.93	7	10	0.84
Weighted average shares outstanding (thousands) <sup>(5)</sup>	413,790		405,209	419,451	

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	Pro Forma		Actual		
	Year Ended December		Six Months Ended June 30,		
	31,	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>
(Millions of constant June 30, 2006 pesos)	(Millions of dollars)	(Millions of constant June 30, 2006 pesos)	(Millions of constant June 30, 2006 pesos)	(Millions of constant June 30, 2006 pesos)	(Millions of dollars)
	(except per share and per ADS data)				
Weighted average ADSs outstanding (thousands)	137,930	137,930	135,070	139,817	139,817
<i>U.S. GAAP including effects of inflation:</i>					
Net sales	22,380	1,964	12,388	11,912	1,045
Operating income <sup>(4)</sup>	2,241	197	1,554	1,660	146
Minority interest	198	17	196	193	17
Net Income	1,457	128	943	1,386	122
Income per share <sup>(5)</sup>	4	0.31	2	3	0.28
Income per ADS	11	1	7	10	0.87
<b>Other Data:</b>					
<i>Mexican GAAP:</i>					
Capital expenditures	53	5	6	167	15
Adjusted EBITDA <sup>(6)</sup>	2,578	226	1,694	1,768	155
Depreciation and amortization from continuing operations	339	30	144	202	18
<b>Operational information:</b>					
Annual Installed capacity (thousands of tons)	2,847		2,897	2,902	
Tons shipped	2,683		1,400	1,369	
Mexico	910		449	461	
United States, Canada and others	1,773		951	908	
SBQ steel	1,936		1,047	997	
Structural and other steel products	747		352	372	
Per ton:					
Net sales per ton	8,341	732	8,849	8,699	763
Cost of sales per ton	6,916	607	7,134	7,070	620
Operating income per Ton	835	73	1,107	1,144	100
Adjusted EBITDA per ton	961	84	1,210	1,291	113
Number of employees	4,360		4,433	4,340	

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 11.3973 per \$1.00, the interbank transactions rate in effect on June 30, 2006.

(2) Due to a stock split effective May 30, 2006, one ADS represents three series B shares; previously one ADS represented one series B share.

(3) Long-term debt includes amounts relating to deferred taxes.

(4) Reflects a reclassification in 2005 from other expenses under Mexican GAAP to operating expenses under U.S. GAAP of Ps. 38 million due to the cancellation of technical assistance.

(5) For U.S. GAAP and Mexican GAAP purposes, the weighted average shares outstanding were calculated to give effect to the stock split described in Note 13(a) to the audited financial statements.

(6) Adjusted EBITDA is not a financial measure computed under Mexican or U.S. GAAP. Adjusted EBITDA derived from our Mexican GAAP financial information means Mexican GAAP net income (loss) excluding (i) depreciation and amortization, (ii) financial income (expense), net (which is composed of net interest expense, foreign exchange gain or loss and monetary position gain or loss), (iii) other income (expense) and (iv) income tax expense and employee statutory profit-sharing expense.

Adjusted EBITDA does not represent, and should not be considered as, an alternative to net income, as an indicator of our operating performance, or as an alternative to cash flow as an indicator of liquidity. In making such comparisons, however, you should bear in mind that adjusted EBITDA is not defined and is not a recognized financial measure under Mexican GAAP or U.S. GAAP and that it may be calculated differently by different companies and must be read in conjunction with the explanations that accompany it. Adjusted EBITDA as presented in this table does not take into account our working capital requirements, debt service requirements and other commitments.

We believe that adjusted EBITDA can be useful to facilitate comparisons of operating performance between periods and with other companies in our industry because it excludes the effect of (i) depreciation and amortization, which represents a non-cash charge to earnings, (ii) certain financing

costs, which are significantly affected by external factors, including interest rates, foreign currency exchange rates, and inflation rates, which have little or no bearing on our operating performance, (iii) other income (expense) that are not constant operations and (iv) income tax expense and employee statutory profit-sharing expense. However, adjusted EBITDA has certain material limitations, including that (i) it does not include taxes, which are a necessary and recurring part of our operations; (ii) it does not include depreciation and amortization, which, because we must utilize property, equipment and other assets in order to generate revenues in our operations, is a necessary and recurring part of our costs; (iii) it does not include comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenue; and (iv) it does not include other income and expenses that are part of our net income. Therefore, any measure that excludes any or all of taxes, depreciation and amortization, comprehensive cost of financing and other income and expenses has material limitations.

Adjusted EBITDA should not be considered in isolation or as a substitute for net income, net cash flow from operating activities or net cash flow from investing and financing activities. Reconciliation of net income to adjusted EBITDA is as follows:

	Pro Forma		Actual		
	Year Ended December 31,		Six Months Ended June 30,		
	2005	2005	2005	2006	2006
	(Millions of constant June 30, 2006 pesos)	(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)
<i>Mexican GAAP:</i>					
Net income	1,660	146	1,141	1,539	135
Depreciation and amortization	339	30	144	202	18
Financial income (expense)	(234)	(20)	(120)	45	4
Income tax expense and employee profit sharing	390	34	323	105	9
Other income (expense)	45	4	34	33	3
Adjusted EBITDA	2,578	226	1,694	1,768	155

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following tables present our summary consolidated financial information for each of the periods indicated. This information should be read in conjunction with, and is qualified in its entirety by reference to, our financial statements, including the notes thereto, as well as “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included elsewhere in this prospectus. Our financial statements are prepared in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP. Note 19 to our audited consolidated financial statements and Note 16 to our unaudited condensed consolidated interim financial statements for the six-month period ended June 30, 2006 provide a summary of the principal differences between Mexican GAAP and U.S. GAAP as they relate to our business, along with a reconciliation to U.S. GAAP of net income and stockholders’ equity, a statement of changes in stockholders’ equity and, for the unaudited condensed consolidated interim financial statements, a statement of cash flows under U.S. GAAP.

Mexican GAAP provides for the recognition of certain effects of inflation by restating non-monetary assets and non-monetary liabilities using the Mexican National Consumer Price Index, restating the components of stockholders’ equity using the Mexican National Consumer Price Index and recording gains or losses in purchasing power from holding monetary liabilities or assets. Mexican GAAP also requires the restatement of all financial statements to constant Mexican pesos as of the date of the most recent balance sheet presented. Our audited consolidated financial statements and all other financial information contained herein with respect to the years ended December 31, 2001, 2002, 2003, 2004 and 2005 are accordingly presented in constant pesos with purchasing power as of June 30, 2006, unless otherwise noted. Our unaudited interim financial statements for the six-month period ended June 30, 2006, which include comparative unaudited financial information for the six-month period ended June 30, 2005, and all other financial information presented herein, with respect to the six-month periods ended June 30, 2006 and 2005 are presented in constant pesos with purchasing power as of June 30, 2006. Our results of operations for the six-month period ended June 30, 2006 are not necessarily indicative of our expected results of operations for the year ended December 31, 2006 and should not be construed as such.

The financial information includes the consolidation of Republic from July 22, 2005 and the consolidation of the Atlax Acquisition from August 1, 2004. Period to period comparison of our results of operations and financial condition is made more difficult as a result of the inclusion of financial information relating to the acquisition of Republic only from July 22, 2005 and of financial information relating to the Atlax Acquisition only from August 1, 2004.

We have derived the selected financial and operating information set forth below in part from our consolidated financial statements, which have been reported on by KPMG Cárdenas, Dosal, S.C. for the fiscal years ended December 31, 2001, 2002, 2003 and 2004 and by Mancera S.C., a Member Practice of Ernst & Young Global, an independent, registered public accounting firm for the fiscal year ended December 31, 2005. In so doing, Mancera, S.C. has relied on the audited consolidated financial statements of our subsidiary SimRep and its subsidiaries, reported on by BDO Hernández Marrón y Cía., S.C., a member firm of BDO International.

	Year Ended December 31,					Six Months Ended June 30,			
	2001	2002	2003	2004	2005	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>
	(Millions of constant June 30, 2006 pesos)					(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)
	(except per share and per ADS data)								
<b>Income</b>									
<b>Statement Data:</b>									
<i>Mexican GAAP:</i>									
Net sales	2,288	2,403	3,047	5,910	12,967	1,138	3,574	11,912	1,045
Direct cost of sales	1,536	1,608	2,002	3,435	10,371	910	2,327	9,682	849
Marginal profit	752	795	1,045	2,475	2,596	228	1,247	2,230	196
Indirect manufacturing, selling, general and administrative expenses	376	327	308	371	692	61	244	462	41
Depreciation and amortization	160	177	199	222	326	29	131	202	18
Operating income	216	291	538	1,882	1,578	138	872	1,566	137
Financial income (expense)	6	(141)	(27)	(38)	(145)	(13)	(35)	45	4
Other income (expense), net	73	(41)	(32)	(38)	55	5	8	33	3
Income before taxes, employee profit sharing and minority interest	295	109	479	1,806	1,488	131	845	1,644	144
Income tax expense and employee profit sharing	19	(25)	159	344	191	17	98	105	9
Net income (loss)	276	134	320	1,462	1,297	114	747	1,539	135
Minority interest	0	0	0	0	17	2	0	193	17
Majority interest	276	134	320	1,462	1,280	112	747	1,346	118
Net income per share	2	0.4	1	4	3	0.27	2	3	0.28
Net income per ADS <sup>(2)</sup>	5	1	3	11	9	0.81	6	10	0.84
Weighted average shares outstanding (thousands) <sup>(5)</sup>	164,448	299,901	357,159	398,916	413,790	413,790	405,209	419,451	419,451
Weighted average ADSs outstanding (thousands)	54,816	99,967	119,053	132,972	137,930		135,070	139,817	
<i>U.S. GAAP including effects of inflation:</i>									

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Net sales	2,288	2,403	3,048	5,911	12,967	1,138	3,573	11,912	1,045
Direct cost sales	1,530	1,612	2,007	3,429	10,375	910	2,329	9,594	842
Marginal profit	758	791	1,041	2,482	2,592	228	1,244	2,318	203
Operating income <sup>(4)</sup>	200	255	544	1,865	1,544	135	875	1,660	146
Financial income (expense)	7	(141)	(27)	(38)	(145)	(13)	(35)	45	4
Other income (expense), net	657	(74)	(32)	(4)	93	8	8	33	3
Income before taxes, employee profit sharing and minority interest	864	40	485	1,823	1,492	130	848	1,737	152
Income tax expense (income)	69	(182)	207	389	197	17	102	118	10
Income before minority interest	795	222	278	1,434	1,295	113	746	1,619	142
Minority interest	0	0	0	0	17	1	0	193	17
U.S. GAAP adjustment on minority interest	0	0	0	0	0	0	0	40	3
Net Income	795	222	278	1,434	1,278	112	746	1,426	125
Income per share <sup>(5)</sup>	5	1	1	4	3	0.27	2	3	0.30
Income per ADS	14	2	2	11	9	0.81	6	10	0.89

**Balance Sheet**

**Data:**

*Mexican GAAP:*

Total assets	5,557	5,035	6,570	9,306	14,588	1,280	9,531	16,439	1,442
Total long-term liabilities <sup>(3)</sup>	803	881	1,153	1,513	2,244	197	1,439	2,003	176
Total stockholders' equity	3,338	4,089	5,062	6,848	9,628	845	7,368	11,902	1,044

*U.S. GAAP including effects of*



	Year Ended December 31,					Six Months Ended June 30,				
	2001	2002	2003	2004	2005	2005 <sup>(1)</sup>	2005	2006	2006 <sup>(1)</sup>	
	(Millions of constant June 30, 2006 pesos)					(Millions of dollars)	(Millions of constant June 30, 2006 pesos)		(Millions of dollars)	
	(except per share and per ADS data)									

*inflation:*

Total assets	6,507	6,228	6,497	9,173	14,796	1,298	9,548	16,421	1,441
Total long-term liabilities <sup>(3)</sup>	803	914	1,097	1,476	2,303	202	1,426	1,974	173
Total stockholders' equity	3,949	4,338	5,045	6,752	7,969	699	7,442	9,613	843

**Other Data:***Mexican GAAP:*

Capital expenditures	46	10	65	1,285	503	44	6	167	15
Adjusted EBITDA <sup>(6)</sup>	376	468	737	2,104	1,904	167	1,003	1,768	155
Depreciation and amortization from continuing operations	160	177	199	222	326	29	131	202	18
Working capital	(560)	(11)	1,023	1,968	4,063	356	2,907	5,854	514

**Operational information:**

Annual installed capacity (thousands of tons)	730	730	730	1,210	2,847	2,847	2,902		
Tons shipped <sup>(7)</sup>	561	609	628	773	1,708	524	1,369		
Mexico	512	529	547	676	899	449	461		
United States, Canada and others	49	80	81	97	809	75	908		
SBQ steel	78	78	63	168	923	170	997		
Structural and other steel products	483	531	565	605	785	352	372		
Per ton:									
Net sales per ton	4,080	3,943	4,851	7,644	7,591	666	6,825	8,699	763
Cost of sales per ton	2,740	2,639	3,187	4,442	6,072	533	4,443	7,070	620
Operating income per Ton	385	476	857	2,435	924	81	1,666	1,145	100
Adjusted EBITDA per ton	670	767	1,174	2,722	1,115	98	1,916	1,291	113
Number of employees	1,386	1,333	1,288	2,018	4,360	1,975	4,340		-

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 11.3973 per \$1.00, the interbank transactions rate in effect on June 30, 2006 and at the rate of Ps. 10.7777 per \$1.00, the interbank transactions rate in effect on December 31, 2005.

(2) Due to a stock split effective May 30, 2006, one ADS represents three series B shares; previously one ADS represented one series B share.

(3) Total long-term liabilities include amounts relating to deferred taxes.

(4) Reflects a reclassification in 2005 from other expenses under Mexican GAAP to operating expenses under U.S. GAAP of Ps. 38 million due to the cancellation of technical assistance.

(5) For U.S. GAAP and Mexican GAAP purposes, the weighted average shares outstanding were calculated to give effect to the stock split described in Note 13(a) to the Consolidated Financial Statements.

(6) Adjusted EBITDA is not a financial measure computed under Mexican or U.S. GAAP. Adjusted EBITDA derived from our Mexican GAAP financial information means Mexican GAAP net income (loss) excluding (i) depreciation and amortization, (ii) financial income (expense), net (which is composed of net interest expense, foreign exchange gain or loss and monetary position gain or loss), (iii) other income (expense) and (iv) income tax expense and employee statutory profit-sharing expense.

Adjusted EBITDA does not represent, and should not be considered as, an alternative to net income, as an indicator of our operating performance, or as an alternative to cash flow as an indicator of liquidity. In making such comparisons, however, you should bear in mind that adjusted EBITDA is not defined and is not a recognized financial measure under Mexican GAAP or U.S. GAAP and that it may be calculated differently by different companies and must be read in conjunction with the explanations that accompany it. Adjusted EBITDA as presented in this table does not take into account our working capital requirements, debt service requirements and other commitments.

We believe that adjusted EBITDA can be useful to facilitate comparisons of operating performance between periods and with other companies in our industry because it excludes the effect of (i) depreciation and amortization, which represents a non-cash charge to earnings, (ii) certain financing costs, which are significantly affected by external factors, including interest rates, foreign currency exchange rates, and inflation rates, which have little or no bearing on our operating performance, (iii) other income (expense) that are not constant operations and (iv) income tax expense and employee statutory profit-sharing expense. However, adjusted EBITDA has certain material limitations, including that (i) it does not include taxes, which are a necessary and recurring part of our operations; (ii) it does not include depreciation and amortization, which, because we must utilize property, equipment and other assets in order to generate revenues in our operations, is a necessary and recurring part of our costs; (iii) it does not include comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenue; and (iv) it does not include other income and expenses that are part of our net income. Therefore, any measure that excludes any or all of taxes, depreciation and amortization, comprehensive cost of financing and other income and expenses has material limitations.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion is derived from our audited financial statements, which are presented elsewhere in this prospectus. This discussion does not include all of the information included in our financial statements. You should read our financial statements to gain a better understanding of our business and our historical results of operations.*

*We have prepared our financial statements in accordance with Mexican GAAP, which differs in certain respects from U.S. GAAP. See Note 19 to our audited financial statements for the years ended December 31, 2003, 2004 and 2005 and Note 16 to our unaudited condensed consolidated financial statements for the six-month period ended June 30, 2006 for a summary of the principal differences between Mexican GAAP and U.S. GAAP as they relate to us and a reconciliation to U.S. GAAP of net income and stockholders' equity, a statement of changes in stockholders' equity and, in our unaudited condensed consolidated interim financial statements, a statement of cash flows under U.S. GAAP. Our audited financial statements and all other financial information contained herein with respect to the years ended December 31, 2003, 2004 and 2005 are presented in constant pesos with purchasing power as of June 30, 2006, unless otherwise noted. Our unaudited consolidated financial statements for the six-month period ended June 30, 2006, which include comparative unaudited financial information for the six-month period ended June 30, 2005, and all other financial information presented below with respect to the six-month periods ended June 30, 2006 and 2005 are presented in constant pesos with purchasing power as of June 30, 2006, unless otherwise noted.*

*Our financial statements and the corresponding discussion below includes the consolidation of Republic from July 22, 2005 and the consolidation of the Atlax Acquisition from August 1, 2004. Period to period comparison of our results of operations and financial condition may be difficult as a result of the inclusion of the Republic financial information only from July 22, 2005 and of the Atlax Acquisition financial information only from August 1, 2004.*

### Overview

We are producers of SBQ and structural steel products. Accordingly, our net sales and profitability are highly dependent on market conditions in the steel industry which is greatly influenced by general economic conditions in North America and elsewhere. As a result of the significant competition in the steel industry and the commodity-like nature of some of our products, we have limited pricing power over many of our products. The North American and global steel markets influence finished steel product prices. Nevertheless, the majority of our products are SBQ products for which competition is limited, therefore generating somewhat higher margins as compared with our more commoditized steel products. We attempt to adjust the mix of our product output toward higher margin products to the extent that we are able to do so, and we also adjust our overall product levels based on the product demand and marginal profitability of doing so.

We focus on controlling our direct cost of sales as well as our indirect manufacturing, selling, general and administrative expenses. Our direct cost of sales largely consist of the costs of acquiring the raw materials necessary to manufacture steel, primarily scrap and iron ore. Market supply and demand generally determine scrap and iron ore prices, and, as a result, we have limited ability to influence their cost or the costs of other raw materials, including energy costs. There is a correlation between the prices of scrap and iron ore and finished product prices, although the degree and timing of this correlation varies from time to time, so we may not always be able to fully pass along scrap, iron ore and other raw material price increases to our customers. Therefore, our ability to decrease our direct cost of sales as a percentage

of net sales is largely dependent on increasing our productivity. Our ability to control indirect manufacturing, selling, general and administrative expenses, which do not correlate to net sales as closely as direct costs of sales do, is a key element of our profitability.

Production costs at our U.S. facilities are higher than those in our facilities in Mexico principally due to the higher cost of labor and the higher cost of ferroalloys used to manufacture SBQ steel, which is the only steel product that we produce in the United States.

### Sales Volume, Price and Cost Data, 2005 - 2003

	Year ended December 31,			Six months ended June 30	
	2003	2004	2005	2005	2006
Shipments (thousands of tons)	628	773	1,708	524	1,369
Guadalajara and Mexicali	628	617	617	311	307
Apizaco and Cholula	-	156	416	213	210
Republic facilities	-	-	675	0	852
Net Sales (Ps. mm)	3,047	5,910	12,967	3,574	11,912
Guadalajara and Mexicali	3,047	4,669	3,957	2,101	2,107
Apizaco and Cholula	-	1,241	2,750	1,473	1,439
Republic facilities	-	-	6,260	0	8,366
Direct Cost of Sales (Ps. mm)	2,002	3,435	10,371	2,327	9,682
Guadalajara and Mexicali	2,002	2,567	2,442	1,273	1,204
Apizaco and Cholula	-	868	2,028	1,054	1,012
Republic facilities	-	-	5,901	0	7,466
Average Price per Ton (Ps.)	4,852	7,646	7,592	6,821	8,701
Guadalajara and Mexicali	4,852	7,567	6,413	6,756	6,863
Apizaco and Cholula	-	7,955	6,611	6,915	6,852
Republic facilities	-	-	9,274	0	9,819
Average Cost per Ton (Ps.)	3,188	4,444	6,072	4,441	7,072
Guadalajara and Mexicali	3,188	4,160	3,958	4,093	3,922
Apizaco and Cholula	-	5,564	4,875	4,948	4,819
Republic facilities	-	-	8,742	0	8,763

Our results are affected by general global trends in the steel industry and by the economic conditions in the countries in which we operate and in other steel producing countries. Our results are also affected by the specific performance of the automotive, non-residential construction, industrial equipment, tooling equipment and other related industries. Our profitability is also impacted by events that affect the price and availability of raw materials and energy inputs needed for our operations. The variables and trends mentioned below could also affect our results and profitability.

*Our primary source of revenue is the sale of SBQ steel and structural steel products.*

In August 2004, we completed the Atlax Acquisition. In July 2005, we and our controlling shareholder, Industrias CH, completed the acquisition of Republic. These acquisitions allowed us to become the leading producer of SBQ steel in North America and the leading producer of structural and light structural steel in Mexico. We expect the sale of SBQ steel, structural steel and other steel products to continue to be our primary source of revenue. The markets for our

products are highly competitive and highly dependent on developments in global markets for those products. The main competitive factors are price, product quality and customer relationships and service.

*Our results are affected by economic activity, steel consumption and end-market demand for steel products.*

Our results of operations depend largely on macroeconomic conditions in North America. Historically, there has been a strong correlation between the annual rate of steel consumption and the annual change in gross domestic products (“GDP”) in the Mexican, U.S. and Canadian markets.

We sell our steel products to the construction, automotive, manufacturing and other related industries. These industries are generally cyclical, and their demand for steel is impacted by the stage of their industry market cycles and the country’s economic performance. In 2004 and 2005, Mexico’s GDP increased 4.2% and 3.0%, respectively. In 2004 and 2005, the U.S. GDP increased 3.9% and 3.2%, respectively. Recession or a deterioration in economic conditions in the countries in which we operate could adversely affect our results

*Our results are affected by international steel prices and trends in the global steel industry.*

Steel prices are generally set by reference to world steel prices, which are determined by global supply and demand trends. As a result of general excess capacity in the industry, the world steel industry was previously subject to substantial downward pricing pressure, which negatively impacted the results of steel companies in the second half of 2000 and all of 2001. International steel prices generally improved beginning in 2003, driven by a strong increase in global demand fostered by economic growth in Asia and an economic recovery in the United States, combined with increased rationalization of production capacity in the United States and elsewhere.

However, this new period of high prices for steel encouraged reactivation of investment in production capacity, and, consequently, an increase in the supply of steel products that contributed to a decline in steel prices. Average steel prices in 2005 were below those of 2004, but remained substantially higher than steel prices for the 2001 to 2003 period. In the first nine months of 2006, steel prices increased to levels above those of 2005 due to strong end-market demand fundamentals for a number of key steel-consuming industries, continued strong steel demand in China, India and other developing economies, relatively high raw material and energy costs and reductions in U.S. production from some of the industry’s largest producers. In the last quarter of 2006, global steel prices have shown signs of weakening.

In recent years, there has been a trend toward consolidation of the steel industry. For example, Aceralia, Arbed and Usinor merged in February 2002 to create Arcelor, and LNM Holdings and Ispat International merged in October 2004 to create Mittal Steel, which subsequently acquired International Steel Group. In 2006, Arcelor completed the acquisition of Dofasco in Canada, and Mittal Steel announced the acquisition of Arcelor, forming the largest steel company in the world. In addition, a number of other steel acquisition transactions have been announced, including the pending acquisition of Oregon Steel by Evraz and the pending acquisition of Corus by either Tata Steel or CSN. Consolidation has enabled steel companies to lower their production costs and allowed for more stringent supply-side discipline, including through selective capacity closures or idling, as the ones observed recently in the United States by Mittal Steel, U.S. Steel and others. Consolidation may result in increased competition and could adversely affect our results.

*Our results are affected by competition from imports.*

Our ability to sell our products is influenced, to varying degrees, by global trade for steel products, particularly trends in imports of steel products into the Mexican and U.S. markets. In 2004, imports to Mexico declined as international market conditions improved and the peso weakened. During 2005, the Mexican government, at the request of CANACERO, implemented several measures to prevent unfair

trade practices such as dumping in the steel import market. These measures include initiating anti-dumping and countervailing duty proceedings temporarily increasing import tariffs for countries with which Mexico does not have free trade agreements. As a result, the competitive price pressure from dumping declined, contributing to a general upward trend in domestic Mexican steel prices.

Steel imports to the United States, accounted for an estimated 25% of the domestic steel market in 2005 and an estimated 26% in 2004. Foreign producers typically have lower labor costs, and are in some cases owned, controlled or subsidized by their governments, allowing production and pricing decisions to be influenced by political and economic policy considerations as well as prevailing market conditions. Increases in future levels of imported steel in the United States could reduce future market prices and demand levels for steel in the United States. To this extent, the U.S. Department of Commerce and the U.S. International Trade Commission are currently conducting five year "sunset" reviews of existing trade relief in several different steel products. Imports represent less of a threat to SBQ producers like us in the United States than to commodity steel producers because of the high quality requirements and standard required by buyers of SBQ steel products.

*Our results are affected by the cost of raw materials and energy.*

We purchase substantial quantities of raw materials, including scrap, iron ore, coal and ferroalloys for use in the production of our steel products. The availability and price of these inputs vary according to general market and economic conditions and thus are influenced by industry cycles. Since 2003, the general recovery of the North American economy, the significant increase in the demand for steel in China and shortage of shipping capacity has resulted in a tight market and higher prices for these raw materials.

In addition to raw materials, natural gas and electricity are both relevant components of our cost structure. We purchase natural gas and electricity at prevailing market prices in Mexico and the United States. These prices are impacted by general demand and supply for energy in the United States and Mexico and have increased significantly in 2004 and 2005 as economic activity fueled energy demand and the supply and price of oil was impacted by geopolitical conflicts.

### **Comparison of Six Months Ended June 30, 2006 and 2005**

#### *Net Sales*

Our net sales in the six months ended June 30, 2006 increased 233% to Ps. 11,912 million (including sales in Mexico of Ps. 3,546 million and net sales in our newly acquired Republic plants in the United States and Canada, or our "Republic facilities", of Ps. 8,366 million), compared to Ps. 3,574 million in the same period of 2005 (which sales were only in Mexico). We attribute this increase to net sales generated by the Republic facilities. Sales in tons of basic steel products increased 162% to 1,369,352 metric tons in the six months ended June 30, 2006 (including 851,752 metric tons generated by the Republic facilities) compared to 523,501 metric tons in the same period of 2005. Our net sales in the six-months ended June 30, 2006 decreased 4% to \$11,912 million compared to \$12,388 million in the same period in 2005 on a pro forma basis.

Sales outside Mexico (including sales by our U.S. subsidiaries) of basic steel products increased 1,116% to 908,283 metric tons in the six months ended June 30, 2006 (including 851,752 metric tons generated by the Republic facilities) compared to 74,692 metric tons in the same period of 2005. We attribute this increase to sales from our Republic facilities. We sold 1,388 metric tons of billet in the six months ended June 30, 2006, compared to 12,870 tons of billet in the same period of 2005. Billet sales do not contribute materially to our net sales or to our operating results.



The average price of our steel products (excluding the sales from our Republic facilities) increased 2% in real terms in the six months ended June 30, 2006 compared to the same period of 2005. We attribute this increase to higher prices prevailing in the Mexican steel markets.

#### *Direct Cost of Sales*

Our direct cost of sales in the six months ended June 30, 2006 increased 316% to Ps. 9,682 million (including Ps. 7,466 million relating to the newly acquired Republic facilities) compared to Ps. 2,327 million in the same period of 2005. Direct cost of sales as a percentage of our net sales was 81% (62% excluding the cost of sales of Republic) in the six months ended June 30, 2006 compared to 65% in the same period of 2005 and 81% on a pro forma basis. We attribute the higher cost of sales in the six months ended June 30, 2006 primarily to the cost of sales of the products that we produce in our Republic facilities. The higher cost of sales of the Republic facilities is mainly a result of higher labor costs prevailing in our U.S. operations, and the higher cost of raw materials, which our U.S. operations use in the production of SBQ steel. Hourly wages at our Mexican operations are approximately \$4 per hour on average compared to average hourly wages in our U.S. operations of an average of more than \$30 per hour. Although raw material costs are similar in the United States and Mexico, our U.S. operations produce only the more costly SBQ steel, which requires more expensive raw materials such as chromium, nickel, molybdenum and other alloys. Our Mexican operations require these alloys to a lesser extent, because they produce commodity steel as well as SBQ steel. The average cost of raw materials that we used to produce steel products (excluding the production of Republic) decreased 2% in real terms in the six months ended June 30, 2006 compared to the same period of 2005, primarily as a result of decreases in the price of scrap and certain other raw materials.

#### *Marginal Profit*

Our marginal profit in the six months ended June 30, 2006 increased 79% to Ps. 2,230 million (including Ps. 900 million relating to the newly acquired plants of Republic) compared to Ps. 1,247 million in the same period of 2005. We attribute this increase to the increase in sales from the Republic facilities and to higher prices prevailing in the Mexican steel markets. In early April 2006, one of our competitors, Siderurgica Lazaro Cardenas Las Truchas, S.A. ("SICARTSA"), the principal producer of rebar in Mexico, stopped production because its employees went on strike until mid-August 2006. The strike generated a shortage in the supply of rebar and light section structurals, which generated a price increase in those products compared to international prices because of an imbalance in the supply and demand in the Mexican market. As a percentage of net sales, marginal profit was 19% (37% excluding the marginal profit of Republic) in the six months ended June 30, 2006 compared to 35% in the same period of 2005 and 19% on a pro forma basis. This decrease is the result of the higher cost of sales prevailing at our Republic facilities.

#### *Indirect Manufacturing, Selling, General and Administrative Expenses*

Our indirect manufacturing, selling, general, and administrative expenses (including depreciation and amortization) in the six months ended June 30, 2006 increased 77% to Ps. 664 million (including Ps. 304 million relating to the Republic facilities) from Ps. 375 million in the same period of 2005. We recorded an increase of Ps. 71 million, or 54%, in depreciation and amortization expense, which in the six months ended June 30, 2006 was Ps. 202 million (including Ps. 68 million relating to the Republic facilities) compared to Ps. 131 million in the same period of 2005 and increase of Ps. 58 million, or 40%, compared to Ps. 144 million on a pro forma basis. We attribute this increase to the operating expenses from our Republic facilities, which we acquired in July of 2005.

