Kraton Performance Polymers, Inc.
Form 10-Q
April 30, 2015

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

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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

Commission File Number 001-34581

KRATON PERFORMANCE POLYMERS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	20-0411521 (I.R.S. Employer Identification No.)
15710 John F. Kennedy Blvd. Suite 300 Houston, TX 77032 (Address of principal executive offices, including zip code)	281-504-4700 (Registrant's telephone number, including area code)

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 ý 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 ý No ¨

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

Large accelerated filer:	ý	Accelerated filer:	¨
Non-accelerated filer:	¨	Smaller reporting company:	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý

Number of shares of Kraton Performance Polymers, Inc. Common Stock, $0.01 par value, outstanding as of April 27, 2015: 31,328,930.

Index to Quarterly Report
on Form 10-Q for
Quarter Ended March 31, 2015

PART I. FINANCIAL INFORMATION		Page
	The Report of KPMG LLP, Independent Registered Public Accounting Firm	5
Item 1	Condensed Consolidated Financial Statements (Unaudited)	6
	Condensed Consolidated Balance Sheets as of March 31, 2015 and December 31, 2014	6
	Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014	7
	Condensed Consolidated Statements of Comprehensive Loss for the three months ended March 31, 2015 and 2014	8
	Condensed Consolidated Statements of Changes in Equity for the three months ended March 31, 2015 and 2014	9
	Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and 2014	10
	Notes to the Condensed Consolidated Financial Statements	11
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3	Quantitative and Qualitative Disclosures About Market Risk	44
Item 4	Controls and Procedures	44
PART II. OTHER INFORMATION		
Item 1	Legal Proceedings	45
Item 1A	Risk Factors	45
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 6	Exhibits	46
	Signatures	47

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Quarterly Report on Form 10-Q under the headings "Condensed Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written or oral forward-looking statements in our periodic reports on Forms 10-K, 10-Q and 8-K, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements are often characterized by the use of words such as "outlook," "believes," "estimates," "expects," "projects," "may," "intends," "plans" or "anticipates," or by discussions of strategy, plans o intentions; anticipated benefits of or performance of our products; beliefs regarding opportunities for new, high-margin applications and other innovations; adequacy of cash flows to fund our working capital requirements; our investment in the joint venture with Formosa Petrochemical Corporation ("FPCC"); our expectations regarding indebtedness to be incurred by our joint venture with FPCC; debt payments, interest payments, benefit plan contributions, and income tax obligations; our anticipated 2015 capital expenditures, compliance with the MACT rule, health, safety and environmental and infrastructure and maintenance projects, projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform; our ability to fully access our senior secured credit facilities; expectations regarding our counterparties' ability to perform, including with respect to trade receivables; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding high-margin applications; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; expectations regarding our full year effective tax rate; estimates related to the useful lives of certain assets for tax purposes; expectations regarding our pension contributions for fiscal year 2015; estimates or expectations related to monomer costs, ending inventory levels and related estimated charges; the outcome and financial impact of legal proceedings; expectations regarding the spread between FIFO and ECRC in future periods; the estimates and matters described under the caption "Item 2. Management's Discussion and Analysis—Results of Operations—Outlook" and projections regarding environmental costs and capital expenditures and related operational savings. Such forward-looking statements involve known and unknown risks, uncertainties, assumptions and other important factors that could cause the actual results, performance or our achievements, or industry results, to differ materially from historical results, any future results, or performance or achievements expressed or implied by such forward-looking statements. There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Further description of these risks and uncertainties and other important factors are set forth in this report, in our latest Annual Report on Form 10-K, including but not limited to "Part I, Item 1A. Risk Factors" and "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" therein, and in our other filings with the Securities and Exchange Commission, and include, but are not limited to, risks related to:

