

GROUP SIMEC SA DE CV  
Form 20-F  
May 16, 2018

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

---

**FORM 20-F**

---

**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, 2017**

**OR**

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

**OR**

**SHELL COMPANY 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 Lázaro Cárdenas 601  
Colonia La Nogalera, Guadalajara,  
Jalisco, México 44440**

(Address of principal executive offices)

**Mario Moreno Cortez, telephone number 011-52-33 3770-6700, e-mail [mmoreno@gruposimec.com.mx](mailto:mmoreno@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 (each representing one Series B share)	NYSE Amex LLC
Series B Common Stock	NYSE Amex LLC*

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

**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, 2017 was:**

Series B Common Stock —494,046,650 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files). Yes No (note: not required of registrant)

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

U.S. 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

**Table of Contents**

**Page**

<b><u>PART I</u></b>	<b><u>1</u></b>
<u>Item 1. Identity of Directors, Senior Management and Advisers</u>	<u>1</u>
<u>Item 2. Offer Statistics and Expected Timetable</u>	<u>1</u>
<u>Item 3. Key Information</u>	<u>1</u>
<u>Item 4. Information on the Company</u>	<u>21</u>
<u>Item 4A. Unresolved Staff Comments</u>	<u>47</u>
<u>Item 5. Operating and Financial Review and Prospects</u>	<u>47</u>
<u>Item 6. Directors, Senior Management and Employees</u>	<u>73</u>
<u>Item 7. Major Shareholders and Related Party Transactions</u>	<u>80</u>
<u>Item 8. Financial Information</u>	<u>81</u>
<u>Item 9. The Offer and Listing</u>	<u>84</u>
<u>Item 10. Additional Information</u>	<u>85</u>
<u>Item 11. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>97</u>
<u>Item 12. Description of Securities Other than Equity Securities</u>	<u>98</u>
<b><u>PART II</u></b>	<b><u>100</u></b>
<u>Item 13. Defaults, Dividends Arrearages and Delinquencies</u>	<u>100</u>
<u>Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	<u>100</u>
<u>Item 15. Controls and Procedures</u>	<u>100</u>
<u>Item 16. Reserved</u>	<u>106</u>
<u>Item 16A. Audit Committee Financial Expert</u>	<u>106</u>
<u>Item 16B. Code of Ethics</u>	<u>107</u>
<u>Item 16C. Principal Accountant Fees and Services</u>	<u>107</u>
<u>Item 16D. Exemptions from the Listing Standards for Audit Committees</u>	<u>107</u>

<u>Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	<u>107</u>
<u>Item 16F. Change in Registrant's Certifying Accountant</u>	<u>107</u>
<u>Item 16G. Corporate Governance</u>	<u>107</u>
<b><u>PART III</u></b>	<b><u>109</u></b>
<u>Item 17. Financial Statements</u>	<u>109</u>
<u>Item 18. Financial Statements</u>	<u>109</u>
<u>Item 19. Exhibits</u>	<u>109</u>

## **CERTAIN TERMS**

Grupo Simec, S.A.B. de C.V. is a corporation (*sociedad anónima bursátil de capital variable*) organized under the laws of the United Mexican States (“Mexico”). Unless the context requires otherwise, when used in this annual report, the terms “we,” “our,” “the company,” “our company” and “us” refer to Grupo Simec, S.A.B. de C.V., together with its consolidated subsidiaries.

References in this annual report to “U.S. dollars” or “U.S.\$” are to the lawful currency of the United States. References in this annual report to “pesos” or “Ps.” are to the lawful currency of Mexico. References to “tons” in this annual report refer to 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. 19.7354 per U.S.\$1.00, the interbank transactions rate in effect on December 31, 2017. On May 11, 2018, the interbank transactions rate for the peso was Ps. 19.5387 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 U.S. 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, we cannot assure you 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, the following:

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, U.S. 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 Mexican and U.S. environmental laws;

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 Item 3.D – “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, 2016 and 2017 and for each of the three years ended December 31, 2015, 2016 and 2017. We have adopted International Financial Reporting Standards (IFRS), and its amendments and interpretations, as issued by the International Accounting Standard Board (IASB). We have adjusted the financial statements of our subsidiaries to conform to IFRS, and we have translated them to Mexican pesos. See Note 4 to our consolidated financial statements included elsewhere herein.

When preparing the financial statements for our individual subsidiaries and transactions in currencies other than our functional currency, 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 U.S. dollar was considered as the functional currency of all the U.S. subsidiaries (except Simec International 8, Inc., Steel Promotor, Inc. and Coadm Steel, Inc., which were subsidiaries of Corporacion Aceros DM, S.A. de C.V., until they merged in 2015) and the Brazilian Real was considered as the functional currency for GV do Brasil Industria e Comercio de Aço LTDA.; therefore, the financial statements of these subsidiaries were translated into Mexican pesos by applying:

-The exchange rates at the balance sheet date, to all assets and liabilities.

-The historical exchange rate at stockholders' equity accounts and revenues, costs and expenses.

Translation differences are carried directly to the consolidated statements of comprehensive income as other comprehensive income under the caption “translation effects of foreign subsidiaries.”

The Mexican peso was considered until 2015 the functional currency of the Simec International 8, Inc., Steel Promotor, Inc. and Coadm Steel, Inc. until the date they merged, after which they use the U.S. dollar as their recording currency. Therefore, the financial statements were translated to Mexican pesos before the subsidiaries merged, as follows:

- Monetary assets and liabilities, by applying the exchange rates at the balance sheet date.
- Non-monetary assets and liabilities, as well as stockholders’ equity accounts, at the historical exchange rate.

Revenues, costs and expenses, except those arising from non-monetary assets or liabilities that are translated using the historical exchange rate for the related non-monetary asset or liability, are translated on the base of the exchange rates in force at the dates of the transactions.

Translation differences were carried directly to the consolidated statement of comprehensive income as part of the income of the year under the caption foreign exchange gain (loss).

The translation effect in the results of operations for the years ended December 31, 2017, 2016 and 2015 resulted from applying the following exchange rates (peso/dollar) to the active or passive monetary position in foreign currency:

<b>Year ended</b>	<b>Exchange Rate (pesos)</b>	<b>Change</b>
December 31, 2015	17.3398	2.6050
December 31, 2016	20.6640	3.3242
December 31, 2017	19.7354	(0.9286)

The following tables present the selected consolidated financial information as of and for each of the periods indicated. The selected financial and operating information as of December 31, 2013, 2014 and 2015 and for each of the years ended December 31, 2013, 2014 and 2015 has been derived in part from our consolidated financial statements, which have been reported on by Castillo Miranda y Compañía, S.C., a member practice of BDO International Limited (“BDO”), and the selected financial and operating information as of and for the years ended December 31, 2016 and 2017 set forth below has been derived in part from our consolidated financial statements, which have been reported on by Marcelo de los Santos y Cía., S. C. a practice member of Moore Stephens International Limited (“Moore Stephens”). BDO and Moore Stephens have relied on the audited consolidated financial statements of Corporación Aceros DM., S.A. de C.V. (“Aceros DM”) subsidiaries and affiliates, reported on by Marcelo de los Santos y Cía., S. C. a practice member of Moore Stephens. The financial and operating information of GV do Brasil Industria e Comercio de Aço LTDA, as of December 31 2015 and 2014 and for each of the years ended December 31, 2015 and 2014, have been reported by BDO RCS Independent Auditors SS and for the years ended

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

December 31, 2016 and 2017, the financial and operating information of GV do Brasil Industria e Comercio de Aço LTDA have been reported by Moore Stephens Lima Lucchesi, member of Moore Stephens International Limited. 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.

	As of and for Year Ended December 31,					2017 <sup>(1)</sup>
	2013	2014	2015	2016	2017	(Millions of U.S. dollars)
<b>Income Statement Data:</b>						
Net sales	24,369	26,829	24,476	27,516	28,700	1,454
Cost of sales	22,410	25,492	23,097	22,776	23,994	1,216
Impairment of property, plant and equipment	-	-	2,072	-	-	-
Gross profit (loss)	1,959	1,337	(693)	4,740	4,706	238
Administrative expenses	732	801	1,163	879	954	48
Depreciation and amortization	385	393	419	398	285	14
Other (expense) income, net	(59)	61	173	(36)	7	-
Interest income	20	25	34	107	54	3
Interest expense	28	23	40	40	54	3
Foreign exchange gain (loss)	(67)	474	(382)	1,775	(654)	(33)
Income (loss) before taxes	708	680	(2,490)	5,269	2,820	143
Income tax expense	(281)	162	771	926	1,098	56
Net income (loss)	989	518	(3,261)	4,343	1,722	87
Non-controlling interest income (loss)	(527)	(686)	(2,047)	1,458	-	-
Controlling interest income (loss)	1,516	1,204	(1,214)	2,885	1,722	87
Net income (loss) per share <sup>(2)</sup>	3.06	2.44	(2.47)	5.93	3.49	0.18
Net income (loss) per ADS <sup>(2)</sup>	9.18	7.33	(7.40)	17.79	10.468	0.53
Weighted average shares outstanding (thousands) <sup>(2)</sup>	495,732	492,781	492,421	486,516	493,918	493,918
Weighted average ADSs outstanding (thousands) <sup>(2)</sup>	165,244	164,260	164,140	162,172	164,639	164,639
<b>Balance Sheet Data:</b>						
Total assets	33,280	35,896	32,244	41,639	45,538	2,308
Total short-term liabilities	4,705	5,821	5,588	5,519	7,237	367
Total long-term liabilities <sup>(3)</sup>	2,300	2,295	1,535	2,910	4,179	212
Total stockholders' equity	26,275	27,780	25,121	33,210	34,122	1,729
<b>Cash Flow Data:</b>						
Cash provided by operating activities	2,051	1,370	(382)	5,822	2,772	140
Cash provided by (used in) financing activities	(259)	(48)	(285)	(3,166)	(2,706)	(137)
Cash (used in) provided by investing activities	(2,948)	(2,060)	(655)	(1,495)	(374)	(19)
<b>Other Data:</b>						
Capital expenditures	3,178	1,858	648	3,100	3,040	154
Adjusted EBITDA <sup>(4)</sup>	1,895	1,261	1,058	4,892	4,933	250
Working capital <sup>(5)</sup>	11,497	11,852	11,392	17,488	18,872	956
Depreciation and Amortization	1,053	1,118	1,261	1,429	1,466	74
Dividends declared	0	0	0	0	0	0

**Operational Data:**

(capacity and production in thousands of tons):

Annual installed capacity <sup>(6)</sup>	3,818	3,830	4,330	4,132	4,001	N/A
Mexico	1,288	1,419	1,452	1,495	1,404	N/A
United States, Canada, Brazil and elsewhere outside Mexico	776	778	574	590	687	N/A
Total tons shipped	2,064	2,197	2,026	2,085	2,091	N/A
SBQ steel	989	1,131	929	761	733	N/A
Structural and other steel products	1,075	1,066	1,097	1,324	1,358	N/A
Number of employees	5,117	4,861	4,420	3,973	3,767	N/A

**Per ton data**

Net sales per ton <sup>(7)</sup>	11,807	12,212	12,081	13,197	13,725	695
Cost of sales per ton <sup>(7)</sup>	10,858	11,603	11,400	10,924	11,475	581
Adjusted EBITDA <sup>(4)</sup> per ton <sup>(7)</sup>	918	574	522	2,346	2,359	120

(1) Peso amounts have been translated into U.S. dollars solely for the convenience of the reader, at the exchange rate of Ps. 19.7354 per U.S.\$1.00, the interbank transactions rate in effect on December 31, 2017.

(2) Our series B shares are listed on the Mexican Stock Exchange, and the ADSs are listed on the New York Stock Exchange. One American depositary share, or "ADS," represents three series B shares.

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

Adjusted EBITDA is not a financial measure computed under U.S. GAAP or IFRS. Adjusted EBITDA is derived from our IFRS financial information and means net income (loss) excluding: (i) depreciation, amortization and (4) impairment expense; (ii) financial income (expense), net (which is composed of net interest expense and foreign exchange 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. You should bear in mind that Adjusted EBITDA is not defined and is not a recognized financial measure under MFRS, U.S. GAAP or IFRS 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, amortization and impairment loss which represents a non-cash charge to earnings; (ii) certain financing costs, which are significantly affected by external factors, including interest rates and foreign currency exchange rates, which can have little bearing on our operating performance; (iii) other income (expense) that are non-recurring operations; and (iv) income tax expense and employee statutory profit-sharing expense. However, Adjusted EBITDA has certain significant limitations, including that it does not include the following:

taxes, which are a necessary and recurring part of our operations;  
depreciation, amortization and impairment loss 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;  
comprehensive cost of financing, which reflects our cost of capital structure and assisted us in generating revenues;  
and  
other income and expenses that are part of our net income.

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 (loss) to Adjusted EBITDA is as follows:

	<b>Year Ended December 31,</b>					<b>2017<sup>(1)</sup></b> (millions of U.S. dollars)
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	
	(millions of pesos)					
Net income (loss)	989	518	(3,261)	4,343	1,722	87
Impairment of property, plant and equipment	-	-	2,072	-	-	-
Depreciation and amortization	1,053	1,118	1,261	1,429	1,466	74
Other (expense) income	(59 )	61	173	(36 )	7	-
Interest income	20	25	34	107	54	3
Interest Expense	28	23	40	40	54	3
Foreign exchange gain (loss)	(67 )	474	(382 )	1,775	(654)	(33)
Income tax expense	(281 )	162	771	926	1,098	56
Adjusted EBITDA	1,895	1,261	1,058	4,892	4,933	250

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

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

(7) Data in pesos and U.S. dollars, respectively, not in millions.

## Exchange Rates

The following table sets forth, for the periods indicated, the high, low, average and period-end free-market exchange rate expressed in Mexican 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 U.S. Federal Reserve Board 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.

<b>Year Ended December 31</b>	<b>High</b>	<b>Low</b>	<b>Average<sup>(1)</sup></b>	<b>Period End</b>
2013	13.43	11.98	12.76	13.10
2014	14.79	12.85	13.30	14.75
2015	17.36	14.56	15.87	17.20
2016	20.84	17.19	18.67	20.62
2017	21.89	17.48	18.88	19.64

<b>Month in 2018</b>	<b>High</b>	<b>Low</b>	<b>Average<sup>(1)</sup></b>	<b>Period End</b>
January	19.48	18.49	18.91	18.62

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

February	18.90	18.36	18.65	18.84
March	18.86	18.17	18.59	18.17
April	19.02	17.97	18.39	18.77
May (through May 4)	19.20	18.83	19.05	19.20

(1) Average of month-end 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, we cannot assure you 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 or at all.

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 New York Stock Exchange of the 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**

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

The steel industry is highly cyclical and sensitive to regional and global macroeconomic conditions. Global demand for steel as well as global production capacity levels significantly influence prices for our products, and changes in global demand or supply for steel in the future will likely impact our results of operations. The steel industry has suffered in the past, especially during downturn cycles, from substantial over-capacity. Currently, as a result of the increase in steel production capacity in recent years, there are signs of excess capacity in steel markets, which is impacting the profitability of the steel industry. Global steel prices decreased in 2013, 2014 and 2015, and in 2016 and 2017 global steel prices began to recover. We cannot give you any assurance as to prices of steel in the future.

***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 of our steel products have fluctuated significantly in the past and may do so in the future. Significant increases in raw material prices could adversely affect our gross profit. During periods when prices for scrap metal, iron ore, ferroalloys, coke and other raw materials have increased, our industry has historically sought to maintain profit margins by passing along increased raw material costs to customers by means of price increases. For example, prices of scrap metal in 2013 decreased approximately 6%, in 2014 increased approximately 7%, in 2015 decreased approximately 16%, in 2016 increased approximately 2% and in 2017 increased approximately 31%; prices of ferroalloys in 2013 decreased approximately 5%, in 2014 increased approximately 16%, in 2015 decreased approximately 9%, in 2016 decreased approximately 13% and in 2017 increased approximately 22%. We may not be able to pass along these and other cost increases in the future and, therefore, our profitability may be materially and adversely affected. Even when we can successfully increase our prices, 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 our customers will agree to pay increased prices for our steel products that compensate us for increases in our raw material costs.

We purchase our raw material requirements either in the open market or from certain key suppliers. Both scrap metal and ferroalloy prices are negotiated on a monthly basis with our suppliers and are subject to market conditions. We cannot assure you 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. In addition, if any of our key suppliers fails to deliver or we fail to renew our supply contracts, we could face limited access to some raw materials, or higher costs and delays resulting from the need to obtain our raw materials requirements from other suppliers.

***The inability to use our existing inventory in the future or impairments in the valuation of our inventory could adversely affect our business.***

As of December 31, 2017, we had 136,541 metric tons of coke inventory, which is one of the principal raw materials used in blast furnaces. We have not used this raw material in recent years because our Lorain, Ohio blast furnace facility has been idle since 2008. We intend to start using coke as a substitute for coal in our productive process in our other plants in Mexico and the United States. However we cannot assure you that we will be able to effectively utilize such inventory.

We have assigned a fair market value of Ps. 1,037 million (U.S.\$52.6 million) to our coke inventory. However, prices for coke have fluctuated significantly in the past and could continue to do so in the future and significant fluctuations in coke prices could adversely affect the value of our existing inventory.

***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.***

Our production processes are dependent on adequate supplies of electricity and natural gas. A substantial increase in the cost of electricity or natural gas could have a material adverse effect on our gross profit. In addition, a disruption or curtailment in supply could have a material adverse effect on our production and sales. Prices for electricity increased approximately 9% in 2013 and 7% in 2014, decreased approximately 12% in 2015, in 2016 increased approximately 1.5% and in 2017 increased approximately 22%, and prices for natural gas increased approximately 16% in 2013 and 25% in 2014, decreased approximately 23% in 2015, increased approximately 8% in 2016 and increased approximately 22% in 2017. Moreover, energy costs constitute a significant and increasing component of our costs of operations. Our energy cost was 13.1% of our manufacturing conversion cost for 2017 compared to 13.5% for 2016, 13% for 2015, 14% for 2014, and 13% for 2013.

We 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 of Mexico, for natural gas used at our facilities in Mexico. We cannot assure you that these special rates will continue to be available to us or that these rates may not increase significantly in the future, particularly in light of recent energy reforms in Mexico. In the United States, we have contracts in place with special rates from the electric utilities. We cannot assure you that these special rates will continue to be available to us or that these rates may not increase significantly in the future. In certain deregulated electric markets in the United States, we have third party electric generation contracts under a fixed price arrangement. These contracts mitigate our price risk for electric generation from the volatility in the electric markets. In addition, we purchase natural gas from various suppliers in the United States and Canada. These purchase prices are generally established as a function of monthly New York Mercantile Exchange settlement prices. We also contract with different natural gas transportation and storage companies to deliver the natural gas to our facilities. In addition, we enter into futures contracts to fix and reduce volatility of natural gas prices both in Mexico and the United States, as appropriate. As of December 31, 2017, we have not entered into derivative financial instruments in Mexico, the United States or Brazil. We have not always been able to pass the effect of increases in our energy costs on to our customers and we cannot assure you that we will be able to pass the effect of these increases on to our customers in the future. We also cannot assure you that we will be able to maintain futures contracts to reduce volatility in natural gas prices. Changes in the price or supply of electricity or natural gas would materially and adversely affect our business and results of operations.

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

Competition in the steel industry is intense, which 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 further increase competitive pressures on independent producers of our size, particularly if large steel producers formed through consolidations, which have access to greater resources than us, adopt predatory pricing strategies that decrease prices and profit margins. If we are unable to remain competitive with these producers, our profitability and market share would likely be materially and adversely affected.

A number of our competitors in Mexico, the United States and Canada have undertaken modernization and expansion plans, including the installation of production facilities and manufacturing capacity for certain products that 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 Mexico, the United States and Canada 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 profit margins.

***Competition from other materials could significantly reduce demand and market prices for steel products.***

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 demand and market prices for steel products and thereby affect our results of operations.

***A sudden slowdown in consumption in or increase in exports from China could have a significant impact on international steel prices, therefore affecting our profitability.***

As demand for steel has surged in China, steel production capacity in that market has also increased, and China is now the largest worldwide steel producing country, accounting for approximately half of the worldwide steel production. Due to the size of the Chinese steel market, a slowdown in steel consumption in that market could cause a sizable increase in the volume of steel offered in the international steel markets, exerting a downward pressure on sales and margins of steel companies operating in other markets and regions, including us.

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

As part of our growth strategy, we may seek to expand our existing facilities, build additional plants, acquire additional steel production assets, enter into joint ventures or form strategic alliances that we expect will expand or complement our existing business. If we undertake any of these transactions, 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.

We will require significant capital for acquisitions and other strategic plans, as well as for the maintenance of our facilities and compliance with environmental regulations. We may not be able to fund our capital requirements from operating cash flow and we may be required to issue additional equity or debt securities or obtain additional credit facilities, which could result in additional dilution to our shareholders. We cannot assure you that adequate equity or debt financing would be available to us on favorable terms or at all. If we are unable to fund our capital requirements, we may not be able to implement our growth strategy.

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, the United States and Canada. Acquisitions involve a number of special risks, in addition to those described above, that could adversely affect our business, financial condition and results of operations, including 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.

***We and our auditors have identified material weaknesses in our internal controls over financial reporting, for each of the last seven years, and if we fail to remediate these material weaknesses and achieve an effective system of internal controls, we may not be able to report our financial results accurately, and current and potential shareholders could lose confidence in our reporting, which would harm our business and the trading price of our Series B shares or the ADSs.***

In connection with the preparation of our financial statements as of and for each of the years ended December 31, 2011, 2012, 2013, 2014, 2015, 2016 and 2017, we and our auditors identified material weaknesses (as defined under standards established by the Public Company Accounting Oversight Board, (United States of America)) in our internal controls over financial reporting (our management did not assess the effectiveness of our internal controls over financial reporting as of December 31, 2016). 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.

*Fiscal Year Ended December 31, 2011.* On January 12, 2012, our audit and corporate practices committee (“Audit Committee”) received a formal complaint from the General Accounting and Treasury Services Manager of Republic Engineered Products, Inc. (“Republic”), stating that he had identified, during his review of the financial statements of SimRep and its subsidiaries for the year ended December 31, 2011, what he considered to be material accounting errors, and potential “management override of internal controls” at SimRep. In response, our Audit Committee instructed our internal audit department to perform a review, and subsequently engaged outside counsel to conduct an internal investigation concerning the accounting matters and potential management overrides of internal controls at SimRep. As a result of our investigation, we identified material weakness at SimRep, finding that, with respect to SimRep and its subsidiaries, management did not design and maintain effective controls relating to the year-end closing and financial reporting process, resulting in accounting errors with respect to the reconciliation of certain balance sheet accounts, and a failure to timely review and control the preparation and closing of SimRep’s consolidated financial statements. In addition, SimRep also had insufficient personnel resources and technical accounting and reporting expertise to appropriately address certain accounting and financial reporting matters in accordance with generally accepted accounting principles.

In addition, our external auditors notified our management that, during their audit of our consolidated financial statements for the year ended December 31, 2011, it identified what it considered to be, under standards established by the Public Company Accounting Oversight Board, material weaknesses in internal controls over financial reporting:

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness, and which include (i) ineffective controls in the patents registry; (ii) inadequate resources and inadequate distribution of duties among personnel, resulting in too many functions centralized among too few personnel; (iii) out-of-date accounting and human resources policies and information technology procedures, and a lack of proper monitoring of the foregoing; (iv) a lack of adequate implementation of our ethical code; (v) failure to integrate all control processes into an Enterprise Resource Planning (ERP) system; (vi) a lack of an accounting manual (including instructions on accounting recordkeeping) for the entire company; (vii) failure to create and implement a training plan for management personnel preparing financial records; and (viii) failure of audit personnel to report periodically to the Audit Committee in order to monitor the remediation

procedures previously adopted with respect to previous accounting periods;

A lack of appropriate accounting resources, which led to inadequate supervision and controls within the accounting department and therefore prejudiced the financial statement closing process, the deferred income tax process and the conversion of foreign subsidiaries process, resulting in material accounting errors;

A lack of an appropriate consolidation system to allow management to supervise properly the preparation of consolidated financial information. Financial information of subsidiaries was presented at a level of detail that was insufficient to allow for a clear and precise understanding of operations; and

A lack of appropriate accounting resources at SimRep, which led to material weaknesses with respect to SimRep's internal controls over financial reporting, which resulted in material corrections to its consolidated financial statements. Such material weaknesses included: (i) a lack of proper controls to reconcile certain balance sheet accounts at a detailed level, including certain accounts payable debit balances that could not be substantiated, resulting in audit adjustments; (ii) financial close control failure due to lack of timely review of monthly financial statements; (iii) a necessity to perform several reclassifications to basic financial statements and adjustments to the footnotes after the auditors' review of such financial statements; and (iv) a lack of appropriate expertise at SimRep to address technical accounting and financial reporting matters.



Significant deficiencies were detected also at our subsidiary Corporación Aceros DM, S.A. de C.V. which, in the aggregate, constitute a material weakness. These significant deficiencies include (i) lack of physical inventory of fixed assets; (ii) lack of proper segregation of duties analysis and authorization of personnel access to main information systems (iii) lack of evidence of reconciliation of physical and accounting information of raw material inventory; (iv) lack of evidence of review of interim financial statements; and (v) failure to document and communicate adequately responsibilities and authority of key financial roles.

*Fiscal Year Ended December 31, 2012.* In our assessment of our internal controls over financial reporting for the year ended December 31, 2012, we and our external auditors identified the following material weaknesses:

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness, and which include: (i) failure to keep all our policies and procedures, including IFRS accounting policies, updated; (ii) limited IFRS understanding within our Internal Audit department; (iii) inadequate controls in the review and approval process of the disclosures of our financial statements; (iv) poor maintenance of our whistleblower line for the Mexican subsidiaries; (v) ineffective controls in our patents registry; (vi) inadequate distribution and segregation of duties within our accounting department; (vii) deficient distribution to employees and officers of our code of ethics; (viii) failure to integrate all control processes into an Enterprise Resource Planning (ERP) system; (ix) lack of an accounting manual with accounting instructions for our most important transactions; (x) failure to create and implement a training plan for our management personnel preparing financial records; and (xi) incomplete monitoring of certain control deficiencies identified on previous years;

Inadequate supervision and controls within our accounting department which prejudiced the financial statement closing process, conversion of foreign subsidiaries, presentation of financial statements and assets valuation, resulting in material accounting errors;

A lack of an appropriate consolidation system to allow our management to supervise properly the preparation of consolidated financial information with the required detail;

Deficient and not standardized controls in SimRep related to the physical inventory counts and a very vulnerable procedure to determine costs due to manual calculations, and;

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM S.A. de C.V. which in the aggregate, constitute a material weakness. These significant deficiencies include: (i) failure to timely approve our policies and procedures to prepare financial statements in accordance with IFRS and limited knowledge of those standards, (ii) undocumented process and deficient controls in the control access to information systems, (iii) deficient controls to review and approve cost calculation of finished goods, (iv) lack of physical inventory of fixed assets; and (v) failure to document and communicate adequately responsibilities and authority of key financial roles.

*Fiscal Year Ended December 31, 2013.* In our assessment of our internal controls over financial reporting for the year ended December 31, 2013, we and our external auditors identified the following material weaknesses:

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness, and which include: (i) inadequate controls in the review and approval process of the disclosure in the financial statements and our annual report on form 20-F, (ii) out of date whistleblower line for the Mexican subsidiaries, (iii) ineffective controls in our patents registry, (iv) inadequate distribution and segregation of duties within the accounting department in the Mexican subsidiaries, (v) deficient distribution to employees and officers of our code of ethics and poor promotion of strong control environment and internal controls, (vi) failure to integrate all control processes into an Enterprise Resource Planning (ERP) system, (vii) lack of an accounting manual with accounting instructions for our most important transactions, (viii) lack of specific procedures to authorize and register intercompany transactions, (ix) failure to create and implement a complete training plan for our management personnel preparing financial records, (x) limited IFRS and consolidation process understanding and reduced personnel within our Internal Audit department which limited the scope of the management assessment, also the internal audit plan was not carried out in full and did not include test about risk assessment, environmental, fraud and compliance with law, and only included a limited review of the consolidated financial statements, (xi) lack of committees to review and approve all our contracts and to make risk assessments, these activities are currently executed by selected persons only, (xii) lack of a transition plan for the establishment of the new COSO 2013; and (xiii) insufficient resources to implement and follow up on the remedial measures identified in previous years for the Mexican subsidiaries due to the prevalence of such deficiencies, and informal communication of deficiencies and remediation plans;

8

Inadequate supervision and controls within our accounting department which prejudiced the financial statement closing process, conversion of foreign subsidiaries, presentation of financial statements, assets valuation and deferred taxes, resulting in material accounting errors;

A lack of an appropriate consolidation system to allow our management to supervise properly the preparation of consolidated financial information with the required detail;

Deficient and not standardized controls in SimRep related to authorization, control and accounting of capitalized expenditures and related fixed assets, and;

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM, S.A. de C.V. which in the aggregate, constitute a material weakness. These significant deficiencies include (i) incomplete procedures for the review process over financial closings; (ii) incomplete documental support for authorization and extension of customer credit lines, (iii) deficient controls in the control access to the information systems, (iv) deficient controls to review and approve inventory valuation, cost of production calculation and cost of sales computation, (v) lack of physical inventory of fixed assets; and (vi) failure to document and communicate adequately responsibilities and authority of key financial roles.

*Fiscal Year Ended December 31, 2014.* In our assessment of our internal controls over financial reporting for the year ended December 31, 2014, we and our external auditors identified the following material weaknesses:

Insufficient resources applied to the remediation and appropriate monitoring of internal control weaknesses, most of which were identified in previous years and continue to be unresolved.

Inadequate distribution and segregation of duties within the accounting department in the Mexican Subsidiaries due to insufficient resources. Additionally, the internal audit staff was reduced and considered insufficient to fulfill their role.

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness, and which include: (i) inadequate controls for the definition, review and approval process of the disclosure in the financial statements and our annual report on form 20-F, (ii) non-operating and outdated whistleblower line for the Mexican subsidiaries, (iii) ineffective controls in our patents registry, (iv) deficient distribution of our code of ethics to employees and officers and poor promotion of strong control environment and internal controls in accordance with the COSO model, (v) failure to integrate all control processes into one Enterprise Resource Planning (ERP) system, (vi) lack of an accounting manual with accounting instructions on most of accounting records, (vii) lack of specific procedures for the approval of transactions with related parties, (viii) failure to create and implement a complete training plan for management personnel preparing financial records, (ix) limited IFRS and consolidation process understanding and reduced personnel within our Internal Audit department which limited the scope of the management assessment; the internal audit plan was not carried out in full and did not include tests about risk assessment, including environmental, fraud, compliance with laws and review of

the consolidated financial statements; (x) lack of committees to review, approve and make risk assessments of all our contracts, and (xii) informal communications of deficiencies and remediation plan to the areas and managers involved.

Inadequate supervision and controls within the accounting department which impacted the financial statement closing process, conversion of foreign subsidiaries and intercompany reconciliations, resulting in material accounting errors.

A lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

SimRep did not maintain effective controls relating to accounting of certain capital expenditures and related fixed assets were found. Lastly, the evaluation for impairments is not reasonable given actual results of such Subsidiary.

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM, S.A. de C.V. which in the aggregate, constitute a material weakness. These significant deficiencies include (i) ineffective controls and insufficient supporting documentation for closings of periods end and financial statements review and authorization; the related procedures were incomplete and do not include specific procedures to enter transactions into the general ledger, to select and apply accounting policies and have not been updated in the last 3 years, which such controls are necessary to give reasonable assurance of compliance with IFRS, (ii) no evidence of review of some account balances, such as fixed assets, sales and tax calculations by the responsible individuals; there is also no evidence of review of the financial statements by the General Manager of Corporación Aceros DM, S.A de C.V., (iii) undocumented processes and deficient controls in the access to the information systems, (iv) deficient controls to review and approve cost calculations of finish goods, period end costs and inventories and cost of sales report, (v) lack of physical inventory of fixed assets in several years; and (vi) failure to document and communicate adequately responsibilities and authority of key financial roles.

*Fiscal Year Ended December 31, 2015.* In our assessment of our internal controls over financial reporting for the year ended December 31, 2015, we and our external auditors identified the following material weaknesses:

The internal audit department did not develop its functions to comply with the analysis of the controls during 2015. Consequently, this limited the functions of the Audit Committee.

Insufficient resources applied to the remediation and appropriate monitoring of internal control weaknesses, most of which were identified in previous years and continue to be unresolved.

Inadequate distribution and segregation of duties within the accounting department in our Subsidiaries due to insufficient resources. Additionally, the internal audit staff was considered insufficient to fulfill their role.

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness and create a reasonable likelihood that a material misstatement of our annual and interim financial statements will not be prevented or detected on a timely basis. Such deficiencies include: (i) inadequate controls for the definition, review and approval process of the disclosure in the financial statements and our annual report on form 20-F, (ii) whistleblower line for our Mexican subsidiaries was not fully operational, our website information is outdated and does not include information about our Brazilian operations, (iii) ineffective controls in our patents registry, (iv) deficient distribution of our code of ethics to employees and officers and poor promotion of strong control environment and internal controls in accordance with the COSO model, (v) failure to integrate all control processes into one Enterprise Resource Planning (ERP) system, (vi) lack of an accounting manual with accounting instructions on most of accounting records, (vii) lack of specific procedures for the approval of transactions with related parties, (viii) failure to create and implement a complete training plan for management personnel preparing financial records under IFRS, (ix) limited IFRS and consolidation process understanding and reduced personnel within our Internal Audit department which limited the scope; also the internal audit plan was not carried out, and therefore the audit department did not perform risk assessment an environmental, fraud, compliance with laws, review of the consolidated financial statements and review of our annual report on form 20-F; (x) lack of committees to review, approve and make risk assessments of all our contracts; and (xi) informal communications of deficiencies and remediation plan to the areas and managers involved.

Inadequate supervision and controls within the accounting department which impacted the financial statement closing process, conversion of foreign subsidiaries, intercompany reconciliations and a lack of controls for the issuance and authorizations of journal entries, resulting in material accounting errors.

A lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

SimRep did not maintain personnel with the appropriate level of knowledge and experience of accounting and training required to comply with financial reporting requirements. This material weakness led to the certain control deficiencies, each of which are considered to be a material weakness.

Failure to provide our external auditors with evidence of the evaluation of the effectiveness of internal controls in our Brazilian subsidiary, in addition of not hiring an external auditor for this evaluation.

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM, S.A. de C.V. which in the aggregate, constitute a material weakness.

*Fiscal Year Ended December 31, 2016.* Our external auditors incorporated into their “Attestation Report of the Independent Registered Public Accounting Firms” for the year ended December 31, 2016, the following assessment of our internal controls, which included the following material weaknesses:

Regarding the control environment and entity level controls, the following material weaknesses were identified: (i) lack of a whistleblower tool that covers the entirety of the company; (ii) regarding the distribution of the code of ethics, certain sectors of the employees did not recognize the code of ethics; (iii) ineffective control of the patent registration process, which lacks a policy and a procedure; (iv) lack of a policy and procedure for the valuation of assets and the company’s physical inventories; (v) lack of a policy and procedure governing the extensions of credit to the clients; (vi) lack of a policy and procedure for the registration of related parties and the approval of transactions with related parties.

Lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

In connection with certain financial reporting processes, lack of a robust role-segregation model for the creation, editing, deletion, display only, and modification of such processes.

Lack of communication between the internal audit team, which impacted time of test execution, leaving out of scope cycles such as income, human resources, general controls of information technology and costs and inventories.

Lack of documentation setting out the procedure in the event of a disaster (Disaster Recovery Plan) and documentation setting out the procedure in order to continue the operations of the business (Business Continuity Plan).

*Fiscal Year Ended December 31, 2017.* In our assessment of our internal controls over financial reporting for the year ended December 31, 2017, we and our external auditors identified the following material weaknesses:

Insufficient training on, and knowledge of, COSO and the related operation of the control environment for mid-level personnel of the Company.

A lack of a formalized policy related to the delegation of authority clearly defining the roles and responsibilities for employees.

The Company lacks a system of assessing and monitoring employee performance to increase their skills to be prepared for the complexity of the Company’s operation.

The Company does not maintain a detailed accounting manual and closing checklists. The lack of such procedures reduces the likelihood of detecting errors on a timely basis during the financial close. Similarly, there is a lack of documents supporting the existence of supervisory review over accounting entries recorded by the Company.

The Company does not maintain appropriate evidence over records supporting certain matters in regards to fixed assets:

· There is insufficient data to support certain adjustments to fixed assets recorded on the books of the Company.

The Company does not have an appropriate system to properly store records in regards to significant acquisitions of fixed assets.

· The Company failed to reconcile their recorded fixed assets to the underlying support.

The Company did not document appropriate authorizations in regards to capital investments or to increases in the planned size of an ongoing investment project.

The Company has neither a system of tagging and tracking fixed assets nor a process for taking periodic inventories to determine the continued existence of recorded fixed assets.

The Company lacks sufficient documentation and internal controls related to the process of obtaining credit. The

Company also lacks sufficient training for personnel responsible for monitoring such credit facilities in regards to fraud detection and ongoing compliance matters.

The Company lacks a program to ascertain that the administrative staff with access to accounting records are sufficiently trained and monitored.



The Company lacks an appropriate environment to ensure that the financial records are closed in accordance with International Financial Reporting Standards properly and in a timely manner. Items identified included:

A lack of appropriate accounting resources at the corporate level which adversely impacted the operation of key supervision controls over the accounting department, the financial statement closing process, and the process of computing and authorizing journal entries.

o A lack of appropriate procedures to analyze the results of the business units prior to consolidation.

o A lack of a unified computerized general ledger or enterprise resource planning system among the business units.

o There is also a lack of a common chart of accounts which would simplify the consolidation process.

A lack of an appropriate consolidation system allowing management to properly supervise the preparation of consolidated financial information. The system is highly manual, increasing the risk of human error and lacking sufficient oversight as the process is largely performed by a single member of the accounting staff.

An audit performed on the information technology systems of the Company determined that approximately 25% of controls over the information technology infrastructure were either deficient in design or missing. Additional findings include:

o A lack of an internal reference framework methodology to ascertain and assess information technology risks.

o The lack of a methodology to evaluate the design and operational effectiveness of key controls over critical business processes.

o No system of verification of the access profiles of personnel or a process to verify that accounts of former employees are properly closed.

In the case of GV do Brasil Indústria e Comércio de Aço Ltda in Brasil we observed an inadequate segregation of duties, in respect to system access and activities related to:

The person with final responsibility for the preparation of the financial reports is also responsible for the corporate tax area, financial management (approval of payments and receipts, analysis of client credit risks including credit limits still not established, and negotiations with clients), monthly calculation of the costs of the products sold (and, consequently, of the value of the inventories of finished products), and assessment of the amount of physical impurities contained in scrap inventories, which also determines the valuation.

The person responsible for supervising the physical movements of raw materials and finished products also has the following duties: authorization to issue sales invoices, the authority to adjustment quantities of inventory items, and also responsibility for planning and authorizing the movements of the physical inventory of between inventory locations.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that as a component of the financial control process, certain accounts are not being reconciled quarterly to the underlying details and the components of certain other accounts are not being reviewed by management.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that a control requiring the signatures of the vice-president of Finance, head of information technology and the General Manager to authorize all expenditures over \$25,000 was not operating effectively. A number of the purchases lacked the required supporting signatures.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that the controller at one of the production plants failed to properly perform all required tests to review the inventories to be sure they are properly recorded at the lower of cost or market, and also failed to obtain approval for a journal entry which should be generated from the analysis.

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 weaknesses 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 material adverse impact on the trading price of our Series B shares or the ADSs.

For further details, see Items 15.B “Controls and Procedures—Management’s Annual Report on Internal Control Over Financial Reporting – Material Weaknesses,” 15.C “Attestation Report of the Independent Registered Public Accounting Firms” and 15.D “Changes in Internal Control over Financial Reporting.”

***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.***

On October 14, 2014, the United States International Trade Commission (USITC) determined that the U.S. steel industry is materially injured by reason of imports of steel concrete reinforcing bars from Mexico, that are sold in the United States at less than fair value, and from Turkey, that are subsidized by the government of Turkey. As a result of the USITC’s affirmative determinations, the U.S. Department of Commerce issued an antidumping duty order on imports of this product from Mexico and a countervailing duty order on imports of this product from Turkey. The U.S. government imposed tariffs of 66.7% against imports for rebar from Deacero, S.A.P.I de C.V. and us and tariffs of 20.58% for rebar imports from all other producers in Mexico. On June 8, 2017, the US Department of Commerce issued a final resolution in which it determined that the tariff would be 0%.

Recent events, including the U.S. presidential election and Brexit in the U.K., have resulted in substantial regulatory uncertainty regarding international trade and trade policy. On March 1, 2018, U.S. President Trump announced a 25% tariff on all steel products and a 10% tariff on all aluminum products imported into the United States for an indefinite amount of time under Section 232 of the Trade Expansion Act. If formally enacted, such tariff may have a material effect on the demand and price of steel in Canada, Brazil, South Korea, Mexico, Russia and China (which include some of the top importers of steel products into the United States). In addition, the announced tariff may cause other countries and trading blocks to impose similar tariffs and trade barriers and could ignite a global trade war that limits the supply and restricts the free trade of steel.

Many of our products are subject to existing duties, tariffs, anti-dumping duties and quotas that may limit the quantity of some types of goods that we import into the United States. Furthermore, certain of our competitors may be better positioned than us to withstand or react to border taxes, tariffs or other restrictions on global trade and as a result we may lose market share to such competitors. Due to broad uncertainty regarding the timing, content and extent of any regulatory changes in the U.S. or elsewhere, we cannot predict the impact, if any, that these changes could have to our business, financial condition and results of operations. See “—Risks Related to Mexico—Developments in other countries

could adversely affect the Mexican economy, our financial performance and the price of our shares.”

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

As of December 31, 2017, approximately 81% of our non-Mexican and 44% of our Mexican employees were members of unions. 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. In addition, collective bargaining agreements are typically negotiated on a facility-by-facility basis for our Mexican facilities. 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 business. Labor disruptions or significant negotiated wage increases could reduce our sales or increase our costs, which could in turn have a material adverse effect on our results of operations.

***Operations at our Lackawanna, New York, facility depend on our continuing right to use certain property and assets of an adjoining facility 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 upon certain arrangements and understandings 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. and its affiliates (“Mittal Steel”), were effective through April 30, 2009, at which time Mittal Steel transferred its Lackawanna plant to Tecumseh Redevelopment, Inc. (“Tecumseh”). In December 2010, Tecumseh transferred a portion of the former Mittal Steel facility to Great Lakes Industrial Development, LLC (“GLID”). Upon the transfer to GLID, we entered into a written agreement with GLID regarding the provision of compressed air to our facility. This lease assures that compressed air will be provided to our facility during the lease term (initially two years with automatic one year renewals until terminated by either party) and grants us an option to purchase the equipment at various times and at stated prices, thereby providing us some flexibility while we consider the installation of our own compressed air system at our facility. The water pump that services our plant is located on property still owned by Mittal Steel and is maintained by Mittal Steel, which also continues to furnish industrial water to us on a month-to-month basis. The electric system which services the compressed air equipment, as well as the electric system which services the GLID property, has been re-routed through our electric meter located at a substation on the adjacent GLID property. We continue to pursue a written agreement with GLID covering our use of the electric substation and related equipment on the GLID property, as well as the sanitary sewer lift station on the GLID property that serves our facility, and a truck entrance and security monitoring equipment located on the GLID property. All of these rights are essential to the use and operation of our Lackawanna facility. It is our understanding that GLID has sold or is in the process of selling a portion of its property to an unrelated third party. In the event of a termination of any of our rights, either due to a failure to negotiate a satisfactory outcome with Mittal Steel, GLID or any third party to which it sells all or part of its facility, 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 United States 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 United States 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. During 2017, 2016, 2015, 2014 and 2013, sales to our ten largest customers in the United States accounted for approximately 68.7%, 62.1%, 56.8%, 51.4% and 40.6% of our consolidated revenues in the United States, respectively, and approximately 20%, 18.1%, 21.5%, 23.6% and 21.1% of our total consolidated revenues, respectively. A disruption in sales to one or more of our largest customers would adversely affect our cash flow and results of operations.

We cannot assure you 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 are favorable to us or at all. 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.

***Negative trends in the operation in our United States segment.***

Our significant investment in the new Lorain, Ohio, electric arc furnace, built in response to the expected growth prospects in the United States oil and gas drilling and exploration industry, was a major contributor to the operational losses incurred in 2014 and 2015. Additionally, the U.S. \$15 million (Ps. 310 million) investment in an electric bottom tapping furnace in 2012 at the Canton facility, intended to drive operational and productivity improvements, resulted in an initial challenge to master the new technology, which drove operational losses in 2013 in our United States segment. In response to the severe economic downturn in the energy exploration sector, which caused a significant drop in demand for seamless pipe, the entire Lorain facility was temporarily idled in

2015. This action halted the significant losses and allowed the business to focus on other industries which we continued to supply (mainly the automotive industry) where demand for our products remains strong. We cannot assure you that a new economic downturn in the future could not 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 unexpected 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 profitability, liquidity and financial condition.

***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 Mexican and U.S. facilities that sell to automotive parts customers are currently certified, as required. If the foregoing certifications are canceled, approvals are withdrawn or 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 that we will be able to maintain these required certifications.

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 vehicle quality and safety. We currently are an approved supplier for our automotive parts customers. Maintaining these certifications is key to preserving our market share, because they can be a barrier to entry in the SBQ market, and we cannot assure you that we will be able to do so.

***Failure to comply with environmental laws and regulations may result in fines, penalties or other significant liabilities or prevent us from operating our facilities.***

Our operations are subject to a broad range of environmental laws and regulations governing our impact on air, water, soil and groundwater and exposure to hazardous substances. The costs of complying with and the imposition of liabilities pursuant to, environmental laws and regulation can be significant. Despite our efforts to comply with environmental laws and regulations, environmental incidents or events that negatively affect the operations of our facilities may occur. In addition, 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, or be forced to shut down non-compliant operations and face lawsuits by third parties. In addition, environmental laws and regulations are becoming increasingly stringent and it is possible that future laws and regulations may require us to undertake material environmental compliance expenditures and require modifications in our operations. Furthermore, 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 federal, state and local environmental authorities. See Item 8. “Financial Information—Legal Proceedings.”

***Greenhouse gas policies and regulations, particularly any binding restriction on emissions of greenhouse gases such as carbon dioxide, could negatively impact our steelmaking operations.***

Our steel making operations in the United States and in Mexico use electric arc furnaces where carbon dioxide generation is primarily linked to energy use. In the United States, the Environmental Protection Agency has issued rules imposing inventory and reporting obligations to which some of our facilities are subject, and has also issued rules that will affect preconstruction permits for our facilities where increases in greenhouse gas pollutants are contemplated. The U.S. Congress has debated various measures for

regulating greenhouse gas emission (such as carbon dioxide) and may enact them in the future. Such laws and regulations may also result in higher costs for coking coal, natural gas and electricity generated by carbon-based systems (such as coal-fired electric generating facilities). Canada's federal government is also considering various approaches for reducing greenhouse gas emissions, although we do not presently believe Republic's Hamilton, Ontario facility would be significantly impacted by these efforts since it is not a steel-producing facility. Such future laws and regulations, whether in the form of a cap-and-trade emissions permit system, a carbon tax or other regulatory regime may have a negative effect on our operations. Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place. As signatories to the United Nations Framework Convention on Climate Change (the "UNFCCC"), Mexico, the U.S. and Canada became subject to the Paris Agreement to fight climate change, which was approved at the 21th session of the UNFCCC conference in 2015. However, in June 2017, U.S. President Trump stated that the United States would withdraw from the Paris Agreement, but may enter into a future international agreement related to greenhouse gas emissions. In August 2017, the U.S. State Department officially informed the United Nations of the intent of the United States to withdraw from the Paris Agreement. The United States' adherence to the exit process is uncertain and/or the terms on which the United States may reenter the Paris Agreement or a separately negotiated agreement are unclear at this time. As a result, some of our facilities may ultimately be subject to future regional, provincial and/or federal climate change regulations to manage greenhouse emissions. More stringent greenhouse gas policies and regulations could adversely affect our business and results of operations.

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

Certain of our U.S. facilities are currently engaged in the investigation and/or remediation of environmental contamination. Most of these investigations relate to legacy activities by prior owners. We may in the future be subject to similar investigations or required to undertake similar remediation measures at other facilities. We recognize a liability for environmental remediation when it becomes probable that such remediation will be required and the amount can be reasonably estimated. As estimated costs to remediate change, or when new liabilities become probable, we adjust the record liabilities accordingly. However, due to the numerous variables associated with the judgments and assumptions that are part of these estimates and changes in governmental regulations and environmental technologies over time, 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. See Item 8. "Financial Information—Legal Proceedings."

***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, S.A.B. DE C.V., (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 April 23, 2018, 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 is in a position 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 the ADSs.

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

Historically, we have engaged in a number and variety of transactions on market terms with our 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. See Item 7.B “Related Party Transactions.”

***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 our best efforts at compliance, and could result in a greater than expected tax burden. In addition, many of the jurisdictions in which we operate, including Mexico, 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 our financial condition and results of operations.

***If we are unable to protect our information systems against data corruption, cyber-based attacks or network security breaches, our operations could be disrupted.***

We are increasingly dependent on information technology networks and systems, including over the Internet, to process, transmit and store electronic information. In particular, we depend on our information technology infrastructure for digital marketing activities and electronic communications among us and our clients, suppliers and also among our subsidiaries and facilities. Security breaches or infrastructure flaws can create system disruptions, shutdowns or unauthorized disclosure of confidential information. If we are unable to prevent such breaches or flaws, our operations could be disrupted, or we may suffer financial damage or loss because of lost or misappropriated information.

Cyber threats are rapidly evolving and those threats and the means for obtaining access to information in digital and other storage media are becoming increasingly sophisticated. Cyber threats and cyber-attackers can be sponsored by countries or sophisticated criminal organizations or be the work of single “hackers” or small groups of “hackers.”