#### *Operating Income*

Our operating income in the six months ended June 30, 2006 increased 79% to Ps. 1,566 million (including Ps. 596 million relating to the newly acquired plants of Republic) compared to Ps. 872 million in the same period of 2005. Operating income was 13% of net sales in the six months ended June 30, 2006 compared to 24% of net sales in the same period of 2005 and 13% on a pro forma basis. We attribute the overall decrease as a percentage of our net sales to the consolidation of Republic's lower operating income with the operating income at the Mexican facilities.

*Financial Income (Expense)*

We recorded financial income of Ps. 45 million in the six months ended June 30, 2006 compared to financial expense of Ps. 35 million in the same period of 2005. Financial income or expense reflects the sum of three components: exchange gain or loss, net interest income or expense, and gain or loss from monetary position. We recorded an exchange gain of approximately Ps. 19 million in the six months ended June 30, 2006 compared to an exchange loss of Ps. 36 million in the same period of 2005, reflecting a 5.7% decrease in the value of the peso compared to the dollar in the six months ended June 30, 2006 compared to a 3.7% increase in the value of the peso versus the dollar in the same period of 2005. Net interest income was Ps. 15 million in the six months ended June 30, 2006 compared to Ps. 8 million in the same period of 2005 and Ps. 77 million on a pro forma basis. We recorded a gain from monetary position of Ps. 12 million in the six months ended June 30, 2006 compared to a loss from monetary position of Ps. 8 million in the same period of 2005, reflecting the domestic inflation rate of 0.7% in the six months ended June 30, 2006 as compared to 0.8% in the same period of 2005. We attribute the increase in financial income to exchange gains due to a decrease in the value of the peso relative to the dollar and to higher interest net income due in part to our low levels of debt.

*Other Income (Expense), Net*

We recorded other income, net, of Ps. 33 million in the six-months ended June 30, 2006, consisting of (i) income of Ps. 15 million from the cancellation of labor obligations in the acquisition of Atlax and Metamex, (ii) income of Ps. 3 million from recovery of expenses, (iii) income of Ps. 2 million from recovery of insurance freight charges and (iv) other income net, related to other financial operations of Ps. 13 million. Other income, net of Ps. 8 million in the same period of 2005 consisted of (i) income of Ps. 4 million for the recovery of added value tax, (ii) income of Ps. 1 million from recovery of insurance freight charges and (iii) other income net, related to other financial operations of Ps. 3 million.

*Income Tax and Employee Profit Sharing*

We recorded an income tax provision of Ps. 105 million for income tax and employee profit sharing in the six months ended June 30, 2006 (including a decrease in the provision of Ps. 63 million with respect to deferred income tax) compared to a provision of Ps. 97 million in the same period of 2005 and Ps. 323 million on a pro forma basis (including an increase in the provision of Ps. 24 million with respect to deferred income tax). This provision increased due to higher net sales, operating income and financial income.

The effective tax rate was 12% and 7% for the six month periods ended June 30, 2005 and 2006 respectively. For the six month period ended June 30, 2005 the effective tax rate was lower than the 30% applicable tax rate in Mexico, mainly because in 2005 the company determined a tax benefit due of the non-accumulation of taxes, in the coming years, of its inventory balance at December 31, 2004 due to a corporate restructure (spin-off of its subsidiary COSICA) of the company. In addition, there was a decrease in the deferred assets valuation allowance based on an improvement on the recovery of these assets. For the six month period ended June 30, 2006 the effective tax rate was lower than the 29% and 35% tax rates applicable in Mexico and the United States respectively, mainly because in 2006 the



company amortized all of its deferred credit (See Note 1f to the interim financial statements) which is non-taxable income.

#### *Net Consolidated Income*

Our net income increased 106% in the six months ended June 30, 2006 to Ps. 1,539 million compared to net income of Ps. 747 million in the same period of 2005 and 35% to Ps. 1,141 million on a pro forma basis. We attribute this increase primarily to net income from the Republic facilities, higher prices in the Mexican steel market and higher financial income.

#### **Comparison of Years Ended December 31, 2005, 2004 and 2003**

##### *Net Sales*

Our net sales in 2005 increased 119% to Ps. 12,967 million (including the net sales of Ps. 2,750 million generated by the plants that we acquired in August 2004 in Apizaco and Cholula and of Ps. 6,260 million generated by the plants of Republic that we acquired in July 2005) compared to Ps. 5,910 million in 2004 (including the net sales of Ps. 1,241 million generated since August 1, 2004 by the plants in Apizaco and Cholula) and in 2004 increased 94% compared to Ps. 3,047 million in 2003. We attribute the increase in 2005 net sales compared to 2004 to the inclusion for the full year 2005 of net sales of Ps. 2,750 million from the plants in Apizaco and Cholula as well as Ps. 6,260 million from the Republic plants. We attribute the increase in 2004 net sales compared to 2003 net sales to substantially higher prices for our basic steel products, reflecting global steel price increases, primarily in the second quarter of the year and from significantly higher production levels, largely resulting from the inclusion of production by the Apizaco and Cholula facilities. Sales in tons of basic steel products increased 121% in 2005 to 1,708,140 tons (including 413,925 metric tons generated by the plants in Apizaco and Cholula and 674,957 metric tons generated by the Republic plants) from 773,297 tons in 2004, which in turn had increased 23% in 2004 (including 155,614 tons produced by the plants in Apizaco and Cholula) from 628,243 tons in 2003.

Sales outside Mexico of steel products (including sales of our U.S. subsidiaries) increased 733% to 809,083 metric tons in 2005 (including 19,261 tons from our plants in Apizaco and Cholula and 674,957 metric tons from the Republic facilities) compared to 97,126 metric tons 2004 (including 12,394 metric tons from the plants in Apizaco and Cholula). Exports of basic steel products in 2004 increased 20% compared to 2003 to 97,126 tons (including 12,394 tons from the plants in Apizaco and Cholula). We sold 14,488 tons of billet in 2005, 41,832 tons of billet in 2004 and 63,616 tons of billet in 2003. Billet sales do not contribute materially to our net sales or otherwise to our operating results.

The average price of steel products (excluding the sales of Republic) decreased 14% in real terms in 2005 compared to 2004 and increased 63% in real terms in 2004 compared to 2003. We attribute the 2005 decrease to the global decrease of finished steel product prices reflecting higher inventory levels worldwide, and we attribute the 2004 increase to the significant global rise in overall demand and of finished steel product prices.

##### *Direct Cost of Sales*

Our direct cost of sales increased 202% in 2005 to Ps. 10,371 million (including Ps. 2,028 million relating to the newly acquired plants in Apizaco and Cholula and Ps. 5,901 million relating to the newly acquired Republic facilities) compared to Ps. 3,435 million in 2004 (including Ps. 868 million relating to the Apizaco and Cholula plants) and in 2004 increased 72% compared to Ps. 2,002 million in 2003. Our



direct cost of sales as a percentage of net sales increased to 80% in 2005 from 58% in 2004 and 66% in 2003.

We attribute our higher direct cost of sales in 2005 compared to 2004 to the cost of sales relating to the Republic plants, which represented 94.3% as a percentage of net sales. The higher cost of sales was mainly the result of higher labor costs prevailing in our U.S. operations and the higher cost of raw material involved in the production of SBQ steel, which is the only steel product that we produce in the United States. We attribute our higher direct cost of sales in 2004 compared to 2003 to the increased cost of raw materials and somewhat higher production levels. The average cost of raw materials that we used to produce steel products (excluding the production of Republic) increased 1% in real terms in 2005 compared to 2004, primarily as a result of increases in the price of scrap and certain other raw materials. The average cost of raw materials that we used to produce steel products in 2004 increased 44% from 2003, primarily as a result of increases in the price of scrap, electricity and gas.

In 2004 we experienced a 45% increase in the price of scrap and other raw materials. However, due to strong customer demand reflecting low inventory levels, we were able to increase our prices by 63%. During this uptrend in the steel cycle in 2004, we were able to pass on to our customers substantially all raw material increases through surcharges. As inventory levels started to rise in early 2005 in the international and Mexican markets, we reduced our prices by 14% (excluding the production of Republic) from 2004 levels, while our direct costs of sales per ton increased 1%.

#### *Marginal Profit*

Our marginal profit in 2005 increased 5% to Ps. 2,596 million (including Ps. 722 million relating to the newly acquired plants in Apizaco and Cholula and Ps. 359 million relating to the newly acquired plants of Republic) compared to Ps. 2,475 million in 2004 (including Ps. 373 million relating to the plants in Apizaco and Cholula) and in 2004 increased 137% compared to Ps. 1,045 million in 2003. As a percentage of net sales, our marginal profit was 20% in 2005 (33% without Republic) compared to 42% in 2004 and 34% in 2003. We attribute the decrease in marginal profit as a percentage of net sales in 2005 to higher labor costs prevailing in our U.S. operations and higher cost of raw material involved in the production of SBQ steel, and we attribute the increase in 2004 to the significant global rise of finished product prices. Because of low steel inventories in 2004, we were able to pass on to customers, through surcharges, more than the cost increases in scrap and certain other raw materials. Therefore, our marginal profit as a percentage of net sales increased to 42% in 2004 compared to 34% in 2003. As international steel inventory levels increased in 2005, prices and surcharges decreased, with our marginal profit as a percentage of net sales falling to 33% which was similar to our 34% marginal profit level in 2003.

#### *Indirect Manufacturing, Selling, General and Administrative Expenses*

Indirect manufacturing, selling, general and administrative expenses, which include depreciation and amortization, increased 72% (25% without Republic) to Ps. 1,018 million in 2005 (including Ps. 249 million relating to the newly acquired plants in Apizaco and Cholula and Ps. 271 million relating to the newly acquired Republic plants) compared to Ps. 593 million in 2004 (including Ps. 75 million relating to the plants in Apizaco and Cholula) and in 2004 increased 17% compared to Ps. 507 million in 2003.

We attribute the increase in these expenses in 2005 compared to 2004 primarily to the Republic plants. We attribute the increase in these expenses in 2004 compared to 2003 primarily to the Apizaco and Cholula plants.

Depreciation and amortization increased by 47% to Ps. 326 million in 2005 (including Ps. 60 million relating to the plants in Apizaco and Cholula and Ps. 69 million relating to the Republic plants)

and increased by 11% to Ps. 222 million in 2004 (including Ps. 25 million relating to the plants in Apizaco and Cholula) from Ps. 199 million in 2003. We attribute the increase in 2005 compared to 2004 to the inclusion for the full year 2005 of the depreciation that the Apizaco and Cholula plants generated and the depreciation relating to the Republic plants. We attribute the increase in 2004 compared to 2003 to the depreciation relating to the Apizaco and Cholula plants.

#### *Operating Income*

Our operating income decreased by 16% to Ps. 1,578 million in 2005 from Ps. 1,882 million in 2004 and in 2004 increased 250% from Ps. 538 million in 2003. Operating income represented 12%, 32% and 18% of our net sales in 2005, 2004 and 2003, respectively. We attribute the decrease in 2005 to the global decrease of finished steel product prices, and we attribute the increase in 2004 to the significant global rise in demand and in finished steel product prices.

#### *Financial Income (Expense)*

Our financial expense increased 282% to Ps. 145 million in 2005 from Ps. 38 million in 2004, and in 2004 increased 40% from Ps. 27 million in 2003. Financial income or expense reflects the sum of three components: exchange gain or loss, net interest income or expense and gain or loss from monetary position. We recorded an exchange loss of approximately Ps. 75 million in 2005 compared to an exchange gain of Ps. 4 million in 2004 and an exchange loss of Ps. 3 million in 2003. These exchange results reflect the 4.3% increase in the value of the peso versus the dollar in 2005 compared to a decrease of 0.3% in the value of the peso versus the dollar in 2004. The exchange gain in 2004 also reflected lower debt levels than in the prior year. During 2003 and 2004, we made various prepayments on our bank debt and we also converted certain loans from our parent to equity.

Net interest expense was Ps. 16 million in 2005 compared to Ps. 6 million of net interest income in 2004 and Ps. 14 million of net interest expense during 2003. The increase in 2005 reflected a higher amount of debt outstanding during 2005 compared to 2004 resulting from the acquisition of Republic, and the decrease in 2004 reflected a lower amount of debt outstanding compared to 2003.

We recorded a loss from monetary position of Ps. 54 million in 2005 compared to a loss from monetary position of Ps. 47 million in 2004 and a loss from monetary position of Ps. 10 million in 2003. These increases reflected the domestic inflation rate of 3.3% in 2005 as compared to 5.2% in 2004 and 4% in 2003 as well as higher debt levels during 2005 compared to 2004 and in 2004 lower debt levels as compared to 2003 as a result of the developments discussed above.

#### *Other Income (Expense), Net*

We recorded other income, net, of Ps. 55 million in 2005. This amount reflected:

- income from the amortization of the deferred credit of Ps. 67 million;
- expense for the cancellation of the technical assistance of Ps. 38 million;
- income from the recovery of a commission from Banco Nacional de Comercio Exterior for Ps. 8 million; and
- other income, net, related to other financial operations of Ps. 18 million.

We recorded other expense, net, of Ps. 38 million in 2004. This amount reflected:





- income from the reversal of an account recorded as a doubtful account of Ps. 14 million;
- a reserve of Ps. 6 million relating to the clean-up of contaminated land at the Pacific Steel facilities;
- a reserve of Ps. 13 million relating to the realizable value of idle machinery and equipment;
  - a reserve for doubtful accounts of Ps. 10 million; and
- other expense related to other financial operations of Ps. 23 million.

We recorded other expense, net, of Ps. 32 million in 2003. This amount reflected:

- a reserve of Ps. 12 million relating to the clean-up of contaminated land at the Pacific Steel facilities;
- a reserve of Ps. 19 million relating to the realizable value of idle machinery and equipment; and
  - other expense, net, related to other financial operations of Ps. 1 million.

#### *Income Tax and Employee Profit Sharing*

For the years ended December 31, 2005, 2004 and 2003 we recorded an income tax provision of Ps. 191 million, Ps. 344 million and Ps. 159 million, respectively. These amounts included a provision for deferred income taxes of Ps. 112 million in 2005, Ps. 320 million in 2004 and Ps. 140 million in 2003.

Our effective income tax rates for the fiscal years ended December 31, 2005, 2004 and 2003 were 12.8%, 19.02% and 31.98% respectively. The effective income tax rate in 2005 was less than the statutory rate of 30%, mainly for the following reasons:

- In 2004, we had a valuation allowance that covered almost the total amount of the recoverable asset tax and tax loss carryforwards due to the uncertainty of their recovery. However, in 2005 we recovered Ps. 84 million of assets tax. As a result of this recovery and future estimations, we reduced our valuation allowance on our deferred tax asset as of December 31, 2005. The net change in the valuation allowance for the year ended December 31, 2005 was a decrease of Ps. 132.4 million.
- In accordance with tax laws in effect through December 31, 2004, inventory purchases were tax deductible in the year in which they were made, regardless of the time of sale of finished goods. As of 2005, the cost of acquiring inventories was tax deductible only when sold, although the law provides transition provisions to tax the ending inventory balance at December 31, 2004 over periods that vary depending on the circumstances of each entity. During 2005 we obtained a tax benefit of Ps. 420.5 million, because of the non-accumulation, in subsequent years, of tax on our inventory balance at December 31, 2004 due to our corporate restructuring (spin-off of its subsidiary COSICA). Also, we recorded an additional deferred tax liability for the amount of Ps. 303.5 million, to account for the difference of the net income of the 2005 period for which we did not pay taxes. See Note 13(c) to the Consolidated Financial Statements.

These changes resulted in favorable tax differences that had a one time impact in our effective income tax rate for 2005 and 2004.

A new income tax law was enacted in Mexico on December 1, 2004, which established an income tax rate of 30% for 2005, 29% for 2006, and 28% for 2007 and subsequent years. As a result of these changes, for the year ended December 31, 2004, we recognized a decrease in the net deferred tax liability of Ps. 288.5 million which was credited to results of operations.

#### *Net Consolidated Income*

We recorded net income of Ps. 1,280 million, Ps. 1,462 million and Ps. 320 million in 2005, 2004 and 2003, respectively. We attribute the decrease in 2005 to the global decrease of finished steel product prices, and we attribute the increase in 2004 to the significant global increase in overall demand and in finished steel product prices.

#### **Liquidity and Capital Resources**

As a result of the economic crisis in Mexico arising from the devaluation of the peso versus the U.S. dollar in 1994, including the liquidity crisis which affected the Mexican banking system, the insolvency of our former parent, Sidek, and our high levels of short-term indebtedness, we became unable to generate or borrow funds to refinance our debt or to support our operations and capital improvements. As of December 15, 1997, and immediately prior to the consummation of the restructuring discussed below, we had total outstanding indebtedness of approximately \$322 million. Over half of our debt had matured and was unpaid and substantially all of the balance was subject to acceleration.

In December 1997, we consummated a corporate reorganization and restructuring of our liabilities. As part of this restructuring, our wholly-owned subsidiary, Compañía Siderúrgica de Guadalajara, S.A. de C.V. ("CSG"), incurred new bank debt and issued new debt securities and paid limited amounts of accrued interest on certain outstanding debt in exchange for and in an aggregate amount approximately equal to our aggregate outstanding consolidated debt at the date of consummation of the restructuring. In exchange, CSG received equity in all of our subsidiaries, and we eliminated the intercompany debt that CSG owed to us.

The restructuring did not result in a reduction in the overall amount of our consolidated outstanding debt, and, accordingly, following the restructuring, through CSG, we continued to be highly leveraged. In 2001, subsequent to Industrias CH's acquisition of a controlling interest in us, CSG redeemed or repurchased all of the outstanding debt securities it had issued in connection with the restructuring, which it financed principally with borrowings from Industrias CH. In 2001, we converted approximately \$90 million of bank debt to equity, which equity Industrias CH acquired. From 2001 through 2004, CSG continued to pay down its outstanding bank debt, making scheduled amortization payments as well as additional principal payments which it financed primarily by capital contributions from Industrias CH or borrowings from Industrias CH which it later converted to equity. In March 2004, we prepaid U.S.\$1.7 million of the remainder of our outstanding bank debt.

At June 30, 2006, our total consolidated debt consisted of U.S.\$302,000 of 8-7/8% medium-term notes due 1998 (accrued interest at June 30, 2006 was U.S.\$322,798). We conducted exchange offers for the MTNs in October 1997 and August of 1998. This amount reflects sums that we did not pay to holders that we could not identify at the time of the exchange offers.

At December 31, 2005, our total consolidated debt consisted of U.S.\$38 million (Ps. 433 million), of which U.S.\$33.4 million was debt held by GE Capital, U.S.\$4.3 million was held by the Ohio



Department of Development Loan, and U.S.\$302,000 was 8-7/8% medium-term notes due 1998 (accrued interest at December 31, 2005 was U.S.\$309,311). The U.S.\$309,311 reflects sums that we did not pay to holders that we could not identify at the time of the exchange offers. At December 31, 2003 and 2004, respectively, our total consolidated debt consisted of U.S.\$2 million (Ps. 25 million) and U.S.\$13.9 million (Ps. 163 million).

On August 9, 2004, we acquired the property, plant and equipment and the inventories, and assumed liabilities associated with seniority premiums of employees, of the Mexican steel-making facilities of Grupo Sidor located in Apizaco and Cholula. Our total net investment in this transaction was approximately U.S.\$122 million ((Ps. 1,483 million) which amount excludes value added tax of \$16 million (Ps. 196 million)) which we paid in 2004 and recouped from the Mexican government in 2005), funded with our internally generated resources and capital contributions from Industrias CH of U.S.\$19 million (Ps. 230 million) for capital stock to be issued in the second quarter of 2005. Approximately \$107.5 million (Ps. 1,260 million) of our investment related to the acquisition of property, plant and equipment, approximately \$7 million (Ps. 86 million) related to a technical assistance contract with the seller and the balance relates to inventories acquired.

On July 22, 2005, we and our parent company Industrias CH acquired 100% of the stock of Republic. We acquired 50.2% of Republic's stock for U.S.\$115 million (Ps. 1,310 million) through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% through SimRep for U.S.\$114 million (Ps. 1,299 million). We financed our portion of the U.S.\$229 million (Ps. 2,609 million) purchase price principally from a loan received through Industrias CH that has since been repaid in full. At December 31, 2005, the total amount of Republic's debt was U.S.\$37.7 million (Ps. 409 million), which debt has since been repaid in full.

We depend heavily on cash generated from operations as our principal source of liquidity. Other sources of liquidity have included financing made available to us by our parent Industrias CH (primarily in the form of equity, or debt substantially all of which was subsequently converted to equity), most significantly for the purpose of repaying third party indebtedness, and limited amounts of vendor financing. We have had very limited access to and have not borrowed any material amounts from unaffiliated third parties since consummation of the restructuring. We believe that our existing cash, cash equivalents and cash generated from operations will be sufficient to satisfy our currently anticipated cash requirements through the next 12 months, including our currently anticipated capital expenditures.

Republic has a committed secured revolving line of credit from General Electric Capital Corporation ("GE Capital") under which it can borrow up to U.S.\$150 million (the "GE Facility"), which matures on May 20, 2009, extendible for one year at the option of Republic. This facility is secured by all of Republic's inventory and accounts receivable and bears interest based on one of the two following formulas, at Republic's discretion: (1) at an indexed rate equal to the highest prime rate published by the Wall Street Journal, plus the applicable margin, or the federal funds rate plus 50 base percentage points per year and the applicable margin, or (2) LIBOR plus the applicable margin. Margins were adjusted based on the available rate for the quarter on a base established in advance. Republic currently has no debt outstanding under this facility.

The GE Facility contains covenants including restrictions on engaging in any business other than our current businesses or businesses reasonably related to our current businesses, sales of properties or other assets (including the stock of any of our subsidiaries), and the amount of capital expenditures; for example, on a consolidated basis with our subsidiaries, we are restricted from making unfinanced capital expenditures during any fiscal year that exceed U.S.\$ 110 million in the aggregate. However, we may increase our unfinanced capital expenditures in any fiscal year by the lesser of (i) U.S.\$ 7.5 million and (ii) the amount (if any) equal to U.S.\$100 million minus the actual amount of unfinanced capital

expenditures in the prior fiscal year. The GE Facility also restricts our ability to incur additional indebtedness. For example, during any fiscal quarter, we may not prepay more than U.S.\$ 7.5 million in the aggregate of the senior secured promissory notes due 2009. In addition, after prepayment, we must have on a consolidated basis with our subsidiaries a fixed charge coverage ratio for the fiscal quarter most recently ended of not less than 1.1:1.0. The GE Facility also requires that on a consolidated basis with our subsidiaries, we maintain a fixed charge coverage ratio of 1.00:1.0 for the 12-month period most recently ended if at any time 85% of the book value of our eligible accounts plus the lesser of (i) 65% of the book value of our eligible inventory at the lower of cost or market, (ii) 85% of the net orderly liquidation percentage of eligible inventory and (iii) U.S.\$ 115 million, minus the sum of the revolving loan and swing line loan then outstanding, is less than U.S.\$ 30 million. In the GE Facility, the term “fixed charge coverage ratio” means the ratio of (i) EBITDA less direct proceeds of business interruption insurance solely to the extent attributable to claims arising as a consequence of events occurring prior to May 20, 2004 to (ii) the aggregate of all interest expense paid or accrued during that period, plus payments of principal with respect to indebtedness during that period plus unfinanced capital expenditures during that period plus income taxes paid or payable in cash with respect to that fiscal period (but excluding income taxes, if any on insurance proceeds) plus to the extent not otherwise deducted in the determination of EBITDA, restricted payments made during that period.

Our principal use of cash has generally been to fund our operating activities, for debt repayments, to acquire businesses and, to a significantly lesser degree, capital expenditure programs. The following is a summary of cash flows for the three years ended December 31, 2005 and for the six months ended June 30, 2006:

#### Principal Cash Flows

	Years ended December 31,			Six Months Ended June	
	2003	2004	2005	2005	2006
	(millions of constant Pesos)				
Resources provided by operating activities	436	915	1,863	664	778
Resources provided by (used in) financing	31	404	(242)	(158)	(287)
Resources provided by (used in) investing activities	(26)	(1,357)	(1,938)	133	248

Our net resources provided by operations were Ps. 778 million in the six-month period ended June 30, 2006 compared to Ps. 664 million of net resources provided by operations in the same period of 2005 and reflected our net income for the period. Our net resources provided by operating activities was Ps. 1,863 million in 2005 and reflected the net income of the year. Our net resources provided by operating activities was Ps. 915 million in 2004 and reflected significant net income offset by increases in inventories and receivables attributable to the acquisition of the Apizaco and Cholula facilities. Our net resources provided by operating activities was Ps. 436 million in 2003 and reflected the conversion of loans of Industrias CH into our series B shares for Ps. 201 million.

Our net resources used by financing activities were Ps. 287 million in the six-month period ended June 30, 2006 (which amount includes the prepayment of Ps. 409 million (U.S. \$37.7 million) of Republic’s bank debt and a capital contribution of certain minority shareholders of Simec of Ps. 122 million) compared to Ps. 158 million of net resources used by financing activities in the same period of 2005. Our net resources used in financing activities was Ps. 242 million in 2005. This amount reflected the prepayment of Ps. 1,052 million of bank debt of Republic and the loan from Industrias CH for Ps. 451 million. Our net resources provided by financing activities was Ps. 404 million in 2004. This amount reflected prepayment of bank debt of U.S.\$20 million (Ps. 228 million), the increase in capital stock



issued to minority shareholders of Ps. 25 million and a capital contribution from Industrias CH to us in the amount of Ps. 230 (\$20 million) for capital stock to be issued in the second quarter of 2005. Our net resources provided by financing activities was Ps. 31 million in 2003. This amount reflected the semi-annual amortization installments on our bank debt of Ps. 16 million (U.S.\$1.4 million), the prepayment of Ps. 352 million (\$30 million) of bank debt, the conversion into shares by Industrias CH of Ps. 201 million of loans plus accrued interest thereon, the increase of the capital stock by the minority shareholders for Ps. 21 million and the conversion into series B shares of the capital contribution from Industrias CH to us in the amount of Ps. 169 million (U.S.\$15 million) in 2003.

We attribute our net resources used in investing activities primarily to the acquisition of property, plant and equipment and other non-current assets and reflects changes in long-term inventories and proceeds from insurance claim. Our net resources provided by investing activities (to acquire property, plant and equipment and other non-current assets) were Ps. 248 million for the six months ended June 30, 2006 compared to net resources provided by investing activities of Ps. 133 million in the same period of 2005. Our net resources used in investing activities (to acquire property, plant and equipment and other non-current assets) were Ps. 1,938 million in 2005, and our net resources used to acquire Republic were Ps. 1,310 million. Our net resources used in investing activities were Ps. 1,357 million in 2004 (which amount reflects the acquisition of the Apizaco and Cholula facilities) and Ps. 26 million in 2003.

At June 30, 2006, our total consolidated debt consisted of approximately \$302,000 (Ps. 3.4 million) of U.S. dollar denominated debt (accrued interest at June 30, 2006 was \$322,798). At December 31, 2005, our total consolidated debt consisted of approximately \$38 million of U.S. dollar denominated debt. At December 31, 2004, we had outstanding approximately \$13.9 million of U.S. dollar-denominated debt.

In December 2003, we acquired Administradora de Cartera de Occidente, S.A. de C.V. ("Acosa") from Industrias CH for nominal consideration. Acosa's sole asset is a portfolio of defaulted receivables it acquired in June 2003 from various Mexican banks which are in the process of liquidation. The purchase price of the portfolio is payable by Acosa solely from recoveries, if any, net of expenses of collection, with respect to the defaulted receivables. Upon payment of the purchase price from recoveries on the portfolio, Acosa and the Mexican banks will share in any additional recoveries, net of expenses of collection, on a 50%/50% basis. At December 31, 2005, we did not have any recoveries with respect to the defaulted receivables. We sold Acosa in October of 2006 for nominal consideration.

In May 2004, certain minority of our shareholders exercised their pre-emptive rights arising as a result of the conversion by Industrias CH of certain indebtedness to purchase capital stock for Ps. 24.7 million at the price per share of Ps. 14.59 (the equivalent of U.S.\$1.25 per ADS). See "Related Party Transactions" below.

We do not have in place any interest rate or currency hedging instruments. We are not a party to any non-exchange traded contracts accounted for at fair value other than, as described in Note 6 to the audited financial statements, certain futures contracts that we entered into in late 2003 to fix the price of our natural gas purchases from 2004 to 2006.

### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.

## Contractual Obligations

The table below sets forth our significant long-term contractual obligations as of December 31, 2005:

	Maturity				Total
	Less than 1 year	1 - 3 years	4 - 5 years	In excess of 5 years	
	(millions of constant Pesos)				
Long-term debt obligations	18	29	362	0	409
Long-term debt obligations (MTNs)	3	0	0	0	3
Long-term contractual obligations	0	0	0	0	0
Total	21	29	362	0	412

As of December 31, 2005, Republic had U.S.\$0.1 million included in property, plant and equipment for various equipment and computer capital leases. Republic's capital leases required future minimum payments of U.S.\$0.3 million for 2006 and were repaid in full in 2006.

## Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk, which is the potential risk of loss in fair values, cash flows or earnings due to changes in interest rates and foreign currency rates (primarily the peso/dollar exchange rate), as a result of our holdings of financial instrument positions. Our financial instruments include cash and cash equivalents, trade and other accounts receivable, accounts payable, long-term debt securities and related party debt. We do not maintain a trading portfolio. Our borrowings are entirely denominated in dollars. We do not utilize derivative financial instruments to manage our market risks with respect to our financial instruments. Historically, based on the last ten years of data, inflation in Mexico has been 327% higher than the Mexican peso's devaluation relative to the dollar.

We are exposed to market risk due to fluctuations of the purchase price of natural gas. To limit our exposure, in late 2003, we entered into futures contracts with PEMEX. We expect the contracts will guarantee a portion of our natural gas consumption in our Mexican operations at a fixed price of \$4.462 per million British thermal unit ("MMBtu"). Through December 31, 2006, our Mexican operations obtained approximately 95% of their natural gas consumption, or 2,200,000 MMBtus, from PEMEX. Between January 1, 2007 and January 31, 2007, we expect that our operations in the United States will obtain approximately 15% of their natural gas consumption, or 1,800,000 MMBtus, from futures contracts. These futures contracts are not entered into for trading purposes but, subject to market prices of natural gas, are expected to be settled by delivery of natural gas at the contract price. As described in Note 6 to our audited financial statements, at December 31, 2005, we recorded an asset of Ps. 57.5 million with respect to these contracts. We do not believe our market risk with respect to these natural gas futures contracts is material.