- our reliance on LyondellBasell Industries for the provision of significant operating and other services;
- conditions in the global economy and capital markets;
- the failure of our raw materials suppliers to perform their obligations under long-term supply agreements, or our inability to replace or renew these agreements when they expire;
- limitations in the availability of raw materials we need to produce our products in the amounts or at the prices necessary for us to effectively and profitably operate our business;
- significant fluctuations in raw material costs may result in volatility in our quarterly operating results and impact the market price of our common stock;
- competition from other producers of styrenic block copolymers and from producers of products that can be substituted for our products;
- our ability to produce and commercialize technological innovations;
- our ability to protect our intellectual property, on which our business is substantially dependent;
- the possibility that our products infringe upon the intellectual property rights of others;
- a major failure of our information systems, which could harm our business;
- seasonality in our business, particularly for sales into paving and roofing applications;
-

our substantial indebtedness, which could adversely affect our financial condition and prevent us from fulfilling our obligations under the senior secured credit facilities, the senior notes, and the KFPC loan agreement;

- financial and operating constraints related to our indebtedness;

- the inherently hazardous nature of chemical manufacturing;
- product liability claims and other lawsuits arising from environmental damage, personal injuries, other damages associated with chemical manufacturing or our products;
- lawsuits arising from the termination of the Combination Agreement with LCY Chemical Corp.;
- political, economic and local business risks in the various countries in which we operate;
- health, safety and environmental laws, including laws that govern our employees' exposure to chemicals deemed harmful to humans;
- regulation of our company or our customers, which could affect the demand for our products or result in increased compliance and other costs;
- customs, international trade, export control, antitrust, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs;
- fluctuations in currency exchange rates;
- we may have additional tax liabilities;
- our formation of a joint venture to expand HSBC capacity in Asia;
- our relationship with our employees;
- loss of key personnel or our inability to attract and retain new qualified personnel;
- the fact that we generally do not enter into long-term contracts with our customers;
- a decrease in the fair value of our pension assets could require us to materially increase future funding requirements of the pension plan;
- domestic or international natural disasters or terrorist attacks may disrupt our operations;
- Delaware law and some provisions of our organizational documents that make a takeover of our company more difficult;
- our expectation that we will not pay dividends for the foreseeable future; and
- we are a holding company with nominal net worth and will depend on dividends and distributions from our subsidiaries to pay any dividends.

There may be other factors of which we are currently unaware or that we deem immaterial that may cause our actual results to differ materially from the expectations we express in our forward-looking statements. Although we believe the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions could themselves prove to be inaccurate. Forward-looking statements are based on current plans, estimates, assumptions and projections, and therefore you should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update them publicly in light of new information or future events.

Presentation of Financial Statements

The terms "Kraton," "our company," "we," "our," "ours" and "us" as used in this report refer collectively to Kraton Performan Polymers, Inc. and its consolidated subsidiaries.

This Form 10-Q includes financial statements and related notes that present the condensed consolidated financial position, results of operations, comprehensive loss, and cash flows of Kraton and its subsidiaries. Kraton is a holding company whose only material asset is its investment in its wholly owned subsidiary, Kraton Polymers LLC. Kraton Polymers LLC and its subsidiaries own all of our consolidated operating assets.

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
Kraton Performance Polymers, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Kraton Performance Polymers, Inc. and subsidiaries (the Company) as of March 31, 2015, and the related condensed consolidated statements of operations, comprehensive loss, changes in equity, and cash flows for the three-month periods ended March 31, 2015 and 2014. These condensed consolidated financial statements are the responsibility of the Company’s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2014, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for the year then ended (not presented herein); and in our report dated February 25, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2014 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Houston, Texas
April 30, 2015

