

GROUP SIMEC SA DE CV
Form 20-F
June 29, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

FORM 20-F

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

For the fiscal year ended December 31, 2006

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)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
American Depositary Shares	American Stock Exchange
Series B Common Stock	American Stock Exchange*

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

None

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, 2006 was:

Series B Common Stock — 421,214,706 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

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 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

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

TABLE OF CONTENTS

		Page
PART I.		
Item 1.	Identity of Directors, Senior Management and Advisers	2
Item 2.	Offer Statistics and Expected Timetable	2
Item 3.	Key Information	2
Item 4.	Information on the Company	15
Item 5.	Operating and Financial Review and Prospects	41
Item 6.	Directors, Senior Management and Employees	55
Item 7.	Major Shareholders and Related Party Transactions	61
Item 8.	Financial Information	63
Item 9.	Offer and Listing Details	65
Item 10.	Additional Information	67
Item 11.	Quantitative and Qualitative Disclosures About Market Risk	82
Item 12.	Description of Securities Other than Equity Securities	83
PART II.		
Item 13.	Defaults, Dividends Arrearages and Delinquencies	83
Item 14.	Material Modifications to the Rights of Security Holders and Use of Proceeds	83
Item 15.	Controls and Procedures	83
Item 16.	[Reserved]	84
PART III.		
Item 17.	Financial Statements	85
Item 18.	Financial Statements	85
Item 19.	Exhibits	85

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” 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 prospectus to “pesos”, “Pesos” or “Ps.” are to the lawful currency of Mexico. References to “tons” in this prospectus refer to metric tons; a metric ton equals 1,000 kilograms or 2,204 pounds. We publish our financial statements in Pesos.

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

This 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. 10.881 per U.S.\$1.00, the interbank transactions rate in effect on December 31, 2006. On June 27, 2007, the interbank transactions rate for the Peso was Ps. 10.8671 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 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 ability to operate at high capacity levels;
 - the costs of compliance with U.S. and Mexican environmental laws;

- the integration of the Mexican steel manufacturing facilities located in Apizaco and Cholula, as well as the recently acquired Republic in the United States;
 - future capital expenditures and acquisitions;
 - future devaluations of the peso;
- the imposition by Mexico of foreign exchange controls and price controls;
- the influence of economic and market conditions in other countries on Mexican securities; and
 - the factors discussed in “Risk Factors” 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 we distribute this prospectus because of new information, future events or other factors. In light of the risks and uncertainties described above, the forward looking events and circumstances discussed in this prospectus might not occur.

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

SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

This annual report includes our consolidated financial statements as of December 31, 2006 and 2005 and for each of the three years ended December 31, 2006, 2005 and 2004. We have prepared our financial statements in accordance with Mexican Generally Accepted Accounting Principles (“Mexican GAAP”) and presented them in Mexican pesos. We have adjusted the financial statements of our non-Mexican subsidiaries to conform to Mexican GAAP, and we have translated them to Mexican pesos. See Note 2(d) to our Consolidated Financial Statements.

Mexican GAAP differs in certain respects from Generally Accepted Accounting Principles in the United States (“U.S. GAAP”). Note 19 to the Consolidated Financial Statements provides a description of the principal differences between Mexican GAAP 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.

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Pursuant to Mexican GAAP, in our financial statements and the selected financial information set forth below:

- nonmonetary assets (including plant, property and equipment of Mexican origin) and stockholders' equity are restated for inflation based on the Mexican National Consumer Price Index; plant, property and equipment of non-Mexican origin are restated based on the rate of inflation in the country of origin and converted into Mexican pesos using the prevailing exchange rate at the balance sheet date; and
- gains and losses in purchasing power from holding monetary liabilities or assets are recognized in income; and all financial statements are restated in constant pesos as of December 31, 2006.

Certain of the financial information set forth below is presented in accordance with U.S. GAAP. The effect of inflation accounting under Mexican GAAP has not been reversed in the reconciliation to U.S. GAAP of net income and total stockholders' equity, except with respect to some information included in the cash flow statement. See Note 19 to our Consolidated Financial Statements.

The selected financial and operating information set forth below has been derived in part from our consolidated financial statements, which have been reported on by KPMG Cárdenas, Dosal, S.C. for the fiscal year ended December 31, 2004 and by Mancera S.C., a member practice of Ernst & Young Global, an independent, registered public accounting firm for the fiscal years ended December 31, 2005 and 2006. In so doing, Mancera, S.C. has relied on the audited Consolidated Financial Statements of the Company's subsidiary SimRep Corporation ("SimRep") and its subsidiaries, reported on by BDO Hernández Marrón y Cía., S.C., a member firm of BDO International for the year ended December 31, 2005. The selected financial and operating information should be read in conjunction with, and is qualified in its entirety by reference to our Consolidated Financial Statements.