## Market Risk Measurement

We measure our market risk related to our financial instruments based on changes in interest rates and foreign currency rates utilizing a sensitivity analysis. The sensitivity analysis measures the potential loss in fair values, cash flows and earnings based on a hypothetical increase in interest rates and a decline in the peso/dollar exchange rate. We used market rates as of December 31, 2005 on our financial instruments to perform the sensitivity analysis. We believe that these potential changes in market rates are reasonably possible in the near-term (one year or less). Based upon our analysis of the impact of a 100 basis point increase in interest rates and a 10% decline in the peso/dollar exchange rate, we have determined that such increase in interest rates and such decline in the peso/dollar exchange rate would





have a material adverse effect on our earnings. Because there is no active trading market for our debt instruments, we are not able to determine the impact of these changes on the fair value of those debt instruments. The sections below describe our exposure to interest rates and currency rates including the impact of changes in these rates on our earnings.

### **Interest Rate Exposure**

Our primary interest rate exposure relates to long-term debt. On the asset side, we are exposed to changes in short-term interest rates as we invest in short-term dollar-denominated interest bearing investments. On the liability side, we utilize a combination of floating rate debt and fixed rate debt. The floating rate debt is exposed to changes in interest expense and cash flows from changes in LIBOR, while the fixed rate debt is mostly exposed to changes in fair value from changes in medium term interest rates. Based on an immediate 100 basis point rise in interest rates, we estimate that our earnings before taxes over a one-year time horizon would decrease by Ps. 4 million (\$0.38 million).

### **Currency Rate Exposure**

Our primary foreign currency exchange rate exposure relates to our debt securities as well as our dollar-denominated trade receivables and trade payables. Our principal currency exposure is to changes in the peso/dollar exchange rate. We estimate that a 10% decline in the peso/dollar exchange rate would result in a decrease in our earnings before taxes of Ps. 41 million (\$3.8 million).

The sensitivity analysis is an estimate and should not be viewed as predictive of our future financial performance. Additionally, we cannot assure that our actual losses in any particular year will not exceed the amounts indicated above. However, we do believe that these amounts are reasonable based on the financial instrument portfolio at December 31, 2005 and assuming that the hypothetical market rate changes selected by us in our market risk analysis occur during 2006. The sensitivity analysis does not give effect to the impact of inflation on its exposure to increases in interest rates or the decline in the peso/dollar exchange rate.

### **Critical Accounting Policies**

The discussion in this section is based upon our financial statements, which have been prepared in accordance with Mexican GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at year-end, and the reported amount of revenues and expenses during the year. Management regularly evaluates these estimates, including those related to the carrying value of property, plant and equipment and other non-current assets, inventories and direct cost of sales, income taxes and employee profit sharing, foreign currency transactions and exchange differences, valuation allowances for receivables, inventories and deferred income tax assets, liabilities for deferred income taxes, valuation of financial instruments, obligations relating to employee benefits, potential tax deficiencies, environmental obligations, and potential litigation claims and settlements. Management estimates are based on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Accordingly, actual results may differ materially from current expectations under different assumptions or conditions.

Management believes that the critical accounting policy which requires the most significant judgments and estimates used in the preparation of the financial statements relates to the impairment of property, plant and equipment and valuation allowance on accounts receivable. We evaluate periodically the adjusted values of our property, plant and equipment, to determine whether there is an indication of



potential impairment. Impairment exists when the carrying amount of an asset exceeds future revenues or net cash flow expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the expected revenues or fair value. Assets to be disposed of are reported at the lower of the carrying amount or realizable value. Significant judgment is involved in estimating future revenues and cash flows or realizable value, as applicable, of our property, plant and equipment due to the characteristics of those assets. The class of our assets which most require complex determinations based upon assumptions and estimates relates to idle machinery.

With respect to valuation allowance on accounts receivable, on a periodic basis management analyzes the recoverability of accounts receivable in order to determine if, due to credit risk or other factors, some receivables may not be collected. If management determines that such a situation exists, the book value of the non-recoverable assets is adjusted and charged to the income statement through an increase in the doubtful accounts allowance. This determination requires substantial judgment by management. As a result, final losses from doubtful accounts could differ significantly from estimated allowances.

### **New Accounting Pronouncements**

The following accounting bulletins issued by the Mexican Institute of Public Accountants are obligatory as of January 1, 2005.

#### *Business Acquisitions*

The most significant issues in Bulletin B-7 are as follows: (i) use of the purchase method as the only alternative for valuing businesses acquired and investments in associated companies, (ii) change in the accounting for goodwill, eliminating amortization and also requiring that negative goodwill not fully amortized at the date of adoption of Bulletin B-7 be carried to the results of operations, as a change in accounting principle and (iii) establishment of specific rules to account for the acquisition of minority interest and for transfers of assets or exchange of shares among entities under common control.

We opted for the early adoption of this Bulletin (see Note 14 to the audited financial statements).

#### *Labor Obligations*

The new accounting Bulletin D-3, *Labor Obligations*, was issued in January 2004. The revised Bulletin replaces and nullifies the previous Bulletin D-3, issued in January 1993 and revised in 1998. The observance of Bulletin D-3 is compulsory for fiscal years beginning on or after January 1, 2004, except for termination payments, which were in force as of January 1, 2005.

The revised Bulletin incorporates the matter of remunerations for other post-retirement benefits, thus nullifying the provisions of Circular 50, *Interest rates to be used in the valuation of labor obligations and supplementary application of accounting principles related to labor obligations*. Bulletin D-3 also eliminates the subject related to unexpected payments and, instead includes the subject related to termination payments, defining such payments as those granted to workers at the end of their employment before reaching the age of retirement, which include two types: (i) due to corporate restructuring, for which the guidelines of Mexican accounting Bulletin C-9, *Liabilities, Provisions, Contingent Assets and Liabilities and Commitments*, must be followed, and (ii) due to reasons other than restructuring, for which we must apply the valuation and disclosure rules required for retirement pensions and seniority premiums payments, thus allowing at the time that this Bulletin is adopted, to immediately recognize the transition



asset or liability in results of operations, or its amortization, in conformity with the remaining working life of the workers.

We believe that the adoption of this Bulletin did not have a material effect on our financial position or on our results of operations.

#### *Other Pronouncements*

As of May 31, 2004, the Mexican Institute of Public Accountants, or IMCP, formally transferred the function of establishing and issuing financial reporting standards to the Mexican Board for Research and Development of Financial Reporting Standards, or CINIF, consistent with the international trend of requiring this function to be performed by an independent entity.

Accordingly, the task of establishing bulletins of Mexican GAAP and circulars issued by the IMCP was transferred to CINIF, who subsequently renamed the standards of Mexican GAAP as *Normas de Información Financiera*, or Financial Reporting Standards and determined that the Financial Reporting Standards would encompass (i) new bulletins established under the new function; (ii) any interpretations issued thereon; (iii) any Mexican GAAP bulletins that have not been amended, replaced or revoked by the new Financial Reporting Standards; and (iv) International Financial Reporting Standards, or IFRS, that are supplementary guidance to be used when Mexican GAAP does not provide primary guidance.

One of the main objectives of CINIF is to achieve greater concurrence with IFRS. To this end, it started by reviewing the Conceptual Framework, or “CF” contained in Mexican GAAP and modifying it to support the development of financial reporting standards and to serve as a reference in resolving issues arising in the accounting practice. The CF consists of eight financial reporting standards, which comprise the Financial Reporting Standards-A series. The Financial Reporting Standards-A series, together with Financial Reporting Standards B-1, were issued on October 31, 2005. Their provisions are effective for years beginning January 1, 2006 and thereafter, and supersede all existing Mexican GAAP series A bulletins.

The new Financial Reporting Standards are as follows:

- Financial Reporting Standards A-1, Structure of Financial Reporting Standards
  - Financial Reporting Standards A-2, Fundamental Principles
- Financial Reporting Standards A-3, Users’ Needs and Financial Statement Objectives
- Financial Reporting Standards A-4, Qualitative Characteristics of Financial Statements
  - Financial Reporting Standards A-5, Basic Elements of Financial Statements
    - Financial Reporting Standards A-6, Recognition and Valuation
    - Financial Reporting Standards A-7, Presentation and Disclosure
- Financial Reporting Standards A-8, Supplementary Standards to Mexican GAAP
  - Financial Reporting Standards B-1, Accounting Changes

The most significant changes established under standards are as follows:



- In addition to the statement of changes in financial position, Financial Reporting Standards A-3 makes reference to a cash flows statement, which should be issued when required by a particular standard.
- Financial Reporting Standards A-5 includes a new classification for revenues and expenses: ordinary and not ordinary. Ordinary revenues and expenses are derived from transactions or events that are within the normal course of business or that are inherent in the entity's activities, whether frequent or not; revenues and expenses classified as not ordinary refer to unusual transactions and events, whether frequent or not.
- Financial Reporting Standards A-7 requires the presentation of comparative financial statements for at least the preceding period. Through December 31, 2004, the presentation of prior years' financial statements was optional. The financial statements must disclose the authorized date for their issuance, and the names of any officers or administrative bodies authorizing the related issuance.
  - Financial Reporting Standards B-1 establishes that changes in particular standards, reclassifications and corrections of errors must be recognized retroactively. Consequently, basic financial statements presented on a comparative basis with the current year that might be affected by the change, must be adjusted as of the beginning of the earliest period presented.

The implementation of these new standards did not have a significant impact on our financial information.



## BUSINESS

### Our History and Development

#### *General*

We are a diversified manufacturer, processor and distributor of SBQ steel and structural steel products with production and commercial operations in the United States, Mexico and Canada.

We believe that we are the leading producer of SBQ products in North America, with leading market positions in both the United States and Mexico and that we offer the broadest SBQ product range in those markets today. We also believe that we are the leading producer of structural and light structural steel products in Mexico, and we have an increasing presence in the U.S. market.

Our SBQ products are used across a broad range of highly engineered end-user applications, including axles, hubs and crankshafts for automobiles and light trucks, machine tools and off-highway equipment. Our structural steel products are mainly used in the non-residential construction market and other construction applications.

We focus on the Mexican and U.S. specialty steel markets by providing high value added products and services from our strategically located plants. The quality of our products and services, together with the cost advantage generated by our facility locations has allowed us to develop long standing relationships with most of our SBQ clients, which include U.S. and Mexico based automotive and industrial equipment manufacturers and their suppliers. In addition, our facilities located in the North West and Central parts of Mexico allow us to serve the structural steel and construction markets in those regions and South West California with a significant advantage in the cost of freight.

In the United States and Mexico, we own and operate ten state-of-the-art steel making, processing and/or finishing facilities with a combined annual crude steel installed production capacity of 3.4 million tons and a combined annual installed rolling capacity of 2.9 million tons. We operate both mini-mill and integrated steel making facilities, which gives us the flexibility to optimize our production and reduce production costs based on the relative prices of raw materials (e.g., scrap for mini-mills and iron ore for blast furnace).

We currently own and operate:

- Mexico's largest non-flat structural steel mini-mill, located in Guadalajara, Jalisco;
  - a mini-mill in Mexicali, Baja California Norte;
  - a mini-mill in Apizaco, Tlaxcala;
- a cold finishing facility in Cholula, Puebla; all of these facilities are owned through our indirect wholly-owned subsidiaries, Simec International, S.A. de C.V. ("SI"), Controladora Simec S.A. de C.V. and Compañía Siderurgica de Guadalajara S.A. de C.V.; and
- a mini mill in Canton, Ohio, an integrated facility in Lorain, Ohio and value-added rolling and finishing facilities in Canton, Lorain and Massillon, Ohio; Lackawanna, New York; Gary, Indiana; and Hamilton, Ontario, all of which are owned through our majority-owned subsidiary, Republic.

We are domiciled in the city of Guadalajara, Jalisco, and our principal administrative office is located at Calzada Lázaro Cárdenas 601, Guadalajara, Jalisco, Mexico 44440. Our telephone number is 011-52-33-1057-5757.

In the first half of 2006, almost all of our consolidated sales were in the North American market, 27.9% in Mexico, 71.9% in the United States and Canada, and 0.2% of our consolidated sales were exports to markets outside North America.

In 2005, we had net sales of Ps. 13.0 billion, marginal profit of Ps. 2.6 billion and net income attributable to majority interest of Ps. 1.3 billion. In the first half of 2006, our net sales were Ps. 11.9 billion, marginal profit of Ps. 2.2 billion and net income attributable to majority interest of Ps. 1.3 billion.

The chart below sets forth a summary of our corporate structure:

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(1) Includes the following non-operating subsidiaries: Compañía Siderúrgica del Pacífico, S.A. de C.V. (99.99%), Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V. (100%), Administradora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V. (99.99%), Industrias del Acero y del Alambre, S.A. de C.V. (99.99%), Procesadora Mexicali, S.A. de C.V. (99.99%), Servicios Simec, S.A. de C.V. (100%), Sistemas de Transporte de Baja California, S.A. de C.V. (100%), Operadora de Metales, S.A. de C.V. (100%), Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V. (100%), Administradora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V. (100%), and Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V. (100%), Arrendadora Simec S.A. de C.V. (100%), Controladora Simec S.A. de C.V. (100%) Compañía Siderúrgica de Guadalajara S.A. de C.V. (100%).

(2) Our principal Mexican facilities consist of steel-making facilities in Guadalajara, Jalisco, Mexicali, Baja California, and Apizaco, Tlaxcala, and a cold finishing facility in Cholula, Puebla.

(3) The remaining 49.8% of SimRep Corporation is owned by our controlling shareholder, Industrias CH, S.A.B. de C.V.

(4) SimRep owns 100% of Republic Engineered Products through its 100% interest in PAV Republic Inc. Our principal U.S. and Canadian facilities consist of a steel-making facility in Canton, Ohio, a steel-making and hot-rolling facility in Lorain, Ohio, a hot-rolling facility in Lackawanna, New York, and cold finishing facilities in Massillon, Ohio, Gary, Indiana, and Hamilton, Ontario, Canada.

### *Our History*

Our steel operations commenced in 1969 when a group of families from Guadalajara, Jalisco, formed CSG, a mini-mill steel company. In 1980, Grupo Sidek, S.A. de C.V. ("Sidek"), our former parent, was incorporated and became the holding company of CSG. In 1990, Sidek consolidated its steel and aluminum operations into a separate subsidiary, Grupo Simec, S.A. de C.V., a Mexican corporation with limited liability.

In March 2001, Sidek consummated the sale of its entire approximate 62% controlling interest in us to Industrias CH. In June 2001, Industrias CH increased its interest in us to 82.5% by acquiring additional shares from certain of our bank creditors that had converted approximately \$95.4 million of our debt (\$90.2 million of principal and \$5.2 million of interest) into our common shares. Industrias CH subsequently increased its equity position in us through various conversions of debt to equity and capital contributions to an 85% interest.

In August 2004, we acquired the property, plant and equipment and the inventories, and assumed liabilities associated with the seniority premiums of employees of the Mexican steel-making facilities of Grupo Sidenor located in Apizaco, Tlaxcala and Cholula, Puebla. Our total net investment in this transaction was approximately U.S.\$122 million (excluding value added tax of approximately \$16 million paid in 2004 and recouped from the Mexican government in 2005), funded with cash from operations, and a \$19 million capital contribution from Industrias CH. We began to operate the plants in Apizaco, Tlaxcala and Cholula, Puebla on August 1, 2004, and, as a result, the operations of both plants are reflected in our financial results since that date.

In July 2005, we and Industrias CH acquired 100% of the stock of Republic, a U.S. producer of SBQ steel. We acquired 50.2% of Republic's stock through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% through SimRep. We financed our portion of the U.S.\$229 million purchase price principally through a loan we received from Industrias CH that we have repaid in full.

### **Competitive Strengths**

We believe the following are our principal competitive strengths:

*Leading SBQ producer in North America.*

We believe we have been the leading market producer and supplier of SBQ steel in Mexico since August 2004 and in the United States since July 2005. In 2005, we supplied approximately 28% of the Mexican market and 20% of the U.S. market.

*Higher value-added product mix.*

To maximize operating margins, we focus our production on higher value-added SBQ products, which represented 79% of our total sales in the first six months of 2006.

*Long-standing customer relationships.*

Our SBQ products are highly engineered and tailored to specific client needs. We continuously work with our clients on design engineering and new product development to meet the requirements of their evolving platforms. We believe that the quality of our products and services allows us to develop long lasting direct relationships with the largest end-users of SBQ products in North America, which, we believe, increases switching costs and improves our competitive position.

*Reduced price volatility.*

The quality requirements of the majority of our SBQ clients and the nature of our relationships have allowed us to implement favorable pricing policies that include annual price revisions and price adjustments based on the price of key inputs such as scrap, iron ore, energy, alloys and other key raw

materials. These contribute to maintaining operating margins against raw material price fluctuations relatively stable.

*Competitive cost structure.*

We believe our cost structure is highly favorable due to our:

- *Competitive cost of raw materials.* We believe our centralized purchasing strategy and strong financial position allow us to obtain favorable terms from our raw materials suppliers.
- *Low freight expenses.* We believe the strategic location of our facilities allows us to serve our SBQ steel and other clients with lower distribution and freight costs than most of our competitors.
- *Relatively low cost of labor in Mexico.* Our Mexican operations benefit from the relatively lower cost of labor in the Mexican market compared to the United States. In addition, our Mexican, U.S. and Canadian operations do not currently have any significant legacy liabilities or their associated costs.
- *Favorable labor agreement in the United States.* The labor agreement in place in our U.S. operations has eliminated legacy costs and enhances our ability to maximize workforce flexibility, allowing us to reduce production costs.
- *Lean operational structure and overhead cost.* We maintain non-operating costs at low levels by relying on a lean and cost efficient overhead structure.

*State-of-the-art production facilities.*

We have recently completed the revamping of our mini-mill steel-making facility in Canton, Ohio including the installation of a new continuous caster. We believe that our remaining steel making and processing facilities in Mexico and the United States are among the most modern and well maintained in North America.

*Extensive track record of profitable growth.*

Over the last two years we have significantly increased our installed capacity through the acquisition of Republic and of plants in Tlaxcala and Cholula, Mexico. As a result of these acquisitions, organic growth and operational improvements, we have increased our installed capacity from 0.7 million tons as of December 31, 2003 to 3.4 million tons of crude steel as of June 30, 2006.

*Significant organic growth opportunities.*

Our liquid steel making capacity exceeds our rolling and finished steel capacity, which allows us to continue increasing our finished product capacity through comparatively low levels of capital investments. We intend to pursue this option and plan to invest approximately U.S.\$250 million in a rolling mill with an annual capacity of 600,000 tons in our facilities. We also intend to explore expanding our liquid steel-making facilities in Lorain, Ohio by bringing an existing second blast furnace online at a cost significantly lower than that of purchasing a new blast furnace with the same capacity.

*Solid financial position.*

We seek to maintain a conservative capital structure and prudent leverage levels. We currently have no significant financial debt or significant legacy liabilities. We believe that these factors, combined



with our strong cash flow generation, provide us with the financial flexibility and resources to continue to pursue growth enhancing initiatives.

*Experienced and committed management team.*

Our management team has extensive experience in, and knowledge of, the North American steel industry and in evaluating, pursuing and completing both strategic and organic growth opportunities as well as a track-record of increasing productivity and reducing costs.

## **Business Strategy**

We intend to further consolidate our position as a leading producer, processor and distributor of SBQ steel in North America and structural steel in Mexico. We also intend to expand our presence in the steel industry by identifying and pursuing growth opportunities and value enhancing initiatives. Our strategy includes:

*Further integrating our operations.*

We intend to continue the integration of our Mexican, U.S. and Canadian operations to capitalize on the commercial and cost related synergies contemplated at the time of the Atlax Acquisition in 2004 and of the acquisition of Republic in 2005.

*Improving our cost structure.*

We have substantially reduced our operating cost and non-operating expenses and plan to continue to do so by reducing overhead expenses and operating costs through sharing best practices among our operating facilities and maintaining a conservative capital structure.

*Focusing on high margin and value-added products.*

We prioritize the production of high margin steel products over volume and utilization levels. We plan to continue to base our production decisions on achieving relatively high margins.

*Building on our strong customer relationships.*

We intend to strengthen our long-standing customer relationships by maintaining strong customer service and proactively responding to changing customer needs.

*Pursuing strategic growth opportunities.*

We have successfully grown our business by acquiring, integrating and improving under-performing operations. In addition, we intend to continue in pursuit of acquisition opportunities that will allow for disciplined growth of our business and value creation for our shareholders. We also intend to pursue organic growth by reinvesting the cash generated by our operating activities to expand the capacity and increase the efficiency of our existing facilities.

## **Business Overview**

*Our Products*

We produce a wide range of value-added SBQ steel, long steel and medium-sized structural steel products. In our Mexican facilities, we produce I-beams, channels, structural and commercial angles, hot



rolled bars (round, square and hexagonals), flat bars, rebars, and cold finished bars. In our U.S. facilities, we produce hot rolled bars, cold finished bars, semi-finished tube rounds and other semi-finished trade products. The following is a description of these products and their main uses:

- I-beams. I-beams, also known as standard beams, are “I” form steel structural sections with two equal parallel sides joined together by the center with a transversal section, forming 90° angles. We produce I-beams in our Mexican facilities and they are mainly used by the industrial construction as structure supports.
- Channels. Channels, also known as U-Beams because of their “U” form, are steel structural sections with two equal parallel sides joined together by its ends with a transversal section, forming 90° angles. We produce channels in our Mexican facilities and they are mainly used by industrial construction as structure supports and for stocking systems.
- Angles. Angles are two equal sided sections joined by their ends with a 90° angle, forming an “L” form. We produce angles in our Mexican facilities and they are used mainly by the construction and furniture industries as joist structures and framing systems.
- Hot rolled bars. Hot rolled bars are round, square and hexagonal steel bars that can be made of special or commodity steel. The construction, autopart and furniture industries mainly use the round and square bars. The hexagonal bars are made of special steel and are mainly used by the hand tool industry. We produce the steel sections in our Mexican and U.S. facilities.
- Flat bars. Flat bars are rectangular steel sections that can be made of special or commodity steel. We produce flat bars in our Mexican facilities. The auto part industry mainly uses special steel as springs, and the construction industry uses the commodity steel flat bars as supports.
- Rebar. Rebar is reinforced, corrugated round steel bars with sections from 0.375 to 1.5 inches in diameter, and we produced rebar our Mexican facilities. Rebar is only used by the construction sector to reinforce concrete. Rebar is considered a commodity product due to general acceptance by most costumers of standard industry specifications.
- Cold-finished bars. Cold-finished bars are round and hexagonal SBQ steel bars transformed through a diameter reduction process. This process consists of (1) reducing the cross sectional area of a bar by drawing the material through a die without any pre-heating or (2) turning or “peeling” the surface of the bar. The process changes the mechanical properties of the steel, and the finished product is accurate to size, free from scale with a bright surface finish. We produce these bars in our Mexican, U.S. and Canadian facilities, and mainly the auto part industry uses them.
- Semi-finished tube rounds. These are wide round bars used as raw material for the production of seamless pipe. The semi-finished tube rounds are made of SBQ steel, and we produce them in our U.S. facilities. Seamless pipe manufacturers use them to produce pipes used in the oil extraction and construction industry.

The following table sets forth, for the periods indicated, our sales volume for basic steel products. These figures reflect the sales of products manufactured at the Apizaco and Cholula facilities as of August 1, 2004 and sales of products manufactured at the U.S. and Canadian facilities as of July 22, 2005.



**Steel Product Sales Volume**

	Years ended December 31,			Six months ended June 30,	
	2003	2004	2005	2005	2006
	(Thousands of tons)				
I-Beams	83.8	76.1	82.2	41.4	42.2
Channels	50.7	58.9	59.7	23.7	35.1
Angles <sup>(1)</sup>	108.5	135.7	222.6	87.5	107.9
Hot-rolled Bars (round, square and hexagonal rods)	174.6	189.0	600.0	100.9	602.0
Flat Bar	45.7	91.7	188.5	99.7	81.1
Rebar	139.0	191.9	239.1	144.1	135.8
Cold Finished Bars	17.1	15.7	105.6	22.2	101.7
Semi-finished tube rounds	0.00	0.00	165.2	0	210.0
Other semi-finished trade products <sup>(2)</sup>	0.00	0.00	43.3	0	48.5
Other	8.8	14.3	1.9	2.8	4.0
<b>Total Steel Sales</b>	<b>628.2</b>	<b>773.3</b>	<b>1,708.1</b>	<b>522.3</b>	<b>1,368.3</b>

(1) Angles include structural angles and commercial angles.

(2) Includes billets and blooms (wide section square and round bars).

*Our Operations and Production Facilities*

We conduct our operations at ten facilities throughout North America. At June 30, 2006, our crude steel production capacity was 3.4 million tons, of which 1.0 million tons were based on an integrated blast furnace technology, and 2.4 million were based on electric arc furnace, or mini-mill, technology. Our Mexican facilities have 1.1 million tons of crude steel production capacity, operating three mini-mill facilities. Our U.S. operations have 2.2 million tons of crude steel production capacity. In addition, we have 2.9 million tons of rolling and finishing capacity, of which 1.2 million are located in Mexico, and 1.6 million are located in the United States and Canada.

We operate four mini-mills, three in Mexico and one in the United States. The Mexican mini-mills are located in Guadalajara, Jalisco; Apizaco, Tlaxcala and Mexicali, Baja California. Our mini-mill in the United States is located in Canton, Ohio, and we have recently completed a revamping process that has increased capacity of the mill to 1,300,000 tons of steel billet. We also operate an integrated blast furnace in Lorain, Ohio. There is a second blast furnace in the same facility with 750,000 tons of yearly capacity that is not currently operating, but that we believe could be made operational with relatively low levels of investment. We operate rolling and finishing facility in each of our mill facilities in Cholula and in the United States and Canada.

Because we operate both mini-mill and integrated blast furnace production facilities, we can allocate production between each type of facility based on efficiency and cost. In addition, as long as our facilities are not operating at full capacity, we can allocate production based on the relative cost of basic inputs (iron ore, coke, scrap and electricity) to the facility where production costs would be the lowest. Our production facilities are designed to permit the rapid changeover from one product to another. This flexibility permits us to efficiently produce small volume orders to meet customer needs and to produce varying quantities of standard product. Production runs, or campaigns, occur on four to eight weeks cycles, minimizing customer waiting time for both standard and specialized products.

We use ferrous scrap and iron ore to produce our finished steel products. We produce molten steel using both an electric arc furnace and integrated blast furnace technology, alloying elements and carbon are added, and which then is transported to continuous casters for solidification. The continuous



casters produce long, square strands of steel that are cut into billet and transferred to the rolling mills for further processing or, in some cases, sold to other steel producers. In the rolling mills, the billet is reheated in a walking beam furnace with preheating burners, passed through a rolling mill for size reduction and conformed into final sections and sizes. The shapes are then cut into a variety of lengths. In addition, to producing billet, our Canton, Ohio facility also produces blooms.

Our mini-mill plants use an electric arc furnace to melt ferrous scrap and other metallic components, which are then cast into long, square bars called billet in a continuous casting process, all of which occurs in a melt shop. The billet is then transferred to a rolling mill, reheated and rolled into finished product. In contrast, an integrated steel mill heats iron pellets and other primary materials in a blast furnace to first produce pig iron, that must be refined in a basic oxygen furnace to liquid steel, and then cast to billet and finished product. Mini-mill plants typically produce certain steel products more efficiently because of the lower energy requirements resulting from their smaller size and because of their use of ferrous scrap. Mini-mills are designed to provide shorter production runs with relatively fast product changeover times. Integrated steel mills are more efficient in producing longer runs and are able to produce certain steel products that a mini-mill cannot.

The production levels and capacity utilization rates for our melt shops and rolling mills for the periods indicated are presented below. These figures reflect the sales of products manufactured at the Apizaco and Cholula facilities starting from August 1, 2004. These figures reflect the sales of the products manufactured at the Republic facilities starting from July 22, 2005.

#### Production Volume and Capacity Utilization

	Years ended December 31,			Six months ended June	
	2003	2004	2005	2005	2006
	(Tons in thousands)				
<b>Melt shops</b>					
Steel billet production	705.9	877.5	1,748.2	532.6	1,550.5
Annual installed capacity <sup>(1)</sup>	780.0	1,160.0	3,115.9	1,160.0	3,398.1
Effective capacity utilization	90.5%	93.5%	89.6%	91.8%	91.3%
<b>Rolling mills</b>					
Total production	598.1	766.0	1,544.0	502.6	1,242.3
Annual installed capacity <sup>(1)</sup>	730.0	1,210.0	2,847.5	1,210.0	2,901.9
Effective capacity utilization	81.9%	82.4%	81.6%	83.1%	85.6%

(1) Annual installed capacity is determined based on the assumption that billet of various specified diameters, width and length is produced at the melt shops or that a specified mix of rolled products are produced in the rolling mills on a continuous basis throughout the year except for periods during which operations are discontinued for routine maintenance, repairs and improvements. Amounts presented represent annual installed capacity as at December 31 for each year. The percentage of effective capacity utilization for 2004 is determined in the case of the Apizaco and Cholula facilities based on utilization over the period from August 1 to December 31, 2004. The percentage of effective capacity utilization for 2005 is determined in the case of Republic facilities based on utilization over the period from July 22 to December 31, 2005.

The following table presents production by product at each of our Mexican facilities as a percentage of total production at that facility for the six-months ended June 30, 2006.

**Mexican Production per Facility by Product**

Product	Guadalajara	Location		Total
		Mexicali	Apizaco/Cholula (Production %)	
I Beams	20.6%	0.7%	0%	8.1%
Channels	9.6%	14.8%	0%	6.8%
Angles	24.0%	13.6%	21.2%	20.9%
Hot Rolled Bars (round, square and hexagonal rods)	18.8%	9.0%	18.4%	16.6%
Rebar	14.2%	60.0%	21.5%	26.3%
Flat Bars	7.9%	1.9%	30.0%	15.7%
Cold Finished Bars	3.2%	0%	8.9%	4.8%
Other	1.7%	0%	0.0%	0.8%
Total	100%	100%	100%	100%

*Guadalajara.* Our Guadalajara mini-mill facility is located in central western Mexico in Guadalajara, Jalisco, which is Mexico's third largest city. Our Guadalajara facilities and equipment include one improved electric arc furnace utilizing water-cooled sidewalls and roof, one four-strand continuous caster, five reheating furnaces and three rolling mills. The Guadalajara mini-mill has an annual installed capacity of 350,000 tons of billet and an annual installed capacity of finished product of 480,000 tons. In 2005, the Guadalajara mini-mill produced 304,295 tons of steel billet and 393,958 tons of finished product operating at 87% capacity for billet production and 82% capacity for finished product production. The Guadalajara rolling facilities process billet production from our Mexicali and Apizaco mills. Our Guadalajara facility is 336 miles from Mexico D.F. Our Guadalajara facility mainly produces structurals, SBQ steel, light structurals and rebars.