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	March 31, 2015	December 31, 2014
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$39,791	$53,818
Receivables, net of allowances of $301 and $245	121,004	107,432
Inventories of products	279,438	326,992
Inventories of materials and supplies	10,782	10,968
Deferred income taxes	7,487	7,247
Other current assets	22,406	24,521
Total current assets	480,908	530,978
Property, plant and equipment, less accumulated depreciation of $382,482 and $387,463	455,644	451,765
Intangible assets, less accumulated amortization of $91,723 and $88,939	48,518	49,610
Investment in unconsolidated joint venture	11,235	12,648
Debt issuance costs	6,473	7,153
Deferred income taxes	2,142	2,176
Other long-term assets	26,532	28,122
Total assets	$1,031,452	$1,082,452
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt	$135	$87
Accounts payable-trade	51,210	72,786
Other payables and accruals	41,169	50,888
Deferred income taxes	1,431	1,633
Due to related party	15,573	18,121
Total current liabilities	109,518	143,515
Long-term debt, net of current portion	392,517	351,785
Deferred income taxes	11,853	15,262
Other long-term liabilities	102,499	103,739
Total liabilities	616,387	614,301
Commitments and contingencies (note 10)		
Equity:		
Kraton stockholders' equity:		
Preferred stock, $0.01 par value; 100,000 shares authorized; none issued	—	—
Common stock, $0.01 par value; 500,000 shares authorized; 31,377 shares issued and outstanding at March 31, 2015; 31,831 shares issued and outstanding at December 31, 2014	314	318
Additional paid in capital	354,644	361,342
Retained earnings	154,648	168,041
Accumulated other comprehensive loss	(132,302)	(99,218)

Total Kraton stockholders' equity	377,304	430,483
Noncontrolling interest	37,761	37,668
Total equity	415,065	468,151
Total liabilities and equity	$1,031,452	$1,082,452

See Notes to Condensed Consolidated Financial Statements
6

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three months ended March 31,	
	2015	2014
Revenue	$261,429	$311,656
Cost of goods sold	214,868	254,583
Gross profit	46,561	57,073
Operating expenses:		
Research and development	7,947	8,297
Selling, general and administrative	26,949	34,218
Depreciation and amortization	15,296	16,409
Total operating expenses	50,192	58,924
Earnings of unconsolidated joint venture	76	117
Interest expense, net	6,120	6,338
Loss before income taxes	(9,675)	(8,072)
Income tax expense	66	122
Consolidated net loss	(9,741)	(8,194)
Net loss attributable to noncontrolling interest	(285)	(285)
Net loss attributable to Kraton	$(9,456)	$(7,909)
Loss per common share:		
Basic	$(0.30)	$(0.24)
Diluted	$(0.30)	$(0.24)
Weighted average common shares outstanding:		
Basic	31,067	32,162
Diluted	31,067	32,162

See Notes to Condensed Consolidated Financial Statements

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)
(In thousands)

	Three months ended March 31,	
	2015	2014
Net loss attributable to Kraton	$(9,456)	$(7,909)
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax of $0	(33,084)	1,799
Other comprehensive income (loss), net of tax	(33,084)	1,799
Comprehensive loss attributable to Kraton	(42,540)	(6,110)
Comprehensive income (loss) attributable to noncontrolling interest	93	(866)
Consolidated comprehensive loss	$(42,447)	$(6,976)

See Notes to Condensed Consolidated Financial Statements

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited)
(In thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Kraton Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2013	$325	$363,590	$170,827	$ (21,252)	$ 513,490	$ 40,908	$554,398
Net loss	—	—	(7,909)	—	(7,909)	(285)	(8,194)
Other comprehensive income (loss)	—	—	—	1,799	1,799	(581)	1,218
Retired treasury stock from employee tax withholdings	—	(429)	—	—	(429)	—	(429)
Exercise of stock options	1	534	—	—	535	—	535
Non-cash compensation related to equity awards	2	3,612	—	—	3,614	—	3,614
Balance at March 31, 2014	$328	$367,307	$162,918	$ (19,453)	$ 511,100	$ 40,042	$551,142
Balance at December 31, 2014	$318	$361,342	$168,041	$ (99,218)	$ 430,483	$ 37,668	$468,151
Net loss	—	—	(9,456)	—	(9,456)	(285)	(9,741)
Other comprehensive income (loss)	—	—	—	(33,084)	(33,084)	378	(32,706)
Retired treasury stock from employee tax withholdings	—	(548)	—	—	(548)	—	(548)
Retired treasury stock from share repurchases	(7)	(8,937)	(3,937)	—	(12,881)	—	(12,881)
Exercise of stock options	—	181	—	—	181	—	181
Non-cash compensation related to equity awards	3	2,606	—	—	2,609	—	2,609
Balance at March 31, 2015	$314	$354,644	$154,648	$ (132,302)	$ 377,304	$ 37,761	$415,065