	Year Ended December 31,					
	2002	2003	2004	2005	2006	2006 ⁽¹⁾
	(Millions of constant December 31, 2006 pesos)					(Millions of dollars)
	(except per share and per ADS data)					

Income Statement Data:

Mexican GAAP:

Net sales	2,484	3,151	6,110	13,405	22,689	2,085
Direct cost of sales	1,662	2,070	3,551	10,721	18,460	1,696
Marginal profit	822	1,081	2,559	2,684	4,229	389
Indirect manufacturing, selling, general and administrative expenses	339	318	383	716	870	80
Depreciation and amortization	183	206	230	337	434	40
Operating income	300	557	1,946	1,631	2,925	269
Financial income (expense)	(145)	(28)	(39)	(150)	(61)	(6)
Other income (expense), net	(42)	(34)	(39)	(12)	37	4
Income before taxes, employee profit sharing and minority interest	113	495	1,868	1,469	2,901	267
Income tax expense and employee profit sharing	(26)	164	355	128	587	54
Net income	139	331	1,513	1,341	2,314	213
Minority interest	0	0	0	18	212	20
Majority interest	139	331	1,513	1,323	2,102	193
Net income per share	0.5	1	4	3	5	0.46

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Net income per ADS ⁽²⁾	1	3	11	10	15	1.38
Weighted average shares outstanding (thousands) ⁽⁵⁾	299,901	357,159	398,916	413,790	420,340	420,340

3

Weighted average ADSs outstanding (thousands)	99,967	119,053	132,972	137,930	140,113	140,113
<i>U.S. GAAP including effects of inflation:</i>						
Net sales	2,484	3,150	6,110	13,405	22,689	2,085
Direct cost of sales	1,666	2,074	3,545	10,725	18,390	1,690
Marginal profit	818	1,076	2,565	2,680	4,299	395
Operating income ⁽⁴⁾	263	562	1,928	1,596	3,034	279
Financial income (expense)	(145)	(28)	(39)	(150)	(61)	(6)
Other income (expense), net	(77)	(33)	(4)	28	23	2
Income before taxes, employee profit sharing and minority interest	41	501	1,885	1,474	2,996	275
Income tax expense (income)	(189)	214	402	135	614	56
Income before minority interest	230	287	1,483	1,339	2,382	219
Minority interest	0	0	0	18	212	20
U.S. GAAP Adjustment on minority interest	0	0	0	0	24	2
Net Income	230	287	1,483	1,321	2,146	197
Income per share ⁽⁵⁾	1	1	4	3	5	0.47
Income per ADS	2	2	11	10	15	1.41

Balance Sheet Data:*Mexican GAAP:*

Total assets	5,205	6,792	9,620	15,081	17,409	1,600
Total long-term liabilities ⁽³⁾	910	1,192	1,564	2,320	2,099	193
Total stockholders' equity	4,228	5,233	7,079	9,959	12,505	1,149

U.S. GAAP including effects of inflation:

Total assets	6,438	6,716	9,483	15,295	17,566	1,614
Total long-term liabilities ⁽³⁾	945	1,134	1,525	2,381	2,142	197
Total stockholders' equity	4,485	5,215	6,980	8,239	10,421	958

Other Data:*Mexican GAAP:*

Capital expenditures	10	67	1,328	520	403	37
Adjusted EBITDA ⁽⁶⁾	483	763	2,176	1,968	3,359	309
Depreciation and amortization from continuing operations	183	206	230	337	434	40
Working capital	(11)	1,058	2,034	4,200	6,719	617

Operational information:

Annual installed capacity (thousands of tons)	730	730	1,210	2,847	2,902	
Tons shipped	609	628	773	1,708	2,676	
Mexico	529	547	676	899	945	
United States, Canada and others	80	81	97	809	1,731	

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SBQ steel	78	63	168	923	1,918	
Structural and other steel products	531	565	605	785	758	
Per ton:						
Net sales per ton	4,076	5,015	7,904	7,848	8,479	779
Cost of sales per ton	2,728	3,294	4,592	6,276	6,898	634
Operating income per ton	472	886	2,516	955	1,093	100
Adjusted EBITDA per ton	793	1,214	2,814	1,152	1,255	115
Number of employees	1,333	1,288	2,018	4,360	4,053	