**Guadalajara Mini-Mill**

	Years ended December 31,			Six months ended June 30	
	2003	2004	2005	2005	2006
Steel Sales (thousands of tons)	430	430	407	204	203
Average finished product price per ton	Ps. 4,650	Ps. 7,375	Ps. 6,556	Ps. 6,959	Ps. 6,903
Average scrap cost per ton	1,713	2,774	2,343	2,535	2,349
Average manufacturing conversion cost per ton of finished product	1,366	1,387	1,645	1,625	1,617
Average manufacturing conversion cost per ton of billet	848	961	1,050	1,020	1,074

*Mexicali.* In 1993, we began operations at our mini-mill located in Mexicali, Baja California. The mini-mill is strategically located approximately 22 miles south of the California border and approximately 220 miles from Los Angeles.

Our Mexicali facilities and equipment include one electric arc furnace utilizing water-cooled sidewalls and roof, one four-strand continuous caster, one walking beam reheating furnace, one SACK rolling mill, a Linde oxygen plant and a water treatment plant. This facility has an annual installed capacity of 430,000 tons of steel billet and an annual installed capacity of finished product of 250,000



tons. Excess billet produced at the Mexicali facility is used primarily by the Guadalajara facility. This allows us to increase the utilization of the Guadalajara facility's finishing capacity, which exceeds its production capacity. In 2005, the Mexicali mini-mill produced approximately 385,873 tons of billet, of which the Guadalajara mini-mill used 104,415 tons, the Apizaco mini-mill 60,124 used tons, and we sold 14,488 tons to third parties. In 2005, the Mexicali mini-mill produced 201,607 tons of finished product. In 2005 we operated the Mexicali mini-mill at 90% capacity for billet production and at 81% capacity for finished product production. Our facility is strategically located and has access to key markets in Mexico and the United States, stable sources of scrap, electricity, a highly skilled workforce and other raw materials. The Mexicali mini-mill also is situated near major highways and a railroad linking the Mexicali and Guadalajara mini-mills, allowing for coordinated production at the two facilities. Our Mexicali facility mainly produces structurals, light structurals and rebar. In 2005, 66% of the products produced at the Mexicali mini-mill were rebar, 15% were angles, 9% were hot rolled bars (round, square and hexagonal rods) and the remaining 10% were other products, principally channels and flat bars.

#### Mexicali Mini-Mill

	Years ended December 31,			Six months ended June 30	
	2003	2004	2005	2005	2006
Steel Sales (thousands of tons)	199	187	210	105	105
Average finished product price per ton	Ps. 4,310	Ps. 7,031	Ps. 5,680	Ps. 5,803	Ps. 6,691
Average scrap cost per ton	1,373	2,046	2,034	2,100	2,041
Average manufacturing conversion cost per ton of finished product	1,294	1,426	1,516	1,492	1,520
Average manufacturing conversion cost per ton of billet	817	857	908	890	918

*Apizaco mini-mill and Cholula facility.* We have operated the Apizaco mini-mill and Cholula facility since August 1, 2004. The mini-mill is located in central Mexico in Apizaco, Tlaxcala. Our Apizaco facilities and equipment include one EBT Danieli electric arc furnace utilizing water-cooled sidewalls and roof, two ladle stations (one Danieli and the other Daido), one Daido degasification station, one Danieli four-strand continuous caster, two walking beam reheating furnaces and two rolling mills (one Danieli and the other Pomini). This facility has an annual installed capacity of 380,000 tons of steel billet and an annual installed capacity of finished product of 432,000 tons. In 2005, the Apizaco mini-mill produced 377,832 tons of steel billet, of which the Guadalajara mini-mill used 3,685 tons, and 392,681 tons of finished products. Our Apizaco facility is 1,112 miles from Mexicali and less than 124 miles from Mexico D.F. Our Apizaco facility mainly produces SBQ steel, light structurals and rebar. Our Cholula facility is approximately 25 miles from our Apizaco facility, which allows the integrated operations of the Apizaco mini-mill and Cholula facility. Our Cholula facilities and equipment include cold drawing and turning machines for peeling bars. This facility has an annual installed capacity of finished product of 48,000 tons. In 2005, the Cholula facility produced 32,494 tons of finished product, at 68% capacity. Our Cholula facility mainly produces cold finished SBQ steel.

In 2005, 17% of the products we produced at the Apizaco and Cholula facilities were rebar, 23% were angles, 17% were hot rolled bars (round, square and hexagonals) and the remaining 43% were other products, flat merchant bar and cold finished products.

**Apizaco Mini-Mill and Cholula Facility**

	<b>Years ended December 31,</b>		<b>Six months ended June 30,</b>	
	<b>2004<sup>(1)</sup></b>	<b>2005</b>	<b>2005</b>	<b>2006</b>
Steel Sales (thousands of tons)	156	416	213	209
Average finished product price per ton	Ps. 7,822	Ps. 6,632	Ps. 6,923	Ps. 6,891
Average scrap cost per ton	3,112	2,745	2,850	2,614
Average manufacturing conversion cost per ton of finished product	2,135	2,091	2,023	2,134
Average manufacturing conversion cost per ton of billet	1,428	1,416	1,457	1,400

(1) Since August 1, 2004.

*U.S. and Canada Operations and Facilities*

We have operated our Republic facilities (in Ohio, New York, Indiana and Canada) since we acquired them from Republic on July 22, 2005. As of December 31, 2005, these facilities had an annual installed capacity of 1,956,000 tons of billet and 1,637,000 tons of finished product. From July 22, 2005 to December 31, 2005, the Republic facilities produced 680,219 tons of steel billet, of which 165,201 tons were sold as semi-finished tube rounds and 43,273 were sold as other semi-finished trade products. The remainder went to the Lorain, Ohio and Lackawanna, New York facilities for further processing. For the same period, the Republic facilities produced 453,509 tons of hot-rolled bar, of which 49,624 tons were used by the cold finish facilities. The Republic facilities produced 69,764 tons of cold finish bars. During this period, 60% of the products produced at the Republic facilities were hot-rolled bars, 9% were cold-finished bars, 25% were semi-finished tube rounds, and 6% were other semi-finished trade products.

The following table sets forth, for the periods indicated, selected operating data for our Republic facilities.

	<b>July 22 - December 31 2005</b>	<b>Six months ended June 30 2006</b>
Steel Sales (thousands of tons)	675	852
Average finished product price per ton	Ps. 8,245	Ps. 9,822
Average scrap cost per ton	1,800	2,291
Average iron ore pellet cost per ton	647	661
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	5,033	4,787
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	3,729	3,545

(1) Manufacturing conversion cost is defined as all production costs excluding the cost of scrap and related yield loss.

*Lorain, Ohio.* The Lorain facility mainly produces SBQ steel and operates an integrated steel mill. We operate one blast furnace, two 220-ton basic oxygen furnaces, a ladle metallurgy facility, a vacuum degasser, a five-strand continuous bloom caster, a six-strand billet caster, a billet rolling mill and two bar rolling mills.

Our Lorain facility had, at December 31, 2005, an annual installed capacity of 1,170,000 tons of steel billet and 840,000 tons of finished product. During the period of July 22 to December 31, 2005, the Lorain facility, was operated at 82.5% capacity for steel billet and for finished product, 64.6% for 9-10”





rolling mill and 70.1% for 20" mill finishing and shipping production, and it produced 376,130 tons of billets and 240,000 tons of finished products.

*Canton, Ohio.* Our Canton facility mainly produces SBQ steel and includes two 200-ton top charge electric arc furnaces, a 5-strand bloom/billet caster, two ladle metallurgical furnaces, two vacuum degassers and two slag rakes. This facility also includes a combination Caster rolling facility that continuously casts blooms in a 4-strand caster, heats the blooms to rolling temperature in a walking beam furnace, then rolls billets through an 8-stand rolling mill in an inline operation. We installed and commissioned the electric arc furnace, the bloom/billet caster, ladle metallurgical furnace and vacuum degasser in 2005. Other Canton equipment includes a Mecana billet inspection line, four stationary billet grinders, a saw line and a quality verification line (or "QVL line").

Canton produces blooms and billets for the three rolling mills in the Republic facilities and for trade customers. We use the QVL inspection line to inspect finished bar produced in Lackawanna and Lorain. As of December 2005, the Canton facility had annual installed capacity of 790,000 tons of steel billet. In the period from July 22, 2005 to December 31, 2005, this facility produced 302,000 tons of blooms, billets and other semi-finished trade product and was operated at 88% capacity of steel billet.

*Lackawanna, New York.* Our Lackawanna facility mainly produces SBQ steel and includes a three-zone walking beam billet reheat furnace, a recently upgraded 22 stand rolling mill capable of producing rounds, squares, and hexagons in both cut length and coils. This facility produces hot rolled bar sizes that range from .562" to 3.250" with coil weights up to 6000 lb. Our Lackawanna facility's finishing equipment includes a QVL inspection line and three saw lines. We sell a portion of the hot rolled bars produced at our Lackawanna facility to trade customers, and we also ship a portion of the finished bars to our cold finishing operations for further processing. As of December 2005, the Lackawanna facility had annual installed capacity of 540,000 tons of hot rolled bars. In the period from July 22, 2005 to December 31, 2005 this facility produced 212,000 tons of hot rolled bars and was operated at 89.6% capacity of finished product.

*Massillon, Ohio.* Our Massillon facility mainly produces SBQ steel and contains a cold finishing facility which includes the machinery and equipment to clean, draw, turn, chamfer, anneal, grind, straighten and saw bars. Our Massillon facility had, at December 31, 2005, an annual installed capacity of 125,000 tons of finished product. During the period of July 22 to December 31, 2005, the Massillon facility was operated at 70.3% capacity of finished product and produced 39,000 tons of cold finished bars.

*Gary, Indiana.* Our Gary facility mainly produces SBQ steel and has a cold finishing facility which includes the machinery and equipment to clean, draw, turn, chamfer, anneal, grind, straighten and saw bars. As of December 2005, the Gary facility had annual installed capacity of 70,000 tons of cold finished bars. In the period from July 22, 2005 to December 31, 2005, this facility produced 16,000 tons of cold finished bars and was operated at 53% capacity of finished product.

*Hamilton, Ontario, Canada.* Our Hamilton facility mainly produces SBQ steel and has a cold finishing facility which includes the machinery and equipment to clean, draw, turn, chamfer, anneal, grind, straighten and saw bars. As of December 2005, the Hamilton facility had annual installed capacity of 60,000 tons of cold finished bars. In the period from July 22, 2005 to December 31, 2005, this facility produced 14,000 tons of cold finished bars and was operated at 56.5% capacity of finished product.

The following table shows the products that we produce, the equipment that we use and the volume that we produce in each of our separate production facilities:

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**Production per Facility by Product, Equipment and Volume**

<b>Location</b>	<b>Product (%)</b>	<b>Equipment</b>	<b>2005 Annual Production Volume (tons)</b>	<b>Finished Product Annual Installed Capacity (tons)<sup>(2)</sup></b>
Guadalajara	Structurals (56%); Light Structurals (16%); SBQ (21%), Rebar (7%)	electric arc furnace with continuous caster, rolling mill and bar processing lines	393,958	480,000
Mexicali	Structurals (7%); Rebar (67%); Light Structurals (26%)	electric arc furnace with continuous caster and bar rolling mills	201,607	250,000
Apizaco and Cholula	SBQ (60%); Rebar (17%); Light Structurals (23%)	electric arc furnace with vacuum tank degasser, continuous caster, bar rolling mills, cold drawn and bar turning equipment	425,175	480,000
Lorain	SBQ (100%)	blast furnace, vacuum tank degasser, continuous caster, bar and wire rod rolling mills	240,000 <sup>(1)</sup>	840,000
Canton	SBQ (100%)	electric arc furnace, vacuum tank degasser, continuous caster, rolling mills	302,000 <sup>(1)</sup>	790,000 <sup>(3)</sup>
Lakawanna	SBQ (100%)	reheat furnace, bar and wire rod rolling mills	212,000 <sup>(1)</sup>	540,000
Massillon	SBQ (100%)	cold drawn bar turning and heat treating equipment	39,000 <sup>(1)</sup>	125,000
Gary	SBQ (100%)	cold drawn bar turning and heat treating equipment	16,000 <sup>(1)</sup>	70,000

Hamilton	SBQ (100%)	cold drawn bar turning and heat treating equipment	14,000 <sup>(1)</sup>	60,000
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(1) Production from July 22, 2005 to December 31, 2005.

(2) At December 31, 2005.

(3) Installed capacity at Canton increased to 1,200,000 tons at June 30, 2006 due to the additional 400,000 tons of rolling capacity.

## **Principal Capital Expenditures and Divestitures**

We continually seek to improve our operating efficiency and increase sales of our products through capital investments in new equipment and technology.

In 2005, we spent \$46.4 million (Ps. 503 million) on capital investments in our Mexican and our U.S. operations. Projects at the Guadalajara facilities in 2005 included the addition of a railroad weighing-machine and improvements to the warehouse. Projects at the Mexicali facility in 2005 included the addition of a cooling bed for the rolling mill, special site for dust and a co-jet system for the melt shop in order to increase productivity and reduce energy consumption. Projects at the Apizaco facility included the addition of a Straightening Line for the rolling mill and an inspection system for the rolling mill. From July 22, 2005 to December 31, 2005, capital investments in our Republic facilities were \$34.4 million (Ps. 392 million), including \$17.8 million (Ps. 203 million) for the new five strand combined billet/bloom caster in our Canton, Ohio facility, and the remainder for the revamping of the Canton melt shop, maintenance, general capital and infrastructure improvements and modernization.

In 2004, we spent \$109.7 million (Ps. 1,285 million) on capital investments (\$107.5 million of which (Ps. 1,225 million) we allocated to the acquisition of the Apizaco and Cholula facilities). Projects at the Guadalajara facilities in 2004 included the addition of a reheating furnace and a new stand for the rolling mill. Projects at the Mexicali facility in 2004 included the addition of a special site for dust.

In 2003, we spent \$5.4 million (Ps. 64 million) on capital investments. Projects at the Guadalajara facility included the addition of a slitting system in order to increase production at the rolling mill. Projects at the Mexicali facility included the addition of a digital regulation system to the electric arc furnace in order to reduce energy consumption at the melt shop.

We anticipate capital investments of \$34.1 million (Ps. 389 million) at our Republic facilities in 2006, including \$23.4 million (Ps. 267 million) at the Canton, Ohio facility, \$9.2 million (Ps. 105 million) at the Lorain, Ohio facility, \$0.5 million (Ps. 5.7 million) at the Lackawanna, New York facility, \$0.4 million (Ps. 4.6 million) at the Massillon, Ohio facility, \$0.1 million (Ps. 1.1 million) at the Hamilton, Ontario, Canada facility, \$0.2 million (Ps. 2.3 million) at the Gary, Indiana facility and \$0.3 million (Ps. 3.4 million) at our corporate location in Fairlawn, Ohio. We expect to have spent \$9.4 million (Ps. 107 million) on capital improvements at our facilities in Mexico in 2006, including \$7.7 million (Ps. 88 million) at the Apizaco facility, \$1.4 million (Ps. 16 million) at the Mexicali facility and \$0.3 million (Ps. 3.4 million) at the Guadalajara facility.

## **Sales and Distribution**

We sell and distribute our steel products throughout North America. We also export steel products from Mexico to Central and South America and Europe. We believe that on a pro forma basis, including Republic for all of 2005, approximately 79% of our steel product sales represented SBQ steel products, of which we sold 45% to the auto part industry, 15% to service centers, 13% for energy related products, 5% for hand tools, 5% for mining equipment and the remaining 17% to other industries. We estimate that 85% of our total production comes from special orders from our clients.

The following table sets forth, for the periods indicated, our Mexico, U.S. and Canada sales as a percentage of total product sales by market. These figures reflect the sales of products manufactured at the Apizaco and Cholula facilities starting since August 1, 2004 and the sales of products manufactured at our U.S. facilities starting since July 22, 2005.

## Steel Product Sales By Region

	Mexico			U.S. and Canada <sup>(1)</sup>			Mexico		U.S. and Canada <sup>(1)</sup>	
	2003	2004	2005	2003	2004	2005	2005	2006	2005	2006
I-Beams	99%	100%	99%	1%	0%	1%	100%	98%	0%	2%
Channels	81%	80%	81%	19%	20%	19%	85%	59%	15%	41%
Angles	89%	95%	94%	11%	5%	6%	94%	90%	6%	10%
Hot-rolled Bars(round, square and hexagonal rods)	96%	91%	10%	4%	9%	90%	88%	12%	12%	88%
Rebar	67%	71%	66%	33%	29%	34%	65%	91%	35%	9%
Flat bar	89%	95%	98%	11%	5%	2%	97%	97%	3%	3%
Cold Drawn finished bars	96%	95%	40%	4%	5%	60%	99%	23%	1%	77%
Semi-finished tube rounds	0%	0%	0%	0%	0%	100%	0%	0%	0%	100%
Other semi-finished trade products	0%	0%	0%	0%	0%	100%	0%	0%	0%	100%
Other	100%	100%	100%	0%	0%	0%	100%	100%	0%	0%
Total (weighted average)	87%	87%	53%	13%	13%	47%	86%	34%	14%	66%

(1) Includes sales principally into the United States and Canada.

During the six months ended June 30, 2006, approximately 66% of our sales by volume came from the U.S. market, with almost 100% of such sales representing SBQ products. The Mexican market represents approximately 34% of our sales by volume, with SBQ products representing approximately 28.5% of such sales and the remainder representing commercial steel products. Approximately 61% of our sales in the United States and Canadian markets come from contractual long-term agreements that establish minimum quantities and prices, which are adjustable based on fluctuations of key production materials. The remainder of our sales in the United States and Canadian markets are spot sales either directly to end customers through our sales force or through independent distributors.

We sell to the Mexican market through a group of approximately 100 independent distributors, who also carry other steel companies' product lines, and through our wholly owned distribution center in Guadalajara. Our sales force and distribution center are an important source of information concerning customer needs and market developments. By working through our distributors, we believe that we have established and can maintain market leadership with small and mid-market end-users throughout Mexico. We believe that our domestic customers are highly service-conscious.

We sell to customers in the U.S. and Canadian markets through a staff of professional sales representatives and sales technicians located in the major manufacturing centers of the Midwest, Great Lakes and Southeast regions of the United States.

We distribute our exports outside North America primarily through independent distributors who also carry other product lines. In addition, we have three full-time employees in Mexico dedicated exclusively to exports.

During 2004 and 2005, we received orders for our products in our Mexican facilities on average approximately two weeks before producing those products. We generally fill orders for our U.S. and Canadian SBQ steel products within one to 12 weeks of the order depending on the product, customer needs and other production requirements. Customer

orders are generally cancelable without penalty prior to finish size rolling and depend on customers' changing production schedules. Accordingly, we do not believe that backlog is a significant factor in our business. A substantial portion of our production is

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ordered by our customers prior to production. There can be no assurance that significant levels of pre-production sales orders will continue.

We have long term relationships with most of our major customers, in some cases for 10 to 20 years or longer. Our major direct and indirect customers include leading automotive and industrial equipment manufacturers General Motors Corporation, Ford Motor Company, DaimlerChrysler AG, Honda Motor Co., Ltd. Toyota Motor Corporation, and Caterpillar Inc., first tier suppliers to automotive and industrial equipment manufacturers such as American Axle, ArvinMeritor, Inc., Delphi, Formtech Industries LLC, NTN Driveshaft, Inc., TRW Automotive Holdings Corp., and Visteon Corporation; forger Jernberg Industries, Inc.; service centers which include AM Castle & Co., Earle M. Jorgensen Co., and Eaton Steel Bar Company; and tubular product manufacturer, U.S. Steel. In 2002 we entered into a long term supply contract with U.S. Steel, which we have extended several times. On September 22, 2006, we renewed our long term supply contract with U.S. Steel through September 30, 2008. This contract provides for our obligation to produce and sell to U.S. Steel, and U.S. Steel's obligation to purchase from us 25,000 to 30,000 tons of our tube rounds per month, and we may agree to sell rounds to U.S. Steel in excess of 30,000 tons. We may not deliver fewer than 75,000 tons during any quarter without paying a penalty, unless the shortfall is based solely on U.S. Steel's act or omission.

Our U.S. and Canadian facilities are strategically located to serve the majority of consumers of SBQ products in the United States. Our U.S. and Canadian facilities ship products between their mills and finished products to customers by rail and truck. Customer needs and location dictate the type of transportation used for deliveries. The proximity of our rolling mills and cold finishing plants to our U.S. customers allows us to provide competitive rail and truck freight rates and flexible deliveries in order to satisfy just-in-time and other customer manufacturing requirements. We believe that the ability to meet the product delivery requirements of our customers in a timely and flexible fashion is a key to attracting and retaining customers as more SBQ product consumers reduce their in-plant raw material inventory. We optimize freight costs by using our significantly greater scale of operations to maintain favorable transportation arrangements, continuing to combine orders in shipments whenever possible and "backhauling" scrap and other raw materials.

## **Competition**

### *Mexico*

We compete in the Mexican domestic market and in its export markets for non-flat steel products primarily on the basis of price and product quality. In addition, we compete in the domestic market based upon our responsiveness to customer delivery requirements. We believe that we are one of the lowest cost producers of non-flat steel products in Mexico. We endeavor to enhance our competitive position in Mexico by working closely with our clients and distributors and adjusting our production schedule to meet customer requirements. The flexibility of our production facilities, allows us to respond quickly to the demand for our products. We also believe that the geographic locations of our various facilities throughout Mexico and large variety of products help us to maintain our competitive market position in Mexico and in the southwestern United States. Our Mexicali mini-mill, one of the closest mini-mills to the southern California market, provides a production and transportation cost advantage in northwestern Mexico and southern California.

We believe that our competitors' closest plants to the southern California market are: Nucor Steel, located in Plymouth, Utah, Schnitzer Steel (Cascade), located in McMinnville, Oregon, Oregon Steel (Rocky Mountain Steel Mills), located in Pueblo, Colorado, Tamco Steel, located in Rancho Cucamonga, California and Grupo Villacero (Border Steel), located in El Paso, Texas. We believe that in addition to our significant advantage in terms of lower transportation cost, we also believe that we have an advantage in lower labor cost in our Mexican operations. We believe our transportation costs in



northwestern Mexico compare favorably to other local producers, including Grupo Villacero (SICARTSA), located in Lazaro Cardenas, Michoacan; Ternium (Hylsa), located in Apodaca, Nuevo Leon and DeAcero, located in Saltillo, Coahuila.

We estimate, based on information compiled by Mexico's National Steel and Iron Industry Chamber (*Cámara Nacional de la Industria del Hierro y del Acero*, or "CANACERO"), that we are the sole Mexican producer of 5 inch, 6 inch and 200 mm I-beams and that there is one other small producer of 4-inch I-beams. These products accounted for approximately 75,894 tons, or 10%, and approximately 80,000 tons, or 5%, of our total finished product sales in 2004 and 2005, respectively. The revenue that we derived from I-beam products represented 10% and 5% of our net sales in 2005 and 2004, respectively. Total imports of these products, which come mainly from Spain and the United States, represent approximately 10% of the Mexican market.

In 2005, we sold approximately 200,000 tons of I-beams, channels and angles at least three inches in width (including the 80,000 tons of I-beams described above) which represented approximately 12% of our total finished product sales for the year. In 2004, we sold approximately 180,000 tons of I-beams, channels and angles at least three inches in width (including the 75,000 tons of I-beams described above) which represented approximately 24% of our total finished product sales for the year. We believe that the domestic competitors in the Mexican market for structural steel are Altos Hornos de Mexico, S.A. de C.V. ("Ahmsa"), Siderúrgica del Golfo, S.A. de C.V. (a wholly-owned subsidiary of Industrias CH), Aceros Corsa, S.A. de C.V. ("Corsa") and Gerdão, S.A. We estimate that our share of Mexican production of structural steel was 71% in 2005 and 64% in 2004.

In 2005, we sold approximately 700,000 tons of hot rolled and cold finished steel bar, compared to 200,000 tons in 2004. We estimate, based on information compiled by CANACERO, that our share of domestic production of steel bar was 41% in 2005 and 37% in 2004. Our other major product lines are rebar and light structural steel (angles less than three inches in width and flat bar), for which our share of domestic production in 2005 was 7% and 88%, respectively, compared to 6% and 40%, respectively, in 2004. Rebar and light structural steel together accounted for approximately 600,000 tons, or 35%, of our total production of finished steel products in Mexico and the United States in 2005, compared to approximately 390,000 tons, or 50%, in 2004. We compete in the Mexican market with a number of producers of these products, including Ahmsa, Hylsamex, S.A. de C.V., Sicartsa, S.A. de C.V., Corsa, Aceros Tultitlán, S.A. de C.V., Commercial Metals Inc., Belgo Mineira Aeralia Perfiles Bergara, S.A., Chaparral Steel Company, Aceros San Luis, S.A. de C.V., Deacero, S.A. de C.V., Talleres y Acero, Nucor Corporation and Bayou Steel Corporation.

We distributed our sales of SBQ steel in Mexico as of December 31, 2005 as follows:

- auto parts industry, 63%,
- service centers, 8%,
- mining equipment, 7%,
- hand tools, 6%, and
- bar processing industry, 15%.

We have been able to maintain our domestic market share and profitable pricing levels in Mexico in part because the central Mexico sites of the Guadalajara, Apizaco and Cholula facilities afford us substantial cost advantages relative to U.S. producers when shipping to customers in central and southern Mexico, and our flexible production facility gives us the ability to ship specialty products in relatively



small quantities with short lead times. The Mexicali mini-mill has helped to increase sales in northwestern Mexico and the southwestern United States because of its relatively close proximity to these areas reduces our freight costs.

#### *United States and Canada*

In the United States and Canada, we compete primarily with both domestic SBQ steel producers and importers. Our U.S. domestic competition for hot-rolled engineered bar products is both large U.S. domestic steelmakers and specialized mini-mills. Non-U.S. competition may impact segments of the SBQ market, particularly where certifications are not required, and during periods when the U.S. dollar is strong as compared with foreign currencies.

The principal areas of competition in our markets are product quality and range, delivery reliability, service and price. Special chemistry and precise processing requirements characterize SBQ steel products. Maintaining high standards of product quality, while keeping production costs low, is essential to our ability to compete in our markets. We believe that we have the widest selection of product grades and sizes in our industry and in many cases provide “niche” products to our customer base that our U.S. competitors cannot provide; for example we are the sole U.S. producer of long lead steel. The ability of a manufacturer to respond quickly to customer orders currently is, and is expected to remain, important as customers continue to reduce their in-plant raw material inventory.

We estimate that the total market for SBQ products in the United States is 8 million tons per year, and in 2005 we produced 1.7 million tons. We, therefore, estimate that we have a market share of more than 20%.

We believe our principal competitors in the U.S. market, depending on the product, include Nucor Corporation, Niagara LaSalle, Mittal Steel, Charter Steel, Steel Dynamics, Inc., The Timken Company and QUANEX Corporation.

#### **Certifications**

ISO is a worldwide federation of national standards bodies which have united to develop internationally accepted standards so that customers and manufacturers have a system in place to provide a product of known quality and standards. The standards set by ISO cover every facet of quality from management responsibility to service and delivery. We believe that adhering to the stringent ISO procedures not only creates efficiency in manufacturing operations, but also positions us to meet the strict standards that our customers require. We are engaged in a total quality program designed to improve customer service, overall personnel qualifications and team work. The facilities at Apizaco and Cholula have received ISO 9001:2000 certification from International Quality Certifications covering the period January 16, 2004 to January 15, 2007.

Our U.S. operations are currently QS-9000 certified. QS-9000 sets forth a standard set of quality requirements for components and materials suppliers to the automotive industry. Certification requirements vary in scope and generally take between three and twelve months to achieve. Frequently, the qualification process requires a producer to supply one or more trial heats of SBQ products for customer evaluation, although some customers have longer pre-qualification requirements.

The QS-9000 standard will cease to be a certification standard as of December 15, 2006. Suppliers currently certified under QS-9000 will need to update their certifications to comply with the ISO/TS 16949 standard. We are actively working toward transitioning to this standard in all of our facilities. The ISO/TS 16949 standard, developed by the International Automotive Task Force, is the result of the harmonization of the supplier quality requirements of vehicle manufacturers worldwide and

provides for a single quality management system of continuous improvement, defect prevention and reduction of variation and waste in the supply chain. It places greater emphasis on management's commitment to quality and customer focus.

Our Republic facilities are currently ISO 14001 certified. This certification is a voluntary international standard that defines the organizational structure, responsibilities, procedures, processes and resources for implementing environmental management systems ("EMS"). It also requires the development of an environmental policy statement which includes commitments to prevention of pollution, continual improvement of the EMS leading to improvements in overall environmental performance and compliance with applicable statutory and regulatory compliance. Most of the automotive customers of our Republic facilities require this certification. The certification is effective until November 2007.

## Employees

At June 30, 2006, we had 4,340 employees (of whom 1,912 were employed at our Mexico facilities, and 1,143 were unionized, and 2,428 were employed at the Republic facilities, of whom 2,014 were unionized) compared to 4,360 employees at December 31, 2005 (of whom 1,905 were employed at our Mexican facilities, and 1,141 were unionized, and 2,455 were employed at the Republic facilities, and 2,007 were unionized), compared to 2,018 employees at December 31, 2004 (781 employed at the Apizaco and Cholula facilities and 1,237 employed at the Guadalajara and Mexicali facilities, and across these facilities a total of 1,194 were unionized) compared with 1,288 employees at December 31, 2003 (of whom 889 were unionized).

The unionized employees in each of our Mexican facilities are affiliated with different unions. Salaries and benefits of our Mexican unionized employees are determined annually through union contracts. Set forth below is the union affiliation of the employees of each of our Mexican facilities and the expiration date of the current contract.

- *Guadalajara facilities*: Sindicato de Trabajadores en la Industria Siderúrgica y Similares en el Edo. de Jalisco. The contract expires in February 14, 2008.
- *Mexicali facilities*: Sindicato de Trabajadores de la Industria Procesadora y Comercialización de Metales de Baja California. The contract expires in January 16, 2008.
- *Apizaco facilities*: Sindicato Nacional de Trabajadores de Productos Metalicos, Similares y Conexos de la República Mexicana. The contract expires in January 16, 2007.
- *Cholula facilities*: Sindicato Industrial "Acción y Fuerza" de Trabajadores Metalurgicos Fundidores, Mecánicos y Conexos Crom del Estado. The contract expires in March 1, 2008.

We have had good relations with the unions in our Mexican facilities. The bargaining agreements are revised every two years, and wages are adjusted every year.