See Notes to Condensed Consolidated Financial Statements
9

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three months ended March 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net loss	$(9,741)	$(8,194)
Adjustments to reconcile consolidated net loss to net cash used in operating activities:		
Depreciation and amortization	15,296	16,409
Amortization of debt premium	(42)	(40)
Amortization of debt issuance costs	551	553
Loss (gain) on disposal of property, plant and equipment	17	(17)
Earnings from unconsolidated joint venture, net of dividends received	287	370
Deferred income tax benefit	(2,254)	(2,393)
Share-based compensation	2,609	3,614
Decrease (increase) in:		
Accounts receivable	(20,464)	(20,748)
Inventories of products, materials and supplies	35,361	(14,300)
Other assets	177	573
Increase (decrease) in:		
Accounts payable-trade	(16,958)	(24,362)
Other payables and accruals	(7,091)	(6,617)
Other long-term liabilities	(1,688)	582
Due to related party	(2,557)	983
Net cash used in operating activities	(6,497)	(53,587)
CASH FLOWS FROM INVESTING ACTIVITIES		
Kraton purchase of property, plant and equipment	(14,725)	(15,205)
KFPC purchase of property, plant and equipment	(15,968)	(4,980)
Purchase of software and other intangibles	(541)	(1,062)
Net cash used in investing activities	(31,234)	(21,247)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt	25,000	—
Repayments of debt	(5,000)	—
KFPC proceeds from debt	19,977	—
Capital lease payments	(32)	(3,011)
Purchase of treasury stock	(13,429)	(429)
Proceeds from the exercise of stock options	181	535
Net cash provided by (used in) financing activities	26,697	(2,905)
Effect of exchange rate differences on cash	(2,993)	(814)
Net decrease in cash and cash equivalents	(14,027)	(78,553)
Cash and cash equivalents, beginning of period	53,818	175,872
Cash and cash equivalents, end of period	$39,791	$97,319
Supplemental disclosures:		
Cash paid during the period for income taxes, net of refunds received	$1,963	$2,293
Cash paid during the period for interest, net of capitalized interest	$11,183	$11,608
Capitalized interest	$1,016	$636
Supplemental non-cash disclosures:		

Property, plant and equipment accruals	$3,410	$15,168
Asset acquired through capital lease	$681	$7,033