4

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- (1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the rate of Ps. 10.881 per \$1.00, the interbank transactions rate in effect on December 31, 2006.
- (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 2006 we recorded Ps. 15 million for the cancellation of the provision of labor obligations assumed in the acquisition of Atlax on the 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 described in Note 14(a) to the audited financial statements.
- (6) Adjusted EBITDA is not a financial measure computed under Mexican or U.S. GAAP. Adjusted EBITDA derived from our Mexican GAAP financial information means Mexican GAAP net income excluding (i) depreciation and amortization, (ii) financial income (expense), net (which is composed of net interest expense, foreign exchange gain or loss and monetary position gain or loss), (iii) other income (expense) and (iv) income tax expense and employee statutory profit-sharing expense.

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

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

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

Year Ended December 31,

	2002	2003	2004	2005	2006	2006 ⁽¹⁾
	(Millions of constant December 31, 2006 pesos)					(Millions of dollars)
<i>Mexican GAAP:</i>						
Net income	139	331	1,513	1,341	2,314	213
Depreciation and amortization	183	206	230	337	434	40
Financial income (expense)	(145)	(28)	(39)	(150)	(61)	(6)
Income tax expense and employee profit sharing	(26)	164	355	197	587	54
Other income (expense)	(42)	(34)	(39)	57	37	4
Adjusted EBITDA	483	763	2,176	1,968	3,359	309

EXCHANGE RATES

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

Year Ended December 31	High	Low	Average ⁽¹⁾	Period End
2002	10.43	9.00	9.66	10.43
2003	11.41	10.11	10.79	11.24
2004	11.64	10.81	11.29	11.15
2005	11.41	10.41	10.89	10.63
2006	11.46	10.43	10.91	10.80

Month	High	Low	Average ⁽¹⁾	Period End
December 2006	10.99	10.77	10.85	10.80
January 2007	11.09	10.77	10.96	11.04
February 2007	11.16	10.92	10.99	11.16
March 2007	11.18	11.01	11.11	11.04
April 2007	11.03	10.92	10.98	10.93
May 2007	10.93	10.74	10.82	10.74

(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.

RISK FACTORS

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

Risks Related to Our Business

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

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

6

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

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

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

- disruption of our ongoing business;
- diversion of our resources and of management's time;
- decreased ability to maintain uniform standards, controls, procedures and policies;
- difficulty managing the operations of a larger company;
- increased likelihood of involvement in labor, commercial or regulatory disputes or litigation related to the new enterprise;
- potential liability to joint venture participants or to third parties;
- difficulty competing for acquisitions and other growth opportunities with companies having greater financial resources; and
- difficulty integrating the acquired operations and personnel into our existing business.

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

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

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

In 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. Our future success will depend in part on our ability to integrate the operations of Republic successfully into our historic operations. Furthermore, while we have not yet encountered any material problems related to the assets acquired, there can be no assurance that problems will not arise in the future and that the costs associated with those problems, should they arise, will not be significant.

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

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

Approximately 32% of our sales in 2006 were in Mexico, where we face strong competition from other Mexican steel producers. A number of our Mexican competitors have undertaken modernization and expansion plans, including the installation of production facilities and manufacturing capacity for certain products that will compete with our products. As these producers become more efficient, we may experience increased competition from them and a loss of market share. In addition, we face competition from international steel producers. Increased international competition, especially when combined with excess production capacity, could force us to lower our prices or to offer increased services at a higher cost to us, which could reduce our gross margins and net income.

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

We depend on distributions from our 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 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, 2006, approximately 81% of our non-Mexican and 60% of our Mexican employees were members of unions. Collective bargaining agreements are typically negotiated on a facility by facility basis for our Mexican facilities. The compensation terms of our labor contracts are adjusted on an annual basis, and all other terms of the labor contracts are renegotiated every two years. Any failure to reach an agreement on new labor contracts or to negotiate these labor contracts might result in strikes, boycotts or other labor disruptions. These potential labor disruptions could have a material adverse effect on our results of operations and financial condition. There have been no labor disruptions in the past five years in our Mexicali and Guadalajara facilities, and there have been no labor disruptions in the Apizaco and Cholula facilities or our U.S. and Canadian facilities since we acquired them in 2004 and 2005, respectively. Labor disruptions, strikes or significant negotiated wage increases could reduce our sales or increase our cost, and accordingly could have a material adverse effect on our business.

