

GROUP SIMEC SA DE CV  
Form 20-F/A  
December 22, 2009

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**FORM 20-F/A  
(Amendment No. 1)**

**(Mark One)**

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Commission File Number 1-11176

**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)

**UNITED MEXICAN STATES**

(Jurisdiction of incorporation or organization)

**Calzada Lazaro Cardenas 601  
Colonia La Nogalera, Guadalajara,  
Jalisco, Mexico 44440**

(Address of principal executive offices)

**José Flores Flores, telephone number 011-52-33 3770-6700, e-mail jflores@gruposimec.com.mx**  
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

| <b>Title of Each Class</b>                          | <b>Name of Each Exchange on Which Registered</b> |
|---|--|
| American Depositary Shares<br>Series B Common Stock | NYSE Amex LLC<br>NYSE Amex LLC*                  |

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of common stock as of December 31, 2008 was:

Series B Common Stock 497,709,214 shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

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If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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\* Not for trading, but only in connection with the registration of American depositary shares.

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**TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| PART I.  |             |
| <u>Item 1. Identity of Directors, Senior Management and Advisers</u>                         | <u>2</u>    |
| <u>Item 2. Offer Statistics and Expected Timetable</u>                                       | <u>2</u>    |
| <u>Item 3. Key Information</u>   | <u>2</u>    |
| <u>Item 4. Information on the Company</u>  | <u>20</u>   |
| <u>Item 5. Operating and Financial Review and Prospects</u>                                  | <u>48</u>   |
| <u>Item 6. Directors, Senior Management and Employees</u>                                    | <u>69</u>   |
| <u>Item 7. Major Shareholders and Related Party Transactions</u>                             | <u>77</u>   |
| <u>Item 8. Financial Information</u>   | <u>79</u>   |
| <u>Item 9. The Offer and Listing</u>   | <u>81</u>   |
| <u>Item 10. Additional Information</u>   | <u>82</u>   |
| <u>Item 11. Quantitative and Qualitative Disclosures About Market Risk</u>                   | <u>98</u>   |
| <u>Item 12. Description of Securities Other than Equity Securities</u>                       | <u>99</u>   |
| PART II.   |             |
| <u>Item 13. Defaults, Dividends Arrearages and Delinquencies</u>                             | <u>99</u>   |
| <u>Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds</u> | <u>99</u>   |
| <u>Item 15. Controls and Procedures</u>  | <u>99</u>   |
| <u>Item 16. [Reserved]</u>   | <u>102</u>  |
| <u>Item 16A. Audit Committee Financial Expert</u>  | <u>102</u>  |
| <u>Item 16B. Code of Ethics</u>  | <u>102</u>  |
| <u>Item 16C. Principal Accountant Fees and Services</u>                                      | <u>103</u>  |
| <u>Item 16D. Exceptions from the Listing Standards for Audit Committees</u>                  | <u>103</u>  |
| <u>Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>      | <u>103</u>  |
| <u>Item 16F. Change in Registrant's Certifying Accountant</u>                                | <u>103</u>  |
| <u>Item 16G. Corporate Governance</u>  | <u>103</u>  |
| PART III.  |             |
| <u>Item 17. Financial Statements</u>   | <u>104</u>  |
| <u>Item 18. Financial Statements</u>   | <u>104</u>  |



## EXPLANATORY NOTE

This Amendment No. 1 to the Annual Report on Form 20-F for the year ended December 31, 2008, as filed with the U.S. Securities and Exchange Commission on July 20, 2009 (the "Original 20-F"), amends Items 15A, 15B, 15D and 19 of the Original 20-F, exhibits 10.3, 12.1, 12.2 and 13.1 thereto, and the audit report of the Company's independent public accountants, in each case to correct certain inadvertent irregularities therein. No other information included in the Original 20-F is amended hereby. For presentation purposes only, this Amendment No. 1 restates in its entirety the Original 20-F.

## CERTAIN TERMS

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

References in this annual report to dollars, U.S. dollars, \$ or U.S.\$ are to the lawful currency of the United States. References in this annual report to pesos, Pesos or Ps. are to the lawful currency of Mexico. References to tons in this annual report 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 annual report 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. 13.5383 per U.S.\$1.00, the interbank transactions rate in effect on December 31, 2008. On June 30, 2009, the interbank transactions rate for the Peso was Ps. 13.17 per U.S.\$1.00.

## FORWARD LOOKING STATEMENTS

This annual report 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 annual report, 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 materially from forward looking statements include, but are not limited to,

- factors relating to the steel industry (including the cyclicity 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 inability to operate at high capacity levels;
- the costs of compliance with U.S. and Mexican environmental laws;



- the integration of our 2008 acquisition in Mexico of Corporación Aceros DM, S.A. de C.V. and certain of its affiliates;
- 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 below.

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 the date of this annual report 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 annual report might not occur.

## PART I.

### Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

### Item 2. Offer Statistics and Expected Timetable

Not applicable.

### Item 3. Key Information

#### A. Selected Financial Data

This annual report includes our consolidated financial statements as of December 31, 2008 and 2007 and for each of the three years ended December 31, 2008, 2007 and 2006. We have prepared our financial statements in conformity with Mexican Financial Reporting Standards ( MFRS or Mexican GAAP ) which include Bulletins and Circulars issued by the Accounting Principles Commission ( CPC ) of the Mexican Institute of Public Accountants (IMCP) which have not been amended, replaced or abrogated by MFRS issued by the Mexican Financial Reporting Standards Research and Development Board (*Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera, A.C.* ( CINIF ). We have adjusted the financial statements of our non-Mexican subsidiaries to conform to MFRS, and we have translated them to Mexican pesos. See Note 2(d) to our consolidated financial statements included elsewhere herein.

MFRS differ in certain significant respects from generally accepted accounting principles in the United States ( U.S. GAAP ). Note 18 to our consolidated financial statements included elsewhere herein provides a description of the principal differences between MFRS and U.S. GAAP, as they relate to us, a reconciliation to U.S. GAAP of net income, total stockholders equity and a statement of cash flows under U.S. GAAP.



Pursuant to MFRS, in our consolidated financial statements and the selected financial information set forth below:

- beginning January 1, 2008 and as a result of the adoption of the Mexican Financial Reporting Standard (MFRS) NIF B-10, Effects of inflation, we concluded that during 2008 the economic environment was non-inflationary and ceased recognition of inflation because annual inflation in Mexico published by the Mexican Central Bank (Banco de Mexico) during 2005, 2006 and 2007 was 3.3%, 4.1% and 3.8 %, respectively, and the cumulatively inflation for those years was 11.6%. However, the financial information for the years ended on December 31, 2007 and 2006, is presented in Mexican pesos with purchasing power as of December 31, 2007, the last date on which we recognized the effects of inflation in our financial statements; and
- we considered that it was impractical to identify the realized and unrealized part of the deficit by holding non-monetary assets included in the Deficit on restatement of stockholders' equity at January 1, 2008 and the Ps. 132,155 related to this amount were reclassified to retained earnings.
- MFRS B-2 was issued by the CINIF to replace Mexican accounting Bulletin B-12, *Statement of Changes in Financial Position*. This standard establishes the replacement of the statement of changes in financial position by a statement of cash flows as part of the basic financial statements. The main differences between both statements lie in the fact that the statement of cash flows shows the entity's cash receipts and disbursements for the period, while the statement of changes in financial position showed the changes in the entity's financial structure rather than its cash flows. In an inflationary environment, the amounts of both financial statements are expressed in constant Mexican pesos. However, in preparing the statement of cash flows, the entity must first eliminate the effects of inflation for the period and, accordingly, determine cash flows at constant Mexican pesos, while in the statement of changes in financial position, the effects of inflation for the period are not eliminated. Mexican FRS B-2 establishes that in the statement of cash flows, the entity must first present cash flows derived from operating activities, then from investing activities, the sum of these activities and finally cash flows derived from financing activities. The statement of changes in financial position first shows the entity's operating activities, then financing activities and finally its investing activities. Under this new standard, the statement of cash flows may be determined by applying the direct or indirect method. The transitory rules of MFRS B-2 establish that the application of this standard is prospective. Therefore, the financial statements for years ended prior to 2008 presented for comparative purposes, should include a statement of changes in financial position, as established by Mexican accounting Bulletin B-12. The company opted to prepare and present its cash flow statement under the indirect method.

Certain of the financial information set forth below is presented in accordance with U.S. GAAP. The effect of inflation accounting under MFRS until December 31, 2007 has not been reversed in the reconciliation to U.S. GAAP of net income and total stockholders' equity, except with respect to certain information included in the cash flow statement. See Note 18 to our consolidated financial statements included elsewhere herein.

The following tables present the selected consolidated financial information for our company as of and for the years ended December 31, 2004, 2005, 2006, 2007 and 2008. The selected financial and operating information as of and for the years ended December 31, 2006, 2007 and 2008 set forth below has been derived in part from our consolidated financial statements, which have been reported on by

Mancera S.C., a member practice of Ernst & Young Global, an independent, registered public accounting firm. In so doing, Mancera, S.C. has relied on the audited combined financial statements of Corporacion Aceros D.M., S.A. de C.V. and Affiliates, reported on by Moore Stephens Marcelo de los Santos y Cia., S.C, a member firm of Moore Stephens International, for the year ended December 31, 2008. The selected financial information as of and for the year ended December 31, 2005 set forth below has been derived in part from our consolidated financial statements, which have been reported on by Mancera S.C. and are not included elsewhere herein. In so doing, Mancera S.C. has relied on the audited consolidated financial statements of our subsidiary SimRep Corporation ( SimRep ) and its subsidiaries, which have been reported on by BDO Hernández Marrón y Cía., S.C., a member firm of BDO International, an independent, registered public accounting firm, and are not included elsewhere herein. The selected financial information as of and for the year ended December 31, 2004 set forth below has been derived in part from our consolidated financial statements, which have been reported on by KPMG, an independent, registered public accounting firm, and are not included elsewhere herein. The selected financial information should be read in conjunction with, and is qualified in its entirety by reference to our consolidated financial statements included elsewhere herein.

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Year Ended December 31,

|  | 2004                                | 2005    | 2006    | 2007    | 2008    | 2008 <sup>(1)</sup>   |
|--|-------------------------------------|---------|---------|---------|---------|-----------------------|
|  | (Millions of pesos)                 |         |         |         |         | (Millions of dollars) |
|  | (except per share and per ADS data) |         |         |         |         |                       |
| <b>Income Statement Data:</b>  |                                     |         |         |         |         |                       |
| <i>Mexican GAAP:</i>   |                                     |         |         |         |         |                       |
| Net sales  | 6,333                               | 13,893  | 23,515  | 24,106  | 35,185  | 2,599                 |
| Direct cost of sales   | 3,681                               | 11,112  | 19,132  | 20,499  | 29,796  | 2,201                 |
| Gross profit   | 2,652                               | 2,781   | 4,383   | 3,607   | 5,389   | 398                   |
| Indirect manufacturing, selling, general and administrative expenses | 397                                 | 742     | 902     | 874     | 1,379   | 102                   |
| Depreciation and amortization  | 238                                 | 349     | 450     | 549     | 895     | 66                    |
| Operating income   | 2,016                               | 1,690   | 3,031   | 2,184   | 3,115   | 230                   |
| Financial (expense) income   | (40)                                | (155)   | (63)    | 41      | (175)   | (13)                  |
| Other (expense) income, net  | (41)                                | (12)    | 39      | 21      | (4)     | 0                     |
| Income before taxes, employee profit sharing and minority interest   | 1,935                               | 1,523   | 3,007   | 2,246   | 2,936   | 217                   |
| Income tax expense and employee profit sharing                       | 368                                 | 133     | 609     | 621     | 1,036   | 77                    |
| Net income   | 1,567                               | 1,390   | 2,398   | 1,625   | 1,900   | 140                   |
| Minority interest  | 0                                   | 19      | 220     | 96      | 104     | 8                     |
| Majority interest  | 1,567                               | 1,371   | 2,178   | 1,529   | 1,796   | 132                   |
| Net income per share   | 3.93                                | 3.31    | 5.18    | 3.27    | 3.70    | 0.27                  |
| Net income per ADS <sup>(2)</sup>                                    | 11.78                               | 9.94    | 15.54   | 9.82    | 11.10   | 0.82                  |
| Weighted average shares outstanding (thousands) <sup>(5)</sup>       | 398,916                             | 413,790 | 420,340 | 468,228 | 484,904 | 484,904               |
| Weighted average ADSs outstanding (thousands)                        | 132,972                             | 137,930 | 140,113 | 155,743 | 161,635 | 161,635               |

*U.S. GAAP including effects of inflation until 2007:*

|  |       |        |        |        |        |       |
|--|-------|--------|--------|--------|--------|-------|
| Net sales  | 6,333 | 13,893 | 23,515 | 24,106 | 35,185 | 2,599 |
| Cost of sales  | 3,674 | 11,116 | 19,059 | 20,422 | 29,755 | 2,198 |
| Gross profit   | 2,659 | 2,777  | 4,456  | 3,684  | 5,430  | 401   |
| Operating income <sup>(4)</sup>                                    | 1,998 | 1,654  | 3,144  | 2,310  | 3,166  | 234   |
| Financial (expense) income   | (40)  | (155)  | (63)   | 41     | (175)  | (13)  |
| Other (expense) income, net  | (4)   | 29     | 24     | 12     | 20     | 1     |
| Income before taxes, employee profit sharing and minority interest | 1,954 | 1,528  | 3,105  | 2,363  | 3,011  | 222   |
| Income tax expense   | 417   | 140    | 636    | 653    | 1,057  | 78    |
| Income before minority interest                                    | 1,537 | 1,388  | 2,469  | 1,709  | 1,954  | 144   |
| Minority interest  | 0     | 18     | 220    | 122    | 110    | 8     |
| U.S. GAAP adjustment on minority interest                          | 0     | 0      | 25     | 0      | 0      | 0     |
| Net income   | 1,537 | 1,370  | 2,224  | 1,587  | 1,844  | 136   |
| Net income per share <sup>(5)</sup>                                | 3.85  | 3.31   | 5.29   | 3.39   | 3.80   | 0.28  |
| Net income per ADS   | 11.56 | 9.93   | 15.87  | 10.19  | 11.41  | 0.84  |

**Balance Sheet Data:**

*Mexican GAAP:*

|  |       |        |        |        |        |       |
|--|-------|--------|--------|--------|--------|-------|
| Total assets                               | 9,971 | 15,630 | 18,043 | 22,841 | 30,814 | 2,276 |
| Total long-term liabilities <sup>(3)</sup> | 1,621 | 2,405  | 2,175  | 2,729  | 4,253  | 314   |
| Total stockholders' equity                 | 7,337 | 10,316 | 12,960 | 17,252 | 21,305 | 1,574 |

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|   | Year Ended December 31,                                    |         |        |        |         |                       |
|---|--|---------|--------|--------|---------|-----------------------|
|   | 2004   | 2005    | 2006   | 2007   | 2008    | 2008(1)               |
|   | (Millions of pesos)<br>(except per share and per ADS data) |         |        |        |         | (Millions of dollars) |
| <i>U.S. GAAP including effects of inflation until 2007:</i> |  |         |        |        |         |                       |
| Total assets  | 9,828  | 15,852  | 18,205 | 22,849 | 30,908  | 2,283                 |
| Total long-term liabilities <sup>(3)</sup>                  | 1,581  | 2,467   | 2,220  | 2,731  | 4,280   | 316                   |
| Total stockholders equity                                   | 7,234  | 8,539   | 10,801 | 14,813 | 18,182  | 1,343                 |
| <b>Cash Flow Data:</b>                                      |  |         |        |        |         |                       |
| <i>Mexican GAAP:</i>  |  |         |        |        |         |                       |
| Cash provided by operating activities                       | 981  | 1,996   | 2,384  | 2,352  | 1,845   | 136                   |
| Cash provided by (used in) financing activities             | 433  | (260)   | (417)  | 2,324  | 1,334   | 99                    |
| Cash (used in) provided by investing activities             | (1,454)  | (2,076) | 13     | (484)  | (9,000) | (665)                 |
| <b>Other Data:</b>  |  |         |        |        |         |                       |
| <i>Mexican GAAP:</i>  |  |         |        |        |         |                       |
| Capital expenditures  | 1,377  | 539     | 417    | 486    | 480     | 35                    |
| Adjusted EBITDA <sup>(6)</sup>                              | 2,254  | 2,039   | 3,481  | 2,733  | 4,010   | 296                   |
| Depreciation and amortization                               | 238  | 349     | 450    | 549    | 895     | 66                    |
| Working capital <sup>(7)</sup>                              | 2,108  | 4,353   | 6,964  | 11,594 | 7,790   | 575                   |
| Dividends declared  | 0  | 0       | 0      | 0      | 0       | 0                     |
| Dividends declared per share                                | 0  | 0       | 0      | 0      | 0       | 0                     |
| Dividends declared per ADS                                  | 0  | 0       | 0      | 0      | 0       | 0                     |
| <b>Operational information:</b>                             |  |         |        |        |         |                       |
| Annual installed capacity<br>(thousands of tons)            | 1,210  | 2,847   | 2,902  | 2,902  | 3,522   |                       |
| Tons shipped  | 773  | 1,708   | 2,676  | 2,691  | 2,924   |                       |
| Mexico  | 676  | 899     | 945    | 900    | 1,028   |                       |
| United States, Canada and elsewhere<br>outside Mexico       | 97   | 809     | 1,731  | 1,791  | 1,896   |                       |
| SBQ steel   | 168  | 923     | 1,918  | 1,951  | 1,952   |                       |
| Structural and other steel products                         | 605  | 785     | 758    | 740    | 972     |                       |
| Per ton ( <i>Mexican GAAP</i> ):                            |  |         |        |        |         |                       |
| Net sales per ton   | 8,190  | 8,133   | 8,787  | 8,958  | 12,033  | 889                   |
| Cost of sales per ton                                       | 4,760  | 6,505   | 7,149  | 7,617  | 10,190  | 753                   |
| Operating income per ton                                    | 2,608  | 989     | 1,133  | 812    | 1,065   | 79                    |
| Adjusted EBITDA per ton                                     | 2,916  | 1,194   | 1,301  | 1,016  | 1,371   | 101                   |
| Number of employees   | 2,018  | 4,360   | 4,053  | 4,437  | 4,823   |                       |

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 13.5383 per \$1.00, the interbank transactions rate in effect on December 31, 2008.

- (2) Following our stock split effective May 30, 2006, one American depositary share, or 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) In 2008 we recorded other expense of Ps. 24 million for employee profit sharing, which were reclassified to operating expenses for U.S. GAAP purposes. In 2007 we recorded Ps. 17 million of gain on derivative instruments in other income and an expense of Ps. 8 million for fiscal amnesty offered by the Mexican Government in other expense, which were reclassified to operating expenses for U.S. GAAP purposes. In 2006 we recorded Ps. 15 million for the cancellation of the provision of labor obligations assumed in the acquisition of Atlax in other income which was reclassified to operating expenses for U.S. GAAP purposes. Reflects a reclassification in 2005 from other expenses under Mexican GAAP to operating expenses under U.S. GAAP of Ps. 39 million due to the cancellation of technical assistance and in 2004 reflects several entries recorded in other expenses under Mexican GAAP, which amount to approximately Ps. 36 million and according to U.S. GAAP, should be presented as operating expenses.
- (5) For U.S. GAAP and Mexican GAAP purposes, the weighted average shares outstanding were calculated to give effect to the stock split mentioned in point (2) above.
- (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 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:

- it does not include taxes, which are a necessary and recurring part of our operations;
- 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
- it does not include comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenue; and
- 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.

(7) Working capital is defined as excess of current assets over current liabilities.

(8) Installed capacity is determined at December 31 of the relevant year.

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:

|  | Year Ended December 31, |       |       |       |       |                       |
|--|-------------------------|-------|-------|-------|-------|-----------------------|
|  | 2004                    | 2005  | 2006  | 2007  | 2008  | 2008(1)               |
|  | (Millions of pesos)     |       |       |       |       | (Millions of dollars) |
| <i>Mexican GAAP:</i>                           |                         |       |       |       |       |                       |
| Net income                                     | 1,567                   | 1,390 | 2,398 | 1,625 | 1,900 | 140                   |
| Depreciation and amortization                  | 238                     | 349   | 450   | 549   | 895   | 66                    |
| Financial income (expense)                     | (40)                    | (155) | (63)  | 41    | (175) | (13)                  |
| Income tax expense and employee profit sharing | 368                     | 133   | 609   | 621   | 1,036 | 77                    |
| Other income (expense)                         | (41)                    | (12)  | 39    | 21    | (4)   | 0                     |
| Adjusted EBITDA                                | 2,254                   | 2,039 | 3,481 | 2,733 | 4,010 | 296                   |

**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 annual report could have been or could be converted into U.S. dollars at any particular rate or at all.



## Exchange Rates

| Year Ended December 31 | High  | Low   | Average (1) | Period End |
|------------------------|-------|-------|-------------|------------|
| 2004                   | 11.64 | 10.81 | 11.29       | 11.15      |
| 2005                   | 11.41 | 10.41 | 10.89       | 10.63      |
| 2006                   | 11.46 | 10.43 | 10.91       | 10.80      |
| 2007                   | 11.27 | 10.67 | 10.93       | 10.92      |
| 2008                   | 13.94 | 9.92  | 11.14       | 13.83      |

  

| Month         | High  | Low   | Average (1) | Period End |
|---------------|-------|-------|-------------|------------|
| December 2008 | 13.83 | 13.09 | 13.42       | 13.83      |
| January 2009  | 14.33 | 13.33 | 13.88       | 14.33      |
| February 2009 | 15.09 | 14.13 | 14.61       | 15.09      |
| March 2009    | 15.41 | 14.02 | 14.65       | 14.21      |
| April 2009    | 13.89 | 13.05 | 13.40       | 13.80      |
| May 2009      | 13.82 | 12.88 | 13.19       | 13.18      |
| June 2009     | 13.64 | 13.16 | 13.34       | 13.17      |

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

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 on the American Stock Exchange of the American depositary shares, or ADSs, that represent the series B shares. Such fluctuations will also affect the U.S. dollar conversion by the depositary of any cash dividends paid in pesos on series B shares represented by ADSs.

## B. Capitalization and Indebtedness

Not applicable.

## C. Reasons for the Offer and Use of Proceeds

Not applicable.

## D. Risk Factors

Investing in our 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 annual report, 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 significantly, and you could lose all or substantially all 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. In 2007 and 2008 prices of scrap metal increased in real terms, approximately 26% and 57% respectively, prices of ferroalloys increased in real terms, approximately 10% and 19% in 2007 and 2008 respectively, electricity prices increased in real terms, approximately 36% in 2008 and gas prices increased in real terms approximately 28% in 2008.

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 materially and 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 additional 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 July 2005, we and our controlling shareholder, Industrias CH, S.A.B. de C.V., or Industrias CH, acquired 100% of the stock of PAV Republic, Inc., or 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. In May 2008, we acquired 100% of the shares of Corporación Aceros DM, S.A. de C.V. and certain of its affiliates (Grupo San). Grupo San is a long products steel mini-mill and the second-largest corrugated rebar producer in Mexico in terms of production volume. Grupo San's plants and 1,450 employees produce 700,000 tons of finished products annually. Our future success will depend in part on our ability to integrate the operations of Republic and Grupo San successfully into our historic operations. Furthermore, we cannot assure you that we will not encounter unexpected problems related to these acquired businesses, and if we do, the unbudgeted costs of addressing any such problems could 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 would likely be materially and adversely affected.

Since most of our sales are in the United States and Canada, we also face strong competition from other steel producers in the United States and Canada. Approximately 36% of our sales in 2008 were in Mexico (which include 16% of exports) where we face strong competition from other Mexican steel producers. A number of our competitors in the United States, Canada and Mexico 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 will face increased competition from them and may experience a loss of market share. In each of the United States, Canada and Mexico we also face competition from international steel producers. Increased international competition, especially when combined with excess production

capacity, would likely force us to lower our prices or to offer increased services at a higher cost to us, which could materially reduce our gross margins and net income.

***Tariffs, anti-dumping and countervailing duty claims imposed in the future could harm our ability to export our products outside of Mexico, and changes in Mexican tariffs on steel imports could adversely affect the profitability and market share of our Mexican steel business.***

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, and if this were to occur it could materially and adversely affect our results of operations.

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 eliminated or that countries seeking to export steel products to Mexico will not impose similar tariffs on Mexican exports to those countries, and in either case such developments could have a material adverse effect on our financial condition and results of operations.

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

We need to receive sufficient funds from our Mexican 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 materially and 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 December 31, 2008, approximately 75% of our non-Mexican and 52% 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 could result in strikes, boycotts or other labor disruptions. These potential labor disruptions could have a material and adverse effect on our results of operations and financial condition. 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 continuing right to use certain property and assets of an adjoining facility that the Tecumseh Redevelop Inc. owns, and the***



***termination of any such rights would interrupt our operations and have a material adverse effect on our results of operations and financial condition.***

The operations of our Lackawanna facility depend on certain easements and other recorded agreements relating to, among other things, our use of industrial water, compressed air, sanitary sewer and electrical power. These service and utility arrangements, initially entered into with the Mittal Steel Company N.V. ( *Mittal Steel* ), were effective through April 30, 2009. In 2009, however, Mittal Steel transferred its Lackawanna Plant to Tecumseh Redevelopment, Inc. ( *Tecumseh* ), and as a result we are currently negotiating with Tecumseh to extend these services and utility arrangements. These services and utility arrangements are currently scheduled to expire on April 30, 2010, and automatically renew thereafter for three-month periods. If Tecumseh completely ceases to supply a particular utility service prior to the end of the current term, Tecumseh shall notify Republic sixty days prior to their intent to send a discontinuation notice and must deliver such written notice at least ninety days prior to such cessation. Within thirty days of the receipt of any such discontinuation notice, Republic can exercise its right to purchase the Tecumseh water system, in which event Republic agrees to pay Tecumseh the fair market value of the water system as determined by the average fair market value established by three independent appraisers. These rights are essential to the use and operation of our Lackawanna facility. In the event of a termination of any of these rights, due to a failure to negotiate a satisfactory outcome with Tecumseh or an inability to pay the value assigned by the independent appraisers, or for any other reason, we could be required to cease all or substantially all of our operations at the Lackawanna facility. Because we produce certain types of products in our Lackawanna facility that we do not produce in our other facilities, an interruption of production at our Lackawanna facility would result in a substantial loss of revenue and could damage our relationships with customers.

***Our sales in the U.S. are 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 in the U.S. 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 year ended December 31, 2008, direct sales of our products to one of our customers, United States Steel Corporation ( *U.S. Steel* ) accounted for approximately 20% of our revenues in the U.S. and approximately 11% of our consolidated revenues for such year. During the year ended December 31, 2008, sales to our ten largest customers in the U.S. accounted for approximately 54% of our consolidated revenues in the U.S. for such year and approximately 31% of our total consolidated revenues for such year. A disruption in sales to one or more of our largest customers would adversely affect our cash flow and results of operations. Starting in the fourth quarter of 2008, due to the U.S. financial crisis and the ensuing worldwide economic recession, all of our top ten customers have suffered reduced demand for their products. This reduction in demand has in turn adversely affected 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 our largest 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 materially and 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. 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 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, and capital investments necessary to repair any destroyed or damaged facilities or machinery would adversely affect our cash flows and our profitability.

***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, TS 16949 and ISO 14001 certification. All of the U.S. and Mexican facilities that sell to automotive parts customers are currently 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 and adversely affect our revenues and results of operations. We 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 our market share, because they 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 would 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 December 31, 2008, Industrias CH, which the chairman of our board of directors, Rufino Vigil González, controls, owned approximately 84% of our shares. Industrias CH nominated and elected all of the current members of our board of directors, and Industrias CH continues and, 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.

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

Historically, we have engaged a 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 and retain additional senior management could materially and 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. 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.

***Our tax liability may increase if the tax laws and regulations in countries in which we operate change or become subject to adverse interpretations.***

Taxes payable by companies in the countries in which we operate are substantial and include income tax, value-added tax, excise duties, profit taxes, payroll related taxes, property taxes and other taxes. Tax laws and regulations in some of these countries may be subject to change, varying interpretation and inconsistent enforcement. Ineffective tax collection systems and continuing budget requirements may increase the likelihood of the imposition of onerous taxes and penalties which could have a material adverse effect on our financial condition and results of operations. In addition to the usual tax burden imposed on taxpayers, these conditions create uncertainty as to the tax implications of various business decisions. This uncertainty could expose us to significant fines and penalties and to enforcement measures despite its best efforts at compliance, and could result in a greater than expected tax burden. In addition, many of the jurisdictions in which we operate have adopted transfer pricing legislation. If tax authorities impose significant additional tax liabilities as a result of transfer pricing adjustments, it could have a material adverse effect on our financial condition and results of operations. It is possible that tax authorities in the countries in which we operate will introduce additional revenue raising measures. The introduction of any such provisions may affect our overall tax efficiency and may result in significant additional taxes becoming payable. Any such additional tax exposure could have a material adverse effect on its financial condition and results of operations.

#### **Risk Factors Concerning the Current Global Recession**

***The global recession has significantly impacted our business.***

The economic downturn that began in the United States in late 2007 led to a worldwide economic recession following the financial crisis precipitated by the collapse of Lehman Brothers Holdings Inc. in September of 2008. Since this time period, overall economic activity has decreased across the world generally and in North America in particular. The corresponding reduction in demand across the economy in general and in the automotive, manufacturing and construction sectors, in particular, has reduced demand for steel products in North America and globally. The volatile global economic climate is having significant negative effects on our business and our forward view is limited because of low order backlogs and short lead times. All segments of our business have been impacted and such impacts have created certain new risks and have also affected the other risks set forth below.

***Our end product markets have been severely affected.***

We sell our products to the automotive and construction-related industries, both of which have reported substantially lower customer demand due to the ongoing global recession. As a result, our operating levels have fallen and will remain at depressed levels until our customers' demand increases. In addition to slackening demand by end customers, we believe that some of our customers are experiencing difficulty in obtaining credit or maintaining their ability to qualify for trade credit insurance, resulting in a further reduction in purchases and an increase in our credit risk exposure. The duration of the recession and the trajectory of the recovery for these industries may have a significant impact on our operations.

***We may face increased risks of customer and supplier defaults.***

There is an increased risk of insolvency and other credit related issues of our customers, particularly those in hard hit industries such as automotive, construction and appliance. Also, there is the possibility that our suppliers may face similar risks. This decrease in available credit may increase the risk of our customers defaulting on their payment obligations to us and may cause some of our suppliers to be delayed in filling or to be unable to fill our needs.

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

Direct sales of products to automotive assemblers and manufacturers accounted for approximately 26% of our net sales of SBQ in 2008. 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. In addition, two of the largest U.S. automobile manufacturers have recently filed for bankruptcy. Chrysler LLC filed for Chapter 11 bankruptcy protection on April 30, 2009, and emerged from Chapter 11 protection on June 10, 2009, and General Motors Corporation filed for Chapter 11 bankruptcy protection on June 1, 2009 and emerged from such protection on July 10, 2009. While Chrysler and General Motors have emerged from bankruptcy protection, both have significantly reduced their manufacturing and sales capacity. A reduction in vehicles manufactured in North America, the principal market for Republic's SBQ steel products, would have a potentially significant adverse effect on our results of operations. 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.

***Our customers in the automotive industry continually seek to obtain price reductions from us. These price reductions may adversely affect our results of operations and financial condition.***

A challenge that we and other suppliers of intermediary products used in the manufacture of automobiles currently face is continued price reduction pressure from our customers in the automobile manufacturing business. Downward pricing pressure has been a characteristic of the automotive industry in recent years and it is migrating to all our vehicular markets. Virtually all automobile manufacturers have aggressive price reduction initiatives that they impose upon their suppliers, and such actions are expected to continue in the future. In the face of lower prices to customers, we must reduce our operating costs in order to maintain profitability. We have taken and continue to take steps to reduce our operating costs to offset customer price reductions; however, price reductions are adversely affecting our profit margins and are expected to do so in the future. If we are unable to offset customer price reductions through improved operating efficiencies, new manufacturing processes, sourcing alternatives, technology enhancements and other cost reduction initiatives, or if we are unable to avoid price reductions from our customers, our results of operations and financial condition could be adversely affected.

### **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 first

three quarters of 2006, but weakening in the last quarter of 2006. In 2007, steel prices remained similar to prices in 2006. In 2008, global steel prices increased during the first three quarters of 2008, but weakened in the last quarter of 2008 and are likely to continue to weaken, perhaps significantly, in 2009. 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 2006, scrap prices remained similar to 2005 levels. Scrap prices increased in 2007. In 2008, scrap prices increased significantly. 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.

We purchased 50% of our iron ore pellet and 100% of our coke requirement on the open market. 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 purchased more of the material in the open market. In 2006, iron ore and coke prices decreased from 2005 levels. Iron ore and pellet prices increased in 2007. Iron ore and coke prices increased significantly in 2008. We cannot give you any assurance that we will be able to continue to find suppliers of these raw materials in the open market, that the prices of these materials will not increase or that the quality will remain the same. Moreover, we cannot give you any assurance that 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 and increasing component of our costs of operations. Energy cost as a percentage of direct cost was 11.6% for the year ended December 31, 2008, and is likely to increase in 2009. 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. As of December 31, 2008, the Company has contracted derivative financial instruments in Mexico for hedging purposes to cover the risk of fluctuations in the price of natural gas (swaps) with PEMEX Gas and Basic

Petrochemicals (PGBP), Gas Natural TETCO (TETCO) Natgasmex, SA of C.V. (Natgasmex) Ecogas Mexico, S of the R. L C. V. (ECOGAS).

***Competition from other materials could significantly reduce market prices and demand for steel products and thereby reduce our cash flow and profitability.***

In many applications, steel competes with other materials that may be used as steel substitutes, such as aluminum (particularly in the automobile industry), cement, composites, glass, plastic and wood. Additional substitutes for steel products could significantly reduce market prices and demand for steel products and thereby reduce our cash flow and profitability.

### **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 adversely 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 incidences of crime in Mexico, and drug trafficking in particular, could adversely affect our business.***

Beginning in early 2007, following the election of Felipe Calderón Hinojosa, there has been a national government policy which has involved a concentrated effort on the part of the Mexican Federal Police and military to combat narco-trafficking cartels within Mexico. This increase in government pressure in turn led to a response in violence from well armed narco-traffickers, and the result has been an overall increase in narcotics related violence during 2008 and the first part of 2009. A recent travel alert issued by the U.S. Department of State (Bureau of Consular Affairs) on February 20, 2009 (the Travel Alert ), provides information for U.S. citizens on security issues in Mexico. According to the Travel Alert, violent criminal activity fueled by an increasingly violent conflict (both among Mexican drug cartels and between such cartels and Mexican security services) for control of narcotics trafficking routes continues along the U.S.-Mexico border and throughout other parts of Mexico. The Travel Alert reports that large firefights, involving the Mexican army, police and the drug cartels, have taken place in many towns and cities across Mexico and most recently in northern Mexico, including Tijuana, Chihuahua and Ciudad Juarez. Although attacks are aimed primarily at members of drug trafficking organizations and Mexican police forces, Mexican and foreign bystanders, including U.S. citizens, have been among the victims of violent attacks, homicides and kidnappings across Mexico. According to the Travel Alert, moreover, a number of areas along the border are experiencing rapid growth in the rates of many types of crime such as robberies, homicides, petty thefts, and carjackings.

***We face risks related to health epidemics and other outbreaks.***

Our business could be adversely affected by the effects of swine flu or another epidemic or outbreak. In April 2009, an outbreak of swine flu occurred in Mexico and the United States and there have been recent cases in China and elsewhere in Asia. Any prolonged occurrence or recurrence of swine flu or other adverse public health developments in Mexico may have a material adverse effect on our business operations. Our operations may be impacted by a number of health-related factors, including, among other things, quarantines or closures of our facilities, which could severely disrupt our operations, the sickness or death of our key officers and employees, and a general slowdown in the Mexican economy. Any of the foregoing events or other unforeseen consequences of public health problems could adversely affect our business and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of swine flu or any other epidemic.

***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 materially and 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.

***We and our auditors recently identified a material weakness in our internal controls over financial reporting, and if we fail to remediate this material weakness and achieve an effective system of internal controls, we may not be able to accurately report our financial results and current and potential stockholders could lose confidence in our reporting, which would harm our business and the trading price of the ADSs or the Series B Shares.***

In connection with the preparation of our financial statements as of and for the year ended December 31, 2008, we and our auditors identified a material weakness (as defined under standards established by the Public Company Accounting Oversight Board) in our internal controls over financial reporting. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Specifically, we found that due to our continuing growth, and in particular our recent acquisition of Corporación Aceros D.M.S.A. de C.V., the current structure of our finance department is no longer sufficient to allow key supervision controls to function effectively with respect to our financial statement closing process, deferred taxes and business acquisitions.

Any failure to implement and maintain the needed improvements in the controls over our financial reporting, or difficulties encountered in the implementation of these improvements in our controls, could result in a material misstatement in our annual or interim financial statements that would not be prevented or detected or cause us to fail to meet our reporting obligations under applicable securities laws. Any failure to improve our internal controls to address the identified weakness could result in our incurring substantial liability for not having met our legal obligation and could also cause investors to lose confidence in our reported financial information, which could have a negative impact on the trading price of the ADSs or the Series B Shares.

***Our financial statements are prepared in accordance with MFRS and therefore are not 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 MFRS which differs in certain significant respects from U.S. GAAP. Accordingly, Mexican financial statements and reported earnings are likely to differ from those of companies in other countries in this and other respects. See Note 18 to our consolidated financial statements included elsewhere herein for a description of certain principal differences between MFRS and U.S. GAAP as they relate to us.

***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.

#### **Item 4. Information on the Company**

## **A. History and Development of the Company**

### **Overview**

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 in 2008 we were the largest producer of SBQ products in both the United States and Mexico, in each case in terms of sales volume. We also believe that in 2008 we were the largest producer of structural and light structural steel products in Mexico in terms of sales volume.

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 cost benefits generated by our facility locations has allowed us to develop long standing relationships with many 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 an advantage in the cost of freight over competitors which do not have production facilities in such regions

Our legal name is Grupo Simec, S.A.B. de C.V. and our commercial name for advertising and publicity purposes is Simec. We are organized under the laws of the United Mexican States.

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 011-52-33-3770-6700.

## **Our History**

Our steel operations commenced in 1969 when a group of families from Guadalajara, Jalisco, formed Compañía Siderúrgica de Guadalajara, S.A. de C.V. ( 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, organized under the laws of the United Mexican States.

In March 2001, Sidek consummated the sale of its entire approximate 62% controlling interest in our company 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 84% 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 Industrias Ferricas del Norte S.A. (Corporacion Sidenor of Spain, or Grupo Sidenor ) located in Apizaco, Tlaxcala and Cholula, Puebla. We refer to this acquisition as the Atlax Acquisition. 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 and Cholula 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.\$245 million purchase price principally through a loan we received from Industrias CH that we have repaid in full.

On October 9, 2006 the Company sold its total share ownership in Administradora de Cartera de Occidente, S.A. de C.V. (ACOSA). ACOSA engages in the recovery of non-performing loans acquired pursuant to a public bidding process conducted by the *Instituto de Protección al Ahorro Bancario* in Mexico.