The employees of our Republic facilities are affiliated with United Steelworkers of America. The existing labor agreement with the employees of our Republic facilities includes an employee profit sharing program, to which our Republic subsidiary must contribute 15% of its quarterly net income before taxes exceeding \$12.5 million (Ps. 142 million) for the period ending June 30, 2006 for unionized employees and 3% of its quarterly net income before taxes exceeding \$12.5 million (Ps. 142 million) for the period ending June 30, 2006 for the non-unionized employees.

Wages and benefits for non-unionized employees are fixed by a compensation system that incorporates both performance incentives and market wages. We believe that our relations with employees are satisfactory within all our operating subsidiaries, and we have had no strikes or work stoppage in our history. We consider employee training a priority and, as a result, have implemented programs in the professional and technical areas of each operating facility.

### **Raw Materials**

In 2005, our cost of sales in Mexico was 67% compared to our U.S. operations where our cost of sales was 94%, and our consolidated cost of sales was 80%.

Ferrous scrap, electricity, iron ore coke, ferroalloys, electrodes and refractory products are the principal materials that we use to manufacture our steel products.

*Scrap.* Ferrous scrap is among the most important components for our steel production and accounted for approximately 36% of our consolidated direct cost of sales in 2005 (56% of the direct cost in our Mexico operations and 17.5% of the direct cost in our U.S. operations) and 59% of our direct cost of sales in 2004, and represented 32% of our consolidated direct costs in sales for the six months ended June 30, 2006 (55% of the direct cost in our Mexico operations and 25% of the direct cost in our U.S. operations). Ferrous scrap is principally generated from automobile, industrial, naval and railroad industries. The market for ferrous scrap is influenced by availability, freight costs, speculation by scrap brokers and other conditions largely beyond our control. Fluctuations in scrap costs directly influence the cost of sales of finished goods.

We purchase raw scrap from dealers in Mexico and the San Diego area, and processes the raw scrap into refined ferrous scrap at our Guadalajara, Mexicali and Apizaco facilities. We meet our refined ferrous scrap requirements through three sources: (i) our wholly owned scrap processing facilities, which in the aggregate provided us with approximately 5% and 6% of our refined scrap tonnage in 2005 and 2004, respectively, and (ii) purchases from third party scrap processors in Mexico and the southwestern United States, which, in the aggregate, provided us with approximately 84% and 11% in 2005, respectively, and approximately 64% and 30% in 2004, respectively, of our refined ferrous scrap requirements. We are a dominant scrap collector in the Mexicali, Tijuana and Hermosillo regions, and, by primarily dealing directly with small Mexican scrap collectors, we believe we have been able to purchase scrap at prices lower than those in the international and Mexican markets. We purchase scrap on the open market through a number of brokers or directly from scrap dealers for our U.S. and Canadian facilities. We do not depend on any single scrap supplier to meet our scrap requirements.

*Iron Ore Pellets and Coke.* Our U.S. and Canadian facilities purchase iron ore pellets and coke. These are the principal raw materials used in our blast furnaces. Iron ore pellets and coke accounted for approximately 19% of our U.S. and Canadian facilities' direct costs for the six months ended June 30, 2006. In 2005, our U.S. and Canadian facilities purchase 100% of their iron ore pellet and a portion of their coke requirement from U.S. Steel. For the six month period ended June 30, 2006, we used iron ore pellets and coke in our Lorain, Ohio facility. The iron ore pellets and coke made up 9% and 10%, respectively, of the direct costs of sales in this period. We purchase the remainder of our coke requirement on the open market. Our Mexican facilities do not use iron ore pellets or coke.

*Ferroalloys, Electrodes and Refractory Products.* In our Mexican operations, ferroalloys, electrodes and refractory products collectively accounted for approximately 13% of our direct cost of sales in 2005 and 11% in 2004, and they accounted for 20.8% of our direct cost of sales for the six months ended June 30, 2006 in our U.S. and Canadian facilities. Ferroalloys are essential for the production of steel and are added to the steel during manufacturing process to reduce undesirable elements and to enhance its hardness, durability and resistance to friction and abrasion. For our Mexican





operations, we buy most of our manganese ferroalloys from Compañía Minera Autlán, S.A., and the remainder from Electrometalúrgica de Veracruz, S.A. de C.V., Manuchar Internacional, S.A. de C.V. and Industria Nacional de la Fundición, S.A. de C.V.

We obtain electrodes used to melt raw materials from Ucar Carbon Mexicana, S.A. de C.V., Graphite Electrode Sales and SGL Carbon, LLC.

Refractory products include firebricks, which line and insulate furnaces, ladles and other transfer vessels. We purchase our refractory products from RHI Refmex, S.A. de C.V., LWB de México, S.A. de C.V., Fedmet Resources Corp., Vesivius de México, S.A. de C.V., Mayerton Refractories and Tecnologías Minerales de México, S.A. de C.V. Our U.S. and Canadian facilities purchase most of their ferroalloys from International Nickel, Climax Molybdenum Co., Considar Inc., Minerais U.S. LLC and Glencore LTD. The direct cost for the ferroalloys represents 14% of our consolidated costs, 8% of the direct costs incurred at our Mexican operations and 18.7% of the direct costs incurred at our U.S. operations.

*Electricity.* As of December 31, 2005, electricity accounted for approximately 7% of our consolidated direct cost of sales for the period (10% of the direct cost of our Mexican operations and 4% of the direct cost of our U.S. operations). Electricity accounted for 10% of our direct cost of sales in 2005 and 9% of direct cost of sales in 2004 and is supplied by the *Comisión Federal de Electricidad* (“CFE”) in our Mexico facilities. It accounted for 3.6% of direct costs of sales from July 22 to December 31, 2005 in our U.S. and Canadian operations and is supplied by American Electric Power Company and Ohio Edison. We, like all other high volume users of electricity in Mexico, pay special rates to CFE for electricity. Energy prices in Mexico have historically been very volatile and subject to dramatic price increases in short periods of time. In the late 1990s, the CFE began to charge for electricity usage based on the time of use during the day and the season (summer or winter). As a result, we have modified our production schedule in order to reduce electricity costs by limiting production during periods when peak rates are in effect. There can be no assurance that any future cost increases will not have a material adverse effect on our business. From May through October 2005 and August through October 2004, the Mexicali facility acquired electricity from Sempra Energy Solutions (“Sempra”), a company based in San Diego, California. The *Comisión Reguladora de Energía* of the Mexican Secretary of Energy authorized this agreement for peak hours in the period; the rates were less expensive than the rates of CFE in the same period. In 2006, the Mexicali facility entered into a new contract with Sempra for the period May through October 2006.

*Natural Gas.* Natural gas (including “combustoleo” which is an oil derivative that is less refined than gasoline and diesel fuel oil that can be used instead of gasoline in our Mexicali plant) consisted of approximately 8% of our consolidated direct cost of sales (4.5% of the direct cost of our Mexican operations and 11% of the direct cost of our U.S. operations). We use natural gas cash-flow exchange contracts or swaps where we receive a floating price and pay a fixed price to hedge our risk of from fluctuations in natural gas prices. Fluctuations in natural gas prices from volume consumed are recognized as part of our operating costs. As applicable, we recognized the fair value of instruments either as liabilities or assets. Such fair value and thus, the value of these assets or liabilities were restated at each month’s-end. As indicated in Note 6 to the audited financial statements, we opted for the early adoption of Bulletin C-10 “*Derivative Financial Instruments and Hedging*”; therefore, at December 31, 2005 and 2004, we recognized the fair value of the natural gas swap designated for hedging exposure of future gas consumption for the remaining period of January 2004 to December 2006 in terms of fluctuations in natural gas prices, were recognized within the comprehensive income account in stockholders’ equity.

Our contracts are forwards with a minimum volume required to purchase.

At the end of 2003, we entered into derivative transactions with PEMEX, to hedge against fluctuations in natural gas prices. The derivatives will guarantee a portion of our natural gas consumption from 2004 to 2006 at a fixed price of \$4.462 per MMBtu. At the end of 2005, we also held in one of our subsidiaries in the United States, 23 open contracts for natural gas swaps, entered to offset the potential natural gas price volatility for the months of January through March 2006. These swaps resulted in marking to market all of our open contracts as of December 2005 and a liability for \$1.2 million (Ps. 13 million).

Natural gas consisted of approximately 9.0% of our U.S. and Canadian facilities' direct costs for the period from July 22 through December 31, 2005. Our U.S. and Canadian operations have a hedging policy to manage their exposure to natural gas price fluctuations when practical. During 2005, we began using cash flow hedges with respect to natural gas. Our policy includes establishing a risk management philosophy and objectives designed to cap our exposure to the extreme price volatility of natural gas and thereby limiting the unfavorable effect of price increases on our operating costs. We do not enter into contracts for the purpose of speculation. We account for these derivative instruments in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" and with Mexican GAAP relating to Bulletin C-10 "Derivative Financial Instruments and Hedging". At December 31, 2005, we held cash flow hedges for natural gas with the effective portion of such instruments reflected in accumulated other comprehensive loss.

## Legal Matters and Regulations

### *U.S. and Canadian Operations*

We are subject to U.S. federal, state and local environmental laws and administrative regulations concerning, among other things, hazardous materials disposal. Our U.S. operations have been the subject of administrative action by state and local environmental authorities. The resolution of any of these claims may result in significant liabilities. See "Risk Factors- Risk Factors Related to our business - In the event of environmental violations at our facilities we may incur significant liabilities" and "Legal Proceedings—Environmental Claims".

### *Environmental Matters*

We are subject to a broad range of environmental laws and regulations, including those governing the following:

- discharges to the air, water and soil;
- the handling and disposal of solid and hazardous wastes;
- the release of petroleum products, hazardous substances, hazardous wastes, or toxic substances to the environment; and
- the investigation and remediation of contaminated soil and groundwater.

We monitor our compliance with these laws and regulations through our environmental management system, and believe that we currently are in substantial compliance with them, although we cannot assure you that we will at all times operate in compliance with all such laws and regulations. If we fail to comply with these laws and regulations, we may be assessed fines or penalties which could have a material effect on us.

Future changes in the applicable environmental laws and regulations, or changes in the regulating agencies' approach to enforcement or interpretation of their regulations, could cause us to make additional capital expenditures beyond what we currently anticipate. We do not believe that any of our facilities are



subject to the Maximum Achievable Control Technology standard for Iron & Steel Manufacturers, or the Maximum Achievable Control Technology standard for Industrial, Commercial and Institutional Boilers and Process Heaters, because they do not emit hazardous air pollutants above the regulatory threshold. However, it is possible that in the future the regulatory agency could disagree with our determination or that operations at one or more of our facilities will change such that the applicability threshold is exceeded. In that event, or under similar circumstances, we could incur additional costs of compliance.

Various federal, state and local laws, regulations and ordinances govern the removal, encapsulation or disturbance of asbestos-containing materials (“ACMs”). These laws and regulations may impose liability for the release of ACMs and may permit third parties to seek recovery from owners or operators of facilities at which ACMs were or are located for personal injury associated with exposure to ACMs. We are aware of the presence of ACMs at our facilities, but we believe that such materials are being properly managed and contained at this time.

#### *Mexican Operations*

We are subject to Mexican federal, state and municipal laws, administrative regulations and Mexican Official Rules (*Normas Oficiales Mexicanas*) relating to a variety of environmental matters, anti-trust matters, trade regulations, and tax and employee matters.

Among other matters, Mexican tax returns are open for review generally for a period of five years, and, according to Mexican tax law, the purchaser of a business may become jointly and severally liable for unpaid tax liabilities of the business prior to its acquisition, which may have an impact on the liabilities and contingencies derived from any such acquisitions. Although we believe that we are in compliance with all material Mexican federal, state and municipal laws, administrative regulations and Mexican Official Rules, we cannot assure you that the interpretation of the Mexican authorities of the laws and regulations affecting our business or the enforcement thereof will not change in a manner that could increase our costs of doing business or could have a material adverse effect on our business, results of operations, financial condition or prospects.

#### *Environmental Matters*

We are subject to various Mexican federal, state and municipal laws, administrative regulations and Mexican Official Rules (*Normas Oficiales Mexicanas*) relating to the protection of human health, the environment and natural resources.

The major federal environmental laws applicable to our operations are: (i) the General Law of Ecological Balance and Environmental Protection (*Ley General del Equilibrio Ecológico y la Protección al Ambiente* or “LGEEPA”) and its regulations, which are administered and overseen by the Ministry of the Environment and Natural Resources (*Secretaría de Medio Ambiente y Recursos Naturales* or “SEMARNAT”) and enforced by the Ministry’s enforcement branch, the Federal Attorney’s Office for the Protection of the Environment (*Procuraduría Federal de Protección al Ambiente* or “PROFEPA”); (ii) the General Law for the Prevention and Integral Management of Waste (*Ley General para la Prevención y Gestión Integral de los Residuos* or the “Law on Wastes”), which is also administered by SEMARNAT and enforced by PROFEPA; and (iii) the National Waters Law (*Ley de Aguas Nacionales*) and its regulations, which are administered and enforced by the National Waters Commission (*Comisión Nacional de Agua*), also a branch of SEMARNAT.

In addition to the foregoing, Mexican Official Rules, which are technical standards issued by applicable regulatory authorities pursuant to the General Normalization Law (*Ley General de Metrología y Normalización*) and to other laws that include the environmental laws described above, establish standards relating to air emissions, waste water discharges, the generation, handling and disposal of



hazardous wastes and noise control, among others. Mexican Official Rules regarding soil contamination and waste management were enacted in order to protect this potential contingencies. Although not enforceable, the internal administrative criteria on soil contamination established by PROFEPA are widely used as guidance in cases where soil remediation, restoration or clean-up is required.

LGEEPA sets forth the legal framework applicable to the generation and handling of hazardous wastes and materials, the release of contaminants into the air, soil and water, as well as the environmental impact assessment of the construction, development and operation of different projects, sites, facilities and industrial plants similar to the ones owned and/or operated by us and our subsidiaries. In addition to LGEEPA, the Law on Wastes regulates the generation, handling, transportation, storage and final disposal of hazardous waste.

LGEEPA also mandates that companies that contaminate soil be responsible for the clean-up. Furthermore, the Law on Wastes provides that owners and lessors of real property with soil contamination are jointly and severally liable for the remediation of such contaminated sites, irrespective of any recourse or other actions such owners and lessors may have against the contaminating party, and aside from the criminal or administrative liability to which the contaminating party may be subject. The Law on Wastes also restricts the transfer of contaminated sites.

PROFEPA can bring administrative, civil and criminal proceedings against companies that violate environmental laws, regulations and Mexican Official Rules, and has the power to impose a variety of sanctions. These sanctions may include, among others, monetary fines, revocation of authorizations, concessions, licenses, permits or registries, administrative arrests, seizure of contaminating equipment, and in certain cases, temporary or permanent closure of facilities.

Additionally, as part of its inspection authority, PROFEPA is entitled to periodically visit the facilities of companies whose activities are regulated by Mexican environmental legislation, and verify compliance. Similar rights are granted to state environmental authorities pursuant to applicable state environmental laws.

Companies in Mexico are required to obtain proper authorizations, concessions, licenses, permits and registries from competent environmental authorities for the performance of activities that may have an impact on the environment or may constitute a source of contamination. Such companies in Mexico are also required to comply with a variety of reporting obligations that include, among others, providing PROFEPA and SEMARNAT with periodic reports regarding compliance with various environmental laws. Among other permits, the operations and related activities of the steel industry are subject to the prior obtainment of an environmental impact authorization granted by SEMARNAT.

We believe that we have obtained all the necessary authorizations, concessions, general operating licenses, permits and registries from the applicable environmental authorities to duly operate our facilities, plants and sites, and sell our products and that we are in material compliance with applicable environmental legislation. We, through our subsidiaries, have made significant capital investments to assure our production and operation facilities comply with requirements of federal, state and municipal law and administrative regulation, and to remain in compliance with our current authorizations, concessions, licenses, permits and registries.

We cannot assure you that in the future, we and our subsidiaries will not be subject to stricter Mexican federal, state or municipal environmental laws and administrative regulations, or more stringent interpretation or enforcement of existing laws and administrative regulations. Mexican environmental laws and administrative regulations have become increasingly stringent over the last decade, and this trend is likely to continue, influenced recently by the North American Agreement on Environmental Cooperation entered into by Mexico, the United States and Canada in connection with the North



American Free Trade Agreement or NAFTA. Further, we cannot assure you that we will not be required to devote significant expenditures to environmental matters, including remediation-related matters. In this regard, any obligation to remedy environmental damages caused by us or any contaminated sites owned or leased by us could require significant unplanned capital expenditures and be materially adverse to our financial condition and results of operations.

#### *Water*

In Mexico, the National Waters Law regulates water resources. In addition, the Mexican Official Rules govern the quality of water. A concession granted by the National Waters Commission is required for the use and exploitation of national waters. All of our facilities have a five-year renewable concession to use and exploit underground waters from wells in order to meet the water requirements of our production processes. We pay the National Waters Commission duties per cubic meter of water extracted under our concessions. We believe we are in substantial compliance with all the requirements imposed by each of the concessions we have obtained.

Pursuant to the National Waters Law, companies that discharge waste into national water bodies must comply with certain requirements, including maximum permissible contaminant levels. Periodic reports on water quality must be provided by dischargers to applicable authorities. Liability may result from the contamination of underground waters or recipient water bodies. We believe that we are in substantial compliance with all water and waste water legislation applicable to us.

#### *Antitrust Matters*

We are also subject to the Mexican Antitrust Law (*Ley Federal de Competencia Económica*), which regulates monopolies and monopolistic practices in Mexico and requires Mexican government approval of certain mergers, acquisitions and joint ventures. We believe that we are currently in compliance with the Mexican Antitrust Law. However, due to our growth strategy of acquiring new businesses and assets and because we are a large manufacturer with a significant share of the markets in Mexico with respect to certain of our products, we may be subject to greater regulatory scrutiny in the future.

#### *Measurements Law*

Mexico's Ministry of Economy (*Secretaría de Economía*), through the General Rules Department (*Dirección General de Normas* or "DGN"), promulgates regulations regarding many products that we manufacture. Specifically, pursuant to the Measurements Law (*Ley Federal sobre Metrología y Normalización*), the DGN issues specifications on the quality and safety standards for our product lines. We believe that all of our products are in material compliance with all applicable DGN regulations.

#### *Trade Regulation Matters*

We have experienced significant competition from imports into Mexico in the past as a result of excess worldwide steel production capacity, particularly in periods of economic slowdown, and as a consequence of the Peso's appreciation, making imports cheaper and more competitive in Peso terms. In 2003, imports declined as international market conditions improved and the Peso weakened. Recently, the Mexican government, at the request of CANACERO, has taken several measures to prevent unfair trade practices such as dumping the steel import market. The overall climate for imports in Mexico is influenced by the free trade agreements that Mexico has entered into with other countries, as well as the level of tariffs and anti-dumping duties (some of which are described below).



We have benefited from the free trade agreements that Mexico has entered into. Specifically, we have directly benefited from our ability to export finished steel products directly to export markets and compete with similar products manufactured in those markets. We have also indirectly benefited from increased demand from our domestic customers who similarly manufacture their products to foreign markets under free trade agreements.

*North American Free Trade Agreement.* NAFTA became effective on January 1, 1994. NAFTA provided for the progressive elimination over a period of ten years of the 10% duties formerly in effect on most steel products imported into Mexico from the United States and Canada, including those that compete with our main product lines. The 1% duty on most steel imports into Mexico from the United States and Canada that remained in 2003 was eliminated in 2004. There is currently no duty.

*Mexican-European Community Free Trade Agreement.* The Mexican-European Free Trade Agreement, or “MEFTA”, became effective on July 1, 2000. MEFTA provides for the progressive elimination of Mexican duties for steel producers that are members of the European Union over a period of 6.5 years for finished steel products, including those that compete with our products. In July of 2000, European imports of steel products paid an initial duty of 8% when importing into Mexico, which is scheduled to be reduced progressively until reaching zero in 2007. This agreement also provides an opportunity to increase our exports to the European countries that are parties to MEFTA since their duties on Mexican steel products were reduced to 1.7% in July 2002 and eliminated in 2003. Since 2004, following the commitment of the G-7, the duties were established at a zero percent rate, giving us an opportunity to increase our sales to the United States.

*Mexico-Japan Economic Association (the “Association”).* The governments of Mexico and Japan started negotiations to sign the Association in June 2001. The negotiations ended up until March 2004 where after fourteen rounds of negotiations the Association was signed. After the approval from the legislative authorities of both countries, the Association was effective as of April 1, 2005.

On January 1, 2004, Japan and the other members of the G-7, agreed to reduce the steel tariffs to zero percent, so Mexico has been benefit from this rate since such date. However, Mexico is sensitive to the steel exports coming from Japan, so the Association was negotiated in the following terms: (i) the specialized steel that is not produced in Mexico, and that is used to produce vehicles, spare parts, electronics, machinery and heavy equipment, was released from any tariffs, as from the effective date of the Association, (ii) the Japanese steel that Mexico imports will be maintained without changes (13% and 18%) during the first five years as of the effective date (iii) the steel products coming from Japan will start paying less taxes gradually as from January 1, 2010 until reaching a zero percent rate in 2015, (iv) the products to be imported from the Sectors Programs, will pay the tariffs pursuant to the fixed tariffs established in such Sector Programs, so the electronic and vehicles industries will be exempted as of the effective date of the Association.

*Other Trade Agreements.* In the last several years, Mexico has signed other free trade agreements with Israel (2000), Iceland, Norway, Liechtenstein and Switzerland (2001), and with the following Latin American countries: Chile (1992 and amended in 1999); Venezuela and Colombia (1995); Costa Rica (1995); Bolivia (1995); Nicaragua (1998); Honduras, El Salvador and Guatemala (2001); and Uruguay (2003). We do not anticipate any significant increase in competition in the Mexican steel market as a result of these trade agreements due to their minimal steel production or, in the case of Venezuela and Chile, minimal share of the Mexican market.

*Dumping and Countervailing Duties.* We are or have been a party to, or have been affected by, numerous steel dumping and countervailing duty claims. Many of these claims have been brought by Mexican steel producers against international steel companies, while others have been brought against Mexican steel companies. In certain instances, such cases have resulted in duties being imposed on



certain imported steel products and, in a few instances, duties have been imposed on Mexican steel exports. In the aggregate, these duties have not had a material impact on our results of operations.

*U.S. and Mexican Safeguard Tariffs on Steel Imports.* In September 2001, Mexico's Ministry of Economy announced a one-year increase in tariffs to 25% on 39 steel products imported into Mexico from countries with which Mexico does not have a free trade agreement. On March 15, 2002, Mexico's Ministry of Economy announced an immediate increase of such tariffs to 35%. In September 2002, the average tariffs returned to 25% and remained at that level for 12 months. From September 2003 to March 2003, tariffs were set at 18%, and in April 2004, they returned to their previous levels (18% for coated steel and 13% for the rest of the products).

From January to October 2002, imports of steel plaques coming from Romania, Russia and Ukraine increased. The Mexican authorities found sufficient elements to start an investigation in 2003, and in 2004, the government announced a preliminary resolution imposing anti-dumping duties of 120.4% to the exports of steel plaques coming from Romania, 36.8% coming from Russia and 60.9% coming from Ukraine. On March 17, 2006 a final resolution was announced imposing final anti-dumping duties of 67.6% to the exports of steel plaques coming from Romania, 36.8% coming from Russia and 60.1% from Ukraine.

### *Legal Proceedings*

#### *Mexico*

With the exception of the tax litigation noted below, there are currently no material legal or administrative proceedings pending in Mexico against us or any of our subsidiaries which we expect to have a material adverse effect on our financial condition or results of operations, or we expect to result in material capital expenditures or materially adversely affect our competitive position.

*Tax Litigation.* On July 2, 2003, CSG filed a suit with the Mexican Federal Tax and Administrative Court of Justice in response to an official communication of the Central International Fiscal Auditing Office of the Tax Administration Service that stated that CSG owed unpaid taxes in the amount of Ps. 89,970 and that alleged that CSG failed to withhold income from third parties on interest payments abroad in 1998, 1999, 2000 and for the period from January 1, 2001 through June 30, 2001. CSG is currently waiting for the authorities to respond to its suit. See Note 16(g) to the audited financial statements for the year ended December 31, 2005.

#### *United States*

Our operations in the United States and Canada have been the subject of various environmental claims, including those described below. The resolution of any of these claims may result in significant liabilities.

*Department of Toxic Substances Control.* In September 2002, the Department of Toxic Substances Control inspected Pacific Steel's facilities based on an alleged complaint from neighbors due to Pacific Steel's excavating to recover scrap metal on its property and on a neighbor's property which it rents from a third party. In this same month, the Department of Toxic Substances Control issued an enforcement order of imminent and substantial endangerment determination, which alleges that certain soil piles, soil management and metal recovery operations may cause an imminent and substantial danger to human health and the environment. Consequently, the department sanctioned Pacific Steel for violating hazardous waste laws and the State of California Security Code and imposed the obligation to make necessary changes to the location. In July 2004, in an effort to continue with this order, the department filed a Complaint for Civil Penalties and Injunctive Relief in San Diego Superior Court. On

July 26, 2004, the court issued a judgment, whereby Pacific Steel is obligated to pay \$235,000 (payable in four payments of \$58,750 over the course of one year) for fines of \$131,250, the department's costs of \$45,000 and an environmental project of \$58,750. At December 31, 2005, Pacific Steel has made all of the payments.

In August 2004, Pacific Steel and the Department of Toxic Substances Control entered into a corrective action consent agreement. In September 2005, the Department of Toxic Substances Control approved the Corrective Measures Plan presented by Pacific Steel, provided it obtains permits from the corresponding local authorities, which are in process at date.

Due to the fact that the cleanliness levels have not yet been defined by the Department and since the characterization of all the property has not yet been finished, the allowance for the costs for the different remedy options are still subject to considerable uncertainty.

We estimated, based on experience in prior years and using the same processes, a liability of between \$0.8 million and \$1.7 million. Due to the above, at December 31, 2002 and 2003, we created a reserve for this contingency of approximately \$0.8 million and \$1.7 million, respectively. At December 31, 2005, such reserve is Ps. 15,079 million (\$1.4 million).

*The Community Development Commission.* The Community Development Commission of National City, California (CDC) has expressed its intention to develop the site and is preparing a purchase offer for Pacific Steel's land at market value, less the cost of remediation and less certain investigation costs incurred. Pacific Steel has informed the CDC that the land will not be voluntarily sold unless there is an alternate property where it could relocate its business. The CDC, in accordance with the State of California law, has the power to expropriate in exchange for payment at market value and, in the event that there is no other land available to relocate the business, it would also have to pay Pacific Steel the land's book value. The CDC made an offer to purchase the land from Pacific Steel for \$6.9 million, based on a business appraisal. The expropriation process was temporarily suspended through an agreement entered into by both parties in April 2006. This agreement allows Pacific Steel to explore the possibility of finishing the remediation process of the land and to propose an attractive alternative to CDC which would allow us to remain in the area.

Due to this situation and considering the imminent expropriation of part of the land on which Pacific Steel carries out certain operations, for the year ended December 31, 2002, Pacific Steel recorded its land at realizable value based on an appraisal by independent experts. Such appraisal caused a decrease in the value of part of the land of Ps. 22,562 (19,750 historical pesos) and a charge to results of operations of 2002 for the same amount.

*Environmental Liabilities.* At December 31, 2005, we recorded under the caption of "Other Long-term Liabilities", a reserve of Ps. 44.0 million to cover probable environmental liabilities and compliance activities. The current portions of the environmental reserve are included in the caption "Other Accounts Payable and Accrued Expenses", in the attached consolidated balance sheets. We have no knowledge of any additional environmental remediation liabilities or contingent liabilities related to environmental issues in regards to the facilities; consequently, it would not be appropriate to establish an additional reserve at this time.

As is the case for most steel producers in the United States and Canada, we may incur material expenses related to future environmental issues, including those which arise from environmental compliance activities and the remediation of past administrative waste practices in our U.S. facilities.

## MANAGEMENT

### Directors

#### *Election of Directors*

Our board of directors is responsible for managing our business. Pursuant to our by-laws, the board of directors shall consist of a maximum of 21 but not less than five members elected at an ordinary general meeting of shareholders. Alternate directors are authorized to serve on the board of directors in the absence of directors. Our board of directors currently consists of seven directors and seven alternate directors, each of whom is elected at the annual shareholders' meeting for a term of one year or until a successor has been appointed. Under the Mexican Securities Market Law and our by-laws, at least 25% of our directors must be independent. Under the law, the determination as to the independence of our directors made by our shareholders' meeting may be contested by the Mexican National Banking and Securities Commission.

At each shareholders' meeting for the election of directors, the holders of shares are entitled pursuant to our by-laws to elect the directors and their alternates. Each person (or group of persons acting together) holding 10% of our capital stock is entitled to designate one director and an alternate.

The current members of our board of directors were nominated and elected to such position at the 2006 general meeting of shareholders as proposed by Industrias CH. We expect that Industrias CH will be in a position to continue to elect the majority of our directors and to exercise substantial influence and control over our business and policies and to influence us to enter into transactions with Industrias CH and affiliated companies. However, our by-laws provide that at least two of our directors must be independent from us and our affiliates, and our board of directors has passed a resolution requiring the approval of two independent directors for certain transactions between us and our affiliates which are not our subsidiaries.

Under Mexican law, a majority shareholder has no fiduciary duty to minority shareholders but may not act contrary to the interests of the corporation for the majority shareholder's benefit. Such a majority shareholder is required to abstain from voting on any matter in which it directly or indirectly has a conflict of interest and can be liable for actual and consequential damages if such matter passes as a result of its vote in favor thereof. In addition, the directors of a Mexican corporation owe a duty to act in a manner which, in their independent judgment, is in the best interests of the corporation and all its shareholders.

Our board of directors adopted a code of ethics in December 2002.

#### *Authority of the Board of Directors*

The board of directors is our legal representative. The board of directors must approve, among other matters:

- our general strategy;
- annual approval of the business plan and the investment budget;
- capital investments not considered in the approved annual budget for each fiscal year;
- proposals to increase our capital or that of our subsidiaries;

- with input from the audit and corporate practices committee, on an individual basis: (i) any transactions with related parties, subject to certain limited exceptions, (ii) our management structure and any amendments thereto, and (iii) the election of our chief executive officer, his compensation and removal for justified causes; (iv) our financial statements and those of our subsidiaries, (v) unusual or non-recurrent transactions and any transactions or series of related transactions during any calendar year that involve (a) the acquisition or sale of assets with a value equal to or exceeding 5% of our consolidated assets or (b) the giving of collateral or guarantees or the assumption of liabilities, equal to or exceeding 5% of our consolidated assets, and (vi) contracts with external auditors;
  - calling shareholders' meetings and acting on their resolutions;
  - any transfer by us of shares in our subsidiaries;
- creation of special committees and granting them the power and authority, provided that the committees will not have the authority which by law or under our by-laws is expressly reserved for the shareholders;
  - determining how to vote the shares that we hold in our subsidiaries; and
  - the exercise of our general powers in order to comply with our corporate purpose.