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

The operations at our Lackawanna facility depend on certain easements and other recorded agreements that the International Steel Group Inc. made in our favor relating to, among other things, use of certain oxygen pipelines, engine rooms, water pipelines, natural gas and compressed air distribution systems and electrical equipment. Currently we and Mittal Steel are negotiating to extend these services and utility arrangements for a period of three years. Our respective rights under these agreements may be terminated in the event of force majeure or plant closures by either party. In the event that a plant closure occurs and affects the supply of utilities or services, either party, upon notice, has the right of ingress, egress and regress to enter the other party's premises for the sole purpose of continuing the supply of the utility affected. All of these rights are assignable in the event of a sale of either of the parties. These rights are essential to the use and operation of the Lackawanna facility. In the event of a termination of any of these rights, we could be required to cease some or all of our operations at the Lackawanna facility. Because we produced certain types of products in the Lackawanna facility that we do not produce in our other facilities, an interruption of production at the Lackawanna facility could result in a substantial loss of revenue and could damage our relationships with customers.

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

Our sales 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, 2006, direct sales of our products to one of our customers, United States Steel Corporation ("U.S. Steel") accounted for approximately 15% of our revenue. A disruption in sales to them could adversely effect our cash flow and results of operations.

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

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

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

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

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

Direct sales of products to automotive assemblers and manufacturers accounted for approximately 29% of our total net sales in 2006. Demand for our products is affected by, among other things, the relative strength or weakness of the U.S. automotive industry. U.S. automotive manufacturers have experienced significant reductions in market share to mostly Asian companies and have announced planned reduction in working capacity. Many large original equipment manufacturers such as Dana Corporation, Delphi Corporation (“Delphi”) and others, have sought bankruptcy protection. A reduction in vehicles manufactured in North America, the principal market for Republic’s SBQ steel products, would have an adverse effect on our results of operations. In addition, the U.S. automotive industry is significantly unionized and subject to unanticipated and extended work slowdowns and stoppages resulting from labor disputes. We also sell to independent forgers, components suppliers and steel service centers, all of which sell to the automotive market as well as other markets. Developments affecting the U.S. automotive industry may adversely affect us.

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

Most of our automotive parts customers in Mexico and the United States require that we have ISO 9001 and 14001 certification. All of the U.S. facilities that sell to automotive parts customers are currently ISO/TS 16949:2002 and ISO 14001 certified, as required.

If the foregoing certifications are canceled, if approvals are withdrawn or if necessary additional standards are not obtained in a timely fashion, our ability to continue to serve our targeted market, retain our customers or attract new customers may be impaired. For example, our failure to maintain these certifications could cause customers to refuse shipments, which could materially affect our revenues and results of operations. 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 and increasing our market share because these conditions can be a barrier to entry in the SBQ market and we cannot assure you that we will do so.

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

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

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

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

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

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

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

As of December 31, 2006, Industrias CH, which the chairman of our board of directors, Rufino Vigil González, controls, owned approximately 85% of our shares. Industrias CH nominated and elected all of the current members of our board of directors, and Industrias CH continues and, 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 in a significant number and variety of transactions on market terms with affiliates, including entities that Industrias CH owns or controls. We expect that in the future we will continue to enter into transactions with our affiliates, and some of these transactions may be significant.

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

We depend on the performance of our executive officers and key employees. Our senior management has significant experience in the steel industry, and the loss of any member of senior management or our inability to attract and retain additional senior management could adversely affect our business, results of operations, prospects and financial condition. We believe that the SBQ steel market is a niche market where specific industry experience is key to success. We depend on the knowledge of our business and the SBQ industry of our senior management team, including Luis Garcia Limon, our chief executive officer. In addition, we attribute much of the success of our growth strategy to our ability to retain most of the key senior management personnel of the companies and businesses that we have acquired. Competition for qualified personnel is significant, and we may not be able to find replacements with sufficient knowledge of, and experience in, the SBQ industry for our existing senior management or any of these individuals if their services are no longer available. Our business could be adversely affected if we cannot attract or retain senior management or other necessary personnel.

Risks Related to the Steel Industry

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

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

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

U.S. Steel supplies the majority of our iron ore and a portion of our coke requirements. We purchase the balance of our requirements in the open market. We expect to purchase increasing amounts of our iron ore requirements in the open market in the future. In 2004, U.S. Steel supplied essentially all of Republic's iron ore and coke requirements under terms of a supply agreement that was beneficial to us.