On November 24, 2007 we purchased 99.95% of the shares of three subsidiaries of Grupo TMM S.A de C.V. These three subsidiaries were TMM América, S.A. de C.V., TMM Continental, S.A. de C.V. and Mutimodal Doméstica, S.A. de C.V. Following the purchase, these companies have engaged in marketing steel. In February 2008, the names of these three companies were changed to CSG Comercial,

S.A. de C.V., Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V. and Siderúrgica de Baja California, S.A. de C.V.

In 2007, the board of directors of Compañía Siderúrgica de Guadalajara, S.A. de C.V. (CSG) decided to spin-off the company. CSG conveyed 87.4% of the companies' stockholders equity to Tenedora CSG, S.A. de C.V., as the spun-off company. This corporate restructuring did not have a material effect on our consolidated financial statements.

On May 30, 2008, we acquired all the capital stock of Corporación Aceros DM, S. A. de C. V. and certain affiliated companies (Grupo San) for a total cost of approximately Ps. 8,730 million (US 844 million dollars). Grupo San is a long products steel mini-mill and the second-largest corrugated rebar producer in Mexico. Grupo San's operations are based in San Luis Potosí, Mexico. Its plants and 1,450 employees produce 700 thousand tons of finished products annually.

On July 29, 2008, the Company acquired 100% of the shares of Aroproc, S. A. de C. V., Del-Ucral, S. A. de C. V., Qwer, S. A. de C. V. and Transporte Integral Doméstico, S.A. de C.V., subsidiaries of Grupo TMM, S. A. de C. V., to convert them into the operating manager of the iron and steel plants located in Mexico. On July 30 2008, these companies were renamed to Promotora de Aceros San Luis, S. A. de C. V., Comercializadora Aceros DM, S.A. de C.V., Comercializadora Msan, S.A. de C.V. and Productos Siderúrgicos de Tlaxcala, S.A. de C.V. respectively.

On December 26 2008, the Company acquired 99.95% of the shares of Northarc Express, S. A. de C. V. a subsidiary corporation of Grupo TMM, S. A. de C. V., to convert this company in the operating manager of iron and steel plants located in Mexico. On January 6, 2009, this company changed its name to Simec International 2, S. A. de C. V.

## **B. Business Overview**

In the United States and Mexico, we own and operate twelve state-of-the-art steel making, processing and/or finishing facilities with a combined annual crude steel installed production capacity of 4.5 million tons and a combined annual installed rolling capacity of 3.5 million tons. We operate both mini-mill and integrated steel making facilities, which give 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 subsidiary, Simec International, S.A. de C.V. ( SI );
- 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 we own through our majority- owned subsidiary, Republic.

- two mini-mills in San Luis Potosí, San Luis Potosí, México both of which we own through our wholly-owned subsidiary, Grupo San.

In 2008, we had net sales of Ps. 35.2 billion, gross profit of Ps. 5.4 billion and net income attributable to majority interest of Ps. 1.8 billion. In 2008, approximately 62% of our consolidated sales were in the United States and Canada, approximately 32% were in Mexico, and approximately 6% were exports to other markets outside North America.

## **Business Strategy**

We seek 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 seek 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, the acquisition of Republic in 2005 and of the acquisition of Grupo San in 2008.

*Improving our cost structure.*

We are continuing working to reduce 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.

## **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, cold finished bars and wire rods. 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 U.S. and Canadian facilities since July 22, 2005 and the sales of products manufactured at the San Luis facilities from June 1, 2008, through December 31, 2008.

**Steel Product Sales Volume**

|  | Years ended December<br>31, |                |                |                |
|--|-----------------------------|----------------|----------------|----------------|
|  | 2005                        | 2006           | 2007           | 2008           |
|  | (thousands of tons)         |                |                |                |
| I-Beams  | 82.2                        | 75.7           | 74.5           | 66.2           |
| Channels   | 59.7                        | 70.3           | 79.5           | 61.4           |
| Angles(1)  | 222.6                       | 231.2          | 145.2          | 131.0          |
| Hot-rolled bars (round, square and hexagonal rods) | 600.0                       | 1,141.9        | 1,189.0        | 1,210.8        |
| Flat bar   | 188.5                       | 154.4          | 182.9          | 106.8          |
| Rebar  | 239.1                       | 265.2          | 250.8          | 467.6          |
| Cold finished bars                                 | 105.6                       | 201.0          | 216.2          | 190.9          |
| Semi-finished tube rounds                          | 165.2                       | 352.8          | 216.2          | 350.3          |
| Other semi-finished trade products(2)              | 43.3                        | 174.0          | 326.4          | 262.0          |
| Electro-Welded wire mesh                           | -                           | -              | -              | 16.7           |
| Wire rod   | -                           | -              | -              | 14.9           |
| Electro-Welded wire mesh panel                     | -                           | -              | -              | 5.6            |
| Other  | 1.9                         | 9.6            | 10.4           | 40.0           |
| <b>Total steel sales</b>                           | <b>1,708.1</b>              | <b>2,676.1</b> | <b>2,691.1</b> | <b>2,924.2</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 twelve facilities throughout North America. At December 31, 2008, our crude steel production capacity was 4.5 million tons, of which 1.2 million tons were based on an integrated blast furnace technology, and 3.3 million were based on electric arc furnace, or mini-mill, technology. Our Mexican facilities have 1.9 million tons of crude steel production capacity, operating five mini-mill facilities. Our U.S. operations have 2.6 million tons of crude steel production capacity. In addition, we have 3.5 million tons of rolling and finishing capacity, of which 1.8 million are located in Mexico, and 1.7 million are located in the United States and Canada.

We operate six mini-mills, five in Mexico and one in the United States. The Mexican mini-mills are located in Guadalajara, Jalisco; Apizaco, Tlaxcala; Mexicali, Baja California; as well as two in San Luis Potosi, San Luis Potosí. Our mini-mill in the United States is located in Canton, Ohio, and we have completed a revamping process that has increased capacity of the mill to 1.3 million tons of steel billet in 2007. We also operate an integrated blast furnace in Lorain, Ohio. 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 the products manufactured at the Republic facilities starting from July 22, 2005. These figures reflect the sales of products manufactured at the San Luis facilities from June 1, 2008, through December 31, 2008.

### Production Volume and Capacity Utilization

|  | Years ended December 31, |         |         |         |
|--|--------------------------|---------|---------|---------|
|  | 2005                     | 2006    | 2007    | 2008    |
|  | (tons in thousands)      |         |         |         |
| <b>Melt shops</b>                        |                          |         |         |         |
| Steel billet production                  | 1,748.2                  | 2,985.6 | 2,899.2 | 3,228.3 |
| Annual installed capacity <sup>(1)</sup> | 3,115.9                  | 3,763.7 | 3,827.2 | 4,532.2 |
| Effective capacity utilization           | 89.6%                    | 79.3%   | 75.7%   | 76.2%   |
| <b>Rolling mills</b>                     |                          |         |         |         |
| Total production                         | 1,544.0                  | 2,386.0 | 2,384.6 | 2,463.6 |
| Annual installed capacity <sup>(1)</sup> | 2,847.5                  | 2,901.9 | 2,901.9 | 3,521.9 |
| Effective capacity utilization           | 81.6%                    | 82.2%   | 82.2%   | 75.5%   |

- (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 2005 is determined in the case of Republic facilities based on utilization over the period from July 22 to December 31, 2005. The percentage of effective capacity utilization for 2008 is determined in the case of San Luis facilities based on utilization over the period from June 1 to December 31, 2008.

*Mexican Operations and Facilities*

The following table presents production by product at each of our Mexican facilities as a percentage of total production at that facility for the year ended December 31, 2008.

**Mexican Production per Facility by Product**

| Product   | Guadalajara | Mexicali | Location        |          | Total |
|---|-------------|----------|-----------------|----------|-------|
|   |             |          | Apizaco/Cholula | San Luis |       |
|   |             |          | (Production %)  |          |       |
| I Beams   | 17.7%       | 0%       | 0%              | 0%       | 5.3%  |
| Channels  | 11.4%       | 9.1%     | 0%              | 0%       | 5.0%  |
| Angles  | 25.6%       | 16.4%    | 0%              | 0%       | 10.6% |
| Hot rolled bars (round,<br>square and hexagonal rods) | 23.7%       | 7.1%     | 41.3%           | 2.1%     | 21.6% |
| Rebar   | 9.9%        | 52.9%    | 26.6%           | 82.6%    | 37.8% |
| Flat bars   | 7.0%        | 2.6%     | 19.2%           | 0%       | 8.6%  |
| Cold finished bars                                    | 2.8%        | 0%       | 12.9%           | 0%       | 4.9%  |
| Electro-Welded wire mesh                              | 0%          | 0%       | 0%              | 6.4%     | 1.4%  |
| Wire rod  | 0%          | 0%       | 0%              | 5.7%     | 1.2%  |
| Electro-Welded wire mesh panel                        | 0%          | 0%       | 0%              | 2.1%     | 0.4%  |
| Other   | 1.9%        | 11.9%    | 0%              | 1.1%     | 3.2%  |
| Total   | 100%        | 100%     | 100%            | 100%     | 100%  |

*Guadalajara.* Our Guadalajara mini-mill facility is located in central western Mexico in Guadalajara, Jalisco which is Mexico's second 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 2008, the Guadalajara mini-mill produced 297,757 tons of steel billet and 379,275 tons of finished product operating at 85% capacity for billet production and 79% 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, |           |           |            |
|---|--------------------------|-----------|-----------|------------|
|   | 2005                     | 2006      | 2007      | 2008       |
| Steel sales (thousands of tons)                                   | 407                      | 407       | 405       | 377        |
| Average finished product price per ton                            | Ps. 7,024                | Ps. 7,762 | Ps. 7,832 | Ps. 10,749 |
| Average scrap cost per ton  | 2,510                    | 2,520     | 2,831     | 3,798.9    |
| Average manufacturing conversion cost per ton of finished product | 1,763                    | 1,809     | 2,141     | 2,861.9    |
| Average manufacturing conversion cost per ton of billet           | 1,125                    | 1,203     | 1,349     | 1,641.5    |

*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 2008, the Mexicali mini-mill produced approximately 364,468 tons of billet, of which the Guadalajara mini-mill used 118,907 tons, the Apizaco mini-mill used 20,776 tons, and we sold 23,257 tons to third parties. In 2008, the Mexicali mini-mill produced 191,138 tons of finished product. In 2008 we operated the Mexicali mini-mill at 85% capacity for billet production and at 76% 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 2008, 60% of the products produced at the Mexicali mini-mill were rebar, 18% were angles, 8% were hot rolled bars (round, square and hexagonal rods) and the remaining 14% were other products, principally channels and flat bars.

### Mexicali Mini-Mill

|   | Years ended December 31, |           |           |           |
|---|--------------------------|-----------|-----------|-----------|
|   | 2005                     | 2006      | 2007      | 2008      |
| Steel sales (thousands of tons)                                   | 210                      | 224       | 227       | 212       |
| Average finished product price per ton                            | Ps. 6,086                | Ps. 7,188 | Ps. 7,282 | Ps. 9,944 |
| Average scrap cost per ton  | 2,179                    | 2,155     | 2,757     | 3,856.2   |
| Average manufacturing conversion cost per ton of finished product | 1,624                    | 1,700     | 1,690     | 2,352.5   |
| Average manufacturing conversion cost per ton of billet           | 973                      | 1,020     | 1,083     | 1,547.8   |

*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 400,000 tons of steel billet and an annual installed capacity of finished product of 430,000 tons. In 2008, the Apizaco mini-mill produced 365,246 tons of steel billet, of which the Guadalajara mini-mill used 12,813 tons, and 348,920 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 50,000 tons. In 2008, the Cholula facility produced 47,198 tons of finished product, at 94% capacity. Our Cholula facility mainly produces cold finished SBQ steel.

In 2008, 27% of the products we produced at the Apizaco and Cholula facilities were rebar, 41% were hot rolled bars (round, square and hexagonals) and the remaining 32% were other products, flat merchant bar and cold finished products.

**Apizaco Mini-Mill and Cholula Facility**

|   | <b>Years ended December 31,</b> |             |             |             |
|---|---------------------------------|-------------|-------------|-------------|
|   | <b>2005</b>                     | <b>2006</b> | <b>2007</b> | <b>2008</b> |
| Steel sales (thousands of tons)                                   | 416                             | 425         | 448         | 387         |
| Average finished product price per ton                            | Ps. 7,105                       | Ps. 7,560   | Ps. 7,866   | Ps. 10,561  |
| Average scrap cost per ton  | 2,942                           | 2,852       | 3,035       | 4,170.0     |
| Average manufacturing conversion cost per ton of finished product | 2,241                           | 2,447       | 2,749       | 3,227.4     |
| Average manufacturing conversion cost per ton of billet           | 1,517                           | 1,496       | 1,521       | 1,950.1     |

*San Luis Operations and Facilities.* We have operated our San Luis facilities since we acquired them on May 30, 2008. The facilities are located in central Mexico in San Luis Potosi, in the state of San Luis Potosi. Our San Luis facilities and equipment include four electric arc furnaces, three continuous casters, three reheating furnaces, two rebar rolling mills and one wire rod rolling mill. As of December 31, 2008, these facilities had an annual installed capacity of 705,000 tons of billet and 620,000 tons of finished product. From June 1 to December 31, 2008, the San Luis facilities produced 345,616 tons of steel billet and 293,397 tons of finished product operating at 84% capacity for billet production and 81% capacity for finished product production. Our San Luis facilities mainly produces rebar, light structurals and wire rod. In 2008, 80% of the products produced at the San Luis facilities were rebar, 18% wire rod, and the remaining 2% were other light structural.

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

|   | June 1      | December 31 |
|---|-------------|-------------|
|   | <b>2008</b> |             |
| Steel sales (thousands of tons)                                   | 261         |             |
| Average finished product price per ton                            | Ps. 9,701   |             |
| Average scrap cost per ton  | 3,658.6     |             |
| Average manufacturing conversion cost per ton of finished product | 2,269.5     |             |
| Average manufacturing conversion cost per ton of billet           | 1,571.1     |             |

*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, 2008, these facilities had an annual installed capacity of 2,647,000 tons of billet and 1,692,000 tons of finished product. In 2008, the Republic facilities produced 1,855,200 tons of steel billet, of which 350,270 tons were sold as semi-finished tube rounds. 253,560 tons were sold as other semi-finished trade products and 8,453 tons were sold as ingots. The remainder went to the Lorain, Ohio and Lackawanna, New York facilities for further processing. For the same period, the Republic facilities produced 1,046,900 tons of hot-rolled bar, of which 140,160 tons were used by the cold finish facilities. The Republic facilities produced 156,040 tons of cold finish bars. During this period, 56% of the products shipped from the Republic facilities were hot-rolled bars, 8% were cold-finished bars, 21% were semi-finished tube rounds, and 15% were other semi-finished trade products.



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

|  | July 22     | Years ended December 31, |           |            |
|--|-------------|--------------------------|-----------|------------|
|  | December 31 |                          |           |            |
|  | 2005        | 2006                     | 2007      | 2008       |
| Steel sales (thousands of tons)  | 675         | 1,620                    | 1,611     | 1,687      |
| Average finished product price per ton   | Ps. 8,891   | Ps. 8,571                | Ps. 9,566 | Ps. 13,281 |
| Average scrap cost per ton   | 1,941       | 2,301                    | 2,785     | 4,644      |
| Average iron ore pellet cost per ton   | 697         | 677                      | 892       | 1,057      |
| Average manufacturing conversion cost per ton of finished product <sup>(1)</sup> | 5,428       | 4,771                    | 5,724     | 6,499      |
| Average manufacturing conversion cost per ton of billet <sup>(1)</sup>           | 4,021       | 3,530                    | 4,370     | 5,028      |

(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, two ladle metallurgy facilities, 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, 2008, an annual installed capacity of 1,264,000 tons of steel billet and 838,000 tons of finished product. During 2008, the Lorain facility, was operated at 76.5% capacity for steel billet and for finished product, 70.4% for 9-10 rolling mill and 72% for 20 mill finishing and shipping production, and it produced 967,075 tons of billets and 596,030 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 2008, the Canton facility had annual installed capacity of 1,383,000 tons of steel billet. In 2008, this facility produced 888,149 tons of blooms, billets and other semi-finished trade product and was operated at 64.2% 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 31, 2008, the Lackawanna facility had annual installed capacity of 599,000 tons of hot rolled bars. In 2008, this facility produced 451,241 tons of hot rolled bars and was operated at 75.4% 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, 2008, an annual installed capacity of 125,000 tons of finished product. During 2008, the Massillon facility was operated at 74% capacity of finished product and produced 93,079 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 31, 2008, the Gary facility had annual installed capacity of 71,000 tons of cold finished bars. In 2008, this facility produced 33,204 tons of cold finished bars and was operated at 47% 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 31, 2008, the Hamilton facility had annual installed capacity of 59,000 tons of cold finished bars. In 2008, this facility produced 30,119 tons of cold finished bars and was operated at 51% 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:

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

| <b>Location</b>                  | <b>Product (%)</b>   | <b>Equipment</b>   | <b>2008 Annual<br/>Production<br/>Volume (tons)</b> | <b>Finished Product<br/>Annual<br/>Installed<br/>Capacity (tons)(1)</b> |
|----------------------------------|--|--|---|---|
| Guadalajara                      | Structurals (43%); Light structurals (22%); SBQ (25%), Rebar (10%) | electric arc furnace with continuous caster, rolling mill and bar processing lines   | 379,275   | 480,000   |
| Mexicali                         | Structurals (11%); Rebar (60%); Light structurals (29%)            | electric arc furnace with continuous caster and bar rolling mills  | 191,138   | 250,000   |
| Apizaco and Cholula              | SBQ (54%); Rebar (27%); Light structurals (19%)                    | electric arc furnace with vacuum tank degasser, continuous caster, bar rolling mills, cold drawn and bar turning equipment | 396,118   | 480,000   |
| Aceros DM, San Luis Potosí       | Rebar (70%), Light structurals (4%), Wire rod (26%)                | three electric arc furnaces, two continuous casters, two reheating furnaces, rebar rolling mill and wire rod rolling mills | 201,417   | 233,333   |
| Aceros San Luis, San Luis Potosí | Rebar (100%)   | electric arc furnace, continuous caster, reheating furnace and rebar rolling mill  | 91,980  | 128,333   |
| Lorain(2)                        | SBQ (100%)   | blast furnace, vacuum tank degasser, continuous caster, bar and wire rod rolling mills                                     | 596,030   | 838,000   |
| Canton(3)                        | SBQ (100%)   | electric arc furnace, vacuum tank degasser, continuous caster, rolling mills   | 888,149   | 1,383,000   |
| Lackawanna                       | SBQ (100%)   | reheat furnace, bar and wire rod rolling mills   | 451,241   | 599,000   |
| Massillon                        | SBQ (100%)   | cold drawn bar turning and heat treating equipment   | 93,079  | 125,000   |

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|          |            |  |        |        |
|----------|------------|--|--------|--------|
| Gary     | SBQ (100%) | cold drawn bar turning<br>and heat treating<br>equipment | 33,204 | 71,000 |
| Hamilton | SBQ (100%) | cold drawn bar turning<br>and heat treating<br>equipment | 30,119 | 59,000 |

- 
- (1) At December 31, 2008. The percentage of effective capacity utilization for 2008 is determined in the case of San Luis facilities based on utilization over the period from June 1 to December 31, 2008.
- (2) Production capacity are for rolling only.
- (3) Production capacity are for billets only.

## 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. In 2008, approximately 67% of our steel product sales represented SBQ steel products, of which we sold 26% to the auto part industry, 32% to service centers, 19% for energy related products, 1% for hand tools, 2% for mining equipment and the remaining 20% to other industries.

The following table sets forth, for the periods indicated, our Mexico, U.S. and Canada product sales as a percentage of our total product sales. These figures reflect 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(1) |      |      |      |
|--|--------------------------|------|------|------|--------------------|------|------|------|
|  | Years ended December 31, |      |      |      |                    |      |      |      |
|  | 2005                     | 2006 | 2007 | 2008 | 2005               | 2006 | 2007 | 2008 |
| I-Beams  | 99%                      | 96%  | 97%  | 92%  | 1%                 | 4%   | 3%   | 8%   |
| Channels   | 81%                      | 66%  | 67%  | 58%  | 19%                | 34%  | 33%  | 42%  |
| Angles   | 94%                      | 92%  | 81%  | 77%  | 6%                 | 8%   | 19%  | 23%  |
| Hot-rolled bars(round, square<br>and hexagonal rods) | 10%                      | 15%  | 21%  | 19%  | 90%                | 85%  | 79%  | 81%  |
| Rebar  | 66%                      | 88%  | 67%  | 81%  | 34%                | 12%  | 33%  | 19%  |
| Flat bar   | 98%                      | 97%  | 97%  | 86%  | 2%                 | 3%   | 3%   | 14%  |
| Cold drawn finished bars                             | 40%                      | 26%  | 26%  | 29%  | 60%                | 74%  | 74%  | 71%  |
| Semi-finished tube rounds                            | 0%                       | 0%   | 0%   | 0%   | 100%               | 100% | 100% | 100% |
| Other semi-finished trade<br>products                | 0%                       | 0%   | 0%   | 0%   | 100%               | 100% | 100% | 100% |
| Electro-Welded wire mesh                             | -                        | -    | -    | 100% | -                  | -    | -    | 0%   |
| Wire rod   | -                        | -    | -    | 100% | -                  | -    | -    | 0%   |
| Electro-Welded wire mesh<br>panel                    | -                        | -    | -    | 100% | -                  | -    | -    | 0%   |
| Other  | 100%                     | 100% | 99%  | 100% | 0%                 | 0%   | 1%   | 0%   |
| Total (weighted average)                             | 53%                      | 35%  | 33%  | 35%  | 47%                | 65%  | 67%  | 65%  |

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

During the year ended December 31, 2008, approximately 58% 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 42% of our sales by volume, with SBQ products representing approximately 22% of such sales and the remainder representing commercial steel products. Approximately 65% 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 four full-time employees in Mexico dedicated exclusively to exports.

During 2008 and 2007, 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 ordered by our customers prior to production. There can be no assurance that significant levels of preproduction sales orders will continue.

In our Republic plants, 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, Chrysler LLC, Honda of America MFG, Inc. and Caterpillar Inc., first tier suppliers to automotive and industrial equipment manufacturers such as American Axle & Manufacturing Holdings, Inc., ArvinMeritor, Inc., Delphi, NTN Driveshaft, Inc., TRW Automotive Holdings Corp.; 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.

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**

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 would likely be materially and adversely affected.

Since most of our sales are in the United States and Canada, we face strong competition from other steel producers in the United States and Canada. Approximately 32% of our sales in 2008 were in Mexico where we face strong competition from other Mexican steel producers. A number of our competitors in the United States, Canada and Mexico 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 will face increased competition from them and may experience a loss of market share. In each of the United States, Canada and Mexico we also face competition from international steel producers. Increased international competition, especially when combined with excess production capacity, would likely force us to lower our prices or to offer increased services at a higher cost to us, which could materially reduce our gross margins and net income.

### *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. 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 variety of products help us to maintain our competitive market position in Mexico and in the southwestern United States. We believe that our Mexicali mini-mill, one of the closest mini-mills to the southern California market, is competitive in terms of production and transportation costs 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 we have an advantage over certain competitors due to the labor cost in our Mexican operations.

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), we believe that in 2008 we were the sole Mexican producer of 5 inch, 6 inch and 200 mm I-beams, and that during such period there was one other producer of 4-inch I-beams. These products accounted for approximately 66,239 tons, or approximately 2%, and approximately 71,827 tons, or approximately 3%, of our total finished product sales in 2008 and 2007, respectively. The revenue that we derived from I-beam products represented approximately 3% and 2% of our net sales in 2007 and 2008, respectively.

In 2008, we sold approximately 180,576 tons of I-beams, channels and angles at least three inches in width (including the 66,239 tons of I-beams described above) which represented approximately 6% of our total finished product sales for the year. In 2007, we sold approximately 227,970 tons of I-beams, channels and angles at least three inches in width (including the 71,827 tons of I-beams described above) which represented approximately 8% 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 45% in 2008 and 59% in 2007.



In 2008, we sold approximately 1,398,445 tons of hot rolled and cold finished steel bar, compared to 1,404,256 tons in 2007. 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 was 14% and 51%, respectively, in 2008 compared to 7% and 56%, respectively, in 2007. Rebar and light structural steel together accounted for approximately 670,131 tons, or 23%, of our total production of finished steel products in Mexico and the United States in 2008, compared to approximately 516,168 tons, or 19%, in 2007. 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 Aceralia Perfiles Bergara, S.A., Chaparral Steel Company, 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, 2008 as follows:

- auto parts industry, 59%,
- service centers, 22%,
- mining equipment, 11%,
- hand tools, 5%, and
- bar processing industry, 3%.

We believe that 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 cost advantages relative to certain U.S. producers when shipping to customers in central and southern Mexico, and our flexible production facility has given 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 its 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. 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 believe our principal competitors in the U.S. market, depending on the product, include Nucor Corporation, Niagara LaSalle, Arcelor Mittal, Charter Steel, Steel Dynamics, Inc., The Timken Company and Gerdau Macsteel.

## 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 19, 2007 to July 18, 2010 and are working in the process to obtain the ISO/TS 16949 certification.

Our U.S. operations are currently ISO/TS 16949:2002 certified. The ISO/TS 16949:2002 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 and OHSAS 18001 certified. Through these certifications, Republic's Environmental, Health & Safety Management System is structured upon training, communication, employee participation, document control, objective and target setting, and management's periodic reviews to implement our commitments to environmental protection and providing a safe and clean workplace. Most of the automotive customers of our Republic facilities require ISO 14001 certification, however, OHSAS 18001 is voluntary. The ISO 14001 certification is effective until November 2010 and the OHSAS 18001 is effective until February 2012.

## Raw Materials

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.

In 2008, our cost of sales in Mexico, as a percentage of sales in Mexico, was 66% compared to our U.S. operations where our cost of sales, as a percentage of sales in the U.S., was 96%, and our consolidated cost of sales, as a percentage of consolidated sales, was 85%. 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 costs of the raw materials that our U.S. operations use in the production of SBQ steel.

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 42% of our consolidated direct cost of sales in 2008 (51% of the direct cost in our Mexico operations and 27% of the direct cost in our U.S. operations) and 34% of our direct cost of sales in 2007 (49% of the direct cost in our Mexico operations and 19% 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, San Luis, 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 7% and 6% of our refined scrap tonnage in 2008 and 2007, respectively, and (ii) purchases from third party scrap processors in Mexico and the southwestern United States, which, in the aggregate, provided us with approximately 91% and 2%, respectively, in 2008 and approximately 89% and 5%, respectively, in 2007 of our refined ferrous scrap requirements. We are a large 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 22.6% of our U.S. and Canadian facilities' direct costs for the year ended December 31, 2008. The iron ore pellets and coke made up 7.9% and 14.7%, respectively, of the direct costs of sales in this period. We purchased 50% of our iron ore pellet and 100% 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 11% of our direct cost of sales in 2008 and 11% in 2007, and they accounted for 21% of our direct cost of sales for the year ended December 31, 2008 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 obtained 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 purchased 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 13% of our consolidated costs, 8% of the direct costs incurred at our Mexican operations and 18% of the direct costs incurred at our U.S. operations.

*Electricity.* As of December 31, 2008, electricity accounted for approximately 5.4% of our consolidated direct cost of sales for the period (11.3% of the direct cost of our Mexican operations and 3% of the direct cost of our U.S. operations). Electricity accounted for 11.3% of our direct cost of sales in 2008 and 10% of direct cost of sales in 2007 in our Mexico facilities and is supplied by the *Comisión Federal de Electricidad* ( CFE ). It accounted for 3% of direct costs of sales in 2008 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 2007 and 2008, the Mexicali facility entered into a new contract with Sempra for the period May through October 2007 and May to October 2008, respectively.

*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 5.4% of our consolidated direct cost of sales (4.6% of the direct cost of our Mexican operations and 5.4% of the direct cost of our U.S. operations) in 2008. 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 2(g) to our consolidated financial statements, derivative financial instruments are recognized in the balance sheet at fair value, which is initially represented by the amount of consideration agreed on. Such fair value is restated at the end of each month based on the new estimate. We periodically evaluate the changes in the cash flows of derivative instruments to analyze if the swaps are highly effective for mitigating the exposure to natural gas price fluctuations. In 2008, 2007 and 2006, all derivative instruments qualified as hedging instruments of the cash flow type and the fair value and subsequent changes were recorded under stockholders equity as Comprehensive income, net of the deferred tax effect, until such time as the related hedged position is recognized in income. At this time, the hedging instrument s fair value is recognized in income.

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

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*.

## Regulation

### *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 adverse 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 at present believe that such materials are being managed in accordance with applicable law.

*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 material 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. Nevertheless, we cannot assure you that the trade agreements affecting our business or the enforcement thereof will not change in a manner that could have a material adverse effect on our business, results of operations, financial condition or prospects.

*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 continued until March 2004 and the Association was signed after fourteen rounds of negotiations. 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 benefited 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.

### C. Organizational Structure

The chart below sets forth a summary of our corporate structure at December 31, 2008:

- 
- (1) Includes the following subsidiaries: Compañía Siderúrgica del Pacífico, S.A. de C.V. (99.99%), Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V. (100%), Comercializadora Simec, 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%), Arrendadora Norte de Matamoros, S.A. de C.V. (100%), Siderúrgica de Baja California, S.A. de C.V. (99.95%), CSG Comercial, S.A. de C.V. (99.95%), Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V. (99.95%), Productos Siderúrgicos de Tlaxcala, S.A. de C.V. (100%), Comercializadora MSAN, S.A. de C.V. (100%), Comercializadora Aceros DM, S.A. de C.V. (100%), Promotora de Aceros San Luis, S.A. de C.V. (100%) and Compañía Siderúrgica de Guadalajara S.A. de C.V. (99.99%).
  - (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, all of which are owned directly by Simec International.
  - (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. 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, all of which are owned directly by Republic.
  - (5) Simec owns 100% of Grupo San (Corporación Aceros DM, S.A. de C.V.) and its subsidiaries.

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The following table identifies each of our significant operating subsidiaries, including its country of incorporation and our percentage ownership thereof:

| Name of Subsidiary  | Country of Incorporation | Ownership Interest (%) |
|---|--------------------------|------------------------|
| Simec International, S.A. de C.V.   | Mexico                   | 100 %                  |
| Undershaft Investments, N.V.  | Netherlands Antillas     | 100 %                  |
| Pacific Steel, Inc.   | USA                      | 100 %                  |
| SimRep Corporation  | USA                      | 50.22 %                |
| Republic Engineered Products, Inc:  | USA                      | 50.22 %                |
| Compañía Siderúrgica del Pacífico, S.A. de C.V.   | Mexico                   | 99.99 %                |
| Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V.   | Mexico                   | 100 %                  |
| Comercializadora Simec, S.A. de C.V. (since 2007, before Administradora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V.) | Mexico                   | 100 %                  |
| Industrias del Acero y del Alambre, S.A. de C.V.  | Mexico                   | 99.99 %                |
| Procesadora Mexicali, S.A. de C.V.  | Mexico                   | 99.99 %                |
| Servicios Simec, S.A. de C.V.   | Mexico                   | 100 %                  |
| Sistemas de Transporte de Baja California, S.A. de C.V.   | Mexico                   | 100 %                  |
| Operadora de Metales, S.A. de C.V.  | Mexico                   | 100 %                  |
| Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.   | Mexico                   | 100 %                  |
| Administradora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.  | Mexico                   | 100 %                  |
| Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V.  | Mexico                   | 100 %                  |
| Arrendadora Simec S.A. de C.V.  | Mexico                   | 100 %                  |
| Controladora Simec S.A. de C.V. (merged)  | Mexico                   | 100 %                  |

with Grupo Simec in 2008)

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|   |        |         |
|---|--------|---------|
| Compañía Siderúrgica de Guadalajara S.A. de C.V.  | Mexico | 99.99 % |
| Arrendadora Norte de Matamoros, S.A. de C.V. (since 2007)   | Mexico | 100 %   |
| Tenedora CSG, S.A. de C.V. (merged with Grupo Simec in 2008)  | Mexico | 100 %   |
| CSG Comercial, S.A. de C.V. (since 2007, before TMM America, S.A. de C.V. )   | Mexico | 99.95 % |
| Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V. (since 2007, before TMM Continental, S.A. de C.V.) | Mexico | 99.95 % |
| Siderúrgica de Baja California, S.A. de C.V. (since 2007, before Multimodal Domestic, S.A. de C.V.)                 | Mexico | 99.95 % |
| Corporación Aceros DM, S.A. de C.V. and subsidiaries (since 2008)   | México | 100 %   |
| Productos Siderúrgicos de Tlaxcala, S.A. de C.V. (since 2008)   | México | 100 %   |
| Comercializadora MSAN, S.A de C.V. (since 2008)   | México | 100 %   |
| Comercializadora Aceros DM, S.A. de C.V. (since 2008)   | México | 100 %   |
| Promotora de Aceros San Luis, S.A. de C.V. (since 2008)   | México | 100 %   |
| Northarc Express, S.A. de C.V. (since 2008)   | México | 99.95 % |

### **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.

We currently estimate capital expenditures for the year 2009 will be approximately \$35.2 million (Ps. 476.5 million), consisting of \$16.8 million (Ps. 227 million) of estimated capital expenditures in our Republic facilities and \$18.4 million (Ps. 249 million) of capital expenditures in our facilities in Mexico. Nevertheless, this estimate is subject to certain uncertainties and actual capital expenditures in 2009 may differ significantly from such estimate.

In 2008, we spent \$28 million (Ps. 331 million) on capital investments at our Republic facilities, including \$13.8 million (Ps. 163 million) at the Canton, Ohio facility, \$2.5 million (Ps. 30 million) at the Lorain, Ohio facility, \$9.5 million (Ps. 112 million) at the Lackawanna, New York facility, \$1 million (Ps. 12 million) at the Massillon, Ohio facility, \$0.1 million (Ps. 1 million) at the Gary, Indiana facility and \$1.1 million (Ps. 13 million) at our corporate location in Fairlawn, Ohio. We spent \$13 million (Ps. 149 million) on capital improvements at our facilities in

Mexico, including \$2 million (Ps. 24 million) at the Apizaco facility, \$6 million (Ps. 71 million) at the Mexicali facility, \$1 million (Ps. 15 million) at the Guadalajara facility, \$3 million (Ps. 32 million) at the San Luis facilities and \$1 million (Ps. 7 million) in the acquisition of land in the state of Tamaulipas, México.

In 2007, we spent \$27 million (Ps. 293 million) on capital investments at our Republic facilities, including \$7.8 million (Ps. 85 million) at the Canton, Ohio facility, \$17.2 million (Ps. 187 million) at the Lorain, Ohio facility, \$1.3 million (Ps. 14 million) at the Lackawanna, New York facility, \$0.2 million



(Ps. 2 million) at the Massillon, Ohio facility, \$0.1 million (Ps. 1 million) at the Hamilton, Ontario, Canada facility, \$0.2 million (Ps. 2 million) at the Gary, Indiana facility and \$0.3 million (Ps. 3 million) at our corporate location in Fairlawn, Ohio. We spent \$18 million (Ps. 193 million) on capital improvements at our facilities in Mexico, including \$7 million (Ps. 77 million) at the Apizaco facility, \$8 million (Ps. 89 million) at the Mexicali facility and \$2 million (Ps. 17 million) at the Guadalajara facility and \$1 million (Ps. 10 million) in the acquisition of land in the state of Tamaulipas, México.

In 2006, we spent \$30.3 million (Ps. 342 million) on capital investments at our Republic facilities, including \$13.5 million (Ps. 152 million) at the Canton, Ohio facility, \$15.7 million (Ps. 177 million) at the Lorain, Ohio facility, \$0.6 million (Ps. 6.7 million) at the Lackawanna, New York facility, \$0.2 million (Ps. 2.3 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 \$0.02 million (Ps. 0.2 million) at our corporate location in Fairlawn, Ohio. We spent \$6.7 million (Ps. 75 million) on capital improvements at our facilities in Mexico, including \$5 million (Ps. 56 million) at the Apizaco facility, \$1.6 million (Ps. 18 million) at the Mexicali facility and \$0.1 million (Ps. 1 million) at the Guadalajara facility.

#### **Item 4A. Unresolved Staff Comments**

There are no unresolved written comments received from the staff of the Securities and Exchange Commission regarding our periodic reports under the United States Securities Exchange Act of 1934, as amended.

#### **Item 5. Operating and Financial Review and Prospects**

The following discussion is derived from our audited financial statements, which are presented elsewhere in this annual report. 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 MFRS, which differ in certain significant respects from U.S. GAAP. See Note 18 to our consolidated financial statements included elsewhere herein for the years ended December 31, 2006, 2007 and 2008 for a summary of the principal differences between MFRS 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 a statement of cash flows under U.S. GAAP. Our consolidated financial statements and all other financial information contained herein with respect to the years ended December 31, 2006 and 2007 are presented in constant pesos with purchasing power as of December 31, 2007, unless otherwise noted. As of January 1, 2008 and as a result of the adoption of the Mexican Financial Reporting Standard MFRS B-10, Effects of inflation, we ceased recognizing the impact of inflation on our financial information for the year 2008. However, in the case of the financial information presented for the years ended on December 31, 2007 and 2006, it is expressed in peso purchasing power as of December 31, 2007, the last date on which we applied the method of comprehensive recognition of inflation.

## A. Operating Results

### 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. The sharp reduction in economic activity and consumer demand in general, and in the construction, appliance, and automotive industries in particular, in North America starting in the fourth quarter of 2008 has had a significant negative impact on the demand and price levels for all steel products, including SBQ and structural steel products. The steel industry as a whole is greatly impacted by the business cycle, and the current global downturn has depressed demand for new commercial and residential construction and new automobiles in particular within the United States and the rest of North America, and this has had an impact on all segments of operations since the fourth quarter of 2008.

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, many of our products are SBQ products for which competition is limited, therefore generating somewhat higher margins 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 gross 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. Although our revenues and costs fluctuate from quarter to quarter, we do not experience large fluctuations due to seasonality.

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.

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Sales Volume, Price and Cost Data, 2006 - 2008

|                                     | Year ended December 31, |        |        |
|-------------------------------------|-------------------------|--------|--------|
|                                     | 2006                    | 2007   | 2008   |
| Shipments (thousands of tons)       | 2,676                   | 2,691  | 2,924  |
| Guadalajara and Mexicali            | 631                     | 632    | 589    |
| Apizaco and Cholula                 | 425                     | 448    | 387    |
| San Luis facilities                 | -                       | -      | 261    |
| Republic facilities                 | 1,620                   | 1,611  | 1,687  |
| Net sales (Ps. millions)            | 23,515                  | 24,106 | 35,185 |
| Guadalajara and Mexicali            | 4,891                   | 4,888  | 6,161  |
| Apizaco and Cholula                 | 3,129                   | 3,519  | 4,087  |
| San Luis facilities                 | -                       | -      | 2,532  |
| Republic facilities                 | 15,495                  | 15,699 | 22,405 |
| Direct cost of sales (Ps. millions) | 19,131                  | 20,498 | 29,796 |
| Guadalajara and Mexicali            | 2,747                   | 3,123  | 3,995  |
| Apizaco and Cholula                 | 2,232                   | 2,593  | 2,963  |
| San Luis facilities                 | -                       | -      | 1,444  |
| Republic facilities                 | 14,152                  | 14,782 | 21,394 |
| Average price per ton (Ps.)         | 8,787                   | 8,958  | 12,033 |
| Guadalajara and Mexicali            | 7,751                   | 7,734  | 10,460 |
| Apizaco and Cholula                 | 7,362                   | 7,855  | 10,561 |
| San Luis facilities                 | -                       | -      | 9,701  |
| Republic facilities                 | 9,565                   | 9,745  | 13,281 |
| Average cost per ton (Ps.)          | 7,149                   | 7,617  | 10,190 |
| Guadalajara and Mexicali            | 4,353                   | 4,941  | 6,783  |
| Apizaco and Cholula                 | 5,252                   | 5,788  | 7,656  |
| San Luis facilities                 | -                       | -      | 5,533  |
| Republic facilities                 | 8,736                   | 9,176  | 12,682 |

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. Also see Risk Factors.