Insider or employee cyber and security threats are increasingly a concern for all companies, including ours. Nevertheless, as cyber threats evolve, change and become more difficult to detect and successfully defend against, one or more cyber-attacks might defeat our or a third-party service provider's security measures in the future and obtain the personal information of customers or employees. Employee error or other irregularities may also result in a defeat of security measures and a breach of information systems. Moreover, hardware, software or applications we use may have inherent defects of design, manufacture or operations or could be inadvertently or intentionally implemented or used in a manner that could compromise information security. A security breach and loss of information may not be discovered for a significant period of time after it occurs. While we have no knowledge of a material security breach to date, any compromise of data security could result in a violation of applicable privacy and other laws or standards, the loss of valuable business data, or a disruption of our business. A security breach involving the misappropriation, loss or other unauthorized disclosure of sensitive or confidential information could give rise to unwanted media attention, materially damage to our customer relationships and reputation, and result in fines, fees, or liabilities, which may not be covered by our insurance policies.

#### **Risks Related to Global Economic Conditions**

*Global economic conditions, such as the latest financial crisis and economic recession that occurred during 2008 and 2009, may significantly impact our business.*

The financial crisis that began in the United States in 2008 led to a global recession in which overall economic activity 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, construction and manufacturing sectors in particular has reduced demand for steel products in North America and globally. These economic conditions significantly impacted our business and results of operations. Although demand, production levels and prices in certain segments and markets have recovered and stabilized to a certain degree, the extent, timing and duration of the recovery and potential return to pre-crisis levels remains uncertain. If global macroeconomic conditions deteriorate, however, the outlook for steel producers would be adversely affected. It is difficult to predict the duration or severity of a new global economic downturn, or to what extent it will affect us. An unsustainable recovery and persistently weak economic conditions in our key markets could depress demand for our products and adversely affect our business and results of operations. We sell our products to the automotive and construction-related industries, both of which reported substantially lower customer demand during and after the latest global recession. As a result, our operating levels declined compared to pre-recession levels. While some of our end-product markets, such as the automotive industry, experienced recoveries during 2013, 2014 and 2015, in 2016 we experienced a reduction in our sales, and in 2017 there was a slight increase in sales to the automotive industry compared to 2016. In addition to slackening demand by end consumers, we believe that some of our customers continue to experience and may experience in the future 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. Moreover, if a new global economic downturn occurs, we may face increased risk of insolvency and other credit related issues of our customers and suppliers, as we faced with our customers and suppliers particularly in industries that were hard hit by the latest recession, such as automotive, construction and appliance. Also, there is the possibility that our suppliers may face similar risks. A 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. The impact of global economic conditions on these industries may have a significant effect on our results of operations.

Additionally, if global economic conditions deteriorate, we may be required to undertake asset impairments, as we have been required to undertake in the past.

***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 our products to automotive assemblers and manufacturers accounted for approximately 63% of our net sales of SBQ in 2017. Demand for our products is affected by, among other things, the relative strength or weakness of the North American automotive industry. 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. 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 North American automotive industry may adversely affect us.

***Our customers in the automotive industry continually seek to obtain price reductions from us, which may adversely affect our results of operations.***

A challenge that we and other suppliers of intermediary products used in the manufacture of automobiles 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 continue to 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 could be adversely affected.

*Sales may fall as a result of fluctuations in industry inventory levels.*

Inventory levels of steel products held by companies that purchase our products can vary significantly from period to period. These fluctuations can temporarily affect the demand for our products, as customers draw from existing inventory during periods of low investment in construction and the other industry sectors that purchase our products and accumulate inventory during periods of high investment and, as a result, these companies may not purchase additional steel products or maintain their current purchasing volume. Accordingly, we may not be able to increase or maintain our current levels of sales volumes or prices.

#### **Risks Related to Mexico**

*Adverse economic conditions in Mexico may adversely affect our financial performance.*

A substantial portion of our operations are conducted in Mexico and our business is affected by the performance of the Mexican economy. The latest global credit crisis and the economic recession has had significant adverse consequences on the Mexican economy, which in 2009 contracted by 6.5%, in 2010 grew by 5.5%, in 2011 and 2012 grew by 3.9%, in 2013 grew by 1.1%, in 2014 grew by 2.3%, in 2015 grew 2.5%, in 2016 grew by 2.9% and in 2017 grew by 2% (according to preliminary figures of the *Instituto Nacional de Estadística y Geografía* (INEGI)), in terms of gross domestic production. Moreover, in the past, Mexico has experienced prolonged periods of economic crises, caused by internal and external factors over which we have no control. Those periods have been characterized by exchange rate instability, high inflation, high domestic interest rates, changes in oil prices, economic contraction, a reduction of international capital flows, balance of payment deficits, a reduction of liquidity in the banking sector and high unemployment rates. Decreases in the growth rate of the Mexican economy, or periods of negative growth, or increases in inflation may result in lower demand for our products. The Mexican government recently cut spending in response to a downward trend in international crude oil prices, and it may further cut spending in the future. These cuts could adversely affect the Mexican economy and, consequently, our business, financial condition, operating results and prospects. We cannot assure you that economic conditions in Mexico will not worsen, or that those conditions will not have an adverse effect on our financial performance.

***Political, social and other developments in Mexico could adversely affect our business.***

Political, social and other developments in Mexico may adversely affect our business. Social unrest, such as strikes, suspension of labor, demonstrations, acts of violence and terrorism in the Mexican states in which we operate could disrupt our financial performance. Additionally, the Mexican government has exercised, and continues to exercise, significant influence over the economy. Accordingly, Mexican federal governmental actions and policies concerning the economy, the regulatory framework, the social or political context, and state-owned and state-controlled entities or industries could have a significant impact on private sector companies and on market conditions, prices and returns of Mexican securities. In the past, governmental actions have involved, among other measures, increases in interest rates, changes in tax policies, price controls, currency devaluations, capital controls and limits on imports.

Currently, no single political party has a majority in either chamber of the Mexican Congress. The absence of a clear majority and the lack of alignment between the legislature and the administration could result in deadlock and prevent the timely implementation of political and economic reforms, which in turn could have an adverse effect on Mexican economic policy. We cannot assure you that the current political situation or future developments in Mexico, over which we have no control, will not have an adverse effect on our business, financial condition or results of operations. Further, we cannot assure you that any new government policies will not adversely affect our business, financial condition and results of operations.

***The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy.***

The Mexican federal government has exercised, and continues to exercise, significant influence over the Mexican economy. Accordingly, Mexican federal governmental actions and policies concerning the economy, state-owned enterprises and state controlled, funded or influenced financial institutions could have a significant impact on private sector entities in general and on us in particular, and on market conditions, prices and returns on securities of Mexican companies. The Mexican federal government occasionally makes significant changes in policies and regulations, and may do so again in the future. Actions to control inflation and other regulations and policies have involved, among other measures, increases in interest rates, changes in tax policies, price controls, currency devaluations, capital controls and limits on imports. Tax legislation in Mexico is subject to continuous change and we cannot assure you whether the Mexican government may maintain existing political, social, economic or other policies, or whether changes may have a material adverse effect on our financial performance.

***Violence in Mexico may adversely impact the Mexican economy and have a negative effect on our financial performance.***

Mexican drug related violence and other organized crime have escalated significantly since 2006, when the Mexican federal government began increasing the use of the army and police to fight drug trafficking. Drug cartels have carried out attacks largely directed at competing drug cartels and law enforcement agents, however they also target companies and their employees, including companies' industrial properties, including through extortion, theft from trucks or industrial sites, kidnapping and other forms of crime and violence. This increase in violence and criminal activity has led to increased costs for companies in the form of stolen products and added security and insurance. Corruption and links between criminal organizations and authorities also create conditions that affect our business operations, as well as extortion and other acts of intimidation, which may have the effect of limiting the level of action taken by federal and local governments in response to such criminal activity. We cannot assure you that the levels of violent crime in Mexico, over which we have no control, will not have an adverse effect on the country's economy and, as a result, on our financial performance.

***Depreciation of the Mexican peso relative to the U.S. dollar could adversely affect our financial performance.***

The peso historically has been subject to significant depreciation against the U.S. dollar. Depreciation of the Mexican peso relative to the U.S. dollar decreases a portion of our revenues in U.S. dollar terms, as well as increases the cost of a portion of the raw materials we require for production and any debt obligations denominated in U.S. dollars, and thereby may negatively affect our results of operations. The Mexican Central Bank may from time to time participate in the foreign exchange market to minimize volatility and support an orderly market. The Mexican Central Bank and the Mexican government have also promoted market-based mechanisms for stabilizing foreign exchange rates and providing liquidity to the exchange market, such as using over-the-counter derivatives contracts and publicly-traded futures contracts on the Chicago Mercantile Exchange. However, the Peso is currently subject to significant fluctuations against the U.S. dollar and may be subject to such fluctuations in the future. Since the second half of 2008, the value of the Mexican peso relative to the U.S. dollar has fluctuated significantly. According to the U.S. Federal Reserve Board, during this period the exchange rate registered a low of Ps. 9.91 to U.S.\$1.00 in August 5, 2008, and a high of Ps. 20.84 to U.S.\$1.00 in November 14, 2016. In 2017 the exchange rate registered a low of Ps. 17.48 to U.S.\$1.00 and a high of Ps. 21.89 to U.S.\$1.00.

A severe depreciation of the Mexican peso may also result in disruption of the international foreign exchange markets and may limit our ability to transfer to convert Mexican pesos into U.S. dollars and other currencies. While the Mexican government does not currently restrict, and since 1982 has not restricted the right or ability of Mexican or foreign persons or entities to convert Mexican pesos into U.S. dollars or to transfer other currencies out of Mexico, the Mexican government could institute restrictive exchange rate policies in the future.

Currency fluctuations or restrictions on transfer of funds outside Mexico may have an adverse effect on our financial performance, and could adversely affect the U.S. dollar value of the price of our Series B shares and the ADSs.

On December 17, 2015, a day after the U.S. Federal Reserve increased the target range for the federal funds rate in the United States by 25 basis points, the Mexican Central Bank increased the reference rate from 3.00% to 3.25% in an effort to counteract a sharp depreciation of the Mexican peso that could affect Mexico's expected rate of inflation. On February 17, 2016, the Mexican Central Bank further increased the reference rate from 3.25% to 3.75%, and has been increasing the reference rate regularly since then, to 7.50% as of February 4, 2018. We cannot assure you that, as a result of future increases by U.S. Federal Reserve of the target range for the federal funds rate in the United States, the Mexican economy or the value of securities issued by Mexican companies will not be affected, including as a result of any precipitous unwinding of investments in emerging markets, depreciations and increased volatility in the value of their currency and higher interest rates.

***High inflation rates in Mexico may affect demand for our products and result in cost increases.***

Mexico has historically experienced high annual rates of inflation. The annual rate of inflation, as measured by changes in the Mexican national consumer price index (*Índice Nacional de Precios al Consumidor*) published by the INEGI was 4.0% for 2013, 4.1% for 2014, 2.1% for 2015, 3.4% for 2016 and 6.8% for 2017. High inflation rates could adversely affect our business and results of operations by reducing consumer purchasing power, thereby adversely affecting demand for our products, increasing certain costs beyond levels that we could pass on to



consumers, and by decreasing the benefit to us of revenues earned if the inflation rate exceeds the growth in our pricing levels.

***Developments in other countries could adversely affect the Mexican economy, our financial performance and the price of our shares.***

The Mexican economy and the market value of Mexican companies may be, to varying degrees, affected by economic and market conditions globally, in other emerging market countries and major trading partners, in particular the United States. Although economic conditions in other countries may differ significantly from economic conditions in Mexico, investors' reactions to adverse developments in other countries may have an adverse effect on the market value of securities of Mexican issuers or of Mexican assets. In recent years, for example, prices of both Mexican debt securities and equity securities decreased substantially as a result of developments in Russia, Asia, Europe and Brazil. Also, credit issues in the United States have in the past resulted in significant fluctuations in global financial markets, including Mexico.

In addition, in recent years economic conditions in Mexico have become increasingly correlated with economic conditions in the United States as a result of NAFTA, increased economic activity between the two countries, and the remittance of funds from Mexican immigrants working in the United States to Mexican residents. However, Donald Trump's victory in the U.S. presidential election in November 2016, as well as the Republican Party maintaining control of both the House of Representatives and Senate of the United States in the congressional election, has generated volatility in the global capital markets and may create uncertainty regarding the future of NAFTA and trade between the U.S. and Mexico. On January 20, 2017, Donald Trump became president of the U.S. President Trump and the Trump administration have made comments suggesting that he intends to re-negotiate the free trade agreements that the U.S. is party to, including NAFTA, and to implement high import taxes. On March 1, 2018, President Trump announced a 25% tariff on all steel products and a 10% tariff on all aluminum products imported into the United States for an

indefinite amount of time under Section 232 of the Trade Expansion Act. In addition, leaders from the United States, Canada and Mexico also commenced discussions regarding NAFTA on January 23, 2018 in Montreal, Canada. After numerous rounds of discussion, there was no progress on divisive issues such as car manufacturing. Tariffs could impact the interconnected supply chain of many industries, including automobiles, and this could potentially harm NAFTA renegotiation talks. Moreover, under the terms of the NAFTA agreement, President Trump has the authority to withdraw from NAFTA with a six month notice. Because the Mexican economy is heavily influenced by the U.S. economy, the re-negotiation, or even termination, of NAFTA and/or other U.S. government policies that may be adopted by the new U.S. administration (which may result in regulatory gridlock or on the contrary, it could result in a major regulatory change) could have a material adverse effect on the Mexican economy, which, in turn, could affect our business, financial condition and results of operations.

Moreover, the recent debt crisis in the European Union, the August and September 2015 Chinese stock market crashes, changes in Chinese exchange rate policy, continuing concerns regarding the slowdown of the Chinese economy, recent terrorist attacks and recent sharp declines in the price of crude oil, may also affect the global and Mexican economies. We cannot assure you that events in other emerging market countries, in the United States or elsewhere will not adversely affect our financial performance.

***We could be adversely affected by violations of the Mexican Federal Anticorruption Law in Public Contracting, the U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws.***

The Mexican Federal Anticorruption Law (*Ley Federal de Anticorrupción en Contrataciones Públicas*), the U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws generally prohibit companies and their intermediaries from making improper payments to government officials and other persons for the purpose of obtaining or retaining business. There can be no assurance that our internal control policies and procedures will protect us from reckless or criminal acts committed by our employees or agents. Violations of these laws, or allegations of such violations, could disrupt our business and could have an adverse effect on our business, financial condition and results of operations.

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

All Mexican companies listed on the Mexican Stock Exchange must prepare their financial statements in accordance with IFRS which differs in certain significant respects from U.S. GAAP. Items on the financial statements of a company prepared in accordance with IFRS may not reflect its financial position or results of operations in the way they would be reflected had such financial statements been prepared in accordance with 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.

***Mexico has different corporate disclosure and accounting standards than those in the United States and other countries.***

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, including accounting information. However, there may be different or less publicly available information about issuers of securities in Mexico than is regularly made available by public companies in countries with more highly developed capital markets, including the United States. The disclosure standards imposed by the Mexican Stock Exchange may be different than those imposed by securities exchanges in other countries or regions such as the United States.

### **Risks Related to Brazil**

***Brazilian political and economic conditions, and the Brazilian government's economic and other policies, may negatively affect demand for our products.***

The Brazilian economy has been characterized by frequent and occasionally extensive intervention by the Brazilian government and unstable economic cycles. The Brazilian government has often changed monetary, taxation, credit, tariff and other policies to influence the course of Brazil's economy. The Brazilian government's actions to control inflation and implement other policies have at times involved wage and price controls, blocking access to bank accounts, imposing capital controls and limiting imports into Brazil.

Our results of operations and financial condition may be adversely affected by factors such as:

fluctuations in exchange rates;

exchange control policies;

interest rates;

inflation;

tax policies;

expansion or contraction of the Brazilian economy, as measured by rates of growth in GDP;

liquidity of domestic capital and lending markets; and

other political, diplomatic, social and economic developments in or affecting Brazil.

Brazilian markets have been experiencing heightened volatility due to the uncertainties derived from the ongoing *Lava Jato* investigation, which is being conducted by the Office of the Brazilian Federal Prosecutor, and its impact on the Brazilian economy and political environment. Members of the Brazilian federal government and of the legislative branch, as well as senior officers of the state-owned oil company *Petróleo Brasileiro S.A. – Petrobras*, or *Petrobras*, have faced allegations of political corruption. These government officials and senior officers allegedly accepted bribes by means of kickbacks on contracts granted by *Petrobras* to several infrastructure, oil and gas and construction companies. As a result of the ongoing *Lava Jato* investigation, a number of senior politicians, including congressman and officers of the major state-owned companies in Brazil resigned or have been arrested.

In addition, the Brazilian Congress opened impeachment proceedings against President Dilma Rousseff on December 2, 2015 for allegedly breaking budget laws as she increased economic stimulus during her re-election campaign last year. On April 17, 2016, the Brazilian Congress voted in favor of the admissibility of the impeachment proceedings. On August 31, 2016, the Brazilian Senate voted in favor of the dismissal of President Dilma Rousseff and the then-Vice-President Temer assumed office to complete the remainder of the presidential mandate. More recently, in May 2017, the development of the investigations conducted by the Federal Police Department and the General Federal Prosecutor's Office has increased uncertainty with respect to the future prospects of the Brazilian market. Furthermore, although the Brazilian Superior Electoral Court (*Tribunal Superior Eleitoral*) in a 4 to 3 vote has recently acquitted Dilma Rousseff and Michel Temer of charges of illegal campaign financing that could annul the presidential election that took place in 2014 and ultimately could require President Michel Temer to vacate the presidential office, this decision may still be appealed to the Brazilian Supreme Court (*Supremo Tribunal Federal*). In addition, a number of requests for impeachment have been filed against Mr. Temer, as well as criminal charges by the Brazilian Federal Prosecutor's Office, which could also result in his removal from office, after allegations surfaced that Mr. Temer had allegedly been leading a political corruption related criminal organization. Furthermore, recently a Brazilian federal appeals court unanimously upheld the conviction of former president Luís Inácio Lula da Silva on corruption charges uncovered by the *Lava Jato* operation, a decision which can still be appealed to the Brazilian Supreme Court. We cannot predict whether these investigations and lawsuits will bring about further economic and political instability or if new allegations against high officers of the Brazilian Federal Government will arise in the future. This situation has adversely affected, and we expect that they will continue to adversely affect, the Brazilian markets and trading prices

of securities issued by Brazilian issuers. We cannot predict their effects on the Brazilian economy which could have a material adverse effect on us.

The potential outcome of these investigations and proceedings is uncertain, but they have adversely affected and we expect that they will continue to adversely affect the Brazilian markets and trading prices of securities issued by Brazilian issuers. We cannot predict whether the allegations or proceedings will lead to further political and economic instability or whether new allegations against government officials or other companies in Brazil will arise in the future. In addition, we can neither predict the outcome of any such allegations and proceedings nor their effect on the Brazilian economy.

In addition, the Brazilian steel sector is facing a severe crisis. According to the Brazilian Steel Institute, steel consumption fell by 14% in the first nine months of 2015. We believe this crisis is largely due to a sharp decrease in durable goods manufacturing, particularly motor vehicle production, which is depressing steel consumption and offsetting the positive impact of construction activity associated with the summer 2016 Olympic Games held in Rio de Janeiro. The crisis in the Brazilian steel sector could have a material and adverse effect on our Brazilian business segment.

Brazil has experienced extremely high rates of inflation in the past and has therefore implemented monetary policies that have resulted in one of the highest interest rates in the world. According to the IGP-M, a general price inflation index, the inflation rates in Brazil were, 5.5% in 2013, 3.7% in 2014, 10.5% in 2015, 7.2% in 2016 and 2.95% in 2017. In addition, according to the National Extended Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), published by the IBGE, the Brazilian price inflation rates were 5.6% in 2013, 6.2% in 2014, 11.3% in 2015, 6.6% in 2016 and 2.95% in 2017. Despite the Brazilian Central Bank's repeated increases of interest rates during the period from 2013 to 2015, the Brazilian price inflation rate (IPCA) has continued to increase, reaching 10.7% in 2015 (the highest level recorded since 2003), and reaching 6.3% for the twelve-month period ending December 31, 2016.

Inflation has eased back into the target range of 4.5% as consumer prices moderated to 3.6% in May, 2017, down from 9.3% a year before and a peak of 10.7% in late 2015. Hence, monetary authorities have adopted a pro-growth policy stance. The key rate has been cut by 3% since October 2016 to 10.25% in June 2017. Moreover, downward pressures on the currency have eased.

However, the real Brazilian currency (“BRL”) remains very sensitive to political developments. For example, it depreciated by -9% against the U.S. dollar the day after the Temer scandal surfaced. Although the disinflation process is expected to continue over the next months, allowing for further rate cuts, short-term risks should be closely monitored such as (i) the impact on prices of the approval of fiscal consolidation measures, (ii) the uncertain external environment and its impact on the currency and (iii) shocks on food prices stemming to a large extent from unfavorable weather conditions.

There have been significant fluctuations in the exchange rate between the Brazilian currency and the U.S. dollar and other currencies. For example, the Brazilian real depreciated 19.7% and 53.2% against the U.S. dollar in 2001 and 2002, respectively and appreciated 18.0%, 8.0%, 12.3%, 8.5% and 17.0% against the U.S. dollar in 2003, 2004, 2005, 2006 and 2007, respectively. In 2008, the Brazilian real depreciated again approximately 31.9% against the U.S. dollar. In 2009, the Brazilian real appreciated 25.3% against the U.S. dollar, while in December 31, 2010 the Brazilian real to U.S. dollar exchange rate was R\$1.6662, according to the Brazilian Central Bank. In 2011, the Brazilian real depreciated by 13.6% against the U.S. dollar, from R\$1.6510 in the beginning of the period to R\$1.8758 by the end of the period, and in 2012 the Brazilian real went from R\$1.8683 in the beginning of the year to R\$2.0435 by the end of the period, amounting to a 9.4% depreciation against the U.S. dollar. In 2013, the Brazilian real went from R\$2.0415 in the beginning of the year to R\$2.3426 by the end of the period. In 2014, the Brazilian real went from R\$2.3975 in the beginning of the year to R\$2.6652 by the end of the period, corresponding to a 10.8% depreciation against the U.S. dollar.

However, during 2015, due to the poor economic conditions in Brazil, including as a result of political instability, the Brazilian real has devalued at a rate that is much higher than in previous years. On September 24, 2015, the Brazilian real fell to the lowest level since the introduction of the currency, at R\$4.1949 per U.S.\$1.00. In 2015, the Brazilian real depreciated 45%, reaching R\$3.9048 per U.S.\$1.00 on December 31, 2015. Conversely, in 2016, the Brazilian real went from R\$4.0387 per U.S.\$1.00 at the beginning of the year to R\$3.2591 per U.S.\$1.00 on December 31, 2016, corresponding to a 19.3% appreciation against the U.S. dollar. In 2017, the Brazilian real went from R\$3.2591 per U.S.\$1.00 at the beginning of the year to R\$3.3080 per U.S.\$1.00 on December 31, 2017, corresponding to a depreciation of 1.5% against the U.S. dollar. There can be no assurance that the Brazilian real will not depreciate or appreciate further against the U.S. dollar.

#### **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, Canada and Brazil. We believe that in 2013, 2014, 2015, 2016 and 2017 we were an important producer of SBQ products in both the United States and Mexico, in each case in terms of sales volume. We also believe that in 2013, 2014, 2015, 2016 and 2017 we were an important 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 Mexico and U.S.-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 a *sociedad anónima bursátil de capital variable*, organized under the laws of Mexico. 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 +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 company, 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 Mexico.

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 Ps. 1,185 million (U.S.\$95.4 million) of our debt (U.S.\$90.2 million of principal and U.S.\$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 Ps. 1,589 million (U.S.\$122 million) (excluding value added tax of approximately Ps. 208 million (U.S.\$16 million) paid in 2004 and recouped from the Mexican government in 2005), funded with cash from operations, and a Ps. 247 million (U.S.\$19 million) capital contribution from Industrias CH.

In July 2005, we and Industrias CH acquired 100% of the capital 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 Ps. 2,795 million (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 we sold our 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 CSG decided to spin-off CSG. CSG conveyed 87.4% of its 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 Aceros DM and certain affiliated companies (“Grupo San”) for a total cost of approximately Ps. 8,730 million (U.S.\$844 million at the exchange rate at that time). 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 have a production capacity of 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 into 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.

On February 5, 2009, Simec International 2, S.A. de C.V. divested assets and liabilities to three new wholly owned Mexican subsidiaries. As a consequence of such reorganization, Simec International 3, S.A. de C.V. now operates the Tlaxcala and Puebla facilities, Simec International 4, S.A. de C.V. and Simec International 5, S.A. de C.V jointly operate the San Luis de Potosí facilities, and Simec International 2, S.A. de C.V. kept the operation of the Guadalajara and Mexicali facilities.

In 2009 we incorporated two new wholly owned subsidiaries. Simec Acero, S.A. de C.V. distributes all Grupo Simec products in Mexico and Simec USA, Corp. is responsible for all export sales of our Mexican companies.

On May 12, 2009, we incorporated Pacific Steel Projects, Inc., a wholly owned subsidiary organized under the laws of the State of California whose purpose is to develop technology improvement projects for our Mexican facilities.

On August 10, 2009, Simec International, S.A. de C.V. divested assets and liabilities to four new wholly owned Mexican subsidiaries named Siminsa A, S.A. de C.V., Siminsa B, S.A. de C.V., Siminsa C, S.A. de C.V. and Siminsa D, S.A. de C.V. After the divestiture, Siminsa A was merged into Simec International 2, Siminsa B was merged into Simec International 3, Siminsa C was merged into Simec International 4 and Siminsa D was merged into Simec International 5.

On November 10, 2009, Simec International 2, Simec International 3, Simec International 4 and Simec International 5 divested assets and liabilities to Simec Steel, Inc., a new wholly owned subsidiary organized under the laws of the State of California whose purpose is to provide financing to the Mexican companies of the group and to seek new investment opportunities.

On May 31, 2010 Arrendadora Simec, S.A. de C.V. divested assets, liabilities and equity to our subsidiary Corporacion ASL, S. A. de C.V. which assumed the operation of Arrendadora Simec, S.A. de C.V.

On June 28, 2010, our subsidiary Simec International 6, S.A. de C.V., whose purpose is to produce steel, was constituted. Simec International 6, S.A. de C.V. begun operations in November of 2010.

On June 30, 2010, Simec International, S.A. de C.V., divested assets and equity to our subsidiary Simec International 7, S.A. de C.V. Among the assets transferred the shares of Aceros DM were included.

On September 3, 2010 we formed a Brazilian entity denominated GV do Brazil Indústria e Comércio de Aço Ltda. On August 5, 2011 we acquired 1,300,000 square meters of land on Pindamonhangaba, São Paulo State, Brazil, and paid Ps. 121.1 million (U.S.\$8 million) for the construction of a new steel facility. In November 2015, our steel plant in Brazil started operations. This facility has a production capacity of 450,000 tons of finished goods of rebar and wire, and 800 employees. We have already established contact with major local suppliers of raw materials. The next step is to attract the special steels market for the automotive and electro-welded wire derivatives products.

On October 21, 2010 in the Extraordinary Shareholders Meeting of Arrendadora Simec S.A. de C.V. the dissolution of the company was approved.

On November 2, 2010, we acquired 100% of the shares of Lipa Capital, LLC. The total cost of this acquisition was of Ps. 187 million (U.S.\$15.2 million at the exchange rate at that time). On December 9, 2010, Lipa Capital, LLC merged to Simec International 6, S. A. de C. V.

On February 3, 2011, we, through two of our wholly owned subsidiaries (Solon Wire Processing LLC, and the newly formed Republic Memphis LLC), acquired certain plants, machinery and equipment from BCS Industries LLC and affiliates (“Bluff City Steel”), which was our customer and vendor. For these assets we paid Ps. 30.6 million (U.S.\$2.5 million) in cash and forgave approximately Ps. 73.5 million (U.S.\$6 million due) by Bluff City Steel to us.

On May 2, 2011 in Extraordinary Shareholders Meetings of Acero Transportes S.A. de C.V. and Acero Transportes San S.A. de C.V. (subsidiaries of Grupo San), authorized the merger two subsidiaries, whereby Acero Transportes S.A. de C.V. was merged into Acero Transportes San S.A. de C.V.

On May 20 and October 3, 2011 in Extraordinary Shareholders Meetings, Simec International 2, S.A. de C.V., Simec International 3 S.A. de C.V., Simec International 4 S.A. de C.V. and Simec International 5 S.A. de C.V., changed their address and tax authority to report to the State of California, USA, transforming them into incorporated companies in accordance with the laws and regulations of the State of California, USA.

On May 31, 2011 we sold our shares in Arrendadora del Norte de Matamoros S.A. de C.V. to Perfiles Comerciales Sigosa, S.A. de C.V. (subsidiary of ICH) for Ps. 42.5 thousand, paid in cash.

On September 1, 2011, the merger of Procesadora Industrial San S.A. de C.V. into Malla San S.A. de C.V. (subsidiaries of Grupo San) was authorized in their respective Extraordinary Shareholders Meetings.

On November 2011, Republic Steel, Inc. (a subsidiary of SimRep Corporation) entered into an agreement with an unrelated third-party “purchaser” for the factoring of specific accounts receivable in order to reduce the amount of working capital required to

fund accounts receivable. The agreement was amended on October 26, 2016, so that any party can terminate the agreement after giving seven days' notice. On the sale date, the purchaser advances funds equivalent to 80% of the value of receivables. The maximum amount of outstanding advances related to the assigned receivables is U.S.\$30 million (Ps. 620 million). Proceeds on the transfer reflect the face value of the account minus a discount. The remaining amount between the receivable balance and the advance is held in reserve by the purchaser. Payment of the funds held in reserve, minus a discount fee are made by the purchaser within four days of receipt of payment on collection of funds related to each assigned receivable. The discount fee, which generally ranges from 1% if paid within 30 days (of the advance date) to 3.75% if paid within 90 days, is recorded as a charge to interest expense in the Consolidated Statements of Comprehensive Income. The purchaser shall have no recourse against the Republic Steel, Inc. if payments are not received due to insolvency of an account debtor within 120 days of the invoice date. However, while the facility calls for the sale, assignment, transfer and conveyance of all rights, title and interests in the selected accounts receivable, the purchaser may put and charge-back any receivable not paid to the purchaser within 90 days of purchase for any reason besides insolvency of the account debtor. As collateral for the repayment of advances for receivables sold, the purchaser has a priority security interest in all accounts receivable of Republic Steel, Inc. Republic Steel, Inc. sold a face amount of Ps. 501.3 million (U.S.\$25.4 million) and Ps. 427.7 million (U.S.\$20.7 million) of accounts receivable to purchasers during the years ended December 31, 2017 and 2016, respectively. Discount fees incurred pursuant to this agreement were approximately Ps. 9.5 million (U.S.\$0.5 million) and Ps. 5.6 million (U.S.\$0.3 million) for the years ended December 31, 2017 and 2016, respectively. Of the face amount of accounts receivable sold to purchasers, Ps. 37.5 million (U.S.\$1.9 million) and Ps. 55.8 million (U.S.\$2.7 million) had not been collected by the purchaser at December 31, 2017 and 2016, respectively, and therefore, such amount at December 31, 2017, is subject to possible charge-back to us.

On December 30, 2011 Simec International 7, S.A. de C.V. sold to Corporación ASL S.A. de C.V. all of its shares in Corporación Aceros DM, S.A de C.V., comprising of a total of 627,305,446 shares (99.9% of the common stock) for a value of Ps. 3,200 million, comprised of a down payment of Ps. 63 million and the remaining of Ps. 3,137 million due on April 30, 2012. This transaction generated a tax loss of Ps. 7,860 million which amount under the Mexican Income Tax Law (*Ley de Impuesto Sobre la Renta*), may be deducted against future gains related to dispositions of securities. On January 30, 2012 Simec International 7, S.A. de C.V. filed a demand challenging the current law, which limits the deduction of this net loss related to shares sales. On September 24, 2013, the second district judge denied the shelter and protection of the federal courts against the company pursuant to Article 32, Section XVII of the Mexican Income Tax Law, arguing that constitutional guaranties were not violated. Dissatisfied with the decision, the company filed an application for review of such judgment with the Mexican Supreme Court of Justice. The Supreme Court resolved that the constitutionality of Article 32, Section XVII of the Mexican Income Tax Law was not violated arguing that the Income Tax Law does not violate the guaranties of tax fairness and proportionality under Article 31, section IV of the Mexican Constitution. As a result, tax losses of the company may only be applied against future gains related to dispositions of securities.

On August 1, 2012 in their respective extraordinary shareholders meetings of Abastecedora Siderúrgica, S.A. de C.V. and Aceros DM, S.A. de C.V. (subsidiaries of Grupo San) the merger of both companies was authorized, whereby Abastecedora Siderúrgica, S.A. de C.V. was merged into Aceros DM, S.A. de C.V.

On October 8, 2012 in their respective extraordinary shareholders meetings of Simec Steel, Inc., Simec International 2, Inc., Simec International 3, Inc. and Simec International 4, Inc., the merger of three subsidiaries was authorized, whereby Simec International 2, Inc., Simec International 3, Inc., Simec International 4, Inc. were merged into Simec

Steel, Inc.

On October 30, 2012, we and our subsidiary Corporacion ASL, S.A. de C.V. purchased shares of a company called Orge S.A. de C.V. (Orge) for Ps. 27 million, on that same date, Corporacion ASL, S.A. de C.V. made a capital increase of Ps. 67 million, which proceeds were used for the payment of an outstanding liability of Orge. The shares acquired correspond to one Class "I," series "B" share, which represents 0.01% of the shares of such class, and 53,564,127 Class "II," series "L" shares, which represent 100% of the shares of such class. These shares are without par value and shares of Class "II" are restricted and confer limited voting rights and no power to appoint the management of the company, however the Board of Directors is comprised exclusively of officers and shareholders of us, therefore, from that date on, we consolidate the financial statements of Orge. Orge was incorporated on July 19, 2012 through a split and tax losses of Ps. 498 million were transferred. Before we acquired the shares, Orge had a loss on the sale of certain securities that will carry a tax loss of Ps. 1,700 million. Orge is engaged in the production of steel and began operating in October 2012.

On December 18, 2012 in an extraordinary shareholders meeting of Simec International 6, S.A. de C.V., the split of this company was approved and two new wholly owned Mexican subsidiaries were incorporated, under the names Simec International 8, S.A. de C.V. and Siminsa E, S.A. de C.V.

In May 2013, Malla San, S.A. de C.V., operator of the plant which produces mesh and wire derivatives in San Luis Potosi, split into two new entities, Malla San 1 S.A. de C.V. and Malla San 2 S.A. de C.V., and therefore ceased to exist.

On August 8, 2013, we and our subsidiary Simec International, S.A. de C.V. purchased shares of a company called Seehafen Operadora Maritima, S.A.P.I. de C.V. (Seehafen) for Ps. 44 million. The shares acquired correspond to (i) 500 ordinary, nominative

Class “I” shares, representative of the fixed portion of the capital stock of Seehafen, which represents 50% of the shares of such class and (ii) 99,000 nominative Class “II” shares, representative of the variable portion of the capital stock of Seehafen, which represents 100 % of the shares of such class. These shares are without par value and Class “II” shares confer no voting rights. The transactions described above were approved in an extraordinary shareholders meeting of Seehafen celebrated on the same date, which also approved its change of name to Simec International 9, S.A.P.I. de C.V. (Simec 9), the modification of its corporate purpose and the appointment of members to its Board of Directors, comprised exclusively of officers and shareholders of us, therefore, from that date on, we consolidate the financial statements of Simec 9. Seehafen was incorporated on August 3, 2012 through a split and tax losses of Ps. 983 million were transferred.

On November 20, 2013, the merger of Simec USA, Corporation and Simec International 5, Inc. was authorized in their respective extraordinary shareholders meetings, whereby the first entity subsisted and the second ceased to exist.

On November 30, 2013 and December 2, 2013, the merger of Compañía Siderúrgica del Pacífico, S.A. de C.V., Comercializadora Msan S.A. de C.V., Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V., Productos Siderúrgicos de Tlaxcala, S.A. de C.V., Comercializadora Simec, S.A. de C.V., Siminsa E, S.A. de C.V., and Siderúrgica de Baja California, S.A. de C.V. was authorized in their respective extraordinary shareholders meetings, whereby the first entity subsisted and the others ceased to exist.

On January 16, 2015, we entered into a cooperation agreement with the government of the State of Tlaxcala, Mexico, to build a new steel facility, which will have a production capacity of 600,000 tons of bar quality steel (SBQ). In October and December 2015, we acquired land adjacent to our existing plant in Tlaxcala, which will increase the extension to a total of 100 hectares. On October 20, 2015, we entered into an agreement with Danieli & Officine Meccaniche for the construction (excluding civil engineering) of the plant and the provision of all required equipment. The total budget for the project will be approximately U.S.\$600 million (Ps. 12,398 million), which will be financed with our own resources. The start of steelmaking operations is scheduled for the month of May 2018 and an estimated pre-operating period of between six to eight months.

On January 20, 2015, we incorporated a new wholly-owned subsidiary named Aceros Especiales Simec Tlaxcala, S.A. de C.V., in which Grupo Simec, S.A.B. de C.V. holds 49,999 class “I” shares and Simec International, S.A. de C.V. holds one class “I” share.

On January 20, 2015, we incorporated a new wholly-owned subsidiary named Recursos Humanos de la Industria Siderúrgica de Tlaxcala, S.A. de C.V., in which Grupo Simec, S.A.B. de C.V. holds 49,999 class “I” shares and Simec International, S.A. de C.V. holds one class “I” share.

On March 21, 2015, we and our subsidiary Simec International, S.A. de C.V. purchased 2,500 class “I1”, ordinary, nominative and without par value shares of a company called RRLC, S.A.P.I. de C.V. (RRLC), representing the fixed

portion of its capital stock, which represented 50% of the shares of such class, and 46,103 class "II", non-voting, nominative, without par value shares of RRLC, representing the variable portion of its capital stock, which represented 100% of the shares of that class, in the aggregate amount of Ps. 18.6 million. RRLC was incorporated as a result of a spin-off of another company on December 11, 2014, with a tax loss of Ps. 311.5 million.

On October 30, 2015, our subsidiaries Simec International 7, S.A. de C.V. and Simec International, S.A. de C.V., acquired 25,000 class "I", ordinary, nominative and without par value shares in a company called Grupo Chant, S.A.P.I. de C.V. (Chant), representing the fixed portion of its capital stock, which represented 50% of the shares of such class, and 1,000,000 class "II", non-voting, nominative and without par value shares of Chant, representing the variable portion of its capital stock, which represented 100% of the shares of that class, in the aggregate amount of Ps. 167 million. Chant was incorporated as a result of a spin-off of another company on June 12, 2015, with a tax loss of Ps. 2,380 million.

On January 13, 2016, we incorporated a new wholly-owned subsidiary named GSIM de Occidente, S.A. de C.V., in which Grupo Simec, S.A.B. de C.V. holds 49,999 class "I" shares and Simec International, S.A. de C.V. holds one class "I" share.

On January 13, 2016, we incorporated a new wholly-owned subsidiary named Fundiciones de Acero Estructural, S.A. de C.V., in which Grupo Simec, S.A.B. de C.V. holds 49,999 class "I" shares and Simec International, S.A. de C.V. holds one class "I" share.

In August 2016 Republic Steel sold to a third party, at a price of U.S.\$350 thousand (Ps. 7 million), the assets of the Memphis, Tennessee plant, which had been idle.

On December 5, 2017, Grupo Simec, S.A.B. de C.V. and Simec International 7, S.A. de C.V. (a subsidiary), acquired 2,000 Class "I" ordinary shares, nominative and without nominal value in a company called Señales del Norte S.A. de C.V., representing the

fixed portion of its capital stock, which represented 100% of the shares of that class and 3,908,782 class "II" shares, without voting rights, nominative, and without nominal value, which represented 100% of the variable portion of the share capital, in the aggregate amount of Ps. 122.7 million pesos, so that as of that date Señales del Norte SA de CV is consolidated in our financial statements. On March 13, 2018 we changed its name to "Siderúrgicos Noroeste S.A. de C.V. "

## Principal Capital Expenditures

We continually seek to improve our operating efficiency and increase sales of our products through capital investments in new equipment and technology. These capital expenditures are financed primarily with funds that we segregate monthly from the results of operations generated by each facility.

We currently estimate capital expenditures for the year 2018 will be approximately Ps. 1,161.7 million (U.S.\$58.9 million), consisting of capital expenditures in our facilities in Mexico. Nevertheless, this estimate is subject to certain uncertainties and actual capital expenditures in 2018 may differ significantly from such estimate.

In 2017, we spent Ps. 622.8 million (U.S.\$31.6 million) on capital investments for Republic's facilities, including Ps. 8.1 million (U.S.\$0.4 million) at the Lorain, Ohio facility, Ps. 54.8 million (U.S.\$2.8 million) at the Lackawanna, New York facility, Ps. 546.5 million (U.S.\$27.7 million) at the Canton, Ohio facility, Ohio facility, Ps. 8.7 million (U.S.\$0.4 million) at the Solon, Ohio facility, and Ps. 4.7 million (U.S.\$0.2 million) at the Massillon, Ohio, facility. We spent Ps. 2,394.5 million (U.S.\$121.3 million) on capital improvements at our facilities in Mexico, including Ps. 1,525 million (U.S.\$77.3 million) at the Apizaco facility, Ps. 3.5 million (U.S.\$0.2 million) at the Mexicali facility, Ps. 106.8 million (U.S.\$5.4 million) at the Guadalajara facility, and Ps. 759.2 million (U.S.\$38.4 million) at the San Luis facilities. We also spent Ps. 22.2 million (U.S.\$1.1 million) in our steel facility on Pindamonhangaba, Sao Paulo State, Brazil.

In 2016, we spent Ps. 816.6 million (U.S.\$37.1 million) on capital investments for Republic's facilities, including Ps. 691.6 million (U.S.\$31.4 million) at the Lorain, Ohio facility, Ps. 2.8 million (U.S.\$0.1 million) at the Lackawanna, New York facility, Ps. 105.3 million (U.S.\$4.8 million) at the Canton, Ohio facility, Ohio facility, Ps. 15 million (U.S.\$0.7 million) at the Solon, Ohio facility, and Ps. 1.9 million (U.S.\$0.1 million) at the Gary, Indiana, facility. We spent Ps. 2,169.3 million (U.S.\$135.6 million) on capital improvements at our facilities in Mexico, including Ps. 2,006.1 million (U.S.\$125.4 million) at the Apizaco facility, Ps. 1.2 million (U.S.\$0.1 million) at the Mexicali facility, Ps. 26.4 million (U.S.\$1.6 million) at the Guadalajara facility, and Ps. 135.6 million (U.S.\$8.5 million) at the San Luis facilities. We also spent Ps. 114.3 million (U.S.\$7.1 million) in our steel facility on Pindamonhangaba, Sao Paulo State, Brazil.

In 2015, we spent Ps. 0.4 million (U.S.\$0.02 million) on capital investments for Republic, at the Lorain, Ohio facility. We spent Ps. 574.2 million (U.S.\$35.9 million) on capital improvements at our facilities in Mexico, including Ps.



509.2 million (U.S.\$31.8 million) at the Apizaco facility, Ps. 43.1 million (U.S.\$2.7 million) at the Mexicali facility, Ps. 7.4 million (U.S.\$0.5 million) at the Guadalajara facility, and Ps. 14.5 million (U.S.\$0.9 million) at the San Luis facilities. We also spent Ps. 73.1 million (U.S.\$4.6 million) in the construction of a new steel facility on Pindamonhangaba, Sao Paulo State, Brazil, which started operations in November 2015.

## **B. Business Overview**

In the United States, Mexico and Brazil, we own and operate thirteen state-of-the-art steel making, processing and/or finishing facilities with a combined annual crude steel installed production capacity of 4.6 million tons and a combined annual installed rolling capacity of 4 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:

a mini-mill in Guadalajara, Jalisco;

a mini-mill in Mexicali, Baja California Norte;

a mini-mill in Apizaco, Tlaxcala;

a cold finishing facility in Cholula, Puebla;

two mini-mills in San Luis Potosí, San Luis Potosí, Mexico;

a mini mill in Canton, Ohio, an integrated facility in Lorain, Ohio and value-added rolling and finishing facilities in Lorain and Massillon, Ohio; Lackawanna, New York; Solon, Ohio and Hamilton, Ontario, all of which we own through our majority-owned subsidiary, Republic, and

a mini-mill and rebar and wire rod rolling mill in Pindamonhangaba; São Paulo, Brazil.

In 2017, we had net sales of Ps. 28.7 billion, gross profit of Ps. 4.7 billion and net income of Ps. 1.7 billion. In 2017, approximately 30% of our consolidated sales were in the United States and Canada, approximately 58% were in Mexico, approximately 11% were in Brazil and approximately 1% were exports to other markets outside the American Continent.

## **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:

### *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 to pursue 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. In our Brazil facility, we produce rebars. 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 sector 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 sector as structure supports and for stocking systems.

*Angles.* Angles are two equal sided sections joined by their ends with a 90° angle, in 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, auto part 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 at 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 in our Mexican facilities and in our Brazil facility. Rebar is only used by the construction industry to reinforce concrete. Rebar is considered a commodity product due to its general acceptance by most consumers of industry standard 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, primarily to supply the auto part industry.

*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 industries.

The following table sets forth, for the periods indicated, our sales volume for basic steel products.

### Steel Product Sales Volume

	<b>Years ended December 31,</b>				
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
	(thousands of tons)				
I-Beams	66.2	71.7	83.2	81.7	76.6
Channels	64.1	62.7	63.3	65.8	54.3
Angles <sup>(1)</sup>	142.2	164.3	182.3	182.5	155.9
Hot-rolled bars (round, square and hexagonal rods)	781.6	823.2	666.9	600.4	560.0
Flat bar	92.3	94.5	183.1	129.7	150.0
Rebar	568.5	567.4	577.8	774.6	854.9
Cold finished bars	195.9	207.5	126.3	163.2	149.4
Other semi-finished trade products <sup>(2)</sup>	23.6	130.8	89.4	10.7	8.4

Electro-Welded wire mesh	20.9	17.7	21.7	22.3	18.7
Wire rod	27.2	12.2	3.8	24.8	34.9
Electro-Welded wire mesh panel	25.2	19.9	22.8	28.1	24.9
Other	56.7	25.1	5.3	1.1	3.2
Total steel sales	2,064.4	2,197.0	2,025.9	2,084.9	2,091.2

(1) Includes structural angles and commercial angles.

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

## 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 2017, approximately 35% of our steel product sales in tons represented SBQ steel products, of which we sold 65% to the auto part industry, 20% to service centers, 1% for hand tools and the remaining 14% to other industries.

In 2017, direct sales in tons to the automotive industry increased by 6% compared to 2016. In 2016, direct sales in tons to the automotive industry decreased by 23% compared to 2015. In 2015, direct sales in tons to the automotive industry increased by 18% compared to 2014. In 2014, direct sales in tons to the automotive industry increased by 44% compared to 2013. In 2013, direct sales in tons to the automotive industry decreased by 16% compared to 2012. In 2013, 2014, 2015, 2016 and 2017 sales in tons to the energy sector accounted 0.5%, 10%, 0.01%, 0.1% and 0.5%, respectively, of our sales of SBQ steel products.

The following table sets forth, for the periods indicated, our Mexico, U.S., Canada and Brazil product sales as a percentage of our total product sales in tons.

### Steel Product Sales By Region

	Mexico					United States, Canada, Brazil and Other Countries				
	Years ended December 31,									
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
I-Beams	97%	99%	98%	97%	98%	3%	1%	2%	3%	2%
Channels	51%	44%	54%	62%	55%	49%	56%	46%	38%	45%
Angles	78%	75%	82%	84%	83%	22%	25%	18%	16%	17%
Hot-rolled bars (round, square and hexagonal rods)	30%	33%	36%	42%	39%	70%	67%	64%	58%	61%
Flat bar	91%	99%	92%	95%	96%	9%	1%	8%	5%	4%
Rebar	100%	100%	99%	75%	63%	—	—	1%	25%	37%
Cold drawn finished bars	49%	54%	66%	73%	73%	51%	46%	34%	27%	27%
Other semi-finished trade products	—	—	—	—	—	100%	100%	100%	100%	100%
Electro-Welded wire mesh	100%	100%	100%	100%	100%	—	—	—	—	—
Wire rod	100%	100%	100%	96%	100%	—	—	—	4%	—
Electro-Welded wire mesh panel	100%	100%	100%	100%	100%	—	—	—	—	—
Other	39%	3%	12%	76%	—	61%	97%	88%	24%	100%
Total (weighted average)	62%	60%	67%	68%	63%	38%	40%	33%	32%	37%

During 2017, approximately 18.5% of our sales by volume came from the U.S. segment, with almost 100% of such sales representing SBQ product and 14.4% of our sales by volume came from the Brazil segment. The Mexican segment represents approximately 67.1% of our sales by volume, with SBQ products representing approximately 35% of such sales and the remainder representing commercial steel products.

Approximately 75% 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 prices 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 customers in the United States 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 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 distribute our exports outside North America primarily through independent distributors who also carry other product lines. In addition, we have three full-time employees in Mexico dedicated exclusively to exports.

During 2017 and 2016, 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 finishing size rolling and depending 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. We cannot assure you 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 Nissan North America, Inc.; first tier suppliers to

automotive and industrial equipment manufacturers such as American Axle & Manufacturing Holdings, Inc. and Neexteer, NSK and NTN Driveshafts, Inc.; service centers which include AM Castle & Co., Earle M. Jorgensen Co., and Eaton Steel Bar Company.

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, determine 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.

Our plant in Brazil began production in June 2015 with 30,000 tons produced and 4,000 tons shipped in 2015, all of which correspond to rebar. Our main objective is to sell our products through independent distributors, targeting the construction market by providing quality service, a key factor in attracting and retaining customers.

Notwithstanding, our sales policy in Brazil has been well accepted by our customers and, even in the midst of a global crisis, our sales have begun to increase steadily, opening us a place in the steel Market in Brazil.

Our major customers in 2017 include: Risatec Distribuidor, Marson Com, Fav Comercio de Ferr, Udiaco Comercio e In, Acos Sao Carlos Come, J G Ind. Metalurgica, Comercial Litoranea, Globoferros Comercio and Paranaferros Parana.