See Notes to Condensed Consolidated Financial Statements
10

KRATON PERFORMANCE POLYMERS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General
Description of our Business. We are a leading global producer of styrenic block copolymers ("SBCs") and other engineered polymers. SBCs are highly-engineered synthetic elastomers, which we invented and commercialized almost 50 years ago, that enhance the performance of numerous products by imparting greater flexibility, resilience, strength, durability and processability.
Our polymers are typically formulated or compounded with other products to achieve improved, customer-specific performance characteristics in a variety of applications. We seek to maximize the value of our product portfolio by emphasizing complex or specialized polymers and innovations that yield higher margins than more commoditized products. We refer to these complex or specialized polymers or innovations as being more "differentiated."
Our products are found in many everyday applications, including personal care products such as disposable diapers and the rubberized grips of toothbrushes, razor blades and power tools. Our products are also used to impart tack and shear properties in a wide variety of adhesive products and to impart characteristics such as flexibility and durability in sealants and corrosion resistance in coatings. Our paving and roofing applications provide durability, extending road and roof life.
We also produce Cariflex™ isoprene rubber and isoprene rubber latex. Our Cariflex products are based on synthetic polyisoprene polymer and do not contain natural rubber latex or other natural rubber products making them an ideal substitute for natural rubber latex, particularly in applications with high purity requirements such as medical, healthcare, personal care and food contact. We believe the versatility of Cariflex products provides opportunities for new, high margin applications.
We manufacture our polymers at five manufacturing facilities globally, including our flagship facility in Belpre, Ohio, as well as facilities in Germany, France, Brazil and Japan. The facility in Japan is operated by an unconsolidated manufacturing joint venture. The terms "Kraton," "our company," "we," "our," "ours" and "us" as used in this report refer collectively to Kraton Performance Polymers, Inc. and its consolidated subsidiaries.
Basis of Presentation. The accompanying unaudited condensed consolidated financial statements presented herein are for us and our consolidated subsidiaries, each of which is a wholly-owned subsidiary, except our 50% investment in our joint venture, Kraton Formosa Polymers Corporation ("KFPC"), located in Mailiao, Taiwan. KFPC is a variable interest entity for which we have determined that we are the primary beneficiary and, therefore, have consolidated into our financial statements. Our 50% investment in our joint venture located in Kashima, Japan is accounted for under the equity method of accounting. All significant intercompany transactions have been eliminated. These interim financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014 and reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly our results of operations and financial position. Amounts reported in our Condensed Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods or any other interim period, in particular due to the effect of seasonal changes and weather conditions that typically affect our sales into paving and roofing applications.
Significant Accounting Policies. Our significant accounting policies have been disclosed in Note 1 Description of Business, Basis of Presentation and Significant Accounting Policies in our most recent Annual Report on Form 10-K. There have been no changes to the policies disclosed therein. The accompanying unaudited condensed consolidated financial statements we present in this report have been prepared in accordance with those policies.
Use of Estimates. The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

11

Significant items subject to such estimates and assumptions include

- the useful lives of fixed assets;
- allowances for doubtful accounts and sales returns;
- the valuation of derivatives, deferred tax assets, property, plant and equipment, inventory, investments and share-based compensation; and
- liabilities for employee benefit obligations, environmental matters, asset retirement obligations ("ARO"), income tax uncertainties and other contingencies.

Income Tax in Interim Periods. We conduct operations in separate legal entities in different jurisdictions. As a result, income tax amounts are reflected in these condensed consolidated financial statements for each of those jurisdictions. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change based on the political and economic climate in those countries. We file our tax returns in accordance with our interpretations of each jurisdiction's tax laws. We record our tax provision or benefit on an interim basis using the estimated annual effective tax rate. This rate is applied to the current period ordinary income or loss to determine the income tax provision or benefit allocated to the interim period.

Losses from jurisdictions for which no benefit can be realized and the income tax effects of unusual and infrequent items are excluded from the estimated annual effective tax rate. Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be realized. The effects of unusual and infrequent items are recognized in the impacted interim period as discrete items.

The estimated annual effective tax rate may be significantly affected by nondeductible expenses and by our projected earnings mix by tax jurisdiction. Adjustments to the estimated annual effective income tax rate are recognized in the period during which such estimates are revised.

We have established valuation allowances against a variety of deferred tax assets, including net operating loss carryforwards, foreign tax credits and other income tax credits. Valuation allowances take into consideration our expected ability to realize these deferred tax assets and reduce the value of such assets to the amount that is deemed more likely than not to be recoverable. Our ability to realize these deferred tax assets is dependent on achieving our forecast of future taxable operating income over an extended period of time. We review our forecast in relation to actual results and expected trends on a quarterly basis. If we fail to achieve our operating income targets, we may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our net deferred tax assets. A change in our valuation allowance would impact our income tax expense/benefit and our stockholders' equity and could have a significant impact on our results of operations or financial condition in future periods.