Meetings of the board of directors will be validly convened and held if a majority of our members are present. Resolutions at the meetings will be valid if approved by a majority of the members of the board of directors, unless our by-laws require a higher number. The chairman has a tie-breaking vote. Notwithstanding the board's authority, our shareholders pursuant to decisions validly taken at a shareholders' meeting at all times may override the board.

#### *Duty of Care and Duty of Loyalty*

The Mexican Securities Market Law imposes a duty of care and a duty of loyalty on directors. The duty of care requires our directors to act in good faith and in the best interests of the company. In carrying out this duty, our directors are required to obtain the necessary information from the general director, the executive officers, the external auditors or any other person to act in the best interests of the company. Our directors are liable for damages and losses caused to us and our subsidiaries as a result of violating their duty of care.

The duty of loyalty requires our directors to preserve the confidentiality of information received in connection with the performance of their duties and to abstain from discussing or voting on matters in which they have a conflict of interest. In addition, the duty of loyalty is violated if a shareholder or group of shareholders is knowingly favored or if, without the express approval of the board of directors, a director takes advantage of a corporate opportunity. The duty of loyalty is also violated, among other things, by (i) failing to disclose to the audit and corporate practices committee or the external auditors any irregularities that the director encounters in the performance of his or her duties or (ii) disclosing information that is false or misleading or omitting to record any transaction in our records that could affect our financial statements. Directors are liable for damages and losses caused to us and our subsidiaries for violations of this duty of loyalty. This liability also extends to damages and losses caused as a result of benefits obtained by the director or directors or third parties, as a result of actions of such directors.

Our directors may be subject to criminal penalties of up to 12 years' imprisonment for certain illegal acts involving willful misconduct that result in losses to us. Such acts include the alteration of financial statements and records.

Liability actions for damages and losses resulting from the violation of the duty of care or the duty of loyalty may be exercised solely for our benefit and may be brought by us, or by shareholders representing 5%



or more of our capital stock, and criminal actions only may be brought by the Mexican Ministry of Finance, after consulting with the Mexican National Banking and Securities Commission. As a safe harbor for directors, the liabilities specified above (including criminal liability) will not be applicable if the director acting in good faith (i) complied with applicable law, (ii) made the decision based upon information provided by our executive officers or third-party experts, the capacity and credibility of which could not be subject to reasonable doubt, (iii) selected the most adequate alternative in good faith or if the negative effects of such decision could not have been foreseeable, and (iv) complied with shareholders' resolutions provided the resolutions do not violate applicable law.

The members of the board are liable to our shareholders only for the loss of net worth suffered as a consequence of disloyal acts carried out in excess of their authority or in violation of our by-laws.

In accordance with the Mexican Securities Market Law, supervision of our management is entrusted to our board of directors, which shall act through an audit and corporate practices committee for such purposes, and to our external auditor. The audit and corporate practices committee (together with the board of directors) replaces the statutory auditor (comisario) that previously had been required by the Mexican Corporations Law. See "Management - Committees".

The following table sets forth the names and the year of their initial appointment to their position, of the members of our board of directors and their alternates.

<b>Name</b>	<b>Director Since</b>
<i>Directors:</i>	
Rufino Vigil González	2001
Raúl Arturo Pérez Trejo	2003
Eduardo Vigil González	2001
Raúl Vigil González	2001
José Luis Rico Maciel	2001
Rodolfo García Gómez de Parada	2001
Gerardo Arturo Avendaño Guzmán	2001
<i>Alternate Directors:</i>	
Manuel Rivero Figueroa	2003
José Luis Romero Suárez	2001
Sergio Vigil González	2001
Juan Méndez Martínez	2001
Luis García Limón <sup>(1)</sup>	2006
Jaime Vigil Sánchez Conde	2001
Sergio Villagómez Martínez	2003

(1) Luis García Limón is also our Chief Executive Officer.

#### *Biographical Information*

**Gerardo Arturo Avendaño Guzmán.** Mr. Avendaño was born in 1955. He is an independent director for purposes of Mexican law and has been a member of our board of directors and the audit committee since 2001 and is a member of our audit and corporate practices committee. Mr. Avendaño is an independent lawyer specializing in civil, mercantile



and fiscal litigation.

***Rodolfo García Gómez de Parada.*** Mr. García was born in 1953. He has been a member of our board of directors since 2001 and is an independent director for purposes of Mexican law. He has been the tax adviser of Industrias CH since 1978 and our tax adviser since 2001 and is a member of the board of directors of a group of self-service stores and restaurants since 1990.

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**Raúl Arturo Pérez Trejo.** Mr. Pérez was born in 1959. He has been a member of our board of directors since 2003, and is an independent director for purposes of Mexican law, and is a member of our audit and corporate practices committee. Mr. Pérez has also served since 1992 as the chief financial officer of a group that produces and sells structural steel racks for warehousing and other industrial storage.

**José Luis Rico Maciel.** Mr. Rico was born in 1926. He has been a member of our board of directors since 2001 and is an independent director for purposes of Mexican law. He also serves as our corporate legal and tax director and is a member of the board of directors of a group of self-service stores and restaurants since 1957.

**Eduardo Vigil González.** Mr. Vigil was born in 1957. He has been a member of our board of directors since 2001. Since 1976, Mr. Vigil has been chief executive officer of a welded pipe corporation. Mr. Vigil is a brother of Rufino Vigil González and Raúl Vigil González.

**Raúl Vigil González.** Mr. Vigil was born in 1961. He has been a member of our board of directors since 2001. Since 1992 he has been chief executive officer of a steel company. In addition, he has also been general manager of a steel distribution company. Mr. Vigil is a brother of Rufino Vigil González and Eduardo Vigil González.

**Rufino Vigil González.** Mr. Vigil was born in 1948. He is currently the chairman of our board of directors and has been a member of the board of directors since 2001. Since 1973, Mr. Vigil has been chief executive officer of a steel related products corporation. From 1988 to 1993, Mr. Vigil was a member of the board of directors of a Mexican investment bank and from 1971 to 1973 he was a construction corporation manager. Mr. Vigil is a brother of Eduardo Vigil González and Raúl Vigil González.

**Luis García Limón.** Mr. García was born in 1944. He is currently our chief executive officer. From 1982 to 1990 he was general director of CSG, from 1978 to 1982 he was operation director of CSG, from 1974 to 1978 he was general manager of Moly Cop and Pyesa, and from 1969-1974 he was engineering manager of CSG. In addition, from 1967 to 1969 Mr. García was the director of electrical installation of a construction company.

**Manuel Rivero Figueroa.** Mr. Rivero was born in 1957. He has been financial manager of the Monclova facility of Industrias CH since 1994.

**José Luis Romero Suárez.** Mr. Romero was born in 1956. Since 1984, he has been commercial director of Procesos de Acero, S.A. de C.V. He is the brother-in-law of Rufino, Eduardo, Sergio and Raúl Vigil González.

**Sergio Vigil González.** Mr. Vigil was born in 1962. Since 2001 he has served as chief financial officer of Industrias CH. He is the brother of Rufino, Eduardo and Raul Vigil González and the uncle of Jaime Vigil Sánchez Conde.

**Juan Méndez Martínez.** Mr. Méndez was born in 1956. Since 1978 he has served as the chief financial officer of Operadora Manufacturera de Tubos, S.A. de C.V.

**Jaime Vigil Sánchez Conde.** Mr. Vigil was born in 1980. Since 2001 he has served as investors' relations manager of Industrias CH. He is the son of Rufino Vigil González and the nephew of Sergio, Raul and Eduardo Vigil González.

**Sergio Villagómez Martínez.** Mr. Villagómez was born in 1956. Since 1981 he has served as the general manager of Perfiles Estructurales del Norte, S.A. de C.V., a steel producing corporation.

The business address of our directors and executive officers is our principal executive headquarters.

## **Committees**

Our by-laws provide for an audit and corporate practices committee to assist the board of directors with the management of our business.

### *Audit and Corporate Practices Committee*

The audit and corporate practices committee is currently composed of three members. Raúl Arturo Pérez Trejo, the president of the audit and corporate practices committee, was elected at our ordinary and extraordinary shareholders' meeting held on October 24, 2006, and Gerardo Arturo Avendaño Guzmán and Rodolfo García Gómez de Parada were appointed. Raúl Arturo Pérez Trejo has been appointed as the "audit committee financial expert". Our by-laws provide that a shareholders' meeting shall determine the number of members of the audit and corporate practices committee, all of which must be members of our board of directors. The chairman of the audit and corporate practices committee is elected by our shareholders' meeting, and the board of directors appoints the remaining members.

The audit and corporate practices committee is responsible, among others, for (i) supervising our external auditors and analyzing their reports, (ii) analyzing and supervising the preparation of our financial statements, (iii) informing the board of our internal controls and their adequacy, (iv) requesting reports of our board of directors and executive officers whenever it deems appropriate, (v) informing the board of any irregularities that it may encounter, (vi) receiving and analyzing recommendations and observations made by the shareholders, members of the board, executive officers, our external auditors or any third party and taking the necessary actions, (vii) calling shareholders' meetings, (viii) supervising the activities of our general director, (ix) providing an annual report to the board, (x) providing opinions to our board of directors, (xi) requesting and obtaining opinions from independent third parties and (xii) assisting the board in the preparation of annual reports and other reporting obligations.

The chairman of the audit and corporate practices committee, shall prepare an annual report to our board of directors with respect to the findings of the audit and corporate practices committee, which shall include (i) the status of the internal controls and internal audits and any deviations and deficiencies thereof, taking into consideration the reports of external auditors and independent experts, (ii) the results of any preventive and corrective measures taken based on results of investigations in respect of non-compliance of operating and accounting policies, (iii) the evaluation of external auditors, (iv) the main results from the review of our financial statements and those of our subsidiaries, (v) the description and effects of changes to accounting policies, (vi) the measures adopted as result of observations of shareholders, directors, executive officers and third parties relating to accounting, internal controls, and internal or external audits; (vii) compliance with shareholders' and directors' resolutions; (viii) observations with respect to relevant directors and officers; (ix) the transactions entered into with related parties; and (x) the remunerations paid to directors and officers.

## **Executive Officers**

The following table sets forth the names of our executive officers, their current position with us and the year of their initial appointment to that position.

<b>Name</b>	<b>Position</b>	<b>Position Held Since</b>
Luis García Limón	Chief Executive Officer	1982*
José Flores Flores	Chief Financial Officer	2005
Juan José Acosta Macías	Chief Operating Officer	2004
Marcos Magaña Rodarte	Chief Sales Officer	2001

\*Represents the date as of which Mr. García Limón first held this office with our predecessor, CSG.

**Luis García Limón.** Mr. García was born in 1944. He is currently our chief executive officer. From 1982 to 1990 he was general director of CSG, from 1978 to 1982 he was Operation Director of CSG, from 1974 to 1978 he was general manager of Moly Cop and Pyesa, and from 1969-1974 he was Engineering Manager of CSG. In addition, from 1967 to 1969 Mr. García was the director of electrical installation of a construction company.

**José Flores Flores.** Mr. Flores was born in 1950. He is currently our chief financial officer. From 2001 to 2004 he was our chief corporate financial planning officer. From 1990 to 2001 he was our manager of financial analysis and stock market disclosure. Before that, Mr. Flores was the auditor manager of a food company from 1988 to 1990, the controller manager of Grupo Situr, Holding Company of Hotels, a subsidiary of Grupo Sidek from 1986 to 1988, and our auditor manager from 1983 to 1986.

**Juan José Acosta Macías.** Mr. Acosta was born in 1960. He is currently our chief operating officer. From 1998 to 2004 he was production manager of CSG, he has been working with us since 1983. Prior to working with us, Mr. Acosta worked for Mexicana de Cobre as a supervisor in 1982.

**Marcos Magaña Rodarte.** Mr. Magaña was born in 1965. He is currently our marketing and sales director. Before holding this position, Mr. Magaña was domestic sales manager of CSG from 1997 to 2001, sales manager for the western region of CSG from 1994 to 1996, sales manager of Metálica las Torres, our subsidiary, from 1992 to 1994 and a salesman for CSG, from 1990 to 1992. Before working with us, Mr. Magaña worked for a bank as executive promoter of sales.

Our chief executive officer and executive officers are required, under the Mexican Securities Market Law, to act for our benefit and not that of a shareholder or group of shareholders. Our chief executive is required, principally, to (i) implement the instructions of our shareholders' meeting and our board of directors, (ii) submit to the board of directors for approval the principal strategies for the business, (iii) submit to the audit and corporate practices committee proposals for the systems of internal control, (iv) disclose all material information to the public and (v) maintain adequate accounting and registration systems and mechanisms for internal control. Our chief executive officer and our executive officers will also be subject to liability of the type described above in connection with our directors.

The business address of our directors and executive officers is our principal executive headquarters.

### **Compensation of Directors and Executive Officers**

For the year ended December 31, 2005 and for the six months ended June 30, 2006, we paid no fees to our seven directors and seven alternate directors, and the aggregate compensation our executive officers earned was approximately Ps. 17 million and Ps. 11 million, respectively.

None of our directors or executive officers are entitled to benefits upon termination under their service contracts with us, except for what is due them according to the Mexican Federal Labor Law (Ley Federal del Trabajo).



## RELATED PARTY TRANSACTIONS

We have engaged from time to time in a number of transactions with certain of our shareholders and companies that are owned or controlled, directly or indirectly, by our controlling shareholder, Industrias CH. These transactions were made on terms that we believe were not less favorable to us than those obtainable on an arm's length basis. See note 4 to our financial statements and note 3 to our unaudited financial statements. On July 22, 2005, we and Industrias CH acquired 100% of the stock of Republic through SimRep. We acquired 50.2% (U.S.\$115 million Ps. 1,310 million) of Republic's stock through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% (U.S.\$114 million Ps. 1,299) through SimRep.

We financed our portion of the U.S.\$229 million (Ps. 2,609 million) purchase price principally from a loan that we received through Industrias CH that has since been repaid in full. At December 31, 2005, the total amount of Republic's debt liabilities was U.S. \$37.7 million (Ps. 430 million). Republic's debt has since been repaid in full.

We have borrowed various amounts from Industrias CH, primarily to finance acquisitions (including the acquisition of Republic), debt redemptions and bank loan amortization and interest payments, a substantial portion of which borrowings were converted to equity. We have also received various capital contributions from Industrias CH.

From time to time we sell steel products, primarily billet, to Industrias CH and its affiliates. In 2003, these sales totaled Ps. 190 million, in 2004, these sales totaled Ps. 129 million, and in 2005 these sales totaled Ps. 25 million. In addition, in 2004 we purchased Ps. 11 million of steel products from Industrias CH and its affiliates, and in 2005 we purchased Ps. 2 million of steel products from Industrias CH and its affiliates. We negotiated these prices on an arms-length basis.

We have a services agreement with Industrias CH, by which Industrias CH provides administrative services to us and other of our subsidiaries. The term of the agreement is indefinite. The payments are paid to Industrias CH on a monthly basis. In 2003, we paid to Industrias CH for its services Ps. 9 million, in 2004 we paid Ps. 9 million, and in 2005 we paid Ps. 8 million.

In 1992, we sold Ferrometal de Baja California, S.A. de C.V. ("Ferrometal"), which operates steel distribution centers in northwestern Mexico, to two individuals, Sergio Luis González Melo (our former director) and an executive officer of Ferrometal. The purchase price of U.S.\$2.9 million was determined based upon arms-length negotiations. The amounts payable from such individuals were initially denominated in dollars bearing interest at 15% per annum. In 1995, we entered into an agreement with the purchasers pursuant to which the interest accrued as of December 31, 1994 was capitalized, the debt was converted into pesos with no interest accruing from January 1995, and the entire principal amount was to be paid no later than December 31, 1996. The executive officer of Ferrometal timely paid his obligations. Mr. González, however, still owes us approximately Ps. 10 million in nominal pesos at December 31, 2002. We obtained favorable judgments against him in February 2002, June 2002 and February 2003. This proceeding is not completed, however, and we are not yet entitled to execute on the judgment. We have established a reserve equal to 100% of the amount owed by Mr. González. In January 2004 we and Mr. González' successors entered into an agreement to pay \$1.3 million Ps. 15.6 million to us. In 2004, the successors of Mr. González paid us a total of \$1.3 million (Ps. 15.6 million).

**MAJOR SHAREHOLDERS**

As of September 30, 2006, based on information available to us, we believe that our officers and directors own no series B shares. Accordingly, on an individual basis, and as a group, our directors and executive officers beneficially owned less than one percent of any class of our shares. None of our directors or officers holds any options to purchase series B shares or preferred shares.

Industrias CH and its direct wholly-owned subsidiaries currently hold approximately 84% of our series B shares. Rufino Vigil González, the chairman of our board of directors, owns approximately 63% of Industrias CH directly or through its subsidiaries. Members of the Vigil family currently control indirectly approximately another 10% of our series B shares.

The following table shows the ownership of our series B shares immediately prior to the offering and as adjusted to give effect to the combined offering, assuming no exercise of the over-allotment options.

<b>Name of Shareholder</b>	<b>Number of shares owned prior to the offering</b>	<b>% of shares owned prior to the offering</b>	<b>Number of shares after the offering</b>	<b>% of shares owned after the offering</b>
Industrias CH	260,184,672	62%	260,184,672	
Tuberías Procarsa, S.A. de C.V. (1)	93,977,250	22%	93,977,250	
Operadora de Manufacturera de Tubos, S.A. de C.V. (2)	25,707,345	6%	25,707,345	
Aceros y Laminados Sigosa, S.A. de C.V.(1)	4,136,373	1%	4,136,373	
SEYCO Estructuras S.A. de C.V. (2)	5,847,159	1%	5,847,159	
Industrial de Herramientas CH, S.A. de C.V. (2)	2,117,073	1%	2,117,073	
Compañía Mexicana de Tubos, S.A. de C.V. (2)	3,629,274	1%	3,629,274	
Public Investors.	25,615,560	6%		
<b>Total</b>	<b>421,214,706</b>	<b>100%</b>		<b>100%</b>

(1) A subsidiary of Industrias CH.

(2) Companies directly or indirectly owned by members of the Vigil family.

## DESCRIPTION OF CAPITAL STOCK

Set forth below is a description of our capital stock and a brief summary of material provisions of our by-laws and Mexican law (including the new Mexican Securities Market Law). This description gives effect to the amendment and restatement of our by-laws, which we adopted on October 24, 2006.

### General

We were incorporated under the name Grupo Simec, S.A. de C.V. on August 22, 1990, as a variable capital corporation (*sociedad anónima de capital variable*) under the laws of Mexico.

On October 24, 2006, we amended and restated our by-laws to incorporate the provisions required by the Mexican Securities Market Law. As a result, we became a public variable capital corporation, a new corporate form for corporations with stock registered with the Mexican National Securities Registry (*Registro Nacional de Valores*) maintained by the National Banking and Securities Commission and listed on the Mexican Stock Exchange.

The following table sets forth our authorized capital stock and our issued and outstanding capital stock at October 24, 2006, the date of our last meeting of shareholders.

Capital Stock	Authorized	Issued and outstanding
Series B shares	481,214,706	421,214,706
Total	481,214,706	421,214,706

All ordinary shares confer equal rights and obligations to holders within each series. Our capital stock is divided into ordinary series B and limited series L shares. Prior to June 2002, our capital stock also included series A shares. On June 5, 2002, we converted all of our series A shares to series B shares on a one-for-one basis.

Shares other than ordinary shares, having limited, restricted or no voting rights, may never represent more than 25% of our outstanding capital stock. Series B shares represent 100% of our capital stock. We have issued no series L shares. At September 30, 2006, our total share capital was Ps. 3,513 million, represented by a fixed portion of Ps. 1,306 million, and a variable portion of Ps. 2,207 million. On February 20, 2003, we effected a 1 for 20 reverse stock split. On May 30, 2006, we effected a 3 for 1 stock split.

The fixed portion of our capital stock may be increased or decreased by a resolution adopted at a general extraordinary shareholders' meeting and upon amendment to our by-laws. The variable portion of our capital stock may be increased or decreased by a resolution adopted at a general ordinary shareholders' meeting and without amending our by-laws. Increases or decreases in the fixed or variable portion of the capital stock must be recorded in our registry of capital variations and in our share registry. New shares cannot be issued unless the then-issued and outstanding shares have been paid in full.

### Voting Rights and Shareholders' Meetings

Each series B share entitles its holder to one vote at any meeting of our shareholders. Each series L share would entitle its holder to one vote at any meeting at which holders of series L shares are entitled to vote. Holders of series L shares would be entitled to vote only on the following matters:

- our transformation from one type of company to another;





- extension of our corporate existence;
- to elect one member of our board of directors and the corresponding alternate director pursuant to the provisions of our by-laws and the Securities Market Law;
  - any merger or corporate spin-off in which we are not the surviving entity;
  - our dissolution or liquidation;
  - cancellation of the registration of our shares with the National Registry of Securities; and
- any action that would prejudice the rights of holders of series L shares and not prejudice the other classes of shares similarly. A resolution on any such action requires the affirmative vote of a majority of all outstanding series L shares.

Shareholders may vote by proxy duly appointed in writing. Under Mexican law, holders of shares of any series are also entitled to vote as a class on any action that would prejudice the rights of holders of shares of such series but not rights of holders of shares of other series, and a holder of shares of such series would be entitled to judicial relief against any such action taken without such a vote. Our board of directors or other party calling for shareholder action initially would determine whether an action requires a class vote on these grounds. A negative determination would be subject to judicial challenge by an affected shareholder, and a court ultimately would determine the necessity for a class vote. There are no other procedures for determining whether a proposed shareholder action requires a class vote, and Mexican law does not provide extensive guidance on the criteria to be applied in making such a determination.

Under Mexican law and our by-laws, we may hold three types of shareholders' meetings: ordinary, extraordinary and special. Ordinary shareholders' meetings are those called to discuss any issue not reserved for extraordinary shareholders' meeting. An annual ordinary shareholders' meeting must be convened and held within the first four months following the end of each fiscal year to discuss, among other things, the board of director's report on our financial statements, the appointment of members of the board of directors, declaration of dividends and the determination of compensation for members of the board of directors. Under the Mexican Securities Market Law, our ordinary shareholders' meeting, in addition to those matters described above, will have to approve any transaction representing 20% or more of our consolidated assets, executed in a single or a series of transactions, during any fiscal year.

Extraordinary shareholders' meetings are those called to consider any of the following matters:

- extension of a company's duration or voluntary dissolution;
- an increase or decrease in a company's minimum fixed capital;
  - change in corporate purpose or nationality;
- any transformation, merger or spin-off involving the company;
- any stock redemption or issuance of preferred stock or bonds;
- the cancellation of the listing of our shares with the National Securities Registry or on any stock exchange;
  - any other amendment to our by-laws; and



- any other matters for which applicable Mexican law or our by-laws specifically require an extraordinary meeting.

Special shareholders' meetings are those that shareholders of the same series or class call and hold to consider any matter particularly affecting the relevant series or class of shares.

Shareholders' meetings are required to be held in our corporate domicile, which is Guadalajara, Jalisco. Calls for shareholders' meetings must be made by the chairman or the secretary of the board of directors or the chairman of our audit and corporate practices committee. Any shareholder or group of shareholders representing at least 10% of our capital stock has the right to request that the chairman of the board of directors or the chairman of the audit and corporate practices committee call a shareholders' meeting to discuss the matters indicated in the relevant request. If the chairman of the board of directors or the chairman of the audit and corporate practices committee fail to call a meeting within 15 calendar days following receipt of the request, the shareholder or group of shareholders representing at least 10% of our capital stock may request that the call be made by a competent court.

Calls for shareholders' meetings must be published in the official gazette of the state of Jalisco or any major newspaper located in the City of Guadalajara, Jalisco at least 15 calendar days prior to the date of the meeting. Each call must set forth the place, date and time of the meeting and the matters to be addressed. Calls must be signed by whomever makes them, provided that calls made by the board of directors or the audit and corporate practices committee must be signed by the chairman, the secretary or a special delegate appointed by the board of directors or the audit and corporate practices committee as appropriate, for that purpose. Shareholders' meetings will be validly held and convened without the need of a prior call or publication whenever all the shares representing our capital are duly represented.

To be admitted to any shareholders' meeting, shareholders must: (i) be registered in our share registry; and (ii) at least 24 hours prior to the commencement of the meeting submit (a) an admission ticket issued by us for that purpose, and (b) a certificate of deposit of the relevant stock certificates issued by the Secretary or by a securities deposit institution, a Mexican or foreign bank or securities dealer in accordance with the Mexican Securities Market Law. Shareholders may be represented at any shareholders' meeting by one or more attorneys-in-fact, and these representatives may not be one of our directors. Representation at shareholders' meetings may be substantiated pursuant to general or special powers of attorney or by a proxy executed before two witnesses.

At or prior to the time of the publication of any call for a shareholders' meeting, we will provide copies of the publication to the depository for distribution to the holders of ADSs. Holders of ADSs are entitled to instruct the depository as to the exercise of voting rights pertaining to the Series B shares. See "Description of American Depository Receipts — Voting Rights".

## **Quorums**

Ordinary meetings are regarded as legally convened pursuant to a first call when shares representing more than 50% of our capital are present or duly represented. Resolutions at ordinary meetings of shareholders are valid when approved by a majority of the shares present at the meeting approves them. Any number of shares represented at an ordinary meeting of shareholders convened pursuant to a second or subsequent call constitutes a quorum. Resolutions at ordinary meetings of shareholders convened pursuant to a second or subsequent call are valid when a majority of the shares present at the meeting approves them.

Extraordinary shareholders' meetings are regarded as legally convened pursuant to a first call when shares representing at least 75% of our capital are present or duly represented, and extraordinary shareholders' meetings convened pursuant to a second or subsequent call are regarded as legally



convened when shares representing 50% of our capital are present or duly represented. Resolutions at extraordinary meetings of shareholders are valid when approved by 50% of our capital. Special meetings of holders of series L shares are governed by the same rules applicable to extraordinary general meeting of holders of series B shares. The quorum for an extraordinary general meeting at which holders of series L shares may not vote is 75% of the series B shares, and the quorum for an extraordinary general meeting at which holders of L shares are entitled to vote is 75% of the outstanding capital stock. Whether on first, second or subsequent call, actions at an extraordinary general meeting generally may be taken by a majority vote of the series B shares outstanding and, on matters which holders of series L shares are entitled to vote, a majority vote of all the outstanding capital stock.

Our by-laws also establish that a delisting of our shares requires the vote of holders of 95% of our capital stock.

### **Right of Redemption**

Whenever the shareholders approve a change of corporate purposes, change of nationality of the corporation or transformation from one form of corporate organization to another, the Mexican Corporations Law provides that any shareholder entitled to vote on that change that has voted against it may withdraw from its shares. The redemption of the shareholders' shares will be effected at the lower of (a) 95% of the average trading price determined based on the average of the prices of our shares on the 30 days on which the shares may have been quoted prior to the date of the meeting, or (b) the book value of the shares in accordance with the most recent audited financial statements approved by our shareholders' meeting, provided that the shareholder exercises that right within 15 days following the adjournment of the meeting at which the change was approved.

### **Mandatory Redemption**

In accordance with the Mexican Corporation Law shares representing our capital stock are subject to redemption in connection with either (i) a reduction of capital stock or (ii) a redemption with retained earnings, which in either case must be approved by our shareholders. In connection with a capital reduction, the redemption of shares shall be made pro rata among the shareholders, or, if affecting the variable portion of the capital stock, as otherwise determined in the relevant shareholders' meeting, but in no case shall the redemption price be less than the book value of the shares according to our latest balance sheet approved at a general ordinary shareholders' meeting. In the case of a redemption with retained earnings, such redemption shall be conducted (a) by means of a tender offer conducted on the Mexican Stock Exchange at prevailing market prices, in accordance with the Mexican Corporations Law, the new Mexican Securities Market Law and our by-laws or (b) pro rata among the shareholders.

### **Registration and Transfer**

Our shares are registered with the National Securities Registry, as required under the Mexican Securities Market Law and regulations issued by the National Banking and Securities Commission. Our shares are evidenced by share certificates in registered form, and registered dividend coupons may be attached thereto. Our shareholders either may hold their shares directly, in the form of physical certificates, or indirectly, in book-entry form, through institutions that have accounts with INDEVAL.

INDEVAL is the holder of record in respect of all such shares held in book-entry form. INDEVAL will issue certificates on behalf of our shareholders upon request. INDEVAL participants, brokers, banks, other financial entities or other entities approved by the National Banking and Securities Commission maintain accounts at INDEVAL. We maintain a stock registry and only those persons listed in such stock registry, and those holding certificates issued by INDEVAL indicating ownership, and any relevant INDEVAL participants, will be recognized as our shareholders.

### **Dividends and Distributions**



At the annual general ordinary shareholders' meeting, the board of directors submits our financial statements for the previous fiscal year, together with their report on us, to the series B shareholders for approval. Under our by-laws and Mexican law, our annual net income, based upon our audited financial statements prepared in accordance with Mexican GAAP, is applied as follows: (i) five percent of our net earnings must be allocated to a legal reserve fund, until such fund reaches an amount equal to a least 20% of our then current capital stock (which, as of June 30, 2006, was approximately Ps. 3,513 million), (ii) thereafter, a certain percentage of net earnings may be allocated to any general or specific reserve fund, and (iii) the remainder of any net earnings is allocated as determined by the majority of our shareholders and may be distributed as dividends. All shares that are fully paid and outstanding at the time a dividend or other distribution is declared are entitled to share equally in any or other distribution. We will distribute through INDEVAL cash dividends on shares held through INDEVAL. Any cash dividends on shares evidenced by physical certificates will be paid by surrendering to us the relevant dividend coupon registered in the name of its holder. See "Dividends and Dividend Policy".

To the extent that we declare and pay dividends on our shares, owners of ADSs at the time a dividend or other distribution is declared will be entitled to receive any dividends payable in respect of the series B shares underlying their ADSs, subject to the terms of the Deposit Agreement. Cash dividends will be paid to the Depositary in pesos, and, except as otherwise described under "Description of American Depositary Receipts—Dividends, Other Distribution and Rights", the Depositary will convert them into dollars and pay them to the holders of ADSs net of currency expenses and applicable fees.

A shareholder's entitlement to uncollected dividends lapses within five years following the stated payment date, in favor of us.

For additional tender offer and insider trading rules applicable to our securities pursuant to Mexican Law, see "Market Information".

### **Changes in Capital Stock**

Increases and reductions of our share capital must be approved at an ordinary or extraordinary shareholders' meeting, subject to the provisions of our by-laws and the Mexican Corporations Law.