## **Competition**

Competition in the steel industry is significant. 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 further increase competitive pressures on independent producers of our size, particularly if large steel producers formed through consolidations, which have access to greater resources than us, adopt predatory pricing strategies that decrease prices and profit margins. If we are unable to remain competitive with these producers, our profitability and market share would likely be materially and adversely affected.



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 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 Mexico, the United States and Canada 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 profit margins.

### *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, Corporation, located in Plymouth, Utah; Commercial Metals Company, located in Meza, Arizona; Thyssenkrupp Steel North America, Inc., located in Santa Fe Springs, California; Deacero, S.A. de C.V. ("Deacero"), located in Saltillo, Coahuila, México and Gerdau Corsa, S.A.P.I. de C.V. ("Gerdau Corsa"), located in Tijuana, Baja California, Mexico. We believe that we have an advantage over certain competitors due to the labor cost in our Mexican operations.

In 2017, we sold approximately 179,483 tons of I-beams, channels and angles at least three inches in width which represented approximately 8.6% of our total finished product sales for the year. In 2016, we sold approximately 208,660 tons of I-beams, channels and angles at least three inches in width which represented approximately 10% of our total finished product sales for the year. We

believe that the domestic competitors in the Mexican market for structural steel are Gerdau Corsa, Deacero, and Siderúrgica del Golfo, S.A. de C.V. (a wholly-owned subsidiary of Industrias CH). We estimate that our share of Mexican production of structural steel was 20.6% in 2017 and 24.1% in 2016, according to information provided by the *Cámara Nacional de la Industria del Hierro y del Acero* (CANACERO).

In 2017, we sold approximately 859,427 tons of hot rolled and cold finished steel bars and 894,062 tons in 2016. 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 21%, respectively, in 2017 and 14% and 27%, respectively, in 2016. Rebar and light structural steel together accounted for approximately 963,802 tons, or 46%, of our total production of finished steel products in Mexico, the United States and Brazil in 2017. Rebar and light structural steel together accounted for approximately 895,988 tons, or 43%, of our total production of finished steel products in Mexico, the United States and Brazil in 2016. We compete in the Mexican market with a number of producers of these products, including Deacero, Talleres y Aceros, S.A., Grupo Acerero, S.A. de C.V., Nucor Corporation, ArcelorMittal Lazaro Cardenas, S.A. de C.V., Ternium Mexico, S.A. de C.V. and Gerdau Corsa.

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, Cholula and San Luis 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 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 United States market, depending on the product, include Nucor, Corporation, Niagara LaSalle, Corporation, Charter Steel, Inc., Steel Dynamics, Inc., The TimkenSteel Corporation and Gerdau.

*Brazil*

Our main competitors in the Brazilian market: Aperam, ArcelorMittal Brazil, CSN, Gerdau, Sinobras, Thyssenkrupp CSA; Usiminas, VSB tubes, V & M do Brasil, Villares Metals and Votorantim.

The Brazilian steel industry is comprised of 14 private companies, controlled by 11 business groups and operating 30 mills in 10 Brazilian states, making Brazil the 8th largest producer in the world.

The privatization of steel companies, finalized in 1993, brought a significant flow of capital into the sector, with diverse shareholder composition. Thus, many steel companies came to be part of industrial and/or financial groups, with their interests in steelmaking unfolding into related activities, aiming to improved economies of scale and competitiveness.

Plants in Sao Paulo:

Gerdau Aços Especiais (Usina Pindamonhangaba)

Gerdau Aços Especiais (Usina Mogi das Cruzes)

ArcelorMittal Aços Longos (Piracicaba)

Usiminas (Cubatão)

Gerdau Aços Longos (Usina São Paulo)

Gerdau Aços Longos (Usina Araçariguama)

Villares Metals

Simec Aços Barra (Usina Pindamonhangaba)

In 2017 there was a merger between Votorantim Aço and ArcelorMittal. The Brazilian unit of ArcelorMittal expects to conclude the takeover of rival Votorantim Siderurgia SA in the second quarter of 2018 to become the country's largest long steel producer, with a capacity in Brazil of up to 6 million tons per year. ArcelorMittal expects to conclude the asset sales demanded by the country's antitrust watchdog Cade to approve the takeover by April, 2018.

## **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/TS 16949:2009 certification from International Quality Certifications covering the period from December 20, 2017 to September 14, 2018.

As of March 19, 2018, two plants of Republic Steel are certified to ISO9001:2015 and IATF16949:2016. In the case of our plants in Canton and Lackawanna, the current certification is effective until February 2021. The Massillon Plant is certified to TS16949, and the current certification is effective until June 2018, and is in the process of being recertified to the IATF 16949 standard. By the end of 2018, we expect all plants to be certified to ISO9001:2015 and IATF16949:2016. The plant in Solon is certified to ISO 9001:2015, and the current certification is effective until January 2021. The ISO/TS 16949:2009 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. ISO 9001 is a set of international quality control standards for management and practices.

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.

## **Raw Materials**

Prices for raw materials necessary for production of our steel products have fluctuated significantly in the past and significant increases in raw material prices could adversely affect our profit margins. During periods when prices for scrap metal, iron ore, ferroalloys, coke and other raw materials have increased, our industry has historically sought to

maintain profit margins by passing along increased raw materials costs to customers by means of price increases. For example, prices of scrap metal decreased approximately 6% in 2013, increased approximately 7% in 2014, decreased approximately 16% in 2015, increased approximately 2% in 2016 and increased approximately 30.8% in 2017 and prices of ferroalloys decreased approximately 5% in 2013, increased approximately 16% in 2014, decreased approximately 9% in 2015, decreased approximately 13% in 2016 and increased approximately 22% in 2017. We may not be able to pass along these and other cost increases in the future and, therefore, our profitability may be materially and adversely affected. Even when we can successfully increase our prices, 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 our customers will agree to pay increased prices for our steel products that compensate us for increases in our raw material costs.

We purchase our raw material requirements either in the open market or from certain key suppliers. We cannot assure you 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. In addition, if any of our key suppliers fails to deliver or we fail to renew our supply contracts, we could face limited access to some raw materials, or higher costs and delays resulting from the need to obtain our raw materials requirements from other suppliers.

In 2017, our cost of sales in Mexico, as a percentage of sales in Mexico, was 78%, compared to our U.S. operations where our cost of sales, as a percentage of sales in the United States, was 93%, as a percentage of sales in Brazil, was 89% and our consolidated cost of sales, as a percentage of consolidated sales, was 83%. The higher cost of sales of 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.

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

*Scrap metal.* Scrap metal is among the most important components for our steel production and accounted for approximately 59% of our consolidated manufacturing conversion cost in 2017 (64% of the manufacturing conversion cost in our Mexico operations and 47% of the manufacturing conversion cost in our U.S. operations), compared to 56% of our consolidated manufacturing conversion cost in 2016 (65% of the manufacturing conversion cost in our Mexico operations and 37% of the manufacturing conversion cost in our U.S. operations). Scrap metal is principally generated from automobile, industrial, naval and railroad industries. The market for scrap metal 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 we process the raw scrap into refined scrap metal at our Guadalajara, San Luis, Mexicali and Apizaco facilities. We meet our refined scrap metal requirements through: (i) our wholly-owned scrap processing facilities, which in the aggregate provided us with approximately 19.1% and 9.3% of our refined scrap tonnage in 2017 and 2016, respectively, and (ii) purchases from third party scrap processors in Mexico and the southwestern United States, which, in the aggregate, provided us with approximately 72.2% and 8.7%, respectively, in 2017 and approximately 83.0% and 7.7%, respectively, in 2016 of our refined scrap metal 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.

*Ferroalloys, Electrodes and Refractory Products.* In our Mexican operations, ferroalloys, electrodes and refractory products collectively accounted for approximately 12% of our manufacturing conversion cost in 2017, compared to 13% in 2016, and they accounted for 16% of our manufacturing conversion cost in 2017, compared to 16% in 2016 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., Elmet, S.A. de C.V., Ferroatlántica de México, S.A. de C.V., Marco Metales de Mexico, S. de R.L. de C.V., Possehl México, S.A. de C.V. and Distribuidora de Aleaciones y Metales, S.A. de C.V. Our U.S. and Canadian facilities purchase most of their ferroalloys from Affival, Duferco Steel, Globe Met., Gottlieb, Kennecott, Rusian Ferro, Traxys, Vale Americas, Minerais U.S. LLC and Glencore LTD.

We obtain electrodes used to melt raw materials from Graftech Comercial de Mexico, S.A. de C.V., Heg Limited and Graphite Cova GmbH. Our U.S. and Canadian facilities purchase most of their electrodes from SGL Carbon, Showa Denko Carbon, SK Carbon and E. J. Bognar Inc.

Refractory products include firebricks, which line and insulate furnaces, ladles and other transfer vessels. We purchase our refractory products for our Mexican operations from Vesuvius de México, S.A. de C.V., Magnesita Refractories México, S.A. de C.V., Magna Refractorios México, S.A. de C.V., Refratechnik Steel GmbH and Puyang Refractories Group Co., LTD. Our U.S. and Canadian facilities purchase most of their refractory products from Inc - RHI, Vesuvius USA, Corp., Nock & Son Co.-Minteq, Magna Refractories Inc., Refractory Materials Intl., Altus Refractories, LLC, Thermatex Sales Corp., Harbison-Walker Refractories Company and Magnesita Refractories Co.

*Electricity.* In 2017 and 2016 electricity accounted for approximately 9% and 10% respectively, of our consolidated manufacturing conversion cost. Electricity accounted for 9% in 2017 of our manufacturing conversion cost and 9% in 2016 in our Mexico facilities and is supplied by the CFE. It accounted for 8% in 2017 and 12% in 2016 of the manufacturing conversion cost in our U.S. and Canadian operations and is supplied by American Electric Power Company, Nipsco Industries, Inc., New York Power and Ohio Edison. We, like most 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. We cannot assure that any future cost increases will not have a material adverse effect on our business.

*Natural Gas.* Natural gas (including “combustoleo” fuel oil 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 3% of our consolidated manufacturing conversion cost (2% of the manufacturing conversion cost of our Mexican operations and 3% of the manufacturing conversion cost of our U.S. operations) in 2017 and 2016. In previous years we have entered into 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. 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. At December 31,

2017 and 2016 we did not have natural gas cash-flow exchange contracts or swaps. For the derivatives that qualified for hedge accounting, their fair value was adjusted through the stockholders' equity under the caption fair value of derivative financial instruments until such time as the related item in the derivative hedges is recognized as income.

We do not enter into contracts for speculation purposes.

## **Regulation**

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

Our U. S. and Canadian operations are subject to U.S. and Canadian federal, state and local environmental laws and administrative regulations concerning, among other things the management of, hazardous materials and the discharge of pollutants to the atmosphere and to surface waters. Our U.S. operations have been the subject of administrative action by federal, state (or provincial) and local environmental authorities. The resolution of any of these claims may result in significant liabilities. See Item 3.D. "Risk Factors—Risk Factors Related to our Business—In the event of environmental violations at our facilities we may incur significant liabilities" and Item 8. "Financial Information—Legal Proceedings."

### *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, sediment 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 or be subject to injunctive relief 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.

Our Lorain, Ohio plant (which is not currently in operation) and our Canton, Ohio facility are subject to the Maximum Achievable Control Technology ("MACT") standard for Electric Arc Furnaces as an "area source." Revisions of this standard are under development and, when promulgated, may impose additional restrictions on our Lorain and Canton operations including those relating to mercury emissions and control.

Our steelmaking operations in the United States and in Mexico use electric arc furnaces where carbon dioxide generation is primarily linked to energy use. In the United States, the federal environmental agency has issued rules imposing inventory and reporting obligations to which some of our facilities are subject, and has also issued rules that will affect preconstruction permits for our facilities where increases in greenhouse gas pollutants are contemplated. The U.S. Congress has debated various measures for regulating greenhouse gas emission (such as carbon dioxide) and may enact them in the future. Such laws and regulations may also result in higher costs for coking coal, natural gas and electricity generated by carbon-based systems (such as coal-fired electric generating facilities). Canada's federal government is also considering various approaches for reducing greenhouse gas emissions, although we do not presently believe Republic's Hamilton, Ontario facility would be significantly impacted by this efforts since it is not a steel-producing facility. Such future laws and regulations, whether in the form of cap-and-trade emissions permit system, a carbon tax or other regulatory regime may have a negative effect on our operations. Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place. As signatories to the UNFCCC, Mexico, the U.S. and Canada became subject to the Paris Agreement to fight climate change, which was taken by the parties at the 21th session of the UNFCCC conference of the Parties in 2015. However, in June 2017, U.S. President Trump stated that the United States would withdraw from the Paris Agreement, but may enter into a future international agreement related to greenhouse gas emissions. In August 2017, the U.S. State Department officially informed the United Nations of the intent of the United States to withdraw from the Paris Agreement. The United States' adherence to the exit process is uncertain and/or the terms on which the United States may reenter the Paris Agreement or a separately negotiated

agreement are unclear at this time. As a result, some of our significant facilities may ultimately be subject to future regional, provincial and/or federal climate change regulations to manage greenhouse emissions. More stringent greenhouse policies and regulations could adversely affect our business and results of operations.

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

In the United States, the federal environmental protection agency is developing a new rule that is expected, among other things, to impose a timeline for the phasing out of polychlorinated biphenyl (“PCB”) -containing fluid in equipment that we currently use at many of our U.S. facilities. A preliminary notice regarding this future regulation was published in 2016 for comments, and a formal proposed rule is expected within the next two years. If the rule is enacted as proposed, it will require our facilities to reduce the levels of PCBs in our equipment to less than 50 ppm within 5 years following its adoption, which will in turn require us to incur cost for the removal and disposal of PCB containing oils, sampling and possible replacement of equipment in the event PCB levels cannot be reduced to acceptable levels.

Also in the United States, more stringent standards for particulate matter were promulgated in 2012. As these new more stringent standards were implemented through the different state programs, we experienced higher costs associated with any preconstruction permitting of new or modified sources at our U.S. facilities in 2014 and subsequent years. These costs were related to extensive dispersion modeling and/or pre-construction monitoring not previously required.

### ***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, among others, 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; (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; and (iv) the Federal Law on Environmental Responsibility (*Ley Federal de Responsabilidad Ambiental*), which is also administered by SEMARNAT and enforced by PROFEPA.

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 these 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. Some of our facilities in Mexico have a 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. There is currently no duty. Leaders from the United States, Canada and Mexico also commenced discussions regarding NAFTA on January 23, 2018 in Montreal, Canada. After numerous rounds of discussion, there was no progress on divisive issues such as car manufacturing. Tariffs could impact the interconnected supply chain of many industries, including automobiles, and this could potentially harm NAFTA renegotiation talks. Moreover, under the terms of the NAFTA agreement, President Trump has the authority to withdraw from NAFTA with a six month notice. See “Item 3.D. Risk Factors—Risks Related to Mexico—Developments in other countries could adversely affect the Mexican economy, our financial performance and the price of our shares.”

*Mexican-European Community Free Trade Agreement.* The Mexican-European Free Trade Agreement, or “MEFTA,” became effective on July 1, 2000, and taxes applying to a large quantity of imported goods were eliminated or reduced. The goal of this trade agreement is to establish a bilateral and preferential, progressive and reciprocal framework to encourage the development of trade in goods and services, taking into account the sensitivity of certain products and services sectors, and in accordance with relevant rules of the World Trade Organization (WTO). The Joint Council is responsible for deciding the arrangements and timetable for the liberalization of duties and non-duty barriers to trade in goods, in accordance with the relevant WTO rules.

*Mexico-Japan Economic Association (the “Association”).* 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 steel products coming from Japan currently have a zero percent rate, (iii) the products to be imported from the under the programs established by the Association, 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.

*Transpacific Partnership Trade Agreement (TPP)*. On February 4, 2016, Mexico, along with Australia, Brunei, Canada, Chile, United States, Japan, Malaysia, New Zealand, Peru, Singapore and Vietnam, signed the TPP, in the City of Auckland, New Zealand. This treaty will grant Mexican products access to six markets (Australia, Brunei, Malaysia, New Zealand, Singapore and Vietnam) with approximately 155 million of potential consumers, which were not covered by any other trade agreement. The TPP will become effective two years after its signature, provided all 12 participating countries ratify the agreement, or when at least six countries representing at least 85% of the gross domestic product of the TPP ratify the agreement.

The TPP eliminates or reduces tariff and non-tariff barriers across substantially all trade in goods and services and covers the full spectrum of trade, including goods and services trade and investment, so as to create new opportunities and benefits for the businesses, workers, and consumers of the countries members.

The TPP facilitates the development of production and supply chains, and seamless trade, enhancing efficiency and supporting our goal of creating and supporting jobs, raising living standards, enhancing conservation efforts, and facilitating cross-border integration, as well as opening domestic markets.

The TPP promotes innovation, productivity, and competitiveness by addressing new issues, including the development of the digital economy, and the role of state-owned enterprises in the global economy.

The TPP includes new elements that seek to ensure that economies at all levels of development and businesses of all sizes can benefit from trade. It includes commitments to help small- and medium-sized businesses understand the Agreement, take advantage of its opportunities, and bring their unique challenges to the attention of the TPP governments. It also includes specific commitments on development and trade capacity building, to ensure that all Parties are able to meet the commitments in the Agreement and take full advantage of its benefits.

The TPP is intended as a platform for regional economic integration and designed to include additional economies across the Asia-Pacific region.

The President of the United States, Donald Trump, signed an executive order on January 2017 withdrawing the United States from the TPP.

On January 23, 2018, the 11 remaining countries participating in the TPP reached an agreement in Tokyo, Japan. Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, member countries of the TPP, signed the agreement on March 8, 2018 in Santiago de Chile.



*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.

On September 11, 2013, the United States International Trade Commission (USITC) started an official anti-dumping investigation against rebar exports from Mexico and Turkey promoted by Nucor, Gerdau, Commercial Metals, and Cascade Steel Buyer.

On September 25, 2013, the USITC determined that there was sufficient evidence of “injury” therefore, on October 2, 2013, the Department of Commerce (DOC) started the antidumping investigation.

On November 21, 2013, DeAcero was named a “Mandatory Respondent” of the questionnaires and on February 12, 2014, we were named the second “Mandatory Respondent” thereby replacing Grupo Acerero, S.A. de C.V. which is not participating in the process.

On April 21, 2014, preliminary “dumping” quotas were published: 66.7 % to Grupo Acerero, S.A. de C.V., 10.66 % to us and 20.59% to other Mexican exporters (including DeAcero).

On October 14, 2014, the United States International Trade Commission (USITC) determined that a U.S. industry is materially injured by reason of imports of steel concrete reinforcing bar from Mexico that are sold in the United States at less than fair value and from Turkey that are subsidized by the government of Turkey. As a result of the USITC’s affirmative determinations, the U.S. Department of Commerce will issue an antidumping duty order on imports of this product from Mexico and a countervailing duty order on imports of this product from Turkey. The U.S. government imposed tariffs of 66.7% against imports for rebar from Deacero and us and tariffs of 20.58% for rebar from all other imports from producers in Mexico. On November 16, 2015, we filed a request for review with the U.S. Department of Commerce against the imposed tariffs. On December 6, 2016, the US Department of Commerce issued a preliminary resolution in which it determined that the tariff is 0%.

On June 8, 2017, the US Department of Commerce issued a final resolution in which it determined that the tariff should become 0%.

On August 14, 2013, the Ministry of Industry and Tourism of Colombia (MIT) started an official safeguard investigation against imports of commercial angles and plates originating from countries that are members of the World Trade Organization (WTO) at the request of DIACO-GERDAU and SIDOC, seeking the imposition of a countervailing duty of 35%.

We were the only Mexican producer that responded to the questionnaire in October 10, 2013.

On April 2, 2014, the MIT announcement at a press conference that they would not impose safeguard measures to rebar straight and roll nor to profiles of steel angles, square bars / slabs / plates. Only wire was subject to safeguard measures with an antidumping duty of 21.29%.

### ***Brazil operations***

We produce according to the technical specifications of the Brazilian standard ABNT NBR 7480:2007 for steel bars and wires designed for the reinforcement for concrete structures. Our products are also registered with the Brazilian National Institute of Metrology, Quality and Technology (INMETRO), in accordance with Resolution CONMETRO No. 05, dated May 6, 2008, and comply with conformity assessment regulations, including Ordinance No. 73, dated March 17, 2010, and with compulsory product certification regulations.

We have received environmental permits from the Sao Paulo State, for which hydrological studies and feasibility of groundwater have been conducted, such permits include a license granted by the Ministry of Environment of Sao Paulo and an operations license granted by the Ministry of Environment CETESBE Sao Paulo State Comnahia.

### **C. Organizational Structure**

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



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%); 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%); CSG Comercial, S.A. de C.V. (99.95%); Compañía Siderúrgica de Guadalajara S.A. (1) de C.V. (99.99%); Simec Acero, S.A. de C.V. (100%); Undershaft Investment N. V., (100%); Simec USA Corp. (100%); Pacific Steel Projects Inc. (100%); Simec Steel Inc. (100%); Simec International, S. A. de C. V.(100%); Corporativos G&DL, S.A. de C.V. (100%); Simec International 7, S. A. de C. V., (99.99%), Simec International 9, S.A.P.I. de C.V., (100.00%); Corporación ASL, S.A. de C.V. (99.99%); Siderúrgica del Occidente y Pacífico, S.A. de C.V. (100%) (incorporated in 2014); GS steel B.V. (100%) (incorporated in 2014); Aceros Especiales Simec Tlaxcala, S.A. de C.V. (100%) (incorporated in 2015), Recursos Humanos de la Industria Siderúrgica de Tlaxcala, S.A. de C.V. (100%) (incorporated in 2015) and Siderúrgicos Noroeste, S.A. de C.V. (100%) (incorporated in 2017).

Our principal Mexican facilities consist of steel-making facilities in Guadalajara, Jalisco; Mexicali, Baja California; Apizaco, Tlaxcala; and cold finishing facilities in Cholula, Puebla; and San Luis Potosí., these facilities were operated by Simec International 6, S.A. de C.V. until October 31, 2012 (began operations in (2) November 2010). Since November 1, 2012 these facilities are operated by Orge, S.A. de C.V. (incorporated in October, 2012). These facilities are operated by RRLC, S.A.P.I. de C.V. (95.10%) (incorporated in 2015) and Grupo Chant, S.A.P.I. de C.V. (97.61%) (incorporated in 2015), since April, 2015 and October 2015, respectively. These facilities are operated by GSIM de Occidente, S.A. de C.V. (incorporated in 2016) y Aceros Especiales Simec Tlaxcala, S.A. de C.V. (incorporated in 2015), since March 2016 and July 2016, respectively.

(3) The remaining 49.8% of SimRep is owned by our controlling shareholder, Industrias CH.

SimRep, Co. owns 100% of Republic Steel, Inc. Our principal U.S. and Canadian facilities consist of a (4) 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; Solon, Ohio; and Hamilton, Ontario, Canada, all of which are owned directly by Republic.

Grupo San facilities are conformed by Corporacion Aceros DM, S.A. de C.V. (100%) and Subsidiaries, Aceros (5) DM, S.A. de C.V. (99.99%) Acero Transportes SAN, S.A. de C.V. (99.99%), Aceros San Luis, S.A. de C.V. (99.99%), Malla San 1, S.A. de C.V. (99.98%) and Malla San 2, S.A. de C.V. (99.98%).

The following table identifies each of our significant operating subsidiaries, including its country of incorporation and our percentage ownership thereof at December 31, 2016:

Name of Subsidiary	Country of Incorporation	Ownership Interest (%)
--------------------	--------------------------	------------------------

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Simec International, S.A. de C.V.	Mexico	100.00%
Undershaft Investments, N.V.	Curaçao	100.00%
Pacific Steel, Inc.	United States	100.00%
SimRep Corporation and subsidiaries (Republic)	United States	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	100.00%
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	100.00%
Sistemas de Transporte de Baja California, S.A. de C.V.	Mexico	100.00%
Operadora de Metales, S.A. de C.V.	Mexico	100.00%
Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.	Mexico	100.00%
Administradora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.	Mexico	100.00%
Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V.	Mexico	100.00%
Arrendadora Simec S.A. de C.V.	Mexico	100.00%
Compañía Siderúrgica de Guadalajara S.A. de C.V.	Mexico	99.99%
CSG Comercial, S.A. de C.V.	Mexico	99.95%
Corporación Aceros DM, S.A. de C.V. and subsidiaries	Mexico	100.00%
Corporación ASL, S.A. de C.V.	Mexico	99.99%
Simec International 6, S. A. de C. V.	Mexico	100.00%
Simec International 7, S. A. de C. V.	Mexico	99.99%
Simec International 9, S.A.P.I. de C. V.	Mexico	100.00%
Simec Acero, S. A. de C. V.	Mexico	100.00%
Simec USA, Corp.	United States	100.00%
Pacific Steel Projects, Inc.	United States	100.00%
Simec Steel, Inc.	United States	100.00%
Corporativos G&DL, S.A. de C.V.	Mexico	100.00%
GV do Brasil Industria e Comercio de Aço LTDA.	Brazil	100.00%
Orge, S.A. de C.V.	Mexico	99.99%
Siderúrgica del Occidente y Pacífico, S.A. de C.V.	Mexico	100.00%
GS Steel BV	Netherlands	100.00%
RRLC S.A.P.I. de C.V.	Mexico	95.10%
Grupo Chant S.A.P.I. de C.V.	Mexico	97.61%

Aceros Especiales Simec Tlaxcala, S.A. de C.V.	Mexico 100.00%
Recursos Humanos de la Industria Siderúrgica de Tlaxcala, S.A. de C.V.	Mexico 100.00%
GSIM de Occidente, S.A. de C.V.	Mexico 100.00%
Fundiciones de Acero Estructural, S.A. de C.V.	Mexico 100.00%
Siderúrgicos Noroeste, S.A. de C.V.	Mexico 100.00%

The U.S. dollar is the functional currency of our U.S. subsidiaries, except Simec 8 International, Inc., Steel Promotor, Inc. and Coadm Steel, Inc., which are not listed above and whose functional currency is the peso. These entities were merged into Simec USA Corp at the beginning of 2015 and, therefore, are no longer in operations. Prior to the merger, these entities recorded uncollected accrued interest for the year ended December 31, 2014 and their main assets and liabilities were accounts receivable and payable to related parties denominated in pesos. These three subsidiaries were previously Mexican entities and in 2014 changed their tax residence to the United States. Prior to the merger but after changing their tax residence to the United States, these entities had minimal operations and, therefore, until 2015 we considered, that their functional currency was the Mexican peso. In 2013, these subsidiaries operated in Mexico and were treated as Mexican subsidiaries.

#### **D. Property, Plants and Equipment**

#### **Our Operations and Production Facilities**

We conduct our operations at 13 facilities throughout America. At December 31, 2017, our crude steel production capacity was 4.6 million tons, of which 1.2 million tons were based on an integrated blast furnace technology, and 3.4 million were based on electric arc furnace, or mini-mill, technology. Our Mexican facilities have 2 million tons of crude steel production capacity, operating five mini-mill facilities. Our U.S. operations have 2.1 million tons of crude steel production capacity and our Brazil operations have 0.5 million tons of crude steel production capacity. In addition, we have 4 million tons of rolling and finishing capacity, of which 1.8 million are located in Mexico, 1.7 million are located in the United States and Canada and 0.5 million are located in Brazil.

We operate seven mini-mills, five in Mexico, one in the United States and one in Brazil. The Mexican mini-mills are located in Guadalajara, Jalisco; Apizaco, Tlaxcala; Mexicali, Baja California; as well as two in San Luis Potosí. Our mini-mill in the United States is located in Canton, Ohio. Our mini-mill in Brazil is located in Pindamonhangaba; São Paulo. We also own an integrated blast furnace and an electric arc furnace in Lorain, Ohio and a rolling mill in Lackawanna, New York. Processing mills are located in Massillon, Ohio, Hamilton, Ontario and Solon, Ohio.

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 metal 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 scrap metal and iron ore to produce our finished steel products. We produce molten steel using an electric arc furnace, 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. Our facility in Canton, Ohio is capable of producing billets and 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 billets 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.

**Production Volume and Capacity Utilization**

	<b>Years ended December 31,</b>				
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
	(tons in thousands)				
<b>Melt shops</b>					
Steel billet production	2,289.5	2,483.7	2,318.0	2,219.6	2,288.0
Annual installed capacity <sup>(1)</sup>	4,500.0	4,207.9	4,552.9	4,552.9	4,596.9
Effective capacity utilization	50.9%	59.0%	50.9%	48.8%	49.8%
<b>Rolling mills</b>					
Total production	2,300.2	2,286.3	2,206.4	2,211.4	2,171.6
Annual installed capacity <sup>(1)</sup>	3,817.6	3,829.6	4,279.6	4,131.8	4,000.0
Effective capacity utilization	60.3%	59.7%	51.6%	53.5%	54.3%

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 (1) 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 of December 31 for each year.

*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 2017.

**Mexican Production per Facility by Product Location**

<b>Product</b>	<b>Guadalajara</b>	<b>Mexicali</b>	<b>Apizaco/ Cholula</b>	<b>San Luis</b>	<b>Total</b>
	Production (%)				
I Beams	24.4%	0%	0%	0%	4.5%
Channels	9.0%	13.3%	0%	0%	3.2%
Angles	31.3%	18.8%	0%	0%	9.1%
Hot rolled bars (round, square And hexagonal rods)	21.7%	4.2%	36.9%	3.8%	13.1%
Rebar	0%	58.7%	0%	81.7%	50.2%



Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Flat bars	10.7%	4.2%	31.9%	0%	8.8%
Cold finished bars	2.9%	0%	31.2%	0%	6.5%
Electro-Welded wire mesh	0%	0%	0%	3.5%	1.1%
Wire rod	0%	0%	0%	6.4%	2.0%
Electro-Welded wire mesh panel	0%	0%	0%	4.6%	1.5%
Other	0%	0.8%	0%	0%	0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

*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 370,000 tons of billet and an annual installed capacity of finished product of 480,000 tons. In 2017, the Guadalajara mini-mill produced 343,930 tons of steel billet and 345,824 tons of finished product, operating at 93% capacity for billet production and 72% 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 City. Our Guadalajara facility mainly produces structurals, SBQ steel, light structurals and rebars.

### Guadalajara Mini-Mill

	Years ended December 31,				
	2013	2014	2015	2016	2017
Steel sales (thousands of tons)	323	335	369	375	340
Average finished product price per ton	Ps. 9,929	Ps. 10,410	Ps. 9,726	Ps. 10,779	Ps. 12,000
Average scrap cost per ton	4,775	4,934	4,539	4,691	5,695
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	2,879	2,613	2,399	2,452	2,789
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	1,685	1,586	1,489	1,588	1,927

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

*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 2017, the Mexicali mini-mill produced approximately 231,198 tons of billet, of which the Guadalajara mini-mill used 29,292 tons. In 2017, the Mexicali mini-mill produced 184,645 tons of finished products. In 2017 we operated the Mexicali mini-mill at 54% capacity for billet production and at 74% 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 2017, 59% of the products produced at the Mexicali mini-mill were rebar, 19% were angles, 4% were hot rolled bars (round, square and hexagonal rods) and the remaining 18% were channels and flat bar.

### **Mexicali Mini-Mill**

	<b>Years ended December 31,</b>				
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Steel sales (thousands of tons)	195	206	220	216	193
Average finished product price per ton	Ps. 9,097	Ps. 9,170	Ps. 9,405	Ps. 9,935	Ps. 10,720
Average scrap cost per ton	4,580	4,348	3,981	3,942	4,544
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	2,643	2,659	2,414	2,277	2,878
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	1,819	1,752	1,608	1,541	2,013

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

*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 510,000 tons of steel billet and an annual installed capacity of finished product of 492,000 tons. In 2017, the Apizaco

mini-mill produced 405,818 tons of steel billet. In 2017, the Apizaco mini-mill produced 367,823 tons of finished products. In 2017, we operated the Apizaco mini-mill at 80% capacity for billet production and at 75% capacity for finished product production. Our Apizaco facility is 1,112 miles from Mexicali and less than 124 miles from Mexico City. 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 120,000 tons. In 2017, the Cholula facility produced 101,958 tons of finished products, at 85% capacity. Our Cholula facility mainly produces cold finished SBQ steel.

In 2017, 37% of the products we produced at the Apizaco and Cholula facilities were hot rolled bars (round, square and hexagonals), 32% were flat merchant bar and 31% were cold finished products.

### Apizaco Mini-Mill and Cholula Facility

#### Years ended December 31,

	2013	2014	2015	2016	2017
Steel sales (thousands of tons)	329	361	339	350	331
Average finished product price per ton	Ps. 11,845	Ps. 12,047	Ps. 12,366	Ps. 12,763	Ps. 15,426
Average scrap cost per ton	4,498	4,800	4,111	4,376	5,725
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	3,239	3,400	3,455	3,321	4,524
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	2,084	2,154	2,195	2,168	2,796

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

*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 Potosí, in the state of San Luis Potosí. 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, 2017, these facilities had an annual installed capacity of 704,000 tons of billet and 610,000 tons of finished product. In 2017, the San Luis facilities produced 581,128 tons of steel billet. In 2017, the San Luis facilities produced 548,964 tons of finished product, operating at 83% capacity for billet production and 90% capacity for finished product production. Our San Luis facilities mainly produces rebar, light structurals and wire rod. In 2017, 82% of the products produced at the San Luis facilities were rebar, 14% were electro-welded wire mesh, wire rod and electro-welded wire mesh panel, and the remaining 4% were other light structurals.

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

**Years ended December 31,**

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Steel sales (thousands of tons)	528	517	524	554	540
Average finished product price per ton	Ps. 9,309	Ps. 9,269	Ps. 9,786	Ps. 10,301	Ps. 10,870
Average scrap cost per ton	4,818	4,936	4,462	4,628	5,859
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	2,594	2,268	2,060	2,032	2,414
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	1,750	1,764	1,584	1,571	1,857

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

*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, 2017, these facilities had an annual installed capacity of 2,083,000 tons of billet and 1,719,000 tons of finished product. In 2017, Republic facilities produced 453,600 tons of steel billet. For the same period, Republic facilities produced 372,859 tons of hot-rolled bars. Republic facilities produced 58,151 tons of cold finish bars. In 2017, Republic facilities produced 20,684 tons of wire products.

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

	<b>Years ended December 31,</b>			
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Steel sales (thousands of tons)	6,878	570	397	387
Average finished product price per ton	PPs. 15,582	Ps. 16,611	Ps. 23,526	Ps. 21,630
Average scrap cost per ton	4,554	3,899	3,939	6,114
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	6,648	7,042	6,621	6,790
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	3,965	4,481	4,661	4,915

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

*Lorain, Ohio.* The Lorain facility operates an integrated steel mill, it has a blast furnace, two 220-ton basic oxygen furnaces, a 150-ton electric arc furnace, 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, 2017, an annual installed capacity of 952,000 tons of steel billet and 816,000 tons of finished product. This facility did not produce tons of steel billets and finished steel bars in 2017.

*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 Republic facilities and for trade customers. We use the QVL inspection line to inspect finished bar produced in Lackawanna and Lorain. As of December 2017, the Canton facility had annual installed capacity of 1,131,000 tons of steel billet. In 2017, this facility produced 453,600 tons of blooms, billets and other semi-finished trade product and was operated at 40% 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 16 conventional stand mill with a 5 stand sizing mill and two saw lines capable of producing rounds, squares, and hexagons in both cut length and coils. This facility produces hot rolled bar sizes that range from 0.562” to 3.250” with coil weights up to 6,000 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, 2017, the Lackawanna facility had annual installed capacity of 653,000 tons of hot rolled bars. In 2017, this facility produced 372,859 tons of hot rolled bars and was operated at 57% 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, 2017, an annual installed capacity of 125,000 tons of finished product. During 2017, the Massillon facility was operated at 26% capacity of finished product and produced 32,296 tons of cold finished bars.

*Gary, Indiana.* The idled Cold Finish plant in Gary, Indiana was relocated to a fellow subsidiary company in Tlaxcala, Mexico in 2016. This was a turnkey project to design the relocation, de-commission and ship the equipment, install and then re-commission the plant for an all-in cost of Ps. 1,478 million (U.S.\$79.2 million).

*Solon, Ohio.* Our Solon facility, acquired in February, 2011, mainly produce Cold Heading Quality (CHQ) wire products and have wire drawing and finishing facilities that include the machinery and equipment to clean and coat, draw, and anneal wire. As of December 31, 2017, the Solon facility had installed capacities of 65,000, for wire

products. During 2017, the Solon facility produced and shipped 20,684 tons of wire products and was operated at 32% 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, 2017, the Hamilton facility had annual installed capacity of 59,000 tons of cold finished bars. In 2017, this facility produced 25,855 tons of cold finished bars and was operated at 44% capacity of finished product.

*Pindamonhangaba, Sao Paulo, Brazil.*

Our plant is located 140 kms from the city of Sao Paulo, in a town called Pindamonhangaba, State of Sao Paulo and is 218 miles from Rio de Janeiro. Our Brazil facility and equipment include an electric German arc furnace and an Italian rebar and wire rod rolling mill. This plant began operations in July 2015 and currently produces rod. As of December 31, 2017, this plant had installed capacity to produce 500,000 tons of “billet” and 450,000 tons of finished product per year capacity. In 2017 our mini-steel plant in Brazil produced 272,345 tons of “billet” and 272,652 tons of finished product, operating at 54% of its capacity for “billet” and 61% capacity for finished product.

The following table sets forth, for the period indicated selected operating data for our Brazil facility.

	<b>Years ended</b>		
	<b>December 31,</b>		
	<b>2015</b>	<b>2016</b>	<b>2017</b>
Steel sales (thousands of tons)	4	193	300
Average finished product price per ton	Ps. 7,500	Ps. 9,399	Ps. 10,680
Average scrap cost per ton	2,322	3,679	4,846
Average manufacturing conversion cost per ton of finished product <sup>(1)</sup>	2,481	2,551	3,181
Average manufacturing conversion cost per ton of billet <sup>(1)</sup>	1,103	1,703	2,403

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

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

Location	Product (%)	Equipment	2017 Annual Production Volume (tons)	Finished Product Annual Installed Capacity (tons)
Guadalajara	Structurals (42%); Light structurals (24%); Bars (34%)	electric arc furnace with continuous caster rolling mill and bar processing lines	345,824	480,000
Mexicali	Structurals (19%); Rebar (59%); Light structurals (14%), Hot rolled bars (8%)	electric arc furnace with continuous caster and bar rolling mills	184,645	250,000
Apizaco and Cholula	SBQ (100%)	electric arc furnace with vacuum tank degasser, continuous caster, bar rolling mills, cold drawn and bar turning equipment	367,823	492,000
Aceros DM, San Luis Potosí	Rebar (73%), Wire rod (9%), Electro-Welded wire mesh (5%), Electro-Welded wire mesh panel (7%), Bars (6%)	three electric arc furnaces, two continuous casters, two reheating furnaces, rebar rolling mill and wire rod rolling mills	375,552	410,000
Aceros San Luis, San Luis Potosí	Rebar (100%)	electric arc furnace, continuous caster, reheating furnace and rebar rolling mill	173,412	200,000
Lorain <sup>(1)</sup>	SBQ (100%)	electric arc furnace, blast furnace, vacuum tank degasser, continuous caster, bar and wire rod rolling mills	0	816,000
Canton <sup>(2)</sup>	SBQ (100%)	electric arc furnace, vacuum tank degasser, continuous caster	453,600	1,131,000
Lackawanna	SBQ (100%)	reheat furnace, bar and wire rod rolling mills	372,859	653,000
Massillon	SBQ (100%)	cold drawn bar turning and heat treating equipment	32,296	125,000



Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Solon (acquired in February, 2011)	Cold Heading Quality (CHQ) wire products (100%)	machinery and equipment to clean and coat, draw, and anneal wire	20,684	65,000
Hamilton	SBQ (100%)	cold drawn bar turning and heat treating equipment	25,855	59,000
Brazil	Rebar (100%)	electric arc furnace, rebar and wire rod rolling mill	272,652	450,000

(1) Production capacity is for rolling only.

(2) Production capacity is for billets only.

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

There are no unresolved written comments received from the staff of the U.S. Securities and Exchange Commission (the “Commission”) regarding our periodic reports under the U.S. Securities Exchange Act of 1934, as amended.

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

The following discussion is derived from our audited consolidated 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.

##### ***Adoption of International Financial Reporting Standards (IFRS)***

The Mexican National Banking and Securities Commission (CNBV) has established the requirement that listed companies must disclose their financial information to the public, through the Mexican Stock Exchange (BMV), and therefore, beginning in 2012, we prepare our financial information in accordance with IFRS, issued by the IASB. IFRS 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.

#### **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 globally. The sharp reduction in economic activity and consumer demand in general, and in the automotive, construction and manufacturing 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. These economic conditions have had an impact on all parts of our operations since the fourth quarter of 2008. Demand, production levels and prices in certain segments and markets have recovered and stabilized

to a certain degree, although the extent, timing and duration of the recovery and potential return to pre-crisis levels remains uncertain. Our net revenue from sales decreased in 2013, compared to 2012, decreased by 23% in the automotive sector, decreased 15% in the independent distributor sector, decreased 33% in the hand tools sector, increased 3% in the mining sector and decreased 13% in other industries. The total decrease in net revenue from sales of SBQ products in 2013, compared to 2012, was 18%. Our net revenue from sales increased in 2014, compared to 2013, increased by 42% in the automotive sector, decreased 13% in the independent distributor sector, decreased 34% in the hand tools sector, decreased 61% in the mining sector and increased 29% in other industries. The total increase in net revenue from sales of SBQ products in 2014, compared to 2013, was 18%. Our net revenue from sales decreased in 2015, compared to 2014, increased by 20% in the automotive sector, decreased 43% in the independent distributor sector, increased 204% in the hand tools sector, decreased 52% in the mining sector and decreased 48% in other industries. The total decrease in net revenue from sales of SBQ products in 2015, compared to 2014, was 16%. Our net revenue from sales decreased in 2016, compared to 2015, decreased by 18% in the automotive sector, increased 9% in the independent distributor sector, decreased 72% in the hand tools sector, decreased 42% in the mining sector and decreased 10% in other industries. The total decrease in net revenue from sales of SBQ products in 2016, compared to 2015, was 13%. In 2017, the total increase in net revenue from sales of SBQ products compared to 2016 was 13%.

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, and, therefore, these products tend to generate 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.

We focus on controlling our cost of sales as well as our selling, general and administrative expenses. Our cost of sales largely consist of the costs of acquiring the raw materials necessary to manufacture steel, primarily scrap metal 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; however, in 2013, 2014, 2015, 2016 and 2017 we did not purchase iron ore pellets or coke since our Lorain, Ohio blast furnace facility, which is our only facility that utilizes these materials, was idle during these periods. 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 cost of sales as a percentage of net sales is largely dependent on increasing our productivity. Our ability to control selling, general and administrative expenses, which do not correlate to net sales as closely as cost 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.

The negative operating trends in our USA segment are primarily driven by under-utilized production capacity that severely impacts cost. The automotive sector is stable and continues to provide good demand for our products.

Our U.S. subsidiaries have entered into sale agreements with customers and, in order to comply with the terms thereof, any existing orders pursuant to those agreements need to be fulfilled even if the price of raw material increases with time. As the existing sale agreements expire, we will evaluate new agreements which would result in a production of profitable products.

Typically, about 75% of our business uses a fixed base price that is negotiated annually, plus monthly scrap and alloy surcharges. The remaining 25% is transaction business, where we can adjust the base pricing as required. Scrap metal and commodity prices stabilized somewhat midway through 2016, and in 2017 the prices of scrap and other inputs increased significantly. Financial resources will continue to be made available as our U.S. segment tackles the cost curve and restores the business to profitability.

#### **Sales Volume, Price and Cost Data, 2013 - 2017**

	<b>Year ended December 31,</b>				
	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Shipments (thousands of tons)	2,064	2,197	2,026	2,085	2,091

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Guadalajara and Mexicali	518	540	589	591	533
Apizaco and Cholula	329	362	339	350	331
San Luis facilities	528	517	524	554	540
Republic facilities	689	778	570	397	387
Brazil	—	—	4	193	300
Net sales (Ps. millions)	24,369	26,829	24,476	27,516	28,700
Guadalajara and Mexicali	4,981	5,366	5,658	6,188	6,149
Apizaco and Cholula	3,897	4,361	4,192	4,467	5,106
San Luis facilities	4,915	4,792	5,128	5,707	5,870
Republic facilities	10,576	12,310	9,468	9,340	8,371
Brazil	—	—	30	1,814	3,204
Cost of sales (Ps. millions)	22,410	25,492	23,097	22,776	23,994
Guadalajara and Mexicali	4,087	4,740	3,955	5,364	4,703
Apizaco and Cholula	2,729	3,115	2,764	3,635	3,607
San Luis facilities	4,240	4,221	4,529	4,726	5,030
Republic facilities	11,354	13,416	11,829	7,332	7,814
Brazil	—	—	20	1,719	2,840
Average price per ton (Ps.)	11,807	12,212	12,081	13,197	13,725
Guadalajara and Mexicali	9,616	9,937	9,606	10,470	11,537
Apizaco and Cholula	11,845	12,047	12,366	12,763	15,426
San Luis facilities	9,309	9,269	9,786	10,301	10,870
Republic facilities	15,350	15,823	16,611	23,526	21,630
Brazil	—	—	7,500	9,399	10,680
Average cost per ton (Ps.)	10,858	11,603	11,400	10,924	11,475
Guadalajara and Mexicali	7,890	8,778	6,715	9,076	8,824
Apizaco and Cholula	8,295	8,605	8,153	10,386	10,897
San Luis facilities	8,030	8,164	8,643	8,531	9,315
Republic facilities	16,479	17,244	20,753	18,469	20,191
Brazil	—	—	5,000	8,907	9,467

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 factors and trends discussed below also affect our results and profitability.

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

In August 2004, we completed the Atlax Acquisition (Tlaxcala and Cholula facilities). 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 case 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 automotive, construction, 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. Mexico’s GDP increased 2% in 2017 (according to preliminary figures of the INEGI) and increased 2.9% in 2016. The U.S. GDP increased 2.3% in 2017 (according to preliminary figures of the U.S. Department of Commerce) and 1.5% in 2016. Deterioration in economic conditions in the countries in which we operate is likely to adversely affect our results of operation.

*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. Average steel prices continued to improve from 2003 to 2008 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.

This 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. In 2009 the average steel price decreased approximately 22% compared to 2008. Due to an increase in the demand, in 2010, the average steel price increased approximately 16% compared to 2009. The average steel price increased approximately 17% in 2011 compared to 2010. The average steel price increased approximately 2% in 2012 compared to 2011. The average steel price decreased approximately 10% in 2013 compared to 2012. The average steel price increased approximately 3% in 2014 compared to 2013. The average steel price decreased approximately 23% in 2015 compared to 2014, mainly due to the deceleration in China. The average steel price increased approximately 2% in 2016 compared to 2015. Our average steel price increased approximately 2% in 2017 compared to 2016.

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. 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. In 2006 and 2007, imports to Mexico increased as market conditions improved, and in 2008, imports to Mexico continued to increase, notwithstanding the worsening of international market conditions. In 2009, however, imports to Mexico decreased as domestic and global market conditions worsened. In 2010, 2011 and 2012, imports to Mexico increased as market conditions improved. In 2013, imports to Mexico decreased as domestic and global market conditions worsened. In 2014, imports to Mexico increased slightly. In 2015, imports to Mexico increased 10% compared to 2014 according to preliminary information of CANACERO. In 2016, imports to Mexico increased 1.6% compared to 2015 according to preliminary information of CANACERO. In 2017, imports to Mexico in tons increased 6.8% compared to 2016 according to preliminary information of CANACERO.

Steel imports to the United States accounted for an estimated 27% of the domestic U.S. steel market in 2017 and an estimated 26% in 2016. Foreign producers typically have lower labor costs, and in some cases are 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 metal, iron ore, coke 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. As a result of the 2008 financial crisis that continues to affect the international markets, the prices of these inputs have remained highly volatile. For example, prices of scrap metal decreased approximately 6% in 2013, increased approximately 7% in 2014, decreased approximately 16% in 2015, increased approximately 2% in 2016 and increased approximately 31% in 2017; and prices of ferroalloys decreased approximately 5% in 2013, increased approximately 16% in 2014 and decreased approximately 9% and 13% in 2015 and 2016, respectively, in 2017 increased approximately 22%. As with other raw materials, iron ore and coke prices fluctuate significantly. However, in 2013, 2014, 2015, 2016 and 2017 we did not purchase coke or pellets since our Lorain, Ohio blast furnace facility was idle during this period.

In addition to raw materials, electricity and natural gas are both relevant components of our cost structure. We purchase electricity and natural gas 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 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 in response to the financial crisis, they have remained highly volatile. Prices for electricity increased approximately 9% in 2013, 7% in 2014, decreased approximately 12% in 2015, increased approximately 1.5% in 2016 and increased approximately 22% in 2017; and prices for natural gas increased approximately 16% in 2013 and 25% in 2014, decreased approximately 23% in 2015, increased approximately 8% in 2016 and increased approximately 22% in 2017.

*If inflation rates in Mexico rise significantly, our costs may increase and the demand for our services may decrease.*

Mexico has historically experienced high annual rates of inflation. The annual rate of inflation, as measured by changes in the Mexican national consumer price index (*Índice Nacional de Precios al Consumidor*) published by the INEGI was 4.0% for 2013, 4.1% for 2014, 2.1% for 2015, 3.4% for 2016 and 6.8% for 2017. High inflation rates could adversely affect our business and results

of operations by increasing certain costs, such as the labor costs of our Mexican facilities, beyond levels that we could pass on to our customers and reducing consumer purchasing power, thereby adversely affecting demand for our products.

*Depreciation of the Mexican peso relative to the U.S. dollar, as well as the reinstatement of exchange controls and restrictions, could adversely affect our financial performance.*

Depreciation of the Mexican peso relative to the U.S. dollar may negatively affect our results of operations. Since the second half of 2008, the value of the Mexican peso relative to the U.S. dollar has fluctuated significantly. According to the Mexican Central Bank (*Banco de Mexico*), during this period the exchange rate registered a low of Ps. 9.92 per U.S.\$1.00 at August 6, 2008, and a high of Ps. 20.84 per U.S.\$1.00 at November 14, 2016. The appreciation of the Mexican peso relative to the U.S. dollar in 2017 was 4.5%. The exchange rate at December 31, 2017 was 19.7354 compared to 20.6640 at December 31, 2016. At May 11, 2018 the exchange rate was Ps. 19.5387 per U.S.\$1.00.