2. New Accounting Pronouncements

Adoption of Accounting Standards

We have implemented all new accounting pronouncements that are in effect and that management believes would materially affect our financial statements.

New Accounting Standards

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most current revenue recognition guidance. The standard is effective for public entities for annual and interim periods beginning after December 15, 2016. Early adoption is not permitted. Our evaluation of this standard is currently ongoing and therefore, the effects of this standard on our financial position, results of operations and cash flows are not yet known.

In April 2015, the Financial Accounting Standards Board issued ASU No. 2015-03, Interest-Imputation of Interest. This standard requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of such debt liability. In adopting ASU 2015-03, companies must apply the guidance on a retrospective basis. The standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015 and early adoption is permitted. We plan to adopt ASU 2015-03 in accordance with these requirements. We have assessed the impact of this new standard on our Condensed

Consolidated Financial Statements and concluded that it would result in reductions of approximately $2.3 million, $6.5 million, and $8.8 million of other current assets, debt issuance costs, and long-term debt, respectively, as of March 31, 2015.

3. Share-Based Compensation

We account for share-based awards under the provisions of ASC 718, "Compensation—Stock Compensation." Accordingly, share-based compensation cost is measured at the grant date based on the fair value of the award and we expense these costs using the straight-line method over the requisite service period. Share-based compensation expense was $2.6 million and $3.6 million for the three months ended March 31, 2015 and 2014, respectively.

4. Detail of Certain Balance Sheet Accounts

	March 31, 2015	December 31, 2014
	(In thousands)	
Inventories of products:		
Finished products	$229,033	$253,834
Work in progress	3,769	5,552
Raw materials	46,636	67,606
Total inventories of products	$279,438	$326,992
Other payables and accruals:		
Employee related	$14,659	$16,156
Interest payable	2,236	7,959
Other	24,274	26,773
Total other payables and accruals	$41,169	$50,888
Other long-term liabilities:		
Pension and other postretirement benefits	$89,157	$86,605
Other	13,342	17,134
Total other long-term liabilities	$102,499	$103,739
Accumulated other comprehensive loss:		
Foreign currency translation adjustments	$(54,954)	$(21,870)
Net unrealized loss on net investment hedge	(1,926)	(1,926)
Benefit plans liability	(75,422)	(75,422)
Total accumulated other comprehensive loss	$(132,302)	$(99,218)

5. Earnings Per Share ("EPS")

Basic EPS is computed by dividing net income attributable to Kraton by the weighted-average number of shares outstanding during the period.

Diluted EPS is computed by dividing net income attributable to Kraton by the diluted weighted-average number of shares outstanding during the period and, accordingly, reflects the potential dilution that could occur if securities or other agreements to issue common stock, such as stock options, were exercised, settled or converted into common stock and were dilutive. The diluted weighted-average number of shares used in our diluted EPS calculation is determined using the treasury stock method.

Unvested awards of share-based payments with rights to receive dividends or dividend equivalents, such as our restricted stock awards are considered to be participating securities, and therefore, the two-class method is used for purposes of calculating EPS. Under the two-class method, a portion of net income is allocated to these participating securities and is excluded from the calculation of EPS allocated to common stock. Our restricted stock awards are subject to forfeiture and restrictions on transfer until vested and have identical voting, income and distribution rights to the unrestricted common shares outstanding. Our weighted average restricted stock awards outstanding were 536,790 and 458,319 for the three months ended March 31, 2015 and 2014, respectively. We withheld 27,028 and 15,707 shares of restricted stock upon vesting to satisfy employee payroll tax withholding requirements for the three months ended March 31, 2015 and 2014, respectively. We immediately retired all shares withheld and the transactions were reflected in additional paid in capital in the Condensed Consolidated Statements of Changes in Equity and as a

purchase of treasury stock in the Condensed Consolidated Statements of Cash Flows.