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

In August 2004, we completed the Atlix Acquisition. In July 2005, we and our controlling shareholder, Industrias CH, completed the acquisition of Republic. We believe that 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, in each sale in terms of sales volume. 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 2008 and 2007, Mexico's GDP increased 1.3% and 3.3%, respectively. In 2008 and 2007, the U.S. GDP increased 1.1% and 2.2%, respectively. Recession or a deterioration in economic conditions in the countries in which we operate is likely to 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. As the 2008 financial crisis worsened in late 2008 and early 2009, global demand for steel fell while new steel production capacity was coming into the market, and as a result steel prices fell worldwide. Average steel prices of finished products sold in the first quarter 2009 decreased approximately 25% compared to the fourth quarter 2008. Average steel prices in 2007 were above those of 2006 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 and were higher than steel prices for the 2004 to 2002 period.

In recent years, there has been a trend toward consolidation of the steel industry. For example, 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. 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 addition, a number of other steel acquisition transactions have been announced, including the acquisition of Oregon Steel by Evraz and the acquisition of Corus by Tata Steel. 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 2008, imports to Mexico increased as international market conditions worsened. In 2007 imports to Mexico increased as international market conditions improved. In 2006, imports to Mexico increased as international market conditions improved. 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 23% of the domestic steel market in 2008 and an estimated 22% in 2007. 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 2004, 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 increased significantly in 2008 and 2007 as economic activity fueled energy demand and the supply and price of oil was impacted by geopolitical events. While natural gas and electricity prices in the United States and Mexico decreased during the fourth quarter of 2008 in response to the financial crisis, they have remained highly volatile.

## **Segment Information**

We are required to disclose segment information in accordance with MFRS B-5 Segment Information which establishes standards for reporting information about operating segments in annual financial statements and requires reporting of selected information about operating segments in interim financial reports issued to shareholders. Operating segments are components of a company about which separate financial information is available that is regularly evaluated by the chief operating decision maker(s) in deciding how to allocate resources and assess performance. The statement also establishes standards for related disclosures about a company's products and services, geographical areas and major customers.

We conduct business in two principal business segments which are organized on a geographical basis:

- Our Mexican segment represents the results of our operations in Mexico including our plants in Mexicali, Guadalajara, Tlaxcala and San Luis Potosí.
- Our USA segment represents the results of our operations of Republic, including its our seven plants of which six are located in the USA and one is located in Canada.

Financial information for each segment follows:

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For the year ended on December 31st, 2008

|   | Mexico        | USA           | Operations<br>between<br>Segments | Total         |
|---|---------------|---------------|-----------------------------------|---------------|
| Net sales   | \$ 12,780,358 | \$ 22,448,283 | \$ (43,421)                       | \$ 35,185,220 |
| Cost of sales   | 8,402,516     | 21,438,719    | (45,072)                          | 29,796,163    |
| Marginal profit   | 4,377,842     | 1,009,564     | 1,651                             | 5,389,057     |
| Indirect overhead, selling and<br>administrative expenses | 1,567,060     | 706,768       | -                                 | 2,273,828     |
| Operating income  | 2,810,782     | 302,796       | 1,651                             | 3,115,229     |
| Other (expense) income, net                               | (29,166)      | 25,250        | -                                 | (3,916)       |
| Financial income (expenses),<br>net                       | 100,522       | (22,000)      | -                                 | 78,522        |
| Exchange loss, net  | (253,183)     | -             | -                                 | (253,183)     |
| Income before income tax                                  | 2,628,955     | 306,046       | 1,651                             | 2,936,652     |
| Income tax  | 937,761       | 98,542        | -                                 | 1,036,303     |
| Net income  | \$ 1,691,194  | \$ 207,504    | \$ 1,651                          | \$ 1,900,349  |

| <b>Other Data</b>                                  | Mexico        | United States<br>of America | Operations<br>Between<br>Segments | Total         |
|--|---------------|-----------------------------|-----------------------------------|---------------|
| Total assets                                       | \$ 19,885,862 | \$ 10,928,155               | \$ -                              | \$ 30,814,017 |
| Depreciation and<br>Amortization                   | 677,339       | 217,967                     | -                                 | 895,306       |
| Additions of property, plant<br>and equipment, net | 148,749       | 331,055                     | -                                 | 479,804       |

For the year ended on December 31st, 2007

|                                | Mexico       | United States<br>Of America | Operations<br>Between<br>Segments | Total         |
|--------------------------------|--------------|-----------------------------|-----------------------------------|---------------|
| Net sales                      | \$ 8,407,018 | \$ 16,118,609               | \$ (419,533)                      | \$ 24,106,094 |
| Cost of sales                  | 5,716,571    | 15,199,112                  | (416,765)                         | 20,498,918    |
| Marginal profit                | 2,690,447    | 919,497                     | (2,768)                           | 3,607,176     |
| Indirect overhead, selling and |              |                             |                                   |               |

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|   |               |              |            |               |
|---|---------------|--------------|------------|---------------|
| administrative expenses                         | 837,246       | 585,913      | -          | 1,423,159     |
| Operating income                                | 1,853,201     | 333,584      | (2,768)    | 2,184,017     |
| Other (expense) income, net                     | (8,666)       | 29,995       | -          | 21,329        |
| Financial income (expenses), net                | 291,189       | (17,876)     | -          | 273,313       |
| Exchange loss, net                              | (37,879)      | -            | -          | (37,879)      |
| Result on monetary position                     | (227,014)     | 32,083       | -          | (194,931)     |
| Income before income tax                        | 1,870,831     | 377,786      | (2,768)    | 2,245,849     |
| Income tax                                      | 435,973       | 184,701      | -          | 620,674       |
| Net income                                      | \$ 1,434,858  | \$ 193,085   | \$ (2,768) | \$ 1,625,175  |
| <b>Other Data</b>                               |               |              |            |               |
| Total assets                                    | \$ 15,221,534 | \$ 7,619,723 | \$ -       | \$ 22,841,257 |
| Depreciation and amortization                   | 334,010       | 215,246      | -          | 549,256       |
| Additions of property, plant and equipment, net | 168,926       | 316,742      | -          | 485,668       |



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For the year ended on December 31st, 2006

|   | Mexico        | United States<br>of America | Operations<br>Between<br>Segments | Total         |
|---|---------------|-----------------------------|-----------------------------------|---------------|
| Net sales   | \$ 8,019,635  | \$ 15,722,015               | \$ (226,353)                      | \$ 23,515,297 |
| Cost of sales   | 4,980,439     | 14,377,065                  | (225,625)                         | 19,131,879    |
| Marginal profit   | 3,039,196     | 1,344,950                   | (728)                             | 4,383,418     |
| Indirect overhead, selling and<br>administrative expenses | 766,768       | 570,564                     | 14,350                            | 1,351,682     |
| Operating income  | 2,272,428     | 774,386                     | (15,078)                          | 3,031,736     |
| Other income, net   | 38,235        | 970                         | -                                 | 39,205        |
| Financial income (expenses),<br>net                       | 47,755        | (823)                       | -                                 | 46,932        |
| Exchange loss, net  | (37,424)      | -                           | -                                 | (37,424)      |
| Result on monetary position                               | (91,773)      | 14,581                      | 4,240                             | (72,952)      |
| Income before income tax                                  | 2,229,221     | 789,114                     | (10,838)                          | 3,007,497     |
| Income tax  | 267,390       | 341,331                     | -                                 | 608,721       |
| Net income  | \$ 1,961,831  | \$ 447,783                  | \$ (10,838)                       | \$ 2,398,776  |
| <b>Other Data</b>   |               |                             |                                   |               |
| Total assets  | \$ 10,537,244 | \$ 7,505,536                | -                                 | \$ 18,042,780 |
| Depreciation and<br>amortization                          | 270,836       | 164,556                     | 14,350                            | 449,742       |
| Additions of property, plant<br>and equipment, net        | 75,885        | 341,334                     | -                                 | 417,219       |

The Company's net sales to foreign or regional customers during 2008, 2007 and 2006 are as follows:

|                         | Sales         |               |               |
|-------------------------|---------------|---------------|---------------|
|                         | 2008          | 2007          | 2006          |
| Mexico                  | \$ 11,366,526 | \$ 7,393,755  | \$ 7,575,777  |
| USA                     | 21,622,442    | 15,296,430    | 14,797,494    |
| Canadá                  | 598,711       | 583,917       | 654,725       |
| Latin America           | 394,998       | 113,058       | 67,185        |
| Other (Europe and Asia) | 1,202,543     | 718,934       | 420,116       |
| Total                   | \$ 35,185,220 | \$ 24,106,094 | \$ 23,515,297 |

**Comparison of Years Ended December 31, 2008, 2007 and 2006***Net Sales*

Net sales increased 46% to Ps. 35,185 million in 2008 (including the net sales generated by the newly acquired plants of Grupo San of Ps. 2,532 million and including sales in Mexico of Ps. 12,780 million and net sales in the United States and Canada of Ps. 22,405 million) compared to Ps. 24,106 million in 2007 (including sales in Mexico of Ps. 8,407 million and net sales in the United States and Canada of Ps. 15,699 million). Our net sales in 2007 increased 3% to Ps. 24,106 million (including sales in Mexico of Ps. 8,407 million and net sales in the United States and Canada of Ps. 15,699 million), compared to Ps. 23,515 million in 2006 (including sales in Mexico of Ps. 8,020 million and net sales in the United States and Canada of Ps. 15,495 million). The increase in sales can be explained due to higher shipments during 2008, compared with 2007 (a 233,078 tons increase), including the net sales generated by the newly acquired plants of Grupo San of 261,167 tons and 34% increase in the average price of steel products. The increase in net sales in 2007 due to higher shipments compared with 2006 (15,065 tons increase). The increase in tons shipped originated mainly in the plant of Apizaco and compensated for the two unexpected stoppages in the rolling lines of the plants in Guadalajara and Apizaco during the periods July 5-8, July 10-13, and September 10-15, as a result of the shortage of natural gas due to the explosions on the property of Petroleos Mexicanos. Shipments of finished steel products increased 9% to 2,924,202 tons in 2008 (including the net sales generated by the newly acquired plants of Grupo San of 261,167 tons) compared to 2,691,124 tons in 2007. Shipments of finished steel products increased 0.5% to 2,691,124 tons in 2007 compared to 2,676,059 tons in 2006.

Sales outside Mexico (including sales by our U.S. subsidiaries) of basic steel products increased 6% to 1,895,966 metric tons in 2008 compared to 1,790,572 metric tons in 2007, while total Mexican sales increased 14% from 900,552 tons in 2007 to 1,028,236 tons in 2008. Sales outside Mexico (including sales by our U.S. subsidiaries) of basic steel products increased 3% to 1,790,572 metric tons in 2007 compared to 1,731,879 metric tons in 2006, while total Mexican sales decreased 5% from 944,180 tons in 2006 to 900,552 tons in 2007.

The average price of steel products increased 34% in real terms in 2008 compared to 2007. The average price of steel products increased 2% in real terms in 2007 compared to 2006. We attribute the 2008 increase to higher prices prevailing in the worldwide steel markets.

*Direct Cost of Sales*

Our direct cost of sales increased 45% from Ps. 20,499 million in 2007 to Ps. 29,796 million in 2008 (including the cost of sales generated by the newly acquired plants of Grupo San of Ps. 1,444 million). Our Direct cost of sales increased 7% from Ps. 19,132 million in 2006 to Ps. 20,499 million in 2007. Direct cost of sales as a percentage of net sales was 85% in each of 2008 and 2007 and was 81% in 2006. The increase in the direct cost of sales is attributable mainly to an increase of 34% in the average cost of raw materials used to produce steel products in 2008 versus 2007, primarily as a result of increases in the price of scrap and certain other raw materials, as well as a 9% increase in shipments. The increase in the Direct Cost of Sales is attributable mainly to an increase of 6% in real terms in the average cost of raw materials used to produce steel products in 2007 versus 2006, primarily as a result of increases in the price of scrap and certain other raw materials and an increase in the labor costs per ton sold, due to the three unexpected stoppages in the rolling lines of the plants in Guadalajara and Apizaco during the

periods July 5-8, July 10-13, and September 10-15, as a result from the shortage in natural gas due to the explosions on the property of Petroleos Mexicanos. 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 increased 34% in real terms in 2008 compared to 2007, primarily as a result of increase in the price of scrap and certain other raw materials. The average cost of raw materials that we used to produce steel products increased 6% in real terms in 2007 compared to 2006, primarily as a result of increase in the price of scrap and certain other raw materials.

### *Gross Profit*

Our gross profit in 2008 increase 49% to Ps. 5,389 million (including the gross profit generated by the newly acquired plants of Grupo San of Ps. 1,088 million) compared to Ps. 3,607 million in 2007. This increase in gross profit was principally due to an increase of 9% in sales volume. Our gross profit in 2007 decreased 18% to Ps. 3,607 million compared to Ps. 4,383 million (including Ps. 1,344 million relating to our Republic facilities) in 2006. As a percentage of net sales, our gross profit was 15% in 2008 and 2007. As a percentage of net sales, our gross profit was 15% in 2007 compared to 19% in 2006. The decline in gross profit is due to the increase in cost of goods sold due to the reasons previously mentioned.

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

Our indirect manufacturing, selling, general, and administrative expenses (including depreciation and amortization) in 2008 increased 60% to Ps. 2,274 million in 2008 (including the operating expenses from the newly acquired plants of Grupo San of Ps. 433 million and the depreciation and amortization of the tangible and intangible assets of Ps. 277 million registered by the acquisition of Grupo San) from Ps. 1,423 million in 2007. Our indirect manufacturing, selling, general, and administrative expenses (including depreciation and amortization) in 2007 increased 5% to Ps. 1,423 million in 2007 from Ps. 1,352 million in 2006.

The operating expenses as a percentage of net sales represented 6% in 2008, 2007 and 2006. We recorded an increase of Ps. 346 million, or 63%, in depreciation and amortization expense, which in 2008 was Ps. 895 million compared to Ps. 549 million in 2007. We recorded an increase of Ps. 99 million, or 22%, in depreciation and amortization expense, which in 2007 was Ps. 549 million compared to Ps. 450 million in 2006. We attribute the increases in 2008 to the inclusion of the depreciation and amortization of the newly acquired plants of Grupo San.

### *Operating Income*

Our operating income increased 43% from Ps. 2,184 million in 2007 to Ps. 3,115 million in 2008 (including Ps. 655 million of operating profit from the newly acquired plants of Grupo San which we began consolidating as of June 1, 2008). Our operating income decreased 28% from Ps. 3,031 million in 2006 to Ps. 2,184 million in 2007. Operating income represented 9%, 9% and 13% of our net sales in 2008, 2007 and 2006, respectively. In 2008 we attribute the increase in operating income due to the

increase of 9% in sales volume (including the net sales generated by the newly acquired plants of Grupo San of 261,167 tons) and an increase of 34% in the average price of steel products.

*Financial Income (Expense)*

We recorded financial expense of Ps. 175 million in 2008 compared to financial income of Ps. 41 million in 2007 and financial expense of Ps. 63 million in 2006. 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 until 2007. We recorded an exchange loss of approximately Ps. 254 million in 2008 compared to an exchange loss of approximately Ps. 37 million in 2007 and 2006. These exchange results reflect the 25% decrease in the value of the peso versus the dollar in 2008, 0.1% decrease in the value of the peso versus the dollar in 2007 and the 1% decrease in the value of the peso versus the dollar in 2006.

Our net interest income was Ps. 79 million in 2008 (reflecting the use of cash and debt for the acquisition of Grupo San) compared to Ps. 273 million of net interest income in 2007. Our net interest income was Ps. 273 million in 2007 compared to Ps. 47 million of net interest income in 2006. The increase in 2007 reflect larger cash balances during this year partly reflecting the capital stock increase in February 2007.

As of January 1, 2008, and as a result of the adoption of the MFRS B-10, Effects of inflation, the Company ceased in recognizing the gain or loss from monetary position on its financial information for the year 2008. We recorded a loss from monetary position of Ps. 195 million in 2007 compared to a loss from monetary position of Ps. 73 million in 2006, reflecting the domestic inflation rate of 3.6 % for the year ended December 31, 2007 as compared to 4.0 % for the year ended December 31, 2006. We attribute the increase to the higher levels of cash and cash equivalents in 2007. The increase in financial income in 2007 reflect larger cash balances during this year partly reflecting the capital increase in February 2007.

*Other Income (Expense), Net*

We recorded other expense, net, of Ps. 4 million in 2008. This amount reflected:

- expense of Ps. 24 million for employee profit sharing;
- other income of Ps. 5 million for by load maneuvers;
- other income of Ps. 3 million in the returns restated for inflation of the value added tax; and
- other income, net, related to other financial operations of Ps. 12 million.

We recorded other income, net, of Ps. 21 million in 2007. This amount reflected:

- income of Ps. 17 million from gain in the derivative instruments;
- other expense of Ps. 8 million for fiscal amnesty offered by the Federal Government,
- gain of Ps. 9 million in the sale of shares; and
- other income, net, related to other financial operations of Ps. 3 million.

We recorded other income, net, of Ps. 39 million in 2006. This amount reflected:

- income of Ps. 16 million for the cancellation of the provision of labor obligations assumed in the acquisition of Atlax;
- gain of Ps. 17 million in the sale of Acosa; and
- other expense, net, related to other financial operations of Ps. 6 million.

### *Income Tax*

For the years ended December 31, 2008, 2007 and 2006 we recorded an income tax provision of Ps. 1,036 million, Ps. 621 million and Ps. 609 million, respectively. These amounts included a provision for deferred income taxes of Ps. 293 million in 2008, Ps. 509 million in 2007 and Ps. (19) million in 2006.

Our effective income tax rates for the fiscal years ended December 31, 2008, 2007 and 2006 were 35.3%, 27.6% and 20% respectively. In 2008, income tax rate was higher than the statutory rate, mainly because the new Flat-Rate Business Tax paid during the year and an increase in the deferred tax valuation allowance. The effective income tax rate in 2006 was less than the statutory rate of 29%, mainly because we amortized all of our remaining deferred credit which is non-taxable income.

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.

The Flat-Rate Business Tax (FRBT) Law was published in the *Official Gazette* on October 1, 2007. This Law came into force on January 1, 2008, and abolished the Asset Tax Law. Current-year FRBT is computed by applying the 17.5% rate (16.5% for 2008 and 17% for 2009) to income determined on the basis of cash flows, net of authorized credits. FRBT shall be payable only to the extent it exceeds income tax for the same period. In other words, to determine FRBT payable, income tax paid in a given period shall first be subtracted from the FRBT of the same period and the difference shall be the FRBT payable. The deferred taxes of the exercise were determined based on the specific rules of each tax.

### *Net Income*

We recorded net income of Ps. 1,900 million, Ps. 1,625 million and Ps. 2,398 million in 2008, 2007 and 2006, respectively. We attribute the increase in 2008 due to an increase of 9% in sales volume (including the net sales generated by the newly acquired plants of Grupo San of 261,167 tons) and an increase of 34% in the average price of steel products. We attribute the decrease in 2007 to an increase of 6% in real terms in the average cost of raw materials used to produce steel products and the average price of steel products increased only 2% in real terms.

### **Critical Accounting Policies**

The discussion in this section is based upon our financial statements, which have been prepared in accordance with MFRS. 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 deferred income taxes, the impairment of property, plant and equipment, impairment of intangible assets and valuation allowance on accounts receivable. We evaluate the recoverability of deferred income tax assets, including those for net operating loss (NOL) carryforwards, considering the probability of not recovering all or a portion of the assets. The final realization of deferred income tax assets depends on the generation of taxable profits in the periods when the temporary differences are deductible. In conducting this evaluation, we consider the expected reversal of deferred income tax liabilities, projected taxable profits and planning strategies. We evaluate periodically the adjusted values of our property, plant and equipment and intangible assets to determine whether there is an indication of potential impairment. Impairment exists when the carrying amount of an asset exceeds 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 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 indefinite lived intangibles including goodwill, due to the current market environment.

In assessing the recoverability of the goodwill and other intangibles the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. The Company performs an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of recorded goodwill is impaired. The impairment review process compares the fair value of the reporting unit in which goodwill resides to its carrying value. The Company estimates the reporting unit's fair value based on a discounted future cash flow approach that requires estimating income from operations based on historical results and discount rates based on a weighted average cost of capital from a market participant perspective. The estimated fair value of this reporting unit as of December 31, 2008 substantially exceeded its respective carrying value; therefore the Company determined there was no impairment of goodwill as of that date. Additionally, the Company reconciles the aggregate fair value of the reporting units to its market capitalization. The total premium of aggregate fair value to market capitalization was approximately 157 percent. The Company's belief that a portion of this is due to the general economic environment was corroborated by independent valuation analyses available to the public that suggested that the market capitalization as of December 2008 was significantly undervalued. Independent estimates of the Company's market capitalization indicate an implied control premium of approximately 41 percent. This implied control premium is consistent with recent observed control premiums. Assumptions used in the analysis considered the current market conditions in developing short and long-term growth expectations. The reconciliation includes such factors as historical and industry multiples, industry performance statistics, and recent comparable transaction pricing among others. A key assumption made is that, in general, business activity will be lower in 2009 and in 2008 and will recover somewhat in 2010. After that time the Company anticipates that their revenues will grow at 5% average per year approximately until 2013. If these estimates or their related assumptions for prices and demand change in the future, we may be required to record impairment charges for these assets not previously recorded.

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 most important new pronouncements that came into force in 2008 are as follows:

#### **MFRS B-2, Statements of Cash Flows**

MFRS B-2 was issued by the CINIF to replace Mexican accounting Bulletin B-12, *Statement of Changes in Financial Position*. This standard establishes the replacement of the statement of changes in financial position by a statement of cash flows as part of the basic financial statements. The main differences between both statements lie in the fact that the statement of cash flows shows the entity's cash receipts and disbursements for the period, while the statement of changes in financial position showed the changes in the entity's financial structure rather than its cash flows. In an inflationary environment, the amounts of both financial statements are expressed in constant Mexican pesos. However, in preparing the statement of cash flows, the entity must first eliminate the effects of inflation for the period and, accordingly, determine cash flows at constant Mexican pesos, while in the statement of changes in financial position, the effects of inflation for the period are not eliminated.

Mexican FRS B-2 establishes that in the statement of cash flows, the entity must first present cash flows derived from operating activities, then from investing activities, the sum of these activities and finally cash flows derived from financing activities. The statement of changes in financial position first shows the entity's operating activities, then financing activities and finally its investing activities. Under this new standard, the statement of cash flows may be determined by applying the direct or indirect method.

The transitory rules of MFRS B-2 establish that the application of this standard is prospective. Therefore, the financial statements for years ended prior to 2008 presented for comparative purposes, should include a statement of changes in financial position, as established by Mexican accounting Bulletin B-12. The company opted to prepare and present its cash flow statement under the indirect method.

#### **MFRS B-10, Effects of Inflation**

MFRS B-10, *Effects of Inflation*, which is applicable for years beginning on or after January 1, 2008 and replaces Mexican accounting Bulletin B-10, *Accounting Recognition of the Effects of Inflation on Financial Information*, defines the two economic environments that will determine whether or not entities must recognize the effects of inflation on financial information: i) inflationary, when inflation is equal to or higher than 26%; accumulated in the preceding three fiscal years; and ii) non-inflationary, when accumulated inflation for the preceding three fiscal years is less than the aforementioned accumulated 26%. Based on these definitions, the effects of inflation on financial information must be recognized only when entities operate in an inflationary environment.

Mexican FRS B-10 also establishes the accounting rules applicable whenever the economy changes from one type of environment to the other. When the economy changes

from an inflationary environment to a non-inflationary one, the entity must maintain in its financial statements the effects of inflation recognized through the immediate prior year, since the amounts of prior periods are taken as the base amounts of the financial statements for the period of change and subsequent periods. Whenever the economy changes from a non-inflationary environment to an inflationary one, the effects of inflation on the financial information must be recognized retrospectively, meaning that all information for prior periods must be adjusted to recognize the accumulated effects of inflation of the periods in which the economic environment was considered non-inflationary.

This standard also abolishes the use of the specific-indexation method for the valuation of imported fixed assets and the replacement-cost method for the valuation of inventories, thus eliminating the result from holding non-monetary assets. Therefore, at the date this Mexican FRS comes into force, entities which have recognized any accumulated result from holding non-monetary assets in their shareholders' equity, under Retained earnings (accumulated deficit), must identify the realized and unrealized portions of such result.

The realized result from holding non-monetary assets must be reclassified to Retained earnings, while the unrealized portion must be maintained as such within shareholders' equity, and reclassified to results of operations when the asset giving rise to it is realized. Whenever it is deemed impractical to separate the realized from the unrealized result from holding non-monetary assets, the full amount of this item may be reclassified to the Retained earnings caption. The company considered that it was impractical to separate the realized from the unrealized result for holding non-monetary asset and the Ps. 132,155 was reclassified to Retained earnings.

Interpretation 9 of MFRS establishes that comparative financial statements for years prior to 2008 must be expressed in Mexican pesos with purchasing power at December 31, 2007, which was the last date on which the effects of inflation were recognized. Therefore amounts as of December 31, 2008 do not include inflation effects, and the comparative figures as of December 31, 2007 and for the years ended December 31, 2007 and 2006, are stated in thousands of pesos as of December 31, 2007.

The effects of the adoption of this standard on the Company's 2008 financial statements resulted in an increase of net income by Ps. 498,428 in the year caused by not recognizing the Result for Monetary assets and inflation effects in the Statement of income

**MFRS B-15, Conversion of foreign currencies and MFRS Interpretation 15, Financial Reporting currency is equal to the recording, but different from the functional.**

MFRS B-15 incorporates the concepts of recording currency, functional currency and reporting currency, and establishes the methodology to translate financial information of a foreign entity, based on those terms. Additionally, this rule is aligned with NIF B-10, which defines translation procedures of financial information from subsidiaries that operate in inflationary and non-inflationary environments. Prior to the application of this rule, translation of financial information from foreign subsidiaries was according to inflationary environments methodology. The requirement and implementation effect of these new MFRS are described in Note 2(d).

**MFRS D-3, Employee Benefits**

On January 1, 2008, the new Mexican FRS D-3, *Employee Benefits*, issued by the CINIF, went into effect and replaced the old Mexican accounting Bulletin D-3, *Labor Obligations*. The most significant changes contained in Mexican FRS D-3 are as follows: i) shorter periods for the amortization of unamortized items, with the option to credit or charge actuarial gains or losses directly to results of operations, as they accrue; ii) elimination of the recognition of an additional liability and resulting recognition of an intangible asset and comprehensive income item; iii) accounting treatment of current-year and deferred employee profit sharing, requiring that deferred employee profit sharing be recognized using the asset and liability method established under Mexican FRS D-4; and iv) current-year and deferred employee profit sharing expense is to be presented as an ordinary expense in the income statement rather than as part of taxes on profits.

The adoption of this standard in 2008 required that both the additional liability and the related intangible asset and comprehensive income item be eliminated and that the unamortized items be carried to results of operations in a period not exceeding five years. The effects of the implementation of the MFRS were not significant.

The implementation of this MFRS is prospective; therefore the financial statements of prior periods have not been edited or modified. The effects of the implementation of the MFRS were not significant.

#### **MFRS D-4 Taxes on Profits**

MFRS D-4, *Taxes on Profits*, is applicable for years beginning on or after January 1, 2008 and replaces Mexican accounting Bulletin D-4, *Accounting for Income Tax, Asset Tax and Employee Profit Sharing*. The most significant changes included in this standard with respect to Mexican accounting Bulletin D-4, are as follows: i) The concept of permanent differences is eliminated, since the asset and liability method requires the recognition of deferred taxes on basically all temporary differences in balance sheet accounts for financial and tax reporting purposes; ii) since current-year and deferred employee profit sharing is considered as an ordinary expense, it is excluded from this standard and reincorporated into Mexican FRS D-3; iii) asset tax is required to be recognized as a tax liability and, consequently, as a deferred income tax asset only in those cases in which there is certainty as to its realization in the future; and iv) the cumulative effect of adopting Mexican accounting Bulletin D-4 is to be reclassified to retained earnings, unless it is identified with comprehensive items in stockholders' equity not yet taken to income.

The implementation of this MFRS is prospective; therefore the financial statements of prior periods have not been edited or modified. The effect of the implementation of the MFRS was the reclassification of Cumulative deferred income tax of Ps. 970,513 to Retained earnings.

#### **MFRS interpretation 5, Accounting Recognition of the Additional Consideration Agreed at the Inception of a Derivative to Adjust the Instrument to its Fair Value**

MFRS interpretation 5, is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether or not the additional consideration agreed at the inception of a derivative to adjust the instrument to its fair value should be amortized over the life of the hedge. This Interpretation clarifies that the additional consideration agreed at the inception of a derivative is part of the fair value of the derivative and, accordingly, it must be included as part of the fair value in which the derivative is initially



recorded, which will be adjusted for changes in its fair value in subsequent periods. Therefore, the additional consideration should not be amortized.

### **MFRS interpretation 6, When a Hedge May Be Formally Designated**

MFRS interpretation 6, is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether a derivative may be formally designated as a hedge on a date subsequent to its contract date. Mexican interpretation FRS 6 establishes that a derivative may be designated as a hedge at its inception date or contract date or at a subsequent date, provided that it meets the conditions established in Mexican accounting Bulletin C-10 for such designation. Also, this standard establishes that the hedge accounting treatment must not commence until such time as the entity evaluates whether the instrument qualifies as and meets the conditions for hedge accounting. When a derivative instrument is designated as a hedge on a date subsequent to its contract date, the related effects will only be recognized as of the date on which it first meets the formal conditions and qualifies for consideration as a hedge.

### **MFRS interpretation 7, Application of Comprehensive Income Item Generated by a Cash Flow Hedge on a Forecasted Purchase of a Non-financial Asset**

In November 2007, the CINIF issued MFRS interpretation 7, which is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether or not the amount resulting from a cash flow hedge on a forecasted transaction that is recognized in stockholders' equity as part of other comprehensive income items may be included in the cost of the non-financial asset whose value is being set by the hedge.

This Interpretation clarifies that if a derivative is designated as a cash flow hedge on a forecasted transaction, to set the price of the non-financial asset to the functional currency, the effect recognized in comprehensive income is considered a complement to the cost of the asset and, therefore, must be included in such cost. The effect of the adoption of this Interpretation must be recognized by reclassifying at the Interpretation's effective date, all relevant balances presented in Comprehensive income to the cost of the asset acquired.

The adoption of the aforementioned interpretations 5, 6 and 7 did not have a significant impact on the Company's results of operations and financial position.

The new accounting pronouncements that come into effect on January 1, 2009 are summarized below:

### **MFRS B-7, Business Acquisitions**

This MFRS substitutes MFRS B-7 Business Acquisitions, and establishes general rules for the initial recognition of net assets, non-controlling interests and other items, as of the acquisition date. According to this statement, purchase and restructuring expenses resulting from acquisition process, should not be part of the consideration, because these expenses are not an amount being shared by the business acquired. In addition, MFRS B-7 requires a company to recognize non-controlling interests in the acquiree at fair value as of the acquisition date. MFRS B-7 is effective for future acquisitions.

### **MFRS B-8, Consolidated or Combined Financial Statements**

This MFRS replaces MFRS B-8 Consolidated Financial Statements and describes general rules for the preparation, presentation and disclosure of consolidated and combined financial statements. The main changes of this MFRS are as follows: (a) this rule defines Specific-purpose Entity (SPE), establishes the cases in which an entity has control over a SPE, and when a company should consolidate this type of entity; (b) addresses that potential voting rights should be analyzed when evaluating the existence of control over an entity; and, (c) set new terms for controlling interest instead of majority interest, and non-controlling interest instead of minority interest.

### **MFRS C-7, Investments in Associates and Other Permanent Investments**

MFRS C-7 describes the accounting treatment for investments in associates and other permanent investments, which were previously treated within MFRS B-8 Consolidated Financial Statements. This MFRS requires the recognition of a Specific-Purpose Entity, through equity method. Also, this MFRS establishes that potential voting rights should be considered when analyzing the existence of significant influence. In addition, this rule defines a procedure and a limit for the recognition of losses in an associate.

### **MFRS C-8, Intangible Assets**

This rule substitutes MFRS C-8 Intangible Assets. The new rule defines intangible assets as non-monetary items and broadens the criteria of identification, indicating that an intangible asset must be separable; this means that such asset could be sold, transferred, or used by the entity. In addition, intangible asset arises from legal or contractual rights, whether those rights are transferable or separable from the entity.

On the other hand, this standard establishes that preoperative costs should be eliminated from the capitalized balance, affecting retained earnings, and without restating prior financial statements. This amount should be presented as an accounting change in consolidated financial statements.

### **MFRS D-8, Share-Based Payments**

MFRS D-8 establishes the recognition of share-based payments. When an entity purchases goods or pay services with share-based payments, the entity is required to recognize those goods or services at fair value and the corresponding increase in equity. According with MFRS D-8, if share-based payments cannot be settled with equity instruments, they have to be settled using an indirect method considering MFRS D-8 parameters.

At the date of the financial statements, management is evaluating the effect of the observance of these new accounting standards will have on the Company's consolidated results of operations and financial position

#### **a) International Financial Reporting Standards (IFRS)**

On November 11, 2008 the Mexican Securities Commission (Comisión Nacional Bancaria y de Valores) issued a press release in which it debriefed that this Commission

will perform the necessary regulatory adaptations on which it will be established the requirements for the listed companies to prepare and reveal their financial information under IFRS beginning the year 2012. Likewise it was specified that early adoption for the years 2008, 2009, 2010 and 2011 is allowed.

At the date of the financial statements, management is evaluating the effects of the adoption and implementation of IFRS as well as the potential adoption date.

## **B. 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, 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 \$1.7 million of the remainder of our outstanding bank debt.

On December 31, 2008, our total consolidated debt was U.S. \$952,000 which consisted of (i) U.S. \$650,000 of a bank loan made by General Electric Capital Corporation and (ii) U.S. \$302,000 of 8 7/8% medium-term notes ( MTNs ) due 1998 which remained outstanding after we conducted exchange offers for the MTNs in October 1997 and August of 1998. We could not identify the holders of such MTNs at the time of the exchange offers and as a result such MTNs, which matured in 1998, have not been paid and remain outstanding.

On September 6, 2006, Republic entered into a subordinated demand promissory note with Industrias CH. Interest accrues at a rate of 5.23% per annum. As of December 31, 2008 and 2007, Republic had \$20 and \$4.2 million, respectively, outstanding under this intercompany promissory note.

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. 1,589 million) which amount excludes value added tax of \$16 million (Ps. 210 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. 247 million) for capital stock to be issued in the second quarter of 2005. Approximately \$107.5 million (Ps. 1,350 million) of our investment related to the acquisition of property, plant and equipment, approximately \$7 million (Ps. 92 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.\$123 million (Ps. 1,403 million) through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% through SimRep for U.S.\$122 million (Ps. 1,392 million). We financed our portion of the U.S.\$245 million (Ps. 2,795 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. 438 million), which debt has since been repaid in full.

On May 30, 2008, we acquired 100% of the stock of Grupo San for approximately U.S. \$844 million (Ps. 8,730 million). To finance the purchase price, on May 29, 2008 we accepted a loan from Banco Inbursa S.A. for U.S. \$120 million (Ps. 1,325 million) at Libor + 1.45% that was due on May 29, 2009, which debt has since been repaid in full as of December 31, 2008. We also received U.S. 112.5 million (Ps. 1,169 million) of capital stock increase from Industrias CH that was formalized on July 22, 2008. We paid the remaining balance of the purchase price through our own cash reserves.

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. On February 8, 2007, we completed a public offering of ADSs and series B shares and raised cash proceeds of approximately U.S.\$214 million. In part due to this offering, as of December 31, 2007, we had on hand cash in the amount of approximately U.S.\$589 million. As of December 31, 2008, we had cash and cash equivalents of Ps. 576.7 million and we believe that this amount 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 in May 2010. 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. As of December 31, 2008, Republic has a balance payable to GE Capital for \$ 650 thousand dollars.

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.\$ 150 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:

### Principal Cash Flows

|  | Years ended December 31,                       |       |         |
|--|--|-------|---------|
|  | 2006   | 2007  | 2008    |
|  | (millions of constant December 31, 2007 Pesos) |       |         |
| Funds provided by operating activities           | 2,384  | 2,352 | 1,845   |
| Funds (used in) provided by financing            | (417)  | 2,324 | 1,334   |
| Funds (used in) provided by investing activities | 13   | (484) | (9,000) |

The amounts presented in the table above are not comparable, due to the adoption of MFRS B-2 Cash flow statement in January 1, 2008. The information for 2007 and 2006 is presented in accordance with MFRS B-12 Statement of changes in financial position.

Our net funds provided by operations were Ps. 1,845 million in 2008, Ps. 2,352 million in 2007 and Ps. 2,384 million in 2006 and reflected the net income of the year.

Our net funds provided by financing activities were Ps. 1,334 million (which amount includes the capital increase of Ps. 1,169 million in July 2008) in 2008 compared to Ps. 2,324 million of net funds provided by financing activities in 2007 (which amount includes the capital increase of Ps. 2,421 million in February 2007). Our net funds provided by financing activities were Ps. 2,324 million in 2007 compared to Ps. 417 million of funds used in 2006 (which amount includes the prepayment of Ps. 439 million (U.S.\$37.7 million) of Republic's bank debt and a capital contribution of certain minority shareholders of Simec of Ps. 131 million).

We attribute our net funds used in investing activities primarily to the acquisition of new facilities (Grupo San), property, plant and equipment and other non-current assets and reflects changes in long-



term inventories and proceeds from insurance claim. Our net funds used in investing activities (to acquire property, plant and equipment and other non-current assets) were Ps. 9,000 million in 2007, primarily due to our use of net funds to acquire Grupo San for Ps. 8,730 million, as compared to net funds used for investing activities of Ps. 484 million in 2007. Our net funds used in investing activities (to acquire property, plant and equipment and other non-current assets) were Ps. 484 million in 2007 compared to net resources provided by investing activities of Ps. 13 million in 2006 (which amount includes the proceeds from an insurance claim of Ps. 436 million).

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 our audited financial statements, certain futures contracts that we entered to fix the price of our natural gas purchases.

As of December 31, 2008, we had no material commitments for capital expenditures.

### C. Research and Development, Patents and Licenses

We do not own any registered patents or copyrights which are material to our business as a whole.