A severe depreciation of the Mexican peso may also result in disruption of the international foreign exchange markets and may limit our ability to convert Mexican pesos into U.S. dollars and other currencies. While the Mexican government does not currently restrict, and has not recently restricted the right or ability of Mexican or foreign persons or entities to convert Mexican pesos into U.S. dollars or to transfer other currencies out of Mexico, it has done so in the past and could reinstate exchange controls and restrictions in the future. Currency fluctuations or restrictions on the transfer of foreign currency outside of Mexico may have an adverse effect on our financial performance.

## **Segment Information**

We are required to disclose segment information in accordance with IFRS 8 “Operating Segments”: 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 three 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 U.S. segment represents the results of our operations of Republic, including its eight plants, seven of which are located in the United States and one in Canada; and

our Brazil segment represents the results of our operations in one plant located in Pindamonhangaba, São Paulo State, Brazil, which started operations in June 2015.

The following information shows other results by segment.

	<b>For the year ended December 31, 2017</b>				
	<i>Mexico</i>	<i>United States</i>	<i>Brazil</i>	<i>Operations between Segments</i>	<i>Total</i>
	(in thousands of pesos)				
Net sales	17,125,369	8,370,999	3,204,082	—	28,700,450
Cost of sales	13,340,648	7,814,180	2,839,698	—	23,994,526
Gross profit (loss)	3,784,721	556,819	364,384	—	4,705,924
Administrative expenses	753,676	257,001	228,266	—	1,238,943
Other (income) expense, net	98,915	(105,849)	—	—	(6,934)
Interest income	54,021	217	—	—	54,238
Interest expense	(7,459)	(50,962)	(65,186)	69,203	(54,404)
Exchange (loss) gain, net	(1,291,909)	(26,256)	1,861	661,942	(654,362)
Income (loss) before income tax	1,686,783	328,666	72,793	731,145	2,819,387
Income tax	761,953	322,444	13,463	—	1,097,860
Net income (loss)	924,830	6,222	59,330	731,145	1,721,527

<b>Other Data</b>	<b>Mexico</b>	<b>United States</b>	<b>Brazil</b>	<b>Operations between Segments</b>	<b>Total</b>
Depreciation and amortization	677,665	538,699	249,395	—	1,465,759
Total assets	32,440,109	10,548,895	5,356,860	(2,807,367)	45,538,497
Total liabilities	891,037	10,760,999	2,570,925	(2,807,367)	11,415,594
Additions of property, plant and equipment, net	2,394,541	622,785	22,175	—	3,039,501

**For the year ended December 31, 2016**

	<i>Mexico</i>	<i>United States</i>	<i>Brazil</i>	<i>Operations between Segments</i>	<i>Total</i>
	(in thousands of pesos)				
Net sales	16,361,808	9,339,527	1,814,230	—	27,515,565
Cost of sales	13,724,880	7,332,094	1,718,619	—	22,775,593
Gross profit (loss)	2,636,928	2,007,433	95,611		4,739,972
Administrative expenses	901,849	298,967	76,671		1,277,487
Other (income) expense, net	40,134	(1,481,573)	—	1,477,637	36,198
Interest income	108,004	147	—	—	108,151
Interest expense	(15,053)	(45,120)	(50,980)	70,983	(40,170)
Exchange gain (loss), net	2,343,393	42,727	765,684	(1,376,820)	1,774,984
Income (loss) before income tax	4,131,289	3,187,793	733,644	(2,783,474)	5,269,252
Income tax	667,667	256,089	2,285	—	926,041
Net income (loss)	3,463,622	2,931,704	731,359	(2,783,474)	4,343,211

<b>Other Data</b>	<b>Mexico</b>	<b>United States</b>	<b>Brazil</b>	<b>Operations between Segments</b>	<b>Total</b>
Depreciation and amortization	620,354	551,650	257,377	—	1,429,381
Total assets	33,124,471	9,684,303	5,293,891	(6,463,293)	41,639,372
Total liabilities	4,151,297	9,893,536	2,325,325	(7,940,930)	8,429,228
Additions of property, plant and equipment, net	2,169,375	816,586	114,298	—	3,100,259

**For the year ended December 31, 2015**

	<b>Mexico</b>	<b>United States</b>	<b>Brazil</b>	<b>Operations between Segments</b>	<b>Total</b>
	(in thousands of pesos)				
Net sales	14,978,728	9,467,604	29,489	—	24,475,821
Cost of sales	11,247,661	11,828,885	20,421	—	23,096,967
Impairment of property, plant and equipment	—	2,071,901	—	—	2,071,901
Gross profit (loss)	3,731,067	(4,433,182)	9,068	—	(693,047)
Administrative expenses	1,100,622	457,435	24,432	—	1,582,489

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Other (income) expense, net	(5,656)	(184,039)	16,268	—	(173,427)
Interest income	33,872	155	—	—	34,027
Interest expense	(9,987)	(47,032)	(24,805)	41,629	(40,195)
Exchange gain (loss), net	840,156	—	(496,906)	(725,312)	(382,062)
Income (loss) before income tax	3,500,142	(4,753,455)	(553,343)	(683,683)	(2,490,339)
Income tax	1,412,695	(642,123)	—	—	770,572
Net income (loss)	2,087,447	(4,111,332)	(553,343)	(683,683)	(3,260,911)
<b>Other Data</b>	<b>Mexico</b>	<b>United States</b>	<b>Brazil</b>	<b>Operations between Segments</b>	<b>Total</b>
Depreciation and amortization	747,436	512,393	1,264	—	1,261,093
Total assets	28,530,321	7,891,964	3,226,150	(7,404,019)	32,244,416
Total liabilities	1,889,025	10,808,505	1,829,524	(7,404,019)	7,123,035
Additions of property, plant and equipment, net	574,211	396	73,136	—	647,743

Our net sales by product during 2015, 2016 and 2017 were as follows:

### SALES BY PRODUCT

(in thousands of pesos)

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Light structurals	1,270,459	1,467,727	1,557,567
Structurals	1,957,388	2,321,771	2,232,979
Bars	1,272,580	1,122,116	1,065,731
Rebar	5,235,167	7,449,278	8,931,862
Flat bar	906,243	1,090,841	1,552,578
Hot rolled bars	8,568,417	7,729,167	8,594,130
Cold drawn bars	2,750,380	3,207,924	3,370,150
Other	2,515,187	3,126,741	1,395,453
Total	24,475,821	27,515,565	28,700,450

Our net sales by country or region during 2015, 2016 and 2017 are as follows:

### SALES BY COUNTRY OR REGION

(in thousands of pesos)

	<b>2015</b>	<b>2016</b>	<b>2017</b>
Mexico	14,543,446	16,077,884	16,712,874
USA	9,417,392	9,198,561	8,333,259
Brazil	—	1,828,279	3,214,117
Canada	371,610	350,673	370,803
Latin America	134,031	34,932	30,173
Other (Europe and Asia)	9,342	25,236	39,224
Total	24,475,821	27,515,565	28,700,450

### Consolidated Statements of Comprehensive Income

#### Comparison of Years Ended December 31, 2016 and 2017

*Net Sales*

Net sales increased 4%, to Ps. 28,700 million in 2017 compared to Ps. 27,516 million in 2016. This increase resulted primarily from a 4% increase in the average price per ton of steel products and an increase of 6,000 tons in shipments of finished steel products. Total sales outside of Mexico increased 5%, to Ps. 11,987 million in 2017 compared to Ps. 11,438 million in 2016. Total sales in Mexico increased 4%, from Ps. 16,078 million in 2016 to Ps. 16,713 million in 2017.

Shipments of finished steel products increased 0.3%, to 2.091 million tons in 2017, compared to 2.085 million tons in 2016. Total sales volume outside of Mexico of finished steel products increased 17% to 0.743 million tons in 2017, compared to 0.636 million tons in 2016, while total Mexican sales decreased 7%, from 1.449 million tons in 2016, compared to 1.348 million tons in 2017. The average price of steel products increased 4% in 2017 compared to 2016.

*Cost of Sales*

Our cost of sales increased 5%, from Ps. 22,776 million in 2016 to Ps. 23,994 million in 2017, which increase is mainly attributable to a 5% increase in the average price per ton of steel products sold. Cost of sales as a percentage of net sales was 84% in 2017 and 83% in 2016. We experienced higher cost of sales at our Republic facilities, mainly as a result of (i) higher labor costs corresponding to our U.S. operations, and (ii) the higher cost of raw materials, which our U.S. operations use in the production of SBQ steel. Hourly wages at our Mexican operations were approximately U.S.\$1.6 (Ps. 31) per hour in 2017 and U.S.\$1.4 (Ps. 29) per hour in 2016, compared to U.S.\$56.4 (Ps. 1,113) and U.S.\$61.3 (Ps. 1,267) per hour for 2017 and 2016, respectively, at our U.S. operations. 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.

*Gross Profit (Loss)*

Our gross profit was Ps. 4,706 million in 2017 compared to a Ps. 4,740 million gross profit in 2016. This gross profit is attributable mainly to an increase of 6,000 tons of finished steel products shipped, a 4% increase in the average price of steel products sold, and a 5% increase in the average price per ton of steel products sold. As a percentage of net sales, our gross profit was 16% in 2017 and our gross profit was 17% in 2016.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 3%, to Ps. 1,239 million in 2017, compared to Ps. 1,277 million in 2016. The variation of Ps. 38 million corresponds to the decrease of Ps. 148 million in the Mexican segment, the decrease of Ps. 42 million in the United States segment and an increase of Ps. 152 million in the Brazil segment. In 2017 and 2016, our general and administrative expenses included Ps. 125 million and Ps. 258 million, respectively, of amortization of the tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Operating expenses as a percentage of net sales were 4% in 2017 and 5% in 2016. Depreciation and amortization expense were Ps. 285 million in 2017 compared to Ps. 398 million in 2016.

*Other (Income) Expense, Net*

We recorded other income, net, of Ps. 7 million in 2017, reflecting (i) income of Ps. 10 million related to the sale of scrap, (ii) expense of Ps. 7 million in land treatment at Pacific Steel and (iii) income related to other financial operations of Ps. 4 million.

We recorded other expense, net, of Ps. 36 million in 2016, reflecting (i) income of Ps. 10 million related to the sale of scrap, (ii) expense of Ps. 35 million in the dismantling of machinery and (iii) an expense related to other financial operations of Ps. 11 million.

*Interest Income*



We recorded an interest income of Ps. 54 million in 2017 compared to Ps. 108 million in 2016. This decrease is attributable mainly to interest rates negotiated with financial services institutions.

*Interest Expense*

We recorded an interest expense of Ps. 54 million in 2017 compared to Ps. 40 million in 2016. This increase is attributable mainly to the interest rates negotiated with out lenders.

*Foreign Exchange Loss (Gain)*

We recorded a foreign exchange loss of Ps. 654 million in 2017 compared to an exchange gain of Ps. 1,775 million in 2016; this foreign exchange gain reflected the 4.5% appreciation of the peso against the dollar in 2017, compared to the 19.2% depreciation of the peso against the dollar and the 17% appreciation of the Brazilian real against the dollar in 2016.

*Income Tax*

In 2017 we recorded an income tax provision of Ps. 1,098 million, which included an income tax provision of Ps. 20 million and an income tax provision for deferred income taxes of Ps. 1,078 million. In 2016 we recorded an income tax provision of Ps. 926 million, which included an income tax provision of Ps. 57 million and an income tax provision for deferred income taxes of Ps. 869 million.

Our effective income tax rates for 2017 and 2016 were 38.9% and 17.6%, respectively. According to the Income Tax Law in Mexico, the tax rate for the year 2017 and years thereafter is 30%. We have implemented the practice of recognizing the benefit derived from the amortization of tax losses for the period in which such losses are actually amortized. In 2017 and 2016, we amortized tax losses which generated a benefit on income tax of approximately Ps. 115 million and Ps. 1,166 million, respectively. These effects caused our effective tax rates during 2016 to be lower than the statutory tax rate.

*Net Income (Loss)*

We recorded net income of Ps. 1,722 million in 2017, compared to net income of Ps. 4,343 million in 2016. The decrease in net income for the year 2017 compared to 2016 is mainly as a result of (i) the exchange loss of 654 million in 2017 compared to a foreign exchange gain of 1,775 million in 2016, (ii) in the year 2017 we had no interest compared to the year 2016 where we had \$ 67 million of interest in favor and (iii) the increase in the provision of income taxes in 2017 of Ps. 1,098 million compared to Ps. 926 million in 2016.

**Mexican Segment**

**Statements of Comprehensive Income**

**Comparison of Years Ended December 31, 2016 and 2017**

*Net Sales*

Net sales increased 4.7%, to Ps. 17,125 million in 2017 compared to Ps. 16,362 million in 2016. This increase resulted principally from a 11.5% increase in the average price per ton of steel products.

Shipments of finished steel products decreased 6%, to 1.404 million tons in 2017, compared to 1.495 million tons in 2016.

The average price of steel products increased 11.5% in 2017 compared to 2016.

*Cost of Sales*

Our cost of sales decreased 2.8%, from Ps. 13,725 million in 2016 to Ps. 13,340 million in 2017, which decrease is mainly attributable to a decrease of 91,000 tons of shipments of finished steel products. As a percentage of net sales, our cost of sales was 78% in 2017, compared to 84% in 2016.

*Gross Profit*

Our gross profit increased 43%, to Ps. 3,785 million in 2017 compared to Ps. 2,637 million in 2016. This increase is attributable mainly to an increase of 11.5% in the average price of steel products sold. As a percentage of net sales, our gross profit was 22% in 2017, compared to 16% in 2016.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 16%, to Ps. 754 million in 2017, compared to Ps. 902 million in 2016. In 2017 and 2016, our general and administrative expenses included Ps. 103 million and Ps. 245 million, respectively, of amortization of tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Administrative expenses as a percentage of net sales were 4% in 2017 and 6% in 2016. Depreciation and amortization expense were Ps. 211 million in 2017 compared to Ps. 338 million in 2016.

*Other Expense (Income), Net*

We recorded other expense, net, of Ps. 99 million in 2017, reflecting (i) an income of Ps. 10 million related to the sale of scrap, (ii) other expense of Ps. 108 million related to the acquisition of plant and equipment by the Tlaxcala plant from the Republic plant, (iii) other expense of Ps. 8 million in the land treatment at Pacific Steel and (iv) other income, net, related to other financial operations of Ps. 7 million.

We recorded other expense, net, of Ps. 40 million in 2016, reflecting (i) an income of Ps. 10 million related to the sale of scrap, (ii) other expense of Ps. 35 million related to dismantling machinery and (iii) other expense, net, related to other financial operations of Ps. 15 million.

*Interest Income*

We recorded an interest income of Ps. 54 million in 2017 compared to Ps. 108 million in 2016. This decrease is attributable mainly to interest rates negotiated with financial services institutions.



### *Interest Expense*

We recorded an interest expense of Ps. 7 million in 2017 compared to Ps. 15 million in 2016. This decrease was principally due to negotiations with our lenders in connection with commissions payable to them.

### *Foreign Exchange Gain (Loss)*

We recorded a foreign exchange loss of Ps. 1,292 million in 2017 compared to an exchange gain of Ps. 2,343 million in 2016; this foreign exchange reflected the 4.5% appreciation of the peso against the dollar in 2017.

### *Income Tax*

In 2017, we recorded an income tax provision of Ps. 762 million, which included an income tax provision of Ps. 106 million and an income tax provision for deferred income taxes of Ps. 656 million. In 2016, we recorded an income tax provision of Ps. 668 million, which included an income tax provision of Ps. 7 million and an income tax provision for deferred income taxes of Ps. 661 million.

According to the Income Tax Law in Mexico, the tax rate for the year 2017 and years thereafter is 30%.

### *Net Income*

We recorded net income of Ps. 925 million in 2017, compared to net income of Ps. 3,463 million in 2016. This decrease is attributable mainly to a foreign exchange loss of Ps. 1,292 million in 2017 compared to Ps. 2,343 million of foreign exchange gain in 2016.

## **USA Segment**

### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2016 and 2017**

*Net Sales*

Net sales decreased 10%, to Ps. 8,371 million in 2017 compared to Ps. 9,339 million in 2016. This decrease resulted principally from a decrease of 8% in the average price of steel products.

Shipments of finished steel products decreased 3%, to 387,000 tons in 2017, compared to 397,000 tons in 2016.

The average price of steel products in pesos decreased 8% in 2017 compared to 2016, derived mainly from the appreciation of the peso against the dollar in 2017.

*Cost of Sales*

Our cost of sales increased 7%, from Ps. 7,332 million in 2016 to Ps. 7,814 million in 2017, which increase is mainly attributable to an increase of 9%, approximately, in the prices of raw materials used for the production of finished products. Cost of sales as a percentage of net sales was 93% in 2017, compared to 79% in 2016.

*Gross Profit (Loss)*

Our gross profit was Ps. 557 million in 2017 compared to a Ps. 2,007 million gross profit in 2016. As a percentage of net sales, our gross profit was 7% in 2017, compared to a 21% gross profit in 2016. The selling steel prices throughout the year also impacted our margin since prices for steel products charged to our customers were gradually lower than our costs of steel purchases as a result of the time lag between the production and sales cycles.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 14%, to Ps. 257 million in 2017, compared to Ps. 299 million in 2016.

Administrative expenses as a percentage of net sales were 3% in 2017 and 3% in 2016. Depreciation and amortization expense were Ps. 37 million in 2017 compared to Ps. 58 million in 2016.



*Other Income, Net*

We recorded other income, net, of Ps. 106 million in 2017, reflecting (i) other income, net, of Ps. 108 million related to the sale of plant and equipment by Republic to the Tlaxcala plant and (ii) other expense, net, of Ps. 2 million related to other financial operations.

We recorded other income, net, of Ps. 1,482 million in 2016, reflecting (i) income of Ps. 1,478 million related to the transfer of the total assets of the Gary, Indiana plant in the United States to the current Tlaxcala plant in Mexico, through a turnkey transaction, by which Republic Steel developed the project until the start of the operations in Tlaxcala, Mexico, and (ii) other income, net, of Ps. 4 million related to other financial operations.

*Interest Income*

We recorded an interest income of Ps. 0 million in 2017 compared to Ps. 0 million in 2016.

*Interest Expense*

We recorded an interest expense of Ps. 51 million in 2017 compared to Ps. 45 million in 2016.

*Income Tax*

In 2017 we recorded an income tax provision of Ps. 322 million for deferred income taxes. In 2016 we recorded an income tax provision of Ps. 256 million for deferred income taxes.

*Net Income (Loss)*

We recorded net income of Ps. 6 million in 2017, compared to a net income of Ps. 2,932 million in 2016. The decrease in our net income in 2017 compared to the net income in 2016 is mainly due to (i) the selling steel prices throughout the year, which impacted our margin since prices for steel products charged to our customers were gradually lower than our costs of steel purchases as a result of the time lag between the production and sales cycles, and (ii) the fact



that in 2017 we had other net income of Ps. 106 million, compared to other net income of Ps. 1,482 million in 2016.

## **Brazil Segment**

### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2016 and 2017**

##### *Net Sales*

Net sales increased to Ps. 3,204 million in 2017 compared to Ps. 1,814 million in 2016. This increase resulted principally from an increase of 107 thousand tons of shipments of finished steel products and the 13.6% increase in the average price per ton of steel products.

Shipments of finished steel products increased to 300,000 tons in 2017, compared to 193,000 tons in 2016.

##### *Cost of Sales*

Our cost of sales increased to Ps. 2,840 million in 2017 compared to Ps. 1,719 million in 2016. which increase is mainly attributable to the increase of 107,000 tons in 2017 compared to 2016 and a 6.3% increase in the average cost per ton of steel products sold. Cost of sales as a percentage of net sales was 89% in 2017, compared to 95% in 2016.

##### *Gross Profit*

Our gross profit was Ps. 364 million in 2017 compared to Ps. 95 million of gross profit in 2016. This increase is attributable mainly to an increase of 107,000 tons of shipments of finished steel products and an increase of 13.6% in the average price of steel products sold. As a percentage of net sales, our gross profit was 11% in 2017, compared to 5% of gross profit in 2016.

##### *Administrative Expenses*

Our administrative expenses (including depreciation and amortization) were Ps. 228 million in 2017 compared to Ps. 77 million in 2016. Operating expenses as a percentage of net sales were 7% in 2017 compared to 4% in 2016. This increase is

59

attributable mainly due to the fact that in 2017 we worked at a production capacity of 61% and in 2016 we worked at a production capacity of 45%.

Depreciation and amortization expenses were Ps. 36 million in 2017 compared to Ps. 3 million in 2016.

*Other Expense, Net*

We did not record other expense, net, in 2017 or 2016.

*Interest Expense*

We recorded an interest expense of Ps. 65 million in 2017 compared to Ps. 51 million in 2016.

*Foreign Exchange Gain (Loss)*

We recorded a foreign exchange gain of Ps. 2 million in 2017 compared to an exchange gain of Ps. 766 million in 2016; this exchange gain was generated as a result of the payments made to suppliers during the year 2017. This foreign exchange gain reflected the 17% appreciation of the Brazilian real against the dollar in 2016 compared to 2015.

*Income Tax*

In 2017 we recorded an income tax provision of Ps. 13 million compared to Ps. 2 million in 2016.

*Net Income (Loss)*

We recorded a net income of Ps. 59 million in 2017 compared to Ps. 731 million of net income in 2016. The decrease of our net income in 2017 compared to the net income in 2016 is mainly due to the fact that in 2017 the foreign

exchange gain was Ps. 2 million and in 2016 the foreign exchange gain was Ps. 766 million.

## **Consolidated Statements of Comprehensive Income**

### **Comparison of Years Ended December 31, 2015 and 2016**

#### *Net Sales*

Net sales increased 12%, to Ps. 27,516 million in 2016 compared to Ps. 24,476 million in 2015. This increase resulted primarily from a 9% increase in the average price per ton of steel products and an increase of 59 thousand tons in shipments of finished steel products. Total sales outside of Mexico increased 15%, to Ps. 11,438 million in 2016 compared to Ps. 9,932 million in 2015. Total sales in Mexico increased 11%, from Ps. 14,543 million in 2015 to Ps. 16,078 million in 2016.

Shipments of finished steel products increased 3%, to 2.085 million tons in 2016, compared to 2.026 million tons in 2015. Total sales volume outside of Mexico of finished steel products increased 0.6% to 0.636 million tons in 2016, compared to 0.632 million tons in 2015, while total Mexican sales decreased 0.2%, from 1.452 million tons in 2015, compared to 1.449 million tons in 2016. The average price of steel products increased 9% in 2016 compared to 2015.

#### *Cost of Sales*

Our cost of sales decreased 1%, from Ps. 23,097 million in 2015 to Ps. 22,776 million in 2016, which decrease is mainly attributable to a 4% decrease in the average price per ton of steel products sold and the impairment recorded of the coke inventory. Cost of sales as a percentage of net sales was 83% in 2016 and 94% in 2015. We experienced higher cost of sales at our Republic facilities, mainly a result of (i) higher labor costs corresponding to our U.S. operations, and (ii) the higher cost of raw materials, which our U.S. operations use in the production of SBQ steel. Hourly wages at our Mexican operations were approximately U.S.\$1.4 (Ps. 29) per hour in 2016 and U.S.\$1.7 (Ps. 35) per hour in 2015, compared to U.S.\$61.3 (Ps. 1,267) and U.S.\$52.5 (Ps. 1,085) per hour for 2016 and 2015, respectively, at our U.S. operations. 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.

*Gross Profit (Loss)*

Our gross profit was Ps. 4,740 million in 2016 compared to a Ps. 693 million gross loss in 2015. This gross profit is attributable mainly to an increase of 59 thousand tons of finished steel products shipped, a 9% increase in the average price of steel products sold, a 4% decrease in the average price per ton of steel products sold and in 2015 we registered the impairment of property, plant and equipment of Ps. 2,072 million (U.S. \$130.7 million). As a percentage of net sales, our gross profit was 17% in 2016 and our gross loss was 3% in 2015.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 19%, to Ps. 1,277 million in 2016, compared to Ps. 1,582 million in 2015. The decrease of Ps. 305 million in 2016 compared to 2015 is attributable principally to the fact that in 2015 we made the following payments, which we did not make in 2016: (i) Ps. 178 million in royalties to Industrias CH for use of their brands, (ii) Ps. 78 million related to fees for legal services and (iii) expenses of Ps. 76 million corresponding to severance payments in Republic, which were made in 2015. In 2016 and 2015, our general and administrative expenses included Ps. 258 million and Ps. 256 million, respectively, of amortization of the tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Operating expenses as a percentage of net sales were 5% in 2016 and 6% in 2015. Depreciation and amortization expense were Ps. 398 million in 2016 compared to Ps. 419 million in 2015.

*Other (Expense) Income, Net*

We recorded other expense, net, of Ps. 36 million in 2016, reflecting (i) income of Ps. 10 million related to the sale of scrap, (ii) expense of Ps. 35 million in the dismantling of machinery and (iii) an expense related to other financial operations of Ps. 11 million.

We recorded other income, net, of Ps. 173 million in 2015, reflecting (i) income of Ps. 4 million related to the sale of scrap, (ii) income of Ps. 174 million related to proceeds from a settlement with a client and (iii) an expense related to other financial operations of Ps. 5 million.

*Interest Income*

We recorded an interest income of Ps. 108 million in 2016 compared to Ps. 34 million in 2015. This increase is attributable mainly to better interest rates negotiated with financial services institutions.

#### *Interest Expense*

We recorded an interest expense of Ps. 40 million in 2016 compared to Ps. 40 million in 2015.

#### *Foreign Exchange Gain (Loss)*

We recorded a foreign exchange gain of Ps. 1,775 million in 2016 compared to an exchange loss of Ps. 382 million in 2015; this foreign exchange gain reflected the 19.2% depreciation of the peso against the dollar and the 17% appreciation of the Brazilian real against the dollar in 2016, compared to the 47% depreciation of the Brazilian real against the dollar and the 17.7% depreciation of the peso against the dollar in 2015.

#### *Income Tax*

In 2016 we recorded an income tax provision of Ps. 926 million, which included an income tax provision of Ps. 57 million and an income tax provision for deferred income taxes of Ps. 869 million. In 2015 we recorded an income tax provision of Ps. 771 million, which included an income tax provision of Ps. 1,598 million and an income tax benefit for deferred income taxes of Ps. 827 million. The income tax of 2015 includes Ps. 1,333 million that was paid by Simec International 6 S.A. de C.V. and Simec International 8 S.A. de C.V. arising from a review by the tax authority initiated in July 2015 to the fiscal year ended December 31, 2010, due to a difference of opinion on the deduction of losses on disposal of treasury bonds of the United States.

Our effective income tax rates for 2016 and 2015 were 17.6% and 22.5%, respectively. According to the Income Tax Law in Mexico, the tax rate for the year 2016 and years thereafter is 30%. We have implemented the practice of recognizing the benefit derived from the amortization of tax losses for the period in which such losses are actually amortized. In 2016 and 2015, we amortized tax losses which generated a benefit on income tax of approximately Ps. 1,166 million and Ps. 39 million, respectively. These effects caused our effective tax rates during 2016 and 2015 to be lower than the statutory tax rate.

*Net Income (Loss)*

We recorded net income of Ps. 4,343 million in 2016, compared to net loss of Ps. 3,261 million in 2015. This income is attributable mainly to (i) an increase of 59 thousand shipments of finished steel products, (ii) an increase of 9% in the average price of steel products sold, (iii) the 4% decrease in the average price per ton of steel products sold and (iv) a foreign exchange gain of Ps. 1,775 million in 2016 compared to Ps. 382 million of foreign exchange loss in 2015.

**Mexican Segment**

**Statements of Comprehensive Income**

**Comparison of Years Ended December 31, 2015 and 2016**

*Net Sales*

Net sales increased 9%, to Ps. 16,362 million in 2016 compared to Ps. 14,978 million in 2015. This increase resulted principally from a 6% increase in the average price per ton of steel products and an increase of 43 thousand tons of shipments of finished steel products.

Shipments of finished steel products increased 3%, to 1.495 million tons in 2016, compared to 1.452 million tons in 2015.

The average price of steel products increased 6% in 2016 compared to 2015.

*Cost of Sales*

Our cost of sales increased 22%, from Ps. 11,248 million in 2015 to Ps. 13,725 million in 2016, which increase is mainly attributable to a 18% increase in the cost of sales of our products sold and the increase of 43 thousand tons of shipments of finished steel products. As a percentage of net sales, our cost of sales was 84% in 2016, compared to 75% in 2015.

*Gross Profit*

Our gross profit decreased 29%, to Ps. 2,637 million in 2016 compared to Ps. 3,731 million in 2015. This decrease is attributable mainly to an increase of 18% in the average price of steel products sold. As a percentage of net sales, our gross profit was 16% in 2016, compared to 25% in 2015.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 18%, to Ps. 902 million in 2016, compared to Ps. 1,101 million in 2015. Such decrease is attributable principally to the fact that in 2015 we had an administrative expense of Ps. 178 million in royalties paid to Industrias CH for use of their brands, which we did not have in 2016. In 2016 and 2015, our general and administrative expenses included Ps. 245 million and Ps. 245 million, respectively, of amortization of the tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Administrative expenses as a percentage of net sales were 6% in 2016 and 7% in 2015. Depreciation and amortization expense were Ps. 338 million in 2016 compared to Ps. 366 million in 2015.

*Other Expense (Income), Net*

We recorded other expense, net, of Ps. 40 million in 2016, reflecting (i) an income of Ps. 10 million related to the sale of scrap, (ii) other expense of Ps. 35 million related to dismantling machinery and (iii) other expense, net, related to other financial operations of Ps. 15 million.

We recorded other income, net, of Ps. 6 million in 2015, reflecting (i) an income of Ps. 4 million related to the sale of scrap and (ii) other income related to other financial operations of Ps. 2 million.

*Interest Income*

We recorded an interest income of Ps. 108 million in 2016 compared to Ps. 34 million in 2015. This increase is attributable mainly to better interest rates negotiated with financial services institutions.





### *Interest Expense*

We recorded an interest expense of Ps. 15 million in 2016 compared to Ps. 10 million in 2015. This increase was principally due to negotiations with our lenders in connection with commissions payable to them.

### *Foreign Exchange Gain (Loss)*

We recorded a foreign exchange gain of Ps. 2,343 million in 2016 compared to an exchange gain of Ps. 840 million in 2015; this foreign exchange reflected the 19.2% depreciation of the peso against the dollar in 2016.

### *Income Tax*

In 2016, we recorded an income tax provision of Ps. 668 million, which included an income tax provision of Ps. 7 million and an income tax provision for deferred income taxes of Ps. 661 million. In 2015 we recorded an income tax provision of Ps. 1,413 million, which included an income tax provision of Ps. 1,598 million and an income tax benefit for deferred income taxes of Ps. 185 million. The income tax of 2015 includes Ps. 1,333 million that was paid by Simec International 6 S.A. de C.V. and Simec International 8 S.A. de C.V. arising from a review by the tax authority initiated in July 2015 to the fiscal year ended December 31, 2010, due to a difference of opinion on the deduction of losses on disposal of treasury bonds of the United States.

According to the Income Tax Law in Mexico, the tax rate for the year 2016 and years thereafter is 30%.

### *Net Income*

We recorded net income of Ps. 3,463 million in 2016, compared to net income of Ps. 2,087 million in 2015. This increase is attributable mainly to (i) an increase of 43 thousand shipments of finished steel products, (ii) an increase of 6% in the average price of steel products sold, and (iii) a foreign exchange gain of Ps. 2,343 million in 2016 compared to Ps. 840 million of foreign exchange gain in 2015.

## **USA Segment**

### **Statements of Comprehensive Income**

## Comparison of Years Ended December 31, 2015 and 2016

### *Net Sales*

Net sales decreased 1%, to Ps. 9,339 million in 2016 compared to Ps. 9,468 million in 2015. This decrease resulted principally from a decrease of 173 thousand tons of shipments of finished steel products.

Shipments of finished steel products decreased 30%, to 397 thousand tons in 2016, compared to 570 thousand tons in 2015.

The average price of steel products in pesos increased 41% in 2016 compared to 2015. Also, surcharges of scrap have affected the sales price due to a consistently low level of scrap cost.

### *Cost of Sales*

Our cost of sales decreased 38%, from Ps. 11,829 million in 2015 to Ps. 7,332 million in 2016, which decrease is mainly attributable to a 30% decrease in shipments of finished steel products, a decrease of 11% in the prices of raw materials used for the production of finished products and to the fact that in 2016 Ps. 466 million was charged against the cost of sales as a result of the increase in the value of the coke inventory, compared to Ps. 552 million in 2015. Cost of sales as a percentage of net sales was 79% in 2016, compared to 125% in 2015.

### *Gross Profit (Loss)*

Our gross profit was Ps. 2,007 million in 2016 compared to a Ps. 4,433 million gross loss in 2015. As a percentage of net sales, our gross profit was 21% in 2016, compared to a 47% gross loss in 2015. The selling steel prices throughout the year also impacted our margin since prices for steel products charged to our customers were gradually lower than our costs of steel purchases as a result of the time lag between the production and sales cycles.

### *Administrative Expenses*

Our administrative expenses (including depreciation and amortization) decreased 35%, to Ps. 299 million in 2016, compared to Ps. 457 million in 2015.

Administrative expenses as a percentage of net sales were 4% in 2016 and 5% in 2015. Depreciation and amortization expense were Ps. 58 million in 2016 compared to Ps. 67 million in 2015.

*Other Income, Net*

We recorded other income, net, of Ps. 1,482 million in 2016, reflecting (i) income of Ps. 1,478 million related to the transfer of the total assets of the Gary, Indiana plant in the United States to the current Tlaxcala plant in Mexico, through a turnkey transaction, by which Republic Steel developed the project until the start of the operations in Tlaxcala, Mexico, and (ii) other income, net of Ps. 4 million related to other financial operations.

We recorded other income, net, of Ps. 184 million in 2015, reflecting (i) income of Ps. 174 million related to proceeds from a settlement with a client and (ii) other income, net of Ps. 10 million related to other financial operations.

*Interest Income*

We recorded an interest income of Ps. 0.1 million in 2016 compared to Ps. 0.2 million in 2015.

*Interest Expense*

We recorded an interest expense of Ps. 45 million in 2016 compared to Ps. 47 million in 2015.

*Income Tax*

In 2016 we recorded an income tax provision of Ps. 256 million for deferred income taxes. In 2015 we recorded an income tax benefit of Ps. 642 million for deferred income taxes.

*Net Income (Loss)*

We recorded net income of Ps. 2,932 million in 2016, compared to a net loss of Ps. 4,111 million in 2015. Our net income is attributable mainly to (i) the increase of 41% in the average price of steel products sold, (ii) a decrease of 11% in the prices of raw materials used for the production of finished products and (iii) other income, net, of Ps. 1,482 million.

## **Brazil Segment**

### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2015 and 2016**

Our segment in Brazil started operations in late 2015. The information presented for 2016 is not comparable with 2015 because the information presented for 2016 corresponds to a full year of operations, while the information presented for 2015 corresponds only to a few months of operations.

#### *Net Sales*

Net sales increased to Ps. 1,814 million in 2016 compared to Ps. 29 million in 2015. This increase resulted principally from an increase of 189 thousand tons of shipments of finished steel products.

Shipments of finished steel products increased to 193 thousand tons in 2016, compared to 4 thousand tons in 2015.

#### *Cost of Sales*

Our cost of sales increased to Ps. 1,719 million compared to Ps. 20 million in 2015. Cost of sales as a percentage of net sales was 95% in 2016, compared to 69% in 2015.

#### *Gross Profit*

Our gross profit was Ps. 95 million in 2016 compared to Ps. 9 million of gross profit in 2015. As a percentage of net sales, our gross profit was 5% in 2016, compared to 31% of gross loss in 2015.



*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) were Ps. 77 million in 2016 compared to Ps. 24 million in 2015. Operating expenses as a percentage of net sales were 4% in 2016 compared to 83% in 2015. Depreciation and amortization expense were Ps. 3 million in 2016 compared to Ps. 1 million in 2015.

*Other Expense, Net*

We did not record other expense, net, in 2016. We recorded other expense, net, of Ps. 16 million in 2015, reflecting other expenses related to other financial operations.

*Interest Expense*

We recorded an interest expense of Ps. 51 million in 2016 compared to Ps. 25 million in 2015.

*Foreign Exchange Gain (Loss)*

We recorded a foreign exchange gain of Ps. 766 million in 2016 compared to an exchange loss of Ps. 497 million in 2015; this foreign exchange reflected the 17% appreciation of the Brazilian real against the dollar in 2016 compared to 2015.

*Income Tax*

In 2016 we recorded an income tax provision of Ps. 2 million, while in 2015 we did not record any income tax.

*Net Income (Loss)*

We recorded a net income of Ps. 731 million in 2016 compared to Ps. 553 million of net loss in 2015.



## Consolidated Statements of Comprehensive Income

### Comparison of Years Ended December 31, 2014 and 2015

#### *Net Sales*

Net sales decreased 9%, to Ps. 24,476 million in 2015 compared to Ps. 26,829 million in 2014. This decrease resulted principally from a 1% decrease in the average price per ton of steel products and a decrease of 171 thousand shipments of finished steel products. Total sales outside of Mexico decreased 22%, to Ps. 9,932 million in 2015 compared with Ps. 12,664 million in the same period of 2014. Total sales in Mexico increased 3%, from Ps. 14,165 million in 2014 to Ps. 14,543 million in 2015.

Shipments of finished steel products decreased 8%, to 2.026 million tons in 2015, compared to 2.197 million tons in 2014. Total sales volume outside of Mexico of finished steel products decreased 24% to 0.632 million tons in 2015, compared to 0.837 million tons in 2014, while total Mexican sales increased 2%, from 1.360 million tons in 2014, compared to 1.394 million tons in 2015.

The average price of steel products decreased 1% in 2015 compared to 2014.

#### *Cost of Sales*

Our cost of sales decreased 9%, from Ps. 25,492 million in 2014 to Ps. 23,097 million in 2015, which decrease is mainly attributable to (i) a 1% decrease in the average price per ton of steel products sold, and (ii) an decrease of 171 thousand tons of finished steel products shipped. Cost of sales as a percentage of net sales was 95% in 2015 and 2014. We experienced higher cost of sales at our Republic facilities, mainly a result of (i) higher labor costs corresponding to our U.S. operations, and (ii) the higher cost of raw materials, which our U.S. operations use in the production of SBQ steel. Hourly wages at our Mexican operations were approximately U.S.\$1.7 (Ps. 30) per hour in 2015 and U.S.\$2.0 (Ps. 29) per hour in 2014, compared to U.S.\$52.5 (Ps. 909) and U.S.\$50 (Ps. 736) per hour for 2015 and 2014, respectively, at our U.S. operations. 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.

*Impairment of Property, Plant and Equipment*

We made an analysis of the fair value of the Lorain facility with the assistance of an independent valuation firm and determined the net book value exceeded the fair value by approximately Ps. 2,072 million (U.S.\$130.7 million) and as such, recognized an asset impairment of this amount during the year ended December 31, 2015.

*Gross (Loss) Profit*

Our gross loss was Ps. 693 million in 2015 compared to Ps. 1,337 million of gross profit in 2014. This gross loss is attributable mainly to the impairment of property, plant and equipment and a decrease of 171 thousand tons of finished steel products shipped. As a percentage of net sales, our gross loss was 3% in 2015 and our gross profit was 5% in 2014.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) increased 32%, to Ps. 1,582 million in 2015, compared to Ps. 1,194 million in 2014. The increase of Ps. 388 million in 2015 compared to 2014, is attributable principally to (i) Ps. 178 million in royalties paid to Industrias CH for use of their brands, (ii) Ps. 78 million related to fees paid for legal services and (iii) expenses of Ps. 76 million corresponding to severance payments in Republic. In 2015 and 2014, our general and administrative expenses included Ps. 256 million and Ps. 254 million, respectively, of amortization of the tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Operating expenses as a percentage of net sales were 6% in 2015 and 4% in 2014. Depreciation and amortization expense were Ps. 419 million in 2015 compared to Ps. 393 million in 2014.

*Other Income (Expense), Net*

We recorded other income, net of Ps. 173 million in 2015, reflecting (i) income of Ps. 4 million related to the sale of scrap, (ii) income of Ps. 174 million related to proceeds from a settlement with a client and (iii) an expense related to other financial operations of Ps. 5 million.

We recorded other income, net of Ps. 61 million in 2014, reflecting (i) expenses of Ps. 1 million corresponding to land remediation work at Pacific Steel (ii) an expense of Ps. 2 million related to the write-off of certain account balances (iii) an income of Ps. 29 million related to the sale of scrap and (iv) an income related to other financial operations of Ps. 35 million.

#### *Interest Income*

We recorded an interest income of Ps. 34 million in 2015 compared to Ps. 25 million in 2014. This increase is attributable mainly to better interest rates negotiated with financial services institutions.

#### *Interest Expense*

We recorded an interest expense of Ps. 40 million in 2015 compared to Ps. 23 million in 2014. This increase was principally due to negotiations with our lenders in connection with commissions payable to them.

#### *Foreign Exchange Gain (Loss)*

We recorded a foreign exchange loss of Ps. 382 million in 2015 compared to an exchange gain of Ps. 474 million in 2014; this foreign exchange loss reflected the 47% depreciation of the Brazilian real against the dollar and the 17.7% depreciation of the peso against the dollar in 2015 compared to the 13% depreciation of the peso against the dollar in 2014.

#### *Income Tax*

In 2015 we recorded an income tax provision of Ps. 771 million, which included an income tax provision of Ps. 1,598 million and an income tax benefit for deferred income taxes of Ps. 827 million. The income tax of 2015 includes Ps. 1,333 million that was paid by Simec International 6 S.A. de C.V. and Simec International 8 S.A. de C.V. arising from a review by the tax authority initiated in July 2015 to the fiscal year ended December 31, 2010, by difference of opinion on the deduction of losses on disposal of treasury bonds of the United States. In 2014 we recorded an income tax provision of Ps. 162 million, which included an income tax provision of Ps. 278 million and an income tax benefit for deferred income taxes of Ps. 116 million.

Our effective income tax rates for 2015 and 2014 were 22.5% and 23.8%, respectively. According to the Income Tax Law in Mexico, the tax rate for the year 2015 and years thereafter is 30%. We have implemented the practice of recognizing the benefit derived from the amortization of tax losses for the period in which such losses are actually amortized. In 2015 and 2014, we amortized

tax losses which generated a benefit on income tax of approximately Ps. 39 million and Ps. 145 million, respectively. These effects caused our effective tax rates during 2015 and 2014 to be lower than the statutory tax rate.

### *Net (Loss) Income*

We recorded net loss of Ps. 3,261 million in 2015, compared to net income of Ps. 518 million in 2014. This loss attributable mainly to (i) a decrease of 171 thousand shipments of finished steel products, (ii) an expense of Ps. 2,072 million related to impairment charges in Republic, (iii) a foreign exchange loss of Ps. 419 million in 2015 compared to Ps. 474 million of foreign exchange gain in 2014 and (iv) the Ps. 1,333 million that was paid by Simec International 6, S.A. de C.V. and Simec International 8, S.A. de C.V. derived by a review initiated in July 2015 to the fiscal year 2010 by the tax authority, by difference of opinion on the deduction of losses on disposal of treasury bonds of the United States.

## **Mexican Segment**

### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2014 and 2015**

### *Net Sales*

Net sales increased 3%, to Ps. 14,978 million in 2015 compared to Ps. 14,518 million in 2014. This increase resulted principally from a 1% increase in the average price per ton of steel products and an increase of 33 thousand tons of shipments of finished steel products.

Shipments of finished steel products increased 3%, to 1.452 million tons in 2015, compared to 1.419 million tons in 2014.

The average price of steel products increased 1% in 2015 compared to 2014.

### *Cost of Sales*

Our cost of sales decreased 7%, from Ps. 12,076 million in 2014 to Ps. 11,248 million in 2015, which decrease is mainly attributable to a 9% decrease in the prices of raw materials used for the production of finished products. As a percentage of net sales, our cost of sales was 75% in 2015, compared to 83% in 2014.

#### *Gross Profit*

Our gross profit increased 53%, to Ps. 3,731 million in 2015 compared to Ps. 2,442 million in 2014. This increase is attributable mainly to a 9% decrease in the prices of raw materials used for the production of finished products and an increase of 33 thousand tons of shipments of finished steel products. As a percentage of net sales, our gross profit was 25% in 2015, compared to 17% in 2014.

#### *Administrative Expenses*

Our administrative expenses (including depreciation and amortization) increased 35%, to Ps. 1,101 million in 2015, compared to Ps. 818 million in 2014. Such increase is attributable principally to (i) an administrative expense of Ps. 178 million in royalties paid to Industrias CH for use of their brands, (ii) Ps. 78 million related to fees paid for legal services and (iii) other administrative expenses in our plants in Mexico. In 2015 and 2014, our general and administrative expenses included Ps. 245 million and Ps. 245 million, respectively, of amortization of the tangible and intangible assets registered principally in connection with the acquisition of Grupo San.

Administrative expenses as a percentage of net sales were 7% in 2015 and 6% in 2014. Depreciation and amortization expense were Ps. 366 million in 2015 compared to Ps. 331 million in 2014.

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

We recorded other income, net of Ps. 6 million in 2015, reflecting (i) an income of Ps. 4 million related to the sale of scrap and (ii) other income related to other financial operations of Ps. 2 million.

We recorded other income, net of Ps. 30 million in 2014, reflecting (i) an expenses of Ps. 1 million corresponding to land remediation work at Pacific Steel (ii) an expense of Ps. 2 million related to the deputation of some account balances (iii) an income of Ps. 4 million related to adjustments in inflation for taxes returned to us and (iv) other income related to other financial operations of Ps. 29 million.

*Interest Income*

We recorded an interest income of Ps. 34 million in 2015 compared to Ps. 25 million in 2014. This increase is attributable mainly to better interest rates negotiated with financial services institutions.

*Interest Expense*

We recorded an interest expense of Ps. 10 million in 2015 compared to Ps. 7 million in 2014. This increase was principally due to negotiations with our lenders in connection with commissions payable to them.

*Foreign Exchange Gain (Loss)*

We recorded a foreign exchange gain of Ps. 840 million in 2015 compared to an exchange gain of Ps. 491 million in 2014; this foreign exchange reflected the 17.7% depreciation of the peso against the dollar in 2015 and the 47% depreciation of the Brazilian real against the dollar in 2015 compared to the 13% depreciation of the peso against the dollar in 2014.

*Income Tax*

In 2015 we recorded an income tax provision of Ps. 1,413 million, which included an income tax provision of Ps. 1,598 million and an income tax benefit for deferred income taxes of Ps. 185 million. The income tax of 2015 includes Ps. 1,333 million that was paid by Simec International 6 S.A. de C.V. and Simec International 8 S.A. de C.V. arising from a review by the tax authority initiated in July 2015 to the fiscal year ended December 31, 2010, by difference of opinion on the deduction of losses on disposal of treasury bonds of the United States. In 2014 we recorded an income tax provision of Ps. 222 million, which included an income tax provision of Ps. 278 million and an income tax benefit for deferred income taxes of Ps. 56 million.

According to the Income Tax Law in Mexico, the tax rate for the year 2015 and years thereafter is 30%.

*Net Income*

We recorded net income of Ps. 2,087 million in 2015, compared to net income of Ps. 1,940 million in 2014. Net income for 2015 remains virtually equal to the net income generated in 2014, due to the increase in tons sold that offset the additional expense of income tax.

## **USA Segment**

### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2014 and 2015**

##### *Net Sales*

Net sales decreased 23%, to Ps. 9,468 million in 2015 compared to Ps. 12,310 million in 2014. This decrease resulted principally from a decrease of 208 thousand tons of shipments of finished steel products.

Shipments of finished steel products decreased 27%, to 570 thousand tons in 2015, compared to 778 thousand tons in 2014.

The average price of steel products in pesos increased 5% in 2015 (in dollars decreased 14%) compared to 2014, mainly as a result of lower prices in the steel market. Also, surcharges of scrap have affected the sales price due to a consistently low level of scrap cost.

##### *Cost of Sales*

Our cost of sales decreased 12%, from Ps. 13,416 million in 2014 to Ps. 11,829 million in 2015, which decrease is mainly attributable to a 27% decrease in shipments of finished steel products and the decrease of 25% in the prices of raw materials used for the production of finished products. In 2015 we made a charge to the cost of sales for an inventory valuation allowance of Ps. 681 million. Cost of sales as a percentage of net sales was 125% in 2015, compared to 109% in 2014.



*Impairment of Property, Plant and Equipment*

We made an analysis of the fair value of the Lorain facility with the assistance of an independent valuation firm and determined the net book value exceeded the fair value by approximately Ps. 2,072 million (U.S.\$130.7 million) and as such, recognized an asset impairment of this amount during the year ended December 31, 2015.

*Gross (Loss) Profit*

Our gross loss was Ps. 4,433 million in 2015 compared to Ps. 1,106 million of gross loss in 2014. This gross loss is attributable mainly to the impairment of property, plant and equipment of Ps. 2,072 million (U.S.\$130.7 million), a decrease of 208 thousand tons of shipments of finished steel products and the charge to the cost of sales for an inventory valuation allowance of Ps. 681 million. As a percentage of net sales, our gross loss was 47% in 2015, compared to 9% of gross loss in 2014. The selling steel prices throughout the year also impacted our margin since prices for steel products charged to our customers were gradually lower than our costs of steel purchases as a result of the time lag between the production and sales cycles.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) increased 36%, to Ps. 457 million in 2015, compared to Ps. 335 million in 2014. The administrative expenses in dollars increased by U.S.\$3.6 million (Ps. 74 million), due to the expenses of U.S.\$3.8 million corresponding to severance payments (Ps. 76 million), the other difference in pesos of Ps. 46 million corresponds to 17.7% depreciation of the peso against the dollar, the amount in pesos is recorded as an increase.

Administrative expenses as a percentage of net sales were 5% in 2015 and 3% in 2014. Depreciation and amortization expense were Ps. 67 million in 2015 compared to Ps. 62 million in 2014.

*Other Income, Net*

We recorded other income, net of Ps. 184 million in 2015, reflecting (i) income of Ps. 174 million related to proceeds from a settlement with a client and (ii) other income, net of Ps. 10 million related to other financial operations.