The computation of diluted EPS excludes weighted average restricted share units of 112,594 and 66,973 for the three months ended March 31, 2015 and 2014 as they are anti-dilutive due to a net loss attributable to Kraton for each period.
The computation of diluted EPS excludes weighted average performance share units of 35,732 for the three months ended March 31, 2015 as they are anti-dilutive due to a net loss attributable to Kraton for this period. The computation of diluted earnings per share also excludes the effect of performance share units for which the performance contingencies had not been met as of the reporting date, amounting to 281,605 and 157,771 as of March 31, 2015 and 2014, respectively.
The computation of diluted earnings per share excludes the effect of the potential exercise of stock options that are anti-dilutive, amounting to 1,591,970 and 1,711,814 for the three months ended March 31, 2015 and 2014, respectively.
The calculations of basic and diluted EPS are as follows:

	Three months ended March 31, 2015			Three months ended March 31, 2014		
	Net Loss Attributable to Kraton	Weighted Average Shares Outstanding	Loss Per Share	Net Loss Attributable to Kraton	Weighted Average Shares Outstanding	Loss Per Share
	(In thousands, except per share data)			(In thousands, except per share data)		
Basic:						
As reported	$(9,456)	31,604		$(7,909)	32,620	
Amounts allocated to unvested restricted shares	161	(537)		111	(458)	
Amounts available to common stockholders	(9,295)	31,067	$(0.30)	(7,798)	32,162	$(0.24)
Diluted:						
Amounts allocated to unvested restricted shares	(161)	537		(111)	458	
Amounts reallocated to unvested restricted shares	161	(537)		111	(458)	
Amounts available to stockholders and assumed conversions	$(9,295)	31,067	$(0.30)	$(7,798)	32,162	$(0.24)

Share Repurchase Program. On October 27, 2014, our board of directors approved a share repurchase program through which we may repurchase outstanding shares of our common stock having an aggregate purchase price of up to $50.0 million. We plan to repurchase shares of our common stock over the next two years in the open market at prevailing market prices, through privately negotiated transactions, or through a trading program under Rule 10b5-1, subject to market and business conditions, applicable legal requirements and other considerations. From the inception of the program through March 31, 2015, we have repurchased a total of 1,660,623 shares of our common stock at an average price of $18.97 per share and a total cost of $31.5 million (excluding trading commissions). We are financing the share repurchase program through a combination of cash and debt. We are not obligated to acquire any specific number of shares of our common stock.

6. Long-Term Debt

Long-term debt consists of the following:

	March 31, 2015	December 31, 2014
	(In thousands)	
6.75% unsecured notes	$350,783	$350,825
KFPC loan agreement	20,135	—
Senior secured credit facilities	20,000	—

Capital lease obligation	1,734	1,047
Total debt	392,652	351,872
Less current portion of total debt	135	87
Long-term debt	$392,517	$351,785

Senior Secured Credit Facilities. In March 2013, we entered into an asset-based revolving credit facility consisting of a $150.0 million U.S. senior secured revolving credit facility (the “U.S. Facility”) and a $100.0 million Dutch senior secured revolving credit facility (the “Dutch Facility,” and together with the U.S. Facility, the “Senior Secured Credit Facilities”). Borrowing under the Senior Secured Credit Facilities is subject to borrowing base limitations based on the level of receivables and inventory available for security.