### D. Trend Information

The sharp reduction in economic activity and consumer demand in general, and in the construction, appliance, and automotive industries in particular, in North America starting in the fourth quarter of 2008 has had a significant negative impact on the demand and price levels for all steel products, including SBQ and structural steel products. In the first quarter 2009 net sales decreased 33% compared to the fourth quarter 2008. Sales in tons of finished steel decreased 11% in the first quarter 2009 compared with the fourth quarter 2008. Prices of finished products sold in the first quarter 2009 decreased approximately 25% compared to the fourth quarter 2008.

All of the statements in this Trend Information section are subject to and qualified by the information set forth under the Cautionary Statement Regarding Forward Looking Statements. See also Item 5A Operating and Financial Review and Prospects Overview of Operating Results.

### E. Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

### F. Contractual Obligations

The table below sets forth our significant short-term and long-term contractual obligations as of December 31, 2008:

|   | Maturity            |              |              |                         | Total |
|---|---------------------|--------------|--------------|-------------------------|-------|
|   | Less than<br>1 year | 1 3<br>years | 4 5<br>years | In excess of<br>5 years |       |
|   | (millions of pesos) |              |              |                         |       |
| Short-term debt obligations of related parties(1) | 297                 | -            | -            | -                       | 297   |
| Short-term debt obligations                       | 13                  | -            | -            | -                       | 13    |
| Long-term contractual obligations                 | -                   | -            | -            | -                       | -     |
| Total   | 310                 | 0            | 0            | 0                       | 310   |

- (1) Note payable to Industrias CH is denominated in U.S. dollars, is for an indefinite term and bears annual interest at a rate of 5.23%.

As of December 31, 2008, Republic had U.S.\$ 1.9 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.\$0.7 million for 2009, \$0.3 million for 2010, \$0.01 million for 2011 and will be repaid in full in 2011.

Republic leases certain equipment, office space and computers through operating contracts under non-cancelable operating leases. These lease contracts will expire in several different dates by 2014. During the years ended December 31, 2008 and 2007, the expenses for operating leases were Ps. 84 million and Ps.77 million, respectively. At December 31, 2008, total minimum lease payments under non-cancelable operating leases are Ps. 40.6 million in 2009, Ps. 32.5 million in 2010 and Ps. 2.7 million for the following years.

## **Item 6. Directors, Senior Management and Employees**

### **A. Directors and Senior Management**

#### **Our Board 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. Our board of directors currently consists of seven directors, each of whom is elected at the annual shareholders' meeting for a term of one year with an additional period of thirty days, if a successor has not been appointed. The board of directors may appoint provisional directors until the shareholders' meeting appoints the new directors. 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.

#### *Election of the Board of Directors*

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

The current members of our board of directors were nominated and elected to such position at the 2009 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 25% of our directors must be independent from us and our affiliates, and our board of directors has passed a resolution requiring the approval of at least 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 and the chief executive officer annual report to the shareholders meeting;
- 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 board of directors or 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 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.

#### *Biographical Information of our Board of Directors*

**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.

**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 the chairman 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. 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.

## 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*

Our by-laws provide that the audit and corporate practices committee shall be at least three members, all of which must be independent 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 chief executive officer, (ix) providing an annual report to the annual shareholders meeting, (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 the annual shareholders meeting 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 remuneration 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.

| Name                    | Position                | Position Held Since |
|-------------------------|-------------------------|---------------------|
| 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.

## B. Compensation

For the years ended December 31, 2008 and 2007, we paid no fees to our seven directors, and the aggregate compensation our executive officers earned was approximately Ps. 26.6 million and Ps. 24.5 million, respectively.

## C. Board Practices

The following table sets forth the names of the members of our board of directors and the year of their initial appointment:

| Name                           | Director Since |
|--------------------------------|----------------|
| <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           |

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).

The audit and corporate practices committee is currently composed of three members. Raúl Arturo Pérez Trejo, the chairman of the audit and corporate practices committee, was elected at our annual ordinary shareholders meeting held on April 30, 2009, 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.

## D. Employees

As of December 31, 2008, we had 4,823 employees (of whom 3,030 were employed at our Mexico facilities, and 1,581 were unionized, and 1,793 were employed at the Republic facilities, of whom 1,292 were unionized) compared to 4,437 employees at December 31, 2007 (of whom 1,915 were employed at our Mexico facilities, and 1,136 were unionized, and 2,522 were employed at the Republic facilities, of whom 2,060 were unionized) compared to 4,053 employees at December 31, 2006 (of whom 1,921 were employed at our Mexican facilities, and 1,143 were unionized, and 2,132 were employed at the Republic facilities, and 1,719 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 on February 14, 2010.
- *Mexicali facilities*: Sindicato de Trabajadores de la Industria Procesadora y Comercialización de Metales de Baja California. The contract expires on January 16, 2010.
- *Apizaco facilities*: Sindicato Nacional de Trabajadores de Productos Metalicos, Similares y Conexos de la República Mexicana. The contract expires on January 16, 2010.
- *Cholula facilities*: Sindicato Industrial "Acción y Fuerza" de Trabajadores Metalurgicos Fundidores, Mecánicos y Conexos Crom del Estado. The contract expires on March 1, 2010.
- *San Luis facilities*: At the Aceros San Luis facility: Sindicato de Empresas adherido a la CTM; and at the Aceros DM and Abastecedora Siderúrgica facilities: Sindicato de Trabajadores de la Industria Metal Mecánica, Similares y Conexos del Estado de San Luis Potosí CTM. The contracts expire on January 15, 2010, January 23, 2010, and January 15, 2010, respectively.

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.

Republic is the only subsidiary of the Group which offers other benefits and pension plans to their employees. Benefit plans to employees with Republic are described below.

### **Collective Bargaining Agreements**

Eighty-three percent of the Company's production workers are covered by a collective bargaining agreement with the United Steelworkers of America (USWA). During the year ended December 31, 2007, the Company negotiated a new collective bargaining agreement effective from August 16, 2007 through August 15, 2012 (new labor agreement). The previous collective bargaining agreement expired on August 15, 2007 (previous labor agreement). For the Mexican operations, approximately 60% of the employees are under a collective contract. The Mexican collective contracts expire in periods greater than one year.

### **Defined Contribution Plans**

Both the new and previous labor agreements provide for a defined contribution program for retirement healthcare and pension benefits. The Company is required to make a contribution for every hour worked. Under the previous labor agreement, the contribution amount was U.S.\$3.00 for every hour worked through August 16, 2004, U.S.\$ 3.50 for every hour worked through August 16, 2005, and U.S. \$3.80 for every hour worked thereafter until August 16, 2007. The new labor agreement requires a contribution to the retirement healthcare plan of U.S. \$3.00 for every hour worked, not to be less than U.S. \$2.85 million per quarter, but not to exceed U.S. \$11.4 million per year. Contributions are made to the pension plan at a rate of U.S. \$1.68 per hour as defined in the new labor agreement. The new contribution rates and contribution limit were effective beginning August 16, 2007. For the years ended December 31, 2008, 2007 and 2006 the Company recorded Ps. 216 million, Ps. 176 million and Ps. 170 million, respectively, of expense related to these funding obligations.

The Company has a defined contribution retirement plan that covers substantially all salary and nonunion hourly employees. This plan is designed to provide retirement benefits through Company contributions and voluntary deferrals of employees' compensation. The Company funds contributions to this plan each pay period based upon the participants age and service as of January first of each year. The amount of the Company's contribution is equal to the monthly base salary multiplied by the appropriate percentage based on age and years of service. The contribution becomes 100% vested upon completion of three years of service. In addition, employees are permitted to make contributions into a 401(k) retirement plan through payroll deferrals. The Company provides a 25.0% matching contribution for the first 5.0% of payroll that an employee elects to contribute. Employees are 100.0% vested in both their and the Company's matching 401(k) contributions. For years ended December 31, 2008, 2007 and 2006 the Company recorded expense of Ps. 31.3 million, Ps. 26 million and Ps. 27.1 million respectively. Effective April 1, 2007, the Company amended the defined contribution retirement plan to include all employees covered by the USWA labor agreement. Employees who are covered by the USWA labor agreement are eligible to participate in the defined contribution retirement plan through voluntary deferrals of employees' compensation. There are no Company contributions or employer matching contributions.

### **Profit Sharing Plans**

The previous labor agreement included a profit sharing plan to which the Company was required to contribute 15.0% of its quarterly pre-tax income, as defined in the previous labor agreement, in excess of U.S.\$ 12.5 million. This plan remained in effect until December 31, 2007 under the new labor agreement. For the years ended December 31, 2007 and 2006 the Company recorded Ps. 80 million and Ps. 93 million, respectively, related to its profit sharing funding obligation under the previous labor agreement. The new labor agreement also includes a profit sharing plan to which the Company is required to contribute 2.5% of its quarterly pre-tax income, as defined in the new labor agreement. At the end of the year, the contribution will be based upon annual pre-tax income up to U.S.\$50.0 million multiplied by 2.5%, U.S. \$50.0 million to U.S. \$100.0 million multiplied by 3.0%, and above U.S.\$100.0 million multiplied by 3.5%, less the previous payouts during the year. For the year ended December 31, 2008, the Company recorded Ps. 51 million related to its profit sharing funding obligation under the new labor agreement.

In 2004, Republic Inc. adopted a profit sharing plan for salary and nonunion hourly employees excluding a select group of managers and executives. The Company is required to contribute 3.0% of its quarterly pre-tax income, as defined in the plan, in excess of U.S.\$12.5 million. For the years ended December, 2008, 2007 and 2006 the Company recorded expense of Ps. 26 million, Ps. 16 million and Ps. 21.5 million, respectively, under this plan.

### **Incentive Compensation Plans**

During 2007, Republic Inc. had a Key Employee Incentive Plan which was in effect beginning February 1, 2007. The plan was based on attaining the 2007 Business Plan earnings before income taxes, depreciation and amortization (EBITDA) and individual performance targets. The objectives were measured on an annual basis. For the year ended December 31, 2007, the Company did not record expense under this plan due to not meeting the annual measurement objectives.

Effective January 1, 2008, Republic Inc. adopted a Key Manager Incentive Plan and Operations and Maintenance Incentive Plan. Additionally, effective April 1, 2008, the Company adopted a Commercial Sales Incentive Plan and a Production Planning Incentive Plan. The plans were based on attaining the 2008 Business Plan (EBITDA) and other performance targets. The objectives were measured on a quarterly basis. Individuals designated as participants in these plans were excluded from the profit sharing plan. For the year ended December 31, 2008, the Company recorded Ps. 26 million of expense under these incentive plans.

### **Deferred Compensation Plan**

The Company has a deferred compensation plan covering certain key employees. The plan allows for the covered employee to make annual deferrals of base salary and provides for a fixed annual contribution by the Company based on a percentage of salary. For the years ended December 31, 2008, 2007 and 2006 the Company recorded expense of Ps. 1.1 million related to the deferred compensation plan.

### **E. Share Ownership**

Industrias CH and its direct wholly-owned subsidiaries currently hold approximately 84% of our series B shares. At December 31, 2008, Rufino Vigil González, the chairman of our board of directors, owned approximately 62% of Industrias CH directly or through its subsidiaries, and Eduardo Vigil González and Sergio Vigil González, each members of our board of directors, owned 0.6% and 1.3%, respectively.

## **Item 7. Major Shareholders and Related Party Transactions**

### **A. Major Shareholders**

As of June 1, 2009, we had 497,709,214 shares of series B common stock outstanding, including 53,406,905 additional series B shares that we sold in a public offering on February 8, 2007. 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. 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.

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 62% of Industrias CH directly or through its subsidiaries.

Our major shareholders do not have voting rights different from the rights of our other shareholders.

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The following table shows the ownership of our series B shares as of June 1, 2009.

| Name of Shareholder                                   | Number of shares<br>owned | % of shares<br>owned |
|---|---------------------------|----------------------|
| Industrias CH   | 275,369,337               | 55%                  |
| Tuberías Procarisa, S.A. de C.V. (1)                  | 99,461,866                | 20%                  |
| Operadora de Manufacturera de Tubos, S.A. de C.V. (2) | 27,207,654                | 5.5%                 |
| Aceros y Laminados Sigosa, S.A. de C.V.(1)            | 4,377,776                 | 1%                   |
| SEYCO Estructuras S.A. de C.V. (2)                    | 6,188,406                 | 1%                   |
| Industrial de Herramientas CH, S.A. de C.V. (2)       | 2,240,628                 | 0.5%                 |
| Compañía Mexicana de Tubos, S.A. de C.V. (2)          | 3,841,082                 | 1%                   |
| Controladora VG, S.A. de C.V.                         | 1,948,101                 | 0.5%                 |
| Nueva Pytsa Industrial, S.A. de C.V.                  | 200,000                   | 0%                   |
| Public Investors                                      | 76,874,364                | 15.5%                |
| Total   | 497,709,214 (3)           | 100%                 |

(1) A subsidiary of Industrias CH.

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

(3) Includes 23,087,603 shares issued to Industrias CH and its subsidiaries on July 22, 2008.

At May 31, 2009, 481,510,378 series B common shares were held in Mexico and by approximately 409 shareholders who were record holders in Mexico.

## B. 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 consolidated financial statements included elsewhere herein. On July 22, 2005, we and Industrias CH acquired 100% of the stock of Republic through SimRep. We acquired 50.2% (U.S.\$123 million Ps. 1,403 million) of Republic's stock through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% (U.S.\$122 million Ps. 1,392) through SimRep. We financed our portion of the U.S.\$245 million (Ps. 2,795 million) purchase price principally from a loan that we received through Industrias CH that 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 2006, these sales totaled Ps. 39 million, in 2007 they totaled Ps. 28 million, and in 2008 they totaled Ps. 371 million. In addition, in 2006, 2007 and 2008 we purchased Ps. 7 million, Ps. 76 million and Ps. 89 million, respectively, 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 2006 we paid Ps. 10 million to Industrias CH for its services, in 2007 we paid Ps. 12 million, and in 2008 we paid Ps. 13 million.





### **C. Interests of Experts and Counsel**

Not applicable.

### **Item 8. Financial Information**

#### **A. Consolidated Statements and Other Financial Information**

See Item 18 - Financial Statements and Index to Financial Statements.

#### **Legal Proceedings**

##### *Mexico*

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.

##### *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 claims against us 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. All these payments were duly made by Pacific Steel.

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. The remediation work activities began in November 2006, once the permits were available.

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, 2008, such reserve is Ps. 12.6 million (\$0.9 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. 23,324 (19,750 historical pesos) and a charge to results of operations of 2002 for the same amount.

*Environmental Liabilities.* At December 31, 2008, we had a reserve of \$4 million (Ps. 54.2 million) to cover probable environmental liabilities and compliance activities. The current and non-current portions of the environmental reserve are included in the caption Other Accounts Payable and Accrued Expenses and Other Long-Term Liabilities, respectively, 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.

## **B. Significant Changes**

On February 8, 2007, we sold 53,406,905 series B shares in a public offering, with total cash proceeds in the amount of approximately U.S. \$214 million.

On February 21, 2008, we entered into an agreement to acquire 100% of the shares of Corporación Aceros DM, S.A. de C.V. and certain of its affiliates ( Grupo San ), and on May 30, 2008 such acquisition was consummated. Grupo San is a long products steel mini-mill and the second-largest corrugated rebar producer in Mexico. Grupo San's operations are based in San Luis Potosí, Mexico. Its plants and 1,450 employees produce 700 thousand tons of finished products annually.

On July 22, 2008 at a Shareholders Meeting, the Shareholders approved an increase to the capital stock in its variable portion of Ps. 134,695, represented by 27,699,442 ordinary series B shares, with a subscription price of 50.64 Pesos which included a stock premium of 45.7772612088 Pesos for each share. In this same meeting Industrias CH, two of its affiliate companies, and other related companies were authorized to subscribe and pay for 23,087,603 of these shares, and the 4,611,839 remaining shares were offered to the rest of the shareholders in accordance with their preemptive rights.



Once the subscription term expired the Board of Directors, exercising the powers delegated to it at the Shareholders Meeting of February 24, 2009, cancelled these additional shares corresponding to an amount of Ps. 22,426. The increase of capital stock paid was Ps. 112,269 plus a stock premium of Ps. 1,056,887.

## Item 9. The Offer and Listing

### A. Offer and Listing Details

Our series B common stock is listed on the Mexican Stock Exchange, and the ADSs are listed on the American Stock Exchange. 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. To maintain trading prices in the U.S., the ADS to share ratio was simultaneously adjusted from one ADS representing one share to one ADS representing three shares. The ADSs are evidenced by American depositary receipts, or ADRs, issued by the Bank of New York as depositary under a Deposit Agreement, dated as of July 8, 1993, as amended, among us, the depositary and the holders from time to time of ADRs.

### Share Price Information

The following table sets forth for the periods indicated the high and low sales prices expressed in historical pesos of our series B common stock on the Mexican Stock Exchange, and the high and low sales price expressed in dollars of the ADSs on the American Stock Exchange.

|                | Mexican<br>Stock<br>Exchange |       | American<br>Stock<br>Exchange |       |
|----------------|------------------------------|-------|-------------------------------|-------|
|                | High                         | Low   | High                          | Low   |
| <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>    | 80.00                        | 22.00 | 21.64                         | 3.96  |
| <b>2007</b>    | 55.91                        | 32.50 | 15.46                         | 8.55  |
| <b>2008</b>    | 63.60                        | 15.50 | 18.48                         | 3.21  |
| <b>2007</b>    |                              |       |                               |       |
| First Quarter  | 55.91                        | 40.38 | 15.46                         | 10.00 |
| Second Quarter | 52.00                        | 44.00 | 14.40                         | 11.31 |
| Third Quarter  | 54.50                        | 32.50 | 15.30                         | 8.55  |
| Fourth Quarter | 39.90                        | 34.40 | 11.02                         | 8.89  |
| <b>2008</b>    |                              |       |                               |       |
| First Quarter  | 43.20                        | 32.70 | 12.43                         | 8.75  |
| Second Quarter | 63.60                        | 39.97 | 18.48                         | 11.00 |
| Third Quarter  | 58.80                        | 30.10 | 17.02                         | 7.93  |
| Fourth Quarter | 33.15                        | 15.50 | 8.90                          | 3.21  |
| <b>2009</b>    |                              |       |                               |       |
| First Quarter  | 24.35                        | 17.52 | 5.40                          | 3.56  |
| Second Quarter | 31.95                        | 20.20 | 7.50                          | 4.20  |
| <b>2008</b>    |                              |       |                               |       |
| December       | 23.33                        | 17.40 | 5.80                          | 3.79  |



|             | Mexican<br>Stock<br>Exchange |       | American<br>Stock<br>Exchange |      |
|-------------|------------------------------|-------|-------------------------------|------|
|             | High                         | Low   | High                          | Low  |
| <b>2009</b> |                              |       |                               |      |
| January     | 23.90                        | 17.52 | 5.40                          | 3.68 |
| February    | 24.35                        | 21.70 | 5.21                          | 4.27 |
| March       | 22.90                        | 18.73 | 5.11                          | 3.56 |
| April       | 23.20                        | 20.20 | 5.50                          | 4.20 |
| May         | 29.00                        | 22.00 | 6.60                          | 4.73 |
| June        | 31.95                        | 27.50 | 7.50                          | 5.01 |

### Trading on the Mexican Stock Exchange

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.

## Item 10. Additional Information

### A. Share Capital



Not applicable.

## **B. Memorandum and Articles of Association**

Our principal objects and purposes, as expressed in the Second Clause of our Bylaws, are to engage in the control of companies dedicated to the manufacture, processing and distribution of diversified special bar quality ( SBQ ) steel and structural products.

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. Our directors are liable for damages and losses caused to us and to 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 or 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, which include, among others, altering financial statements or records. In terms of the the General Law of Commercial Companies and our Bylaws, only the shareholders meeting can determinate compensation for the directors. Our directors cannot individually exercise any of our borrowing powers. We do not have any retirement plan. Shareholders, or a group of shareholders, that control 10% of our shares can name a director and (in that director s absence) an alternate director.

### *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;
- to elect one member of our board of directors 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 chief executive officer's report on our operations during the preceding year, a report on fulfillment of our tax obligations of the last fiscal year and the audit and corporate practices committee's report with respect to the preceding year, the appointment of members of the board of directors and the chairman of the audit and corporate practices committee, declaration of dividends and the determination of compensation for members of the board of directors and for members of the audit and corporate practices committee. 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:

- voluntary dissolution of the company;
- 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 depositary for distribution to the holders of ADSs. Holders of ADSs are entitled to instruct the depositary as to the exercise of voting rights pertaining to the Series B shares. See *Description of American Depositary 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.

#### *No Right of Redemption*

The Mexican Securities Market Law and our bylaws provide that our shareholders do not have redemption rights for their shares.

#### *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 December 31, 2008, was approximately Ps. 4,143 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 or in one of the newspapers of general circulation in Guadalajara, Jalisco, 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 our financial statements, 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,
- a report of the chief executive officer on the operations of the company during the preceding year,
- a report of the fulfillment of the company's tax obligations of the last fiscal year,
- a report of the audit and corporate practices committee with respect to 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 bylaws 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, but the audit and corporate practices committee must be comprised entirely of independent directors. 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 Market Regulation 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.

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 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.

**C. Material Contracts**

On July 22, 2005, we and our parent company, Industrias CH, entered into a stock purchase agreement under which we acquired 100% of the stock of Republic, a U.S. producer of SBQ steel. We acquired 50.2% of Republic's stock for U.S.\$123 million (Ps. 1,403 million) through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8% through SimRep for U.S.\$122 million (Ps. 1,392 million). We financed our portion of the U.S.\$245 million (Ps. 2,795 million) purchase price principally from a loan received through Industrias CH that we have since repaid in full.

On February 21, 2008, we entered into an agreement to acquire 100% of the shares of Grupo San, and on May 30, 2008 such acquisition was consummated. Grupo San is a long products steel mini-mill and the second-largest corrugated rebar producer in Mexico. Grupo San's operations are based in San Luis Potosí, Mexico. Its plants and 1,450 employees produce 700 thousand tons of finished products annually.

## D. Exchange Control

There are no legislative or legal provisions currently in force in Mexico or arising under our bylaws restricting the payment of dividends to holders of our common stock not resident in Mexico, except for regulations restricting the remittance of dividends and other payments in compliance with United Nations sanctions. There are no limitations, either under the laws of Mexico or in our by-laws, on the right of foreigners to hold or vote on shares of our common stock.

## E. 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 annual report, 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, 2008. 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 rate of 28% or at 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 depository 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 are 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 2007 or our 2008 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 depository 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, 2008 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.

#### **F. Dividends and Paying Agents**

Not applicable.

#### **G. Statements by Experts**

Not applicable.

#### **H. Documents on Display**

Statements contained in this annual report regarding the contents of any contract or other document are not necessarily complete, and, where the contract or other document is an exhibit to the annual report, each of these statements is qualified in all respects by the provisions of the actual contract or other documents.

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 this annual report 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.



## **I. Subsidiary Information**

Not applicable.

### **Item 11. 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 103% 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, we use derivative financial instruments, which currently consist of natural gas swap contracts. These contracts are recognized on our balance sheet at fair value. The swaps are considered as cash flow hedges since the cash flow exchanges under the swap are highly effective in mitigating exposure to natural gas price fluctuations. The change in fair value of the swaps is recorded as part of comprehensive income in stockholders' equity for those contracts that are designated as accounting hedges until such time as the related item hedged is recorded in income. At that time, the hedging instrument's fair value is recorded in income. For those contracts that are not designated as accounting hedges, the change in fair value is recorded directly into income. We do not believe our market risk with respect to these natural gas futures contracts is material. See note 6 to the consolidated financial statements.

#### **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, 2008 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 not 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**

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 would not be significantly affected.

## 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 approximately Ps. 1.3 million (\$95 thousand).

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, 2008 and assuming that the hypothetical market rate changes selected by us in our market risk analysis occur during 2009. 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.

## Item 12. Description of Securities Other than Equity Securities

Not applicable.

## PART II.

## Item 13. Defaults, Dividends Arrearages and Delinquencies

Simec is in default on the payment of U.S. \$302,000 principal amount of 8 7/8% MTNs due 1998 which were issued in 1993 as part of a U.S. \$68 million exchange offer. Accrued interest on the MTNs at December 31, 2008 was U.S. \$387,882. The U.S. \$387,882 due reflects sums that were not paid to holders that could not be identified at the time of the exchange offer.

## Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

## Item 15. Controls and Procedures

### A. Disclosure Control and Procedures

Our principal executive officer and our principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this annual report, have concluded that, as of such date, our disclosure controls and procedures were not effective.

### B. Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Rule 13a-15(f) defines internal control over financial reporting as a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

1. Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
- 2.

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Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurances with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may decline.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on its assessment and those criteria, our management identified the following weakness in our internal control over financial reporting.

Pursuant to Exchange Act Rule 13a-15(d) or 15d-15(d), our assessment did not include the internal controls of the subsidiaries included in the combined financial statements of Corporación Aceros D.M., S.A. de C.V. and affiliates, which are included in our 2008 consolidated financial statements. These subsidiaries were acquired in May 2008 and they constituted Ps. 3,707,828 (thousands) and Ps. 2,540,272 (thousands) of total and net assets, respectively, as of December 31, 2008 and Ps. 2,871,090 (thousands) and Ps. 503,070 (thousands) of revenues and net income, respectively, for the year then ended.

Due to our continuing growth during the year ended December 31, 2008, the current structure of our finance department became no longer sufficient to allow key supervision controls to function effectively with respect to our financial statement closing process, deferred taxes, and business acquisitions processes. Our management has determined that these deficiencies constitute a material weakness. Accordingly, our management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2008.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2008, has been audited by Mancera, S.C., a member of Ernst & Young Global, an independent registered public accounting firm which also audited the financial statements included in the annual report.

### **C. Attestation Report of the Independent Registered Public Accounting Firm**

#### **Report of Independent Registered Public Accounting Firm**

##### **The Board of Directors and Shareholders of Grupo Simec, S.A.B. de C.V.**

We have audited Grupo Simec, S.A.B. de C.V.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Grupo Simec, S.A.B. de C.V.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, pursuant to Exchange Act Rule 13a-15(d) or 15d-15(d), management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of the subsidiaries included in the combined financial statements of Corporación Aceros D.M., S.A. de C.V. and affiliates, which are included in the 2008 consolidated financial statements of Grupo Simec, S.A.B. de C.V. These subsidiaries were acquired in May 2008 and they constituted Ps. 3,707,828 (thousands) and Ps. 2,540,272 (thousands) of total and net assets, respectively, as of December 31, 2008 and Ps. 2,871,090 (thousands) and Ps. 503,070 (thousands) of revenues and net income, respectively, for the year then ended. Our audit of internal control over financial reporting of Grupo Simec, S.A.B. de C.V. also did not include an evaluation of the internal control over financial reporting of the subsidiaries included in the combined financial statements of Corporación Aceros D.M., S.A. de C.V. and affiliates.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment. Management has a material weakness in controls in the operation of key supervision controls of the finance department affecting the financial statement closing process, the deferred income tax process and the business acquisition process. This material weakness was considered in determining the nature, timing and extent of audit tests applied in our audit of the 2008 financial statements and this report does not affect our report dated July 10, 2009 on those financial statements.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Grupo Simec, S.A.B. de C.V. has not maintained effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

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

Humberto Valdes Mier

Guadalajara, Jalisco, México  
July 10, 2009

## **D. Changes in Internal Control Over Financial Reporting**

Due to our continuing growth during the year ended December 31, 2008, the current structure of our finance department became no longer sufficient to allow key supervision controls to function effectively with respect to our financial statement closing process, deferred taxes, and business acquisitions processes. This change in our internal control over our financial reporting during the year ended December 31, 2008 materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Our management has determined that these deficiencies constitute a material weakness. Accordingly, our management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2008.

### **Item 16. [Reserved]**

#### **Item 16A. Audit Committee Financial Expert**

Our board of directors has determined that it has at least one audit committee financial expert, as defined in Item 16A of Form 20-F, serving on the audit committee. Raul Arturo Pérez Trejo is the director whom the board of directors has determined to be an audit committee financial expert. Holders of ADSs should understand that this designation is a disclosure requirement of the SEC related to Mr. Pérez's experience and understanding with respect to certain accounting and auditing matters. The designation does not impose on Mr. Pérez any duties, obligations or liability that are greater than those which are generally imposed on him as a member of the audit and corporate practices committee and board of directors, and his designation as an audit committee financial expert pursuant to this SEC requirement does not affect the duties, obligations or liability of any other member of the audit and corporate practices committee or board of directors. Mr. Pérez is independent as such term is defined in the listing standards of the American Stock Exchange.

#### **Item 16B. Code of Ethics**

In 2002, we adopted a code of ethics that applies to all of our employees and directors, including our principal executive officer, principal financial officer and principal accounting officer. In 2008, we did not amend our code of ethics in any manner, nor did we grant any waiver from any provision of the code of ethics to any person. We will provide to any person without charge, upon written or oral request, a copy of such code of ethics. Requests should be directed to: Grupo Simec, S.A.B. de C.V., Attention: José Flores Flores, telephone number: 011-52-33-3770-6700.

### **Item 16C. Principal Accountant Fees and Services**

*Audit Fees.* We paid fees in the amount of Ps. 13.7 million and Ps. 17.4 million, respectively, in 2007 and 2008 to Mancera, S.C. Ernst & Young for the audit of our annual consolidated financial statements included in our annual report on Form 20-F.

*Tax Fees.* We paid fees to Mancera, S.C. Ernst & Young in the amount of Ps. 0.08 million and Ps. 2.4 million, respectively, in 2007 and 2008 associated with tax compliance and tax consultation.

*Other Fees.* We paid no fees in 2008 other than those set forth above to Mancera, S.C. Ernst & Young. In 2007 we paid fees to Mancera, S.C. Ernst & Young in the amount of Ps. 4.7 million associated with the public offering of ADS and Series B shares completed on February 8, 2007. The audit committee approved all of the services incurred in 2007 and 2008, described as Audit Fees , Tax Fees and Other Fees , in accordance with our policy on auditor independence.

*Pre-Approval Policies.* Our audit committee has adopted a formal policy on auditor independence requiring it to approve all professional services rendered by our independent auditor prior to the commencement of the specified services. The audit committee will consider annually and, if appropriate, approve the provision of audit services by our independent auditor and consider and, if appropriate, pre-approve the provision of certain defined audit and non-audit services. The audit committee also will consider on a case-by-case basis and, if appropriate, approve specific engagements that are not otherwise pre-approved. Any proposed engagement that does not fit within the definition of a pre-approved service may be presented to the audit committee for consideration at its next regular meeting or, if earlier consideration is required, to the audit committee for action by written consent.

### **Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

### **Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers.**

Not applicable.

### **Item 16F. Change in Registrant's Certifying Accountant.**

Not applicable.

### **Item 16G. Corporate Governance**

Our following corporate governance practices differ from the NYSE AMEX standards:

*Board of Directors Composition, Nomination and Board Meetings.* Pursuant to the Mexican Securities Market Law, our board of directors must be composed of a maximum of 21 members, of which at least 25% must be independent. The board of directors is elected by the shareholders at the annual meeting, for a one year term with the option to be reelected, as determined by the shareholders. One alternate director may be appointed for each director, provided that independent alternates are appointed for the independent directors. In accordance with Mexican law, our shareholders determine directors' independence during the annual shareholders meeting, but this independence determination may be challenged by the Mexican National Banking and Securities Commission. Our board of directors meets at least quarterly and resolutions are binding if adopted by a majority of the directors present at a meeting.





*Nominating and Compensation Committees.* In compliance with Mexican laws, we do not have a nominating or compensation committee. Members of our board of directors are appointed by a majority of shareholders present at our annual shareholders meeting. We do have a corporate practice committee, made up of three independent directors, that assists the board in determining executive compensation. Shareholders, at our annual shareholders meeting, or the board of directors, make the final determination about executive compensation. Shareholders' approval must be acquired for the adoption and amendment of any equity compensation plans.

*Audit Committee and Auditors.* Our audit committee is governed by: (i) our bylaws and (ii) Mexican law. Our audit committee is made up of at least three independent directors, appointed by the board of directors. Our shareholders appoint and/or remove the chairman of the audit committee at the annual shareholders meeting. In accordance with Mexican law, the audit committee must provide an opinion regarding any transaction with a related party, outside of the ordinary course of business. Such transactions must also be approved by the board of directors.

Under Mexican law, we must be audited by an independent public accountant that has received a quality control review, as defined by the general rules issued by the National Banking and Securities Commission. These general rules require accounting firms rendering external audit services, to fulfill higher independence standards, as well as issuing and following quality control internal policies and manuals in accordance with the rules issued by the Mexican Institute of Public Accountants (*Instituto Mexicano de Contadores Públicos, A.C.*).

*Quorum Requirements and Shareholders' Approval.* In compliance with Mexican law, shareholders representing 50% of our capital stock must be present to conduct business at the first call for ordinary shareholders meetings, dealing with general matters. If a quorum is not reached, there is no minimum quorum requirement for a second or subsequent call. Resolutions approved at ordinary shareholders' meetings are valid when approved by a majority of the shares present. On the other hand, shareholders representing 75% of our capital stock must be present to conduct business at the first call for extraordinary shareholders meeting dealing with modifications to the our bylaws. If a quorum is not reached, shareholders representing 50% of our capital stock must be present at the meeting in a second or subsequent call. Resolutions at extraordinary shareholders meetings are valid if approved by shares representing more than 50% of our capital stock. However, resolutions regarding the (i) quorum requirements, (ii) minority shareholders' rights, (iii) merger, spin-off and conversion are valid if approved by at least 75% of our capital stock. Furthermore, resolutions regarding our registration with the National Securities Registry (*Registro Nacional de Valores*) are valid if approved by at least 95% of our capital stock. Class II Series L Shares, representative of our capital stock with limited economic and corporate rights, are not taken into account when determining the quorum at the general shareholders' meeting.

*Code of Conduct and Ethics.* In compliance with Mexican law, we do not have a code conduct and ethics for our directors or executive officers. However, our directors' and executive officers' conduct is subject to the applicable provisions of the Securities Market Law and the regulations issued by the Mexican Banking and Securities Commission.

### **PART III.**

#### **Item 17. Financial Statements**

We have responded to Item 18 in lieu of responding to this item.

#### **Item 18. Financial Statements**

Reference is made to the consolidated financial statements included herein.



**Item 19. Exhibits**

Pursuant to the rules and regulations of the SEC, we have filed certain agreements as exhibits to this annual report on Form 20-F. Documents filed as exhibits to this annual report:

| <u>Exhibit<br/>Number</u> | <u>Item</u>   |
|---------------------------|---|
| 1.1                       | Amended and Restated By-laws ( <i>estatutos sociales</i> ) of the registrant, together with an English translation.*  |
| 8.1                       | List of subsidiaries, their jurisdiction of incorporation and names under which they do business.   |
| 10.1                      | Stock Purchase Agreement by and Among PAV Republic, Inc., The Shareholders of PAV Republic, Inc., SimRep Corporation and Industrias C.H., S.A. de C.V.*   |
| 10.2                      | 2007-2008 Rounds Supply Agreement by and Between Republic, Inc. and United States Steel Corporation.*   |
| 10.3                      | Stock Purchase Agreement, dated as of February 21, 2008, among the Sellers (as defined therein) and Grupo Simec, S.A.B. de C.V. relating to the acquisition of 100% of the shares of Grupo San. |
| 12.1                      | Certification of chief executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 12.2                      | Certification of principal financial officer pursuant to Section 302 of the Sarbanes- Oxley Act of 2002.  |
| 13.1                      | Certifications of chief executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

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\* Previously filed with the SEC as an exhibit and incorporated by reference from our Registration Statement on Form F-1, File No. 333-138239.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this Amendment No. 1 to its annual report on Form 20-F for the year ended December 31, 2008 on its behalf.

**GRUPO SIMEC, S.A.B. DE C.V.**

By: /s/ Luis García Limón

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Luis García Limón  
*Chief Executive Officer*

By: /s/ José Flores Flores

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José Flores Flores  
*Chief Financial Officer*

Dated: December 21, 2009

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INDEX TO FINANCIAL STATEMENTS

(Mexican Pesos)

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

|  |            |
|--|------------|
| <u>Report of Mancera, S.C. Ernst &amp; Young</u>   | <u>F-2</u> |
| <u>Report of Marcelo de Los Santos y Cía., S.C</u>   | <u>F-3</u> |
| <u>Consolidated Balance Sheets as of December 31, 2008 and 2007</u>  | <u>F-4</u> |
| <u>Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006</u>  | <u>F-5</u> |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2008, 2007 and 2006</u>                 | <u>F-6</u> |
| <u>Consolidated Statement of Cash Flow</u>   | <u>F-7</u> |
| <u>Consolidated Statements of Changes in Financial Position for the years ended December 31, 2007 and 2006</u>                         | <u>F-8</u> |
| <u>Notes to Consolidated Financial Statements</u>  | <u>F-9</u> |
| <b>Schedules to Financial Statements</b>   |            |
| <u>Schedule I- Condensed Parent Company Balance Sheets as of December 31, 2008 and 2007</u>  | <u>S-1</u> |
| <u>Schedule I- Condensed Parent Company Statements of Income for the years ended December 31, 2008, 2007 and 2006</u>                  | <u>S-2</u> |
| <u>Schedule I- Consolidated Statement of Cash Flow</u>   | <u>S-3</u> |
| <u>Schedule I- Condensed Parent Company Statements of Changes in Financial Position for the years ended December 31, 2007 and 2006</u> | <u>S-4</u> |
| <u>Schedule I- Note to Parent Company Financial Statements for the years ended December 31, 2007, 2006 and 2005</u>                    | <u>S-5</u> |

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of  
Grupo Simec, S.A.B. de C.V. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Grupo Simec, S.A.B. de C.V. and subsidiaries (the Company ) as of December 31, 2008 and 2007, and the related consolidated statements of income and changes in stockholders' equity for each of the three years in the period ended December 31, 2008, the related consolidated statement of cash flows for the year ended December 31, 2008, and the related consolidated statement of changes in financial position for each of the two years in the period ended December 31, 2007. 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 did not audit the combined financial statements of Corporación Aceros D.M., S.A. de C.V. and affiliates, acquired by the Company on May 31, 2008, which statements reflect total combined assets of Ps. 3,707,828 (thousand), as of December 31, 2008, and total combined revenues of Ps. 2,871,090 (thousand), for the seven month 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 Corporación Aceros D.M., S.A. de C.V. and affiliates, is based solely on the report of the other auditors.

We conducted our audits in accordance with 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Grupo Simec, S.A.B. de C.V. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and cash flows for the year ended December 31, 2008, and the consolidated results of their operations and changes in their financial position for each of the two years in the period ended December 31, 2007, in conformity with Mexican financial reporting standards, which differ in certain respects from accounting principles generally accepted in the United States of America (see Note 19 to the consolidated financial statements).

As disclosed in Note 2 to the accompanying consolidated financial statements, during 2008, the Company adopted Mexican Financial Reporting Standard ( MFRS ) B-2 *Statement of Cash Flows*, MFRS B-10 *Effects of Inflation*, MFRS D-3 *Employee Benefits*, and certain other MFRS. The application of all of these standards was prospective in nature.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Grupo Simec, S.A.B. de C.V.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 10, 2009, expressed an adverse opinion on the effectiveness of internal control over financial reporting.