Subject to the individual ownership limitations set forth in our by-laws, in the event of an increase of our capital stock, other than (i) in connection with mergers, (ii) for the conversion of convertible debentures as provided in Section 210 Bis of the Mexican General Law on Negotiable Instruments and Credit Transactions, (iii) for purposes of conducting a public offering of such shares or (iv) for the resale of shares maintained in our treasury as a result of repurchase of shares conducted on the Mexican Stock Exchange, our shareholders will have a preemptive right to subscribe and pay for new stock issued as a result of such increase in proportion to their shareholder interest at that time. This preemptive right must be exercised by any method provided in Section 132 of the Mexican Corporations Law, by subscription and payment of the relevant stock within fifteen business days after the date of publication of the corresponding notice to our shareholders in the in the official gazette of the state of Jalisco and in one of the newspapers of general circulation in Mexico, provided that if at the corresponding meeting all of our shares are duly represented, the fifteen business day period shall commence on the date of the meeting. Preemptive rights cannot be waived in advance and cannot be traded separately from the corresponding shares that give rise to such right.

Holders of ADSs may exercise preemptive rights in limited circumstances. See "Description of American Depositary Receipts—Dividends, Other Distributions and Rights". If a holder of series B shares or ADSs were unable or unwilling to exercise its preemptive rights in connection with such a capital increase, such holder's proportionate share of dividends and other distributions and voting rights would decline. In addition, depending on the series of shares increased and the pattern in which





preemptive rights were exercised, such a capital increase might increase or reduce the portion of our capital stock represented by series B shares and ADSs or increase or reduce the proportionate voting rights of such holder.

Our capital stock may be reduced by resolution of a shareholders' meeting taken pursuant to the rules applicable to capital increases. Our capital stock also may be reduced upon withdrawal of a shareholder as provided in Section 206 of the Mexican Corporations Law, see “—Voting Rights and Shareholders' Meetings” above, or by repurchase of our own stock in accordance with the Mexican Securities Market Law, see “—Share Repurchases” below.

### **Share Repurchases**

We may choose to acquire our own shares through the Mexican Stock Exchange on the following terms and conditions:

- the acquisition must be carried out through the Mexican Stock Exchange;
- the acquisition must be carried out at market price, unless a public offer or auction has been authorized by the National Banking and Securities Commission;
- the acquisition must be carried out against our net worth (*capital contable*) without adopting a reduction in capital stock or against our capital stock, and the shares so acquired will be held as treasury stock without any requirement to adopt a reduction in capital stock. No shareholder consent is required for such purchases.
- the amount and price paid in all share repurchases must be made public;
- the annual ordinary shareholders meeting must determine the maximum amount of resources to be used in the fiscal year for the repurchase of shares;
- we may not be delinquent on payments due on any outstanding debt issued by us that is registered with the National Securities Registry; and
- any acquisition of shares must be in conformity with the requirements of Article 54 of the Mexican Securities Market Law, and we must maintain a sufficient number of outstanding shares to meet the minimum trading volumes required by the stock markets on which our shares are listed.

### *Ownership of Capital Stock by Subsidiaries*

Our subsidiaries may not, directly or indirectly, invest in our shares, except for shares acquired as part of an employee stock option plan and in conformity with the Mexican Securities Market Law.

### **Delisting**

Pursuant to the Mexican Securities Market Law, in the event that we decide to cancel the registration of our shares in the National Securities Registry and the listing of our shares on the Mexican Stock Exchange, or if the National Banking and Securities Commission orders such cancellation, we will be required to conduct a tender offer for the shares held by minority shareholders and to create a trust with a term of six months, with amounts sufficient to purchase all shares not participating in the tender offer. Under the law, our controlling shareholders will be secondarily liable for these obligations. The price at which the shares must be purchased in the offer must be the greater of (i) the average of the trading price on the Mexican Stock Exchange during the last 30 days on which the shares were quoted



prior to the date on which the tender offer is made or (ii) the book value of such shares as determined pursuant to our latest quarterly financial information filed with the National Banking and Securities Commission and the Mexican Stock Exchange. If the National Banking and Securities Commission orders the cancellation, we must launch the tender offer within 180 days from the date of their request. If we initiate it, under the Mexican Securities Market Law, the cancellation must be approved by 95% of our shareholders.

## **Other Provisions**

### *Information to Shareholders*

The Mexican Corporations Law establishes that companies, acting through their boards of directors, must annually present a report at a shareholder's meeting that includes:

- a report of the directors on the operations of the company during the preceding year, as well as on the policies followed by the directors and on the principal existing projects,
- a report explaining the principal accounting and information policies and criteria followed in the preparation of the financial information,
  - a statement of the financial condition of the company at the end of the fiscal year,
- a statement showing the results of operations of the company during the preceding year, as well as changes in the company's financial condition and capital stock during the preceding year,
  - the notes which are required to complete or clarify the above mentioned information, and

In addition to the foregoing, our by-laws provide that our board of directors also should prepare the information referred to above with respect to any subsidiary that represents at least 20% of our net worth (based on the financial statements most recently available).

### *Shareholders' Conflict of Interest*

Under Mexican law, any shareholder that has a conflict of interest with respect to any transaction must abstain from voting thereon at the relevant shareholders' meeting. A shareholder that votes on a transaction in which its interest conflicts with ours may be liable for damages in the event the relevant transaction would not have been approved without such shareholder's vote.

### *Liquidation*

In the event we are liquidated, the surplus assets remaining after payment of all our creditors will be divided among our shareholders in proportion to their respective share holdings. Shares that are only partially paid will participate in the distribution in the proportion that they were paid. The general extraordinary shareholders' meeting at which the liquidation resolution is made, will appoint one or more liquidators.

### *Foreign Investment*

Ownership by foreign investors of shares of Mexican enterprises in certain economic sectors is regulated by the Foreign Investment Law and the regulations thereunder. The Ministry of the Economy and the National Commission on Foreign Investment are responsible for the administration of the Foreign Investment Law and Regulations.



Pursuant to the Mexican Foreign Investment Law and Regulations, foreign investors may acquire up to 100% of the capital stock of Mexican companies or entities in the steel industry. In accordance with our by-laws, Mexican and non-Mexican nationals may own all series of our share capital. We have registered any foreign owner of our shares, and the depositary with respect to the ADSs representing our shares, with the National Registry of Foreign Investment (*Registro Nacional de Inversión Extranjera*).

#### *Other Provisions*

*Forfeiture of Shares.* As required by Mexican law, our by-laws provide that “any alien who at the time of incorporation or at any time thereafter acquires an interest or participation in the capital of the corporation shall be considered, by virtue thereof, as Mexican in respect thereof and shall be deemed to have agreed not to invoke the protection of his own government, under penalty, in case of breach of such agreement, of forfeiture of such interest or participation in favor of the Mexican nation”. Under this provision, a non-Mexican shareholder is deemed to have agreed not to invoke the protection of his own government by asking such government to interpose a diplomatic claim against the Mexican government with respect to the shareholder’s rights as a shareholder but is not deemed to have waived any other rights it may have, including any rights under the U.S. securities laws, with respect to its investment in us. If the shareholder invokes such governmental protection in violation of this agreement, its shares could be forfeited to the Mexican government. Mexican law requires that such a provision be included in the by-laws of all Mexican corporations unless such by-laws prohibit ownership of shares by non-Mexican persons or entities.

*Duration.* Our existence under our by-laws is indefinite.

#### **Certain Differences between Mexican and U.S. Corporate Law**

You should be aware that the Mexican Corporations Law and the Mexican Securities Market Law, which apply to us, differ in certain material respects from laws generally applicable to U.S. corporations and their shareholders.

#### *Independent Directors*

The Mexican Securities Market Law requires that 25% of the directors of Mexican public companies must be independent. Pursuant to the rules and regulations of the American Stock Exchange, 50% of the directors of listed companies must be independent, and foreign companies subject to reporting requirements under the U.S. federal securities laws and listed on the American Stock Exchange must maintain an audit committee comprised entirely of independent directors as defined in the U.S. federal securities laws.

#### *Mergers, Consolidations, and Similar Arrangements*

A Mexican company may merge with another company only if a majority of the shares representing its outstanding capital stock approve the merger at a duly convened general extraordinary shareholders’ meeting, unless the company’s by-laws impose a higher threshold. Dissenting shareholders are not entitled to appraisal rights. Creditors have ninety days to oppose a merger judicially, provided they have a legal interest to oppose the merger.

Under Delaware law, with certain exceptions, a merger, consolidation, or sale of all or substantially all the assets of a corporation must be approved by the board of directors and a majority of the outstanding shares entitled to vote thereon. Under Delaware law, a shareholder of a corporation participating in certain major corporate transactions, under certain circumstances, may be entitled to appraisal rights pursuant to which the shareholder may receive payment in the amount of the fair market



value of the shares held by the shareholder (as determined by a court) in lieu of the consideration the shareholder would otherwise receive in the transaction. Delaware law also provides that a parent corporation, by resolution of its board of directors and without any shareholder vote, may merge with any subsidiary of which it owns at least 90% of each class of share capital. Upon any such merger, dissenting shareholders of the subsidiary would have appraisal rights.

#### *Anti-Takeover Provisions*

Subject to the approval of the National Banking and Securities Commission, the Mexican Securities Market Law permits public companies to include anti-takeover provisions in their by-laws that restrict the ability of third parties to acquire control of the company without obtaining approval of the company's board of directors. See "Market Information<sup>3</sup>/<sub>4</sub>Market Regulation<sup>3</sup>/<sub>4</sub>Anti-Takeover Protections".

Under Delaware law, corporations can implement shareholder rights plans and other measures, including staggered terms for directors and super-majority voting requirements, to prevent takeover attempts. Delaware law also prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested shareholder for a period of three years after the date of the transaction in which the shareholder became an interested shareholder unless:

- prior to the date of the transaction in which the shareholder became an interested shareholder, the board of directors of the corporation approves either the business combination or the transaction that resulted in the shareholder becoming an interested shareholder;
- upon consummation of the transaction that resulted in the shareholder becoming an interested shareholder, the interested shareholder owns at least 85% of the voting stock of the corporation, excluding shares held by directors, officers, and employee stock plans; or
- at or after the date of the transaction in which the shareholder became an interested shareholder, the business combination is approved by the board of directors and authorized at a shareholders' meeting by at least 66<sup>2</sup>/<sub>3</sub>% of the voting stock which is not owned by the interested shareholder.

#### *Shareholders' Suits*

Pursuant to the Mexican Securities Market Law (*Ley de Mercado de Valores*), only a shareholder or group of shareholders holding at least 5% of our outstanding shares may bring a claim against some or all of our directors, secretary of the board of directors or relevant executives for violation of their duty of care or duty of loyalty. In addition, such shareholder or group of shareholders must include in its claim the amount of damages or losses caused to the company and not only the damages or losses caused to the shareholder or group of shareholders bringing the claim, provided that any amount recovered as indemnification arising from the liability action will be for the benefit of the company, and not for the benefit of the shareholder or group of shareholders. The shareholder or group of shareholders must demonstrate the direct and immediate link between the damage or loss caused to the company, and the acts alleged to have caused it. There is no requirement for the shareholder or group of shareholders to hold the shares for a certain period of time in order to bring a claim.

If the court determines that the shareholder or group of shareholders that initiated the claim acted in bad faith, such shareholder or group of shareholders will be liable to pay the legal fees and legal proceeding expenses.



The statute of limitations for these actions is five years from the date on which the act or event that caused the damage or loss occurred. These actions must be brought in the federal or local courts in Guadalajara, Jalisco (Mexico) and the court must personally notify the parties that have been sued, and must comply with all other legal formalities in order to satisfy the due process requirements of the Mexican Constitution.

Process must be served on the defendant personally, or, in the defendant's absence, process can be served by a judicial officer on the defendant's domicile whether or not the defendant is present. A method of service that does not comply with these requirements could be considered void. Class action lawsuits are not permitted under Mexican law.

#### *Shareholder Proposals*

Under Mexican law and our by-laws, holders of at least 10% of our outstanding capital stock are entitled to appoint one member of our board of directors and an alternate.

Delaware law does not include a provision restricting the manner in which nominations for directors may be made by shareholders or the manner in which business may be brought before a meeting.

#### *Calling of Special Shareholders' Meetings*

Under Mexican law and our by-laws, the board of directors, the chairman of the board of directors or the chairman of the audit and corporate practices committee may call a shareholders' meeting. Any shareholder or group of shareholders with voting rights representing at least 10% of our capital stock may request that the chairman of the board of directors or the audit and corporate practices committee call a shareholders' meeting to discuss the matters indicated in the written request. If the chairman of the board of directors or the chairman of the audit and corporate practices committee fails to call a meeting within 15 calendar days following date of the written request, the shareholder or group of shareholders may request that a competent court call the meeting. A single shareholder may call a shareholders' meeting if no meeting has been held for two consecutive years or if matters to be dealt with at an ordinary shareholders' meeting have not been considered.

Delaware law permits the board of directors or any person who is authorized under a corporation's certificate of incorporation or by-laws to call a special meeting of shareholders.

#### *Cumulative Voting*

Under Mexican law, cumulative voting for the election of directors is not permitted.

Under Delaware law, cumulative voting for the election of directors is permitted if expressly authorized in the certificate of incorporation.

#### *Staggered Board of Directors*

Mexican law does not permit companies to have a staggered board of directors, while Delaware law does permit corporations to have a staggered board of directors.

#### *Approval of Corporate Matters by Written Consent*

Mexican law permits shareholders to take action by unanimous written consent of the holders of all shares entitled to vote. These resolutions have the same legal effect as those adopted in a general or special shareholders' meeting. The board of directors may also approve matters by unanimous written consent.



Delaware law permits shareholders to take action by written consent of holders of outstanding shares having more than the minimum number of votes necessary to take the action at a shareholders' meeting at which all voting shares were present and voted.

*Amendment of Certificate of Incorporation*

Under Mexican law, it is not possible to amend a company's certificate of incorporation (*acta constitutiva*). However, the provisions that govern a Mexican company are contained in its by-laws, which may be amended as described below. Under Delaware law, a company's certificate of incorporation generally may be amended by a vote of holders of a majority of the outstanding stock entitled to vote thereon (unless otherwise provided in the certificate of incorporation), subsequent to a resolution of the board of directors proposing such amendment.

*Amendment of By-laws*

Under Mexican law, amending a company's by-laws requires shareholder approval at an extraordinary shareholders' meeting. Mexican law requires that at least 75% of the shares representing a company's outstanding capital stock be present at the meeting in the first call (unless the by-laws require a higher threshold) and that the resolutions be approved by a majority of the shares representing a company's outstanding capital stock.

Under Delaware law, holders of a majority of the outstanding stock entitled to vote and, if so provided in the certificate of incorporation, the directors of the corporation, have the power to adopt, amend, and repeal the by-laws of a corporation.

## DESCRIPTION OF AMERICAN DEPOSITARY RECEIPTS

### American Depositary Receipts

The Bank of New York, as depositary, will execute and deliver the ADRs. ADRs are American Depositary Receipts. Each ADR is a certificate evidencing a specific number of American Depositary Shares, also referred to as ADSs. Each ADS will represent three series B shares (or a right to receive three series B shares) deposited with the principal Mexico office of BBVA Bancomer, S.A. de C.V., as custodian for the depositary. Each ADS will also represent any other securities, cash or other property which may be held by the depositary. The depositary's corporate trust office at which the ADRs will be administered is located at 101 Barclay Street, New York, New York 10286. The Bank of New York's principal executive office is located at One Wall Street, New York, New York 10286.

You may hold ADSs either directly (by having an ADR registered in your name) or indirectly through your broker or other financial institution. If you hold ADSs directly, you are an ADR holder. This description assumes you hold your ADSs directly. If you hold the ADSs indirectly, you must rely on the procedures of your broker or other financial institution to assert the rights of ADR holders described in this section. You should consult with your broker or financial institution to find out what those procedures are.

As an ADR holder, we will not treat you as one of our shareholders and you will not have shareholder rights. Mexican law governs shareholder rights. The depositary will be the holder of the series B shares underlying your ADSs. As a holder of ADRs, you will have ADR holder rights. A deposit agreement among us, the depositary and you, as an ADR holder, and the beneficial owners of ADRs set out ADR holder rights as well as the rights and obligations of the depositary. New York law governs the deposit agreement and the ADRs.

The following is a summary of the material provisions of the deposit agreement. For more complete information, you should read the entire deposit agreement and the form of ADR. Directions on how to obtain copies of those documents are provided on page 130.

### Dividends and Other Distributions

*How will you receive dividends and other distributions on the series B shares?*

The depositary has agreed to pay to you the cash dividends or other distributions it or the custodian receives on series B shares or other deposited securities, after deducting its fees and expenses. You will receive these distributions in proportion to the number of series B shares your ADSs represent.

- **Cash.** The depositary will convert any cash dividend or other cash distribution we pay on the series B shares into U.S. dollars, if it can do so on a reasonable basis and can transfer the U.S. dollars to the United States. If that is not possible or if any government approval is needed and can not be obtained, the deposit agreement allows the depositary to distribute the foreign currency only to those ADR holders to whom it is possible to do so. It will hold the foreign currency it cannot convert for the account of the ADR holders who have not been paid. It will not invest the foreign currency and it will not be liable for any interest.

Before making a distribution, any withholding taxes that must be paid will be deducted. See "Taxation". It will distribute only whole U.S. dollars and any balance not distributable will be held by the depositary (without liability for interest thereon) and will be added to and become part of the next sum received by the depositary for distribution to ADR holders then outstanding. *If the exchange rates fluctuate during a time when the depositary cannot convert the foreign currency, you may lose some or all of the value of the distribution.*

- *Series B shares.* The depositary may, with our approval and will if we request, distribute additional ADSs representing any series B shares we distribute as a dividend or free distribution. The depositary will only distribute whole ADSs. It will sell series B shares which would require it to deliver a fractional ADS and distribute the net proceeds in the same way as it does with cash. If the depositary does not distribute additional ADRs, the outstanding ADSs will also represent the new series B shares.
- *Rights to purchase additional series B shares.* If we offer holders of our securities any rights to subscribe for additional series B shares or any other rights, the depositary may make these rights available to you. If the depositary decides it is not legal and practical to make the rights available but that it is practical to sell the rights, the depositary may sell the rights and distribute the proceeds in the same way as it does with cash. The depositary will allow rights that are not distributed or sold to lapse. *In that case, you will receive no value for them.*

If the depositary makes rights available to you, it will exercise the rights and purchase the series B shares on your behalf. The depositary will then deposit the series B shares and deliver ADSs to you. It will only exercise rights if you pay it the exercise price and any other charges the rights require you to pay.

U.S. securities laws may restrict transfers and cancellation of the ADSs represented by series B shares purchased upon exercise of rights. For example, you may not be able to trade these ADSs freely in the United States. In this case, the depositary may deliver restricted depositary series B shares that have the same terms as the ADRs described in this section except for changes needed to put the necessary restrictions in place.

- *Other Distributions.* The depositary will send to you anything else we distribute on deposited securities by any means it thinks is legal, fair and practical. If it cannot make the distribution in that way, the depositary has a choice. It may decide to sell what we distributed and distribute the net proceeds, in the same way as it does with cash. Or, it may decide to hold what we distributed, in which case ADSs will also represent the newly distributed property. However, the depositary is not required to distribute any securities (other than ADSs) to you unless it receives satisfactory evidence from us that it is legal to make that distribution.

The depositary is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADR holders. We have no obligation to register ADSs, series B shares, rights or other securities under the Securities Act. We also have no obligation to take any other action to permit the distribution of ADRs, series B shares, rights or anything else to ADR holders. *This means that you may not receive the distributions we make on our series B shares or any value for them if it is illegal or impractical for us to make them available to you.*

## **Deposit and Withdrawal**

### *How are ADSs issued?*

The depositary will deliver ADSs if you or your broker deposit series B shares or evidence of rights to receive series B shares with the custodian. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, the depositary will register the appropriate number of ADSs in the names you request and will deliver the ADRs at its corporate trust office to the persons you request.

*How do ADS holders cancel an ADR and obtain series B shares?*

You may surrender your ADRs at the depositary's corporate trust office. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, the depositary will deliver the series B shares and any other deposited securities underlying the ADR to you or a person you designate at the office of the custodian. Or, at your request, risk and expense, the depositary will deliver the deposited securities at its corporate trust office, if feasible.

**Voting Rights**

*How do you vote?*

You may instruct the depositary to vote the number of series B shares your ADSs represent. Upon receipt of notice of any meeting or solicitation of consents or proxies, the depositary will notify you of shareholders' meetings and arrange to deliver our voting materials to you. Those materials will describe the matters to be voted on and explain how you may instruct the depositary how to vote the series B shares or other deposited securities underlying your ADSs as you direct. For instructions to be valid, they must reach the depositary by a date set by the depositary. The depositary will try, as far as practical, subject to Mexican law and the provisions of the our Estatutos Sociales, to vote or to have its agents vote the series B shares or other deposited securities as you instruct. If the depositary does not receive voting instructions from you by the specified date, the depositary shall vote or cause to be voted the deposited securities in the same manner as directed by the majority of instructions which the Depositary has received for that meeting, or if no such instructions have been received or if there is no majority, the depositary shall vote or cause to be voted the deposited securities in the same manner as informed by us that the majority of deposited securities is voted as such meeting.

We can not assure you that you will receive the voting materials or otherwise learn of an upcoming shareholders' meeting in time to ensure that you can instruct the depositary to vote your series B shares. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. *This means that you may not be able to exercise your right to vote and there may be nothing you can do if your series B shares are not voted as you requested.*

**Fees and Expenses**

***Persons depositing series B shares For:  
or ADR holders must pay:***

- \$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)
- Issuance of ADSs, including issuances resulting from a distribution of series B shares or rights or other property
- Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
- \$.02 (or less) per ADS
- Any cash distribution to you
- Registration or transfer fees
- Transfer and registration of series B shares on our series B share register to or from the name of the depositary or its agent when you deposit



or withdraw series B shares

- Expenses of the depositary
  - Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
  - converting foreign currency to U.S. dollars
- Taxes and other governmental charges the depositary or the custodian have to pay on any ADR or series B share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes
  - As necessary

The depositary has agreed to reimburse us for expenses that we incur that are related to establishment and maintenance of the ADR program, including investor relations expenses and AMEX application and listing fees. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not related to the amounts of fees the depositary collects from investors.

The depositary collects its fees for issuance and cancellation of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary generally may refuse to provide fee-attracting services until its fees for those services are paid.

### **Payment of Taxes**

You will be responsible for any taxes or other governmental charges payable on your ADRs or on the deposited securities underlying your ADRs. The depositary may, and upon receipt of instructions from us will, refuse to transfer your ADRs or allow you to withdraw the deposited securities underlying your ADRs until such taxes or other charges are paid. It may apply payments owed to you or sell deposited securities underlying your ADRs, by public or private sale, to pay any taxes owed and you will remain liable for any deficiency. If the depositary sells deposited securities, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

### **Reclassifications, Recapitalizations and Mergers**

***If we:***

- Change the par value of our series B shares
- Reclassify, split up or consolidate any of the deposited securities
- Distribute securities on the series B shares that are not distributed to you

***Then:***

The series B shares or other securities received by the depositary will become deposited securities. Each ADS will automatically represent its equal series B share of the new deposited securities.

The depositary may, with our approval or at our request, deliver new ADRs or ask you to surrender your outstanding ADRs



- Recapitalize, reorganize, merge, in exchange for new ADRs identifying the new

liquidate, sell all or substantially all of our assets, or deposited securities.  
take any similar action

## **Amendment and Termination**

*How may the deposit agreement be amended?*

We may agree with the depositary to amend the deposit agreement and the ADRs without your consent for any reason. If an amendment adds or increases fees or charges, (except for taxes and other governmental) or prejudices a substantial right of ADR holders, it will not become effective for outstanding ADRs until three months after the depositary notifies ADR holders of the amendment. *At the time an amendment becomes effective, you are considered, by continuing to hold your ADR, to agree to the amendment and to be bound by the ADRs and the deposit agreement as amended.*

*How may the deposit agreement be terminated?*

The depositary will terminate the deposit agreement at our direction by mailing notice of termination to the ADS holders then outstanding at least 30 days prior to the date fixed in such notice for such termination. The depositary may also terminate the deposit agreement by mailing notice of termination to us and the ADS holders then outstanding if 90 days have passed since the depositary told us it wants to resign but a successor depositary has not been appointed and accepted its appointment.

After termination, the depositary and its agents will do the following under the deposit agreement but nothing else: collect distributions on the deposited securities, sell rights and other property, and deliver series B shares and other deposited securities upon cancellation of ADRs. One year after termination, the depositary may sell any remaining deposited securities by public or private sale. After that, the depositary will hold the money it received on the sale, as well as any other cash it is holding under the deposit agreement for the pro rata benefit of the ADR holders that have not surrendered their ADRs. It will not invest the money and has no liability for interest. The depositary's only obligations will be to account for the money and other cash. After termination our only obligations will be to indemnify the depositary and to pay fees and expenses of the depositary that we agreed to pay.

## **Limitations on Obligations and Liability**

*Limits on our Obligations and the Obligations of the Depositary; Limits on Liability to Holders of ADRs*

The deposit agreement expressly limits our obligations and the obligations of the depositary. It also limits our liability and the liability of the depositary. We and the depositary:

- agree to use our best judgment, good faith and diligence in the performance of our obligations specifically set forth in the deposit agreement;
- are not liable if either of us is prevented or delayed by law or circumstances beyond our control from performing our obligations under the deposit agreement;
  - are not liable if either of us exercises discretion permitted under the deposit agreement;
- have no obligation to become involved in a lawsuit or other proceeding related to the ADRs or the deposit agreement on your behalf or on behalf of any other person;



- are not liable for any action or non-action by it in reliance upon the advice of or information from legal counsel, accountants, any person presenting shares for deposit, any ADR holder or beneficial owner or any other person believed by it in good faith to be competent to give such advice or information.

In the deposit agreement, we and the depositary agree to indemnify each other under certain circumstances.

### **Requirements for Depositary Actions**

Before the depositary will deliver or register a transfer of an ADR, make a distribution on an ADR, or permit withdrawal of series B shares or other property, the depositary may require:

- payment of stock transfer or other taxes or other governmental charges and transfer or registration fees charged by third parties for the transfer of any series B shares or other deposited securities;
- satisfactory proof of the identity and genuineness of any signature or other information it deems necessary; and
- compliance with reasonable regulations it may establish, from time to time, consistent with the deposit agreement, including presentation of transfer documents.

The depositary may refuse to deliver ADRs or register transfers of ADRs generally when the transfer books of the depositary or our transfer books are closed or at any time if the depositary or we think it advisable to do so.

### **Your Right to Receive the Series B shares Underlying your ADRs**

You have the right to cancel your ADRs and withdraw the underlying series B shares at any time except:

- When temporary delays caused by closing our or the depositary's transfer books or the deposit of shares in connection with voting at a shareholders' meeting, or the payment of dividends.
  - When you owe money to pay fees, taxes and similar charges.
- When it is necessary to prohibit withdrawals in order to comply with any laws or governmental regulations that apply to ADRs or to the withdrawal of series B shares or other deposited securities.

This right of withdrawal may not be limited by any other provision of the deposit agreement.

### **Pre-release of ADRs**

The deposit agreement permits the depositary to deliver ADRs before deposit of the underlying series B shares. This is called a pre-release of the ADR. The depositary may also deliver series B shares upon cancellation of pre-released ADRs (even if the ADRs are canceled before the pre-release transaction has been closed out). A pre-release is closed out as soon as the underlying series B shares are delivered to the depositary. The depositary may receive ADRs instead of series B shares to close out a pre-release. The depositary may pre-release ADRs only under the following conditions: (1) before or at the time of the pre-release, the person to whom the pre-release is being made represents to the depositary in writing that it or its customer owns the series B shares or ADRs to be deposited; (2) the pre-release is fully

collateralized with cash or other collateral that the depositary considers appropriate; and (3) the depositary must be able to close out the pre-release on not more than five business days' notice. In addition, the depositary will limit the number of ADSs that may be outstanding at any time as a result of pre-release, although the depositary may disregard the limit from time to time, if it thinks it is appropriate to do so.

## TAXATION

The following summary contains a description of the material anticipated U.S. and Mexican federal income tax consequences of the purchase, ownership and disposition of the series B shares or ADSs by a holder that is a citizen or resident of the United States or a U.S. domestic corporation or that otherwise will be subject to U.S. federal income tax on a net income basis in respect of the series B shares or ADSs and that is a “non-Mexican holder” (as defined below) (a “U.S. holder”), but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase the series B shares or ADSs. In particular, the summary deals only with U.S. holders that will hold the series B shares or ADSs as capital assets and use the U.S. dollar as their functional currency and does not address the tax treatment of a U.S. holder that owns or is treated as owning 10% or more of our outstanding voting shares. In addition, the summary does not address any U.S. or Mexican state or local tax considerations that may be relevant to U.S. holders that are subject to special tax rules, such as banks, securities dealers, insurance companies, tax-exempt entities, persons that hold ADSs or series B shares as a hedge or as part of a straddle, conversion transaction or other risk reduction transaction for tax purposes.

The summary is based upon the federal income tax laws of the United States and Mexico as in effect on the date of this prospectus, including the provisions of the income tax treaty between the United States and Mexico and protocol thereto (the “Tax Treaty”), all of which are subject to change, possibly with retroactive effect in the case of U.S. federal income tax law. Prospective investors in the series B shares or ADSs should consult their own tax advisors as to the U.S., Mexican or other tax consequences of the purchase, ownership and disposition of the series B shares or ADSs, including, in particular, the effect of any foreign, state or local tax laws and their entitlement to the benefits, if any, afforded by the Tax Treaty.

For purposes of this summary, the term “non-Mexican holder” shall mean a holder that is not a resident of Mexico and that will not hold the series B shares or ADSs or a beneficial interest therein in connection with the conduct of a trade or business through a permanent establishment or fixed base in Mexico.

An individual is a resident of Mexico for tax purposes, if he established his home in Mexico. When the individual in question has a home in another country, the individual will be deemed a resident in Mexico if his “center of vital interests” is located in Mexico. This will be deemed to occur if (i) more than 50% of the aggregate income realized by such individual in the calendar year is from a Mexican source or (ii) the principal center of his professional activities is located in Mexico.

A Mexican national who files a change of tax residence notice with a country or jurisdiction that does not have a comprehensive exchange of information agreement with Mexico and in which his income is subject to a preferred tax regime pursuant to the provisions of the Mexican Income Tax Law, will be considered a Mexican resident for tax purposes during the year the notice is filed and during the following three years. Unless otherwise proven, a Mexican national is deemed a resident of Mexico for tax purposes.