We recorded other income, net of Ps. 31 million in 2014, reflecting an income of (i) Ps. 29 million related to the sale of scrap and (ii) Ps. 2 million related to other financial operations.

#### *Interest Income*

We recorded an interest income of Ps. 0.2 million in 2015 compared to Ps. 0.4 million in 2014.

#### *Interest Expense*

We recorded an interest expense of Ps. 47 million in 2015 compared to Ps. 25 million in 2014.

#### *Income Tax*

In 2015 we recorded an income tax benefit of Ps. 642 million for deferred income taxes. In 2014 we recorded an income tax benefit of Ps. 60 million for deferred income taxes.

#### *Net Loss*

We recorded net loss of Ps. 4,111 million in 2015, compared to net loss of Ps. 1,374 million in 2014. This increase in our net loss is attributable mainly to (i) an expense of Ps. 2,072 million related to asset impairment charges, (ii) a decrease of 208 thousand tons of shipments of finished steel products and (iii) the charge to the cost of sales for an inventory valuation allowance of Ps. 681 million.

### **Brazil Segment**

#### **Statements of Comprehensive Income**

#### **Comparison of Years Ended December 31, 2014 and 2015**

Our segment in Brazil started operations in late 2015; the information presented is not comparable with 2014 because in that year we did not have production and sale of our products.

*Net Sales*

Our net sales were Ps. 29 million in 2015. Our shipments of finished steel products in 2015 were 4 thousand tons.

*Cost of Sales*

Our cost of sales was Ps. 20 million in 2015. As a percentage of net sales, our cost of sales was 69% in 2015.

*Gross Profit*

Our gross profit was Ps. 9 million in 2015. As a percentage of net sales, our gross loss was 31% in 2015. The selling steel prices throughout the year also impacted our margin since prices for steel products charged to our customers were gradually lower than our costs of steel purchases as a result of the time lag between the production and sales cycles.

*Administrative Expenses*

Our administrative expenses (including depreciation and amortization) were Ps. 24 million in 2015. Operating expenses as a percentage of net sales were 83% in 2015. Depreciation and amortization expense were Ps. 1 million in 2015.

*Other Expense, Net*

We recorded other expense, net of Ps. 16 million in 2015, reflecting other expenses related to other financial operations.

*Interest Expense*

We recorded an interest expense of Ps. 25 million in 2015 compared to Ps. 15 million in 2014.

#### *Foreign Exchange Loss*

We recorded a foreign exchange loss of Ps. 497 million in 2015 compared to an exchange loss of Ps. 203 million in 2014; this foreign exchange reflected the 47% depreciation of the Brazilian real against the dollar in 2015.

#### *Income Tax*

In 2015 we did not record any income tax for 2015.

#### *Net Loss*

We recorded a net loss of Ps. 553 million in 2015. Our net loss is attributable mainly to our foreign exchange loss of Ps. 497 million.

### **Critical Accounting Policies**

The discussion in this section is based upon our consolidated financial statements, which have been prepared in accordance with IFRS. 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 cost of sales, income taxes, foreign currency transactions and exchange differences, 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 policies which require the most significant judgments and estimates used in the preparation of the financial statements relate to deferred income taxes, the impairment of property, plant and equipment, impairment of intangible assets, valuation allowance on accounts receivable and inventories obsolescence. We evaluate the recoverability of operating tax losses (NOL) carry forwards, and only for those who have probability of being recovered is determined a deferred tax asset. The final realization of deferred tax assets depends on the generation of taxable profits in the periods when the temporary differences are deductible. Upon carrying out this evaluation, we considered the expected reversal of deferred tax liabilities,

70

projected taxable profit and planning strategies. Based on the company's evaluation, it determined the amount of deferred tax assets that is more likely than not to be realized in the future against those taxable profits.

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 flows 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 June of 2015 Republic Steel temporarily idled the newly constructed electric arc furnace at the Lorain, Ohio, facility in response to the severe economic downturn in the energy exploration sector following the sharp drop in the price of oil which has led to significant market declines and demand for product. As a consequence of this event management determined a triggering event took place to where the long-lived assets at the Lorain facility may not be fully recoverable. Management performed an analysis of the fair value of the Lorain facility with the assistance of an independent valuation firm and determined the net book value exceeded the fair value by approximately U.S.\$130.7 million (Ps. 2,701 million) and as such recognized an asset impairment of this amount during the year ended December 31, 2015. The fair value determination at the Lorain facility was based on an independent valuation of the Lorain melt shop assets using the comparable match method of the market approach. The income approach was not considered an appropriate fair value measurement due to the absence of reliable forecast data as the facility was idled indefinitely in early 2016.

As of the date of this report, management has no near-term plans to restart the facility. The expectation is that it will be restarted when market conditions improve substantially, particularly in the oil and gas industry. We have property, plant and equipment with a net book value of approximately U.S.\$46.9 million (Ps. 969 million) as of December 31, 2016, pertaining to the Lorain Ohio facility after recording the impairment charge of U.S.\$130.7 million (Ps. 2,700 million) in 2015 (the impairment charge did not impact the cash flows, as it was not a cash expenditure). Management further assessed if there were any impairments at the Company's other asset groups in accordance with IFRS and determined that as of December 31, 2017, no other asset groups were impaired based on current projections. No further impairment was considered necessary or appropriate.

In assessing the recoverability of the goodwill and other intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. We perform 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. We estimate the reporting unit's fair value based on a discounted future cash flow approach that requires estimating income from operations. In order to estimate our cash flows used in impairment computations, we considered the following:

our history of earnings;

our history of capital expenditures;

the remaining useful lives of our primary assets;

current and expected market and operating conditions; and

our weighted average cost of capital.

Other intangible assets are mainly comprised of trademarks, customer list and non-competition agreements. When impairment indicators exist, or at least annually for indefinite live intangibles, we determine our projected revenue streams over the estimated useful life of the asset. In order to obtain undiscounted and discounted cash flows attributable to each intangible asset, such revenues are adjusted for operating expenses, changes in working capital and other expenditures as applicable, and discounted to net present value using the risk adjusted discount rates of return. As of December 31, 2016 and 2017 there was no impairment charge to other intangible assets.

As a result of the downturn in the construction industry in Mexico during 2009 and the negative impact the downturn had on our operations mainly at the San Luis facilities, in which goodwill resides we adjusted the key assumptions used in the valuation model. As of December 31, 2016 and 2017, there was no impairment charge related to the San Luis facilities.



As of December 31, 2017, the main key assumptions used in the valuation models of the San Luis reporting unit are as follows:

discount rate:  
13%; and

sales: we estimate an increase in sales volume of approximately 24.2% in 2018 and 7.4% in 2019, mainly attributable to the increase in volume due to the start of production of the new industrial wire product and an increase of 7% in the sale prices for the year 2018. After 2020, no sales increases in volume terms are considered in the valuation model and for the years after 2019, only an increase in sales prices proportional to estimated inflation.

If these estimates or their related assumptions for prices and demand change in the future, we may be required to record additional impairment charges for these assets.

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.

We apply judgment at each balance sheet date to determine whether the slow moving inventory is impaired. Inventory is impaired when the carrying value is greater than the net realizable value.

The reserve for environmental liabilities represent the estimated environmental remediation costs that we believe are going to incur. These estimates are based on currently available data, existing technology, the current laws and regulations and take into account the likely effects of inflation and other economic and social factors. The time in which we could incur these costs cannot be determined reliably at this time due to the absence of deadlines for remediation under the laws and regulations which apply to remediation costs will be made.

### **New Accounting Pronouncements**

IASB has issued amendments to IFRS, which were enacted but some of which are not yet effective:

IFRS to be effective from 2018:

IFRS 15, Revenue for Contracts with Customers;  
IFRS 9, Financial Instruments;  
Amendment to IAS 40, Investment Property;  
Amendment to IAS 28, Investment Entity;  
Amendments to IFRS 2, related to the Classification and Measurement of Share-based Payment Transactions; and  
Interpretation IFRIC 22, Foreign Currency Transactions and Advance Consideration Issued.

IFRS to be effective from 2019:

IFRS 16, Leases;  
Amendment to IAS 28, regarding long-term interests in associates and joint ventures;  
Amendment to IAS 3, Business Combinations;  
Amendment to IAS 11, Joint Arrangements;  
Amendment to IAS 12, Income Taxes;  
Amendment to IAS 23, Borrowing Costs; and  
Interpretation IFRIC 23, to clarify the recognition of deferred tax assets for unrealised losses related to debt instruments measured at fair value.

At the date of issuance of our consolidated financial statements, these new standards have not had any effect on our financial information.

## **B. Liquidity and Capital Resources**

On December 31, 2017, our total consolidated debt was Ps. 5.960 million (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, Industrias CH and its subsidiaries and affiliates made available a line of credit in favor of Republic. Effective January 1, 2009, Industrias CH reduced the interest rate from 5.23% to 0.25% per annum. As of December 31, 2017 and 2016, Republic had Ps. 985 million (comprised of U.S.\$38 million and Ps. 227 million, including interest) and Ps. 1,016 million (comprised of U.S.\$38 million and Ps. 222 million, including interest), respectively, outstanding under this line of credit. See Note 18 to our consolidated financial statements included elsewhere herein.

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), primarily for the purpose of repaying third party indebtedness, as well as 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 Ps. 2,421 millones (U.S.\$214 million). As of December 31, 2013 we had cash and cash equivalents of Ps. 6,985 million, as of December 31, 2014 we had cash and cash equivalents of Ps. 7,003 million, as of December 31, 2015 we had cash and cash equivalents of Ps. 6,224 million, as of December 31, 2016 we had cash and cash equivalents of Ps. 7,536 million and as of December 31, 2017 we had cash and cash equivalents of Ps. 7,204 million. We believe that this amount of cash generated from operations will be sufficient to satisfy our currently anticipated cash requirements, including our currently anticipated capital expenditures.

Our principal use of cash has generally been to fund our operating activities, to acquire businesses and to fund our capital expenditure programs. The following is a summary of cash flows for the three years ended December 31, 2015, 2016 and 2017:

### Principal Cash Flows

	<b>Years ended</b>		
	<b>December 31,</b>		
	<b>2015</b>	<b>2016</b>	<b>2017</b>
Funds provided (used) by operating activities	(382)	5,822	2,772
Funds used in investing activities	(655)	(3,166)	(2,706)
Funds (used) in financing activities	(285)	(1,495)	(374)

Our net funds provided by operations were Ps. 2,772 million in 2017 compared to Ps. 5,822 million of net funds provided by operations in 2016. The decrease of Ps. 3,050 million in the net funds provided by operations between 2017 and 2016 originated mainly from the lower net income for the year 2017. Our net funds provided by operations were Ps. 5,822 million in 2016 compared to Ps. 382 million of net funds used by operations in 2015. The increase of Ps. 5,440 million in the net funds provided by operations between 2016 and 2015 originated mainly from the net income for the year.

We attribute our net funds used in investing activities primarily to the acquisition of new facilities, property, plant and equipment and other non-current assets. Our net funds used in investing activities were Ps. 2,706 million in 2017 compared to Ps. 3,166 million in 2016. In addition, in 2017 we also recovered temporary investments of Ps. 339 million. Our net funds used in investing activities were Ps. 3,166 million in 2016 compared to Ps. 655 million in 2015. In addition, in 2016 we invested Ps. 54 million in the acquisition of shares of public companies for trading.

Our net funds used by financing activities in 2017 were Ps. 374 million, compared to Ps. 1,495 million used by financing activities in 2016. In 2017, there was a decrease of Ps. 279 million in the repurchase of our own shares compared to Ps. 2,394 million used in loans to related parties and there was an increase of Ps. 938 million in the repurchase of our own shares in 2016. Our net funds used by financing activities in 2016 were Ps. 1,495 million, compared to Ps. 285 million used by financing activities in 2015. In 2016, we made loans to related parties for Ps. 2,394 million and there was an increase of Ps. 938 million in the repurchase of our own shares compared to Ps. 245 million in 2015. We do not have in place any interest rate or currency hedging instruments. We were not a party to any non-exchange traded contracts accounted for at fair value in 2017 and 2016.

As of December 31, 2017, we have the following commitments for capital expenditures:

On September 5, 2015 a turnkey contract became effective with Danieli & Officine Meccaniche Spa (Danieli) for the supply and construction (except for civil engineering) in Tlaxcala, México, of a new Mini mill for the production of 600,000 SBQ, up to a total amount of U.S.\$203.5 million (Ps. 4,205 million). The off-shore portion of the contract price is equal to U.S.\$152.5 million (Ps. 3,151 million), which will be paid to Danieli in various installments according to the project's progress, and the on-shore portion of the contract price is equal to U.S.\$51 million (Ps. 1,054), which will be paid to certain local suppliers of Danieli on a monthly basis, as instructed by them. As of December 31, 2017, the outstanding amount of this project amounts to U.S. \$ 17.9 million (Ps.353.3 million). The project is estimated to be completed in May 2018.

In January 2013, the Company entered into a 15 year product supply agreement with Air Products and Chemicals, Inc. The agreement required that Air Products and Chemicals construct and install a plant for the production of oxygen, nitrogen and argon gas on the premises of the Lorain, Ohio facility. In August of 2016, the Company entered into an agreement with Air Products and Chemicals, Inc. whereby the plant was purchased for U.S.\$30 million (Ps. 592 million) and the supply agreement cancelled in its entirety. The purchase price is repayable over 6 years in equal monthly installments of U.S.\$0.4 million (Ps. 7.9 million) after an initial payment of U.S.\$1.2 million (Ps. 23 million) and carries no interest cost. Obligations are secured by certain physical assets (operating, manufacturing, and storage equipment, buildings and machinery) at the Company's Canton facility.

In December 2017, the Company entered into a contract with the supplier COMERC, LTDA, for an amount of U.S.\$5.2 million (Ps. 103 million) for the purchase of 8,000 MWH of energy per month, for its subsidiary GV do Brasil Industria y Comercio of Aço LTDA. The monthly payments expire 6 days after the closing date of the month. The contract ends in February 2019.

In January 2018, the Company entered into a contract with the supplier ECOM, LTDA, for an amount of U.S.\$ 6.1 million (Ps. 120 million) for the purchase of 10,000 MWH of energy per month, for its subsidiary GV do Brasil Industria e Comercio de Aço LTDA. The monthly payments expire 6 days after the closing date of the month. The contract ends in February 2019.

In January 2018, the Company entered into a contract with the supplier ECOM, LTDA, for an amount of U.S.\$ 6.3 million (Ps. 124 million) for the purchase of 10,000 MWH of energy per month, for its subsidiary GV do Brasil Industria e Comercio de Aço LTDA. The monthly payments expire 6 days after the closing date of the month. The contract ends in February 2020.

On February 22, 2018, a contract was signed with Primental Technologies of Italy, the United States and Mexico for the reconstruction of the rolling mill and the supply of a new reheating furnace for the Mexicali plant, which will increase capacity of finished product manufacturing from 17,500 to 22,500 tons per month. An advance of 20% has already been paid for U.S.\$1.67 million (Ps. 33 million) and the placement of the letters of credit is in process. The term of execution of the project is 16 months and a budget of U.S.\$23.2 million (Ps. 458 million) is estimated.

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

The San Luis facilities are registered with the Mexican Institute of Industrial Property ("IMPI") and the trademarks "SAN" and "Aceros San Luis." The trademark "Grupo Simec" is registered with the IMPI. On October 11, 2017, Simec International 6, S.A. de C.V., concluded the registration of the patent "*Fabricación de Aceros de Mecanizado Fácil con Plomo en la Máquina de Colada Continua*" (Manufacture of Easy Machining Steels with Lead in Continuous Casting Machine) in the IMPI.

**D. Trend Information**

In the first quarter of 2018 net sales increased 17% compared to the fourth quarter of 2017. Sales in tons of finished steel increased 12% in the first quarter of 2018 compared with the fourth quarter of 2017. Prices of finished products sold in the first quarter of 2018 increased approximately 4.4% compared to the fourth quarter of 2017.

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 5.A “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, 2017:

	<b>Maturity</b>			<b>In</b>	
	<b>Less than 1 year</b>	<b>1– 3 years</b>	<b>4– 5 years</b>	<b>excess of 5 years</b>	<b>Total</b>
	(millions of pesos)				
Short-term debt obligations of related parties <sup>(1)</sup>	1,024	—	—	—	1,024
Short-term debt obligations	6	—	—	—	6
Long-term contractual obligations (see paragraph below)	1	1	—	—	2
Total	1,031	1	—	—	1,032

Ps. 984 million correspond to a note payable to Industrias CH (Ps. 227 million) and Tuberías Procarsa, Pytsa (1) Industrial de México and Procarsa Tube and Pipe denominated in U.S. dollars, for an indefinite term and bearing annual interest at a rate of 0.25%; Ps. 40 million correspond to other liabilities.



Republic leases certain equipment, office space and computers through operating contracts under non-cancelable operating leases. These lease contracts expire on several different dates by the end of 2020. During 2017 and 2016, the expenses for operating leases were Ps. 9.5 million (U.S.\$0.5 million) and Ps. 21 million (U.S.\$1.1 million), respectively. As of December 31, 2017, total future minimum lease payments under non-cancelable operating leases are Ps. 0.7 million (U.S.\$0.037 million) in 2018, Ps. 0.6 million (U.S.\$0.032 million) in 2019 and Ps. 0.1 million (U.S.\$0.006 million) in 2020. At December 31, 2017 there are no additional obligations after 2020.

In January 2013, Republic entered into an agreement with EnerNOC which enables Republic to receive payments for reducing the electricity consumption during a dispatch declared by PJM Interconnection as an emergency. The agreement is for 5 years, effective January 31, 2013 and expires on May 31, 2018. Republic recognized income of Ps. 19 million (U.S.\$1 million) and of Ps. 18.6 million (U.S.\$ 1 million) from this agreement in 2017 and in 2016, respectively.

In December 2017, the Company entered into a contract with the supplier COMERC, LTDA. for an amount of Ps. 102.6 million (U.S.\$ 5.2 million) for the purchase of 8,000 MWH of energy per month, for its subsidiary GV do Brasil Industria y Comercio de Aço LTDA. All monthly payments due 6 days after the closing date of the month. The contract ends in February 2019.

In January 2018, the Company entered into a contract with the supplier ECOM, LTDA. for an amount of Ps. 124.3 (U.S.\$ 6.3 million) for the purchase of 10,000 MWH of energy per month, for its subsidiary GV do Brasil Industria y Comercio de Aço LTDA, beginning the supply in 2019. All payments due monthly 6 days after the closing date of the month. The contract ends in February 2020.

## **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 five 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 bylaws, 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 CNBV. In compliance with our bylaws and applicable Mexican law, our board of directors meets on a quarterly basis and resolutions adopted by a majority of directors at the meeting are valid resolutions.



*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 2016 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, the following:

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 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 CNBV. 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 Item 6.C. "— Committees" below.

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

<b>Name</b>	<b>Director Since</b>
Rufino Vigil González	2001
Raúl Arturo Pérez Trejo	2003
Luis García Limón	2011
Rodolfo García Gómez de Parada	2001
Gerardo Arturo Avendaño Guzmán	2001

*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. 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, and is the chairman of our Audit Committee.

He has been the tax advisor of Industrias CH since 1978 and also serves as member of the board of directors of a group of self-service stores and restaurants since 1990.

**Luis García Limón.** Mr. García was born in 1944. He is currently our chief executive officer and has been a member of our board of directors since 2011. From 1982 to 1990 he was general director of Compañía Siderúrgica de Guadalajara, S.A. de C.V. (“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.

**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. 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.

**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.

## Executive Officers

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

<b>Name</b>	<b>Position</b>	<b>Position Held Since</b>
Luis García Limón	Chief Executive Officer	1982*
Mario Moreno Cortez	Coordinator of Finance	2012
Juan José Acosta Macías	Chief Operating Officer	2004

---

\* 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 and has been a member of our board of directors since 2011. 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.

**Mario Moreno Cortez.** Mr. Moreno was born in 1968. He is currently our coordinator of Finance. From 1998 to 2010 he was the general accountant within the main subsidiaries of Grupo Simec. Previously Mr. Moreno worked in various departments of the financial area within certain of our principal subsidiaries.

**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.

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 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, 2017 and 2016, we paid no fees to our five directors, and the aggregate compensation our executive officers earned was approximately Ps. 82.4 million and Ps. 71.6 million, respectively. We do not provide pension, retirement or similar benefits to our directors in their capacity as directors. Our executive officers are eligible for retirement and severance benefits required by Mexican law on the same terms as all other employees, and we do not separately set aside, accrue or determine the amount of our costs that is attributable to executive officers.

## **C. Board Practices**

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*).

## 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 audit and corporate practices committee is governed by our bylaws and Mexican law. 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 currently composed of three members. Raúl Arturo Pérez Trejo was appointed as chairman of the audit and corporate practices committee at our annual ordinary shareholders' meeting held on April 23, 2018, and Gerardo Arturo Avendaño Guzmán and Rodolfo García Gómez de Parada were re-elected as members. Raúl Arturo Pérez Trejo has been ratified as the "audit committee financial expert."

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.

Our audit and corporate practices committee met at least quarterly in 2017.

#### **D. Employees**

As of December 31, 2017, we had 3,767 employees (2,552 were employed at our Mexico facilities, of whom 1,131 were unionized, 892 were employed at Republic facilities, of whom 737 were unionized and 323 were employed at our Brazil plant, of whom 249 were unionized) compared to 3,973 employees as of December 31, 2016, (2,616 were employed at our Mexico facilities, of whom 1,189 were unionized, 1,087 were employed at Republic facilities, of whom 927 were unionized and 270 were employed at our Brazil plant, of whom 198 were unionized) and 4,420 employees as of December 31, 2015, (2,688 were employed at our Mexico facilities, of whom 1,418 were unionized, 1,503 were employed at Republic facilities, of whom 1,247 were unionized and 229 were employed at Brazil plant, of whom 135 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 collective bargaining agreements. Set forth below is the union affiliation of the employees of each of our Mexican facilities and the expiration date of the current collective bargaining agreements.



*Guadalajara facilities:* Sindicato de Trabajadores en la Industria Siderúrgica y Similares en el Estado de Jalisco. The contract expires on February 18, 2020.

*Mexicali facilities:* Sindicato de Trabajadores de la Industria Procesadora y Comercialización de Metales de Baja California. The contract expires on January 15, 2020.

*Apizaco facilities:* Sindicato Nacional de Trabajadores de Productos Metálicos, Similares y Conexos de la República Mexicana. The contract expires on January 16, 2019.

*Cholula facilities:* Sindicato Industrial “Acción y Fuerza” de Trabajadores Metalúrgicos Fundidores, Mecánicos y Conexos CROM del Estado de Puebla. The contract expires on March 1, 2020.

*San Luis facilities:* At the Aceros San Luis facility: Sindicato de Empresas adherido a la CTM, the contract expires on January 15, 2020; and at the Aceros DM facility: Sindicato de Trabajadores de la Industria Metal Mecánica, Similares y Conexos del Estado de San Luis Potosí CTM, the contract expires on January 23, 2020.

We have had good relations with the unions in our Mexican facilities. The collective bargaining agreements are renegotiated 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**

As of December 31, 2017, 83% of Republic’s workers are covered by a collective bargaining agreement with the United Steelworkers (USW). The agreement expired on August 15, 2016 and was extended for a further three years through August 15, 2019. The extended agreement renews all the provisions, understandings and agreements set forth in the January 1, 2012 Basic Labor

Agreement. The base rates of pay determined under the extended agreement will remain. The extended agreement provides that the

company's quarterly contributions to fund the Republic Retirement VEBA Benefit Trust (the "Benefit Trust") be reduced from U.S.\$2.6 million (Ps. 51 million) to U.S.\$0.25 million (Ps. 5 million) beginning in August 15, 2016 through June 30, 2019. Effective July 1, 2019, the Company's contribution to the Benefit Trust will change to U.S.\$4.00 (Ps. 83) per hour for each hour worked by USW represented employees.

For the Mexican operations, approximately 44% of the employees are under collective bargaining agreements, which expire as described above.

For the Brazil operations, approximately 77% of the employees are under collective bargaining agreements, with *Sindicato dos Metalúrgicos de Pindamonhangaba, Moreira César e Roseira afiliado a CUT*, which expires on August 31, 2018.

## **Defined Contribution Plans**

### **Steelworkers Pension Trust**

Republic participates in the Steelworkers Pension Trust (SPT), a defined benefit multi-employer pension plan. While this plan provides defined benefits as a result of lack of information, the company accounts for the plan as a defined contribution plan. Specifically, the plan does not maintain accounting records for purposes of IFRS presentation and does not provide enough information to allocate amounts between participating employers'.

The company obligations to the plan are based upon fixed contribution requirements. The company contributes a fixed dollar amount of U.S.\$1.68 (Ps. 33) per hour for each covered employee's contributory hours, as defined under the plan.

Participation in a multi-employer pension plan agreed to under the terms of a collective bargaining agreement differs from a traditional qualified single employer defined benefit pension plan. The SPT shares risks associated with the plan in the following respects:

- Contributions to the SPT by the company may be used to provide benefits to employees of other participating employers;

- If a participating employer stops contributing to the SPT, the unfunded obligations of the plan may be borne by the remaining participating employers;

- If Republic chooses to stop participating in the SPT, the company may be required to pay an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

On March 21, 2011, the Board of Trustees of the SPT elected funding relief which has the effect of decreasing the amount of required minimum contributions in near-term years, but will increase the minimum funding requirements during later plan years. As a result of the election of funding relief, the SPT's zone funding under the Pension Protection Act may be impacted.

In addition to the funding relief election, the Board of Trustees also elected a special amortization rule, which allows the SPT to separately amortize investment losses incurred during the SPT's December 31, 2008 plan year-end over a 29 year period, whereas they were previously required to be amortized over a 15 year period.

Republic's participation in the SPT for the annual periods ended December 31, 2017 and 2016, is outlined in the table below.

Pension Fund	EIN/ Pension Plan Number	Pension Protection Act Zone Status <sup>(a)</sup>		FIP/RP Status Pending/ Implemented <sup>(b)</sup>	Republic Steel Contributions (U.S.\$ in thousands)		Surcharge Imposed <sup>(c)</sup>		Expiration of Collective Bargaining Agreement
		2017	2016		2017	2016	2017	2016	
Steelworkers Pension Trust	23-6648508/499	Green	Green	No	\$2,467	\$3,153	No	No	August 15, 2019

(a)

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

The zone status is based on information that Republic received from the plan and is certified by the plan's actuary. Among other factors: plans in the green zone are at least 80% funded, plans in the yellow zone are less than 80% funded, and plans in the red zone are less than 65% funded.

- (b) Indicates if a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented.
- (c) Indicates whether there were charges to Republic from the plan.

Republic has not been listed in the plans' Forms 5500 as providing more than five percent of the total contributions for any plan years.

There have been no significant changes that affect the comparability of 2017 and 2016 contributions.

### **VEBA Benefit Trust**

Republic is required to make quarterly contributions to the VEBA Benefit Trust as determined by the terms of the USW collective bargaining agreement. The VEBA Benefit Trust is a health and welfare plan for USW retiree healthcare benefits, and is not a "qualified" plan under the regulations of the Employee Retirement Income Security Act of 1974 (ERISA). Under the terms of the extended collective bargaining agreement referred to above, the Benefit Trust contributions have been reduced from U.S.\$2.6 million (Ps. 54 million) to U.S.\$0.25 (Ps. 5 million) million per quarter, effective August 16, 2016. For the years ended December 31, 2017 and 2016, the company recorded expenses of Ps. 19 million (U.S.\$1 million) and Ps. 128.7 million (U.S.\$6.9 million), respectively, related to the Benefit Trust.

Republic recorded combined expenses of Ps. 66 million (U.S.\$3.5 million) and Ps. 186.6 million (U.S.\$10 million) for the years ended December 31, 2017 and 2016, respectively, related to the funding obligations of the Benefit Trust and SPT.

### **401(k) Plans**

Republic has a defined contribution 401(k) retirement plan that covers substantially all salaried 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 participant's 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 vesting 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% vested in both their and the company's matching 401(k) contributions. For the years ended December 31, 2017 and 2016, the company recorded expense of Ps. 15.1 million (U.S.\$0.8 million) and Ps. 13.1 million (U.S.\$0.7 million), respectively, related to this defined contribution retirement plan.

Employees who are covered by the USW labor agreement are eligible to participate in the defined contribution 401(k) retirement plan through voluntary deferrals of employees' compensation. There are no company contributions or employer matching contributions relating to these employees.

### **Profit Sharing Plans and Incentive Compensation Plans**

The labor agreement includes a profit sharing plan to which Republic is required to contribute 2.5% of its quarterly pre-tax income, as defined in the labor agreement. At the end of each year, the contribution is based upon annual pre-tax income up to U.S.\$50.0 million (Ps. 1,033 million) multiplied by 2.5%, U.S.\$50.0 million (Ps. 1,033 million) to U.S.\$100.0 million (Ps. 2,066 million) multiplied by 3.0%, and above U.S.\$100.0 million (Ps. 2,066 million) multiplied by 3.5%, less the previous payouts during the year. No expense was recorded during the years ended December 31, 2017 and 2016, because the current and prior year thresholds had not been achieved.

Republic has a profit sharing plan for all salaried and nonunion hourly employees. During 2012, the profit sharing plan was based upon achieving target Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) amounts. During 2017 and 2016, the profit sharing plan was based upon achieving certain inventory and shipment targets. During the years ended December 31, 2017 and 2016, Republic paid Ps.17 million (U.S.\$0.9 million) and Ps.11.2 million (U.S.\$0.6 million), respectively, to employees covered by the profit sharing plans.

### **E. Share Ownership**

Industrias CH and its direct wholly-owned subsidiaries currently hold approximately 84% of our series B shares. At March 31, 2018, Rufino Vigil González, the chairman of our board of directors, owned, directly or indirectly, approximately 67% of Industrias CH.

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

As of March 31, 2018, we had 493,907,186 shares of series B common stock outstanding. 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. At March 31, 2018, Rufino Vigil González, the chairman of our board of directors, owned, directly or indirectly, approximately 67% of Industrias CH.

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

The following table shows the ownership of our series B shares as of March 31, 2018.

<b>Name of Shareholder</b>	<b>Number of shares owned</b>	<b>% of shares owned</b>
Industrias CH, S.A.B. de C.V	275,369,337	55.3 %
Tuberías Procarisa, S.A. de C.V. <sup>(1)</sup>	99,461,866	20.0 %
Vigon Control, S.R.L. de C.V. <sup>(2)</sup>	31,048,736	6.2 %
Aceros y Laminados Sigosa, S.A. de C.V. <sup>(1)</sup>	4,377,776	0.9 %
Joist Estructuras S.A. de C.V. <sup>(2)</sup>	6,188,406	1.2 %
Industrial de Herramientas CH, S.A. de C.V. <sup>(2)</sup>	2,240,628	0.5 %
Public Investors	75,220,437	15.1 %
Treasury Shares	3,802,028	0.8 %
Total	497,709,214	100 %

(1) A subsidiary of Industrias CH.

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

At March 31, 2018, 493,907,186 series B common shares were held in Mexico by approximately 141 shareholders who were record holders in Mexico and 14 were ADS record holders in the United States. The ADS represent 2,232,402 common shares.

## **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 18 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 or Ps. 1,403 million at the exchange rate at that time) of Republic's stock through our majority owned subsidiary, SimRep, and Industrias CH purchased the remaining 49.8%. We financed our portion of the purchase price principally from a loan that we received through Industrias CH that has since been repaid in full.

As of December 31, 2017, we have accounts receivable to the following related parties: Proyectos Comerciales el Ninzi, S.A. de C.V. for Ps. 1,715 million, which corresponds to revolving loans granted at an interest rate equivalent to the Interbank Interest Rate of Equilibrium (TIIE) (*Tasa de Interés Interbancaria de Equilibrio*) plus 1%; and the balance related to Perfiles Comerciales Sigosa, S.A. de C.V. includes a loan for Ps. 719 million, which is not charged any interest rate. The related party loans provided to Perfiles Comerciales Sigosa, S.A. de C.V., a wholly-owned subsidiary of Industrias CH S.A.B. de C.V. and an affiliate of the Company, are for a project at the corporate level in connection with a co-investment made by Perfiles Comerciales Sigosa, S.A. de C.V. with Cualititube, S.A. de C.V. in the seam-welded tube business line. The related party loans provided to Proyectos Comerciales el Ninzi, S.A. de C.V. and Operadora Manufacturera de Tubos, S.A. de C.V. (which has been merged into Proyectos Comerciales el Ninzi, S.A. de C.V.), which are both affiliates of Industrias CH S.A.B. de C.V. and the Company, are to acquire companies that are engaged in the seam-welded tube business line.

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 purchase and/or sell steel products, primarily billet, to Industrias CH and its affiliates. In 2015, 2016 and 2017 these purchases totaled Ps. 41 million, Ps. 324 million and Ps. 52 million, respectively. In addition, in 2015, 2016 and 2017 we sold Ps. 7 million, Ps. 5 million and Ps. 4 million, respectively, of steel products to Industrias CH and its affiliates. We negotiated these prices on an arms-length basis.



We have a services agreement with Industrias CH, pursuant to which Industrias CH provides administrative services to us and our subsidiaries. The term of the agreement is indefinite. We make payments to Industrias CH on a monthly basis. Under the services agreement, in 2015, 2016 and 2017 we paid Ps. 22 million, Ps. 24 million and Ps. 26 million, respectively.

In 2015 we paid royalties to Industrias CH for the use of certain brands in an amount of Ps. 183 million. In 2016 and 2017 no such payments were made.

### **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*

On January 19, 2017, we received a letter issued by the General Director of Crimes and Sanctions of the *Comisión Nacional Bancaria y de Valores* (National Banking and Securities Commission) (the “CNBV”), notifying us that certain actions in connection with the repurchase of our own shares could be contrary to the provisions of the *Ley del Mercado de Valores* (Securities Market Law) (the “LMV”). In December 2017, the General Direction of Crimes and Sanctions of the CNBV fined the Company with the amount of Ps. 545,000. Grupo Simec appealed for reconsideration before the CNBV itself, which is pending resolution.

There are currently no other 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 which we expect to result in material capital expenditures or materially adversely affect our competitive position.

The tax authorities in Mexico have the right to review the previous five years and could determine differences in taxes payable, plus corresponding adjustments, surcharges and fines. Currently the authority is reviewing certain of our subsidiaries, and their review is still ongoing.

*United States and Canada*

On February 13, 2017, the Securities and Exchange Commission (the “SEC”) notified us of an informal inquiry it was conducting into our internal controls, specifically regarding material weaknesses in our internal control over financial reporting (“ICFR”) previously disclosed in our Form 20-Fs. We hired an experienced external consultant to assist us in remediating our internal controls and to date have implemented most of the remediation recommendations by such outside consultant. We continue to work with such consultant to complete our improvements with respect to our internal controls. We have been and intend to continue cooperating with the SEC until the final resolution of the matter. We cannot give you any assurance as to the terms of any final resolution with the SEC, but such terms could include, among other things, undertakings to remediate any remaining material weaknesses, periodic reporting on our remediation efforts and possibly other terms none of which we expect to adversely affect us in any material respect.

In connection with a sales and use tax audit by the Ohio Department of Taxation covering the period from January 1, 2009 through December 31, 2012, an assessment of U.S.\$2.4 million (Ps. 47.4 million) (including interest of \$0.4 million, Ps. 7.9 million) was issued against Republic on December 9, 2016. The Company disagrees with the assessment in its entirety and has filed a Petition for Reassessment on January 30, 2017, appealing the assessment with the Ohio Board of Tax Appeals. The Company's position is that the assessment that certain services were taxable is substantively incorrect, and based upon a misinterpretation of the relevant regulations and a misunderstanding of the facts that led the Company to determine that the services qualified for Ohio's sales and use tax exemption for manufacturers. Due to the nature of this matter and its early stages, the Company is unable to determine the amount of loss, if any, it may sustain. Accordingly, the Company has not recorded an expense in fiscal 2017 or 2016 recognizing the assessment or any estimated settlement amount.

The tax authorities in the United States have the right to review the previous three years and could determine differences in taxes payable, plus corresponding adjustments, surcharges and fines.

The tax authorities in Canada have the right to review the previous four years and could determine differences in taxes payable, plus corresponding adjustments, surcharges and fines.

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.

#### **San Diego Regional Water Quality Control Board, SDRWQCB**

On October 30, 2015, the San Diego Regional Water Quality Control Board (SDRWQCB) issued a Non-Compliance Notice to Pacific Steel, Inc. (“PS”) because PS had failed to recertify its facility for coverage under the Industrial General Storm Water Permit. PS submitted the required certification as of July 19, 2016. As of December 31, 2017, the SDRWQCB had taken no action to issue a penalty to PS for this Non-Compliance Notice.

#### **San Diego County Department of Environmental Health**

On July 28, 2016, the San Diego County Department of Public Health (DEH) issued a Notice of Violation to PS for failure to submit a Hazardous Materials Business Plan, pursuant to State law. On August 23, 2016, PS executed a Consent Order and agreed to pay a US\$1,000 fine and to submit its Hazardous Materials Business Plan within fifteen days of the effective date of the Consent Order. PS has paid the fine and submitted its Hazardous Materials Business Plan in compliance with the Consent Order.

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

In September 2002, the Department of Toxic Substances Control (DTSC) inspected Pacific Steel’s (PS) facilities based on an alleged complaint from neighbors due to PS’s excavating to recover scrap metal on its property and on a neighbor’s property, which PS rents from a third party (BNSF Railway). In this same month, DTSC 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, DTSC sanctioned PS for violating the Hazardous Waste Control Laws in the State of California and imposed an obligation to make necessary changes to the location. On July 26, 2004, DTSC filed a Complaint for Civil Penalties and Injunctive Relief against PS in San Diego Superior Court. On July 26, 2004, the court issued a judgment, whereby PS was obligated to pay U.S.\$235,000 (Ps. 5 million). This payment was made by PS in 2004 and 2005.

On June 6, 2010 the DTSC and the San Diego Department of Environmental Health (DEH) inspected the facilities of PS, in response to a general complaint. On August 10, 2010 DTSC and DEH conducted a second inspection and found seven infractions. The DEH was satisfied with the compliance of PS on those issues. On October 19, 2010 the technical division of the DTSC recommended to the enforcement division of DTSC that it impose significant penalties upon PS as a result of such infractions. As of December 31, 2017 PS is awaiting a final decision from DTSC.

The land remediation was suspended at the beginning of 2011 due to the inefficiency of the process, which was verified by several studies. As an alternative, once the necessary permits were obtained from the authorities in Mexico, in November 2011, the Mexicali plant began the process of importing raw land for final disposal in a secure landfill based in Nuevo León, once the metal content was separated, which metal content is used as raw material in the smelting process.

The disposition of a stack estimated at 8,000 tons of material classified RCRA (hazardous for Federal purposes) was also considered for shipment to Mexico. The process began in early 2013, but to date they have not granted permits.

Therefore, on April 9, 2015, a letter from the California Attorney General Department of Justice (Attorney General) was received pursuant to which PS was required, in the absence of obtaining permission from the Mexican authorities, to present a program for transporting the pile of contaminated soil classified as RCRA to an authorized confinement in the United States at the latest on April 22, 2015. This letter warned that PS must ship the stack no later than July 9, 2015, or risk a DTSC proceeding with a civil lawsuit seeking the maximum amount of fines established by law and corresponding legal redress.

On April 21, 2015, PS sent a letter to the Attorney General explaining that the authorities in Mexico had not denied permission to the Company but had simply requested that it present its application in a different format, which had already been presented and reviewed by the authority on April 17, 2015.

On July 23, 2015, the Attorney General denied the extension requested by PS and demanded the immediate shipment of the RCRA stack to an authorized landfill. PS began transporting the RCRA soil on July, 29, 2015, and completed removal of the RCRA stack by September 12, 2015 with a total of 3,000 metric tons.

On January 5, 2016, the Attorney General and PS stipulated to filing a "final judgment and order on consent" or Consent Judgment in San Diego Superior Court. The parties negotiated the Consent Judgment, which includes the following terms:

PS must pay US\$ 0.138 million as a civil penalty for alleged violations of the 2004 Corrective Action Consent Agreement. PS has made all of the required payments to DTSC as of December 31, 2017.

PS agreed to remove the RCRA stack and send it to an approved landfill. The Judgment indicates that the Company complied with this commitment by October 2, 2015.

After removing the RCRA stack, the Company must take samples of the soil in the area where the stack of land was located. Samples were taken and the results indicate that the soil had pollution levels which, although not equal to those of the RCRA stack, exceed the limits set by the State. On April 7, 2016, the Attorney General and DTSC demanded that the Company remove the soil 10 feet across and 2 feet deep on the perimeter of the area where the stack of RCRA land was located and dispose of it in an approved confinement. On August 5, 2016, DTSC informed PS that it did not need to remove the soil in the vicinity of the former RCRA stack that exceeds California hazardous waste standards. Instead, PS and DTSC entered into a Tolling Agreement on August 10, 2016, which tolls for two years (until August 10, 2018) the statute of limitations for DTSC to challenge PS's compliance with the Consent Judgment. This Tolling Agreement remains in force as of December 31, 2017.

PS shall continue to meet the conditions of the final judgment, the corrective measures, and all tasks arising therefrom, which were entered in the same court in 2004. PS is working to develop a "corrective measures study" (CMS) that is intended to develop a plan for determining what remedy will be implemented at the site. As of December 31, 2017, it is not yet clear what the appropriate remedy will be, when the CMS will be completed, how long remediation will take, and how much it will cost.

## **Environmental Liabilities**

As is the case with most steel producers in the United States and Canada, we could incur significant costs related to environmental compliance activities and remediation stemming from historical waste management practices or other environmental issues at Republic's facilities. At December 31, 2017 and 2016, we had a reserve to cover probable environmental liabilities totaling Ps. 53.3 million (U.S.\$2.7 million) and Ps. 55.8 million (U.S.\$2.7 million), respectively. The reserve includes incremental direct costs of remediation efforts and post remediation monitoring costs that are expected to be included after corrective actions are complete. As of December 31, 2017, the current and non-current portions, Ps. 19.7 million (U.S.\$1 million) and Ps. 33.6 million (U.S.\$1.7 million), respectively, of the environmental reserve are included in other accrued liabilities and accrued environmental liabilities, respectively, in the accompanying consolidated statement of financial position. The company is not otherwise aware of any material environmental remediation liabilities or contingent liabilities relating to environmental matters with respect to the Republic's facilities for which the establishment of an additional reserve would be necessary at this time. To the extent the company 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 company's facilities and future changes in applicable laws and regulations may require the company to incur significant costs that may have a

material adverse effect on the company's future financial performance.

*Brasil*

On September 5, 2017, Grupo Simec and GV do Brasil were notified of an arbitration procedure brought by SMS Concast before the International Court of Arbitration (ICC), in which the payment of US\$1.4 million is requested (Ps.27.6 million), plus additional expenses, for additional costs incurred in the construction and assembly of the steel plant area in Brazil. On November 6, 2017, the Company filed a response, suing SMS Concast for various items that amount to US\$5 million (approximately Ps. 98.7 million) approximately. The panel of arbitrators is already constituted and the resolution of the matter is in process.

The tax authorities in Brasil have the right to review the previous five years and could determine differences in taxes payable, plus corresponding adjustments, surcharges and fines.

**B. Significant Changes**

None

**Item 9. The Offer and Listing**

Our series B shares are listed on the Mexican Stock Exchange, and the ADSs are listed on the New York 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 United States, the ADS to share ratio was simultaneously adjusted from one ADS representing one series B share to one ADS representing three Series B 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 shares on the Mexican Stock Exchange, and the high and low sales price expressed in U.S. dollars of the ADSs on the New York Stock Exchange

	Mexican Stock Exchange		New York Stock Exchange	
	High	Low	High	Low
<b>2013</b>	64.62	45.54	15.37	10.15
<b>2014</b>	66.99	42.13	15.17	8.50
<b>2015</b>	50.63	35.21	9.98	6.15
<b>2016</b>	101.29	35.65	15.20	5.93
<b>2017</b>	99.99	58.65	14.76	8.97
<b>2015</b>				
First Quarter	50.63	40.05	9.98	7.84
Second Quarter	50.00	41.07	9.69	7.77
Third Quarter	49.30	41.47	9.14	7.26
Fourth Quarter	47.98	35.21	8.89	6.15
<b>2016</b>				
First Quarter	47.50	35.65	8.23	5.93
Second Quarter	59.50 <sup>(1)</sup>	45.90 <sup>(1)</sup>	10.26	6.97
Third Quarter	62.68 <sup>(1)</sup>	45.12 <sup>(1)</sup>	9.62	6.53
Fourth Quarter	101.29	58.50	15.20	9.06
<b>2017</b>				
First Quarter	99.99	79.28	14.76	12.42
Second Quarter	82.00	58.65	13.02	9.71
Third Quarter	69.69	59.00	11.74	9.95
Fourth Quarter	65.50	59.25	10.72	8.97

**2018**

First Quarter	68.60	56.16	10.77	9.10
Second Quarter (through May 11)	64.95	60.02	10.51	9.31

**2018**

January	68.60	60.71	10.77	9.34
February	65.00	60.10	10.34	9.54
March	62.47	56.16	10.00	9.10
April	62.05	55.63	10.90	9.11
May (through May 11)	64.95	60.02	10.51	9.31



(1) On May 30, 2016, the Mexican Stock Exchange announced the suspension in trading of our stock on the Mexican Stock Exchange, identified with the ticker symbol “SIMEC B” as a result of our failure to timely file our 2015 annual report and audited financial statements. We filed our annual report on August 12, 2016 with the Mexican Banking and Securities Commission. The suspension in trading was lifted on August 15, 2016 and our stock is trading normally again on the Mexican Stock Exchange.

### **Trading on the Mexican Stock Exchange**

The Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A.B. de C.V.*), located in Mexico City, is the only stock exchange in Mexico. Operating continuously since 1907, the Mexican Stock Exchange is organized as a publicly traded corporation with variable capital stock (*sociedad anónima bursátil 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 CNBV, 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 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 by-laws, 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, which generally requires that directors: (i) obtain the information reasonably necessary to make decisions; (ii) request from officers and auditors information that is relevant to a decision to be made; (iii) postpone board of directors meetings when a director is not present, has not arrived on time or has not been provided with the same information as other directors; (iv) deliberate and vote, including if requested with the presence only of the other directors and the secretary of the board. Directors will be subject to liability when damage is caused to the issuer by any of the following: (i) failure to attend board, shareholders’ or committee meetings, which failure prevents such meeting from being duly held; (ii) failure to reveal relevant information to the board of directors or to an applicable committee, subject to legal or contractual limitations on disclosure of such information; or (iii) failure to comply

with the duties imposed by the Mexican Securities Market Law or the issuer's by-laws. Failure of directors to act with due care makes the relevant directors jointly and severally liable for damages and losses caused to the issuer and its subsidiaries, which may be limited in the company's by-laws or by resolution of the shareholders' meeting, except in the case of bad faith, willful misconduct or illegal acts. Liability for breach of the duty of care may also be covered by indemnification provisions and director and executive officer insurance policies.

The duty of loyalty, which primarily consists of maintaining the confidentiality of information received in connection with the performance of the director's duties, and abstaining from discussing or voting on matters where the director has a conflict of interest. Directors will have breached their duty of loyalty in the following cases: (i) if without justification they utilize their position to gain benefits for themselves or third parties, including an individual shareholder or group of shareholders; (ii) if they vote on or participate in deliberations concerning an issue on which they have a conflict of interest; (iii) if they do not reveal the conflicts of interests they have; (iv) if they deliberately favor an individual shareholder or group of shareholders to the detriment of others; (v) if they approve related party transactions without observing the related guidelines under the Mexican Securities Market Law; (vi) if they utilize property of the issuer for their own benefit or that of third parties in contravention of relevant policies; (vii) if they make undue use of privileged information; or (viii) if, for themselves or third parties, they take advantage of a corporate opportunity. A violation of the duty of loyalty makes the relevant directors jointly and severally liable for damages and losses caused to the issuer and its subsidiaries, and in every case require removal from their positions. Unlike the duty of care, liability for breach of the duty of loyalty may not be limited by the company's by-laws, by resolution of the shareholders' meeting or otherwise, nor may indemnification provisions or insurance policies cover such liability.

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 General Law of Commercial Companies and our by-laws, only the shareholders' meetings 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 Committee's report with respect to the preceding year, the appointment of members of the board of directors and the chairman of the Audit

Committee, declaration of dividends and the determination of compensation for members of the board of directors and for members of the Audit 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 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 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 Committee fails 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 Committee must be signed by the chairman, the secretary or a special delegate appointed by the board of directors or the Audit Committee as appropriate, for that purpose. Shareholders' meetings will be validly held and convened without the need of a prior call or publication whenever all the shares representing our capital are duly represented.

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

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

### *Quorum*

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 by-laws 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 CNBV. 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 CNBV 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 MFRS, 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 at least 20% of our then current capital stock, (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.

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 U.S. 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 CNBV;

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.

The economic and voting rights corresponding to repurchased shares may not be exercised during the period in which we own such shares, and such shares are not deemed to be outstanding for purposes of calculating any quorum or vote at any shareholders' meeting during such period.

The shares and negotiable instruments representing title to shares belonging to us or, as the case may be, issued but unsubscribed treasury shares, may be placed with the investing public without the need for a shareholders' meeting or board resolution. As such, the provisions of Article 132 of the Mexican Corporations Law do not apply.

In our Ordinary Shareholders Meeting held on September 14, 2016, an increase in the reserve for repurchase of shares to Ps. 1,000 million was approved and the total reserve at December 31, 2017, amounts to Ps. 2,000 million. In our Ordinary Shareholders

Meeting held on April 23, 2018, an increase in the reserve for repurchase of shares to Ps. 3,000 million was approved and the total reserve at April 23, 2018, amounts to Ps. 5,000 million. In 2015, we repurchased 63,697,541 shares, of which 57,450,890 we resold. At December 31, 2015, we had 11,466,445 treasury shares. In the year 2015 we registered a loss of Ps. 76.3 million in the repurchase of shares. In 2016, we repurchased 36,317,389 shares, and we resold 47,660,950. At December 31, 2016, we had 122,884 treasury shares. In the year 2016 we registered a gain of Ps. 507.7 million in the repurchase of shares. In 2017, we repurchased 5,143,680 shares, and we resold 1,604,000. At December 31, 2017, we had 3,662,564 treasury shares. In the year 2017 we registered a loss of Ps. 22.8 million in the repurchase of shares.