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

C.P.C. Humberto Valdes Mier

Guadalajara, Jalisco, México  
July 10, 2009



**Report of Independent Registered Public Accounting Firm**

**To the Board of Directors and Shareholders of  
Corporación Aceros D.M., S.A. de C.V. and Affiliates**

We have audited the accompanying Combined Balance Sheet of Corporación Aceros D.M., S.A. de C.V. and Affiliates as of December 31, 2008, and the related Combined Income Statements, Statement of Changes in Stockholder's Equity and Cash Flow Statement, for the seven month period from June 1, 2008 to December 31, 2008. 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 the audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes the examination, on a test basis, of the evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying combined financial statements present fairly, in all material respects, the combined financial position of Corporación Aceros D.M., S.A. de C.V., and affiliates, as of December 31, 2008, and the related Combined Statements of Income, Changes in Stockholder's Equity and Cash Flows for the seven month period from June 1, to December 31, 2008, in conformity with Mexican Financial Reporting Standards. Mexican Financial Reporting Standards differ in certain respects from U.S. generally accepted accounting principles; one important difference relates to push-down accounting.

Moore Stephens Marcelo de los Santos y Cía., S.C.

Marcelo de los Santos Anaya, C.P.A.  
Professional Identity Card 1649173  
AGAFF Register 10374

San Luis Potosí, S.L.P., México

July 10, 2009

F-3

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**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Balance Sheets

December 31, 2008 and 2007

(In thousands of Mexican pesos)

|   | <b>2008</b>           |     | <b>2007</b> |
|---|-----------------------|-----|-------------|
| <b>Assets</b>                                   |                       |     |             |
| Current assets:                                 |                       |     |             |
| Cash and cash equivalents                       | <b>Ps. 576,741</b>    | Ps. | 6,396,155   |
| Accounts receivable                             |                       |     |             |
| Trade   | <b>3,091,253</b>      |     | 2,578,444   |
| Related parties (note 4)                        | <b>54,085</b>         |     | 3,572       |
| Recoverable taxes                               | <b>360,422</b>        |     | 517,645     |
| Other receivables                               | <b>90,311</b>         |     | 52,785      |
|   | <b>3,596,071</b>      |     | 3,152,446   |
| Less: allowance for doubtful accounts (note 2e) | <b>235,781</b>        |     | 97,255      |
| Total accounts receivable, net                  | <b>3,360,290</b>      |     | 3,055,191   |
| Inventories, net (note 5)                       | <b>8,849,906</b>      |     | 4,930,404   |
| Prepaid expenses                                | <b>258,492</b>        |     | 72,005      |
| Total current assets                            | <b>13,045,429</b>     |     | 14,453,755  |
| Non-current inventories (note 2i)               | <b>122,223</b>        |     | 97,459      |
| Property, plant and equipment, net (note 7)     | <b>10,291,145</b>     |     | 7,900,638   |
| Intangible assets (note 8)                      | <b>7,089,953</b>      |     | 172,831     |
| Other assets and deferred charges, net (note 9) | <b>265,267</b>        |     | 216,574     |
| Total assets                                    | <b>Ps. 30,814,017</b> | Ps. | 22,841,257  |
| <b>Liabilities and stockholders equity</b>      |                       |     |             |
| Current liabilities:                            |                       |     |             |
| Short-term debt                                 | <b>Ps. 12,855</b>     | Ps. | 3,282       |
| Accounts payable                                | <b>3,399,772</b>      |     | 2,104,235   |
| Related parties (note 4)                        | <b>365,088</b>        |     | 103,879     |
| Derivative financial instruments (note 6)       | <b>376,206</b>        |     | -           |
| Income tax payable                              | <b>298,251</b>        |     | 76,583      |
| Accrued expenses                                | <b>504,351</b>        |     | 328,174     |
| Other liabilities                               | <b>298,622</b>        |     | 243,971     |
| Total current liabilities                       | <b>5,255,145</b>      |     | 2,860,124   |

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|   |                       |                |
|---|-----------------------|----------------|
| Seniority premiums and termination benefits (note 11)   | <b>34,095</b>         | 18,422         |
| Deferred income tax (note 15)                           | <b>4,172,251</b>      | 2,672,480      |
| Other long-term liabilities                             | <b>47,029</b>         | 38,197         |
|   | <hr/>                 |                |
| Total long-term liabilities                             | <b>4,253,375</b>      | 2,729,099      |
|   | <hr/>                 |                |
| Total liabilities                                       | <b>9,508,520</b>      | 5,589,223      |
|   | <hr/>                 |                |
| Stockholders' equity (note 14):                         |                       |                |
| Capital stock   | <b>4,142,696</b>      | 4,030,427      |
| Additional paid-in capital                              | <b>4,208,204</b>      | 3,151,317      |
| Retained earnings                                       | <b>9,507,958</b>      | 8,550,179      |
| Cumulative deferred income tax                          | -                     | (970,513)      |
| Translation effect in foreign subsidiaries, net         | <b>595,165</b>        | (31,710)       |
| Surplus on restatement of stockholders' equity          | -                     | 132,155        |
| Fair value of derivative financial instruments (note 6) | <b>(270,868)</b>      | -              |
|   | <hr/>                 |                |
| Total majority stockholders' equity                     | <b>18,183,155</b>     | 14,861,855     |
| Minority interest                                       | <b>3,122,342</b>      | 2,390,179      |
|   | <hr/>                 |                |
| Total stockholders' equity                              | <b>21,305,497</b>     | 17,252,034     |
|   | <hr/>                 |                |
| Total liabilities and stockholders' equity              | <b>Ps. 30,814,017</b> | Ps. 22,841,257 |
|   | <hr/>                 |                |

See accompanying notes to consolidated financial statements.

**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Statements of Income

Years ended December 31, 2008, 2007 and 2006

(In thousands of Mexican pesos, except share and earnings per share figures)

|   | <b>2008</b>           |     | 2007        |     | 2006        |
|---|-----------------------|-----|-------------|-----|-------------|
| Net sales   | <b>Ps. 35,185,220</b> | Ps. | 24,106,094  | Ps. | 23,515,297  |
| Direct cost of sales  | <b>29,796,163</b>     |     | 20,498,918  |     | 19,131,879  |
| Marginal profit   | <b>5,389,057</b>      |     | 3,607,176   |     | 4,383,418   |
| Indirect overhead, selling, general and administrative expenses | <b>2,273,828</b>      |     | 1,423,159   |     | 1,351,682   |
| Operating income  | <b>3,115,229</b>      |     | 2,184,017   |     | 3,031,736   |
| Other (expenses) income, net:                                   | <b>(3,916)</b>        |     | 21,329      |     | 39,205      |
| Comprehensive financing cost:                                   |                       |     |             |     |             |
| Interest income, net  | <b>78,522</b>         |     | 273,313     |     | 46,932      |
| Foreign exchange (loss) gain, net                               | <b>(253,183)</b>      |     | (37,879)    |     | (37,424)    |
| Monetary position loss  | <b>-</b>              |     | (194,931)   |     | (72,952)    |
| Comprehensive financial result, net                             | <b>(174,661)</b>      |     | 40,503      |     | (63,444)    |
| Income before income tax  | <b>2,936,652</b>      |     | 2,245,849   |     | 3,007,497   |
| Income tax (note 15):   |                       |     |             |     |             |
| Current   | <b>743,255</b>        |     | 111,522     |     | 627,612     |
| Deferred  | <b>293,048</b>        |     | 509,152     |     | (18,891)    |
| Total income tax  | <b>1,036,303</b>      |     | 620,674     |     | 608,721     |
| Net consolidated income   | <b>Ps. 1,900,349</b>  | Ps. | 1,625,175   | Ps. | 2,398,776   |
| <u>Allocation of net income</u>                                 |                       |     |             |     |             |
| Minority interest   | <b>104,212</b>        |     | 96,118      |     | 220,082     |
| Majority interest   | <b>1,796,137</b>      |     | 1,529,057   |     | 2,178,694   |
|   | <b>Ps. 1,900,349</b>  | Ps. | 1,625,175   | Ps. | 2,398,776   |
| Majority earnings per share:                                    |                       |     |             |     |             |
| Weighted average shares outstanding                             | <b>484,903,795</b>    |     | 468,228,497 |     | 420,339,873 |
| Majority earnings per share (pesos)                             | <b>Ps. 3.70</b>       | Ps. | 3.27        | Ps. | 5.18        |

See accompanying notes to consolidated financial statements.

F-5

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**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2008, 2007 and 2006

(In thousands of Mexican pesos)

|  | Capital stock | Additional paid-in capital | Retained earnings | Cumulative deferred income tax | Deficit / Surplus on restatement of stockholders equity | Translation effect in foreign subsidiaries | Fair value of derivative financial instruments | Total majority interest | Minority interest | Total stockholders' equity |
|--|---------------|----------------------------|-------------------|--------------------------------|---|--|--|-------------------------|-------------------|----------------------------|
| Balance at December 31, 2005                                 | Ps. 3,724,756 | Ps. 905,361                | Ps. 4,842,428     | Ps. (970,513)                  | Ps. (181,878)   | Ps. 16,106                                 | Ps. 43,235                                     | Ps. 8,379,495           | Ps. 1,936,770     | Ps. 10,316,265             |
| Increase in capital stock (note 14)                          | 38,656        | 92,245                     | -                 | -                              | -   | -  | -  | 130,901                 | -                 | 261,802                    |
| Investment in PAV Republic ICH                               | -             | -                          | -                 | -                              | -   | -  | -  | -                       | 145,188           | 145,188                    |
| Comprehensive income:  |               |                            |                   |                                |   |  |  |                         |                   |                            |
| Net income for the year                                      | -             | -                          | 2,178,694         | -                              | -   | -  | -  | 2,178,694               | 220,082           | 2,398,776                  |
| Translation effect in foreign subsidiaries                   | -             | -                          | -                 | -                              | -   | (41,645)                                   | -  | (41,645)                | (41,280)          | (82,925)                   |
| Effect of market value of swaps net of deferred taxes        | -             | -                          | -                 | -                              | -   | -  | (47,792)                                       | (47,792)                | -                 | (95,584)                   |
| Result of holding non-monetary assets, net of deferred taxes | -             | -                          | -                 | -                              | 108,219   | -  | -  | 108,219                 | (8,299)           | 100,920                    |
| Balance at December 31, 2006                                 | 3,763,412     | 997,606                    | 7,021,122         | (970,513)                      | (73,659)  | (25,539)                                   | (4,557)  | 10,707,872              | 2,252,461         | 12,985,332                 |
| Increase in capital stock (note 14)                          | 267,015       | 2,153,711                  | -                 | -                              | -   | -  | -  | 2,420,726               | 38,436            | 2,689,888                  |
| Comprehensive income:  |               |                            |                   |                                |   |  |  |                         |                   |                            |
| Net income for the year                                      | -             | -                          | 1,529,057         | -                              | -   | -  | -  | 1,529,057               | 96,118            | 1,625,175                  |

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|  |                      |                      |                      |                |                  |                    |                      |                       |                      |                       |  |
|--|----------------------|----------------------|----------------------|----------------|------------------|--------------------|----------------------|-----------------------|----------------------|-----------------------|--|
| Net income for the year                                      |                      |                      |                      |                |                  |                    |                      |                       |                      |                       |  |
| Translation effect in foreign subsidiaries                   | -                    | -                    | -                    | -              | -                | (6,171)            | -                    | (6,171)               | (6,055)              |                       |  |
| Effect of market value of swaps net of deferred taxes        | -                    | -                    | -                    | -              | -                | -                  | 4,557                | 4,557                 | -                    |                       |  |
| Result of holding non-monetary assets, net of deferred taxes | -                    | -                    | -                    | -              | 205,814          | -                  | -                    | 205,814               | 9,219                |                       |  |
| <hr/>  |                      |                      |                      |                |                  |                    |                      |                       |                      |                       |  |
| Balance at December 31, 2007                                 | 4,030,427            | 3,151,317            | 8,550,179            | (970,513)      | 132,155          | (31,710)           | -                    | 14,861,855            | 2,390,179            | 17,312,218            |  |
| Increase in capital stock (note 14)                          | <b>112,269</b>       | <b>1,056,887</b>     | -                    | -              | -                | -                  | -                    | <b>1,169,156</b>      | -                    | <b>1,169,156</b>      |  |
| Investment in PAV Republic ICH                               | -                    | -                    | -                    | -              | -                | -                  | -                    | -                     | <b>9,794</b>         | <b>9,794</b>          |  |
| Comprehensive income:  |                      |                      |                      |                |                  |                    |                      |                       |                      |                       |  |
| Net income for the year                                      | -                    | -                    | <b>1,796,137</b>     | -              | -                | -                  | -                    | <b>1,796,137</b>      | <b>104,212</b>       | <b>1,796,137</b>      |  |
| Translation effect in foreign subsidiaries                   | -                    | -                    | -                    | -              | -                | <b>626,875</b>     | -                    | <b>626,875</b>        | <b>618,157</b>       | <b>626,875</b>        |  |
| Effect of market value of swaps net of deferred taxes        | -                    | -                    | -                    | -              | -                | -                  | <b>(270,868)</b>     | <b>(270,868)</b>      | -                    | <b>(270,868)</b>      |  |
| Effect of the adoption of the new MFRS B-10                  | -                    | -                    | <b>132,155</b>       | -              | <b>(132,155)</b> | -                  | -                    | -                     | -                    | <b>(132,155)</b>      |  |
| Effect of the adoption of the new MFRS D-4                   | -                    | -                    | <b>(970,513)</b>     | <b>970,513</b> | -                | -                  | -                    | -                     | -                    | <b>(970,513)</b>      |  |
| <hr/>  |                      |                      |                      |                |                  |                    |                      |                       |                      |                       |  |
| Balances at December 31,                                     | <b>Ps. 4,142,696</b> | <b>Ps. 4,208,204</b> | <b>Ps. 9,507,958</b> | <b>Ps. -</b>   | <b>Ps. -</b>     | <b>Ps. 595,165</b> | <b>Ps. (270,868)</b> | <b>Ps. 18,183,155</b> | <b>Ps. 3,122,342</b> | <b>Ps. 21,312,218</b> |  |

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See accompanying notes to consolidated financial statements.

F-6

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**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Statement of Cash Flow

Year ended December 31, 2008

(In thousands of Mexican pesos)

|  | <u>2008</u>        |
|--|--------------------|
| Operating activities:                                      |                    |
| Income before income tax                                   | Ps. 2,936,652      |
| Depreciation and amortization                              | 895,306            |
| Seniority premiums and termination benefits                | 27,016             |
| Interest income  | (135,810)          |
| Accrued interest   | 57,288             |
|  | <u>3,780,452</u>   |
| Decrease in trade receivable, net                          | 367,250            |
| Increase in related parties receivables                    | (49,644)           |
| Increase in inventories, net                               | (2,030,274)        |
| Increase in other accounts receivable and prepaid expenses | (202,276)          |
| Increase in other accounts payable and accrued expenses    | 93,916             |
| Increase in accounts payable                               | 541,938            |
| Increase in related parties payable                        | 17,840             |
| Income tax paid  | (695,852)          |
|  | <u>1,823,350</u>   |
| Resources provided by operating activities                 | <u>1,823,350</u>   |
| Investing activities:                                      |                    |
| Investing in shares of Corporación San                     | (8,450,796)        |
| Acquisition of property, plant and equipment               | (479,804)          |
| Increase in other noncurrent assets                        | (210,035)          |
| Interest income collected                                  | 135,810            |
| Proceeds from sale of machinery and equipment              | 4,769              |
|  | <u>(9,000,056)</u> |
| Resources used in investing activities                     | <u>(9,000,056)</u> |
| Financing activities:                                      |                    |
| Financial debt   | 1,334,129          |
| Financial debt repayment                                   | (1,325,329)        |
| Related parties payable (financing)                        | 232,943            |
| Related parties payable repayment                          | (36,138)           |



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|   |             |
|---|-------------|
| Increase in capital stock                             | 112,269     |
| Additional paid-in capital                            | 1,056,887   |
| Interest paid   | (40,607)    |
|   | <hr/>       |
| Resources (used in ) provided by financing activities | 1,334,154   |
|   | <hr/>       |
| Net decrease in cash and cash equivalents             | (5,842,552) |
| Translation differences in cash and cash equivalents  | 1,238       |
| Exchange rate effect on cash and cash equivalents     | 21,900      |
| Cash and cash equivalents at beginning of year        | 6,396,155   |
|   | <hr/>       |
| Cash and cash equivalents at end of year              | Ps. 576,741 |
|   | <hr/>       |

See accompanying notes to consolidated financial statements.

F-7

**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Statements of Changes in Financial Position

Years ended December 31, 2007 and 2006

(In thousands of Mexican pesos)

|   |     | 2007      |     | 2006        |
|---|-----|-----------|-----|-------------|
|   |     | <hr/>     |     |             |
| Operating activities:   |     |           |     |             |
| Net income  | Ps. | 1,625,175 | Ps. | 2,398,776   |
| Add (deduct) items not requiring the use of resources         |     |           |     |             |
| Depreciation and amortization                                 |     | 549,256   |     | 449,742     |
| Deferred income tax   |     | 509,152   |     | (18,891)    |
| Seniority premiums and termination benefits                   |     | 4,575     |     | 5,461       |
|   |     | <hr/>     |     |             |
|   |     | 2,688,158 |     | 2,835,088   |
| Net changes in operating assets and liabilities:              |     |           |     |             |
| Trade receivable, net   |     | (237,795) |     | 205,508     |
| Other accounts receivable and prepaid expenses                |     | (271,374) |     | 232,258     |
| Inventories, net  |     | 123,835   |     | (1,219,702) |
| Derivative financial instruments                              |     | -         |     | -           |
| Related parties receivables                                   |     | (3,434)   |     | 2,494       |
| Accounts payable, other accounts payable and accrued expenses |     | 84,494    |     | 378,191     |
| Other long-term liabilities                                   |     | (31,928)  |     | (49,944)    |
|   |     | <hr/>     |     |             |
| Resources provided by operating activities                    |     | 2,351,956 |     | 2,383,893   |
|   |     | <hr/>     |     |             |
| Financing activities:   |     |           |     |             |
| Increase in capital stock                                     |     | 2,420,726 |     | 130,901     |
| Related parties payable (financing)                           |     | (134,676) |     | (254,538)   |
| Increase of investment in subsidiaries by Industrias CH       |     | 38,436    |     | 145,188     |
| Short-term loans (repaid)                                     |     | (124)     |     | (19,131)    |
| Financial debt repayment                                      |     | -         |     | (419,510)   |
|   |     | <hr/>     |     |             |
| Resources (used in) provided by financing activities          |     | 2,324,362 |     | (417,090)   |
|   |     | <hr/>     |     |             |
| Investing activities:   |     |           |     |             |
| Increase in long-term inventories                             |     | (8,292)   |     | (6,836)     |
| Acquisition of property, plant and equipment                  |     | (485,668) |     | (417,219)   |
| Proceeds from insurance claim, net                            |     | -         |     | 436,900     |
| Increase in other noncurrent assets                           |     | 9,779     |     | -           |

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|  |     |           |     |           |
|--|-----|-----------|-----|-----------|
| Resources provided by (used in) investing activities |     | (484,181) |     | 12,845    |
|  |     | <hr/>     |     |           |
| Net increase (decrease) in cash and cash equivalents |     | 4,192,137 |     | 1,979,648 |
| Cash and cash equivalents:                           |     |           |     |           |
| At beginning of year                                 |     | 2,204,018 |     | 224,370   |
|  |     | <hr/>     |     |           |
| At end of year                                       | Ps. | 6,396,155 | Ps. | 2,204,018 |
|  |     | <hr/>     |     |           |

See accompanying notes to consolidated financial statements.

F-8

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**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

(In thousands of Mexican pesos, except that other currency is indicated)

**1. Operations and significant accounting policies**

The principal activities of Grupo Simec, S.A.B. de C.V. and subsidiaries (the Company) are the manufacture and sale of iron and steel products for the construction and automotive industries both in Mexico, the United States (USA) and Canada. The Company is a subsidiary of Industrias CH, S.A.B. de C.V. (Industrias CH).

The issuance of the financial statements and accompanying notes were authorized on July 10, 2009 by Luís García Limón and José Flores Flores, Chief Executive Officer and Chief Financial Officer, respectively, which must be also approved by the Company's Board of Directors, Audit Committee and Stockholders at their next meetings.

**Significant Transactions**

On February 21, 2008, the Company entered into a purchase agreement to acquire 100% of the shares of Corporación Aceros DM, S. A. de C. V. and certain affiliated companies (Grupo San). On May 30, 2008 the acquisition was consummated. Grupo San is a large steel producer and one of the most important producers of corrugated rebar of the Mexican United States. The facilities of Grupo San are located in San Luis Potosí, Mexico. Starting June 1, 2008, the consolidated financial statements of the Company include the operations of Grupo San (see note 16).

On December 26, 2008 the Company acquired 99.95% of the shares of Northarc Express, S. A. de C. V. a subsidiary of Grupo TMM, S. A. de C. V., to turn this company in to the operating subsidiary of the manufacturing steel plants located in Mexico (see note 16). On January 6, 2009 this company was renamed to Simec International 2, S. A. de C. V.

On July 29, 2008, the Company acquired 100% of the shares of Aroproc, S. A. de C. V., Del-Ucral, S. A. de C. V., Qwer, S. A. de C. V. and Transporte Integral Doméstico, S.A. de C.V., subsidiaries of Grupo TMM, S. A. de C. V., to turn them into the distribution subsidiaries of the manufacturing plants located in Mexico (see note 16). On July 30 2008, these companies were renamed to Promotora de Aceros San Luis, S. A. de C. V., Comercializadora Aceros DM, S.A. de C.V., Comercializadora Msan, S.A. de C.V. and Productos Siderúrgicos de Tlaxcala, S.A. de C.V. respectively.

On July 22, 2008 at a Shareholders Meeting they approved an increase to the capital stock in its variable portion of Ps. 134,695, represented by 27,699,442 ordinary shares corresponding to B series, with a subscription price of 50.64 Pesos which included a stock premium of 45.7772612088 Pesos for each share. In this same meeting Industrias CH, two of its affiliates companies and other related companies were authorized to subscribe and pay 23,087,603 shares and the 4,611, 839 remaining shares were offered to the rest of the shareholders in accordance with their preemptive rights. Once the subscription term expired the Board of Directors in exercise of its powers delegated by the Shareholders Meeting on February 24, 2009, cancelled these additional shares corresponding to an amount of Ps. 22,426. The increase of capital stock paid was Ps. 112,269 plus a stock premium of Ps. 1,056,887.

On November 24, 2007, the Company acquired 99.95% of the shares of TMM America, S. A. de C. V., TMM Continental, S. A. de C. V. y Multimodal Doméstica, S. A. de C. V., subsidiaries of Grupo TMM, S. A. de C.V., to turn them into three distribution subsidiaries for the manufacturing plants in Mexico (Note 16). In February 2008, these companies were renamed to CSG Comercial, S. A. de C. V., Comercializadora de Productos de Acero de Tlaxcala, S. A. de C. V., and Siderúrgica de Baja California, S. A. de C. V., respectively.

On October 9, 2006, the Company's total share ownership in Administradora de Cartera de Occidente, S. A. de C. V. (ACOSA), was sold since the business purpose of the latter did not relate to the Company's business purpose. ACOSA is engaged in the recovery of non-performing loans formerly acquired pursuant to a public bidding process conducted by the Instituto de Protección al Ahorro Bancario in Mexico.

## 2. Summary of significant accounting policies -

Below is a summary of the most significant accounting policies and practices used in the preparation of the consolidated financial statements, in conformity with Mexican Financial Reporting Standards (hereinafter referred as MFRS or Mexican Accounting Bulletin), which include Bulletins and Circulars issued by the Accounting Principles Commission (CPC) of the Mexican Institute of Public Accountants (IMCP) which have not been amended, replaced or abrogated by MFRS issued by the Mexican Financial Reporting Standards Research and Development Board (*Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera, A.C. (CINIF)*).

### a) Basis of consolidation

The consolidated financial statements include the financial statements of Grupo Simec, S.A.B. de C.V. and those of its majority-owned and/or controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in the consolidation.

The Company's subsidiaries and its equity percentage are as follows:

|   | Percentage of equity owned |        |
|---|----------------------------|--------|
|   | 2008                       | 2007   |
| Compañía Siderúrgica de Guadalajara, S.A. de C.V.                   | 99.99%                     | 99.99% |
| Tenedora CSG, S.A. de C.V. (merged with Grupo Simec in 2008)        | 100%                       | 100%   |
| Arrendadora Norte de Matamoros S.A. de C.V. (effective 2007)        | 100%                       | 100%   |
| Arrendadora Simec, S.A. de C.V.                                     | 100%                       | 100%   |
| Simec International, S.A. de C.V.                                   | 100%                       | 100%   |
| Controladora Simec, S.A. de C.V. (merged with Grupo Simec in 2008)  | 100%                       | 100%   |
| SimRep y Subsidiarias   | 50.22%                     | 50.22% |
| Undershaft Investments, N.V.  | 100%                       | 100%   |
| Pacific Steel, Inc.   | 100%                       | 100%   |
| Compañía Siderúrgica del Pacífico, S.A. de C.V.                     | 99.99%                     | 99.99% |
| Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V.     | 100%                       | 100%   |
| Industrias del Acero y del Alambre, S.A. de C.V.                    | 99.99%                     | 99.99% |
| Procesadora Mexicali, S.A. de C.V.                                  | 99.99%                     | 99.99% |
| Servicios Simec, S.A. de C.V.                                       | 100%                       | 100%   |
| Sistemas de Transporte de Baja California, S.A. de C.V.             | 100%                       | 100%   |
| Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.       | 100%                       | 100%   |
| Operadora de Metales, S.A. de C.V.                                  | 100%                       | 100%   |
| Administradora de Servicios Siderúrgicos de Tlaxcala, S.A., de C.V. | 100%                       | 100%   |
| Comercializadora, Simec S.A. de C.V.                                | 100%                       | 100%   |

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|  |               |               |
|--|---------------|---------------|
| CSG Comercial, S.A. de C.V.                                      | <b>99.95%</b> | <b>99.95%</b> |
| Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V. | <b>99.95%</b> | <b>99.95%</b> |

F-10

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|  |               |               |
|--|---------------|---------------|
| Siderúrgica de Baja California, S.A. de C.V.                         | <b>99.95%</b> | <b>99.95%</b> |
| Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V. | <b>100%</b>   | <b>100%</b>   |
| Corporación Aceros DM, S.A. de C.V. y Subsidiarias (effective 2008)  | <b>100%</b>   | -             |
| Productos Siderúrgicos de Tlaxcala, S.A. de C.V. (effective 2008)    | <b>100%</b>   | -             |
| Comercializadora MSAN, S.A. de C.V. (effective 2008)                 | <b>100%</b>   | -             |
| Comercializadora Aceros DM, S.A. de C.V. (effective 2008)            | <b>100%</b>   | -             |
| Promotora de Aceros San Luis, S.A. de C.V. (effective 2008)          | <b>100%</b>   | -             |
| Northarc Express, S.A. de C.V (effective 2008)                       | <b>99.95%</b> | -             |

### b) Revenue recognition

Revenues from the sale of products are recognized at the time products are shipped and the related risks and benefits of merchandise are transferred to the customer.

The Company recognizes sales returns and sales discounts at the time the related revenue is recognized. These provisions are deducted from net sales in the statement of income.

### c) Recognition of the effects of inflation on the financial information

Beginning January 1, 2008 and as a result of the adoption of the Mexican Financial Reporting Standard (MFRS) NIF B-10, Effects of inflation, the Company concluded that during 2008 the economic environment was non-inflationary and ceased recognition of inflation because annual inflation in Mexico published by the Mexican Central Bank (Banco de Mexico) during 2005, 2006 and 2007 was 3.3%, 4.1% and 3.8 %, respectively, and the cumulatively inflation for those years was 11.6%. However, the financial information for the year ended on December 31, 2007 and 2006, it is presented in Mexican pesos with purchasing power as of December 31, 2007, last date on which the Company recognized the effects of inflation in the financial information.

The Company considered that it was impractical to identify the realized and unrealized part of the deficit by holding non-monetary assets included in the Deficit on restatement of stockholders equity at January 1, 2008 and this was reclassified to Retained earnings.

### d) Foreign currency translation

Transactions in foreign currencies are recorded at the exchange rates prevailing at the celebration and liquidation dates. The assets and liabilities in foreign currencies are translated at the exchange rates prevailing at the date of the consolidated balance sheet. The exchange gains or losses incurred in connection with those assets or liabilities are included in the Statement of income, as part of the comprehensive financing cost. Note 3 presents the consolidated position in foreign currencies at the end of each year and the exchange rates used in the translation.

The functional and reporting currency of the Company is the Mexican peso. The financial statements of foreign subsidiaries were translated to Mexican pesos in accordance with the New Mexican Financial Reporting Standard MFRS B-15 "Conversion of foreign currencies" that came into effect on January 1, 2008. Under this Standard, the first step to convert financial information from operations abroad is the determination of the functional currency. The functional currency is the currency of the primary economic environment of the foreign operation or, if different, the currency that mainly impacts its cash flows. The new rule incorporates the concepts of recording currency that is the currency in which the entity maintains its accounting records, whether for legal or information purposes and the reporting currency, which is the currency chosen by the Company to report its financial information.





The U.S. dollar was considered as the functional currency of the subsidiary SimRep, therefore the financial statements of this subsidiary were translated into Mexican pesos by applying: i) the exchange rates at the balance sheet date to all assets and liabilities and (ii) the historical exchange rate at stockholders' equity accounts and revenues, costs and expenses. The difference resulting from the translation or consolidation processes or from applying the equity method, is recognized as a cumulative translation adjustment as part of Translation effect in foreign subsidiaries in Stockholders' equity.

The Mexican Peso was considered the functional currency of the subsidiary Pacific Steel and the U.S. dollar as its recording currency; therefore the financial statements were translated to Mexican pesos as follows: i) monetary assets and liabilities by applying the exchange rates at the balance sheet date; ii) non-monetary assets and liabilities, as well as stockholders' equity accounts, at the historical exchange rate; and iii) revenues, costs and expenses at the historical exchange rate. Translation differences were carried directly to the income statement under the caption Foreign exchange loss, net.

The adoption of this new standard did not result in a significant change in the financial statements of the Company.

**e) Use of estimates**

The preparation of consolidated financial statements requires management to make reasonable estimates that can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reported that arise during the year. Actual results could differ from these estimates.

The Company has made accounting estimates with respect to the valuations for accounts receivable, inventories, long-term assets, valuation of derivatives, assets and deferred tax liabilities and environmental obligations.

The Company maintains a doubtful accounts reserve to account for uncollectible receivables. The reserve is determined based on several factors including the adjustments to prices, length of overdue accounts and the experience of the Company. The following table shows the movement of the estimate of doubtful accounts receivable for the years ended December 31, 2008 and 2007:

|   | 2008        |     | 2007     |
|---|-------------|-----|----------|
| Opening balance                                     | Ps. 97,255  | Ps. | 61,745   |
| Provision of the year                               | 142,238     |     | 49,405   |
| Write-off of uncollectible accounts                 | (27,077)    |     | (11,561) |
| Inflation and exchange rate effect of previous year | 23,365      |     | (2,334)  |
| Final balance                                       | Ps. 235,781 | Ps. | 97,255   |

**f) Cash and cash equivalents**

Cash and cash equivalents consist basically of bank deposits and highly liquid investments with original maturities of less than 90 days, and are presented at acquisition cost plus accrued interest, which is similar to the market value of these investments.

**g) Derivative financial instruments**

During 2008, 2007 and 2006 the Company used derivative financial instruments for hedging risks associated with natural gas prices for which it conducted studies on historical consumption, future

F-12

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requirement and commitments acquired, thus diminishing its exposure to risks other than its normal operating risks.

To mitigate the risks associated with changes in natural gas prices occurring naturally as a result of the supply and demand on international markets, the Company uses natural gas cash-flow exchange contracts or natural gas swaps to offset fluctuations in the price of natural gas, whereby the Company receives a floating price and pays a fixed price. Fluctuations in natural gas prices from volumes consumed are recognized as part of the Company's operating cost.

The fair value of these assets or liabilities is restated at the end of each month based on the new estimate. The Company periodically evaluates the changes in cash flows of the derivative instrument to analyze if the swaps are highly effective for mitigating the exposure to natural gas price fluctuations. A hedge instrument is considered to be highly effective when changes in its fair value or cash flows of the primary position are compensated on a regular or cumulatively basis, by changes in fair value or cash flows of the hedging instrument in a range between 80% and 125%. In 2008, 2007 and 2006 the fair value of derivatives that did not qualify for hedge accounting was adjusted through Statement of Income. For the derivatives that qualified for hedge accounting their fair value was adjusted through the Stockholders' equity in the caption Fair value of derivative financial instruments until such time as the related item the derivative hedges is recognized in income. At that time, the fair value included in Stockholders' equity is also recognized in income.

**h) Concentration risk**

Cash amounts in excess of current requirements are deposited in bank institutions with qualified credit ratings, which are located in different geographical regions. We use derivative instruments as referred to in paragraph (g) and these contracts contain the risk that the counterparty does not fully comply with its obligations, which could result in a material loss. Products mainly for the construction and automotive industries are sold in the domestic market and the Company has a large base, which is geographically diverse, consequently, there is no significant concentration in a specific customer or market. In the case of the U.S. market, our products are used primarily in automotive and industrial equipment and our sales are concentrated; for the years ended December 31, 2008 and 2007, the five largest customers accounted for 34% and 30.1%, respectively, of total sales for that market. In 2008, 2007 and 2006, United Steel Corporation, Inc. accounted for approximately 20%, (and 13% of our consolidated sales) 10% and 10.1% of total sales in the U.S. market, respectively. Direct sales of products to automotive assemblers and manufacturers accounted for approximately 18%, 22% and 29% of our consolidated net sales in 2008, 2007 and 2006, respectively.

During the year ended December 31, 2008, Republic purchased metallurgical coke from eleven suppliers, of which two vendors supplied approximately 70.0% of the Company's metallurgical coke requirements. Also during 2008, Republic purchased iron ore pellets from four suppliers, of which two vendors supplied approximately 95.0% of the Company's iron ore pellet requirements. In 2007 Republic purchased metallurgical coke from fifteen suppliers, of which three suppliers provided approximately 62% of the Company's metallurgical coke requirements. Also, in 2007 Republic purchased iron ore pellets from four suppliers, of which two suppliers provided approximately 98% of the Company's iron ore pellet requirements. The Company believes that the availability of raw materials is adequate for its needs, and, in general, it is not dependent on any single source of supply.

**i) Inventories, cost of sales, estimate for slow moving inventory and obsolescence**

Beginning January 1, 2008, the Company ceased to recognize the inflation effects in inventories. Inventories are recorded at average cost under the direct costing systems. The inventories for the



year ended on December 31, 2007 are expressed at the lower of replacement cost or net realizable market value under the direct costing system. The amount of inventories does not exceed its market value price.

The Company classifies rollers and spare parts as long-term inventories, which in accordance with historical data and production trends will not be used in the short-term (one year).

The reserve for slow-moving, obsolete and damaged inventory is determined by considering the reprocessing cost of the materials with a turnover above one year.

**j) Property, plant and equipment**

Property, plant and equipment were recorded at historic cost and were updated by factors derived from the NCPI until December 31, 2007, except machinery and equipment of foreign origin which was updated using the inflation rates in the country of origin and changes in exchange rates in relation to Mexican peso until December 31, 2007.

Beginning January 1, 2008, the Company ceased to recognize the effects of inflation in property, plant and equipment according with the MFRS B-10.

The comprehensive financing cost which includes (i) the interest cost, (ii) any foreign currency fluctuations, and (iii) the related monetary position result of assets under construction or installation is capitalized as part of the value of such assets and until December 31, 2007, was restated based on the NCPI factors from the date capitalized through year-end and amortized over the average depreciation period of the related assets. The amount of the comprehensive financing cost to be capitalized results from the average capitalization rate of financing of the average of investments in qualified assets during the period of their acquisition.

Depreciation of property, plant and equipment is computed using the straight-line method based on the estimated remaining useful lives of the related assets.

The value of property, plant and equipment is reviewed whenever there are indicators of impairment in the value of these assets. When the recovery value, which is the greater between the selling price and the value of use, is lower than the net carrying value, the difference is recognized as an impairment loss.

The estimated useful lives of the Company's main assets are the following:

|  | <u>Years</u> |
|--|--------------|
| Buildings                                  | 10 to 65     |
| Machinery and equipment                    | 5 to 40      |
| Transportation equipment                   | 4            |
| Furniture, mixtures and computer equipment | 3 to 10      |

Maintenance and minor repairs are expensed as incurred.

**k) Leases**

Lease arrangements are classified as capital leases if under the agreement, the ownership of the leased asset is transferred to the lessee upon termination of the lease, the agreement includes an option to purchase the asset at a reduced price, the term of the lease is basically the same as the remaining useful life of the leased asset, or the present value of minimum lease payments is



basically the same as the market value of the leased asset, net of any benefit or scrap value. When the lessor retains the risks or benefits inherent to the ownership of the leased asset, the agreements are classified as operating leases and rent is charged to results of operations.

**l) Intangible assets**

Intangibles assets are recorded initially at acquisition cost, and until December 31, 2007 adjusted for inflation applying the NCPI factors. Intangible assets are amortized based on their estimated useful lives through the straight-line method. Intangibles of indefinite life are not amortized and are tested for impairment every year end.

At December 31, 2008, 2007 and 2006 no impairment losses were recognized on intangible assets shown in the balance sheet.

**m) Environmental costs**

The Company established a liability for an amount considered appropriate to cover costs of environmental remediation that are probable of being incurred in the future. The amount was determined based on information currently available, current technology, applicable environmental laws and regulations, and also the effects of inflation and other social and economic factors that could have an effect, in accordance with accounting Bulletin C-9, Liabilities, Provisions, Contingent Assets and Liabilities and Commitments.

**n) Accruals and contingencies**

Accruals are recognized whenever (i) the Company has a current obligation (legal or assumed) as a result of a past event, (ii) it is probable that a transfer of assets or the rendering of services will be required to settle such obligation and (iii) the obligation can be reasonably estimated.

The Company recognizes contingent liabilities only when a cash disbursement to settle the contingent obligation is probable and when there are reasonable elements for quantifying the related liabilities. Also, commitments are only recognized when they generate a loss.

**o) Seniority premiums and termination payments**

The annual cost of accumulated benefits for seniority premiums to which employees are entitled by law, are recognized in the results of operations of each year, based on actuarial computations of the present value of such obligation. Past service costs are being amortized over the estimated remaining working lifetime of employees. At December 31, 2008, the estimated average working lifetime of the Company's employees entitled to pension benefits ranges from 8 to 9 years, approximately.

The costs due to seniority premiums and termination payments are periodically recognized based on actuarial computations of the present value of such obligations, using the projected unit-credit method in conformity with MFRS D-3.

Beginning January 1, 2008, we adopted the MFRS D-3, Employee Benefits, which replaced the Bulletin D-3, Labor Obligations. As a result of the adoption of the MFRS D-3, the transition liabilities from labor obligations are being amortized over a period of five years, while as of December 31, 2007 the transitional liabilities were amortized in a straight line over the remaining work life of our covered employees. The adoption of this new standard did not represent a significant change in the financial statements of the Company.