An entity in Mexico is a resident of Mexico if it maintains its principal place of business or its place of effective management in Mexico. If non-residents of Mexico are deemed to have a permanent establishment in Mexico for tax purposes, all income attributable to the permanent establishment will be subject to Mexican taxes, in accordance with applicable Mexican tax law.

In general, for U.S. federal income tax purposes, holders of ADSs will be treated as the beneficial owners of the series B shares represented by those ADSs.

## Taxation of Dividends

### *Mexican Tax Considerations*

Under Mexican Income Tax Law provisions (*Ley del Impuesto Sobre la Renta*), dividends paid to non-Mexican holders with respect to the series B shares represented by the ADSs are not subject to Mexican withholding tax.

Dividends paid from distributable earnings that have not been subject to corporate income tax are subject to a corporate-level dividend tax at a rate of 38.89% for the year ended December 31, 2007. The corporate-level dividend tax on the distribution of earnings is not final and may be credited against income tax payable during the fiscal year in which the dividend tax was paid and for the following two years. Dividends paid from distributable earnings, after corporate income tax has been paid with respect to these earnings, are not subject to this corporate-level dividend tax. Currently, after corporate tax dividend distributions are not subject to individual withholding taxes for shareholder recipients thereof.

Distributions made by us to our shareholders other than as dividends, including capital reductions, amortization of shares or otherwise, would be subject to taxation in Mexico at the corporate level at the rate of 28% or the rate mentioned above, as the case may be.

### *U.S. Federal Income Tax Considerations*

The gross amount of any distributions paid with respect to the series B shares represented by the ADSs, to the extent paid out of our current or accumulated earnings and profits, as determined for U.S. federal income tax purposes, will be taxable as dividends and generally will be includible in the gross income of a U.S. holder as ordinary income on the date on which the distributions are received by the depositary and will not be eligible for the dividends received deduction allowed to certain corporations under the U.S. Internal Revenue Code of 1986, as amended. Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends received by an individual prior to January 1, 2011 with respect to the B shares and ADSs will be subject to taxation at a maximum rate of 15% if the dividends are “qualified dividends”. Dividends paid on the B shares and ADSs will be treated as qualified dividends if (i) the issuer is eligible for the benefits of a comprehensive income tax treaty with the United States that the IRS has approved for the purposes of the qualified dividend rules and (ii) we were not, in the year prior to the year in which the dividend was paid, and our not, in the year in which the dividend is paid, a passive foreign investment company (“PFIC”). The income tax treaty between Mexico and the United States has been approved for the purposes of the qualified dividend rules. Based on our audited financial statements and relevant market and shareholder data, we believe that we were not treated as a PFIC for U.S. federal income tax purposes with respect to our 2005 taxable year. In addition, based on our unaudited financial statements for our first three fiscal quarters of 2006 and our current expectations regarding the value and nature of our assets, the sources and nature of our income and relevant market and shareholder data, we do not anticipate having become a PFIC for our 2006 taxable year.

To the extent that a distribution exceeds our current and accumulated earnings and profits, it generally will be treated as a non-taxable return of basis to the extent thereof, and thereafter as capital gain from the sale of series B shares or ADSs. Distributions, which will be made in pesos, will be includible in the income of a U.S. holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date they are received by the depositary whether or not they are converted into U.S. dollars. U.S. holders should consult their own tax advisors regarding the treatment of foreign currency gain or loss, if any, on any pesos received that are converted into U.S. dollars on a date subsequent to receipt. Dividend income generally will constitute foreign source “passive income” or, in the case of certain U.S. holders, “financial services income” for U.S. foreign tax credit purposes.

Distributions of additional series B shares to holders of ADSs with respect to their ADSs that are made as part of a pro rata distribution to all our stockholders generally will not be subject to U.S. federal income tax.

## **Taxation of Dispositions of Shares or ADSs**

### *Mexican Tax Considerations*

Gain on the sale or other disposition of ADSs by a U.S. holder will generally not be subject to Mexican tax. Deposits and withdrawals of series B shares in exchange for ADSs will not give rise to Mexican tax or transfer duties.

Gain on the sale of series B shares by a U.S. holder will not be subject to any Mexican tax if the transaction is carried out through the Mexican Stock Exchange or other stock exchange or securities markets approved by the Mexican Ministry of Finance and Public Credit. Gain on sales or other dispositions of series B shares made in other circumstances generally would be subject to Mexican tax at a rate of 25% based on the total amount of the transaction or, subject to certain requirements applicable to the seller, at a rate of 28% for the year ended December 31, 2007 of gains realized from the disposition.

Under the Tax Treaty, a U.S. holder that is eligible to claim the benefits of the Tax Treaty will be exempt from Mexican tax on gains realized on a sale or other disposition of series B shares, in a transaction that is not carried out through the Mexican Stock Exchange or such other approved securities markets, so long as the holder did not own, directly or indirectly, 25% or more of our share capital (including ADSs) during the twelve-month period preceding the sale or other disposition, and the value of those shares does not derive mainly from immovable property located in Mexico. Specific formalities apply to claim such as treaty benefits.

### *U.S. Federal Income Tax Considerations*

Upon the sale or other disposition of the series B shares or ADSs, a U.S. holder generally will recognize capital gain or loss in an amount equal to the difference between the amount realized on the sale or other disposition and such U.S. holder's tax basis in the series B shares or ADSs. Gain or loss recognized by a U.S. holder on such sale or other disposition generally will be long-term capital gain or loss if, at the time of the sale or other disposition, the series B shares or ADSs have been held for more than one year. Long-term capital gain recognized by a U.S. holder that is an individual generally is subject to a maximum federal income tax rate of 15%. The deduction of a capital loss is subject to limitations for U.S. federal income tax purposes. Deposits and withdrawals of series B shares by U.S. holders in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

A U.S. holder that receives pesos upon sale or other disposition of the series B shares will realize an amount equal to the U.S. dollar value of the pesos upon the date of sale (or in the case of cash basis and electing accrual basis taxpayers, the settlement date). A U.S. holder will have a tax basis in the pesos received equal to the U.S. dollar value of the pesos received translated at the same rate the U.S. holder used to determine the amount realized on its disposal of the series B shares. Any gain or loss realized by a U.S. holder on a subsequent conversion of the pesos generally will be a U.S. source ordinary income or loss.

### *Other Mexican Taxes*

There are no Mexican inheritance, gift, succession or value added taxes applicable to the ownership, transfer or disposition of the series B shares or ADSs by non-Mexican holders; provided,



however, that gratuitous transfers of the series B shares or ADSs may in certain circumstances cause a Mexican federal tax to be imposed upon the recipient. There are no Mexican stamp, issue, registration or similar taxes or duties payable by non-Mexican holders of the series B shares or ADSs.

*U.S. Backup Withholding Tax and Information Reporting Requirements*

In general, information reporting requirements will apply to certain payments by a paying agent to a U.S. holder of dividends in respect of the series B shares or ADSs or the proceeds received on the sale or other disposition of the series B shares or ADSs, and a backup withholding tax may apply to such amounts if the U.S. holder fails to provide an accurate taxpayer identification number to the paying agent or fails to establish an exemption or otherwise comply with these provisions. Amounts withheld as backup withholding tax will be creditable against the U.S. holder's U.S. federal income tax liability, provided that the required information is furnished to the U.S. Internal Revenue Service.

## UNDERWRITING

The combined offering consists of

- an international offering of                      ADSs outside of Mexico, and
- an offering of                      series B shares in Mexico.

Citigroup Global Markets Inc. is the global coordinator of the combined offering, the sole book-runner of the international offering, and is acting as representative of the international underwriters named below. Citigroup Global Markets Inc. is located at 388 Greenwich Street, New York, NY 10013.

Subject to the terms and conditions stated in the international underwriting agreement dated the date of this prospectus, each international underwriter named below has agreed to purchase, and we have agreed to sell to that international underwriter, the number of ADSs set forth opposite the international underwriter's name.

Underwriter	Number of ADSs
Citigroup Global Markets Inc.	
Morgan Stanley & Co. Incorporated	
Total	

The international underwriting agreement provides that the obligations of the international underwriters to purchase the series B shares included in this offering are subject to the approval of legal matters by counsel and to other conditions. The international underwriters are obligated to purchase all the series B shares (other than those covered by the over-allotment option described below) if they purchase any of the series B shares.

We also have entered into a Mexican underwriting agreement with a syndicate of Mexican underwriters providing for the concurrent offer and sale of series B shares in Mexico. The offering price and the total underwriting discounts and commissions per series B share for the international offering and the Mexican offering will be substantially equivalent. In addition, the international and Mexican offerings are each conditioned on the closing of the other.

The international underwriters propose to offer some of the series B shares directly to the public at the public offering price set forth on the cover page of this prospectus and some of the series B shares to dealers at the public offering price less a concession not to exceed \$                      per series B share. The international underwriters may allow, and dealers may reallow, a concession not to exceed \$                      per series B share on sales to other dealers. If all of the series B shares are not sold at the initial offering price, the representative may change the public offering price and the other selling terms.

We have granted to the international and Mexican underwriters options, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of                      additional series B shares or the equivalent in ADSs at the public offering price less the underwriting discount. The underwriters may exercise the option solely for the purpose of covering over-allotments, if any, in connection with this offering. To the extent the option is exercised, each underwriter must purchase a number of additional series B shares (a portion of which may be in the form of ADSs) approximately proportionate to that underwriter's initial purchase commitment.

The Mexican underwriters and the international underwriters have entered into an agreement in which they agree to restrictions on where and to whom they and any dealer purchasing from them may



offer series B shares. The Mexican and international underwriters also have agreed that they may sell ADSs or series B shares between their respective underwriting syndicates. The number of ADSs or series B shares actually allocated to each offering may differ from the amount initially offered due to reallocation between the Mexican and international offerings.

We and our officers, directors and principal shareholders have agreed that, for a period of 180 days from the date of this prospectus, we will not, without the prior written consent of Citigroup Global Markets Inc., dispose of or hedge any of our series B shares or any securities convertible into or exchangeable for our series B shares. Citigroup Global Markets Inc. in its sole discretion may release any of the securities subject to these lock-up agreements at any time without notice. The 180-day restricted period described above is subject to extension such that, in the event that either (1) during the last 17 days of the 180-day restricted period, we issue an earnings release or material news, or a material event relating to us occurs or (2) prior to the expiration of the 180-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 180-day period, the “lock-up” restrictions described above will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

Citigroup Global Markets Inc. has no present intent or arrangement to release any of the securities subject to these lock-up agreements. The release of any lock-up is considered on a case by case basis. Factors in deciding whether to release securities may include the length of time before the lock-up expires, the number of shares involved, the reason for the requested release, market conditions, the trading price of our series B shares and ADSs, historical trading volumes of our common stock and whether the person seeking the release is an officer, director or affiliate of us.

In relation to each member state of the European Economic Area that has implemented the Prospectus Directive (each, a relevant member state), with effect from and including the date on which the Prospectus Directive is implemented in that relevant member state (the relevant implementation date), an offer of ADSs or series B shares described in this prospectus may not be made to the public in that relevant member state prior to the publication of a prospectus in relation to the ADSs or series B shares that has been approved by the competent authority in that relevant member state or, where appropriate, approved in another relevant member state and notified to the competent authority in that relevant member state, all in accordance with the Prospectus Directive, except that, with effect from and including the relevant implementation date, an offer of securities may be made to the public in that relevant member state at any time:

- to any legal entity that is authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities; or
- to any legal entity that has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000; and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- in any other circumstances that do not require the publication of a prospectus pursuant to Article 3 of the Prospectus Directive.

Each purchaser of ADSs or series B shares described in this prospectus located within a relevant member state will be deemed to have represented, acknowledged and agreed that it is a “qualified investor” within the meaning of Article 2(1)(e) of the Prospectus Directive.

For purposes of this provision, the expression an “offer to the public” in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe



the securities, as the expression may be varied in that member state by any measure implementing the Prospectus Directive in that member state, and the expression ‘‘Prospectus Directive’’ means Directive 2003/71/EC and includes any relevant implementing measure in each relevant member state.

We have not authorized and do not authorize the making of any offer of ADSs or series B shares through any financial intermediary on our behalf, other than offers made by the underwriters with a view to the final placement of the ADSs or series B shares as contemplated in this prospectus. Accordingly, no purchaser of the ADSs or series B shares, other than the underwriters, is authorized to make any further offer of the ADSs or series B shares on behalf of us or the underwriters.

This prospectus is only being distributed to, and is only directed at, persons in the United Kingdom that are qualified investors within the meaning of Article 2(1)(e) of the Prospectus Directive (‘‘Qualified Investors’’) that are also (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the ‘‘Order’’); or (ii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as ‘‘relevant persons’’). This prospectus and its contents are confidential and should not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom. Any person in the United Kingdom that is not a relevant person should not act or rely on this document or any of its contents.

Neither this prospectus nor any other offering material relating to the ADSs or series B shares described in this prospectus has been submitted to the clearance procedures of the *Autorité des Marchés Financiers* or by the competent authority of another member state of the European Economic Area and notified to the *Autorité des Marchés Financiers*. The ADSs and series B shares have not been offered or sold and will not be offered or sold, directly or indirectly, to the public in France. Neither this prospectus nor any other offering material relating to the ADSs or series B shares has been or will be:

- released, issued, distributed or caused to be released, issued or distributed to the public in France; or
- used in connection with any offer for subscription or sale of the ADSs or series B shares to the public in France.

Such offers, sales and distributions will be made in France only:

- to qualified investors (*investisseurs qualifiés*) and/or to a restricted circle of investors (*cercle restreint d’investisseurs*), in each case investing for their own account, all as defined in, and in accordance with, Article L.411-2, D.411-1, D.411-2, D.734-1, D.744-1, D.754-1 and D.764-1 of the French *Code Monétaire et financier*; or
- to investment services providers authorized to engage in portfolio management on behalf of third parties; or
- in a transaction that, in accordance with article L.411-2-II-1°-or-2°-or 3° of the French *Code Monétaire et Financier* and article 211-2 of the General Regulations (*Règlement Général*) of the *Autorité des Marchés Financiers*, does not constitute a public offer (*appel public à l’épargne*).

The ADSs and series B shares may be resold directly or indirectly, only in compliance with Articles L.411-1, L.411-2, L.412-1 and L.621-8 through L.621-8-3 of the French *Code Monétaire et Financier*.

The ADSs are listed on the AMEX under the symbol “SIM”, and the series B shares are listed on the Mexican Stock Exchange under the symbol “SIMEC.B”.

The following table shows the underwriting discounts and commissions that we are to pay to the international underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the international underwriters’ option to purchase additional series B shares.

	<b>Paid by Grupo Simec, S.A.B. de C.V.</b>	
	<b>No Exercise</b>	<b>Full Exercise</b>
Per series B share	\$	\$
Per ADS	\$	\$
Total	\$	\$

We estimate that our portion of the total expenses of this offering will be \$ ..

In connection with the offering, the representative on behalf of the underwriters, may purchase and sell ADSs or series B shares in the open market. These transactions may include short sales, syndicate covering transactions and stabilizing transactions. Short sales involve syndicate sales of ADSs or series B shares in excess of the number of ADSs or series B shares to be purchased by the Mexican underwriters and the international underwriters in the offering, which creates a syndicate short position. “Covered” short sales are sales of ADSs or series B shares made in an amount up to the number of ADSs or series B shares represented by the Mexican underwriters’ and international underwriters’ over-allotment option. In determining the source of series B shares to close out the covered syndicate short position, the representative will consider, among other things, the price of ADSs or series B shares available for purchase in the open market as compared to the price at which they may purchase ADSs or series B shares through the over-allotment option. Transactions to close out the covered syndicate short position involve either purchases of ADSs or series B shares in the open market after the distribution has been completed or the exercise of the over-allotment option. The international underwriters may also make “naked” short sales of ADSs in excess of the over-allotment option. The Mexican underwriters are not permitted to make “naked” short sales of series B shares on the Mexican Stock Exchange. The international underwriters must close out any naked short position by purchasing ADSs in the open market. A naked short position is more likely to be created if the Mexican underwriters and the international underwriters are concerned that there may be downward pressure on the price of the ADSs or series B shares in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of bids for or purchases of ADSs or series B shares in the open market while the offering is in progress.

The underwriters also may impose a penalty bid. Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when Citigroup Global Markets Inc. repurchases ADSs originally sold by that syndicate member in order to cover syndicate short positions or make stabilizing purchases.

Any of these activities may have the effect of preventing or retarding a decline in the market price of the ADSs or series B shares. They may also cause the price of the ADSs or series B shares to be higher than the price that would otherwise exist in the open market in the absence of these transactions. The international underwriters and the Mexican underwriters may conduct these transactions on the AMEX or the Mexican Stock Exchange or in the over-the-counter market, or otherwise. If the international underwriters and the Mexican underwriters commence any of these transactions, they may discontinue them at any time.

The underwriters may, from time to time, engage in transactions with us and perform services for us in the ordinary course of their business. The underwriters have, from time to time, performed, and expect to perform in the future, investment banking and advisory services for us and our affiliates, for which they have received, and may continue to receive, customary fees and expenses.

A prospectus in electronic format may be made available on the websites maintained by one or more of the underwriters. The representative may agree to allocate a number of ADSs, in the form of ADSs or series B shares, to international underwriters for sale to their online brokerage account holders. The representative will allocate ADSs, in the form of ADSs or series B shares, to international underwriters that may make Internet distributions on the same basis as other allocations. In addition, ADSs, in the form of ADSs or series B shares, may be sold by the international underwriters to securities dealers who resell ADSs, in the form of ADSs or series B shares, to online brokerage account holders.

We have agreed to indemnify the international underwriters against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the international underwriters may be required to make because of any of those liabilities.



## NOTICE TO CANADIAN RESIDENTS

### Resale Restrictions

The distribution of the series B shares in Canada is being made only on a private placement basis exempt from the requirement that we prepare and file a prospectus with the securities regulatory authorities in each province where trades of series B shares are made. Any resale of the series B shares in Canada must be made under applicable securities laws which will vary depending on the relevant jurisdiction, and which may require resales to be made under available statutory exemptions or under a discretionary exemption granted by the applicable Canadian securities regulatory authority. Purchasers are advised to seek legal advice prior to any resale of the shares.

### Representations of Purchasers

By purchasing shares in Canada and accepting a purchase confirmation a purchaser is representing to us, the selling shareholder and the dealer from whom the purchase confirmation is received that—

- the purchaser is entitled under applicable provincial securities laws to purchase the shares without the benefit of a prospectus qualified under those securities laws,
- where required by law, that the purchaser is purchasing as principal and not as agent, and
- the purchaser has reviewed the text above under Resale Restrictions.

### Rights of Action—Ontario Purchasers

The securities being offered are those of a foreign issuer and Ontario purchasers will not receive the contractual right of action prescribed by Ontario securities law. As a result, Ontario purchasers must rely on other remedies that may be available, including common law rights of action for damages or rescission or rights of action under the civil liability provisions of the U.S. federal securities laws.

### Enforcement of Legal Rights

All of the issuer's directors and officers as well as the experts named herein and the selling shareholder may be located outside of Canada and, as a result, it may not be possible for Canadian purchasers to effect service of process within Canada upon the issuer or such persons. All or a substantial portion of the assets of the issuer and such persons may be located outside of Canada and, as a result, it may not be possible to satisfy a judgment against the issuer or such persons in Canada or to enforce a judgment obtained in Canadian courts against such issuer or persons outside of Canada.

### Taxation and Eligibility for Investment

Canadian purchasers of shares should consult their own legal and tax advisors with respect to the tax consequences of an investment in the shares in their particular circumstances and about the eligibility of the shares for investment by the purchaser under relevant Canadian legislation.

## **WHERE CAN YOU FIND MORE INFORMATION**

We have filed with the Commission a registration statement (including amendments and exhibits to the registration statement) on Form F-1 under the Securities Act. This prospectus, which is part of the registration statement, does not contain all of the information set forth in the registration statement and the exhibits and schedules to the registration statement. For further information, we refer you to the registration statement and the exhibits and schedules filed as part of the registration statement. If a document has been filed as an exhibit to the registration statement, we refer you to the copy of the document that has been filed.

We are subject to the informational requirements of the U.S. Securities Exchange Act of 1934, or the Exchange Act. Accordingly, we file reports and other information with the Commission, including annual reports on Form 20-F and reports on Form 6-K. You may inspect and copy the reports and other information that we file with the Commission at the public reference facilities of the Commission at 100 F. Street, N.E., Washington D.C. 20549. You may obtain information on the operation of the Commission's public reference room by calling the Commission in the United States at 1-800-SEC-0330. In addition, the Commission maintains an internet website at [www.sec.gov](http://www.sec.gov) from which you can electronically access the registration statement and the other materials that we file with the Commission.

As a foreign private issuer, we are not subject to the same disclosure requirements as a domestic U.S. registrant under the Exchange Act. For example, we are not required to prepare and issue quarterly reports. However, we are required to file with the SEC, promptly after it is made public or filed, information that we make public in Mexico, file with the Mexican Stock Exchange or the National Banking and Securities Commission or distribute to our securityholders. As a foreign private issuer, we are exempt from Exchange Act rules regarding proxy statements and short-swing profits.

We are not making offers to, nor are accepting offers to buy from, holders in any jurisdiction in which this offer would not comply with local securities laws. Initial offers and sales of series B shares outside the United States may be made in reliance on Regulation S under the Securities Act.

## **ENFORCEABILITY OF CIVIL LIABILITIES**

We are a corporation organized under the laws of Mexico. All of our directors and officers, and certain of the experts named in this prospectus reside in Mexico. In addition, a substantial portion of our assets are located in Mexico. Our Mexican counsel, Mijares, Angoita, Cortés Fuentes, S.C., has advised us that you may not be able to serve process within the United States upon these individuals or enforce against them judgments of U.S. courts, including judgments based on the civil liability provisions of the federal securities laws of the United States, and Mexican courts may not recognize the grounds or remedies for actions originally brought in a Mexican court against us, our directors and officers, the Mexican government and any expert named in this prospectus based on the federal securities laws of the United States.

## **VALIDITY OF SECURITIES**

The validity of the ADSs will be passed upon for us by Thacher Proffitt & Wood llp, our U.S. counsel, and for the underwriters by Milbank, Tweed, Hadley & McCloy llp, U.S. counsel to the underwriters. The validity of the series B shares will be passed upon for us by Mijares, Angoitia, Cortés y Fuentes, S.C., our Mexican counsel, and for the underwriters by Creel Garcia-Cuellar y Muggenberg, S.C., Mexican counsel to the underwriters.

## EXPERTS

Our consolidated financial statements for the fiscal years ended December 31, 2003 and 2004, included in this prospectus have been audited by KPMG Cárdenas, Dosal, S.C., an independent registered public accounting firm, as stated in their report and have been so included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The consolidated financial statements of Grupo Simec, S.A.B. de C.V. at December 31, 2005, and for the year then ended, appearing in this Prospectus and Registration Statement have been audited by Mancera S.C., a Member Practice of Ernst & Young Global, an independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein which, as to the year 2005, are based on the report of BDO Hernández Marrón y Cia, S.C., a member firm of BDO International, an independent registered public accounting firm. The financial statements referred to above are included in reliance upon such reports given on the authority of such firms as experts in accounting and auditing.

The Republic financial statements for the fiscal year ended December 31, 2004 included in this prospectus have been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report and have been so included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing. The Republic financial statements for the period from January 1, 2005 through July 22, 2005 included in this prospectus have been audited by BDO Seidman, LLP, an independent registered public accounting firm, as stated in their report and have been so included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

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Report of Independent Registered Public Accounting Firm

The Stockholders of  
Grupo Simec, S.A. de C.V. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Grupo Simec, S.A. de C.V. and subsidiaries (the "Company") as of December 31, 2005, and the related consolidated statements of income, changes in stockholders' equity, and changes in financial position for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We did not audit the financial statements of Simrep Corporation and subsidiaries, a majority owned subsidiary, which statements reflect total assets of Ps. 6,023,387 (thousand), as of December 31, 2005, and total revenues of Ps. 6,260,674 (thousand), for the period then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Simrep Corporation and subsidiaries, is based solely on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in Mexico and in accordance with the Standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial presentation. We believe that our audit and the report of other independent auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other independent auditors, the above-mentioned consolidated financial statements present fairly, in all material respects, the consolidated financial position of Grupo Simec, S.A. de C.V. and subsidiaries at December 31, 2005, and the consolidated results of their operations and changes in their financial position for the year then ended, in conformity with accounting principles generally accepted in Mexico, which differ in certain respects from those followed in the United States of America (see Note 19).

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

C.P.C. Jose Maria Tabares

Guadalajara, Jalisco México  
April 28, 2006 (except for Note 19,  
as to which the date is June 28, 2006;  
and for the restatement to constant Pesos  
as of June 30, 2006, for Note 13 a v) and  
for the share and per share information both  
as to which the date is July 11, 2006 and for  
Note 15 as to which the date is January 4, 2007)



Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of  
Grupo Simec, S. A. de C. V.:

We have audited the accompanying consolidated balance sheet of Grupo Simec, S.A. de C.V. and subsidiaries (the Company) as of December 31, 2004 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the years in the two-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the Standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As mentioned in note 14 to the consolidated financial statements, on August 9, 2004 the Company acquired, as an industrial unit, assets and labor obligations accrued at such date. The assets consist of inventories and steel plants.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Grupo Simec, S.A. de C.V. and subsidiaries as of December 31, 2004, and the results of their operations and the changes in their financial position for each of the years in the two-year period ended December 31, 2004, in conformity with accounting principles generally accepted in Mexico.

As described in note 2, the accompanying consolidated balance sheet, statements of income, stockholders' equity and changes in financial position have been restated to reflect their presentation in Mexican pesos of constant purchasing power as of June 30, 2006.

Accounting principles generally accepted in Mexico vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in note 19 to the consolidated financial statements.

KPMG CARDENAS DOSAL, S. C.

Jorge O. Pérez Zermeño

Guadalajara, Mexico.

April 25, 2005, except for the restatement to June 30, 2006 constant Mexican pesos, as to which the date is July 10, 2006.



- BDO Hernández Marrón y Cía, S.C.
- Contadores Públicos y
- Consultores de Empresas
- Av. Ejército Nacional 904 Piso 7
- Los Morales Polanco
- 11510 México, D.F.
- Tel.(52-55) 5901-3900
- Fax(52-55) 5901-3925
- www.bdo-mexico.com

**Report of Independent Registered Public Accounting Firm**

**To the Board of Directors and Shareholders of  
SimRep Corporation**

We have audited the consolidated balance sheet of SimRep Corporation and subsidiaries as of December 31, 2005, and the related consolidated statements of operations, changes in shareholders' equity and changes in financial position for the period from July 22 (date of acquisition) to December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Accounting principles generally accepted in Mexico vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 22 to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of SimRep Corporation and subsidiaries as of December 31, 2005, and the consolidated results of their operations, the changes in shareholders' equity and the changes in their financial position for the period from July 22 (date of acquisition) to December 31, 2005, in conformity with accounting principles generally accepted in Mexico.

These consolidated financial statements have been translated into English solely for the convenience of readers of this language.

**Hernández, Marrón y Cía., S.C.**

**Bernardo Soto Peñafiel, CPA**  
**Partner**

**Mexico City**

**April 28, 2006, except for the restatement to June 30, 2006 constant Mexican pesos, as to which the date is July 10, 2006.**

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**GRUPO SIMEC, S.A. DE C.V. AND SUBSIDIARIES**

## Consolidated Balance Sheets

December 31, 2005 and 2004

(Thousands of constant Mexican pesos as of June 30, 2006)

<b>Assets</b>	<b>2005</b>		<b>2004</b>	
Current assets:				
Cash and cash equivalents	Ps.	209,416	Ps.	526,743
Accounts receivable:				
Trade		2,316,954		1,016,826
Related parties (Note 4)		2,456		5,499
Recoverable value added tax		115,703		164,332
Other receivables		216,537		12,676
		2,651,650		1,199,333
Less: allowance for doubtful accounts		31,273		15,080
Total accounts receivable, net		2,620,377		1,184,253
Inventories, net (Note 5)		3,660,501		1,175,075
Prepaid expenses		230,226		8,935
Derivative financial instruments (Note 6)		57,477		19,025
Total current assets		6,777,997		2,914,031
Non-current inventories (Note 2e)		76,843		68,982
Property, plant and equipment, net (Note 7)		7,114,996		6,007,190
Other assets and deferred charges, net (Note 2h)		618,721		315,444
	Ps.	14,588,557	Ps.	9,305,647
<b>Liabilities and stockholders' equity</b>				
Current liabilities:				
Notes payable to banks (Note 9a)	Ps.	-	Ps.	159,252
Current portion of long-term debt (Note 9b)		21,034		3,538
Accounts Payable		1,411,813		612,449
Accruals (Note 8)		15,208		8,938
Other accounts payable and accrued expenses		675,565		161,543
Related parties (Note 4)		460,228		21
Deferred credit (Note 2l)		131,441		-
Total current liabilities		2,715,289		945,741
Long-term debt (Note 9b)		391,550		-
Seniority premiums and termination benefits (Note 10)		19,777		7,002

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Other long-term liabilities (Notes 2q and 16e)	112,067	15,067
Deferred income tax (Note 12)	1,513,079	1,490,545
Deferred credit (Note 2l)	208,114	-
Total long-term liabilities	2,244,587	1,512,614
Total liabilities	4,959,876	2,458,355
Stockholders' equity (Note 13):		
Capital stock	3,476,499	3,408,488
Additional paid-in-capital	845,018	682,066
Contributions for future capital stock increases	-	230,309
Retained earnings	4,519,677	3,239,779
Cumulative deferred income tax	(905,828)	(905,828)
Result of non-monetary assets	(154,723)	179,309
Fair value of derivative financial instruments (Note 6)	40,354	12,847
Majority stockholders' equity	7,820,997	6,846,970
Minority interest	1,807,684	322
Total stockholders' equity	9,628,681	6,847,292
	Ps. 14,588,557	Ps. 9,305,647

See accompanying notes to consolidated financial statements.

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**GRUPO SIMEC, S.A. DE C.V. AND SUBSIDIARIES**

## Consolidated Statements of Income

Years ended December 31, 2005, 2004 and 2003

(Thousands of constant Mexican pesos as of June 30, 2006, except earnings per share figures)

		<b>2005</b>	<b>2004</b>	<b>2003</b>
Net sales (Notes 14 and 15)	Ps.	12,966,627	5,910,363	3,047,392
Direct cost of sales (Note 14)		10,370,940	3,435,057	2,001,987
Marginal profit		2,595,687	2,475,306	1,045,405
Indirect overhead, selling, general and administrative expenses		1,018,105	593,276	507,272
Operating income		1,577,582	1,882,030	538,133
Comprehensive financing cost:				
Interest (expense) income, net		(15,728)	5,791	(13,499)
Foreign exchange (loss) gain, net				