#### *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 CNBV 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 CNBV and the Mexican Stock Exchange. If the CNBV 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 Committee with respect to the preceding year; and

the notes which are required to complete or clarify the above mentioned information.

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 bylaws, 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*).

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

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

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

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

#### *Independent Directors*

The Mexican Securities Market Law requires that 25% of the directors of Mexican public companies must be independent, but the Audit Committee must be comprised entirely of independent directors. One alternate director may be appointed for each principal director, provided that the alternates for the independent directors are also deemed independent. Under Mexican law, certain individuals, including insiders, controlling individuals, major clients and suppliers, and any relatives of such individuals, are per se deemed as non-independent. In addition, under Mexican law, the determination as to the independence of our directors made by our shareholders' meeting may be contested by the CNBV. The independent directors are required under our bylaws to meet as often as necessary to fulfill their responsibilities. Independent directors are not required under Mexican law or our bylaws to meet without the presence of non-independent directors and management.

Pursuant to the rules and regulations of the New York 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 New York Stock Exchange must maintain an audit committee comprised entirely of independent directors as defined in the United States federal securities laws. Further, independent directors are required meet on a regular basis as often as necessary to fulfill their responsibilities, including at least annually in executive session without the presence of non-independent directors and management.

#### *Audit-Committee*

For differences among Mexican Securities Market Law, which apply to us, and laws generally applicable to U.S. corporations regarding audit-committees, see "Item 6. Directors, Senior Management and Employees—C. Board Practices—Committees—Audit and Corporate Practices Committee."

#### *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 CNBV, 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 84% 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, 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 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 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 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**

None

### **D. Exchange Control**

There are no legislative or legal provisions currently in force in Mexico or arising under our by-laws 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 “non-Mexican holder” (as defined below) that is an individual 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 (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 an owner of 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 the effects of the U.S. Medicare tax on net investment income, or any U.S. or Mexican state or local tax considerations that may be relevant to U.S. holders. This summary also does not address U.S. federal income tax consequences applicable to U.S. holders that are subject to special tax rules, such as banks, securities or currency dealers, traders in securities that mark their securities to market, insurance companies, tax-exempt entities, persons liable for the alternative minimum tax, 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 or partnerships or other pass-through entities for U.S. federal income tax purposes. If a partnership (or other pass-through entity for U.S. federal income tax purposes) holds the series B shares or ADSs, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If a U.S. holder is a partner of a partnership holding our series B shares or ADSs, such U.S. holder should consult its tax advisor.

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 of series B shares or ADSs 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 (including the 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 42.86% for 2017. 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, dividend distributions are not subject to individual withholding taxes for shareholder recipients thereof.

Dividends or profits distributed by legal entities resident in Mexico that are paid to natural persons and persons residing abroad on profits generated since fiscal year 2014, are subject to an additional Income Tax rate of 10%; this additional tax will be withheld by the legal person who distributes the dividend and its payment is considered definitive. In this case, the rates established in the agreement to avoid double taxation between Mexico and the United States of America can be applied.

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 30% in 2017, 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 or the ADSs (including any amounts withheld for Mexican taxes), 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 U.S. holder, in the case of series B shares, or the depository, in the case of ADSs. Such dividends 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 non-corporate U.S. holders (including individuals) with respect to the series B shares and ADSs will be subject to taxation at a maximum rate of 20% if the dividends are “qualified dividends.” Dividends paid on the series B shares and

ADSs will generally be treated as qualified dividends if (A) 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”) and (B) (i) we are eligible for the benefits of a comprehensive income tax treaty with the United States that the Internal Revenue Service has approved for the purposes of the qualified dividend rules or (ii) the series B shares or ADSs, as applicable, are readily tradable on an established securities market in the United States. The Tax Treaty has been approved for the purposes of the qualified dividend rules and we believe that we are eligible for the benefits of the Tax Treaty. Further, as discussed below, we do not believe that we are a PFIC. Therefore, we believe that dividends paid to a non-corporate U.S. holder with respect to the series B shares and ADSs will generally be treated as qualified dividends. U.S. holders should consult their own tax advisors in this regard in light of their particular circumstances.

To the extent that a distribution exceeds our current and accumulated earnings and profits for a taxable year, it generally will first be treated as a non-taxable return of basis to the extent thereof, and thereafter as capital gain from the sale of the series B shares or ADSs. However, we do not expect to keep earnings and profits in accordance with U.S. federal income tax principles. Therefore, a U.S. holder should expect that a distribution will generally be treated as a dividend (as discussed above).

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 such U.S. holder, in the case of series B shares, or by the depository, in the case of ADSs, whether or not they are converted into U.S. dollars. If the pesos received as a dividend are converted into U.S. dollars on the date they are received, a U.S. holder generally will not be required to recognize foreign currency gain or loss in respect of the dividend income. If the pesos received as a dividend are not converted into U.S. dollars on the date of receipt, you will have a basis in the pesos equal to their United States dollar value on the date of receipt. 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.

Subject to certain conditions and limitations (including a minimum holding period requirement), Mexican withholding taxes on dividends, if any, may be treated as foreign taxes eligible for credit against a U.S. holder’s U.S. federal income tax liability. Dividend income generally will constitute foreign source “passive category income” or, in the case of certain U.S. holders, “general category income” for U.S. foreign tax credit purposes.

Distributions of additional series B shares or 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 30% for 2017 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 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 U.S. source 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. Under current law, long-term capital gain recognized by a non-corporate U.S. holder (including individuals) generally is subject to a maximum federal income tax rate of 20%. 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 into U.S. dollars 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.

#### *Passive Foreign Investment Company (PFIC)*

Based on our audited financial statements and relevant market and shareholder data, we believe that we are not a PFIC for U.S. federal income tax purposes with respect to our 2015, 2016 and 2017 taxable years, and we expect to operate in such a manner so as to not become a PFIC. If, however, we are or become a PFIC, a U.S. holder could be subject to additional U.S. federal income taxes on gain recognized with respect to the series B shares or ADSs and on certain distributions, plus an interest charge on certain taxes treated as having been deferred under the PFIC rules.

#### *U.S. Backup Withholding Tax and Information Reporting Requirements*

In general, information reporting requirements will apply to certain payments 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 that are paid to such U.S. holder within the United States (and in certain cases, outside the United States), unless such U.S. holder is an exempt recipient. 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 and may entitle the U.S. holder to a refund, 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 Commission, promptly after it is made public or filed, information that we make public in Mexico, file with the Mexican Stock Exchange or the CNBV or distribute to our security holders. 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 U.S. 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 37% lower 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. At December 31, 2017 and 2016 we did not have natural gas cash-flow exchange contracts or swaps.

### **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, 2017 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 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 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. 74.4 million (U.S.\$3.8 million).

The sensitivity analysis is an estimate and should not be viewed as predictive of our future financial performance. Additionally, we cannot assure that our actual losses in any particular year will not exceed the amounts indicated above. However, we do believe that these amounts are reasonable based on the financial instrument portfolio at December 31, 2017 and assuming that the hypothetical market rate changes selected by us in our market risk analysis occur during 2018. 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**

### **A. Debt Securities**

Not applicable.

## **B. Warrants and Rights**

Not applicable

## **C. Other Securities**

Not applicable

## **D. American Depositary Shares**

### **12.D.3. American Depositary Shares**

The Bank of New York Mellon serves as the depositary for our ADSs. The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

100

ADS holders are also required to pay additional fees for certain services provided by the depository, as set forth in the table below.

<b>Depository service</b>	<b>Fee payable by ADR holders</b>
Issuance and delivery of ADSs, including issuances resulting from a distribution of shares or rights or other property	Up to U.S.\$5.00 per 100 ADSs (or portion thereof)
Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates	Up to U.S.\$5.00 per 100 ADSs (or portion thereof)
Distribution of securities distributed to holders of deposited securities which are distributed by the depository to ADS registered holders	A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs
Registration for the transfer of shares	Registration or transfer fees that may from time to time be in effect
Cash distribution fees	U.S.\$0.02 or less per ADS
Depository services	U.S.\$0.02 or less per ADS

In addition, holders may be required to pay a fee for the distribution or sale of securities. Such fee (which may be deducted from such proceeds) would be for an amount equal to the lesser of (1) the fee for the issuance of ADSs that would be charged as if the securities were treated as deposited shares and (2) the amount of such proceeds.

#### **12.D.4 Direct And Indirect Payments By The Depository**

##### **Fees Incurred in Past Annual Period**

We did not receive any reimbursement from the depository in 2017, 2016 or 2015.

##### **Fees to be Paid in the Future**

The Bank of New York Mellon, as depository, has agreed to reimburse us for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depository has agreed to reimburse us for its continuing annual stock exchange listing fees. The depository has also agreed to pay the standard out-of-pocket maintenance costs for the ADSs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information,

mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse us annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to us based on any applicable performance indicators relating to the ADS facility. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not necessarily tied to the amount of fees the depositary collects from investors.

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

101

## **PART II**

### **Item 13. Defaults, Dividends Arrearages and Delinquencies**

None.

### **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 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. Our internal control system is designed to provide reasonable assurance as to the reliability of the published financial statements under applicable International Financial Reporting Standards. 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 of the internal control over financial reporting 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.

The effectiveness of our internal control over financial reporting as of December 31, 2017 has been audited by Marcelo de los Santos, S.C., a practice member of Moore Stephens International Limited, independent registered public accounting firms, as stated in their report which appears in Item 15.C as required by item 15.B(4) of Form

20-F.

Our management was able to assess the effectiveness of our internal control over financial reporting as of December 31, 2017. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013) in Internal Control – Integrated Framework. Based on its assessment and those criteria, our management identified the following material weaknesses in our internal control over financial reporting, and therefore determined that our internal controls over financing reporting were not effective at December 31, 2017:

### **Material Weaknesses**

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for the oversight of the company's financial reporting. A material weakness is a deficiency, or a 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.

#### *Fiscal Year Ended December 31, 2014*

In our assessment of our internal controls over financial reporting for the year ended December 31, 2014, the following material weaknesses were identified:

Insufficient resources applied to the remediation and appropriate monitoring of internal control weaknesses, most of which were identified in previous years and continue to be unresolved.

Inadequate distribution and segregation of duties within the accounting department in the Mexican Subsidiaries due to insufficient resources. Additionally, the internal audit staff was reduced and considered insufficient to fulfill their role.

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness, and which include: (i) inadequate controls for the definition, review and approval process of the disclosure in the financial statements and our annual report on form 20-F, (ii) non-operating and outdated whistleblower line for the Mexican subsidiaries, (iii) ineffective controls in our patents registry, (iv) deficient distribution of our code of ethics to employees and officers and poor promotion of strong control environment and internal controls in accordance with the COSO model, (v) failure to integrate all control processes



into one Enterprise Resource Planning (ERP) system, (vi) lack of an accounting manual with accounting instructions on most of accounting records, (vii) lack of specific procedures for the approval of transactions with related parties, (viii) failure to create and implement a complete training plan for management personnel preparing financial records, (ix) limited IFRS and consolidation process understanding and reduced personnel within our Internal Audit department which limited the scope of the management assessment; the internal audit plan was not carried out in full and did not include tests about risk assessment, including environmental, fraud, compliance with laws and review of the consolidated financial statements; (x) lack of committees to review, approve and make risk assessments of all our contracts, and (xii) informal communications of deficiencies and remediation plan to the areas and managers involved.

102

Inadequate supervision and controls within the accounting department which impacted the financial statement closing process, conversion of foreign subsidiaries and intercompany reconciliations, resulting in material accounting errors.

A lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

SimRep did not maintain effective controls relating to accounting of certain capital expenditures and related fixed assets were found. Lastly, the evaluation for impairments is not reasonable given actual results of such Subsidiary.

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM, S.A. de C.V. which in the aggregate, constitute a material weakness. These significant deficiencies include (i) ineffective controls and insufficient supporting documentation for closings of periods end and financial statements review and authorization; the related procedures were incomplete and do not include specific procedures to enter transactions into the general ledger, to select and apply accounting policies and have not been updated in the last 3 years, which such controls are necessary to give reasonable assurance of compliance with IFRS, (ii) no evidence of review of some account balances, such as fixed assets, sales and tax calculations by the responsible individuals; there is also no evidence of review of the financial statements by the General Manager of Corporación Aceros DM, S.A de C.V., (iii) undocumented processes and deficient controls in the access to the information systems, (iv) deficient controls to review and approve cost calculations of finish goods, period end costs and inventories and cost of sales report, (v) lack of physical inventory of fixed assets in several years; and (vi) failure to document and communicate adequately responsibilities and authority of key financial roles.

*Fiscal Year Ended December 31, 2015*

Our management did not assess the effectiveness of our internal controls over financial reporting as of December 31, 2015. The internal audit department did not develop its functions to comply with the analysis of the controls during 2015. Consequently, this limited the functions of the Audit Committee.

Our external auditors, in their Attestation Report for the year ended December 31, 2015, identified the following material weaknesses:

Insufficient resources applied to the remediation and appropriate monitoring of internal control weaknesses, most of which were identified in previous years and continue to be unresolved.

Inadequate distribution and segregation of duties within the accounting department in our Subsidiaries due to insufficient resources. Additionally, the internal audit staff was considered insufficient to fulfill their role.

Significant deficiencies were detected regarding entity-level controls and control environment which, in the aggregate, constitute a material weakness and create a reasonable likelihood that a material misstatement of our annual and interim financial statements will not be prevented or detected on a timely basis. Such deficiencies include: (i) inadequate controls for the definition, review and approval process of the disclosure in the financial statements and our annual report on form 20-F, (ii) whistleblower line for our Mexican subsidiaries was not fully operational, our website information is outdated and does not include information about our Brazilian operations, (iii) ineffective controls in our patents registry, (iv) deficient distribution of our code of ethics to employees and officers and poor promotion of strong control environment and internal controls in accordance with the COSO model, (v) failure to integrate all control processes into one Enterprise Resource Planning (ERP) system, (vi) lack of an accounting manual with accounting instructions on most of accounting records, (vii) lack of specific procedures for the approval of transactions with related parties, (viii) failure to create and implement a complete training plan for management personnel preparing financial records under IFRS, (ix) limited IFRS and consolidation process understanding and reduced personnel within our Internal Audit department which limited the scope; also the internal audit plan was not carried out, and therefore the audit department did not perform risk assessment and environmental, fraud, compliance with laws, review of the consolidated financial statements and review of our annual report on form 20-F; (x) lack of committees to review, approve and make risk assessments of all our contracts; and (xi) informal communications of deficiencies and remediation plan to the areas and managers involved.

Inadequate supervision and controls within the accounting department which impacted the financial statement closing process, conversion of foreign subsidiaries, intercompany reconciliations and a lack of controls for the issuance and authorizations of journal entries, resulting in material accounting errors.

A lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

SimRep did not maintain personnel with the appropriate level of knowledge and experience of accounting and training required to comply with financial reporting requirements. This material weakness led to the certain control deficiencies, each of which are considered to be a material weakness. See Item 15.C “Attestation Report of the Independent Registered Public Accounting Firms.”

Failure to provide our external auditors with evidence of the evaluation of the effectiveness of internal controls in our Brazilian subsidiary, in addition of not hiring an external auditor for this evaluation.

Significant deficiencies were also detected at our subsidiary Corporación Aceros DM, S.A. de C.V. which in the aggregate, constitute a material weakness. See Item 15.C “Attestation Report of the Independent Registered Public Accounting Firms.”

*Fiscal Year Ended December 31, 2016*

In our assessment of our internal controls over financial reporting for the year ended December 31, 2016, the following material weaknesses were identified: Regarding the control environment and entity level controls, the following material weaknesses were identified: (i) lack of a whistleblower tool that covers the entirety of the company; (ii) regarding the distribution of the code of ethics, certain sectors of the employees did not recognize the code of ethics; (iii) ineffective control of the patent registration process, which lacks a policy and a procedure; (iv) lack of a policy and procedure for the valuation of assets and the company’s physical inventories; (v) lack of a policy and procedure governing the extensions of credit to the clients; (vi) lack of a policy and procedure for the registration of related parties and the approval of transactions with related parties.

Lack of an appropriate consolidation system to allow management to properly supervise the preparation of consolidated financial information with the detail required.

In connection with certain financial reporting processes, lack of a robust role-segregation model for the creation, editing, deletion, display only, and modification of such processes.

Lack of communication between the internal audit team, which impacted time of test execution, leaving out of scope cycles such as income, human resources, general controls of information technology and costs and inventories.

Lack of documentation setting out the procedure in the event of a disaster (Disaster Recovery Plan) and documentation setting out the procedure in order to continue the operations of the business (Business Continuity Plan).

*Fiscal Year Ended December 31, 2017.*

In our assessment of our internal controls over financial reporting for the year ended December 31, 2017, the following material weaknesses were identified:

Insufficient training on, and knowledge of, COSO and the related operation of the control environment for mid-level personnel of the Company.

A lack of a formalized policy related to the delegation of authority clearly defining the roles and responsibilities for employees.

The Company lacks a system of assessing and monitoring employee performance to increase their skills to be prepared for the complexity of the Company's operation.

The Company does not maintain a detailed accounting manual and closing checklists. The lack of such procedures reduces the likelihood of detecting errors on a timely basis during the financial close. Similarly, there is a lack of documents supporting the existence of supervisory review over accounting entries recorded by the Company.

The Company does not maintain appropriate evidence over records supporting certain matters in regards to fixed assets:

- There is insufficient data to support certain adjustments to fixed assets recorded on the books of the Company.

The Company does not have an appropriate system to properly store records in regards to significant acquisitions of fixed assets.

- The Company failed to reconcile their recorded fixed assets to the underlying support.

The Company did not document appropriate authorizations in regards to capital investments or to increases in the planned size of an ongoing investment project.

The Company has neither a system of tagging and tracking fixed assets nor a process for taking periodic inventories to determine the continued existence of recorded fixed assets.

The Company lacks sufficient documentation and internal controls related to the process of obtaining credit. The Company also lacks sufficient training for personnel responsible for monitoring such credit facilities in regards to fraud detection and ongoing compliance matters.

The Company lacks a program to ascertain that the administrative staff with access to accounting records are sufficiently trained and monitored.

The Company lacks an appropriate environment to ensure that the financial records are closed in accordance with International Financial Reporting Standards properly and in a timely manner. Items identified included:

- o A lack of appropriate accounting resources at the corporate level which adversely impacted the operation of key supervision controls over the accounting department, the financial statement closing process, and the process of computing and authorizing journal entries.
- o A lack of appropriate procedures to analyze the results of the business units prior to consolidation.
- o A lack of a unified computerized general ledger or enterprise resource planning system among the business units.
- o There is also a lack of a common chart of accounts which would simplify the consolidation process.
- o A lack of an appropriate consolidation system allowing management to properly supervise the preparation of consolidated financial information. The system is highly manual, increasing the risk of human error and lacking sufficient oversight as the process is largely performed by a single member of the accounting staff.
- o An audit performed on the information technology systems of the Company determined that approximately 25% of controls over the information technology infrastructure were either deficient in design or missing. Additional findings include:
  - o A lack of an internal reference framework methodology to ascertain and assess information technology risks.
  - o The lack of a methodology to evaluate the design and operational effectiveness of key controls over critical business processes.
  - o No system of verification of the access profiles of personnel or a process to verify that accounts of former employees are properly closed.

In the case of GV do Brasil Indústria e Comércio de Aço Ltda in Brasil we observed an inadequate segregation of duties, in respect to system access and activities related to:

The person with final responsibility for the preparation of the financial reports is also responsible for the corporate tax area, financial management (approval of payments and receipts, analysis of client credit risks including credit limits still not established, and negotiations with clients), monthly calculation of the costs of the products sold (and, consequently, of the value of the inventories of finished products), and assessment of the amount of physical impurities contained in scrap inventories, which also determines the valuation.

The person responsible for supervising the physical movements of raw materials and finished products also has the following duties: authorization to issue sales invoices, the authority to adjustment quantities of inventory items, and also responsibility for planning and authorizing the movements of the physical inventory of between inventory locations.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that as a component of the financial control process, certain accounts are not being reconciled quarterly to the underlying details and the components of certain other accounts are not being reviewed by management.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that a control requiring the signatures of the vice-president of Finance, head of information technology and the General Manager to authorize all expenditures over \$25,000 was not operating effectively. A number of the purchases lacked the required supporting signatures.

In the case of SimRep Corporation and Subsidiaries in the United States we identified that the controller at one of the production plants failed to properly perform all required tests to review the inventories to be sure they are properly recorded at the lower of cost or market, and also failed to obtain approval for a journal entry which should be generated from the analysis.

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

#### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

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

### **Adverse Opinion on Internal Control over Financial Reporting**

We have audited Grupo Simec, S.A.B. de C.V. (the Company's) internal control financial reporting as December 31, 2017, based on criteria established in *Internal Control- Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, because of the effect of the material weakness described in the following paragraph on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control- Integrated Framework (2013)* issued by COSO.

A material weakness is a control deficiency, or a 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 weaknesses have been identified and included in management's assessment:

1. Insufficient training on, and knowledge of, COSO and the related operation of the control environment for mid-level personnel of the Company.
2. A lack of a formalized policy related to the delegation of authority clearly defining the roles and responsibilities for employees.
3. The Company lacks a system of assessing and monitoring employee performance to increase their skills to be prepared for the complex of the company's operation.
4. The Company does not maintain a detailed accounting manual and closing checklists. The lack of such procedures reduces the likelihood of detecting errors on a timely basis during the financial close. Similarly, there is a lack of documents supporting the existence of supervisory review over accounting entries recorded by the Company.
5. The Company does not maintain appropriate evidence over records supporting certain matters in regards to fixed assets:
  - a. There is insufficient data to support certain adjustments to fixed assets recorded on the books of the Company.
  - b. The Company does not have an appropriate system to properly store records in regards to significant acquisitions of fixed assets.
    - c. The Company failed to reconcile their recorded fixed assets to the underlying support.
  - d. The Company did not document appropriate authorizations in regards to capital investments or to increases in the planned size of an ongoing investment project.
  - e. The Company has neither a system of tagging and tracking fixed assets nor a process for taking periodic inventories to determine the continued existence of recorded fixed assets.
6. The Company lacks sufficient documentation and internal controls related to the process of obtaining credit. The Company also lacks sufficient training for personnel responsible for monitoring such credit facilities in regards to fraud detection and ongoing compliance matters.
7. The Company lacks a program to ascertain that the administrative staff with access to accounting records are sufficiently trained and monitored.
8. The Company lacks an appropriate environment to ensure that the financial records are closed in accordance with International Financial Reporting Standards properly and in a timely manner. Items identified included:
  - a. A lack of appropriate accounting resources at the corporate level which adversely impacted the operation of key supervision controls over the accounting department, the financial statement closing process, and the process of computing and authorizing journal entries.
    - b. A lack of appropriate procedures to analyze the results of the business units prior to consolidation.
  - c. A lack of a unified computerized general ledger or enterprise resource planning system amongst the business units. There is also a lack of a common chart of accounts which would simplify the consolidation process.
    - d. A lack of an appropriate consolidation system allowing management to properly supervise the preparation of consolidated financial information. The system is highly manual, increasing the risk of human error and lacking sufficient oversight as the process is largely performed by a single member of the accounting staff.
9. An audit performed on the information technology systems of the Company determined that approximately 25% of controls over the information technology infrastructure were either deficient in design or missing. Additional findings include:
  - a. A lack of an internal reference framework methodology to ascertain and assess information technology risks.
  - b. The lack of a methodology to evaluate the design and operational effectiveness of key controls over critical business processes.
  - c. No system of verification of the access profiles of personnel or a process to verify that accounts of former employees are properly closed.





10. In the case of GV do Brasil Indústria e Comércio de Aço Ltda in Brasil we observed an inadequate segregation of duties, in respect to system access and activities related to:

The person with final responsibility for the preparation of the financial reports is also responsible for the corporate tax area, financial management (approval of payments and receipts, analysis of client credit risks including credit limits still not established, and negotiations with clients), monthly calculation of the costs of the products sold (and, consequently, of the value of the inventories of finished products), and assessment of the amount of physical impurities contained in scrap inventories, which also determines the valuation.

a.

- The person responsible for supervising the physical movements of raw materials and finished products also has the following duties: authorization to issue sales invoices, the authority to adjustment quantities of inventory items, and also responsibility for planning and authorizing the movements of the physical inventory of between inventory locations.

- b. In the case of SimRep Corporation and Subsidiaries in the United States we identified that as a component of the financial control process, certain accounts are not being reconciled quarterly to the underlying details and the components of certain other accounts are not being reviewed by management.

11. In the case of SimRep Corporation and Subsidiaries in the United States we identified that a control requiring the signatures of the vice-president of Finance, head of information technology and the General Manager to authorize all expenditures over \$25,000 was not operating effectively. A number of the purchases lacked the required supporting signatures.

12. In the case of SimRep Corporation and Subsidiaries in the United States we identified that the controller at one of the production plants failed to properly perform all required tests to review the inventories to be sure they are properly recorded at the lower of cost or market, and also failed to obtain approval for a journal entry which should be generated from the analysis.

13. These material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2017 financial statements, and this report does not affect our report dated May 11, 2018, on those financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the balance sheets and the related statements of income, comprehensive income, stockholders' equity, and cash flows of the Company, and our report date May 11, 2018, expressed an unqualified opinion.

### **Basis for Opinion**

The Company'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 of internal control over financial reporting. Our responsibility is to express an opinion of the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether affective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining and understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

## **Definition and Limitations of Internal Control over Financial Reporting**

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.

Marcelo de los Santos y Cía., S.C.

Member of Moore Stephens International Limited

C.P.C. Marcelo de los Santos Anaya

San Luis Potosí, S.L.P., México, May 11, 2018

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

*Fiscal Year Ended December 31, 2014*

As a result of our evaluation on the effectiveness of our internal controls for the year ended December 31, 2014 and the material weakness and deficiencies identified during that period, we will need to increase the resources allocated to implement the remedial measures due to prevalence of deficiencies from previous years. If we implement the following remedial measures, we believe such are reasonably likely to materially improve our internal controls over

financial reporting:

We will allocate the required resources to review and reform our entity level controls to ensure compliance with the COSO framework, complete the transition to the COSO 2013 framework and address all the issues that were found on our 2014 assessment of our internal control.

We will increase the internal audit staff to execute testing of control activities that was not otherwise executed on the 2014 management Assessment.

We will conduct an analysis of functions and workloads in the finance departments of all of our Mexican Subsidiaries in order to improve internal controls over financial reporting and to avoid the errors found with respect to our financial statement closing process, and preparation of financial statements under IFRS.

In our subsidiary Corporación Aceros D.M., S.A. de C.V. we will assign more resources to implement the remedial measures that have not been implemented in the last three years and to complete the transition into the 2013 COSO framework.

*Fiscal Year Ended December 31, 2015*

As a result of the evaluation on the effectiveness of our internal controls for the year ended December 31, 2015 by our external auditors and the material weakness and deficiencies identified during that period, we will need to increase the resources allocated to implement the remedial measures due to their prevalence from previous years. If we implement the following remedial measures, we believe such are reasonably likely to materially improve our internal controls over financial reporting:

We will allocate the required resources to reform our entity level controls to ensure compliance with the COSO framework, complete the transition to the COSO 2013 framework and address all the issues that were found on our 2015 assessment of our internal control.

We will conduct an analysis of functions and workloads in the finance departments of all of our subsidiaries in order to improve internal controls over financial reporting to avoid errors found with respect to our financial statement closing process, and preparation of financial statements under IFRS.

In our subsidiary Corporación Aceros D.M., S.A. de C.V. we will assign more resources to implement the remedial measures that have not been implemented in the last four years and to complete the transition into the 2013 COSO framework.

We will designate a new head of the Internal Audit Department and we will strengthen the internal audit function by hiring (one or two) employees to conduct the testing activities of the internal controls over financial reporting.

We will invest Ps.1.5 million in hiring an outside firm to assist our management and our Internal Audit Department in implementing remedial measures for the material weaknesses found in previous years.

*Fiscal Year Ended December 31, 2016*

As a result of the evaluation on the effectiveness of our internal controls for the year ended December 31, 2016 by our external auditors and the material weaknesses and deficiencies identified during that period, the company worked to address material weaknesses and significant deficiencies, focusing particularly on those that were feasible to address within the last quarter of 2016. To this end, the company engaged Mazars, a group of external advisors, to assist in the production of a work plan to resolve or mitigate such material weaknesses and significant deficiencies (although such material weaknesses and significant deficiencies were not resolved or mitigated as of December 31, 2016), including through the following:

Promoting the validation of the code of ethics by the internal audit committee and senior management, so that it will be distributed to new and existing employees, in the first instance, to employees in each business unit.

Aligning the internal control evaluations with the COSO 2013 framework. The company conducted training for the internal auditors in the last quarter of 2016 that will promote the alignment of the evaluation of the internal controls for 2016.

Adhere to the methodology suggested by the external consultants (Mazars) to carry out a SOX audit, starting with the selection of significant accounts, cycles and business units (scoping) in order to, through a risk and control matrix, evaluate the risks and controls in terms of design and control efficiency.

The company believes that it now has a team of internal auditors that will allow it to carry out audit activities in a timely manner, as each business unit now counts with an auditor (USA, Mexicali, Tlaxcala, Guadalajara, San Luis Potosí and Brazil).

The procedures that need to be updated have been identified through the courses carried out for supply cycles, fixed assets, accounting closure, consolidation and treasury. However, it has a remediation plan to include in a technological tool all the procedures of the business cycles, thus allowing existing versions.

The policies that need to be updated have been identified and the company has commenced with the updating and improvement of the policies included in the accounting manual. The company intends to complete all policies in a period of no more than two years.

The company has put out a tender for suppliers of services for the whistleblower line. Although the supplier has not yet been selected, is in the process of obtaining quotes from two selected suppliers.

In connection with the integration of accounting information, the company is developing a procedure with mitigating controls to reduce the risk of not having a consolidated ERP, as the company is not contemplating to acquire an ERP at least for the year 2017.

A work plan for 2017 was also drawn up between external advisors (Mazars) and the company to carry out the remediation or mitigation of the internal control deficiencies.

The implementation of these changes commenced during the last quarter of 2016 and the first quarter of 2017. The company believes it is implementing a robust work plan aligned with the SOX methodology and the COSO 2013 framework, which promotes the participation of top management and business process owners who will actively participate in the implementation of the identified controls.

*Fiscal Year Ended December 31, 2017.*

Our internal audit team, and with the validation of the Audit Committee and our Chief Executive Officer and Chief Financial Officer, developed a program of action plans to remedy the control weaknesses and the material weaknesses associated with the control environment for the entire Company, the internal control within the business processes of each plant and the information technology controls.

The employees in charge of the business process at each plant, supported by the advice of the internal audit team and Mazars, implemented the corrective actions to each of the observations generated in our 20-F annual report for the years ended December 31, 2015 and December 31, 2016, as well as to the findings identified in the internal control over financial information for the year ended December 31, 2017. Some of these corrective actions included, but are not limited to, the following:

Remediation actions related to corporate governance:

- o Evaluation of the control environment with the first and second level executives of all the plants: including the ostandards, processes and structures in the Board of Directors and Senior Management to establish the "tone at the top;"
- o Development of a control environment evaluation guide;
- o Development of internal control framework COSO 2013 and Sarbanes-Oxley Act awareness to first and second level o of management;

A program was created to strengthen the distribution of the code of ethics and ensure its correct understanding  
throughout the organization;

109



- o The firm Resguarda was hired as an anonymous complaint line provider and its implementation and dissemination is ongoing in all the business units of the organization for its correct use;
- o The manual for the structure and function of the audit committee was generated;
- o Creation of a communication protocol between the different actors of the internal control, the audit committee, the Corporate Finance Department, the audit management, the internal auditors and the users in each of the plants;
- o Results were formalized and consolidated on the internal control system of each plant in a letter of certification, signed by the General Director and the Corporate Finance Director of the Company; and
- o A questionnaire was applied to validate the independence of the members of the audit committee.

Remediation actions related to internal control over financial reporting:

- o The findings identified in aspects of Internal Controls over Financial Reporting (ICFR) in all the plants (Guadalajara, San Luis Potosí, Tlaxcala, Mexicali, Brazil and the United States) were addressed and resolved;
- o Consolidation of the audit team, hiring the missing staff and training them in the company's audit processes, the Sarbanes-Oxley Act and the internal control framework COSO 2013;
- o Internal auditors were trained in the audit methodology and the COSO 2013 framework;
- o Generation of the manual for the internal audit and testing function;
- o Generation of the scoping methodology manual;
- o Generation of the guide to use the solution of a GRC for the administration of processes, risk assessment, internal control and audit (MEGA Hopex);
- o Development of a training program on IFRS topics for the key personnel of the financial consolidation process and internal audit team. Taught by certified partners of Mazars;
- o Generation of an internal control certification letter, with appendix of findings and remediation plans to control environment, testing over ICFR and ITGC, to be signed by the directors and finance officers of each plant;
- o Updating and distribution of the documentation of policies and procedures, including flow charts, narratives for each relevant financial cycle, including, but not limited to, Consolidation, accounting closing and Fixed Assets, in each plant, under the Business Process Model and Notation 2.0 methodology (BPMN 2.0). Using the MEGA Hopex tool; and
- o Update of patent registration policy and added to the asset manual.

Remediation actions related to Information Technology General Controls (ITGC):

- o An evaluation of the general information technology controls (CGTI) was carried out for each plant. Including the following topics: i-IT Governance, ii-System and Data Access Security Controls, iii-Change Management, iv-Software Development and Acquisition, v-IT Operations and VI-IT vendors Administration; and
- o ITGC audit reports were generated and action plans were generated to mitigate the findings.

As of December 31, 2017, the Company believes it complied with the observations identified in the 20-F annual report for the years ended December 31, 2015 and December 31, 2016, and has completed or is in process to implement mitigating controls to remedy in full the findings classified as weakness of control or significant weaknesses. The Company did not identify any reasonable material weaknesses, as established in paragraphs 12b - 2 of the SOX Act, which could represent a material risk to the Company's financial information.

## **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 16.A of Form 20-F, serving on the Audit Committee. Rodolfo García Gómez de Parada 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. García's experience and understanding with respect to certain accounting and auditing matters.



The designation does not impose on Mr. García any duties, obligations or liability that are greater than those which are generally imposed on him as a member of the Audit 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 Committee or board of directors. Mr. García is “independent” as such term is defined in the listing standards of the New York 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 2016 and 2017, 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: Mario Moreno Cortez, telephone number: 011-52-33-3770-6700.

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

Our Audit Committee has engaged Marcelo de los Santos y Cía, S.C., a practice member of Moore Stephens International Limited, as independent auditors to audit our consolidated financial statements as of and for the year ending December 31, 2017. The audit of Aceros DM and subsidiaries and affiliates, located in San Luis Potosí, S.L.P. Mexico, continues to be audited by Marcelo de los Santos y Cía., S.C., a practice member of Moore Stephens International Limited.

*Audit Fees.* We paid Ps. 10.4 million in fees to Marcelo de los Santos y Cia., S.C. in connection with the audit of our annual consolidated financial statements for 2017, included in our annual report on Form 20-F. We paid Ps. 10.1 million in fees to Marcelo de los Santos y Cia., S.C. in connection with the audit of our annual consolidated financial statements for 2016, included in our annual report on Form 20-F.

*Audit Related Fees.* In 2017 and 2016, we did not incur any expenses associated with audit related fees.

*Tax Fees.* In 2017 and 2016, we did not incur any expenses associated with tax compliance.

*Other Fees.* We paid no other fees to Marcelo de los Santos y Cía. S.C., S.C. in 2017 and 2016.

*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.

The Audit Committee approved all of the services incurred in 2016 and 2017, described as “Audit Fees,” “Audit Related Fees,” “Tax Fees,” and “Other Fees,” in accordance with our policy on auditor independence.

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

Not applicable.

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

None.

**Item 16F. Change in Registrant’s Certifying Accountant**

Not applicable.

**Item 16G. Corporate Governance**

Our following corporate governance practices differ from the New York Stock Exchange standards in the following ways:

*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 CNBV. 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 by-laws 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 CNBV. 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 by-laws. 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 have a code conduct and ethics for our directors or executive officers. Also, our directors' and executive officers' conduct is subject to the applicable provisions of the Mexican Securities Market Law and the regulations issued by the CNBV.

112

## **PART III**

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

See “Item 18—Financial Statements.”

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

See our Consolidated Financial Statements beginning on page F-1.

### **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:

Exhibit Number	Item
1.1	Amended and Restated by-laws ( <i>estatutos sociales</i> ) of the registrant, together with an English translation.*
4.1	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.*
4.2	2007-2008 Rounds Supply Agreement by and Between Republic, Inc. and United States Steel Corporation.*
4.3	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.**
8.1	List of subsidiaries, their jurisdiction of incorporation and names under which they do business.
12.1	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certification of chief executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1	

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Certifications of chief executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

\*\* Previously filed with the SEC as an exhibit and incorporated by reference to our Annual Report on Form 20-F, filed on July 1, 2008.



**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

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

By: /s/ Luis García Limón  
Luis García Limón  
*Chief Executive Officer*

By: /s/ Mario Moreno Cortez  
Mario Moreno Cortez  
*Coordinator of Finance*

Dated: May 15, 2018

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

**(A subsidiary of Industrias CH, S.A.B. de C.V.)**

**Consolidated Financial Statements**

**As of December 31, 2017, 2016 and 2015**

**and Independent Auditors' Report**

**Index to Consolidated Financial Statements**

<u>Content</u>	<u>Page</u>
Report of Marcelo de los Santos y Cía, S.C.	F-2
Consolidated Statements of Financial Position	F-4
Consolidated Statements of Comprehensive Income (Loss)	F-5
Consolidated Statements of Changes in Stockholders' Equity	F-6
Consolidated Statements of Cash Flows	F-7
Notes to the Consolidated Financial Statements	F-8 to F-46

F-1

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders and the board of directors of

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

### **Opinion on the Financial Statements**

We have audited the accompanying consolidated statements of financial position of Grupo Simec, S.A.B. de C.V. and its subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of comprehensive income (loss), changes in stockholders' equity, and cash flows, for each of the two years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2017, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2017, base on criteria established in *Internal Control- Integrated Framework (2013)* issued by the Commite of Sponsoring Organizations of the Treadway Commision ("COSO"), and our report dated May 11, 2018, expressed an adverse opinion.

### **Basis for Opinion**

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the

amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/Marcelo de los Santos y Cía., S.C.

We have served as the Company's auditor since 2016.

San Luis Potosí, S.L.P., México

May 11, 2018

F-2

**EXPLANATORY NOTE**

The Company's Annual Report on Form 20-F for the fiscal year ended December 31, 2017 (the "Form 20-F") filed on May 15, 2018 with the SEC is being filed without the Report of Castillo Miranda y Compañía, S.C., a member practice firm of BDO International Limited ("BDO"), which had been engaged to audit the Company's consolidated financial statements as of and for the years ended December 31, 2010, 2011, 2012, 2013, 2014 and 2015, regarding the consolidated statements of comprehensive income, changes in stockholders' equity and cash flows for the year ended December 31, 2015. Once such report becomes available, the Company will file an amendment to the Form 20-F in order to include the report in the Company's Form 20-F.

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

(A subsidiary of Industrias CH, S.A.B. de C.V.)

**Consolidated Statements of Financial Position**

As of December 31, 2017, and 2016

(In thousands of Mexican pesos)

	Note	2 0 1 7	2 0 1 6
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	6	\$7,203,604	\$7,536,534
Other investments	6	88,947	428,422
Trade receivables, net	7	3,899,574	2,695,401
Related party receivables	18-b	530,985	506,235
Loans to related parties	18-b	2,913,325	2,443,294
Recoverable taxes	8	2,230,375	1,513,599
Other receivables		469,237	281,882
Prepaid expenses		509,557	420,278
Inventories, net	9	8,263,498	7,181,483
<b>Total current assets</b>		<b>26,109,102</b>	<b>23,007,128</b>
Non-current inventories, net	9	1,220,766	1,596,926
Property, plant and equipment, net	10	15,737,081	14,491,045
Intangible and other non-current assets, net	11	2,471,548	2,544,273
<b>Total assets</b>		<b>\$45,538,497</b>	<b>\$41,639,372</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities:</b>			
Short-term debt	12	\$5,960	\$6,241
Trade accounts payable	13	3,984,898	2,827,559
Related party payable	18-b	39,761	7,867
Loans from related parties	18-b	984,623	1,012,667
Accrued expenses and taxes other than income taxes	13	842,045	665,936
Taxes payable		1,360,753	954,396
Income tax payable		18,628	44,324
<b>Total current liabilities</b>		<b>7,236,668</b>	<b>5,518,990</b>
<b>Long term liabilities:</b>			
Employee benefits	14	91,822	99,783
Deferred income tax	15	3,367,976	2,302,919
Other liabilities		719,128	507,536
Contingencies and Commitments	24 and 25		

<b>Total long-term liabilities</b>		4,178,926	2,910,238
<b>Total liabilities</b>		11,415,594	8,429,228
<b>Stockholders' equity:</b>	16		
Capital stock		2,832,268	2,832,268
Additional paid-in capital		4,579,472	4,602,314
Retained earnings		20,774,810	19,053,138
Repurchase of own capital stock reserve		1,732,447	1,988,468
Cumulative translation effects in foreign subsidiaries		4,312,478	4,839,142
Total controlling interest		34,231,475	33,315,330
Non-controlling interest	17	(108,572)	(105,186)
<b>Total stockholders' equity</b>		34,122,903	33,210,144
<b>Total liabilities and stockholders' equity</b>		\$45,538,497	\$41,639,372

The accompanying notes are an integral part of these consolidated financial statements

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

(A subsidiary of Industrias CH, S.A.B. de C.V.)

**Consolidated Statements of Comprehensive Income (Loss)****For the years ended December 31, 2017, 2016 and 2015****(In thousands of Mexican pesos, except (loss) income per share figures)**

	Note	2 0 1 7	2 0 1 6	2 0 1 5
Net sales		\$ 28,700,450	\$ 27,515,565	\$ 24,475,821
Cost of sales	19	(23,994,526)	(22,775,593)	(23,096,967)
Impairment of property, plant and equipment	3-g and 19	0	0	(2,071,901)
<b>(Loss) income gross profit</b>		<b>4,705,924</b>	<b>4,739,972</b>	<b>(693,047)</b>
Administrative expenses	19	(1,238,943)	(1,277,487)	(1,582,489)
Other income (expense), net	20	6,934	(36,198)	173,427
Interest income		54,238	108,151	34,027
Interest expense		(54,404)	(40,170)	(40,195)
Foreign exchange (loss) gain, net		(654,362)	1,774,984	(382,062)
<b>(Loss) income before income taxes</b>		<b>2,819,387</b>	<b>5,269,252</b>	<b>(2,490,339)</b>
Income taxes	15	(1,097,860)	(926,041)	(770,572)
<b>Net (loss) income for the year</b>		<b>1,721,527</b>	<b>4,343,211</b>	<b>(3,260,911)</b>
<b>Other comprehensive income (loss):</b>				
Translation effects of foreign subsidiaries		(529,905)	2,807,297	846,936
Fair value of derivative financial instruments, net of income taxes				
Total other comprehensive income (loss) for the year, net of income taxes		(529,905)	2,807,297	846,936
<b>Comprehensive (loss) income for the year</b>		<b>\$ 1,191,622</b>	<b>\$ 7,150,508</b>	<b>\$ (2,413,675)</b>
Net (loss) income attributable to:				
Controlling interest		\$ 1,721,672	\$ 2,884,834	\$ (1,214,290)
Non-controlling interest		(145)	1,458,377	(2,046,621)
<b>(Loss) income net for the year</b>		<b>\$ 1,721,527</b>	<b>\$ 4,343,211</b>	<b>\$ (3,260,911)</b>
Comprehensive (loss) income attributable to:				



Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Controlling interest	\$ 1,195,008	\$ 5,803,840	\$ (221,316)
Non-controlling interest	(3,386)	1,346,668	(2,192,659)
<b>Comprehensive (loss) income for the year</b>	<b>\$ 1,191,622</b>	<b>\$ 7,150,508</b>	<b>\$ (2,413,975)</b>
(Loss) income per share:			
Weighted average shares outstanding (in thousands of shares)	493,918	486,516	492,421
<b>(Loss) income per share (controlling interest) (Mexican pesos)</b>	<b>4-n \$ 3.49</b>	<b>\$ 5.93</b>	<b>\$ (2.47)</b>

The accompanying notes are an integral part of these consolidated financial statements

F-5

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

(A subsidiary of Industrias CH, S.A.B. de C.V.)

**Consolidated Statements of Changes in Stockholders' Equity****For the years ended December 31, 2017, 2016 and 2015****(In thousands of Mexican pesos)**

	<b>Capital stock</b>	<b>Additional paid-in capital</b>	<b>Retained earnings</b>	<b>Repurchase of own capital stock reserve</b>	<b>Cumulative translation effects in foreign subsidiaries</b>	<b>Fair value of derivative financial instruments</b>	<b>Total controlling interest</b>	<b>Non- controlling interest</b>
<b>Balance as of December 31, 2014</b>	2,832,268	4,170,857	18,382,594	726,959	927,162	-	27,039,840	740,805
Repurchase of own capital stock, net		(76,257)		(169,032)			(245,289)	
Comprehensive income (loss)			(1,214,290)		992,974		(221,316)	(2,192,600)
<b>Balance as of December 31, 2015</b>	2,832,268	4,094,600	17,168,304	557,927	1,920,136	-	26,573,235	(1,451,800)
Increase in reserve			(1,000,000)	1,000,000			0	
Repurchase of own capital stock, net		507,714		430,541			938,255	
Comprehensive income (loss)			2,884,834		2,919,006		5,803,840	1,346,600
<b>Balance as of December 31, 2016</b>	2,832,268	4,602,314	19,053,138	1,988,468	4,839,142	-	33,315,330	(105,180)
Increase in reserve		(22,842)	0	(256,021)			(278,863)	

Repurchase of own capital stock, net									
Comprehensive income (loss)		1,721,672		(526,664)			1,195,008		(3,386)
<b>Balance as of</b>									
<b>December 31,</b>	\$2,832,268	\$4,579,472	\$20,774,810	\$1,732,447	\$4,312,478	\$-	\$34,231,475		\$(108,572)
<b>2017</b>									

The accompanying notes are an integral part of these consolidated financial statements

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

(A subsidiary of Industrias CH, S.A.B. de C.V.)

**Consolidated Statements of Cash Flows****For the years ended December 31, 2017, 2016 and 2015****(In thousands of Mexican pesos)**

	2017	2016	2015
<b>Operating activities:</b>			
Net (loss) income of the year	\$1,721,527	\$4,343,211	\$(3,260,911)
Adjustments for:			
Depreciation and amortization	1,465,759	1,429,381	1,261,093
Impairment of property, plant and equipment	0	0	2,071,901
Employee benefits	(7,962 )	6,351	9,933
Allowance for slow moving inventories	0	0	681,273
Allowance for doubtful accounts	5,339	(16,453 )	29,512
Interest income from investing activities	(54,237 )	(108,151 )	(34,027 )
Interest expense from financing activities	54,404	40,170	40,195
Unrealized foreign exchange loss (gain), net	(35,754 )	169,699	172,576
Income taxes	1,097,860	926,041	770,572
	4,246,936	6,790,249	1,742,117
Decrease (increase) in trade receivables	(1,209,134)	(209,517 )	646,126
(Increase) due from related parts receivables	(453,754 )	(55,863 )	(325,524 )
Decrease (increase) in inventories	(887,619 )	(84,865 )	687,296
(Increase) in other accounts receivable, recoverable taxes and prepaid expenses	(1,013,274)	(619,378 )	(730,206 )
(Decrease) increase in trade accounts payable	1,249,042	(372,386 )	(954,678 )
(Decrease) increase in due to related parties payable	39,604	(36,093 )	(40,439 )
(Decrease) increase in accrued expenses and taxes other than income taxes	800,111	410,066	(1,406,375)
Net cash flows (used) provided by operating activities	2,771,912	5,822,213	(381,683 )
<b>Investing activities:</b>			
Acquisition of property, plant and equipment	(3,039,501)	(3,100,259)	(647,743 )
Decrease (increase) in other non-current assets	(60,131 )	(119,468 )	27,965
Other investments	339,476	(54,063 )	(69,392 )
Interest income collected	54,237	108,151	34,027
Net cash flows (used) provided by investing activities	(2,705,919)	(3,165,639)	(655,143 )
<b>Financing activities:</b>			

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Repurchase and placement of own capital stocks, net	(278,863 )	938,255	(245,289 )
Interest expense paid	(54,404 )	(40,170 )	(40,195 )
Loans granted to related parties	(41,027 )	(2,393,715)	
Net cash flows (used) provided by financing activities	(374,294 )	(1,495,630)	(285,484 )
Net (decrease) increase in cash and cash equivalents	(308,301 )	1,160,944	(1,322,310)
Cash and cash equivalents at beginning of year	7,536,534	6,224,502	7,003,373
Effects of exchange rate changes on the balance of cash and cash equivalents held in foreign currencies	(24,629 )	151,088	543,439
Cash and cash equivalents at end of year	\$7,203,604	\$7,536,534	\$6,224,502

The accompanying notes are an integral part of these consolidated financial statements

F-7

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

**(A subsidiary of Industrias CH, S.A.B. de C.V.)**

**Notes to the Consolidated Financial Statements**

**For years ended December 31, 2017, 2016 and 2015**

**(In thousands of Mexican pesos, except foreign currency and where indicated)**

**1. Nature of business**

Grupo Simec, S.A.B. de C.V. is a *stock corporation with variable equity*, incorporated under Mexican laws on August 22, 1990, with a life of 99 years. The Company is a subsidiary of Industrias CH, S.A.B. de C.V. (Industrias CH or ICH). The Company is located in Guadalajara, Jalisco, Mexico and the address of its administrative offices is 601 Rd. Lazaro Cardenas, ZIP Code 44440.

The main activity of Grupo Simec, S.A.B. de C.V. and subsidiaries (Simec or the Company) is the manufacturing, processing and distribution of steel and steel alloys products in Mexico, the United States of America (USA), Canada and since November 2015, began partial operations in the plant of Brazil, which have been increased in 2016. (See Note 2-e).