**p) Employees profit sharing (EPS)**

The expenses from EPS caused, are presented as an ordinary expense, rather than forming part of the comprehensive tax of the year in the income statement.

Beginning January 1, 2008, upon the adoption of the MFRS D-3, Employee Benefits, we recognized the effects of deferred EPS, which is determined under the assets and liabilities method. Under this method, we compute deferred EPS on all temporary differences between book and tax values of our assets and liabilities at a rate of 10%. To assess recoverable amount of deferred assets of EPS, management determines which portion of the asset is more likely than not to be recover and when considered appropriate an allowance is included to account for unrecoverable amounts.

Until December 31, 2007, the deferred EPS was computed only if there were no indications that the liabilities or benefits that they originated could not be materialized in the future.

The effects of the implementation of the MFRS were not significant.

**q) Comprehensive income**

As established in accounting Bulletin B-4, comprehensive income consists of the net income or loss for the year, plus the effects of the translation of foreign entities, the changes in the fair value of derivative financial instruments and the result from holding non-monetary assets in the year, applied directly in stockholders equity, as well as the effect of minority interest.

**r) Income taxes**

Income tax is presented as a short-term liability net of advances made during the year.

Deferred taxes are calculated using the assets and liabilities method. Under such method, all temporary differences between accounting and tax reporting amounts of assets and liabilities are calculated using the Income tax rate or Flat rate business tax, as applicable, using the enacted rate which will be applicable when the assets and liabilities estimated for deferred taxes will be recovered or paid.

To assess the recoverable amount of deferred tax assets, management determines which portion of the asset is more likely than not to be recovered. The final realization of deferred tax assets depends largely on taxable profits generated in the periods in which temporary differences are deductible. When this analysis is performed, management considers the expected reversal of deferred tax liabilities, projected taxable profits and planning strategies.

The initial cumulative effect of deferred income tax presented in stockholders equity represents the effect of the recognition of deferred taxes through the date of the initial application of the respective Mexican Financial Reporting Standard restated as of the most recent balance sheet date.

Beginning January 1, 2008, MFRS D-4, Income Tax replaced Bulletin D-4 Accounting for income tax, asset tax and employee profit sharing. The main change under this new MFRS was the reclassification of the cumulative deferred income tax included in stockholders equity to retained earnings.

The Company applied on a supplementary basis to MFRS, US EITF 98-11 Accounting for Acquired Temporary Differences in Certain Purchases Transactions that are not Accounted for as Business Combinations for the acquisition of companies with NOLs. As a result of this application the Company recognized a deferred credit of Ps. 420,046 that is obtained from the difference between the amount paid and

the deferred tax asset recognized from the purchase of future tax benefits. The deferred credit is amortized to result of operations in the same proportion to the realization of the tax benefits that gave rise to the deferred credit.

F-16

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**s) Presentation of income statement**

Costs and expenses in the Company's statement of income are presented by function, since such classification allows proper evaluation of marginal profit and operating income.

The presentation of operating income is not required by MFRS B-3, Statement of operations, however it is presented as it is considered to be an important indicator in evaluating our results.

**t) Earnings per share**

Majority earnings per share have been computed by dividing the net consolidated income by the weighted average number of shares outstanding of each period, in conformity with accounting Bulletin B-14, Earnings per Share.

**u) Segments**

Segment information is presented in accordance with the information used by management for decision making purposes. The Company segments its information by region, due to the operational and organizational structure of its business, in accordance with accounting Bulletin B-5, Financial Information-Segments (see Note 17).

**v) New accounting pronouncements**

The most important new pronouncements that came into force in 2008 are as follows:

**MFRS B-2, Statements of Cash Flows**

MFRS B-2 was issued by the CINIF to replace Mexican accounting Bulletin B-12, *Statement of Changes in Financial Position*. This standard establishes the replacement of the statement of changes in financial position by a statement of cash flows as part of the basic financial statements. The main differences between both statements lie in the fact that the statement of cash flows shows the entity's cash receipts and disbursements for the period, while the statement of changes in financial position showed the changes in the entity's financial structure rather than its cash flows. In an inflationary environment, the amounts of both financial statements are expressed in constant Mexican pesos. However, in preparing the statement of cash flows, the entity must first eliminate the effects of inflation for the period and, accordingly, determine cash flows at constant Mexican pesos, while in the statement of changes in financial position, the effects of inflation for the period are not eliminated.

Mexican FRS B-2 establishes that in the statement of cash flows, the entity must first present cash flows derived from operating activities, then from investing activities, the sum of these activities and finally cash flows derived from financing activities. The statement of changes in financial position first shows the entity's operating activities, then financing activities and finally its investing activities. Under this new standard, the statement of cash flows may be determined by applying the direct or indirect method.

The transitory rules of MFRS B-2 establish that the application of this standard is prospective. Therefore, the financial statements for years ended prior to 2008 presented for comparative purposes, should include a statement of changes in financial position, as established by Mexican accounting Bulletin B-12. The company opted to prepare and present its cash flow statement under the indirect method.

**MFRS B-10, Effects of Inflation**

MFRS B-10, *Effects of Inflation*, which is applicable for years beginning on or after January 1, 2008 and replaces Mexican accounting Bulletin B-10, *Accounting Recognition of the Effects of Inflation on Financial Information*, defines the two economic environments that will determine whether or not entities must recognize the effects of inflation on financial information: i) inflationary, when inflation is equal to or higher than 26%; accumulated in the preceding three fiscal years; and ii) non-inflationary, when accumulated inflation for the preceding three fiscal years is less than the aforementioned accumulated 26%. Based on these definitions, the effects of inflation on financial information must be recognized only when entities operate in an inflationary environment.

Mexican FRS B-10 also establishes the accounting rules applicable whenever the economy changes from one type of environment to the other. When the economy changes from an inflationary environment to a non-inflationary one, the entity must maintain in its financial statements the effects of inflation recognized through the immediate prior year, since the amounts of prior periods are taken as the base amounts of the financial statements for the period of change and subsequent periods. Whenever the economy changes from a non-inflationary environment to an inflationary one, the effects of inflation on the financial information must be recognized retrospectively, meaning that all information for prior periods must be adjusted to recognize the accumulated effects of inflation of the periods in which the economic environment was considered non-inflationary.

This standard also abolishes the use of the specific-indexation method for the valuation of imported fixed assets and the replacement-cost method for the valuation of inventories, thus eliminating the result from holding non-monetary assets. Therefore, at the date this Mexican FRS comes into force, entities which have recognized any accumulated result from holding non-monetary assets in their shareholders' equity, under Retained earnings (accumulated deficit), must identify the realized and unrealized portions of such result.

The realized result from holding non-monetary assets must be reclassified to Retained earnings, while the unrealized portion must be maintained as such within shareholders' equity, and reclassified to results of operations when the asset giving rise to it is realized. Whenever it is deemed impractical to separate the realized from the unrealized result from holding non-monetary assets, the full amount of this item may be reclassified to the Retained earnings caption. The company considered that it was impractical to separate the realized from the unrealized result for holding non-monetary asset and the Ps. 132,155 was reclassified to Retained earnings.

Interpretation 9 of MFRS establishes that comparative financial statements for years prior to 2008 must be expressed in Mexican pesos with purchasing power at December 31, 2007, which was the last date on which the effects of inflation were recognized. Therefore amounts as of December 31, 2008 do not include inflation effects, and the comparative figures as of December 31, 2007 and for the years ended December 31, 2007 and 2006, are stated in thousands of pesos as of December 31, 2007.

The effects of the adoption of this standard on the Company's 2008 financial statements resulted in an increase of net income by Ps. 498,428 in the year caused by not recognizing the Result for Monetary assets and inflation effects in the Statement of income

**MFRS B-15, Conversion of foreign currencies and MFRS Interpretation 15, Financial Reporting currency is equal to the recording, but different from the functional.**

MFRS B-15 incorporates the concepts of recording currency, functional currency and reporting currency, and establishes the methodology to translate financial information of a foreign entity, based on those terms. Additionally, this rule is aligned with NIF B-10, which defines translation procedures of financial information from subsidiaries that operate in inflationary and non-inflationary environments. Prior to the application of this rule, translation of financial information from foreign subsidiaries was according to inflationary environments methodology. The requirement and implementation effect of these new MFRS are described in Note 2(d).

### **MFRS D-3, Employee Benefits**

On January 1, 2008, the new Mexican FRS D-3, *Employee Benefits*, issued by the CINIF, went into effect and replaced the old Mexican accounting Bulletin D-3, *Labor Obligations*. The most significant changes contained in Mexican FRS D-3 are as follows: i) shorter periods for the amortization of unamortized items, with the option to credit or charge actuarial gains or losses directly to results of operations, as they accrue; ii) elimination of the recognition of an additional liability and resulting recognition of an intangible asset and comprehensive income item; iii) accounting treatment of current-year and deferred employee profit sharing, requiring that deferred employee profit sharing be recognized using the asset and liability method established under Mexican FRS D-4; and iv) current-year and deferred employee profit sharing expense is to be presented as an ordinary expense in the income statement rather than as part of taxes on profits.

The adoption of this standard in 2008 required that both the additional liability and the related intangible asset and comprehensive income item be eliminated and that the unamortized items be carried to results of operations in a period not exceeding five years. The effects of the implementation of the MFRS were not significant.

The implementation of this MFRS is prospective; therefore the financial statements of prior periods have not been edited or modified. The effects of the implementation of the MFRS were not significant.

### **MFRS D-4 Taxes on Profits**

MFRS D-4, *Taxes on Profits*, is applicable for years beginning on or after January 1, 2008 and replaces Mexican accounting Bulletin D-4, *Accounting for Income Tax, Asset Tax and Employee Profit Sharing*. The most significant changes included in this standard with respect to Mexican accounting Bulletin D-4, are as follows: i) The concept of permanent differences is eliminated, since the asset and liability method requires the recognition of deferred taxes on basically all temporary differences in balance sheet accounts for financial and tax reporting purposes; ii) since current-year and deferred employee profit sharing is considered as an ordinary expense, it is excluded from this standard and reincorporated into Mexican FRS D-3; iii) asset tax is required to be recognized as a tax liability and, consequently, as a deferred income tax asset only in those cases in which there is certainty as to its realization in the future; and iv) the cumulative effect of adopting Mexican accounting Bulletin D-4 is to be reclassified to retained earnings, unless it is identified with comprehensive items in stockholders' equity not yet taken to income.

The implementation of this MFRS is prospective; therefore the financial statements of prior periods have not been edited or modified. The effect of the implementation of the MFRS was the reclassification of Cumulative deferred income tax of Ps. 970,513 to Retained earnings.

**MFRS interpretation 5, Accounting Recognition of the Additional Consideration Agreed at the Inception of a Derivative to Adjust the Instrument to its Fair Value**

MFRS interpretation 5, is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether or not the additional consideration agreed at the inception of a derivative to adjust the instrument to its fair value should be amortized over the life of the hedge. This Interpretation clarifies that the additional consideration agreed at the inception of a derivative is part of the fair value of the derivative and, accordingly, it must be included as part of the fair value in which the derivative is initially recorded, which will be adjusted for changes in its fair value in subsequent periods. Therefore, the additional consideration should not be amortized.

**MFRS interpretation 6, When a Hedge May Be Formally Designated**

MFRS interpretation 6, is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether a derivative may be formally designated as a hedge on a date subsequent to its contract date. Mexican interpretation FRS 6 establishes that a derivative may be designated as a hedge at its inception date or contract date or at a subsequent date, provided that it meets the conditions established in Mexican accounting Bulletin C-10 for such designation. Also, this standard establishes that the hedge accounting treatment must not commence until such time as the entity evaluates whether the instrument qualifies as and meets the conditions for hedge accounting. When a derivative instrument is designated as a hedge on a date subsequent to its contract date, the related effects will only be recognized as of the date on which it first meets the formal conditions and qualifies for consideration as a hedge.

**MFRS interpretation 7, Application of Comprehensive Income Item Generated by a Cash Flow Hedge on a Forecasted Purchase of a Non-financial Asset**

In November 2007, the CINIF issued MFRS interpretation 7, which is effective for years beginning on or after January 1, 2008. This Interpretation is intended to clarify whether or not the amount resulting from a cash flow hedge on a forecasted transaction that is recognized in stockholders' equity as part of other comprehensive income items may be included in the cost of the non-financial asset whose value is being set by the hedge.

This Interpretation clarifies that if a derivative is designated as a cash flow hedge on a forecasted transaction, to set the price of the non-financial asset to the functional currency, the effect recognized in comprehensive income is considered a complement to the cost of the asset and, therefore, must be included in such cost. The effect of the adoption of this Interpretation must be recognized by reclassifying at the Interpretation's effective date, all relevant balances presented in Comprehensive income to the cost of the asset acquired.

The adoption of the aforementioned interpretations 5, 6 and 7 did not have a significant impact on the Company's results of operations and financial position.

The new accounting pronouncements that come into effect on January 1, 2009 are summarized below:

**MFRS B-7, Business Acquisitions**

This MFRS substitutes MFRS B-7 Business Acquisitions, and establishes general rules for the initial recognition of net assets, non-controlling interests and other items, as of the acquisition date. According to this statement, purchase and restructuring expenses resulting from acquisition process, should not be part of the consideration, because these expenses are not an amount being

shared by the business acquired. In addition, MFRS B-7 requires a company to recognize non-controlling interests in the acquiree at fair value as of the acquisition date. MFRS B-7 is effective for future acquisitions.

### **MFRS B-8, Consolidated or Combined Financial Statements**

This MFRS replaces MFRS B-8 Consolidated Financial Statements and describes general rules for the preparation, presentation and disclosure of consolidated and combined financial statements. The main changes of this MFRS are as follows: (a) this rule defines Specific-purpose Entity (SPE), establishes the cases in which an entity has control over a SPE, and when a company should consolidate this type of entity; (b) addresses that potential voting rights should be analyzed when evaluating the existence of control over an entity; and, (c) set new terms for controlling interest instead of majority interest, and non-controlling interest instead of minority interest.

### **MFRS C-7, Investments in Associates and Other Permanent Investments**

MFRS C-7 describes the accounting treatment for investments in associates and other permanent investments, which were previously treated within MFRS B-8 Consolidated Financial Statements. This MFRS requires the recognition of a Specific-Purpose Entity, through equity method. Also, this MFRS establishes that potential voting rights should be considered when analyzing the existence of significant influence. In addition, this rule defines a procedure and a limit for the recognition of losses in an associate.

### **MFRS C-8, Intangible Assets**

This rule substitutes MFRS C-8 Intangible Assets. The new rule defines intangible assets as non-monetary items and broadens the criteria of identification, indicating that an intangible asset must be separable; this means that such asset could be sold, transferred, or used by the entity. In addition, intangible asset arises from legal or contractual rights, whether those rights are transferable or separable from the entity.

On the other hand, this standard establishes that preoperative costs should be eliminated from the capitalized balance, affecting retained earnings, and without restating prior financial statements. This amount should be presented as an accounting change in consolidated financial statements.

### **MFRS D-8, Share-Based Payments**

MFRS D-8 establishes the recognition of share-based payments. When an entity purchases goods or pay services with share-based payments, the entity is required to recognize those goods or services at fair value and the corresponding increase in equity. According with MFRS D-8, if share-based payments cannot be settled with equity instruments, they have to be settled using an indirect method considering MFRS D-8 parameters.

At the date of the financial statements, management is evaluating the effect of the observance of these new accounting standards will have on the Company's consolidated results of operations and financial position

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**International Financial Reporting Standards (IFRS)**

On November 11, 2008 the Mexican Securities Commission (Comisión Nacional Bancaria y de Valores) issued a press release in which it debriefed that this Commission will perform the necessary regulatory adaptations on which it will be established the requirements for the listed companies to prepare and reveal their financial information under IFRS beginning the year 2012. Likewise it was specified that early adoption for the years 2008, 2009, 2010 and 2011 is allowed.

At the date of the financial statements, management is evaluating the effects of the adoption and implementation of IFRS as well as the potential adoption date.

**3. Foreign Currency Position -**

At December 31, 2008 and 2007, foreign currency denominated assets and liabilities were as follows:

|  | (Figures in thousands of dollars) |                  |             |                  |
|--|-----------------------------------|------------------|-------------|------------------|
|  | 2008                              |                  | 2007        |                  |
| Cash and cash equivalent                       | US\$                              | 13,293           | US\$        | 574,156          |
| Accounts receivable                            |                                   | 147,090          |             | 181,847          |
| Other accounts receivable and prepaid expenses |                                   | 9,247            |             | 2,112            |
| <b>Total</b>                                   | <b>US\$</b>                       | <b>169,630</b>   | <b>US\$</b> | <b>758,115</b>   |
| Current liabilities:                           |                                   |                  |             |                  |
| Suppliers                                      | US\$                              | (238,092)        | US\$        | (169,604)        |
| Related parties                                |                                   | (20,200)         |             | (4,200)          |
| Other accounts payable and accrued expenses    |                                   | (40,214)         |             | (46,510)         |
|  |                                   | (298,506)        |             | (220,314)        |
| Long term liabilities                          |                                   | (3,472)          |             | (3,329)          |
| <b>Total liabilities</b>                       |                                   | <b>(301,978)</b> |             | <b>(223,643)</b> |
| <b>Net assets (liabilities)</b>                | <b>US\$</b>                       | <b>(132,348)</b> | <b>US\$</b> | <b>534,472</b>   |

The exchange rates used to translate U.S. currency amounts were Ps. 13.5383, Ps. 10.8662 and Ps. 10.8810 per U.S. dollar as of December 31, 2008, 2007 and 2006 respectively. As of July 10, 2009, issue date of the financial statements, the exchange rate is Ps.13.5758 per dollar.

At December 31, 2008 and 2007, the Company had the following position of non-monetary assets of foreign origin, or whose net cost of replacement can be determined only in dollars.

(Amounts in thousands)



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|                         | <b>2008</b>         |      | 2007    |
|-------------------------|---------------------|------|---------|
| Machinery and equipment | <b>US\$ 421,231</b> | US\$ | 417,321 |
| Inventories             | <b>536,918</b>      |      | 379,333 |
|                         | <b>US\$ 958,149</b> | US\$ | 796,654 |

F-22

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A summary of transactions carried out for the years ended December 31, 2008, 2007 and 2006, in U.S. dollars, excluding imports of machinery and equipment and excluding transactions of foreign subsidiaries is as follows:

|                              | (Figures in thousands of dollars) |          |      |          |      |          |
|------------------------------|-----------------------------------|----------|------|----------|------|----------|
|                              | 2008                              |          | 2007 |          | 2006 |          |
| Sales                        | US\$                              | 192,618  | US\$ | 119,539  | US\$ | 66,578   |
| Purchases (raw material)     |                                   | (42,184) |      | (39,382) |      | (75,884) |
| Other expenses (spare parts) |                                   | (4,590)  |      | (9,162)  |      | (8,016)  |
| Paid interest                |                                   | (1,307)  |      | (172)    |      | (963)    |

The exchange rate of the peso to the U.S. dollar used by the Company is based on the weighted average of free market rates available to settle its overall foreign currency transactions.

The Company has two foreign subsidiaries, whose combined assets and liabilities are summarized below:

|                                      | Thousands of U.S. dollars |           |      |           |
|--------------------------------------|---------------------------|-----------|------|-----------|
|                                      | 2008                      |           | 2007 |           |
| Monetary current assets              | US\$                      | 116,857   | US\$ | 135,481   |
| Inventories and anticipated expenses |                           | 504,315   |      | 463,379   |
| Short term liabilities               |                           | (265,332) |      | (196,645) |
| Working capital                      |                           | 355,840   |      | 402,215   |
| Buildings, machinery and equipment   |                           | 171,328   |      | 156,740   |
| Other assets and deferred charges    |                           | 14,525    |      | 15,799    |
| Long term liabilities                |                           | (56,643)  |      | (44,982)  |
| Stockholder s equity                 | US\$                      | 485,050   | US\$ | 529,772   |

**4. Balances and transactions with related parties**

Balances due to/from related parties at December 31, 2008 and 2007 were as follows:

| <u>Accounts receivable:</u>                 | 2008 |        | 2007 |       |
|---|------|--------|------|-------|
| Aceros y Laminados SIGOSA, S.A. de C.V. (1) | Ps.  | 39,447 | Ps.  | 3,440 |
| Operadora ICH, S.A. de C.V. (1)             |      | 14,177 |      | -     |
| Others                                      |      | 461    |      | 132   |
| Total (1)                                   | Ps.  | 54,085 | Ps.  | 3,572 |

Payables

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|  |            |                |     |         |
|--|------------|----------------|-----|---------|
| Industrias CH, S.A de C.V. (2)                   | <b>Ps.</b> | <b>296,755</b> | Ps. | 54,100  |
| Pytsa Industrial de México, S.A. de C.V. (1)     |            | <b>67,692</b>  |     | -       |
| Compañía Siderúrgica del Golfo, S.A. de C.V. (1) |            | -              |     | 37,558  |
| Operadora ICH, S.A. de C.V. (1)                  |            | -              |     | 12,125  |
| Others (1)                                       |            | <b>641</b>     |     | 96      |
|  |            | <hr/>          |     |         |
| Total  | <b>Ps.</b> | <b>365,088</b> | Ps. | 103,879 |
|  |            | <hr/>          |     |         |

(1) Affiliate  
company

(2)  
Holding  
company

F-23

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As of December 31, 2008 Ps. 273.6 million of the amount payable to Industrias CH is a note payable denominated in dollars at an indefinite term and bear interest at 5.23% per year. At December 31, 2007, Ps. 45.6 million of the account payable to Industrias CH is a note payable denominated in dollars, at an indefinite term and bear interest at 5.23% per year.

The benefits granted to key senior personnel or relevant directors of the Company as of December 31, 2008, 2007 and 2006 were Ps. 26.6 million, Ps. 24.5 million and Ps. 21.8 million, respectively.

During the years ended December 31, 2008, 2007 and 2006, the following transactions with related parties were carried out:

|                                      | Years ended as of December 31st of |         |      |        |      |        |
|--------------------------------------|------------------------------------|---------|------|--------|------|--------|
|                                      | 2008                               |         | 2007 |        | 2006 |        |
| Sales                                | Ps.                                | 371,163 | Ps.  | 28,351 | Ps.  | 39,206 |
| Purchases                            |                                    | 88,993  |      | 76,015 |      | 6,955  |
| Paid interest                        |                                    | 2,611   |      | 7,261  |      | 3,052  |
| Administrative services expenditures |                                    | 13,346  |      | 11,896 |      | 10,253 |

From time to time we sell steel products, primarily billet, to Industrias CH and its affiliates. In addition we purchased steel products from Industrias CH and its affiliates. We also have a service 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.

## 5. Inventories

Inventories are comprised of the following:

|                                    | Year ended December 31 |                  |      |                  |
|------------------------------------|------------------------|------------------|------|------------------|
|                                    | 2008                   |                  | 2007 |                  |
| Finished goods                     | Ps.                    | 4,329,727        | Ps.  | 2,654,196        |
| Raw materials and supplies         |                        | 3,627,135        |      | 1,524,764        |
| Materials, spare parts and rollers |                        | 424,872          |      | 85,873           |
| Billet                             |                        | 276,078          |      | 294,759          |
| Advanced payments to suppliers     |                        | 138,395          |      | 321,724          |
| Materials in transit               |                        | 29,599           |      | 30,723           |
| Work in process                    |                        | 27,936           |      | 22,351           |
|                                    |                        | <b>8,853,742</b> |      | <b>4,934,390</b> |
| Less allowance for obsolescence    |                        | (3,836)          |      | (3,986)          |
|                                    | Ps.                    | <b>8,849,906</b> | Ps.  | <b>4,930,404</b> |

As of December 31, 2008 the Company recorded a loss of Ps. 727.3 million in the cost of sales caption to recognize the market value of some inventory items.

**6. Derivative financial instruments**

The Company uses derivative financial instruments, primarily to offset the exposure to variability in the price of natural gas. Derivative financial instruments used by the Company consist of natural gas swap contracts. These contracts are recognized on the balance sheet at fair value. The swaps from the

F-24

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Mexican operations are highly effective in mitigating the exposure to natural gas fluctuations, therefore those swaps are considered as cash flow hedges. In the operations of the subsidiary SimRep Corporation ( Republic or SimRep ) which operates in the United States of America, no derivative financial instruments were used during 2008.

As of December 31, 2008, the Company has contracted natural gas swaps with PEMEX Gas and Basic Petrochemicals (PGBP), Gas Natural TETCO (TETCO) Natgasmex, SA of C.V. (Natgasmex) Ecogas Mexico, S of the R. L C. V. (ECOGAS).

The following table shows the existing natural gas swap as of December 31, 2008:

| <b>Date of Contract</b>    | <b>Starting Date</b> | <b>Ending Date</b> | <b>Price (US\$) / MMBTU / G. CAL.</b> | <b>Quantity</b> | <b>Units</b> | <b>Fair Value</b> |
|----------------------------|----------------------|--------------------|---------------------------------------|-----------------|--------------|-------------------|
| 25/06/2008                 | 01/08/2008           | 31/07/2009         | 11.19                                 | 43,400.00       | MMBTU        | Ps. 22,798        |
| 25/06/2008                 | 01/07/2008           | 30/06/2011         | 11.45                                 | 21,420.00       | G.CAL.       | 169,115           |
| 25/06/2008                 | 01/07/2008           | 30/06/2011         | 11.45                                 | 45,000.00       | MMBTU        | 89,532            |
| 13/09/2008                 | 01/01/2007           | 31/12/2009         | 7.92                                  | 16,071.50       | MMBTU        | 5,640             |
| 08/02/2008                 | 01/04/2008           | 31/12/2009         | 9.00+0.64                             | 16,071.50       | MMBTU        | 454               |
| 08/02/2008                 | 01/01/2009           | 31/12/2009         | 8.32                                  | 16,071.50       | MMBTU        | 6,674             |
| 20/06/2008                 | 01/01/2009           | 31/12/2009         | 9.00+3.22                             | 16,071.50       | MMBTU        | (454)             |
| 25/06/2008                 | 01/01/2009           | 30/06/2011         | 11.12                                 | 8,000.00        | MMBTU        | 14,867            |
| 02/09/2008                 | 01/01/2009           | 30/06/2011         | 8.44                                  | 4,000.00        | MMBTU        | 3,170             |
| 02/09/2008                 | 01/07/2011           | 30/06/2012         | 8.47                                  | 4,000.00        | MMBTU        | 737               |
| 13/09/2008                 | 01/01/2007           | 31/12/2009         | 7.92                                  | 21,428.50       | MMBTU        | 7,519             |
| 08/02/2008                 | 01/04/2008           | 31/12/2009         | 9.00+0.64                             | 21,428.50       | MMBTU        | 605               |
| 08/02/2008                 | 01/01/2009           | 31/12/2009         | 8.32                                  | 21,428.50       | MMBTU        | 8,899             |
| 20/06/2008                 | 01/01/2009           | 31/12/2009         | 9.00+3.22                             | 21,428.50       | MMBTU        | (605)             |
| 25/06/2008                 | 01/01/2009           | 30/06/2011         | 11.12                                 | 24,000.00       | MMBTU        | 44,600            |
| 02/09/2008                 | 01/01/2009           | 30/06/2011         | 8.44                                  | 1,750.00        | MMBTU        | 1,387             |
| 02/09/2008                 | 01/07/2011           | 30/06/2012         | 8.47                                  | 6,875.00        | MMBTU        | 1,268             |
| Net Derivative Liabilities |                      |                    |                                       |                 |              | Ps. 376,206       |

As of December 31, 2007, the Company had no hedging contracts for natural gas at the plants located in Mexico. At December 31, 2008, the swaps gave rise to the recognition of a liability of Ps. 376,206 and deferred income tax asset of Ps. 105,338. The amount recorded in equity as part of comprehensive income in the year 2008 was a loss of Ps. 270,868.

Based on its inventory turnover, the Company believes that the natural gas burned and incorporated in its products during a given month is reflected in the cost of sales of the subsequent month; consequently, the realized effects of this hedge are reclassified from the comprehensive income account to results of operations in the following month. In the years ended December 31st, 2008, 2007 and 2006, the Company recorded an increase of Ps. 60.2 million, Ps. 1 million and a reduction of Ps. 26.1 million respectively to its cost of sales resulting from settled transactions.

In the case of Republic, gas swap contracts are used to cover changes in the cost of natural gas. The contracts

are usually no longer than one year. At December 31, 2008 and 2007, Republic had no active natural gas swap contracts.

F-25

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## 7. Property, plant and equipment

Property, plant and equipment are comprised of the following:

|  | 2008 |                    | 2007 |             |
|--|------|--------------------|------|-------------|
| Buildings                                  | Ps.  | 2,909,141          | Ps.  | 2,067,318   |
| Machinery and equipment                    |      | 12,759,738         |      | 8,961,505   |
| Transportation equipment                   |      | 102,718            |      | 41,377      |
| Furniture, mixtures and computer equipment |      | 127,297            |      | 67,860      |
|  |      | <b>15,898,894</b>  |      | 11,138,060  |
| Less accumulated depreciation              |      | <b>(6,847,468)</b> |      | (4,016,312) |
|  |      | <b>9,051,426</b>   |      | 7,121,748   |
| Land                                       |      | 822,554            |      | 552,279     |
| Construction-in-progress (1)               |      | 386,597            |      | 196,043     |
| Machinery and equipment out of use         |      | 30,568             |      | 30,568      |
|  | Ps.  | <b>10,291,145</b>  | Ps.  | 7,900,638   |

(1) Construction in progress corresponds primarily to improvements intended to increase the installed capacity. The completion date of these projects in progress at December 31, 2008, is scheduled for March 2010 and the pending investment amount is Ps. 16,573.

The depreciation expense for the years ended December 31, 2008, 2007 and 2006 amounted to Ps. 578,125, Ps. 464,726 and Ps. 352,941 respectively.

As of December 31, 2008, 2007 and 2006, balances in buildings and machinery and equipment, include capitalized comprehensive financial cost as a complement to the acquisition cost of Ps. 524,298.

At December 31, 2007 and 2006, the specific restatement rate of machinery and equipment was greater than the NCPI, since a significant portion of such machinery is imported and the inflation factor of the country of origin and the fluctuation of the peso versus the respective currency were greater than the NCPI.

## 8. Intangible assets

As a result of the acquisition of Republic, the Company identified and recognized intangible assets to their fair value totaling Ps. 307 million. As a result of the acquisition of Grupo San, the Company identified and recognized intangible assets to their fair value totaling Ps. 7,192 million. Intangibles balances at December 31, 2007 are presented at its indexed value based on the NCPI at that date. At December 31, 2008 and 2007, this item is comprised of the following:

|                               | Cost       | Accrued amortization | Balances as of Dec-31-08 | Cost       | Accrued amortization | Balances as of Dec-31-07 |
|-------------------------------|------------|----------------------|--------------------------|------------|----------------------|--------------------------|
| Recorded name Republic        | Ps. 72,850 | Ps. -                | Ps. 72,850               | Ps. 70,004 | Ps. -                | Ps. 70,004               |
| Kobe Tech Contract (Republic) | 84,980     | 24,193               | 60,787                   | 81,660     | 16,444               | 65,216                   |



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|                                   |                  |                |                  |         |        |         |
|-----------------------------------|------------------|----------------|------------------|---------|--------|---------|
| Listing of customers Republic     | 44,514           | 7,609          | 36,905           | 42,776  | 5,165  | 37,611  |
| Listing of customers Grupo San    | 2,205,700        | 142,962        | 2,062,738        | -       | -      | -       |
| No competition contract Grupo San | 394,700          | 57,560         | 337,140          | -       | -      | -       |
| Trademark San 42                  | 345,600          | -              | 345,600          | -       | -      | -       |
| Gas contracts Grupo San           | 68,200           | 68,200         | -                | -       | -      | -       |
| Technological platform            | 8,800            | 1,027          | 7,773            | -       | -      | -       |
| Goodwill Grupo San                | 4,166,160        | -              | 4,166,160        | -       | -      | -       |
|                                   | <b>7,391,504</b> | <b>301,551</b> | <b>7,089,953</b> | 194,440 | 21,609 | 172,831 |

F-26

The estimated useful lives and amortizations for the following five years are as follows:

|                                   | Value at<br>31-Dec-08 | Useful<br>Life | Amortization at<br>December 31, |             | Estimated future amortization |            |         |
|-----------------------------------|-----------------------|----------------|---------------------------------|-------------|-------------------------------|------------|---------|
|                                   |                       |                | 2008                            | 2009        | 2011                          | 2012       | 2013    |
| Recorded name Republic            | <b>Ps. 72,850</b>     | Indefinite     | Ps. -                           | Ps. -       | Ps. -                         | Ps. -      | -       |
| Kobe Tech Contract (Republic)     | <b>84,980</b>         | 144 months     | 7,749                           | 7,082       | 7,082                         | 7,082      | 7,082   |
| List of clients Republic          | <b>44,514</b>         | 240 months     | 2,444                           | 2,226       | 2,226                         | 2,226      | 2,226   |
| Listing of customers Republic     | <b>2,205,700</b>      | 108 months     | 142,962                         | 245,078     | 245,078                       | 245,078    | 245,078 |
| No competition contract Grupo San | <b>394,700</b>        | 48 months      | 57,560                          | 98,675      | 41,115                        | -          | -       |
| Trademark San 42                  | <b>345,600</b>        | Indefinite     | -                               | -           | -                             | -          | -       |
| Gas contracts Grupo San           | <b>68,200</b>         | 7 months       | 68,200                          | -           | -                             | -          | -       |
| Technological platform            | <b>8,800</b>          | 60 months      | 1,027                           | 1,760       | 1,760                         | -          | 733     |
| Goodwill Grupo San                | <b>4,166,160</b>      | Indefinite     | -                               | -           | -                             | -          | -       |
|                                   | <b>Ps. 7,391,504</b>  |                | Ps. 279,942                     | Ps. 354,821 | Ps. 297,261                   | \$ 255,119 |         |

## 9. Other assets and deferred charges

Other assets balances at December 31, 2007 are presented at its indexed value based date. At December 31, 2008 and 2007, this item is comprised of the following:

|  | Cost               | Accrued<br>amortization | Balances as of<br>Dec-31-08 | Cost        | Accrued<br>amortization | Balances as of<br>Dec-31-07 |
|--|--------------------|-------------------------|-----------------------------|-------------|-------------------------|-----------------------------|
| Preoperative expenses and deferred charges | <b>668,287</b>     | <b>492,898</b>          | <b>175,389</b>              | 626,919     | 455,659                 | 171,260                     |
| Other assets (1)                           | <b>89,878</b>      | -                       | <b>89,878</b>               | 45,314      | -                       | 45,314                      |
|  | <b>Ps. 758,165</b> | <b>Ps. 492,898</b>      | <b>Ps. 265,267</b>          | Ps. 672,233 | Ps. 455,659             | Ps. 216,574                 |

(1) The other assets are not subject to amortization and are comprised mainly of guarantee deposits, among others.

The estimated useful lives and amortizations for the following five years are as follows:

|  | Value at<br>31-Dec-08 | Useful<br>Life | Amortization at<br>December 31, |             | Estimated future amortization |           |
|--|-----------------------|----------------|---------------------------------|-------------|-------------------------------|-----------|
|  |                       |                | 2008                            | 2009 - 2011 | 2012                          | 2013      |
| Preoperative expenses and deferred charges | <b>668,287</b>        | 10 -20 years   | 37,239                          | 37,239      | 37,239                        | 26,433    |
|  | <b>Ps. 668,287</b>    |                | Ps. 37,239                      | Ps. 37,239  | Ps. 37,239                    | \$ 26,433 |

**10. Notes payable, Debt and Medium Term Notes****(a) Revolving line of credit with General Electric (GE) Capital**

On December 31, 2008, the subsidiary Republic Inc. maintained a U.S.\$150.0 million Senior Secured Credit Agreement (GE credit facility) with General Electric Capital Corporation (GE Capital). This facility was scheduled to mature on May 20, 2009. However, on December 1, 2008, Republic Inc. was granted an extension of the GE credit facility until May 20, 2010, at the Company's election.

At December 31, 2008 and 2007, Republic Inc. had U.S.\$0.6 (Ps. 8,800 million) and U.S.\$0, respectively, in outstanding borrowings and had issued U.S.\$5.8 million and U.S.\$16.4 million, respectively, in letters of credit under the GE credit facility. Republic Inc. is required to pay an unused facility fee of 0.50% per annum. The advances under the GE credit facility are limited by the borrowing base, as defined in the GE credit facility as the sum of 85.0% of eligible accounts receivable plus 65.0% of eligible inventory. The amount available under the facility was approximately U.S.\$143.5 million at December 31, 2008.

Borrowings, if any, under the GE credit facility are secured by a first priority perfected security interest in all of Republic Inc.'s presently owned and subsequently acquired inventory and accounts receivable. The obligations under the GE credit facility are secured and are unconditionally and irrevocably guaranteed jointly and severally by Republic Inc.'s subsidiaries. Borrowings under the GE credit facility bear interest, at Republic Inc.'s option, at an index rate equal to the higher of the prime rate published from time to time by The Wall Street Journal, plus the applicable margin, or the federal funds rate plus 50 basis points per annum, plus the applicable margin; or LIBOR plus the applicable margin. The applicable margins range from 0.00% to 0.25% for index rate loans and from 0.875% to 1.25% for LIBOR loans based on the average daily availability in the prior quarter. The margins on the unused facility fee range from 0.50% to 0.375%. Based on the fourth quarter 2008 average daily availability, the margins for the first quarter of 2009 are 0.00% for the index margin, 0.875% for the LIBOR margin, 0.5% for the unused facility fee margin, and 0.875% for the applicable letter of credit margin. The GE credit facility contains customary representations, warranties and covenants including restrictions on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Capital expenditures for any fiscal year are limited under the GE credit facility to U.S.\$100.0 million, excluding capital expenditures financed by proceeds of any insurance recoveries received. Republic Inc. is in compliance with all applicable covenants under the GE credit facility as of December 31, 2008.

**11. Seniority Premiums and Termination Payments**

The cost, obligations and other components of seniority premiums and termination payments were determined based on computations made by independent actuaries at December 31, 2008, 2007 and 2006.

The components of the net period cost for the years ended December 31, 2008, 2007 and 2006 corresponding to seniority premiums and termination benefits are as follows:

|   | 2008      | 2007      | 2006      |
|---|-----------|-----------|-----------|
| Net period cost:                            |           |           |           |
| Labor cost                                  | Ps. 5,602 | Ps. 2,654 | Ps. 2,877 |
| Financial cost                              | 8,517     | 755       | 996       |
| Amortization of transition liability        | 1,342     | 990       | 1,223     |
| Amortization of prior service cost and plan |           |           |           |

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|                                     |                   |                  |                  |
|-------------------------------------|-------------------|------------------|------------------|
| amendments                          | <b>5,715</b>      | 176              | 155              |
| Contributions to pensions in course | <b>3,940</b>      | -                | -                |
| Actuarial loss and others           | <b>1,900</b>      | -                | 210              |
| <hr/>                               |                   |                  |                  |
| Net period cost                     | <b>Ps. 27,016</b> | <b>Ps. 4,575</b> | <b>Ps. 5,461</b> |
| <hr/>                               |                   |                  |                  |

F-28

An analysis of the present value of benefit obligations is as follows:

|  | 2008        | 2007       |
|--|-------------|------------|
| Projected benefits obligations                       | Ps. 202,965 | Ps. 18,756 |
| Plan assets  | (100,460)   | -          |
| Unamortized items                                    |             |            |
| Transition liability                                 | (47,050)    | (6,708)    |
| Prior service cost and plan amendments               | 49          | (398)      |
| Variations in assumptions and experience adjustments | (21,409)    | 1,524      |
| Additional liability                                 | -           | 5,248      |
| Accumulated benefit obligations                      | Ps. 34,095  | Ps. 18,422 |

The most important assumptions used in determining the net period cost of the plans are:

|   | 2008 | 2007 |
|---|------|------|
| Actual discount rate used to reflect current value of obligations | 8.4% | 4.5% |
| Actual rate of future salary increases                            | 4%   | 1%   |
| Actual expected return rate of plan assets                        | 8.4% | 4.5% |

## 12. Other employment benefit plan

Republic is the only subsidiary of the Group which offers other benefits and pension plans to their employees. Benefit plans to employees with Republic are described below.

### Collective Bargaining Agreements

Eighty-three percent of the Company's production workers are covered by a collective bargaining agreement with the United Steelworkers of America (USWA). During the year ended December 31, 2007, the Company negotiated a new collective bargaining agreement effective from August 16, 2007 through August 15, 2012 (new labor agreement). The previous collective bargaining agreement expired on August 15, 2007 (previous labor agreement). For the Mexican operations, approximately 60% of the employees are under a collective contract. The Mexican collective contracts expire in periods greater than one year.

### Defined Contribution Plans

Both the new and previous labor agreements provide for a defined contribution program for retirement healthcare and pension benefits. The Company is required to make a contribution for every hour worked. Under the previous labor agreement, the contribution amount was U.S.\$3.00 for every hour worked through August 16, 2004, U.S.\$ 3.50 for every hour worked through August 16, 2005, and U.S. \$3.80 for every hour worked thereafter until August 16, 2007. The new labor agreement requires a contribution to the retirement healthcare plan of U.S. \$3.00 for every hour worked, not to be less than U.S. \$2.85 million per quarter, but not to exceed U.S. \$11.4 million per year. Contributions are made to the pension plan at a rate of U.S. \$1.68 per hour as defined in the new labor agreement. The new contribution rates and contribution limit were effective beginning August 16, 2007. For the years ended December 31, 2008, 2007 and 2006 the Company recorded Ps. 216 million, Ps. 176 million and Ps. 170 million, respectively, of expense related to these funding obligations.

The Company has a defined contribution retirement plan that covers substantially all salary and nonunion hourly employees. This plan is designed to provide retirement benefits through Company contributions and voluntary deferrals of employees' compensation. The Company funds contributions to this plan each pay period based upon the participants age and service as of January first of each year. The amount of the Company's contribution is equal to the monthly base salary multiplied by the appropriate percentage based on age and years of service. The contribution becomes 100% vested upon completion of three years of service. In addition, employees are permitted to make contributions into a 401(k) retirement plan through payroll deferrals. The Company provides a 25.0% matching contribution for the first 5.0% of payroll that an employee elects to contribute. Employees are 100.0% vested in both their and the Company's matching 401(k) contributions. For years ended December 31, 2008, 2007 and 2006 the Company recorded expense of Ps. 31.3 million, Ps. 26 million and Ps. 27.1 million respectively. Effective April 1, 2007, the Company amended the defined contribution retirement plan to include all employees covered by the USWA labor agreement. Employees who are covered by the USWA labor agreement are eligible to participate in the defined contribution retirement plan through voluntary deferrals of employees' compensation. There are no Company contributions or employer matching contributions.

### **Profit Sharing Plans**

The previous labor agreement included a profit sharing plan to which the Company was required to contribute 15.0% of its quarterly pre-tax income, as defined in the previous labor agreement, in excess of U.S.\$ 12.5 million. This plan remained in effect until December 31, 2007 under the new labor agreement. For the years ended December 31, 2007 and 2006 the Company recorded Ps. 80 million and Ps. 93 million, respectively, related to its profit sharing funding obligation under the previous labor agreement. The new labor agreement also includes a profit sharing plan to which the Company is required to contribute 2.5% of its quarterly pre-tax income, as defined in the new labor agreement. At the end of the year, the contribution will be based upon annual pre-tax income up to U.S.\$50.0 million multiplied by 2.5%, U.S. \$50.0 million to U.S. \$100.0 million multiplied by 3.0%, and above U.S.\$100.0 million multiplied by 3.5%, less the previous payouts during the year. For the year ended December 31, 2008, the Company recorded Ps. 51 million related to its profit sharing funding obligation under the new labor agreement.

In 2004, Republic Inc. adopted a profit sharing plan for salary and nonunion hourly employees excluding a select group of managers and executives. The Company is required to contribute 3.0% of its quarterly pre-tax income, as defined in the plan, in excess of U.S.\$12.5 million. For the years ended December, 2008, 2007 and 2006 the Company recorded expense of Ps. 26 million, Ps. 16 million and Ps. 21.5 million, respectively, under this plan.

### **Incentive Compensation Plans**

During 2007, Republic Inc. had a Key Employee Incentive Plan which was in effect beginning February 1, 2007. The plan was based on attaining the 2007 Business Plan earnings before income taxes, depreciation and amortization (EBITDA) and individual performance targets. The objectives were measured on an annual basis. For the year ended December 31, 2007, the Company did not record expense under this plan due to not meeting the annual measurement objectives.

Effective January 1, 2008, Republic Inc. adopted a Key Manager Incentive Plan and Operations and Maintenance Incentive Plan. Additionally, effective April 1, 2008, the Company adopted a Commercial Sales Incentive Plan and a Production Planning Incentive Plan. The plans were based on attaining the 2008 Business Plan (EBITDA) and other performance targets. The objectives were measured on a quarterly basis. Individuals designated as participants in these plans were excluded from the profit sharing plan. For the year ended December 31, 2008, the Company recorded Ps. 26 million of expense under these incentive plans.

### **Deferred Compensation Plan**

The Company has a deferred compensation plan covering certain key employees. The plan allows for the covered employee to make annual deferrals of base salary and provides for a fixed annual contribution by the Company based on a percentage of salary. For the years ended December 31, 2008,

F-30

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2007 and 2006 the Company recorded expense of Ps. 1.1 million related to the deferred compensation plan.

### 13. Employees Profit Sharing (EPS)

EPS is computed in similar terms to the taxable profit for income tax, excluding the annual adjustment due to inflation and the inflation effects in tax depreciation. The EPS is recorded in the Income Statement in the caption of general expenses. For the years 2008, 2007 and 2006 EPS was as following:

|          | 2008 |        | 2007 |     | 2006 |     |
|----------|------|--------|------|-----|------|-----|
| Current  | Ps.  | 23,979 | Ps.  | 269 | Ps.  | 240 |
| Deferred |      | (38)   |      | -   |      | -   |
| Total    | Ps.  | 23,941 | Ps.  | 269 | Ps.  | 240 |

As of December 31, 2008, the Company has deferred EPS for Ps. 5,396 and it is included in the balance sheet under the Other Assets caption.

### 14. Stockholders' equity

The most significant characteristics of stockholders' equity accounts are described below:

#### (a) Capital stock structure

- i) On July 22, 2008 at a Shareholders Meeting they approved an increase to the capital stock in its variable portion of Ps. 134,695, represented by 27,699,442 ordinary shares corresponding to B series, with a subscription price of 50.64 Pesos which included a stock premium of 45.7772612088 Pesos for each share. In this same meeting Industrias CH, two of its affiliates companies and other related companies were authorized to subscribe and pay 23,087,603 shares and the 4,611, 839 remaining shares were offered to the rest of the shareholders in accordance with their preemptive rights. Once the subscription term expired the Board of Directors in exercise of its powers delegated by the Shareholders Meeting on February 24, 2009, cancelled these additional shares corresponding to an amount of Ps. 22,426. The increase of capital stock paid was Ps. 112,269 plus a stock premium of Ps. 1,056,887.
- ii) At an Extraordinary Meeting held on October 24, 2006, the stockholders approved to increase the capital stock of the Company through a public offer of 60,000,000 shares in the domestic and international markets. On February 8, 2007 an offer price per share was established for the primary purchasing offer (the Offer) for up to 52,173,915 shares, at 45.70 pesos per share. The offer price for the ADSs (American Depositary Shares) was 12.50 dollars per ADS. Each ADS represents 3 B Series shares. In addition to the 52,173,915 shares, the Company granted the underwriters an over-allotment option of 7,826,085 additional B series shares.

The Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) and the Securities and Exchange Commission authorized the Offer in January 2007. The registration of the Offer was performed on February 9, 2007. On February 13, 2007, the Company received payment of this transaction and it amounted Ps. 1,370 million (after commission) for the international offer and Ps. 995 millions (after commission) for the offer in Mexico. On March 15, 2007 the sale of the shares for the over-allotment option of 1,232,990 shares was paid. The proceeds amounted to Ps. 27 millions (after commission) for the international offer and Ps. 29 million (after commission) for the Mexican offer.





- iii) During the year 2006, some minority stockholders exercised their preemptive rights to subscribe and pay the increase in the variable portion of the capital stock declared on April 29, 2005, and made a contribution of Ps. 38,656 (Ps. 36,110 nominal, value of shares Ps. 14.59) and a stock premium of Ps. 92,244 (Ps. 86,170 nominal, premium of Ps. 34.81 per share) through the subscription and payment of 2,475,303 shares, cancelling 252,367 shares that were not subscribed or paid.

Subsequent to the above-mentioned resolutions and activities, the Company's capital stock aggregates Ps. 4,142,696, represented by 497,709,214 common series B shares with no par value. Such shares may be subscribed and paid in by both Mexican and foreign individuals or companies.

The number of shares corresponding to B series originated without expression of nominal value to December 31, 2008, 2007 and 2006 are the following:

|                        | 2008               | 2007        | 2006        |
|------------------------|--------------------|-------------|-------------|
| Common series B shares | <b>497,709,214</b> | 474,621,611 | 421,214,706 |

Each share has the right to one vote at stockholders' meeting. Minimum fixed capital not subject to withdrawal is Ps. 441,786 nominal amount.

#### (b) Comprehensive Income

Comprehensive income reported on the consolidated statement of changes in stockholders' equity represents the result of all the Company's activities during the year and includes the following captions, which in conformity with Mexican Financial Reporting Standards, were applied directly to stockholders' equity, except for the net income:

|  | 2008                 | 2007          | 2006          |
|--|----------------------|---------------|---------------|
| Net income - majority interest                                     | <b>Ps. 1,796,137</b> | Ps. 1,529,057 | Ps. 2,178,694 |
| Result from holding non-monetary assets (1)                        | -                    | 292,936       | 138,777       |
| Deferred taxes applied to result from holding non-monetary assets. | -                    | (77,903)      | (38,858)      |
| Fair value of derivative financial instruments                     | <b>(376,206)</b>     | 6,329         | (67,225)      |
| Deferred taxes in fair value of derivative financial instruments   | <b>105,338</b>       | (1,772)       | 19,434        |
| Translation effect of foreign subsidiaries, net                    | <b>1,245,032</b>     | (12,226)      | (82,925)      |
|  | <b>2,770,301</b>     | 1,736,421     | 2,147,897     |
| Minority interest (2)  | <b>104,212</b>       | 96,118        | 220,082       |
|  | <b>2,874,513</b>     | 1,832,539     | 2,367,979     |
| Total  | <b>Ps. 2,874,513</b> | Ps. 1,832,539 | Ps. 2,367,979 |

(1) Includes primarily the result from holding nonmonetary assets due to fixed assets

(2) The minority interest is the due to the investment of Industrias CH, S.A.B. de C.V. (Holding Company) in SimRep Corporation.

#### (c) Restrictions on stockholder's equity

The Company is required to appropriate at least 5% of the net income of each year to increase the legal reserve. This practice must be continued until the legal reserve reaches 20% of the capital stock issued and outstanding. At December 31, 2008, the legal reserve aggregates to Ps. 484 million.

Stockholder contributions, which are restated for tax purposes, may be refunded tax-free, provided that the reimbursed amount is equal to or in excess of the Company's stockholders' equity.

F-32

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Earnings distributed on which no income tax has been paid, as well as other stockholders' equity account distributions are subject to income tax, payable by the Company, at the rate of 28%, consequently, the stockholders may only receive 72% of such dividends.

## 15. Income tax

### I) Flat Rate Business Tax

a) The Flat-Rate Business Tax (FRBT) Law was published in the Official Gazette on October 1, 2007. This Law will come into force as of January 1, 2008 and abolish the Asset Tax Law.

Current-year FRBT is computed by applying the 17.5% rate (16.5% for 2008 and 17% for 2009) to income determined on the basis of cash flows, net of authorized credits.

FRBT credits derive mainly from the unamortized negative FRBT base and salary credits and social security contributions, as well as credits derived from the deduction of certain investments, such as those made in inventories and fixed assets, during the transition period from the date on which the FRBT comes into force.

FRBT shall be payable only to the extent it exceeds income tax for the same period. In other words, to determine FRBT payable, income tax paid in a given period shall first be subtracted from the FRBT of the same period and the difference shall be the FRBT payable.

Should a negative FRBT base be determined because deductions exceed taxable income, there will be no FRBT payable. The amount of the negative base multiplied by the FRBT rate results in a FRBT credit, which may be applied against income tax for the same year or, if applicable, against FRBT payable in the next ten years.

Based on the financial projections for the next four years, and retrospectively on historical results, the Company considers which of the Group subsidiaries will be subject to income tax and which will be subject to FRBT. The deferred taxes of the period were determined based on the specific rules of each tax.

### II) Income Tax

The Company consolidates its taxable income through ICH, the parent company. Under Mexican Income Tax Law, ICH and each of its subsidiaries calculate their taxes individually, and have the obligation to pay the minority part of such taxes directly to the Mexican Tax Authorities. The majority interest for consolidated tax purposes is paid through the holding company. The Company computes its tax provision on a stand alone basis.

" An analysis of income tax charged to results of operations for the years ended December 31, 2008, 2007 and 2006 is as follows:

|  | 2008                 |  | 2007        |  | 2006        |
|--|----------------------|--|-------------|--|-------------|
| Current income tax Mexican subsidiaries  | <b>Ps. 545,490</b>   |  | Ps. 80,119  |  | Ps. 90,305  |
| Current income Tax foreign subsidiaries  | <b>197,765</b>       |  | 31,403      |  | 537,307     |
| Deferred income tax Mexican subsidiaries | <b>392,271</b>       |  | 356,059     |  | 177,085     |
| Deferred income tax foreign subsidiaries | <b>(99,223)</b>      |  | 153,093     |  | (195,976)   |
| <b>Total income tax</b>                  | <b>Ps. 1,036,303</b> |  | Ps. 620,674 |  | Ps. 608,721 |

F-33

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a) At December 31 2008 and 2007, deferred taxes were analyzed as follows:

|   | 2008                 | 2007                 |
|---|----------------------|----------------------|
| Deferred tax assets:  |                      |                      |
| Allowance for bad debts   | Ps. 62,401           | Ps. 20,250           |
| Liability provisions  | 144,333              | 93,860               |
| Advances from customers   | 20,735               | 13,967               |
| Tax Loss Carryforwards (NOLs)                                       | 1,731,612            | 299,548              |
| Republic tax credits (AMT)  | 192,596              | -                    |
| Recoverable asset tax   | 99,610               | 99,610               |
| EPS provision   | 19,874               | -                    |
| Derivative financial instruments                                    | 105,338              | -                    |
|   | <b>2,376,499</b>     | <b>527,235</b>       |
| Less:   |                      |                      |
| Valuation allowance for deferred tax asset                          | (182,344)            | (99,610)             |
| Valuation allowance for NOLs from acquisitions                      | (1,067,785)          | (289,507)            |
|   | <b>(1,250,129)</b>   | <b>(389,117)</b>     |
|   | <b>1,126,370</b>     | <b>138,118</b>       |
| Deferred tax liabilities:   |                      |                      |
| Inventories   | 644,822              | 456,376              |
| Property, plant and equipment                                       | 2,230,251            | 1,602,184            |
| Additional liabilities from other tax transactions                  | 1,142,882            | 695,973              |
| Preoperative expenses   | 51,001               | 55,155               |
| Intangibles from Grupo San acquisition                              | 765,542              | -                    |
| Deferred flat rate business tax, net                                | 39,693               | -                    |
| Other   | 4,384                | 910                  |
|   | <b>4,878,575</b>     | <b>2,810,598</b>     |
| Deferred credit for future tax benefits from NOLs from acquisitions | <b>420,046</b>       | -                    |
|   | <b>Ps. 4,172,251</b> | <b>Ps. 2,672,480</b> |

b) At December 31, 2008, 2007 and 2006 the tax expense attributable to income before income tax, employee profit sharing and minority interest differed from the expense computed by applying the income tax rate of 28% in 2008 and 2007 and 29% in 2006 to income before these provisions and minority interest. An analysis is as follows:

F-34

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|  | 2008          | 2007        | 2006        |
|--|---------------|-------------|-------------|
| Expected tax expense   | Ps. 822,262   | Ps. 628,838 | Ps. 872,174 |
| Increase (decrease) resulting from:                                |               |             |             |
| Net effect of inflation  | (27,152)      | 15,541      | 18,044      |
| Cancellation on asset tax  | -             | 90,889      | -           |
| Effect on Republic's effective income tax rate                     | 12,849        | 80,191      | 110,271     |
| Change in valuation allowance of deferred tax assets (1)           | 82,734        | (14,612)    | 41,013      |
| FRBT paid in excess of income tax                                  | 87,407        | -           | -           |
| Change of valuation allowance of NOLs from acquisitions (3)        | (446,909)     | (493,010)   | (427,935)   |
| Change in the additional liability from other tax transactions (2) | 446,909       | 342,933     | 27,909      |
| Other, net   | 58,203        | (30,096)    | (32,755)    |
| Income tax expenses  | Ps. 1,036,303 | Ps. 620,674 | Ps. 608,721 |

- (1) At December 31, 2008 and 2007 the total valuation allowance for deferred tax assets was Ps. 1,250,129 and Ps. 389,117, respectively. For the year 2006, the Company has determined that part of its recoverable tax asset generated in the period will not be recovered and increased its allowance. In the year 2007, due to the new FRBT law and the transitions rules regarding the recovery of asset tax from prior years, the Company wrote-off part of its recoverable asset tax and consequently has reduce its valuation allowance. During 2008 the subsidiary SimRep generated a tax credit (ATM) for Ps. 192,596 and the Company determined that part of that credit was not going to be recover and consequently increased its valuation allowance Ps. 82,734 with respect to this asset. To evaluate the recoverability of deferred assets, management considers the probability of not recovering all or a portion of it. The final realization of deferred assets depends on the generation of taxable profits in the periods when the temporary differences are deductible. Upon carrying out this evaluation, management considers the expected reversal of deferred liabilities, projected taxable profit and planning strategies.
- (2) The Company determines an additional deferred tax liability from transactions that result in a deferral of current income tax expense, but they will result in a tax expense in the future. For the years ended December 31, 2008, 2007 and 2006, the increases in this liability are related to the amortization of NOLs from acquisitions.
- (3) This benefit is the result of the change in valuation allowance for recognition of tax loss carry forwards from acquisitions.

The effective rate for the years ended on December 31st, 2008, 2007 and 2006 were 35.3%, 27.6% and 20%, respectively.

- c) The Company has available tax loss carryforwards which can be applied against earnings generated in the following ten years, and indexed for inflation, following the procedures established by the Income Tax Law in force.

At December 31, 2008 there were available tax loss carryforwards, restated for inflation, as follows:

| Year of<br>Origin | Expiration | Tax Losses<br>Carryforward (1) |
|-------------------|------------|--------------------------------|
|-------------------|------------|--------------------------------|



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|      |      |     |           |
|------|------|-----|-----------|
| 2001 | 2011 | Ps. | 10,536    |
| 2002 | 2012 |     | 192,817   |
| 2003 | 2013 |     | 523,101   |
| 2004 | 2014 |     | 260,237   |
| 2005 | 2015 |     | 4,265,800 |
| 2006 | 2016 |     | 281,702   |
| 2007 | 2017 |     | 473,202   |
| 2008 | 2018 |     | 176,933   |
|      |      |     | <hr/>     |
|      |      | Ps. | 6,184,328 |
|      |      |     | <hr/>     |

(1) Tax losses carryforward include Ps. 5,955,351 from acquisitions.

F-35

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## III) Asset tax (AT)

Prior to the new FRBT law, asset tax is levied at the rate of 1.25% and is payable on the average value of most assets net of certain liabilities. Asset tax may be credited against income tax and is payable only to the extent that it exceeds this tax. Asset tax paid can be requested for refund to the extent that the income tax exceeds this tax in the following ten years. For the years 2007 and 2006 the Company determined an asset tax of Ps. 46,914 and Ps. 81,983, respectively.

**16. Acquisitions**

- a) On December 26, 2008 the Company acquired 99.95% of the shares of Northarc Express, S. A. de C. V. a subsidiary of Grupo TMM, S. A. de C. V., to turn this company in to the operating subsidiary of the manufacturing plants steel plants located in Mexico. The total cost of this acquisition was Ps. 172 million. On January 6, 2009 this company was renamed to Simec International 2, S. A. de C. V. On July 29, 2008, the Company acquired 100% of the shares of Aroproc, S. A. de C. V., Del-Ucral, S. A. de C. V., Qwer, S. A. de C. V. and Transporte Integral Doméstico, S.A. de C.V., subsidiaries of Grupo TMM, S. A. de C. V., to turn them into the distribution subsidiaries of the manufacturing plants located in Mexico. The total cost of these acquisitions was Ps. 33 million. On July 30 2008, these companies were renamed to Promotora de Aceros San Luis, S. A. de C. V., Comercializadora Aceros DM, S.A. de C.V., Comercializadora Msan, S.A. de C.V. and Productos Siderúrgicos de Tlaxcala, S.A. de C.V. respectively. The only asset of these acquisitions was a deferred tax asset from NOLs that was reserved up to the amount paid by them.
- b) In order to increase its market share in Mexico, on February 21, 2008, the Company entered into a purchase agreement to acquire 100% of the shares of Corporación Aceros DM, S. A. de C. V. and certain affiliated companies (Grupo San). On May 30, 2008 the acquisition was consummated. Grupo San is a large steel producer and one of the most important producers of corrugated rebar of Mexico. The facilities of Grupo San are located in San Luis Potosí, Mexico.

The fair value of the net assets acquired amounted Ps. 4,564 and the acquisition cost was Ps. 8,730 million, giving rise to a goodwill of Ps. 4,166 million. The factors that led to the recognition of goodwill are mainly the synergies expected with the incorporation of Grupo San to the Company, as well as other non-separable intangibles. The fair value of the net assets acquired is as follows:

|  |     |            |
|--|-----|------------|
| Current assets                         | Ps. | 1,455,815  |
| Property, plant and equipment          |     | 2,052,368  |
| Intangible assets and deferred charges |     | 7,189,160  |
| Other assets                           |     | 56,269     |
|  |     | <hr/>      |
| Total Assets                           | Ps. | 10,753,612 |
|  |     | <hr/>      |
| Current liabilities                    |     | 589,808    |
| Deferred taxes                         |     | 1,426,436  |
| Other long-term liabilities            |     | 7,047      |
|  |     | <hr/>      |
|  |     | 2,023,291  |
|  |     | <hr/>      |
| Net assets acquired                    | Ps. | 8,730,321  |
|  |     | <hr/>      |

The following combined pro forma financial information (unaudited) for 2008, is based on the Company's combined historical financial statements adjusted to reflect the acquisition of Grupo San and certain accounting adjustments related to the net profits of the acquired company.

F-36

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The pro forma adjustments (non-audited) assume that the acquisition was conducted at the beginning of 2008 and 2007, respectively, and is based on available data and certain suppositions that management considers to be reasonable.

The pro forma financial information (unaudited) is not intended to present the results of the consolidated operations had the acquisition occurred on such date, nor to anticipate the Company's results of operations.

|                            | <b>2008</b>        |  | <b>2007</b>        |
|----------------------------|--------------------|--|--------------------|
|                            | <b>(unaudited)</b> |  | <b>(unaudited)</b> |
| Net Sales                  | Ps. 37,869,617     |  | Ps. 28,402,386     |
| Marginal Profit            | 6,301,519          |  | 4,587,178          |
| Net Income                 | Ps. 2,378,033      |  | Ps. 1,867,191      |
| Earnings per Share (Pesos) | 4.90               |  | 3.99               |

- c) On November 24, 2007, the Company acquired 99.95% of the shares of TMM América, S.A. de C.V., TMM Continental, S.A. de C.V. and Mutimodal Doméstica, S.A. de C.V., subsidiaries of Grupo TMM S.A de C.V., to turn them into three distribution subsidiaries for the manufacturing plants located in Mexico. The total cost of these acquisitions was Ps.35,901.

## 17. Segments

The Company segments its information by region, due to the operational structure and the organization of its business. The Company's sales are made mainly in Mexico and the United States of America. The Mexican segment includes the plants in Mexicali, Guadalajara, Tlaxcala and San Luis Potosi. The USA segment includes the seven plants from Republic, of which six are located in the USA (distributed in the states of Ohio, Indiana and New York) and one in Canada (Ontario). The plant in Canada represents approximately 5% of the segment's total sales. Both segments are engaged in the manufacturing and sale of long steel products intended primarily for the building and automotive industries.

For the year ended on December 31st, 2008

|  | Mexico         | USA            | Operations<br>between<br>Segments | Total          |
|--|----------------|----------------|-----------------------------------|----------------|
| Net Sales  | Ps. 12,780,358 | Ps. 22,448,283 | Ps. (43,421)                      | Ps. 35,185,220 |
| Cost of Sales  | 8,402,516      | 21,438,719     | (45,072)                          | 29,796,163     |
| Marginal Profit  | 4,377,842      | 1,009,564      | 1,651                             | 5,389,057      |
| Indirect overhead, selling and administrative expenses | 1,567,060      | 706,768        | -                                 | 2,273,828      |
| Operating income                                       | 2,810,782      | 302,796        | 1,651                             | 3,115,229      |
| Other (expense) income, net                            | (29,166)       | 25,250         | -                                 | (3,916)        |
| Financial income (expenses), net                       | 100,522        | (22,000)       | -                                 | 78,522         |
| Exchange loss, net                                     | (253,183)      | -              | -                                 | (253,183)      |

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|                          |               |             |           |               |
|--------------------------|---------------|-------------|-----------|---------------|
| Income before income tax | 2,628,955     | 306,046     | 1,651     | 2,936,652     |
| Income tax               | 937,761       | 98,542      | -         | 1,036,303     |
| Net income               | Ps. 1,691,194 | Ps. 207,504 | Ps. 1,651 | Ps. 1,900,349 |

F-37

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| Other Data                                      | Mexico |            | United States<br>of America |            | Operations<br>Between<br>Segments |   | Total |            |
|---|--------|------------|-----------------------------|------------|-----------------------------------|---|-------|------------|
|   |        |            |                             |            |                                   |   |       |            |
| Total Assets                                    | Ps.    | 19,885,862 | Ps.                         | 10,928,155 | Ps.                               | - | Ps.   | 30,814,017 |
| Depreciation and Amortization                   |        | 677,339    |                             | 217,967    |                                   | - |       | 895,306    |
| Additions of property, plant and equipment, net |        | 148,749    |                             | 331,055    |                                   | - |       | 479,804    |

For the year ended on December 31st, 2007

| Other Data   | Mexico |           | United States<br>of America |            | Operations<br>Between<br>Segments |           | Total |            |
|--|--------|-----------|-----------------------------|------------|-----------------------------------|-----------|-------|------------|
|  |        |           |                             |            |                                   |           |       |            |
| Net Sales  | Ps.    | 8,407,018 | Ps.                         | 16,118,609 | Ps.                               | (419,533) | Ps.   | 24,106,094 |
| Cost of sales  |        | 5,716,571 |                             | 15,199,112 |                                   | (416,765) |       | 20,498,918 |
| Marginal Profit  |        | 2,690,447 |                             | 919,497    |                                   | (2,768)   |       | 3,607,176  |
| Indirect overhead, selling and administrative expenses |        | 837,246   |                             | 585,913    |                                   | -         |       | 1,423,159  |
| Operating Income                                       |        | 1,853,201 |                             | 333,584    |                                   | (2,768)   |       | 2,184,017  |
| Other (expense) income, net                            |        | (8,666)   |                             | 29,995     |                                   | -         |       | 21,329     |
| Financial income (expenses), net                       |        | 291,189   |                             | (17,876)   |                                   | -         |       | 273,313    |
| Exchange loss, net                                     |        | (37,879)  |                             | -          |                                   | -         |       | (37,879)   |
| Result on monetary position                            |        | (227,014) |                             | 32,083     |                                   | -         |       | (194,931)  |
| Income before income tax                               |        | 1,870,831 |                             | 377,786    |                                   | (2,768)   |       | 2,245,849  |
| Income Tax   |        | 435,973   |                             | 184,701    |                                   | -         |       | 620,674    |
| Net income   | Ps.    | 1,434,858 | Ps.                         | 193,085    | Ps.                               | (2,768)   | Ps.   | 1,625,175  |

| Other Data                                      | Mexico |            | United States<br>of America |           | Operations<br>Between<br>Segments |   | Total |            |
|---|--------|------------|-----------------------------|-----------|-----------------------------------|---|-------|------------|
|   |        |            |                             |           |                                   |   |       |            |
| Total Assets                                    | Ps.    | 15,221,534 | Ps.                         | 7,619,723 | Ps.                               | - | Ps.   | 22,841,257 |
| Depreciation and Amortization                   |        | 334,010    |                             | 215,246   |                                   | - |       | 549,256    |
| Additions of property, plant and equipment, net |        | 168,926    |                             | 316,742   |                                   | - |       | 485,668    |

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For the year ended on December 31st, 2006

|   |     | Mexico     |     | United States<br>of America |     | Operations<br>Between<br>Segments |     | Total      |
|---|-----|------------|-----|-----------------------------|-----|-----------------------------------|-----|------------|
| Net Sales   | Ps. | 8,019,635  | Ps. | 15,722,015                  | Ps. | (226,353)                         | Ps. | 23,515,297 |
| Cost of sales   |     | 4,980,439  |     | 14,377,065                  |     | (225,625)                         |     | 19,131,879 |
| Marginal Profit   |     | 3,039,196  |     | 1,344,950                   |     | (728)                             |     | 4,383,418  |
| Indirect overhead, selling and<br>administrative expenses |     | 766,768    |     | 570,564                     |     | 14,350                            |     | 1,351,682  |
| Operating Income it                                       |     | 2,272,428  |     | 774,386                     |     | (15,078)                          |     | 3,031,736  |
| Other Income, net   |     | 38,235     |     | 970                         |     | -                                 |     | 39,205     |
| Financial income (expenses), net                          |     | 47,755     |     | (823)                       |     | -                                 |     | 46,932     |
| Exchange loss, net  |     | (37,424)   |     | -                           |     | -                                 |     | (37,424)   |
| Result on monetary position                               |     | (91,773)   |     | 14,581                      |     | 4,240                             |     | (72,952)   |
| Income before income tax                                  |     | 2,229,221  |     | 789,114                     |     | (10,838)                          |     | 3,007,497  |
| Income Tax  |     | 267,390    |     | 341,331                     |     | -                                 |     | 608,721    |
| Net income  | Ps. | 1,961,831  | Ps. | 447,783                     | Ps. | (10,838)                          | Ps. | 2,398,776  |
| <b>Other Data</b>   |     |            |     |                             |     |                                   |     |            |
| Total Assets  | Ps. | 10,537,244 | Ps. | 7,505,536                   | Ps. | -                                 | Ps. | 18,042,780 |
| Depreciation and<br>Amortization                          |     | 270,836    |     | 164,556                     |     | 14,350                            |     | 449,742    |
| Additions of property, plant<br>and equipment, net        |     | 75,885     |     | 341,334                     |     | -                                 |     | 417,219    |

The Company's net sales to foreign or regional customers during 2008, 2007 and 2006 are as follows:

|                         | Sales |            |      |            |      |            |
|-------------------------|-------|------------|------|------------|------|------------|
|                         | 2008  |            | 2007 |            | 2006 |            |
| Mexico                  | Ps.   | 11,366,526 | Ps.  | 7,393,755  | Ps.  | 7,575,777  |
| USA                     |       | 21,622,442 |      | 15,296,430 |      | 14,797,494 |
| Canadá                  |       | 598,711    |      | 583,917    |      | 654,725    |
| Latin America           |       | 394,998    |      | 113,058    |      | 67,185     |
| Other (Europe and Asia) |       | 1,202,543  |      | 718,934    |      | 420,116    |
| Total                   | Ps.   | 35,185,220 | Ps.  | 24,106,094 | Ps.  | 23,515,297 |

**18. Commitments and contingent liabilities -*****Commitments-***

- (a) Republic leases certain equipment, office space and computers through operating contracts under non-cancelable operating leases. These lease contracts will expire in several different dates by 2014. During the years ended December 31, 2008 and 2007, the expenses for operating leases were Ps. 84 million and Ps.77 million, respectively. At December 31, 2008, total minimum lease payments under non-cancelable operating leases are Ps. 40.6 million in 2009, Ps. 32.5 million in 2010 and Ps. 2.7 million for the following years.
- (b) As is the case with most steel producers in the USA, Republic could incur significant costs related to environmental issues in the future, including those arising from environmental compliance activities and remediation stemming from historical waste management practices at the Republic's facilities. The reserve to cover probable environmental liabilities totals Ps. 54.2 million and Ps. 42.4 million as of December 31, 2008 and 2007, respectively. The current and non-current portions of the environmental reserve are included in the attached consolidated balance sheet, as Other liabilities and Other long-term liabilities, respectively. Republic is not otherwise aware at this time of any additional environmental remediation liabilities or contingent liabilities relating to environmental matters with respect to Republic's facilities for which the establishment of an additional reserve would be appropriate at this time. To the extent Republic incurs any such additional future costs, these costs will most likely be incurred over a number of years. However, future regulatory action regarding historical waste management practices at the Republic's facilities and future changes in applicable laws and regulations may require Republic to incur significant costs that have a material adverse effect on the Republic's future financial performance.
- (c) Republic has an agreement with the USWA to administer health insurance benefits to the Company's USWA employees while on layoff status and to administer payment of monthly contributions to the Steelworker's Pension Trust on behalf of local union officials while on the union business. In February 2004, to fund this program, Republic provided an initial cash contribution of U.S.\$ 2.5 million to be used to provide health insurance benefits and U.S.\$ 0.5 million to provide steelworkers pension benefits. As of December 31, 2006, the balance of this cash account totaled U.S.\$ 2.6 million. The Company has agreed to administer these programs until the fund is exhausted. Republic will provide the USWA with periodic reports regarding the financial status of the fund. After ratification of the new labor agreement, this fund was returned to Republic in September 2007.

***Contingent Liabilities*****(a) California Regional Water Control Board, CRWCB**

In 1987, Pacific Steel, Inc. ( Pacific Steel or PS ), a subsidiary of Simec based in National City in San Diego County, California, received a notice from the California Regional Water Control Board, San Diego Region (the Regional Board ), which prohibited Pacific Steel from draining into the street waters from spraying borax (waste resulting from the process of the scrap yard). This and other subsequent requirements obligated Pacific Steel to (i) stop operations in the scrap yard, (ii) send an enclosure of the borax which was stored in its yards and (iii) take samples of the soil where the borax was found. The result of this study was that the residual metal contents represented no significant threat to the quality of water. The CRWCB approved the program to monitor both the soil and certain layers submitted by Pacific Steel. In December 2002, the CRWCB notified Pacific Steel that the jurisdiction to decide on the case had been transferred to the DTSC (Department of Toxic Substances Control). Further, the DTSC informed PS that the case would be resolved simultaneously with the other pending issues described below.

In 1996 PS discovered a hydrocarbon deposit in its property and the CRWCB determined that PS was responsible. At the end of 2000 the CRWCB approved the remediation plan to treat the contaminated soil submitted by PS, which concluded in November 2001. In August 2002, with the results obtained from the study of the soil, PS successfully presented to CRWCB the final report of the work activities performed. In December 2002 the CRWCB notified PS



that the jurisdiction to decide on the case had been transferred to the

F-40

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DTSC (Department of Toxic Substances Control). Further, the DTSC informed PS that the case would be resolved simultaneously with the other pending issues described below.

### **Department of Toxic Substances Control, DTSC**

In September 2002, the Department of Toxic Substances Control inspected Pacific Steel's (PS) facilities based on an alleged complaint from neighbors due to PS' 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 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 PS for violating hazardous waste laws and the State of California Security Code and imposed the obligation to make necessary changes to the location. On July 26, 2004, in an effort to continue with this order, the department filed against PS a Complaint for Civil Penalties and Injunctive Relief in San Diego Superior Court. On July 26, 2004, the court issued a judgment, whereby PS was obligated to pay US\$235.0 (payable in four payments of US\$58.75 over the course of one year) for fines of US\$ 131.25, the department's costs of US\$45.0 and an environmental project of US\$58.75. All these payments were duly made by PS.

In August 2004 PS and the DTSC entered into a corrective action consent agreement. In September 2005 the DTSC approved the Corrective Measures Plan presented by PS, provided it obtained permits from the corresponding local authorities. The remediation work activities started in November 2006, once the permits were available.

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.

The Company has prepared an estimate, based on prior years' experience, considering the same processes, volume costs, use of own equipment and personnel and assuming that an agreement will be reached with the DTSC in respect of defining the cleanliness levels. The results range from US\$0.8 million to US\$1.7 million. On such bases, the Company created an allowance for this contingency at December 31, 2002, of approximately US\$1.7 million. At December 31, 2008 the allowance amounts to Ps. 12,589 (US\$0.9 million). The obtaining of permits for the remediation of the site from authorities cannot be warranted, nor can the corrective measures being more costly than expected be warranted.

### **Community Development Commission, CDC**

The Community Development Commission of National City, California (CDC) has expressed its intention to develop the site. 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 US\$6.9 million, based on a business appraisal. The expropriation process was temporarily suspended through an agreement entered into by both parties in November 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 the Company 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 prepared by independent experts. Such appraisal caused a decrease in the value of part of the land of Ps. 23,324 (19,750 historical pesos) and a charge to results of operations of 2002 for the same amount.



- (b) The Company is involved in a number of lawsuits and claims that have arisen throughout the normal course of business. The Company and its legal advisors do not expect the final outcome of these matters to have any significant adverse effects on the Company's financial position and results of operations.

**(19) Differences between Mexican financial reporting standards and United States accounting principles:**

The Company's consolidated financial statements are prepared in accordance with Mexican financial reporting standards (Mexican GAAP), which differ in certain significant respects from United States generally accepted accounting principles (US GAAP).

As described in Note 2 (c), effective January 1, 2008, the Company ceased to recognize the effects of inflation on its financial statements as required by Mexican FRS B-10. However, as required by such new standard, the financial statement amounts that were previously reported remained unchanged, and the inflation adjustments previously recognized have been maintained in their corresponding caption. This new standard requires that the re-expressed amounts of non-monetary assets as reported at December 31, 2007 become the carrying amounts for those assets effective January 1, 2008. The carrying amounts will also affect net income in future periods. For example, depreciation expense after the adoption of Mexican FRS B-10 will be based on carrying amounts of fixed assets that include inflation adjustments recorded prior to the adoption of Mexican FRS B-10.