Part of the Company's shares of capital stock are listed on the Mexican Stock Exchange (BMV) and on the New York Stock Exchange (NYSE). (See Note 26).

**2. Significant events**

a. On December 5, 2017, Grupo Simec, S. A. de C. V., and Simec International 7, S.A. de C. V. (a subsidiary company), acquired 2,000 class "I" shares of a company named Señales del Norte S.A. de C.V., that form 100% of the fixed portion of that company's capital stock and 3,908,782 shares class "II" that form 100% of the variable portion of that company's capital stock. These shares were purchased for \$122.66 million pesos. After the purchase of those shares Señales del Norte S.A. de C.V. came under the control of Grupo Simec, SAB of C. V. From that date the company Señales del Norte S.A. de C.V., is consolidated in the financial statements. Subsequent to December 31, 2017 on March 13, 2018 the name of Señales del Norte S.A. de C.V. was changed to "Siderurgicos Noroeste S.A. de

C. V.".

b. As of May 11, 2018, is under negotiation the acquisition of two steel mills in Brazil from ArcelorMittal, which are located in Cariacica, Espiritu Santo and in Itauna, Minas Gerais and have a production capacity of 600 thousand tons a year and 100 thousand tons a year, respectively. If the transaction is closed, the Group will significantly increase its participation in the long steel market in Brazil.

c. As of January 13, 2016, we were incorporated GSIM de Occidente, S.A. de C.V. with an investment of \$50, being the stockholders Grupo Simec, S.A.B. de C.V. with 49,999 shares class "I" and Simec International, S.A. de C.V., with one class "I" share.

d. As of January 13, 2016, we incorporated Fundiciones de Acero Estructural, S.A. de C.V., with an investment of \$50, being the stockholders Grupo Simec, S.A.B. de C.V., with 49,999 shares class "I" and Simec International, S.A. de C.V., with one class "I" share.

e. On January 20, 2015, we incorporated Aceros Especiales Simec Tlaxcala, S.A. de C.V. with an investment of \$ 50, being the shareholders Grupo Simec, S.A.B. de C.V. with 49,999 shares class "I" and Simec International, S.A. de C.V. with one class "I" share.

f. Grupo Simec, S.A.B. de C.V., during 2015 at Extraordinary Meeting of Stockholders, increased the capital stock by \$ 1,000, with 1,000,000 shares class "II".

g. On January 20, 2015, we incorporated Recursos Humanos de la Industria Siderurgica de Tlaxcala, S.A. de C.V. with an investment of \$ 50, being the stockholders Grupo Simec, S.A.B. de C.V. with 49,999 shares class "I" and Simec International, S.A. de C.V. with one class "I" share.

h. On March 21, 2015, Grupo Simec, S.A.B. de C.V. and Simec International, S.A. de C.V. (subsidiary company) (the "companies"), acquired shares of a company named RRLC, S.A.P.I. de C.V (RRLC). These companies purchased 2,500 shares of Class "I", ordinary, nominative and without par value, representative of the fixed portion of capital stock, representing 50% of the shares of that class. In addition, these companies purchased 46,103 shares of Class "II" which were purchased without

F-8

the right to vote, nominative, and without nominal value, representing the variable portion of capital stock and representing 100% of the shares of that class, in the amount of \$ 18,600. By the Extraordinary General Meeting of Shareholders of RRLC the appointment of members of the Board of Directors of that company, composed exclusively by officers and shareholders of Grupo Simec, S.A.B. de C.V.; so, from that date on the Company consolidates the financial statements of RRLC.

RRLC was formed by split of another company on December 11, 2014, and included tax losses by \$ 311,529, at the date of acquisition.

On October 30, 2015, Simec International 7, S.A. de C.V. and Simec International, S.A. de C.V. (subsidiaries) (the “companies”), acquired shares of a company named Grupo Chant, S.A.P.I. de C.V (Chant). These companies acquired 25,000 shares of Class "I", ordinary, nominative and without par value, of the fixed portion of capital stock, representing 50% of the shares of that class. In addition, these companies acquired 1,000,000 of shares of Class "II" which were acquired without the right to vote, nominative, and without nominal value, representing the variable portion of capital stock and representing 100% of the shares of that class, in the amount of \$ 167,000. The appointment of members of the Board of Directors of that company, is under de control of Grupo Simec, S.A.B. de C.V, so from that date on the Company consolidates the financial statements of Chant.

Chant was formed by split of another company on December 11, 2014, which was referred to tax loss by \$ 2,380,350, at the date of acquisition.

In November 2015, the steel plant in Brazil started partial operations, which have increased subsequently. The plant will has a production capacity of 450,000 tons per year, of commercial steel products, especially rebar and wire rod. Currently, we are in the process of market opening, and we have established contact with major local suppliers of inputs and raw materials. The total cost of this project is USD\$ 300 million, approximately. In a second step, the intention is to enter the market of special steels for the automotive and electro-welded in wire rod derived products.

With regard to a new plant for special steel, on October and December 2015, several pieces of ground adjacent to the plant installed in Tlaxcala, which estimated length will be of 100 hectare. As of October 20, became into force the contract “Key in hand”, signed with Danielli & Officine Meccaniche for the construction (except for civil work) and the supply of all the equipment. This new plant will have an installed capacity for 600 thousand tons. Annually, with a construction term of two and a half years and a previous period to the operations start estimated between 6 and 8 months. The budget for this project is USD\$600 million, approximately. As of December 31, 2016, the major part of the equipment has been received; the last shipment was received in August, 2017. The services of electric energy and gas have already been contracted. The operations start of the steelworks is scheduled for May, 2018 and for the beginning of all the equipment there will be a pre-operative period which will last from 6 to 8 months.

In June of 2015, Republic Steel temporarily idled their newly constructed electric arc furnace at the Lorain facility in response to the severe economic downturn in the energy exploitation sector following a sharp drop in oil prices, which has led to significant market declines and demand for product. As a consequence of this event, the net book value of the furnace exceeded the fair value by approximately USD\$ 130.7 million (equivalent to \$ 2,071,901) and as such recognized an asset impairment of this amount during the year ended December 31, 2015. This effect is



presented in the Income Statement together with the cost of sales, since it corresponds to an impairment of the production plant. See Note 10. The plant of Lorain suspended totally its operations at first quarter of 2016.

**3. Application of new and modified standards and interpretations and standards not yet in force**

The consolidated financial statements of Grupo Simec, S.A.B. Of C.V. and its Subsidiaries for the periods presented have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). IFRS also includes all current International Accounting Standards (IAS), in force, as well as all related interpretations issued by the IFRS Interpretations Committee, including those issued previously by the Standing Interpretations Committee. The company applied the effective IFRS as of December 31, 2017.

a. International Financial Reporting Standards, not yet in force.

## Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

The following are the Standards and Amendments that may have an effect on the financial information of Simec, which were issued by the IASB, but are not in force at the date of these financial statements.

Amendments applicable from 2017:

a) Amendment to IAS 12- Income Tax - recognition of deferred tax assets for unrealized losses.

To clarify the diversity of practices in the recognition of a deferred tax asset arising from a debt instrument measured at fair value, the IASB published amendments to IAS 12- Income Tax - recognition of deferred tax assets for non-realized losses. The amendments to IAS 12 include some clarifying paragraphs and an illustrative example.

The modifications clarify the following aspects:

- Unrealized losses on debt instruments valued at fair value for accounting purposes and at their cost for tax purposes give rise to a deductible temporary difference, independent of the expecting of the holder of the debt instruments, to recover the carrying amount of the debt instrument or by use.
- The book value of an asset does not limit the estimate of probable future tax benefits.
- Estimates of future tax benefits exclude tax deductions resulting from the reversal of deductible temporary differences.
- An entity evaluates a deferred tax asset in combination with other deferred tax assets. When tax law restricts the use of tax losses, an entity could value a deferred tax asset in combination with other deferred tax assets of the same type.

The amendments are retrospective and effective for annual periods beginning on or after January 1, 2017. Early application is permitted.

*Rules applicable starting from 2018:*

a) IFRS 15- Revenue from contracts with customers.

The IASB has published a new standard, IFRS 15- Income from contracts with customers (IFRS 15 or the new standard). The new standard describes a single comprehensive model for accounting of revenue from customer contracts and replaces current revenue recognition guidelines included in IFRS standards and interpretations.

The basic principle of the new rule is that an entity must recognize the income that represents the transfer of goods or services promised to the client, valued by the amount that the entity expects to receive in exchange for such goods or services.

The entities must:

- Identify the contracts with clients which are within the scope of the new standard;
  
- Identify the performance obligations in the contract: i) sales of goods or services separately, ii) sales dependent or interrelated with other products or services; (iii) homogeneous and consistent sales;
  
- Determine the price of the transaction: i) variable consideration and restricted estimates, ii) time value of money and financing component, iii) non-monetary consideration, iv) consideration paid to the customer;
  
- Distribute the transaction price among each separable performance obligation; and
  
- Recognize income when each performance obligation is met: (i) over time, (ii) at a point in time.

The new IFRS 15 increases disclosures on income and is effective for periods beginning on or after January 1, 2018, allowing for early application. Entities may choose to retroactively apply the standard or use a modified approach in the year of application.

b) IFRS 9- Financial Instruments (IFRS 9 (2014)).

The IASB published IFRS 9 (2009) and IFRS 9 (2010) which introduced new classification and valuation requirements, and in 2013 disclosed a new model for hedge accounting. IFRS 9 published in July 2014



represents the final version of the standard, supersedes previous versions of IFRS 9, and completes the IASB project to replace IAS 39, Financial Instruments.

IFRS 9 (2014) includes a logical model for classification and valuation, a single, forward-looking model of impairment, and an approach with substantive changes to hedge accounting.

#### *Classification and valuation*

The classification determines how financial assets and financial liabilities are recorded in the financial statements and, in particular, how they are valued continuously. IFRS 9 (2014) introduces a logical approach to the classification of financial assets, which is based on the flow characteristics and the business model in which the asset is held. This unique, principled approach replaces existing requirements.

#### *Impairment*

The new model results in the application in a single model of impairment to all financial instruments, thus eliminating a source of complexity associated with the previous requirements. As a part of IFRS 9 (2014), IASB has introduced a new impairment model based on expected losses, which will require a more timely recognition of expected losses. Specifically, the new standard requires entities to recognize expected losses since the initial recognition of financial instruments as well as over the life of the instrument on a more timely basis. Further disclosures will be required on how the losses and the movement of the loss estimate were determined and of the activity of the estimate for losses.

#### *Hedge Accounting*

IFRS 9 (2014) introduces an approach with substantive changes for hedge accounting, with improvements to disclosures about risk management activities. The new model represents a major overhaul of hedge accounting, which aligns accounting manage with risk management activities, allowing entities to better reflect these activities in their financial statements. In addition, as a result of these changes, users of financial statements will be better informed about risk management and the effect of hedge accounting on financial reporting.

#### *Own credit risk*

IFRS 9 (2014) also eliminates the volatility in results that was caused by changes in the credit risk of liabilities that are valued at fair value. This accounting change means that gains proceeding from the impairment of the risk of our credit on these liabilities are no longer recognized directly in net earnings or loss but in other comprehensive income (OCI).

IFRS 9 (2014) will come into force for fiscal years beginning on or after January 1, 2018. Early application is allowed. In addition, changes in credit risk can be applied in advance and in isolation, without the other changes in the recognition of financial instruments.

Amendments applicable from 2018

a) Amendment to IAS 40- Investment Property

The amendment clarifies that the transfer of an investment in property will occur when and only when there is a change in its use. A change of use occurs when the property meets, or fails to meet, the definition of investment property and there is evidence of change of use. In isolation, a change in management's intentions to use a property does not provide evidence of a change in use.

b) Amendment to IAS 28- Investments in Associates and Joint Ventures.

This amendment clarifies that a venture capital organization, collective investment fund, investment trust and other similar entities may opt at the initial recognition, to measure investments in associates and joint ventures at fair value through changes in profit and loss separately for each associate and joint business.

In addition, this amendment allows, in applying the equity method, that an entity other than an investment entity retains the measurement of the fair value applied by its associates and joint ventures. It also clarifies that this option is available at the initial recognition for each associate or joint venture that is an investment entity.

c) Amendments to IFRS 2, Classification and measurement of share-based payment transactions.

The amendments clarify the following:

- When estimating the fair value of a share-based payment settled in cash, accounting for the effects of the acquisition conditions and the liability incurred should follow the same approach as for stock-based share-based payment.

- Where tax laws or regulations require an entity to withhold an amount because of an employee's tax liability associated with a share-based payment, the share-based payment arrangements may allow or require to retain a specified number of equity instruments Equivalent to the monetary value of the employee's tax liability, that is, the share-based payment arrangement has a "net settlement characteristic", if the agreement does not include the net settlement characteristic, that agreement should be classified as a whole Transaction with share-based payments settled with equity instruments.

- A share-based payment that is modified to change the settlement transaction in cash to the settlement of capital, should take into account the following:

- i. The original liability is written off;

- ii. The share-based payment with share liquidation is recognized on the date of modification of the fair value of the equity instrument granted to the extent that the services had been rendered until the date of modification; and

- iii. Any difference between the carrying amount of the liability at the date of change and the amount recognized in the net equity must be recognized immediately in profit or loss.

Amendments are effective for annual reporting periods beginning on or after January 1, 2018 with anticipated permitted application.

Interpretation applicable from 2018:

a) IFRIC 22- Transactions in foreign currency and considerations paid in advance.

IFRIC 22 Interpretation, issued by the International Accounting Standards Board, developed by the IFRS Interpretations Committee, addresses how to determine the date of the transaction for the purpose of establishing the exchange rate to be used in the initial recognition of the asset, expense or related income on the write-off of a non-monetary asset or non-monetary liability arising from the payment or collection of the anticipated consideration in foreign currency.

It is established that the date of the transaction for the purpose of determining the exchange rate to be used in the initial recognition is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or collection of the anticipated consideration. If there are multiple payments or prepayments, the entity will determine a date of the transaction for each payment or collection of the anticipated consideration.

Standard applicable from 2019:

A) IFRS 16- Leases

In January 2016, the IASB published a new accounting standard, called IFRS 16- Leases (IFRS 16), which repeals IAS 17- Leases and their interpretation guides.

The main changes in relation to the previous rule are:

- i. IFRS 16 provides a comprehensive model for the identification of leases contracts and their treatment in the financial statements of lessees and lessors.
- ii. The new standard applies a control model for the identification of leases, distinguishing between leases and service contracts based on whether there is an asset identified and controlled by the customer.



iii. The distinction between operating and finance leases is eliminated; therefore, the assets and liabilities of all leases are recognized, with some exceptions, for leases of short-term low-value assets.

iv. The standard does not include significant changes in the requirements for the lessor's accounting.

The standard is effective for annual periods beginning on or after January 1, 2019, with early application permitted for entities that have also adopted IFRS 15- Income from Contracts with Customers.

Simec is appraising the effect that these new standards could have on its financial statements.

#### **4. Basis of preparation and presentation of the financial statements**

***Basis of preparation*** – The consolidated financial statements have been prepared in accordance with the provisions of Note 3 on the historical cost basis. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

***Basis of consolidation*** – The consolidated financial statements incorporate the financial statements of Grupo Simec, S.A.B. de C.V. and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income (loss) of subsidiaries is attributed both to the Company and to the non-controlling interests even if the non-controlling interests having a deficit balance.

During the consolidation process, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by the Company. All significant intercompany transactions and balances, between companies were eliminated on consolidation.

Changes in the Company's ownership interests in subsidiaries that do not result in the Company losing control are accounted for as equity transactions. The carrying amounts of the Company's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to owners of the Company.

When the Company loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. The amounts previously recognized in other comprehensive income related to the subsidiaries are recorded (ie, reclassified to profit or transferred directly to retained earnings) in the same manner established for the case of the disposal of significant assets or liabilities. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting treatment under IAS 39, *Financial Instruments: Recognition and Measurement*, or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

As of December 31, 2017, and 2016, the subsidiaries of Grupo Simec, S.A.B. de C.V. included in the consolidation are as follows.

	<b>Percentage of equity owned</b>	
	<b>2017</b>	<b>2016</b>
<b>Subsidiaries established in Mexico:</b>		
Compañía Siderurgica de Guadalajara, S.A. de C.V.	99.99%	99.99%
Arrendadora Simec, S.A. de C.V.	100.00%	100.00%
Simec International, S.A. de C.V.	100.00%	100.00%
Compañía Siderurgica del Pacifico, S.A. de C.V.	99.99%	99.99%
Coordinadora de Servicios Siderurgicos de Calidad, S.A. de C.V. (10)	100.00%	100.00%
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.	100.00%	100.00%
Sistemas de Transporte de Baja California, S.A. de C.V.	100.00%	100.00%

F-13

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Operadora de Servicios Siderurgicos de Tlaxcala, S.A. de C.V.	100.00%	100.00%
Operadora de Metales, S.A. de C.V.	100.00%	100.00%
Administradora de Servicios Siderurgicos de Tlaxcala, S.A. de C.V.	100.00%	100.00%
CSG Comercial, S.A. de C.V.	99.95%	99.95%
Operadora de Servicios de la Industria Siderurgica ICH, S.A. de C.V.	100.00%	100.00%
Corporacion Aceros DM, S.A. de C.V. and subsidiaries (1)	100.00%	100.00%
Acero Transportes San, S.A. de C.V. (1)	100.00%	100.00%
Simec Acero, S.A. de C.V. (10)	100.00%	100.00%
Corporacion ASL, S. A. de C.V.	99.99%	99.99%
Simec International 6, S.A. de C.V. (10)	100.00%	100.00%
Simec International 7, S.A. de C.V.	99.99%	99.99%
Simec International 9, S.A.P.I. de C.V.	100.00%	100.00%
Corporativos G&DL, S.A. de C.V. (10)	100.00%	100.00%
Orge, S.A. de C.V.	99.99%	99.99%
Siderurgica del Occidente y Pacifico, S.A. de C.V.	100.00%	100.00%
RRLC, S.A.P.I. de C.V. (8)	95.10%	95.10%
Grupo Chant, S.A.P.I. de C.V. (8)	97.61%	97.61%
Aceros Especiales Simec Tlaxcala, S.A. de C.V. (9)	100.00%	100.00%
Recursos Humanos de la Industria Siderurgica de Tlaxcala, S.A. de C.V. (9)	100.00%	100.00%
GSIM de Occidente S.A. de C.V. (11)	100.00%	100.00%
Fundiciones de Acero Estructural, S.A. de C.V. (11)	100.00%	100.00%
Siderúrgicos Noroeste, S.A. DE C.V. (12)	100.00%	100.00%

**Subsidiaries established in foreign countries:**

SimRep Corporation and Subsidiaries (3) (4) (6) (10)	50.22%	50.22%
Pacific Steel, Inc. (4)	100.00%	100.00%
Pacific Steel Projects, Inc. (4)	100.00%	100.00%
Simec Steel, Inc. (4)	100.00%	100.00%
Simec USA, Corp. (4)	100.00%	100.00%
Undershaft Investments, NV. (6)	100.00%	100.00%
GV do Brasil Industria e Comercio de Aço LTDA (7)	100.00%	100.00%
GS Steel B.V. (2)	100.00%	100.00%

Companies located in San Luis Potosi. For purposes of this report constitute the “Grupo San”. This Company (1) includes two subsidiaries that in 2014 changed its address and tax residence to the California State in USA. These subsidiaries are Steel Promotor, Inc. and Coadm Steel, Inc., and in 2015 they merged with Simec USA, Corp.

(2) Company established in Netherlands in 2014.

(3) ICH (Holding Company) owns 49.78% of the shares in this company.

(4) Business established in the United States of America, except a subsidiary of SimRep which is established in Canada.

(5) SimRep as an individual company has no significant operations or assets, other than its investment in Republic Steel. For purposes of this report, these companies are named “Republic”.

(6) Company established in Curaçao.

(7) Company established in Brazil in 2010, in which the Company built a steel plant and starting partial operations in November 2015, which have increased in 2016.

(8) Companies acquired in 2015.

- (9) Companies incorporated in 2015.
- (10) Companies that have lost the entire capital stock, except Corporativos G&DL, S.A. de C.V., and Administradora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V. which only have lost 2/3 of their capital stock.
- (11) Companies incorporated in 2016.
- (12) Companies incorporated in 2017.

**Summary of significant accounting policies** –Preparation of accompanying consolidated financial statements requires management of the Company to make certain estimates and use certain assumptions to value certain items contained in the financial statements and make the disclosures required therein. However, actual results may differ from these estimates. The Company’s management, using its professional judgment, believes that the estimates made and assumptions used were adequate under the circumstances. The significant accounting policies of the Company are those mentioned below:

***Translation of financial statements of foreign subsidiaries*** – 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 International Accounting Standard (IAS) 21,

F-14

*The Effects of Changes in Foreign Exchange Rates.* 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 U.S. dollar (US Dollar or USD\$) was considered as the functional currency of all the U.S. subsidiaries (except Simec International 8, Inc., Steel Promotor, Inc. and Coadm Steel, Inc. subsidiaries of Corporacion Aceros DM, S.A. de C.V., until it's merged in 2015) and Brazilian Real for GV do Brasil Industria e Comercio de Aço LTDA.; therefore, the financial statements of these subsidiaries were translated into Mexican pesos by applying:

- The exchange rates at the balance sheet date, to all assets and liabilities.
  
- The historical exchange rate at stockholders' equity accounts and revenues, costs and expenses.

Translation differences are carried directly to the consolidated statements of comprehensive income as other comprehensive income under the caption translation effects of foreign subsidiaries.

The Mexican peso was considered until 2015 the functional currency of the Company's USA subsidiaries, Simec International 8, Inc., Steel Promotor, Inc. and Coadm Steel, Inc. until the date they merged which use the U.S. dollar as its recording currency; therefore, the financial statements were translated to Mexican pesos before the subsidiaries merged, as follows:

- Monetary assets and liabilities by applying the exchange rates at the statement of financial situation date.
  
- Non-monetary assets and liabilities, as well as stockholders' equity accounts, at the historical exchange rate.

Revenues, costs and expenses, except those arising from non-monetary assets or liabilities that are translated using the historical exchange rate for the related non-monetary asset or liability, are translated on the base of the exchange rates in force at the dates of the transactions.

Translation differences were carried directly to the consolidated statement of comprehensive income as part of the income of the year under the caption foreign exchange gain (loss).

Relevant exchange rates used in the preparation of the consolidated financial statements of foreign subsidiaries were as follows (Mexican pesos per one U.S. dollar):

Current exchange rate as of December 31, 2017	19.74
Current exchange rate as of December 31, 2016	20.66
Weighted average exchange rate for the year ended December 31, 2017 (*)	19.84
Weighted average exchange rate for the year ended December 31, 2016 (*)	18.66
Current exchange rate as of May, 11 of 2018	19.54

(\*) Weighted average exchange rate used to translate revenues, costs and expenses of the companies mentioned above.

***Business combinations*** – Acquisitions of subsidiaries and businesses units are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, at the date of interchange of the assets transferred, liabilities incurred or assumed and the equity interests issued by the Company in exchange for control of the acquire. Acquisition-related costs are generally recognized in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognized at their fair value, except that:

Deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements, which are recognized and measured in accordance with IAS 12, *Income Taxes*, and IAS 19, *Employee Benefits*, respectively.

Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, are measured in accordance with that Standard.

Any excess of the cost of acquisition on the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the associated company recognized at the date of acquisition is recognized as goodwill. Goodwill is included in the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's interest in the net fair value of the assets, liabilities and contingent liabilities over the cost of acquisition, after the reassessment, is immediately recognized in profit and loss.

When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and later adjustments to the consideration are recognized against goodwill, providing that it has arisen from reliable information on the fair value at the acquisition date and occur during the 'measurement period' (which cannot exceed one year from the acquisition date). All other subsequent adjustments are recognized in profit or loss.

The subsequent accounting for changes in the fair value of the contingent estimates that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates. Contingencies classified as assets or liabilities are remeasured at subsequent reporting dates in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognized in profit or loss.

When a business combination is achieved in stages, the Company's previously held equity interest in the acquiree are remeasured to fair value at the acquisition date (i.e. the date when the Company obtains control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have been previously recognized in other comprehensive income (loss) are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

***Cash and cash equivalents and temporary investments*** – Cash consists of deposits in bank accounts that do not generate interest. Cash equivalents consists in temporary investments referred to short-term fixed income investments whose original maturity is less than three months. These investments are expressed at cost plus accrued yields. The value so determined approximates their fair value.

Temporary investments in an equity instruments for trading are measured at its fair value prevailing at the date of the financial statements. Subsequent changes in the fair value are recognized in profit or loss.

***Allowances for doubtful accounts*** – The Company follows the practice of recording an estimation of an allowance for doubtful accounts, which is determined by considering the balances of clients with more than a year old, those in litigation and or specific recovery problems. Actual results may differ materially from these estimates in the future.

F-16



***Inventories and cost of sales*** – Inventories are stated at the lower of cost or net realizable value. The cost allocation formula used is the average cost. The cost includes acquisition costs of materials, labor and overhead costs related to e. manufacturing and distribution, based on normal activity levels. The net realizable value represents the estimated selling price for inventories less all estimated costs of completion and other necessary to make the sale, which is recorded in the statement of financial position and against account is the cost of sales.

The Company classifies inventory of raw materials in the Consolidated Statements of Financial Position based on its expected consumption period, presenting as long-term inventories those which in accordance with historical data and production trends will not be consumed in the short-term (one year).

The Company classified as long-term inventory parts and rollers, that, according to historical data and trends, showing that such inventories will not be consumed in the short-term. The Company utilizes coke, a form of coal, as a raw material input to fuel its blast furnace (see Note 9). The Company has 136,541 metric tons (MT) of coke inventory valued at 1,037 million Mexican pesos (average of USD\$ 385/MT) on hand at December 31, 2017 and 231,942 MT of coke inventory valued at 1,433 million Mexican pesos (average of USD\$ 299.00/MT) on hand at December 31, 2016 that is classified as long-term in the accompanying Consolidated Statements of Financial Position.

The Company follows the practice of providing a reserve for slow-moving inventory, considering the total of products and raw materials (including Coke) with a turnover above one year, which is recorded in the statement of financial position and against account is the cost of sales.

The cost of sales of the Company includes inventory costs, outbound freight charges, purchasing and receiving costs, inspection costs, and warehousing costs in cost of goods sold. Vendor payment incentives are recorded as a reduction to cost of goods sold.

***Property, plant and equipment*** – Property, plant and equipment are recorded at acquisition cost, less any recognized impairment loss. Cost includes all expenses related with acquisition and installation and, for qualifying assets, borrowing costs (interest) capitalized in accordance with the Company's accounting policy. Depreciation is f. recognized so as to write off the cost of assets (other than land and properties under construction) less their residual values over their useful lives, using the straight-line method, and commences when the assets are ready for their intended use. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

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

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

Repair and maintenance costs that significantly increase productive capacity or extend the useful lives of existing plant and equipment are capitalized. Supplies, comprising of spare parts and consumables for internal use are classified under property, plant and equipment and expensed as incurred in the manufacturing process. All other repair and maintenance costs are expensed as incurred. Capital expenditures for projects that cannot be put into use immediately are included in constructions and machinery in-progress. When constructions and machinery in-progress are completed, they are transferred to depreciable assets.

**Leases** – Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

**Borrowing costs** – Borrowing costs directly attributable to the acquisition, construction or production of qualifying **h.** assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

**Intangible assets** – Intangible assets with definite useful lives that are acquired separately are carried at cost, less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis **i.** over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for, on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

Expenditure on research activities is recognized as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognized if, and only if, all of the following have been demonstrated:

- The technical feasibility of completing the intangible asset so that it will be available for use or sale;
- The intention to complete the intangible asset and use or sell it;
- The ability to use or sell the intangible asset;

- How the intangible asset will generate probable future economic benefits;

The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

- The ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognized for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognized, development expenditure is recognized in profit or loss in the period in which it is incurred. Subsequent to initial recognition, internally-generated intangible assets are reported at cost less accumulated amortization and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

Intangible assets acquired in a business combination and recognized separately from goodwill are initially recognized at their fair value at the acquisition date (which is regarded as their cost). Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortization and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss.

**Goodwill** – Goodwill arising on a combination of business is carried as an asset at cost as established at the date of acquisition of the control of the business less accumulated impairment losses, accumulated later, if any. For the purposes of impairment testing, goodwill is allocated to each of the Company's cash-generating units that is expected to benefit from the synergies of the combination. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. An impairment loss recognized for goodwill is not reversed in subsequent periods. On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

**Impairment of tangible and intangible assets other than goodwill** – At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any of such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease. Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. For purposes of allocation of goodwill when there is business combination will be distributed among each of the cash generating units of the acquiring entity, expected synergy benefits. A reversal of an impairment loss is recognized immediately in profit or loss and allocated to the assets of that unit, the carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss of value shall not exceed the carrying amount that would have been obtained if had not recognized an impairment loss in value for the asset in prior periods. Unless the related asset is recognized at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**Provisions** – Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can

be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

**m.** *Employee benefits* – The costs of direct benefits and defined contribution to retirement benefit plans are recognized as an expense when employees have rendered service entitling them to the right to contributions.

F-19

The retirement benefit liability is determined based on the present value of the defined benefit obligation at the date of the statement of financial position. Any compensation included in the determination of the liability premiums corresponds to seniority premiums for retirement.

Actuarial gains and losses are recognized on profit or loss of the year. The retirement benefit liability and the related net cost of the period are determined under the Projected unit credit method based on projected salaries using for this purpose, certain assumptions determined by independent actuaries.

Liabilities for employee benefits recognized in the consolidated statement of financial position represent the present value of the defined benefit obligation.

Republic operates various employee benefit plans. The contributions to these benefit plans are either contractually determined by the terms of a collective bargaining agreement with the United Steelworkers or they are under the terms of a defined contribution plan. Accordingly, the company pays fixed contributions to separate entities and they are expensed in the period in which the employees rendered the services entitling them to the benefits.

***Earnings per share*** – Income per share is calculated by dividing controlling net income, by the weighted average n. shares outstanding during each year presented.

***o. Income taxes*** – Income taxes represents the sum of the tax currently payable and deferred tax.

***Current tax*** – The Company causes Income Tax (ISR) (See note 15) and is recorded in the result in the year in which it is determined. Determined ISR is based in fiscal earnings. Fiscal earning differs from the gain reported in the -Consolidated Comprehensive Income Statement, due to taxable income or deductible expenses in other years and items which never are taxable on deductible. The liability of the Company for caused taxes is computed using the fiscal rates promulgated or substantially approved at the end of the period on report.

***Deferred tax*** –Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases using the liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible -temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are computed using the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The effects of changes in the statutory rates are accounted for in the period that includes the enactment date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

The Company follows the practice of recognizing the benefit from the amortization of acquired or generated tax losses in current earnings that are amortized.



**Current and deferred tax for the period** – Current and deferred tax are recognized as an expense or income in profit or loss, except when they relate to items that are recognized in other comprehensive income (loss) or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income (loss) or directly in equity, respectively. Or when it arises from initial recognition of a business combination.

**Interests on recoverable tax balances** – Interest on recoverable tax balances are presented in the consolidated statements of comprehensive income as interest income.

**Foreign currencies** – In preparing the financial statements of each individual group entity, transactions in currencies other than the entity's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. In the case of non-monetary items, which arise from the payment or collection of anticipated considerations, are recognized at the exchange rate in force of the date of the transaction.

Exchange differences are recognized in profit or loss in the period in which they arise except for:

Exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;

- Exchange differences on transactions entered into in order to hedge certain foreign currency risks; and

Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognized initially in other comprehensive income and reclassified from equity to profit or loss on sell all or part of the net investment.

**Financial instruments** – Financial assets and financial liabilities are recognized when a group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

**r. Financial assets** – Financial assets are classified into the following specified categories: “financial assets at fair value through profit or loss”, “held-to-maturity investments”, “available-for-sale financial assets” and “loans and receivables”. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial

recognition. All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

The effective interest method is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, (where appropriate), a shorter period, to the net carrying amount on initial recognition.

The Company does not have financial assets classified as “available-for-sale financial assets”.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and accounts receivable are measured at amortized cost using the effective interest method, less any impairment.

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty;
- Breach of contract, such as a default or delinquency in interest or principal payments;
- It becoming probable that the borrower will enter bankruptcy or financial re-organization; or
- The disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

Except for equity instruments available for sale, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

The Company recognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On recognition totally a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On partial derecognition of a financial asset other than in its entirety (e.g. when the Company retains an option to repurchase part of a transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Company retains control), the Company allocates the previous carrying amount of the financial asset between the part that continues to recognize under continuing involvement, and the part that no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative

F-22

gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss.

**Financial liabilities** – Debt and equity instruments issued by a group entity are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. Financial liabilities are classified as either financial liabilities “at fair value through profit or loss” or “other financial liabilities”.

Financial liability at fair value with changes through profit or loss is a financial liability classified as held for trading or it is designated as at fair value with changes through profit or loss.

A financial liability is classified as held for trading if:

- It has been acquired principally for the purpose of repurchasing it in the near term;

On initial recognition, it is part of a portfolio of identified financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or

- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at fair value through profit or loss upon initial recognition if:

Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise;

The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Company’s documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

It forms part of a contract containing one or more embedded derivatives, and IAS 39, *Financial Instruments: Recognition and Measurement*, permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

Financial liabilities at fair value through profit or loss are recorded at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability and is included in the ‘other gains and losses’ line item in the consolidated statement of comprehensive income.

Other financial liabilities including borrowings are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate a shorter period), to the net carrying amount on initial recognition.

The Company derecognizes financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

***Derivative financial instruments*** – The Company sometimes uses derivative financial instruments for hedging risks associated with natural gas prices; this commodity is used for the production of goods, for which it conducted studies on historical consumption, future requirement and commitments acquired, thus diminishing its exposure to risks other than its normal operating risks.

These derivatives are initially recognized at fair value at the date the derivative contracts are entered into and subsequently are remeasured to the fair value at the end of reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

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.

At the inception of the hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting exposure to changes in fair values or cash flows of the hedged item attributable to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income and accumulated under the heading of *fair value of derivative financial instruments*, net of the corresponding income taxes. The gain or loss relating to the ineffective portion of hedge instrument is recognized immediately in profit or loss, and is included in the cost of sales line item.

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%.

Amounts previously recognized in other comprehensive income are reclassified to profit or loss in the periods when the hedged item is recognized in profit or loss, in the same line of the consolidated statement of comprehensive income as the recognized hedged item. However, when the hedged forecasted transaction results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously accumulated in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

Hedge accounting is discontinued when the Company revokes the hedging relationship, when the hedging instrument expires or is sold, terminated, or exerted, or when it no longer qualifies for hedge accounting. Any gain or loss accumulated from the hedge instrument that had been recognized in other comprehensive income and accumulated in equity at that time remains in equity until the forecast transaction is ultimately recognized in profit or loss. When a forecast transaction is no longer expected to occur, the gain or loss accumulated in equity is recognized immediately in profit or loss.

**Revenue recognition** – Revenue is measured at the fair value of the consideration received or receivable and is recognized in the period in which the Company transfers the risks and benefits of inventories to customer who purchased them, which usually coincides with the delivery of products to customers in fulfilling their orders. Net sales represent the goods sold at list price, less returns received and discounts.

**Financial information by operating segment** - An operating segment is an identifiable component of the Company that performs business activities, from which it may earn revenues and incur expenses, including those income and v. expenses related to transactions with other components of the entity and upon which the company has separate financial information that is evaluated regularly by the Board of Directors, in making decisions to allocate resources and assess segment performance.

**Environmental liabilities** - The Company and other steel companies are subject to stringent environmental laws and regulations. It is the policy of the Company to endeavor to comply with applicable environmental laws and regulations. The Company established a liability for an amount which the Company believes is appropriate, based w. on information currently available, to cover costs of environmental remediation it deems probable and estimable. The liability represents an estimate of the environmental remediation costs associated with the required future steps of

F-24



remediation, based upon management's evaluation of probable outcomes. These estimates are based on currently available facts, existing technology and presently enacted laws and regulations. The precise timing of remediation activities cannot be reliably determined at this time due to the absence of any deadlines for remediation under the applicable environmental laws and regulations pursuant to which such remediation costs will be expended. Accordingly, the Company has not discounted its environmental liabilities. Currently no claims for recovery are netted against the recorded liabilities.

**Cost of sales and expenses by function** - The Company classifies its costs and expenses by function in the consolidated Statements of Comprehensive Income, according to the industry practices where the Company operates.

## 5. Critical accounting judgments and key sources of estimation

In the application of the Company's accounting policies, which are described in Note 4, management is required to make judgments, estimates and assumptions regarding the carrying amounts of assets and liabilities. The estimates and associated assumptions are based on historical experience, the future and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis and the resulting changes are recorded on the period in which the estimate has been modified, if such change affects only that period or in future periods.

**Critical accounting judgments** – The following are the critical judgments in the application of accounting policies, apart from those involving estimations, that the management have made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in the financial statements:

**Functional currency** – The Company's management has evaluated all the indicators that in its opinion are relevant and has concluded that the Company's functional currency is the Mexican Peso. Likewise, the Company has concluded that the functional currency of the companies located abroad are those mentioned in Note 4-a.

**Key sources of estimation** – The following are the key assumptions, and other key sources of estimation at the consolidated balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the following financial year.

**Allowance for doubtful accounts** – Management applies judgment at each balance sheet date creating an allowance for doubtful accounts, in order to show the possible financial loss caused by the inability of customers to make the corresponding payments. The Company calculates its allowance based on the accounts receivable aging and other considerations for specific accounts.

***Net realizable value of inventory*** – At each balance sheet date, professional judgment is used to determine any impairment in inventory. Inventory is considered as impaired when its carrying value is higher than its net realization value.

***Impairment of long-lived assets in use*** – Management applies professional judgment at each balance sheet date to determine whether the long-lived assets in use are impaired. Long-lived assets in use are impaired when the carrying value is greater than the recoverable amount and there is objective evidence of impairment. The recoverable amount is the present value of the discounted future cash flows that will generate during the remaining useful life, or liquidation value (fair value).

***Estimating useful lives and residual values of property, plant and equipment*** – As described in Note 4 f, the Company reviews the estimated useful life and residual values of property, plant and equipment at the end of each annual reporting period.

***Impairment of goodwill*** – Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires management to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

**Employee Benefits** - The valuation of employee benefits is carried out by independent actuaries based on actuarial studies. Among others, the following assumptions, which can have an effect are used: (i) discount rates, (ii) the expected growth rates of wages and (iii) turnover rates and mortality recognized tables.

A change in the economic, employment and fiscal conditions could modify the estimates.

**Contingencies** – The Company is subject to transactions or contingent events for which it uses professional judgment in the development of estimates of probability of occurrence. Factors that are considered in these estimates are the current legal situation at the date of the estimate and, the opinion of the legal advisers.

**Deferred income tax assets** – The Company reviews the carrying amounts at the end of each reporting period and reduces deferred income tax assets to the extent that it is not probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilized. However, there is no assurance that the Company will generate sufficient taxable profit to allow all or part of its deferred income tax assets to be realized.

**Valuation of financial instruments** – The Company has certain types of derivative financial instruments (gas swaps), and the valuation techniques that includes to determine the fair value are based in data obtained in observable markets.

The Company's management believes that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of derivative financial instruments. At December 31, 2017 and 2016 the Company has not derivative financial instruments.

## 6. Cash and cash equivalents and other investments

Cash and cash equivalents are as follows:

	December 31,	
	2017	2016
Cash	\$1,339,887	\$1,156,723
Cash equivalents (1)	5,863,717	6,379,811
	\$7,203,604	\$7,536,534

(1) Most of these cash equivalents correspond to Treasury Bills issued by Treasury Department of USA, whose original maturity is less than three months.

The temporary investments included in Consolidated Statements of Financial Position at December 31, 2017 amounting \$ 88,947 (\$ 428,422 at December 31, 2016) consists in equity instruments for trading.

**7. Trade receivables – Net**

The average collection period on sales of goods is between 30 and 60 days. No interest is charged on the outstanding accounts receivables from clients. The Company has recognized an allowance for doubtful accounts to show the possible financial loss caused by the inability of customers to make the corresponding payments. Allowances for doubtful accounts are calculated based on several factors including price adjustments, likelihood of recovery, aging and historical experience.

Credit limits and scoring by customer are reviewed twice a year. On December 31, 2017 and 2016 there are no customers who represent more than 5% of the total balance of trade receivables. The Company does not hold any collateral or other credit enhancements over these balances nor does it have a legal right of offset against any amounts owed by the Company to the counterparty.

Trade receivables disclosed below include amounts that are past due at the end of the reporting period for which the Company has not recognized an allowance for doubtful debts because there has not been a significant change in credit quality and the amounts are still considered recoverable. The Company does not hold any collateral. In general terms, the accounts receivable does not show impairment.

Age of receivables that are past due but not impaired is as follows:

**At December 31,  
2017 2016**

30 - 60 days	\$72,778	\$71,182
61 - 90 days	57,629	29,553
91 + days	162,807	124,703
Total	\$ 293,214	\$225,438

During the years ended December 31, 2017 and 2016, the movement in the allowance for doubtful accounts was as follows:

**2017 2016**

Balance at beginning of year	\$59,095	\$75,548
Provisions	5,719	169
Writes off	0	(21,964)
Translations effects	(380)	5,342
Balance at end of year	\$64,434	\$59,095

In determining the nonrecoverable portion of accounts receivable, the Company considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the end of the reporting period. The concentration of credit risk is minimum, due to the fact that the customer base is large and unrelated.

Republic entered into an agreement with an unrelated third-party (“purchaser”) for the factoring of specific accounts receivable in order to reduce the amount of working capital required to fund such receivables. The agreement was amended on October 26, 2016, so that any party can terminate the agreement after giving notice 7 days before.

On the sale date, the purchaser advances funds equivalent to 80% of the value of receivables. The maximum amount of outstanding advances related to the assigned receivables was USD\$ 30 million. The remaining amount between the receivable balance and the advance is held in reserve by the purchaser. Payment of the funds held in reserve less a discount fee are made by the purchaser within four days of receipt of payment on collection of funds related to each assigned receivable. The discount fee, which generally ranges from 1% if paid within 15 days (of the advance date) to 3.75% if paid within 90 days, and 1% for each 15 days additional until the account is paid. This discount fee is recorded as a charge to interest expense in the Consolidated Statements of Comprehensive Income (Loss).

The purchaser has no recourse against the Company if payments are not received due to insolvency of an account debtor within 120 days of the invoice date. However, while the facility calls for the sale, assignment, transfer and

conveyance of all rights, title and interests in the selected accounts receivable, the purchaser may put and charge-back any receivable not paid to the purchaser within 90 days of purchase for any reason besides insolvency of the account debtor. As collateral for the repayment of advances for receivables sold, the purchaser has a priority security interest in all accounts receivable of the Company (as defined by the Uniform Commercial Code of the United States of America).

During the year ended December 31, 2017, the Company sold a nominal amount of USD \$ 25.4 million (\$20.7.0 million in 2016) of accounts receivable. The discount fees incurred by this contract were approximately USD \$ 0.5 million in 2017 and USD\$ 0.3 in 2016. These fees were included in expenses for interest in the Comprehensive Income Statement. As of December 31, 2017, and 2016 the buyer has USD\$ 1.9 million and USD\$ 2.7 million, respectively, of receivables that have not been recovered by the buyer. The amount uncollected for 2016 is subject to a possible return of the Company by the buyer. These accounts receivable are included in the total trade receivables for the purpose of assessing the recoverability of them and, where appropriate, determine the adequacy of allowance for doubtful accounts.

<b>8.</b>	<b>Recoverable taxes</b>	
	<b>December 31,</b>	
	<b>2 0 1 7</b>	<b>2 0 1 6</b>
Valued Added Tax	\$2,075,615	\$1,450,147
Income Tax	146,333	54,983
Business Flat Tax	8,427	8,469
	<b>\$2,230,375</b>	<b>\$1,513,599</b>

**9.****Inventories**

Short-term:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Finished goods	\$1,572,134	\$1,590,555
Work in process	61,129	48,599
Billet	1,443,938	1,531,732
Raw materials and supplies	3,728,737	2,804,771
Materials, spare parts and rollers	1,331,079	1,153,507
Materials in transit	126,481	52,319
	<b>\$8,263,498</b>	<b>\$7,181,483</b>

Long-term:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Coke	\$1,037,470	\$1,433,145
Spare parts	49,831	47,751
Rollers	133,465	116,030
Finished goods	353,095	353,095
	1,573,861	1,950,021
Less, valuation allowance at cost or net realizable value, the lower.	(353,095)	(353,095)
	<b>\$1,220,766</b>	<b>\$1,596,926</b>

The Company has \$ 1,037,470 and \$ 1,433,145 of coke inventory on hand as of December 31, 2017 and 2016 respectively (See note 4-e), which the Company would only use as an input to its blast furnace in Lorain facility which currently is out of operation. Management of the Company continually evaluates both the idled facility and the coke inventory for impairment. Management periodically evaluates the potential degradation of the coke inventory and has determined that it continues to be suitable as a blast furnace input or, alternatively, for sale to other blast furnace facilities.

As of May 11, 2018, Management considers that there will be recovery in the industries in which the Company operates; this would result in an expectation in those markets and therefore, the blast furnace would be restarted in the future. However, the blast furnace shows impairment that has obliged to present in books a value of zero. In

prevention to the date in which the plant restarts operations, the Company has continued incurring in certain costs to keep the blast furnace (within Lorain plant) and the coke (such costs are applied to costs of the period). Restarting of the blast furnace, certain expenses will be required for the restoration of the equipment, in order to return to be a productive equipment, mainly in the refractory covering. However, there is still uncertainty on the date on which the blast furnace will restart its operation. The Company cannot offer any guarantee of the restarting of the total operation of the blast furnace on of conditions economically feasible.

## 10. Property, plant and equipment

Cost of investment property, plant and equipment is as follows (in millions of Mexican pesos):

	Land	Buildings	Machinery and equipment	Transportation equipment	Furniture, mixtures and computer equipment	Constructions and machinery in-progress	Total
Balance as of December 31, 2015	1,029	3,269	21,090	154	117	573	26,232
Additions	12	978	661	1	4	1,444	3,100
Disposals			(153)				(153)
Translation effects	64	612	962		8	1,276	2,922
Balance as of December 31, 2016	1,105	4,859	22,560	155	129	3,293	32,101
Additions	0	36	2,817	4	2	181	3,040

F-28



Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Translation effects	(11)	(119)	(572)	(1)	(2)	(40)	(745)
Balance as of December 31, 2017	\$ 1,094	\$ 4,776	\$ 24,805	\$ 158	\$ 129	\$ 3,434	\$ 34,396

Accumulated depreciation of property, plant and equipment is as follows (in millions of Mexican pesos):

	Buildings	Machinery and equipment	Transportation equipment	Furniture, mixtures and computer equipment	Total
Balance as of December 31, 2015	953	14,008	74	68	15,103
Depreciation expense	51	1,112	7	2	1,172
Translation effects	1	1,337	(3)	0	1,335
Balance as of December 31, 2016	1,005	16,457	78	70	17,610
Depreciation expense	35	1,297	3	6	1,341
Translation effects	(7)	(280)	(1)	(4)	(292)
Balance as of December 31, 2017	\$ 1,033	\$ 17,474	\$ 80	\$ 72	\$ 18,659

The depreciation expense for the years ended December 31, 2017, and 2016 amounted to \$ 1,340,375 and \$ 1,171,476, respectively.

The net book value of property, plant and equipment is as follows (in millions of Mexican pesos):

Net Book Value:	Land	Buildings	Machinery and Equipment	Transportation equipment	Furniture, mixtures and computer equipment	Constructions and machinery in-progress	Total
Balance as of December 31, 2015	\$ 1,029	\$ 2,316	\$ 7,082	\$ 80	\$ 49	\$ 573	\$ 11,129
Balance as of December 31, 2016	\$ 1,105	\$ 3,854	\$ 6,103	\$ 77	\$ 59	\$ 3,293	\$ 14,491
Balance as of December 31, 2017	\$ 1,094	\$ 3,743	\$ 7,331	\$ 78	\$ 57	\$ 3,434	\$ 15,737

As of December 31, 2014, Republic had invested USD\$158.8 million in an electric arc furnace and associated equipment at its steelmaking facility in Lorain, Ohio, USA, to meet growing customer demand for the Company's SBQ (especial bars) steel. The location was chosen for its strategic proximity to customers and its skilled workforce. The construction of the Lorain electric arc furnace began mid-year 2012 and the Company began steelmaking operations in July 2014. The amount indicated includes USD \$ 45.4 million capitalized from labor and manufacturing overhead related to the construction of the furnace and is presented in the investment in machinery and equipment.

In June 2015, Republic Steel temporarily suspended operations in the newly constructed electric arc furnace at the Lorain facility in response to the severe economic downturn in the energy exploration for oil and gas sector, following the sharp drop in the price of oil which has led to significant market declines and demand for steel product, for those markets. As a consequence of this event management determined a triggering event took place to where the long-lived assets at the Lorain facility may not be fully recoverable. Management performed an analysis of the fair value of the Lorain facility with the assistance of an independent valuation firm and determined that net book value exceeded the fair value by approximately USD\$130.7 million and as such recognized an asset impairment of this amount during the year ended December 31, 2015. The fair value determination at the Lorain facility was based on an independent valuation of the assets using the comparable match method of the market approach to determine fair value. The income approach was not considered an appropriate fair value measurement due to the absence of reliable forecast data on the future behavior of oil market and the facility was idled indefinitely in early 2016.

Subsequent to year end, the entire Lorain facility was temporarily idled effective March 31, 2016 and at the date of issuance, May 11, 2018, management has no near-term plans to restart the facility, and the expectation is that it will be restarted when oil and gas market conditions improve substantially,

particularly in the oil and gas drilling industry. The Company has property, machinery, and equipment with a net book value of approximately USD\$ 32.2 million as of December 31, 2016 and 2017, pertaining to the Lorain; Ohio facility after recording the impairment charge of USD\$ 130.7 million as mentioned above. The impairment charge did not impact the operation business neither the future cash flows of the Company, as it was a provision and not a-cash expenditures. Management further assessed if there were any impairments at the Company's other cash generating units and determined that as of December 31, 2016 no other cash generating units were impaired based on current projections.