The Mexican and U.S. GAAP amounts included in this Note, as they relate to the year ended December 31, 2008, are presented in the carrying amounts as required by Mexican FRS B-10, and the effects of inflation that were recorded prior to 2008 have not been included in the reconciliations to U.S. GAAP.

Other significant differences between Mexican GAAP and US GAAP and the effects on consolidated net income and consolidated stockholders' equity are presented below, in thousands of constant Mexican pesos as of December 31, 2008, with an explanation of the adjustments.

**Reconciliation of net income:**

|  | <b>2008</b>   | <b>2007</b> | <b>2006</b> |
|--|---------------|-------------|-------------|
| Net income as reported under Mexican GAAP  | Ps. 1,900,349 | 1,625,175   | 2,398,776   |
| Inventory indirect costs   | 41,465        | 76,695      | 72,410      |
| Depreciation on restatement of machinery and equipment                                       | (5,185)       | 1,496       | (13,384)    |
| Deferred income taxes  | (20,925)      | (32,660)    | (27,294)    |
| Deferred employee profit sharing   | (700)         | 50          | 50          |
| Pre-operating expenses, net  | 30,698        | 30,698      | 30,698      |
| Amortization of gain from monetary position and exchange loss capitalized under Mexican GAAP | 7,755         | 7,755       | 7,755       |
| Minority interest of reconciling items   | (5,536)       | (25,438)    | (24,947)    |
| Minority interest of the period  | (104,212)     | (96,118)    | (220,082)   |
| Total US GAAP adjustments  | (56,640)      | (37,522)    | (174,794)   |
| Net income under US GAAP   | Ps. 1,843,709 | 1,587,653   | 2,223,982   |
| Weighted average outstanding basic   | 484,903,795   | 468,228,497 | 420,339,873 |

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|                                       |     |      |      |      |
|---------------------------------------|-----|------|------|------|
| Net earnings per share (actual pesos) | Ps. | 3.80 | 3.39 | 5.29 |
|---------------------------------------|-----|------|------|------|

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In 2008, the Company recorded expense from employee profit sharing of Ps. 24 million recorded as other expenses that was reclassified to operating expenses for US GAAP purposes. In 2008, 2007 and 2006 the Company recorded Ps. 5 million, Ps. 9 million and Ps. 15.8 million, respectively, under other income which was reclassified under operating income for US GAAP purposes.

F-42

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**Reconciliation of stockholders equity:**

|  |     | 2008               | 2007        | 2006        |
|--|-----|--------------------|-------------|-------------|
| Total stockholders equity reported under Mexican GAAP                | Ps. | <b>21,305,497</b>  | 17,252,034  | 12,960,333  |
| Minority interest included in stockholders equity under Mexican GAAP |     | <b>(3,122,342)</b> | (2,390,179) | (2,252,461) |
| Minority interest of reconciling items                               |     | <b>(55,921)</b>    | (50,385)    | (24,947)    |
| Inventory indirect costs   |     | <b>203,915</b>     | 162,450     | 85,755      |
| Restatement of machinery and equipment                               |     | <b>179,720</b>     | 184,905     | 461,632     |
| Deferred income taxes  |     | <b>(21,217)</b>    | (292)       | (45,534)    |
| Deferred employee profit sharing                                     |     | <b>-</b>           | 700         | 750         |
| Pre-operating expenses   |     | <b>(135,473)</b>   | (166,171)   | (196,869)   |
| Gain from monetary position and exchange loss capitalized, net       |     | <b>(172,386)</b>   | (180,141)   | (187,896)   |
| Total US GAAP adjustments  |     | <b>(3,123,704)</b> | (2,439,113) | (2,159,570) |
| Total stockholders equity under US GAAP                              | Ps. | <b>18,181,793</b>  | 14,812,921  | 10,800,763  |

A summary of changes in stockholders equity, after the US GAAP adjustments described above, is as follows:

|                           |     | Capital<br>Stock and<br>Paid-in<br>Capital | Retained<br>Earnings | Fair Value<br>of<br>Derivative<br>Financial<br>Instruments | Translation<br>effect of<br>foreign<br>subsidiaries | Cumulative<br>Restatement<br>Effect | Total<br>Stockholders<br>Equity |
|---------------------------|-----|--|----------------------|--|---|-------------------------------------|---------------------------------|
| Balances as of            |     |  |                      |  |   |                                     |                                 |
| December 31, 2005         | Ps. | 4,050,904                                  | 3,449,163            | 43,235   | 16,106  | 979,660                             | 8,539,068                       |
| Increase in capital stock |     | 130,901                                    | -                    | -  | -   | -                                   | 130,901                         |
| Net comprehensive income  |     | -  | 2,223,982            | (47,792)   | (41,645)  | (3,751)                             | 2,130,794                       |
| Balances as of            |     |  |                      |  |   |                                     |                                 |
| December 31, 2006         | Ps. | 4,181,805                                  | 5,673,145            | (4,557)  | (25,539)  | 975,909                             | 10,800,763                      |
| Increase in capital stock |     | 2,420,726                                  | -                    | -  | -   | -                                   | 2,420,726                       |
| Net comprehensive income  |     | -  | 1,587,653            | 4,557  | (6,171)   | 5,393                               | 1,591,432                       |
| Balances as of            |     |  |                      |  |   |                                     |                                 |
| December 31, 2007         |     | 6,602,531                                  | 7,260,798            | -  | (31,710)  | 981,302                             | 14,812,921                      |
| Increase in capital stock |     | 1,169,156                                  | -                    | -  | -   | -                                   | 1,169,156                       |
| Net comprehensive income  |     | -  | 1,843,709            | (270,868)  | 626,875   | -                                   | 2,199,716                       |
| Balances as of            |     |  |                      |  |   |                                     |                                 |
| December 31, 2008         | Ps. | 7,771,687                                  | 9,104,507            | (270,868)  | 595,165   | 981,302                             | 18,181,793                      |

The cumulative difference between the amounts included under Capital Stock and Paid-in Capital for US GAAP and Capital Stock and Stock Premiums for Mexican GAAP arise from the following items:

**Issuance of capital stock**

During 1993 and 1994 the Company recorded Ps. 99,214 and Ps. 31,794, respectively, corresponding to expenses related to the issuance of shares in a simultaneous public offering in the United States and Mexico as a reduction of the proceeds from the issuance of capital stock. In 1993 and 1994, these expenses were

F-43

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deducted for tax purposes resulting in a tax benefit of Ps. 34,478 and Ps. 10,812. These tax benefits were included in the statement of operations for Mexican GAAP purposes. For U.S. GAAP purposes these items were shown as a reduction of cost of issuance of the shares, thereby increasing the net proceeds from the offering.

**Maritime operations and amortization of negative goodwill:**

In 1993, Grupo Simec disposed of its maritime operations by spinning-off the two entities acquired in 1992 to Grupo Sidek (former parent company of Grupo Simec) and transferring its remaining maritime subsidiary to Grupo Simek for its approximate book value.

The operations sold had tax loss carryforward of approximately Ps. 211,193 which were related to operations prior to the date the entities were acquired by the Company. During 1994, Ps. 4,936 of these tax loss carryforwards were realized (resulting in a tax benefit of Ps. 1,701).

For U.S. GAAP purposes, the retained tax benefit of Ps. 1,701 realized in 1994, had been reflected as an increase to the corresponding paid-in capital rather than in net earnings as done for Mexican GAAP purposes.

**Gain on extinguishment**

On February 7, 2001, the Company's Board of Directors approved the issuance of 492,852,025 shares of Series B variable capital stock in exchange for the extinguishment of debt amounting to U.S.\$ 110,257,012. Under Mexican GAAP, the increase in stockholders' equity resulting from the conversion or extinguishment of debt is equal to the carrying amount of the extinguished debt. The Company assigned a value of U.S. \$110,257,012 to the Series B capital stock and, therefore, no difference existed between the equity interest granted and the carrying amount of the debt extinguished. Under U.S. GAAP, the difference between the fair value of equity interest granted and the carrying amount of extinguished debt is recognized as a gain or loss on extinguishment of debt in the statement of operations. For U.S. GAAP purposes, the fair value of the Series B capital stock was determined by reference to the quoted market price on March 29, 2001, the date the transaction was effected, and the difference between the fair value of the Series B capital stock and the carrying amount of the extinguished indebtedness was recognized as a gain in the statement of operations. The related restated effect as of December 31, 2008 is Ps. 626,203.

**Reconciliation of Net Income and Stockholders' Equity:**

The Company's consolidated financial statements are prepared in accordance with Mexican GAAP, which differ in certain significant respects from US GAAP. The explanations of the related adjustments included in the Reconciliation of the Net Income and the Reconciliation of stockholders' equity are explained below:

**Inventory -**

As permitted by Mexican GAAP, some inventories are valued under the direct cost system, which includes material, direct labor and other direct costs. For purposes of complying with US GAAP, inventories have been valued under the full absorption cost method, which includes the indirect cost.

Under Mexican GAAP, inventories include prepaids advance to suppliers. For US GAAP purposes, the prepaids advance to suppliers are considered as prepaid expenses.

**Restatement of property, machinery and equipment -**



As explained in note 2(j), in accordance with Mexican GAAP, imported machinery and equipment has been restated during 2007 and 2006 by applying devaluation and inflation factors of the country of origin.

F-44

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Under US GAAP, during 2007 and 2006 the restatement of all machinery and equipment, both domestic and imported, has been done in constant units of the reporting currency, the Mexican peso, using the inflation rate of Mexico.

Accordingly, a reconciling item for the difference in methodologies of restating imported machinery and equipment is included in the reconciliation of net income and stockholders' equity.

### Deferred income taxes and employee profit sharing -

As explained in Note 2(r) under Mexican GAAP, the Company accounts for deferred income tax following the guidelines of Mexican Bulletin D-4. The main differences between SFAS No. 109 and Bulletin D-4, as they relate to the Company, which are included as reconciling items between Mexican and US GAAP are:

- the income tax effect of gain from monetary position and exchange loss capitalized that is recorded as an adjustment to stockholders' equity for Mexican GAAP purposes until December 31, 2007,
- the income tax effect of capitalized pre-operating expenses which for US GAAP purposes, are expensed when incurred,
- the effect on income tax of the difference between the indexed cost and the restatement through use of specific indexation factors of fixed assets which is recorded as an adjustment to stockholders' equity for Mexican GAAP, and,
- the income tax effect of the inventory cost which for Mexican GAAP some inventories are valued under the direct cost system and for US GAAP inventories have been valued under the full absorption cost method.

In Shareholders' equity, the cumulative deferred income tax for US GAAP purposes is included under Retained Earnings. Under Mexican GAAP such effect is included under the cumulative deferred income tax caption through December 31, 2007, and then was reclassified to Retained Earnings in 2008.

In addition, the Company is required to pay employee profit sharing in accordance with Mexican labor law. Deferred employee profit sharing under U.S. GAAP has been determined following the guidelines of SFAS No. 109. Until December 31, 2007, under Mexican GAAP, the deferred portion of employee profit sharing is determined on temporary non-recurring differences with a known turnaround time. As mentioned in Note 2(p), upon the adoption of the new MFRS D-3 the company recognizes deferred employee profit sharing for Mexican GAAP. There are no significant differences between SFAS 109 and MFRS D-3.

Employee statutory profit-sharing expense is classified as an operating expense under US GAAP, and as other (expenses) income, net under MFRS.

The effects of temporary differences giving rise to significant portions of the deferred assets and liabilities for Income Tax (IT) at December 31, 2008 and 2007, under US GAAP are present below:

|                                    | 2008       | 2007   |
|------------------------------------|------------|--------|
| Deferred tax assets:               |            |        |
| Allowance for doubtful receivables | Ps. 62,401 | 20,250 |
| Accrued expenses                   | 144,333    | 93,860 |
| Advances from customers            | 20,735     | 13,967 |
| Derivative financial instruments   | 105,338    | -      |

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|                                  |           |         |
|----------------------------------|-----------|---------|
| Net operating loss carryforwards | 2,151,658 | 299,548 |
| Republic tax credits             | 192,596   | -       |
| Recoverable asset tax            | 99,610    | 99,610  |

F-45

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|  |               |           |
|--|---------------|-----------|
| Employee profit sharing provision                  | 19,874        | -         |
| Total gross deferred tax assets                    | 2,796,545     | 527,235   |
| Less valuation allowance                           | 1,670,175     | 389,117   |
| Net deferred tax assets                            | 1,126,370     | 138,118   |
| Deferred tax liabilities:                          |               |           |
| Inventories, net                                   | 701,918       | 501,862   |
| Property, plant and equipment                      | 2,232,304     | 1,603,518 |
| Preoperating expenses                              | 13,069        | 8,627     |
| Intangible assets in acquisition of Grupo San      | 765,542       | -         |
| Deferred flat-rate business tax                    | 39,693        | -         |
| Others   | 4,384         | 910       |
| Subtotal   | 3,756,910     | 2,114,917 |
| Additional liabilities from other tax transactions | 1,142,882     | 695,973   |
| Total deferred liabilities                         | 4,899,792     | 2,810,890 |
| Net deferred tax liability (asset)                 | Ps. 3,773,422 | 2,672,772 |

For the years ended December 31, 2008 and 2007, the classification of deferred income tax under U.S. GAAP is as follows:

|  |     | <b>2008</b> | 2007      |
|--|-----|-------------|-----------|
| Deferred tax assets:                               |     |             |           |
| Current portion of deferred income tax asset       | Ps. | 463,002     | 133,677   |
| Non-current portion of deferred income tax asset   |     | 663,368     | 4,441     |
| Deferred tax liabilities:                          |     |             |           |
| Current portion of deferred income tax liabilities |     | 745,995     | 501,862   |
| Long-term deferred income tax liability            |     | 4,153,797   | 2,309,028 |

For US GAAP the Company presents the deferred credit from NOLs from acquisitions of Ps. 420,046 as long-term liability

The deferred income taxes of Ps. 2,232,304 and Ps. 1,603,518 result from differences between the financial reporting and tax bases of property, plant and equipment at December 31, 2008 and 2007, respectively. Beginning in 1997 the restatement of property, plant and equipment and the effects thereof on the statement of operations are determined by using factors derived from the NCPI or, in the case of imported machinery and equipment, by applying devaluation and inflation factors of the country of origin. Until 1996, for financial reporting purposes, property, plant and equipment were stated at net replacement cost based upon annual independent appraisals and depreciation was provided by using the straight-line method over the estimated remaining useful lives of the assets. For income tax reporting purposes, property, plant, and equipment and depreciation are computed by a method which considers the NCPI.

Domestic operations accounted for 74% of the Company's pre-tax income in 2006, 83% in 2007 and 90% in 2008.

In accordance with APB Opinion No. 23 it is the policy of the Company to accrue appropriate Mexican and foreign income taxes on earnings of subsidiary companies which are intended to be remitted to the parent company in the near future. Unremitted earnings of subsidiaries which have been, or are intended to be, permanently reinvested, exclusive of those amounts which if remitted in the near future would result in

F-46

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little or no such tax by operation of relevant statutes currently in effect, aggregated Ps. 568 million at December 31, 2008.

**Pre-operating expenses -**

For Mexican GAAP purposes, the Company capitalized pre-operating expenses related to the production facilities at Mexicali, as well as costs and expenses incurred in the manufacturing and design of new products. For US GAAP purposes, these items are expensed when incurred.

**Financial expense capitalized -**

Under Mexican GAAP, financial expense capitalized during the period required to bring property, plant and equipment into the condition required for their intended use, includes interest, exchange losses and gains from monetary position. Under U.S. GAAP when financing is in Mexican pesos, the monetary gain is included in this computation; when financing is denominated in U.S. dollars, only the interest is capitalized and exchange losses and monetary position are not included.

**Minority interest -**

Under Mexican GAAP, the minority interest in consolidated subsidiaries is presented as a separate component within the income statement and stockholders' equity on the consolidated balance sheet. For US GAAP purposes, minority interest is not included in the income statement and the stockholders' equity.

**Disclosure about Fair Value of Financial Instruments-**

In accordance with SFAS No. 107, Disclosures about Fair Value of Financial Instruments, under U.S. GAAP it is necessary to provide information about the fair value of certain financial instruments for which it is practicable to estimate that value. The carrying amounts of cash and short-term investments, accounts receivable and accounts payable and short-term debt approximate fair values due to the short term maturity of these instruments.

The fair values of the long term debt obligations are estimated based upon quoted market prices for the same or similar issues or on the current rates offered for debt of the same remaining maturities. At December 31, 2007 and 2008 the Company does not have long term debt.

**Pension and other retirement benefits-**

The Company records seniority premiums based on actuarial computations as described in note 2(o).

For purposes of determining seniority premium costs under US GAAP, the Company utilized SFAS No. 87. Adjustments to US GAAP for seniority premiums were not individually or in the aggregate significant for any period.

SFAS No. 106, Employers' Accounting for Post-retirement Benefits Other than Pensions, requires accrual of post-retirement benefits other than pensions during the employment period. Adjustments to US GAAP for Post-retirement Benefits Other than pensions were not individually or in the aggregate significant for any period.

SFAS No. 112, Employers' Accounting for Post-employment Benefits, requires employers to accrue for post-employment benefits that are provided to former or inactive employees after employment during the employment period. For the purpose of determining Termination Benefits Obligations for U.S. GAAP, the

Company utilized SFAS No. 112. Adjustments to U.S. GAAP for these benefits were not individually or in the aggregate significant for any period.

F-47

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SFAS No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) requires the employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Adjustments to U.S. GAAP of adoption were not significant.

The additional disclosures for U.S. GAAP related to Pension and other retirement benefits are as follows:

|  | <b>2008</b>  | <b>2007</b> |
|--|--------------|-------------|
| Change in projected benefit obligation-                |              |             |
| Net projected benefit obligation at beginning of year  | Ps. 18,759   | Ps. 24,662  |
| Service cost   | 5,602        | 2,654       |
| Financial cost   | 8,517        | 755         |
| Actuarial (gain) losses, net                           | 49           | (334)       |
| Projected benefit obligations from Grupo San           | 182,500      | -           |
| Plan assets from Grupo San acquisition                 | (99,042)     | -           |
| Transitional liability from Grupo San acquisition      | (47,763)     | -           |
| Actuarial losses from Grupo San acquisition            | (28,810)     | -           |
| Amortization of prior service cost and plan amendments | <b>5,715</b> | -           |
|  | <b>3,940</b> | -           |
| Contributions to pensions in course                    | <b>3,940</b> | -           |
|  | <b>1,900</b> | -           |
| Actuarial loss and others                              | <b>1,900</b> | -           |
|  | (17,272)     | (8,978)     |
| Benefits paid  | (17,272)     | (8,978)     |
| Net projected benefit obligation at end of year        | Ps. 34,095   | Ps. 18,759  |

As of December 31, 2008, the plan assets for the pensions and postretirement fund amounted \$101,750 thousands of pesos. The policies and strategies of the Company in this matter are based on the requirements of Mexican Income Tax Law, which establishes that such funds should be composed by at least 30% of securities issued by federal government and the remaining balance on securities approved by the National Bank and Securities Commission (Comision Nacional Bancaria y de Valores). In accordance with this rule, the fund of the company is 32.53 % of securities issued by the federal government and 67.47% of other securities approved by the National Bank and Securities Commission. Also in conformity with the Mexican Income Tax Law, the fund is managed through a trust administrated by Banco Santander S.A. In 2009 the Company terminated the pension plan from the Grupo San acquisition and the total amount of this fund was liquidated and paid to employees during the first and second quarter of 2009.

**No Right of Redemption-**

The Mexican Securities Market Law and our bylaws provide that our shareholders do not have redemption rights for their shares.



**Goodwill and intangibles-**

In assessing the recoverability of the goodwill and other intangibles the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. The Company performs an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of recorded goodwill is impaired. The impairment review process compares the fair value of the reporting unit in which goodwill resides to its carrying value. The Company estimates the reporting unit's fair value based on a discounted future cash flow approach that requires estimating income from operations based on historical results and discount rates based on a weighted average cost of capital from a market participant perspective. The estimated fair value of each reporting units as of December 31, 2008 exceeded its respective carrying value; therefore the Company determined there was no impairment of goodwill as of that date. Additionally, the Company reconciles the aggregate fair value of the reporting units to its market capitalization. The total premium of

F-48

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aggregate fair value to market capitalization was approximately 157 percent. The Company's belief that a portion of this is due to the general economic environment was corroborated by independent valuation analyses available to the public that suggested that the market capitalization as of December 2008 was significantly undervalued. Independent estimates of the Company's market capitalization indicate an implied control premium of approximately 41 percent. This implied control premium is consistent with recent observed control premiums. Assumptions used in the analysis considered the current market conditions in developing short and long-term growth expectations. The reconciliation includes such factors as historical and industry multiples, industry performance statistics, and recent comparable transaction pricing among others. A key assumption made is that, in general, business activity will be lower in 2009 and in 2008 and will recover somewhat in 2010. After that time the Company anticipates that their revenues will grow at 5% average per year approximately until 2013. If these estimates or their related assumptions for prices and demand change in the future, we may be required to record impairment charges for these assets not previously recorded

### Long-lived assets-

The Company reviews the recoverability of our long-lived assets as required by SFAS No. 144 and must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. As of December 31, 2008 and 2007 there was no impairment charges recorded. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges not previously recorded.

### Statement of cash flows-

Until December 31, 2007, under Mexican GAAP, the Company presented a consolidated statement of changes in financial position in accordance with Bulletin B-12, which identified the generation and application of resources as representing differences between beginning and ending financial statement balances in constant Mexican pesos. It also required that monetary and unrealized exchange gains and losses be treated as cash items in the determination of resources generated by operations. As mentioned in Note 2 (v), upon the adoption of MFRS B-2 in January 1, 2008, the Company presents a statement of cash flows under Mexican GAAP.

The following presents a statement of cash flows under U.S. GAAP:

|  |            | 2008               | 2007      | 2006        |
|--|------------|--------------------|-----------|-------------|
| <b>Net Income under U.S. GAAP</b>              | <b>Ps.</b> | <b>1,843,708</b>   | 1,587,653 | 2,223,982   |
| Depreciation and Amortization                  |            | <b>862,038</b>     | 509,304   | 424,672     |
| Deferred income taxes                          |            | <b>313,973</b>     | 541,813   | 372,205     |
| Deferred credit amortization                   |            | -                  | -         | (363,802)   |
| Minority Interest                              |            | <b>104,212</b>     | 96,118    | 220,082     |
| US GAAP Adjustment on minority interest        |            | <b>5,536</b>       | 25,438    | 24,947      |
| Monetary position loss                         |            | -                  | 194,931   | 72,952      |
| Trade receivable, net                          |            | <b>367,250</b>     | (323,456) | 112,799     |
| Other accounts receivable and prepaid expenses |            | <b>(251,920)</b>   | (294,091) | 213,723     |
| Inventories                                    |            | <b>(2,046,975)</b> | 47,140    | (1,305,457) |
| Accounts payable and accrued expenses          |            | <b>712,730</b>     | 182,579   | 480,419     |
| Other long-term liabilities                    |            | <b>16,084</b>      | (25,529)  | (40,883)    |
| <b>Funds provided by operating activities</b>  |            | <b>1,926,636</b>   | 2,541,900 | 2,435,639   |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Long-term inventory                          | (24,764)  | (8,292)   | (6,836)   |
| Acquisition of property, plant and equipment | (479,804) | (485,668) | (417,219) |
|  | F-49      |           |           |

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|   |                    |                  |                  |
|---|--------------------|------------------|------------------|
| Effect from the acquisition of Grupo San                                  | (8,450,796)        | -                | -                |
| (Increase) decrease in other non-current assets                           | (205,266)          | 9,779            | -                |
| Proceeds from insurance claim, net  | -                  | -                | 434,186          |
| <b>Funds (used for) provided by investing activities</b>                  | <b>(9,160,630)</b> | <b>(484,181)</b> | <b>10,131</b>    |
| Financial debt  | 1,350,810          | -                | -                |
| Financial debt repayment  | (1,325,329)        | -                | (412,736)        |
| Short-term loans (repaid) obtained  | -                  | (4)              | (18,686)         |
| Increase Common Stock and related equity accounts                         | 1,169,156          | 2,403,302        | 129,735          |
| Related parties (payable) financing                                       | 196,805            | (129,038)        | (240,923)        |
| Increase of investment in Pav Republic by ICH                             | -                  | 37,895           | 142,844          |
| <b>Funds obtained from (used for) financing activities</b>                | <b>1,391,442</b>   | <b>2,312,155</b> | <b>(399,766)</b> |
| Effects of inflation accounting   | -                  | (177,737)        | (66,356)         |
| Translation effect in cash and cash equivalents from foreign subsidiaries | 1,238              | -                | -                |
| Exchange rate effect on cash and cash equivalents                         | 21,900             | -                | -                |
| Increase (decrease) in cash   | (5,819,414)        | 4,192,137        | 2,046,004        |
| Cash beginning of the year  | 6,396,155          | 2,204,018        | 224,370          |
| <b>Cash end of the year</b>   | <b>Ps. 576,741</b> | <b>6,396,155</b> | <b>2,204,018</b> |

Funds provided by operating activities include cash payments for interest and income taxes as follows:

|                     |     | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---------------------|-----|-------------|-------------|-------------|
| Total interest paid | Ps. | 40,607      | 10,225      | 3,254       |
| Income taxes paid   | Ps. | 695,852     | 377,281     | 555,357     |

#### Accounting for uncertainty in income taxes-

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) as of January 1, 2007. FIN 48 did not have a material impact on the Company's financial statements either upon adoption or for the year ended December 31, 2008.

Under FIN 48, the Company has to establish reserves to remove some or all of the tax benefit of any of our tax positions when it determines that it becomes uncertain based upon one of the following conditions: (1) the tax position is not more likely than not to be sustained, (2) the tax position is more likely than not to be sustained, but for a lesser amount, or (3) the tax position is more likely than not to be sustained, but not in the financial period in which the tax position was originally taken.

For purposes of evaluating whether or not a tax position is uncertain, (1) we presume the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information, (2) the technical

merits of a tax position are derived from authorities such as legislation and statutes, legislative intent, regulations, rulings and case law and their applicability to the facts and circumstances of the tax position, and (3) each tax position is evaluated without consideration of the possibility of offset or aggregation with other tax positions taken.

F-50

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A number of years may elapse before a particular uncertain tax position is audited and finally resolved or when a tax assessment is raised. The number of years subject to tax assessments varies depending on the tax jurisdiction and is generally three to five years for the countries in which the Company principally operates. The tax benefit that has been previously reserved because of a failure to meet the more likely than not recognition threshold would be recognized in our income tax expense in the first period when the uncertainty disappears under any one of the following conditions: (1) the tax position is more likely than not to be sustained, (2) the tax position, amount, and/or timing is ultimately settled through negotiation or litigation, or (3) the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired

### Recent accounting pronouncements in the US

In September 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Statement No. 157, Fair Value Measurements ( FAS 157 ). SFAS 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS No. 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 - Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

SFAS No. 157 was adopted by the Company effective January 1, 2008, for financial assets and liabilities and January 1, 2009, for nonfinancial assets and liabilities. SFAS No. 157 is applied prospectively. SFAS No. 157 did not have a material impact on the Company's financial statements either upon adoption or for the year ended December 31, 2008.

The Company is exposed to counterparty credit risk on all derivative financial instruments. Because the amounts are recorded at fair value, the full amount of the Company's exposure is the carrying value of these instruments. Credit risk is monitored through established approval procedures, including setting concentration limits by counterparty. The Company only enters into derivative transactions with well-established financial institutions; the Company believes such risk is minimal.

The following table provides a summary of significant liabilities at December 31, 2008 that are measured at fair value on a recurring basis:

|                                  | Fair Value Measurement |             |         | Total       |
|----------------------------------|------------------------|-------------|---------|-------------|
|                                  | Level 1                | Level 2     | Level 3 |             |
| <b>Liabilities</b>               |                        |             |         |             |
| Derivative financial instruments |                        | Ps. 376,206 |         | Ps. 376,206 |

*Valuation Methods:*

F-51

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Derivatives: The fair value of financial derivative instruments is calculated based on Level 2 inputs, which includes the following: natural gas commodity prices, foreign exchange rates, LIBOR interest rates and the reporting entity own credit risk.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. The entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument, is irrevocable and is applied only to entire instruments and not to portion of instruments. SFAS No. 159 was effective for the Company beginning January 1, 2008. The Company's elected not to adopt SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141(revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141(R) also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141(R) was adopted by the Company beginning January 1, 2009. The Company will apply SFAS No. 141 (R) to business combinations executed on a prospective basis.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB NO. 51*. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest of the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except for not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 was adopted by the Company effective January 1, 2009. SFAS 160 will result in changes to the Company's US GAAP financial reporting for noncontrolling interests and the Company is evaluating the impact that this accounting statement will have on its financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivatives Instruments and Hedging Activities - an amendment of FASB Statement No. 133* (SFAS No. 161). This Statement amends the disclosure requirements of Statement 133 with the intent to provide users of financial statements with an enhanced understanding of a) how and why an entity uses derivative instruments, b) how derivative instruments and related hedged items are accounted for under Statement 133, and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 (SFAS No. 161). The Company is evaluating the impact that this accounting statement will have on its disclosures.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. The Company has prepared its 2008 financial statements in accordance with this Statement, and there were no changes to their presentation.



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GRUPO SIMEC, S.A. DE C.V. (PARENT COMPANY ONLY)

SCHEDULE I

Condensed balance sheets

December 31, 2008 and 2007

(In thousands of Mexican pesos)

| Assets  | 2008          | 2007          |
|---|---------------|---------------|
| Current assets:                                       |               |               |
| Cash and cash equivalents                             | \$ 1,327      | \$ 2,567,396  |
| Accounts receivable:                                  |               |               |
| Related parties                                       | 11,385        | 750,181       |
| Prepaid expenses                                      | -             | -             |
| Other receivables                                     | 32,828        | 44,530        |
| Total accounts receivable, net                        | 44,213        | 794,711       |
| Total current assets                                  | 45,540        | 3,362,107     |
| Long term account receivables to subsidiary companies | -             | 673,319       |
| Investment in subsidiary companies                    | 23,524,339    | 10,680,311    |
| Property, net   | 177,591       | 182,017       |
| Other assets, net                                     | 136,496       | -             |
| Deferred income taxes                                 | -             | 9,207         |
|   | \$ 23,883,966 | \$ 14,906,961 |
| <b>Liabilities and Stockholders Equity</b>            | <b>2008</b>   | <b>2007</b>   |
| Current liabilities:                                  |               |               |
| Current installments of long-term debt                | \$ 4,055      | \$ 3,282      |
| Other accounts payable and accrued expenses           | 43,140        | 7,446         |
| Accounts payable to related parties                   | 4,970,732     | 34,378        |
| Total current liabilities                             | 5,017,927     | 45,106        |
| Deferred income taxes                                 | 682,884       | -             |
| Total liabilities                                     | 5,700,811     | 45,106        |
| Stockholders equity:                                  |               |               |
| Capital stock   | 4,142,696     | 4,030,427     |
| Additional paid-in capital                            | 4,208,204     | 3,151,317     |
| Retained earnings                                     | 9,507,958     | 8,550,179     |
| Cumulative deferred income tax                        | -             | (970,513)     |
| Equity adjustment for non-monetary assets             | -             | 132,155       |

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|  |               |               |
|--|---------------|---------------|
| Effect of translation of foreign entities      | 595,165       | (31,710)      |
| Fair value of derivative financial instruments | (270,868)     | -             |
|  | <hr/>         | <hr/>         |
| Total stockholders' equity                     | 18,183,155    | 14,861,855    |
|  | \$ 23,883,996 | \$ 14,906,961 |
|  | <hr/>         | <hr/>         |

See accompanying notes to consolidated financial statements

S-1

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**GRUPO SIMEC, S.A. DE C.V. (PARENT COMPANY ONLY)**

Condensed statement of income

Years ended December 31, 2008, 2007 and 2006

(In thousands of Mexican pesos)

|   | <u>2008</u>      | <u>2007</u>      | <u>2006</u>      |
|---|------------------|------------------|------------------|
| Income:                                   |                  |                  |                  |
| Equity in results of subsidiary companies | \$ 2,073,966     | \$ 1,502,425     | \$ 2,173,486     |
| For leasing                               | 20,556           | 20,982           | 21,813           |
|   | <u>2,094,522</u> | <u>1,523,407</u> | <u>2,195,299</u> |
| Total of income                           |                  |                  |                  |
| Costs and expenses:                       |                  |                  |                  |
| Depreciation                              | 6,751            | 3,597            | 5,099            |
| Administrative                            | 9,073            | 8,680            | 4,468            |
|   | <u>15,824</u>    | <u>12,277</u>    | <u>9,567</u>     |
| Total costs and expenses                  |                  |                  |                  |
|   | <u>2,078,698</u> | <u>1,511,130</u> | <u>2,185,732</u> |
| Operating income                          |                  |                  |                  |
|   | <u>(7,170)</u>   | <u>8,568</u>     | <u>17,020</u>    |
| Other income (expenses), net              |                  |                  |                  |
| Comprehensive financial result:           |                  |                  |                  |
| Interest expense                          | (203,131)        | (949)            | (332)            |
| Interest income                           | 79,443           | 176,207          | 68,190           |
| Foreign exchange (loss) gain, net         | (155,451)        | (23,115)         | (99)             |
| Monetary position loss                    | -                | (105,638)        | (50,650)         |
|   | <u>(279,139)</u> | <u>46,505</u>    | <u>17,109</u>    |
| Comprehensive financial result, net       |                  |                  |                  |
|   | <u>1,792,389</u> | <u>1,566,203</u> | <u>2,219,861</u> |
| Income before income tax                  |                  |                  |                  |
| Income tax:                               |                  |                  |                  |
| Current                                   | 461              | 35,883           | 40,452           |
| Deferred                                  | (4,209)          | 1,263            | 715              |
|   | <u>1,796,137</u> | <u>1,529,057</u> | <u>2,178,694</u> |
| Net income                                |                  |                  |                  |

See accompanying notes to consolidated financial statements

**GRUPO SIMEC, S.A.B. DE C.V. AND SUBSIDIARIES**

## Consolidated Statement of Cash Flow

Year ended December 31, 2008

(In thousands of Mexican pesos)

|  |     | <b>2008</b>        |
|--|-----|--------------------|
| Operating activities:                                      |     |                    |
| Income before income tax                                   | Ps. | <b>1,792,389</b>   |
| Depreciation and amortization                              |     | <b>6,751</b>       |
| Equity in net results of subsidiary companies              |     | <b>(2,073,966)</b> |
| Interest income  |     | <b>(79,443)</b>    |
| Accrued interest   |     | <b>203,131</b>     |
|  |     | <b>(151,138)</b>   |
| Decrease in related parties receivables                    |     | <b>1,646,861</b>   |
| Decrease in other accounts receivable and prepaid expenses |     | <b>22,063</b>      |
| Increase in other accounts payable and accrued expenses    |     | <b>11,653</b>      |
| Increase in related parties payable                        |     | <b>3,443,414</b>   |
| Resources provided by operating activities                 |     | <b>4,972,853</b>   |
| Investing activities:                                      |     |                    |
| Acquisition of Grupo San                                   |     | <b>(8,450,796)</b> |
| Net assets from mergers                                    |     | <b>(323,495)</b>   |
| Acquisition of property, plant and equipment               |     | <b>(46)</b>        |
| Interest collected   |     | <b>79,443</b>      |
| Resources used in investing activities                     |     | <b>(8,694,894)</b> |
| Financing activities:                                      |     |                    |
| Exchange rate effect on financial debt                     |     | <b>773</b>         |
| Financial debt   |     | <b>1,325,329</b>   |
| Financial debt repayment                                   |     | <b>(1,325,329)</b> |
| Increase in capital stock                                  |     | <b>112,269</b>     |
| Additional paid-in capital                                 |     | <b>1,056,886</b>   |
| Interest paid  |     | <b>(13,956)</b>    |
| Resources (used in ) provided by financing activities      |     | <b>1,155,972</b>   |
| Net decrease in cash and cash equivalents                  |     | <b>(2,566,069)</b> |

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|  |     |                  |
|--|-----|------------------|
| Cash and cash equivalents at beginning of year |     | <u>2,567,396</u> |
| Cash and cash equivalents at end of year       | Ps. | <u>1,327</u>     |

See accompanying notes to consolidated financial statements.

S-3

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**GRUPO SIMEC, S.A. DE C.V. (PARENT COMPANY ONLY)**

## Condensed Statement of Changes in Financial Position

Years ended December 31, 2007, 2006 and 2005

(In thousands of Mexican pesos)

|  | <u>2007</u>         | <u>2006</u>      |
|--|---------------------|------------------|
| Operating activities:                                  |                     |                  |
| Net income   | \$ 1,529,057        | 2,178,694        |
| Add (deduct) items not requiring the use of resources: |                     |                  |
| Depreciation   | 3,597               | 5,099            |
| Equity in net results of subsidiary companies          | (1,502,425)         | (2,173,486)      |
| Gain on sale of subsidiary                             | -                   | (16,892)         |
| Deferred income tax                                    | 1,263               | 715              |
|  | <u>31,492</u>       | <u>(5,870)</u>   |
| Funds provided by operations                           |                     |                  |
|  | 31,492              | (5,870)          |
| Net changes in operating assets and liabilities:       |                     |                  |
| Related parties, net                                   | 103,431             | (351,499)        |
| Other accounts receivable, net                         | (5,745)             | (12,208)         |
| Other accounts payable and accrued expenses            | (11,687)            | (1,629)          |
| Deferred revenue for leasing                           | -                   | -                |
| Funds (used in) provided by operating activities       | 117,491             | (371,206)        |
|  | <u>117,491</u>      | <u>(371,206)</u> |
| Financing activities:                                  |                     |                  |
| Increases in capital stock                             | 2,420,726           | 130,900          |
| Contributions for future capital stock increases       | -                   | -                |
| Financial debt   | (124)               | (105)            |
| Tax on assets  | -                   | -                |
| Long term account receivables to subsidiary companies  | 24,509              | 243,237          |
|  | <u>2,445,111</u>    | <u>374,032</u>   |
| Funds provided by financing activities                 |                     |                  |
|  | 2,445,111           | 374,032          |
| Investing activities:                                  |                     |                  |
| Acquisition of property                                | -                   | (29)             |
|  | <u>-</u>            | <u>(29)</u>      |
| Funds used in investing activities                     |                     |                  |
|  | -                   | (29)             |
| Net increase (decrease) in cash and equivalents        | 2,562,602           | 2,797            |
| Cash and equivalents:                                  |                     |                  |
| At beginning of year                                   | 4,794               | 1,997            |
|  | <u>4,794</u>        | <u>1,997</u>     |
| At end of year   | \$ 2,567,396        | \$ 4,794         |
|  | <u>\$ 2,567,396</u> | <u>\$ 4,794</u>  |

See accompanying notes to consolidated financial statements



**GRUPO SIMEC, S.A. DE C.V. (PARENT COMPANY ONLY)**

Condensed statement of changes in financial position

Years ended December 31, 2008, 2007 and 2006

(In thousands of Mexican pesos)

**1. Organization of the Company and certain other information:**

The accompanying condensed financial statements reflect the results of operations of the Company since its incorporation in August 1990.

Information with respect to the Company's material contingencies are presented in note 18 of the consolidated financial statements.

S-5

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