As of December 31, 2015, the machinery and equipment includes a machine called Coss System, valued at \$ 122,880 (which is equivalent to USD\$ 9.9 million), plus related installation expenses in the amount of \$ 22,079, which was installed in an industrial plant of the subsidiary Aceros D.M., S.A. de C.V. (Grupo San). This machinery did not work in accordance with the specifications promised by the supplier, so it is not in operation. Currently, actions are being taken for the recovery, through arbitration in the USA and directly with the supplier Fuchs Technology, A.G, in the amount of USD\$ 5.9 million, which is equivalent to the installation expenses previously mentioned, plus damages. On the other hand, the supplier also has demanded the payment of the USD\$ 9.9 million. In the year 2016 the court conducted the matter has issued a sentence in favor of the Company and its subsidiaries, confirming that the counter-claim of Fuchs Technology, A.G. for the claim of the payment, has been retired of the arbitration existing; for the arguments contained in the resolution, as a big protection against any future intend of counter-claim, it was also established that the Company is free to dispose of the equipment.

As a consequence of that above stated, the Company has written-off from the line of Machinery and Equipment the machinery named Coss System, with a value of \$122,880 (equivalent to USD \$9.9 million at its original value) as well as the related installation expense for \$22,079, installed in the industrial plant of Aceros DM, S.A. de C.V., a subsidiary of Corporación Aceros DM, S.A. de C.V. with the liability that existed in favor of Fuchs Techonology, A.G.; additionally, in other expenses of the Comprehensive Income Statement, was presented the \$35,293 amount, which correspond to the desintallation expenses of the equipment of Fuchs.

## 11. Intangible and other long-term assets

The balances as of December 31, 2017 and 2016 are as follows:

Assets	2017		Net	Amortization
	Original value	Accumulated amortization		period (years)
Republic trade mark	\$106,303	\$ -	\$106,303	*
Kobe Tech	123,887	123,887	-	12

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

contract				
Customers list	64,893	40,288	24,605	20
Total from Republic (1)	295,083	164,175	130,908	
Customers list	2,205,700	2,205,700	-	9
Trademark San 42 (2)	329,600	-	329,600	*
Goodwill	1,814,160	-	1,814,160	*
Total from Grupo San	4,349,460	2,205,700	2,143,760	
	4,644,543	2,369,875	2,274,668	
Other assets	196,880	-	196,880	
	\$4,841,423	\$2,369,875	\$2,471,548	

Assets	2016			Amortization
	Original value	Accumulated amortization	Net	period (years)
Republic trade mark	\$111,305	\$ -	\$111,305	*
Kobe Tech contract	129,716	123,410	6,306	12
Customers list	67,946	38,786	29,160	20
Total from Republic (1)	308,967	162,196	146,771	

Customers list	2,205,700	2,103,584	102,116	9
Trademark San 42 (2)	329,600	-	329,600	*
Goodwill (2)	1,814,160	-	1,814,160	*
Total from Grupo San (3)	4,349,460	2,103,584	2,245,876	
	4,658,427	2,265,780	2,392,647	
Other assets	151,626	-	151,626	
	\$4,810,053	\$2,265,780	\$2,544,273	

\* Intangible assets with undefined useful life.

(1) Intangible assets from Republic acquisition.

(2) The trade mark San 42 and the goodwill are presented net of impairment losses recorded in 2009 for \$16,000 and \$ 2,352,000, respectively.

(3) Intangible assets proceeding from Grupo San acquisition.

The amortization amounted of these assets recorded in net income of the years ended December 31, 2017, 2016 and 2015 amounted to \$ 124,607, \$ 257,905 and \$ 254,217, respectively.

The other assets are not subject to amortization and they are primarily comprised of guarantee deposits.

The reconciliation between the opening and closing balances of each year is presented below:

Assets	Original value	Accumulated amortization	Net
Balance as of December 31, 2015	\$4,632,790	\$ (1,982,690)	\$2,650,100
Additions	127,560	(257,905)	(130,345)
Translation effect of the year	49,703	(25,185)	24,518
Balance as of December 31, 2016	\$ 4,810,053	\$ (2,265,780)	\$2,544,273
Additions	45,253	(124,607)	(79,354)
Translation effect of the year	(13,883)	25,512	6,629
Balance as of December 31, 2017	\$ 4,841,423	\$ (2,369,875)	\$ 2,471,548

**12.****Short-term debt**

On October 22, 1997 and August 17, 1998, the Company offered the holders of medium-term notes of Simec, to exchange their bonds at par, for new bonds denominated subordinated notes in third place. The new notes bear semi-annual interest each at an annual rate of 10.5% interest and principal repayments were semiannual from May 15, 2000 until November 15, 2007. At December 31, 2017 and 2016, the amount of such new notes outstanding totaled USD\$ 0.3 million, plus accrued interest. At December 31, 2017 and 2016, liabilities in pesos for the new notes outstanding amounted \$ 5,960 and \$ 6,241, respectively.

**13.****Trade accounts payable and other accrued liabilities**

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Trade accounts payable	\$3,984,898	\$2,827,559
Other accrued liabilities	842,045	665,936
	<b>\$4,826,943</b>	<b>\$3,493,495</b>

The average credit period on purchases of certain goods or services is 30 to 60 days, from the date of the receipt of the good or service. The Company has financial risk management policies in place to ensure that all payables are paid within the pre-agreed credit terms.

**14.****Employee benefits***Mexican entities*

**Collective bargaining agreements** – For the Mexican operations in 2016, approximately 52% (53% on 2015) of the employees are under collective bargaining agreements. The Mexican collective contracts expire in periods greater than one year.

**Seniority premium benefits** – In accordance with Mexican Labor Law, the Company provides seniority premium benefits to its employees under certain circumstances. Such benefits consist of a one-time payment equivalent to 12 days wages for each year of service (at the employee's most recent salary, but not to exceed twice the legal minimum wage), payable to all employees with 15 or more years of service, as well as to certain employees terminated involuntarily prior to the vesting of their seniority premium benefit. These obligations are calculated by independent actuaries using the projected unit credit method.

The most important actuarial hypothesis used for the purposes of the determination of the net cost of the period related to the retirement benefits plan were as follows:

	2 0 1 7	2 0 1 6	2 0 1 5
Discount rate	7.5	6.75	6.75
Rate of salary increase	4.5	4.50	3.93

Components of net cost of benefits plan to employees are as follows:

	2 0 1 7	2 0 1 6	2 0 1 5
Current service cost	\$5,697	\$5,749	\$4,447
Financial cost	6,637	6,247	5,359
Past service cost	(3,575 )	(7,906)	
Anticipated reduction obligations	(12,517)	0	
Actuarial losses (gains) recognized in the year	(4,339 )	5,801	3,398
	\$ (8,097 )	\$ 9,891	\$ 13,204

The expense for the years 2017, 2016 and 2015 was recorded as follows:

	2017	2016	2015
Cost of sales	\$(4,534)	\$5,539	\$7,395
Administrative expenses	(3,563)	4,352	5,809
	\$(8,097)	\$9,891	\$13,204

The amounts included in the Consolidated Statements of Financial Position as of December 31, 2017 and 2016 are \$ 91,822 and \$ 99,783, respectively, corresponding to the present value of defined benefit obligation.

Changes in the present value of the defined benefit obligation and the balance of the liability are integrated as follows:

	2017	2016
Opening balance of the defined benefit obligation	\$99,783	\$93,432
Current service cost	5,697	5,749
Past service cost	(3,439 )	(7,906 )
Financial cost	6,637	6,247
Actuarial losses (gains)	(4,339 )	5,801
Benefits paid	(12,517)	(3,540 )
Closing balance of the defined benefit obligation	\$91,822	\$99,783



**Severance benefits** – Further, in accordance with the Mexican labor laws, the Company also provides statutorily mandated severance benefits to its employees terminated under certain circumstances. Such benefits consist of a one-time payment of three months’ wages plus 20 days’ wages for each year of service, payable upon involuntary termination without just cause. Severance benefits payments are recorded directly in the consolidated statement of comprehensive income (loss) at the time they are paid, unless they are related to restructuring expenses, which are recorded when there is a present obligation from past events.

**Employee profit sharing (EPS)** – The Mexican Constitution and the Labor Law grant employees the right to receive a 10% share of the employers’ profits. Employee Profit Sharing is computed in similar terms to the taxable profit for income tax, excluding mainly the employee’s profit sharing paid this year and the amortization of tax losses and decreasing the non-deductible part of the social security for purposes of income tax. For the years 2017 and 2016, EPS amounted to \$ 67 and \$ 0, respectively. EPS is recorded in the results of operations for the year in which it is incurred.

**Governmental defined contribution plan** – Under Mexican legislation, the Company must make payments equivalent to 2% of its workers’ daily integrated salary (ceiling) to a defined contribution plan that is part of the retirement savings system. The expense in 2017, 2016 and 2015 was \$12,838, \$11,323 and \$9,323, respectively.

## Foreign entities (Republic)

Republic is the only subsidiary of the Company which offers other benefits and pension plans to their employees. Such benefit plans to employees are described below:

### a. **Collective Bargaining Agreements**

As of December 31, 2017, 83% of the Republic employees are covered by a collective bargaining agreement (labor agreement) with the United Steelworkers (“USW”). The agreement initially expired on August 15, 2016 and was extended for a further three years through August 15, 2019. The extended agreement renews all the provisions, understandings and agreements set forth in the January 1, 2012 Basic Labor Agreement. The base rates of pay were determined under the extended agreement and will remain unchanged from those ruling under the expired agreement as of August 16, 2016. The extended agreement provides the Company’s quarterly contributions to fund the Republic Retirement VEBA and Benefit Trust (the “Benefit Trust”) to be reduced from \$2.6 million to \$0.25 million beginning in August 15, 2016 through June 30, 2019. Effective July 1, 2019, the Company’s contribution to the Benefit Trust will change to \$4.00 per hour for each hour worked by USW represented employees.

### b. **Defined Contribution Plans**

**Plan for employees-** Republic participates in the Steelworkers Pension Trust (SPT), a defined benefit multi-employer pension plan. The Company obligations to the plan are based upon fixed contribution requirements. Republic contributes a fixed amount of USD\$1.68 per hour for each covered employee's contributory hours, as defined under the plan.

Participation in a multi-employer pension plan agreed under terms of a collective bargaining agreement differs from a traditional qualified single employer defined benefit pension plan. The SPT shares risks associated with the plan in the following respects:

- I. Contributions to the SPT by Republic may be used to provide benefits to employees of other participating employers.
- II. If a participating employer stops contributing to the SPT, the unfunded obligations of the plan may be borne by the remaining participating employers; and
- III. If Republic chooses to stop participating in the SPT, Republic may be obliged to pay an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

c. **VEBA Benefit Trust**

The Company is required to make quarterly contributions to the defined contribution plan for post-retirement health benefits VEBA as determined by the terms of the USW collective bargaining agreement. The Benefit Trust is a health and welfare plan for USW retiree benefits, and is not a "qualified" plan under the regulations of the Employee Retirement Income Security Act of 1974. For the years ended December 31, 2017, 2016 and 2015, the Company recorded expenses of USD\$ 1.0 million, USD\$ 6.9 million and USD\$ 10.4 million, respectively, related to this benefits plan.

For the years ended December 31, 2017, 2016 and 2015, Republic recorded combined expenses of USD\$ 3.5 million, USD\$ 10.0 and USD\$ 15.7 million, respectively, related to the funding obligations of the retirement healthcare and pension benefits. The cost contributions to these two funds have been reduced from USD \$ 2.6 million to USD\$ 0.25 million per quarter effective after the review of the collective agreement on August 16 2016.

d. **401(k) Plans**

The Company has a 401 (k) defined contribution retirement plan that covers almost all the salaried 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 on the participant's age and years of service as of January first of each year. The amount of the Company 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 vesting service. In addition, employees are permitted to make contributions to this 401(k)-retirement plan through payroll deferrals. In this case, the Company provides a 25.0% matching contribution for the first 5.0% of payroll that an employee elects to contribute. Employees are 100% vested in both their and Republic matching 401(k) contributions. For the years ended December 31, 2017, 2016 and 2015, the Company recorded expense of USD\$ 0.8 million, USD\$ 0.7 million and USD\$ 1.7 million, respectively, related to this defined contribution retirement plan.

Employees who are covered by the USW labor agreement are eligible to participate in the 401 (k) defined contribution retirement plan through voluntary deferrals of employees' compensation. There are no Company contributions or employer matching contributions relating to these employees.

e. **Profit Sharing and Incentive Compensation Plans**

The labor agreement includes a profit sharing plan to which the Company is required to contribute. The extended agreement modified the plan to the following quarterly pretax income, as defined in the labor agreement ("EBT"): 3% of EBT between \$0 and \$25 million per quarter; 4% of EBT between \$25 and \$75 million per quarter; and 5% of EBT over \$75 million per quarter. No expense was recorded for the years ended December 31, 2017, 2016 and 2015,

because the current and prior year thresholds had not been achieved.

Republic has a profit sharing plan for all salaried employees and nonunion workers. The profit-sharing plan was based on achieving certain EBITDA, inventory and shipments targets. In the year ended December 31, 2017 and 2016, the Company paid USD 0.9 million and USD \$0.6 million respectively under this plan. No payments were made under this plan in the year ended December 31, 2015.

**15.**

**Income taxes**

The Company is subject to Income Tax (ISR).

The analysis of the income tax charged (credited) to the results of 2017, 2016 and 2015 is as follows:

F-34

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

	2017	2016	2015
Income tax of the year of Mexican companies	\$19	\$6,751	\$1,571,766
Income tax year of foreign companies	19,802	50,612	26,469
Deferred Tax of Mexican companies	656,060	660,916	(185,540 )
Deferred Tax of foreign companies	421,979	207,762	(642,123 )
	\$1,097,860	\$926,041	\$770,572

Due to the volatility in the U.S. Dollar - MX. Peso exchange rate, several Companies of the group registered significant losses for exchange rate differences.

During 2017, 2016 and 2015, the income tax expense (benefit) attributable to income was different from the one that will result for applying 30% (tax rate in Mexico) before these provisions, as a result of the losses shown below:

	2017	2016	2015
Expected benefit, expense	\$865,300	\$1,580,776	\$(747,102)
Increase (decrease) as a result of:			
Inflation effects, net	(217,249 )	(62,708 )	34,264
Effect between nominal rate from USA and Mexico	(16,572 )	157,366	(226,258)
Benefit from utilization of tax loss carry-forward and others (1)	(115,068 )	(1,165,805)	(38,562 )
Others, net (includes permanent items)	541,449	416,412	415,377
Income tax expense	\$1,097,860	\$926,041	\$(562,281)
Effective tax rate (2)	38.94%	17.57%	(22.50% )

(1) This amount corresponds to the Income tax benefit obtained by those companies that amortized tax loss carry-forwards in the years presented and that were generated prior to 2017, 2016 and 2015, respectively, and for which were not registered the corresponding deferred tax asset, less the effect of tax losses determined for some subsidiaries in the years that are presented for which no deferred tax asset was recorded.

(2) The Calculation of the effective tax rate in 2015 did not include the charge of \$ 1,332,858, corresponding to the year 2010.

The Company has tax losses in some Mexican subsidiaries which, according to the ISR law in Mexico, can be amortized with taxable income generated in the next ten years. Tax losses can be updated following certain procedures established in the law.

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

As of November 18, 2015, the Finance Ministry (SHCP) issued a decree in which a fiscal incentive is given to those who pay income tax (ISR) under terms of the Titles II or IV, Chapter II, Section I of the Law of ISR, to the taxpayers who had obtained income from its business activity in the last period, up to 100 million pesos, that consist in apply the immediate deduction of the investment of new fixed assets, up to 82% of 2016 and 85% for 2017 the investments, incentive that was used by Aceros Especiales Simec Tlaxcala, S.A. de C.V. and by Fundiciones de Acero Estructural, S.A. de C.V.

As of December 31, 2017, Grupo Simec, S.A.B. de C.V. and certain of its Mexican subsidiaries have updated tax losses pending of amortize as follows:

<b>Origin Settlement</b>		<b>Tax losses</b>
<b>Date</b>	<b>Date</b>	<b>pending of amortization</b>
2008	2018	39
2009	2019	36,642
2010	2020	25,656
2011	2021	10,262,957 (1)
2012	2022	4,563
2013	2023	3,295

F-35

2014	2024	43,492
2015	2025	146,152
2016	2026	1,141,942
2017	2027	2,381,395
		\$14,046,133

This amount includes \$ 10,227,347 updated to December 31, 2017, corresponding to a tax loss obtained in a sale of (1) shares which, according to the Income Tax Law, can only be amortized against taxable profits on the sale of shares to be generated in the future.

As of December 31, 2017, Republic had USD\$ 200.2 million of tax losses pending of amortize for federal tax purposes, which expire between 2033 and 2036; USD\$ 317.9 million of tax losses for state and local purposes that expire between 2019 and 2036 and approximately USD\$ 3.1 million of tax losses at the subsidiary located in Canada, which expire between 2031 and 2034.

As of December 31, 2017, and 2016, GV do Brasil Industria e Comercio of Aço LTDA, a subsidiary established in Brazil, had 96.6 million Brazilian Reals (\$ 595 million of Mexican pesos) of tax losses pending of amortize for federal tax purposes, which do not have an expiration date.

Below is a summary of the effects of the main temporary differences comprising the deferred income tax liability included in the consolidated statements of financial position.

	December 31,	
	2017	2016
Deferred tax assets:		
Allowance for doubtful accounts	\$64,434	\$37,183
Provisions	977	(4,770 )
Advances from customers	79,874	76,709
Deferred tax assets	145,285	109,122
Deferred tax liabilities:		
Property, plant and equipment	3,161,272	1,998,648
Intangible assets from Grupo San	298,566	321,748
Prepaid expenses	53,423	9,645
Total deferred liabilities	3,513,261	2,412,041
Deferred tax liabilities, net	\$3,367,976	\$2,302,919

**16. Stockholders' equity**

- a. Common stock as of December 31, 2017 and 2016, is as follows:

	<b>Number of shares  (in thousands)</b>	<b>Amount</b>
Fixed capital	90,850	\$441,786
Variable capital	406,859	1,978,444
	497,709	2,420,230
Effect of restatement		412,038
Total	497,709	\$2,832,268

Common stock consists of nominative shares, fully subscribed, without nominal value. Variable capital could be increased without limitation.

All shares correspond to Series "B". This series is divided in "Class I" with 90,850,050 shares that represent the fixed capital, and "Class II" with 406,859,164 corresponding to variable capital stock.

Retained earnings include the statutory legal reserve. According to the Mexican General Corporate Law, at least 5% of net profit of the year must be transferred to the legal reserve until the reserve equals 20% of capital stock at par value (historical Mexican Pesos). The legal reserve may be

F-36



capitalized but should not be distributed unless the entity is dissolved, and it must be replenished if it is reduced for any reason. As of December 31, 2017, and 2016, the legal reserve of the Company amounted to \$ 484,046 (nominal pesos), representing 20% of nominal capital.

In 2016, a reserve was approved for \$ 1,000,000 for the repurchase and placement of own shares, with this increase the reserve amounted to \$2,000,000 for purchase and re-purchase operations, in order to increase the liquidity of the shares of the Company and promote stability and continuity of their prices through the Mexican Stock Exchange. As of December 31 2017, and 2016, the Company held 3,662,564 and 122,884 shares in treasury, respectively, which amounted to \$267,553 and \$11,531, respectively. The resulting profit in 2017 for the purchase and sale of treasury shares amounted to \$ 22,842 (loss of \$ 507,714 in 2016).

d. A reconciliation of the number of shares outstanding shows below:

	Thousands of shares	
	2017	2016
Shares outstanding at beginning of year	497,586	486,243
(Repurchase) issuance of capital shares, net	(3,539)	11,343
Shares outstanding at year end	494,047	497,586

#### 17. Non-controlling interest

As mentioned in Note 4, Grupo Simec, S.A.B. de C.V. owns 100% of the capital stock of its subsidiaries, except for SimRep Corporation and subsidiaries (Republic), in which it owns 50.22%. The non-controlling interest represents the equity in this subsidiary owned by minority shareholders, and is presented in the consolidated statements of financial position after the controlling interest. The consolidated statements of comprehensive income (loss) also show total net profit or loss for the year as well as for the net comprehensive income or loss for the year. Controlling and non-controlling interest portions are presented after the consolidated comprehensive earning of the year. The table below shows the changes for the years ended December 31, 2017 and 2016:

	2017	2016
Balance at beginning of year	\$(105,186)	\$(1,451,854)
Share of profits and losses for the year	(145 )	1,458,377
Share of translation effects of foreign subsidiaries	(3,241 )	(111,709 )
Balance at the end of the year	\$(108,572)	\$(105,186 )

#### 18. Transactions and balances with related parties

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

- a. Transactions with related parties, carried out in the ordinary course of business, were as follows:

	2017	2016	2015
Holding company			
Interest expense	\$5,325	\$4,590	\$1,983
Management personnel			
Administrative services expenditures	25,603	23,717	22,084
Other related parties			
Sales	3,632	5,160	7,479
Royalty expense	0	0	182,611
Purchases	51,760	324,145	41,370
Direct short-term benefits	82,447	71,629	58,669

- b. Balances receivable from and payable to related parties are integrated as follows:

	December 31,	
	2017	2016
Accounts receivable:		
Industrias CH, S.A.B. de C.V.	\$475,395	\$475,395
Compañía Laminadora Vista Hermosa, S.A. de C.V.	3,056	0
Operadora Construalco, S.A. de C.V.	793	578
Compañía Manufacturera de Tubos, S.A. de C.V.	39,153	8,302
Operadora Industrial de Herramientas, S.A. de C.V.	1,731	306
Joist del Golfo, S.A. de C.V.	5,328	4,618
Others	5,529	17,036
	\$530,985	\$506,235
Loans to related parties:		
Industrias CH, S.A.B. de C.V.	\$ 478,685	\$ 49,579
Perfiles Comerciales Sigosa, S.A. de C.V.	719,286	678,310
Proyecto Comercializadora el Ninzi, S.A. de C.V.	1,715,354	1,715,405
	\$2,913,325	\$2,443,294
	\$3,444,310	\$2,949,529

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

As of December 31, 2017, and 2016, the account receivable with INDUSTRIAS CH, S.A.B DE C.V. corresponds to balances of Income Tax recoverable, because several consolidated for Income Tax purposes, up to 2013; it also includes a loan granted in 2014, for MXN\$32,462 and other granted in 2017, for USD\$21.7 million Dollars; none of them generate interest. With regard to the balance receivable with PROYECTOS COMERCIALES EL NINZI, S.A. DE C.V., it corresponds to a loan for USD\$ 86.9 million, granted on a current account basis, at TIIE rate plus 1 percentage point to invest in the seam-welded tube business line; the balance related to PERFILES COMERCIALES SIGOSA, S.A. DE C.V., includes a loan for USD \$ 33 million, for which no interest is charged to finance working capital. There are no provisions in the current account contracts that permit the loans to be settled by other means than the payment of cash. The remaining balances of accounts receivable correspond to transactions of sales of finished products in accordance with its activity.

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Accounts payable:		
Aceros y Laminados Sigosa, S.A. de C.V.	\$1,854	\$1,856
Holding Protel, S.A. de C.V.	1,593	1,212
Pytsa Industrial, S.A. de C.V.	3,083	3,221
Operadora Perfiles Sigosa, S.A. de C.V.	11,777	0
Operadora Pytsa Industrial, S.A. de C.V.	20,381	0
Others	1,073	1,578
	<b>\$39,761</b>	<b>\$7,867</b>
Loans from related parties:		
Industrias CH, S.A.B. de C.V.	\$226,820	\$221,628
Tuberias Procarsa, S.A. de C.V.	595,655	622,061
Procarsa Tube and Pipe Co.	59,648	62,303
Pytsa Industrial de Mexico, S.A. de C.V.	102,500	106,675
	<b>\$984,623</b>	<b>\$1,012,667</b>
	<b>\$1,024,384</b>	<b>\$1,020,534</b>

As of December 31, 2017, and 2016, the balances payable to INDUSTRIAS CH, S.A.B. DE C.V., TUBERÍAS PROCARSA, S.A. DE C.V., PROCARSA TUBE ABD PIPE Co. and PYTSA INDUSTRIAL DE MÉXICO, S.A. DE C.V., correspond, mainly, to loans received in U.S. Dollars, equivalent to USD \$ 50 million, with an indefinite term, which generate interest at the 0.25% annual rate primarily to finance acquisitions, debt redemptions and bank loan amortization and interest payments. In the case of INDUSTRIAS CH, S.A.B. DE C.V., in 2016 a part of the loan was restructured in MX, Pesos. The remaining balances of the accounts payable correspond to transactions of purchase of finished products in accordance with its activity, as well as several services.

**19. Cost and expenses by their nature**

At the years ended at December 31, 2017, 2016 and 2015, the cost of sales and administration expenses are integrated as follows:

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

	2 0 1 7	2 0 1 6	2 0 1 5
Raw materials and consumables	\$11,268,400	\$10,968,932	\$13,295,584
Electrical energy	2,123,658	1,767,149	2,298,739
Ferrous alloys	1,734,914	1,403,206	783,824
Refractories	492,781	466,815	252,746
Oxygen	213,838	211,051	123,263
Electrodes	419,741	276,473	214,517
Gas and fuels	612,605	518,072	839,802
Labor	2,699,414	2,931,108	2,847,491
Operation materials	1,000,752	890,002	588,769
Depreciation and amortization	1,465,759	1,429,380	1,261,093
Maintenance	2,586,507	2,565,772	1,035,586
Other expenses	615,100	625,120	1,138,042
	\$25,233,469	\$24,053,080	\$24,679,456

F-38

	2017	2016	2015
Cost of sales	\$23,994,526	\$22,775,593	\$23,096,967
Administrative expenses	1,238,943	1,277,487	1,582,489
	\$25,233,469	\$24,053,080	\$24,679,456

## 20. Other (income) expenses, net

The components of other income (expenses) net, in the years ended December 31, 2017, 2016 and 2015, are the following:

	2017	2016	2015
Cancellation of balances	\$2,615	\$9,844	\$5,594
Allowance for doubtful accounts	0	0	17,841
Uninstalling expenses of equipment Fuch	0	35,293	0
Land treatments in Pacific Steel, Inc.	7,674	9,833	5,251
Other expenses	10,289	54,970	28,686
Sale of scrap	(10,434)	(10,428)	(4,350 )
Penalty to client for canceling its supply contract	0	0	(174,354)
Update of balances in favor in taxes	(519 )	(1,739 )	(406 )
Other income	(6,270 )	(6,605 )	(23,003 )
Other income	(17,223)	(18,772)	(202,113)
Other (income) and other expenses, net	\$(6,934 )	\$36,198	\$(173,427)

## 21. Financial instruments

- a. **Capital risk management** – The Company manages its capital to ensure that its subsidiaries will be able to continue as a going concern while maximizing the return to its stockholders through the reinvestment of its earnings. The Company’s overall strategy remains unchanged in comparison with 2014. The Company’s policy is to not obtain bank loans or any other financing transaction.
- b. **Market risk** – Market risk is the risk that the fair value of future cash flows of a financial instrument fluctuates due to changes in market. Market prices include the exchange risk, interest rate risk and the raw material prices risk.
- c. **Foreign exchange risk management** – The Company undertakes certain transactions denominated in foreign currencies, hence, exposures to exchange rate fluctuations arise. The exposures in exchange rate are managed within the settings of the approved policies. The book value of the monetary assets and monetary liabilities denominated in foreign currency at the end of the reporting period are as follows (includes foreign subsidiaries):

	<b>Currency: Mexican peso</b>	
	<b>December 31,</b>	
	<b>2 0 1 7</b>	<b>2 0 1 6</b>
Short – term assets	\$ 11,228,846	10,354,780
Short – term liabilities	4,763,682	3,744,603
Net monetary asset position in foreign currency	\$ 6,465,164	\$ 6,610,177
Equivalent in U.S. Dollars (thousands)	USD\$327,592	USD\$319,889

***Credit risk management*** – Credit risk refers to the risk that a counterpart will default on its contractual obligations resulting in financial loss for the Company. The Company has adopted a policy of only dealing with creditworthy counterparties. The Company only transacts with entities that have a risk grade equivalent to the investment grade d. and higher. The Company investigates and rates its major customers. The Company exposure and the credit ratings of its counterparties are continuously monitored and the accumulated value of transactions concluded is spread amongst approved counterparties. Credit exposure is controlled by counterparty limits that are reviewed and approved annually by the risk management committee.

Trade receivables consist of a large number of customers dedicated to construction and automotive industries, distributed in different geographic areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

The Company does not have significant credit risk exposure with any single counterparty or any group of counterparties having similar characteristics. The Company defines that the counterparties that have similar characteristics are considered related parties. Concentration of credit risk to any other counterparty did not exceed 5% of gross monetary assets at any time during the year.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

**Liquidity risk and risk tables** – Ultimate responsibility for liquidity risk management rests in the board of directors, which has established an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate reserves, banking and credit facilities, by continuously monitoring forecast and actual cash flows, and by matching the maturity profiles of financial assets and liabilities. The following table sets out details of additional bank lines of credit (to be used as letter of credits) that the Company has at its disposal to reduce liquidity risk. These lines of credit are obtained by the Company and one part of them has been used for some of the subsidiaries of Industrias CH, S.A.B. de C.V.:

(In thousands of US dollars)

December 31,  
2017      2016

Bank loans credit lines:		
Drawn balances	\$350,000	\$350,000
Undrawn balances	108,865	117,005
Available line balance	\$241,135	\$232,995

As of December 31, 2017, and 2016 the amount drawn, \$ 0 and \$ 1,236, respectively, correspond to subsidiaries of Industrias CH, S.A.B. de C.V. holding company.

## 22.

### Non-cash flows transactions

During the years ended December 31, 2017, 2016 and 2015, all investing activities were paid in the same year and did not exist funding activities that does not represent cash flows.

### 23. Financial information by segments

The Company segments its information by region, due to the operational structure and the organization of its business. Information used for making decisions is based on such regions.

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 Republic plants; six of which are located in Ohio, Indiana and New York) and one in Canada (Ontario). The plant in Canada represents approximately 4% and 5% of the segment's total sales in 2017 and 2016, respectively, of all the sales of the segment. As of the year ended December 31, 2015, partial operations began at the plant in Brazil, and selective information is presented retrospectively. The segments are engaged in the manufacturing and sale of long steel products intended mainly for the building and automotive industries.

	Year ended December 31, 2017				
	Mexico	USA	Brazil	Eliminations between segments	Total
Net sales	\$17,125,369	\$8,370,999	\$3,204,082	\$	\$28,700,450



Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Cost of sales	13,340,648	7,814,180	2,839,698		23,994,526
Gross profit (loss)	3,784,721	556,819	364,384		4,705,924
Administrative expenses	753,676	257,001	228,266		1,238,943
Other income (expenses), net	98,915	(105,849 )	0		(6,934 )
Interest income	54,021	217	0		54,238
Interest expense	(7,459 )	(50,962 )	(65,186 )	69,203	(54,404 )
Exchange rate gain (loss), net	(1,291,909 )	(26,256 )	1,861	661,942	(654,362 )
Income (loss) before income taxes	1,686,783	328,666	72,793	731,145	2,819,387
Income taxes	761,953	322,444	13,463		1,097,860
Net income (loss) for the year	\$924,830	\$6,222	\$59,330	\$731,145	\$1,721,527

**Other information:**

Depreciation and amortization	\$677,665	\$538,699	\$249,395		\$1,465,759
Total assets	32,440,109	10,548,895	5,356,860	\$(2,807,367)	45,538,497
Total liabilities	891,037	10,760,999	2,570,925	(2,807,925)	11,415,594
Acquisitions of property, plant and equipment	2,394,541	622,785	22,175		3,039,501

**Year ended December 31, 2016**

	<b>Mexico</b>	<b>USA</b>	<b>Brazil</b>	<b>Eliminations between segments</b>	<b>Total</b>
Net sales	\$16,361,808	\$9,339,527	\$1,814,230		\$27,515,565
Cost of sales	13,724,880	7,332,094	1,718,619		22,775,593
Gross profit (loss)	2,636,928	2,007,433	95,611		4,739,972
Administrative expenses	901,849	298,967	76,671		1,277,487
Other income (expenses), net	40,134	(1,481,573)	0	1,477,637	36,198
Interest income	108,004	147	0		108,151
Interest expense	15,053	45,120	50,980	\$(70,983 )	40,170
Exchange rate gain (loss), net	2,343,393	42,727	765,684	(1,376,820)	1,774,984
Income (loss) before income taxes	4,131,289	3,187,793	733,644	(2,783,474)	5,269,252
Income taxes	667,667	256,089	2,285		926,041

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Net income (loss) for the year	\$3,463,622	\$2,931,704	\$731,359	\$(2,783,474)	\$4,343,211
--------------------------------	-------------	-------------	-----------	---------------	-------------

**Other information:**

Depreciation and amortization	\$620,354	\$551,650	\$257,377		\$1,429,381
-------------------------------	-----------	-----------	-----------	--	-------------

Total assets	33,124,471	9,684,303	5,293,891	\$(6,463,293)	41,639,372
--------------	------------	-----------	-----------	---------------	------------

Total liabilities	4,151,297	9,893,536	2,325,325	(7,940,930)	8,429,228
-------------------	-----------	-----------	-----------	-------------	-----------

Acquisitions of property, plant and equipment	2,169,375	816,586	114,298		3,100,259
---	-----------	---------	---------	--	-----------

**Year ended December 31, 2015**

	<b>Mexico</b>	<b>USA</b>	<b>Brazil</b>	<b>Eliminations between segments</b>	<b>Total</b>
Net sales	\$14,978,728	\$9,467,604	\$29,489		\$24,475,821
Cost of sales	(11,247,661)	(11,828,885)	(20,421)		(23,096,967)

F-41

Impairment of property, plant and equipment		(2,071,901 )			(2,071,901 )
Gross profit	3,731,067	(4,433,182 )	9,068		(693,047 )
Administrative expenses	(1,100,622 )	(457,435 )	(24,432 )		(1,582,489 )
Other income (expenses), net	(5,656 )	184,039	(16,268 )		173,427
Interest income	33,872	155			34,027
Interest expense	(9,987 )	(47,032 )	(24,805 )	\$41,629	(40,195 )
Exchange rate loss, net	840,156		(496,906 )	(725,312 )	(382,062 )
Income (loss) before income taxes	3,500,142	(4,753,455 )	(553,343 )	(683,683 )	(2,490,339 )
Income taxes	(1,412,695 )	642,123			(770,572 )
Net income (loss) for the year	\$2,087,447	\$(4,111,332 )	\$(553,343 )	\$(683,683 )	\$(3,260,911 )

**Other information:**

Depreciation and amortization	\$747,436	\$512,393	\$1,264		\$1,261,093
Impairment of property, plant and equipment		2,071,901			2,071,901
Total assets	28,530,321	7,891,964	3,226,150	\$(7,404,019)	32,244,416
Total liabilities	1,889,025	10,808,505	1,829,524	(7,404,019)	7,123,035
Acquisitions of property, plant and equipment	574,211	396	73,136		647,743

## Information on products:

	Year ended December 31,		
	2017	2016	2015
Light structural	\$1,557,567	\$1,467,727	\$1,270,459
Structural	2,232,979	2,321,771	1,957,388
Bars	1,065,731	1,122,116	1,272,580
Rebar	8,931,862	7,449,278	5,235,167
Flat rebar	1,552,578	1,090,841	906,243
Hot rolled bars	8,594,130	7,729,167	8,568,417

Edgar Filing: GROUP SIMEC SA DE CV - Form 20-F

Cold drawn bars	3,370,150	3,207,924	2,750,380
Others	1,395,453	3,126,741	2,515,187
	\$28,700,450	\$27,515,565	\$24,475,821

Information about geographical areas:

	Year ended December 31,		
	2017	2016	2015
Mexico	\$16,712,874	\$16,077,884	\$14,543,446
USA	8,333,259	9,198,561	9,417,392
Brazil	3,214,117	1,828,279	0
Canada	370,803	350,673	371,610
Latin America	30,173	34,932	134,031
Other (Europe and Asia)	39,224	25,236	9,342
	\$28,700,450	\$27,515,565	\$24,475,821

## 24. Reclassifications

In order to achieve a better presentation of the cash flow of 2016, the Company decided to do a reclassification that does not modify substantially the cash flow. Such modification neither affects the net income nor the earnings per share; the above mentioned reclassification of cash flow of 2016 was the following:

The operating cash flow was increased from PS 3,428,498 to PS 5,822,213, for a loan to related parties that amounted PS 2,393,715, which improperly affected the operation flow. The above mentioned loan was reclassified to financing activities, giving as a result that the financing flows were modified from PS 898,085 to (1,495,630).

## 25.

## Contingencies

As of December 31, 2017, and 2016, the Company has the following contingencies:

<sup>a</sup> Pacific Steel, Inc. (PS), a subsidiary located in National City in San Diego County, California, United States of America which main activity is the purchase and sale of scrap, has the following environmental contingencies:

## 1. Contingencies

### **San Diego Regional Water Quality Control Board, SDRWQCB**

On October 30, 2015, the San Diego Regional Water Quality Control Board (SDRWQCB) issued a Non-Compliance Notice to PS because PS had failed to recertify its facility for coverage under the Industrial General Storm **Water** Permit. PS submitted the required certification as of July 19, 2016. As of December 31, 2017, the SDRWQCB has taken no action to issue a penalty to PS for this Non-Compliance Notice.

### **San Diego County Department of Environmental Health**

On July 28, 2016, the San Diego County Department of Public Health (DEH) issued a Notice of Violation to PS for failure to submit a Hazardous Materials Business Plan, pursuant to State law. On August 23, 2016, PS executed a Consent Order and agreed to pay a USD\$1,000 fine and to submit its Hazardous Materials Business Plan within fifteen days of the effective date of the Consent Order. PS has paid the fine and submitted its Hazardous Materials Business Plan in compliance with the Consent Order.

### **California Department of Toxic Substances Control**

on September 2002, the Department of Toxic Substances Control (DTSC) inspected PS facilities based on an alleged complaint from neighbors due to PS's excavating to recover scrap metal on its property and on a neighbor property, which PS rents from a third party (BNSF Railway). In this same month, DTSC 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, DTSC sanctioned PS for violating Hazardous Waste Control Laws in the State of California and imposed the obligation to remedy the site. On July 26, 2004, in an effort to continue with this order, DTSC 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 USD\$ 0.2 million, which have already been paid.

On June 6, 2010, the DTSC and the San Diego Department of Environmental Health (DEH) inspected the facilities of PS, in response to a general complaint. On August 10, 2010 DTSC and DEH conducted a second inspection and found. Seven infractions. The DEH is satisfied with the compliance of PS on those issues; however, on October 19, 2010 the technical division of the DTSC recommended to the legal division of DTSC that it impose significant penalties.

The land remediation was suspended at the beginning of 2011 due to the inefficiency of the process, which was verified with several studies. As an alternative, once the necessary permits were obtained from the authorities in

Mexico, in November 2011, the Mexicali plant began the process of importing non-RCRA soil for final disposal in a secure landfill based in Nuevo Leon State. This landfill is after the separation of the metal content, which is used as raw material in the smelting process.

PS has completed the shipment of non-RCRA soil for final disposal in Nuevo Leon State at this time. The disposition of a stack estimated at 8,000 tons of material classified RCRA (hazardous for Federal purposes) was also considered for shipment to Mexico. The process began in early 2013, but the response from the authorities was slow.

Therefore, on April 9, 2015, a letter from the California Attorney General Department of Justice (Attorney General) was received where PS is required to, in the absence of obtaining permission from the Mexican authorities; present a program for transport the pile of contaminated soil classified as RCRA to an authorized confinement in the United States at the latest on April 22, 2015. This letter warned that PS must ship the stack no later than July 9, 2015, or risk DTSC proceeding with a civil lawsuit seeking the maximum amount of fines established by law and corresponding legal redress.

On April 21, 2015, PS sent a letter to the Attorney General explaining that the authorities in Mexico had not denied permission to the Company but had simply requested that it present its application in a different format, which had already been presented and reviewed by the authority on April 17, 2015.

On July 23, 2015, the Attorney General denied the extension requested by PS and demanded the immediate shipments of the RCRA stack to an authorized landfill. PS began transporting RCRA soil on July, 29, 2015, and completed removal of the RCRA stack by September 12, 2015 with a total of 3,000 metric tons.

On January 5, 2016, the Attorney General and PS stipulated to filing a "final judgment and order on consent" or Consent Judgment in San Diego Superior Court. The parties negotiated the Consent Judgment, which includes the following terms:

PS to pay USD\$ - 0.138 million as a civil penalty for alleged violations of the 2004 Corrective Action Consent Agreement. PS has made all of the required payments to DTSC as of December 31, 2017.

- Remove the RCRA stack and send it to an approved landfill. The Judgment indicates that the Company complied with this commitment by October 2, 2015.

- After removing the RCRA stack, the Company must take samples of the soil in the area where the stack of land was located. Samples were taken and the results indicate that the soil had pollution levels, although are not equal to those of the RCRA stack, they exceed the limits set by the State. On April 7, 2016, the Attorney General and DTSC demanded that the Company remove soil 10 feet across and 2 feet deep on the perimeter of the area where the stack of land RCRA was located and disposed of it in an approved confinement. On August 5, 2016, DTSC informed PS that it did not need to remove the soil in the vicinity of the former RCRA stack that exceeds California hazardous waste standards. Instead, PS convinced DTSC to enter into a Tolling Agreement on August 10, 2016, which tolls for two years (until August 10, 2018) the statute of limitations for DTSC to challenge PS's compliance with the Consent Judgment. This Tolling Agreement remains in force as of December 31, 2017.

- The Company shall continue to meet the conditions of the final judgment, the corrective measures, and all tasks arising from this, which were entered in the same court in 2004. PS is working to develop a "corrective measures study" (CMS) that is intended to develop a plan for determining what remedy will be implemented at the site. As of December 31, 2017, it is unclear what will be the appropriate remedy to implement at the PS site, when the CMS will be completed, how long remediation will take, and how much it will cost.

b. As with most steel producers in United States of America, 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 created to cover probable environmental liabilities of USD\$ 2.7 million and USD\$ 2.7 million were recorded as of December 31, 2017 and 2016, respectively. The reserve includes incremental direct costs of remediation efforts and post-remediation monitoring costs that are expected to be paid after corrective actions are complete. As of December 31, 2017, the current and non-current portions of the reserve amounted to USD\$ 1.0 million and USD\$ 1.7 million, (USD\$ 1.0 million and USD\$ 1.7 million in 2016), respectively, are included in accounts payable and accumulated liabilities in the short and long term, respectively, in the Consolidated Statements of Financial

Position.

On the other hand, the Company is not aware of any material environmental remediation liabilities or contingent liabilities relating to environmental matters with respect to facilities, for which the establishment of an additional reserve would be necessary at this time. In the event that, in the future, the Company incurs in any such additional c.expenses, these costs will most likely be incurred over a number of years. However, future regulatory action regarding historical waste management practice in the facilities of Republic PS and future changes in applicable laws and regulations may require the Company to incur significant costs that may have a material adverse effect on the future financial performance of the Company.

- d. The Company is involved in a series of lawsuits and legal claims that have arisen during the normal course of its operations. The Company and its legal advisors do not expect the outcome of these matters to have any significant adverse effect on the Company's financial position and results of operations, therefore it has not been recognized any liabilities for such lawsuits and claims.

Mexican tax authorities have the right to review, at least the previous five years and could determine differences in e. taxes payable, plus any corresponding adjustments, surcharges and fines. Such authorities are currently reviewing some subsidiaries and it has not completed its reviews.

- f. Tax authorities in United States of America have the right to review, at least the previous three

F-44



years and could determine differences in taxes payable, plus its corresponding adjustments, surcharges and fines.

g. Canadian tax authorities have the right to review, at least the previous four years and could determine differences in taxes payable, plus its corresponding adjustments, surcharges and fines.

h. Brazilian tax authorities have the right to review, at least the previous five years and could determine differences in taxes payable, plus its corresponding adjustments, surcharges and fines.

On January 19, 2017, the Company was notified with the excerpt issued by the General Direction of Crimes and Sanctions of the National Banking and Exchange Commission (CNBV), for the probable realization, in the re-purchase of own stock operations, of several behaviors that, under the judgment of the CNBV, could be different i. to the ones established in the “Ley del Mercado de Valores (LMV)”. On February 9, 2017 Grupo Simec filed the statement of manifestations to the administrative sanction procedure, which up to date, is pending of resolution and therefore it is not possible to determine its result. The possible sanction imposed, as the case may be, to the Company will be determined in accordance with the parameters established in the LMV.

## 26.

## Commitments

Republic leases certain equipment, office space and computer equipment under non-cancelable operating leases. The leases expire at various dates through 2020. During the years ended December 31, 2017, 2016, and 2015, rental a. expenses relating to operating leases amounted to USD\$ 0.5 million, USD\$ 1.1 million, and USD\$ 1.5 million, respectively. As of December 31, 2017, total minimum lease payments under non-cancelable operating leases will amount USD\$ 0.37 million, USD\$ 0.32 million, and USD \$0.06 million, and 2018, 2019, and 2020 respectively. Currently there are no additional obligations post-2020.

On August, 2012, the Company entered into a contract with the supplier Russula, S.A. for an amount of USD\$ 5.4 b. million for the development of a treatment plant wastewater for its subsidiary GV do Brasil Industria e Comercio de Aço LTDA. As of December 31, 2016, only 10% remains outstanding, until delivery of final acceptance certificate of the plant and the warranty. Such payment was made on January, 17, 2017.

On August of 2012 the Company entered into a contract with the provider Mochetti Gino Industrie Sollevamenti S.r.l. for an amount of USD\$ 4.1 million for the development of two overhead cranes to its subsidiary GV do Brasil c. Industria e Comercio de Aço LTDA. As of December 31, 2016, only 5% remains outstanding, until delivery of the proforma invoice and the final acceptance certificate. Such payment was made on January, 2017.

d. In January 2013, the Company entered into an agreement with EnerNOC which enables Republic to receive payments for reducing the electricity consumption during a dispatch declared by PJM Interconnection as an emergency. The agreement is for 5 years, effective January 31, 2013 and expires on May 31, 2018. During the years ended December 31, 2017, 2016 and 2015, the Company recognized income from this agreement of USD\$ 1.0 million, USD\$ 1.0 million and USD\$ 3.2 million, respectively. Unlike the previous contract the payments are

earned by event and how they accrue.

As mentioned in Note 2-h a new plant of special steels is on construction, consequently, on October 20 began the contract "turnkey" signed with Danieli & Officine Meccaniche for the construction of the new plant (except civil engineering) and the supply of all equipment. The contract value is approximately USD\$ 203 million, of which at 31 e. December 2015 have been paid advances for USD\$ 27.7 million and during 2016, and until March 30, 2017 others USD\$ 59.4 million. The civil work is almost finished, the last shipment of the machinery is scheduled for July 2017, and all the services needed to start operations are already contracted the outstanding. Balance as of December 31, 2017 is USD \$ 17.940 million. The project is estimated to conclude in April. 2018.

In January 2013, the Company entered into a 15-year product supply agreement with Air Products and Chemicals, Inc. The agreement required that Air Products and Chemicals build and install a plant for the production of oxygen, nitrogen and argon in the Lorain, Ohio facilities. The fifteen-year term of this agreement would come in force at the moment the plant came into operation. The plant did not start operations because of what is indicated in Note 10. In August 2016, the Company entered into a new agreement with Air Products and Chemicals, Inc. to purchase the previously installed plant for USD \$ 30 million and totally cancel the supply contract. The amount of the purchase was agreed to settle it as follows: an initial payment of USD \$1.2 million and the

F-45

remaining of USD \$28.8 million over period of 6 years with monthly payments equal to USD \$0.4 million without payment of interest.

In connection with a sales and use tax audit by the Ohio Department of Taxation covering the period from January 1, 2009 through December 31, 2012, an assessment of \$2,452,028 (including interest of \$394,138) was issued against the Company on December 9, 2016. The Company disagrees with the assessment in its entirety and has filed a Petition for Reassessment on January 30, 2017 appealing the assessment with the Ohio Board of Tax Appeals. The Company's position is that the assessment that certain services were taxable is substantively incorrect, and based upon a misinterpretation of the relevant regulations and a misunderstanding of the facts that led the Company to determine that the services qualified for Ohio's sales and use tax exemption for manufacturers.

Due to the nature of this matter and its early stages, the Company is unable to determine the amount of loss, if any, it may sustain. Accordingly, the Company has not recorded an expense in fiscal 2017 or 2016 recognizing the assessment or any estimated settlement amount.

In January 2018, the Company entered into a contract with the supplier ECOM LTDA. For an amount of USD \$ 6.1 million for the energy component of 10,000 MWH per month, for its subsidiary GV do Brazil industry and commerce of Aco LTDA. all monthly payments due 6 days later the closing date of the month. The contract ends in February 2019.

i. In January the 2018, the Company entered into a contract with the supplier ECOM LTDA. For an amount of USD \$ 6.3 million for the energy component of 10,000 MWH per month, for its subsidiary GV do Brazil industry and commerce of Aco LTDA. Starting the supply in 2019. All payments due monthly 6 days after the closing date of the month. The contact ends in February 2020.

j. In December the 2017, the Company entered into a contract with the supplier ECOM LTDA. For an amount of USD \$ 5.2 million for the purchase of 8,000 MWH of energy per month, for its subsidiary GV do Brazil industry and commerce of Aco LTDA. All monthly payments due 6 days later the closing date of the month. The contract will end in February 2019.

On February 22, 2018, a contract was signed with Primental Technologies for the reconstruction of the rolling mill and the supply of a new reheating furnace for the Mexicali plant, which will increase the manufacturing capacity of finished product from 17,500 to 22,500 tons per month. An advance payment of 20% has been paid (USD \$ 1.67 million) subsequent to December 31, 2017 and the placement of the letters of credit is in process. The project execution deadline is 16 months and a budget of USD \$ 23 million has been estimated.

## 27.

### Financial statements issuance authorization

On May, 11, 2018, the issuance of the accompanying consolidated financial statements was authorized by Ing. Luis Garcia Limon and C.P. Mario Moreno Cortez, Chief Executive Officer and Coordinator of Finance, of Grupo Simec, S.A.B. de C.V, respectively, for the approval of the Audit Committee and the board of directors.