We may request up to an aggregate of $100.0 million of additional revolving facility commitments of which up to an aggregate of $40.0 million may be additional Dutch revolving facility commitments, provided that we satisfy additional conditions described in the Senior Secured Credit Facilities, and provided further that the U.S. revolver commitment is at least 60% of the commitments after giving effect to such increase.
Kraton Polymers U.S. LLC and Kraton Polymers Nederland B.V. are the borrowers under the Senior Secured Credit Facilities, and Kraton Performance Polymers, Inc., Kraton Polymers LLC, Elastomers Holdings LLC and Kraton Polymers Capital Corporation are the guarantors for both the U.S. Facility and the Dutch Facility. In addition, K.P. Global Holdings C.V. and Kraton Polymers Holdings B.V. are guarantors for the Dutch Facility. The Senior Secured Credit Facilities terminate on March 27, 2018; however, we may from time to time request that the lenders extend the maturity of their commitments. Availability under the Senior Secured Credit Facilities is limited to the lesser of the borrowing base and total commitments (less certain reserves).
The Senior Secured Credit Facilities are primarily secured by receivables and inventory. The U.S. Facility provides for borrowings in the United States and is secured by assets located in the United States. The Dutch Facility provides for borrowings outside of the United States and is secured by assets located outside of the United States.
Borrowings under the U.S. Facility (other than swingline loans) bear interest at a rate equal to, at the applicable borrower's option, either (a) a base rate determined by reference to the greater of (1) the prime rate of Bank of America, N.A., (2) the federal funds rate plus 0.5% and (3) LIBOR plus 1.0%, or (b) a rate based on LIBOR, in each case plus an applicable margin. U.S. swingline loans shall bear interest at a base rate determined by reference to the greater of (1) the prime rate of Bank of America, N.A., (2) the federal funds rate plus 0.5% or (3) LIBOR plus 1.0%, in each case plus an applicable margin.
Borrowings under the Dutch Facility (other than swingline loans) bear interest at a rate equal to, at the applicable borrower's option, either (a) a fluctuating rate, with respect to Euros, Pounds Sterling and Dollars outside of the U.S. and Canada, equal to the rate announced by the European Central Bank and used as a base rate by the local branch of Bank of America in the jurisdiction in which such currency is funded, or (b) a rate based on LIBOR, in each case plus an applicable margin. Dutch swingline loans shall bear interest at a fluctuating rate, with respect to Euros, Pounds Sterling and Dollars outside of the U.S. and Canada, equal to the rate announced by the European Central Bank and used as a base rate by the local branch of Bank of America in the jurisdiction in which such currency is funded.
The applicable margin is subject to a minimum of 0.5% and a maximum of 1.0% with respect to U.S. base rate loans, and a minimum of 1.5% and maximum of 2.0% for foreign base rate borrowings, and a minimum of 1.5% and maximum of 2.0% for both U.S. and foreign LIBOR loans and is subject to adjustment based on the borrowers' excess availability of the applicable facility for the most recent fiscal quarter. For the three months ended March 31, 2015, our effective interest rate for borrowings on the Senior Secured Credit Facilities was 2.2%.
In addition to paying interest on outstanding principal amounts under the Senior Secured Credit Facilities, the borrowers will be required to pay a commitment fee in respect of the unutilized commitments at an annual rate of 0.375%.
The Senior Secured Credit Facilities contain a financial covenant that if either (a) excess availability is less than the greater of (i) 12.5% of the lesser of the commitments and the borrowing base and (ii) $31,250,000 or (b) U.S. availability is less than the greater of (i) 12.5% of the lesser of the U.S. commitments and U.S. borrowing base and (ii) $18,750,000, then following such event, Kraton and its restricted subsidiaries must maintain a fixed charge coverage ratio of at least 1.0 to 1.0 for four fiscal quarters (or for a shorter duration if certain financial conditions are met). The Senior Secured Credit Facilities contain certain customary events of default, including, without limitation, a failure to make payments under the facility, cross-default and cross-judgment default, certain bankruptcy events and certain change of control events.
As of March 31, 2015, our total borrowing capacity was $175.5 million of which $20.0 million was drawn. As of the date of this filing, our total borrowing capacity was $177.7 million, of which $15.0 million was drawn.
6.75% Senior Notes due 2019. Kraton Polymers LLC and its wholly-owned financing subsidiary Kraton Polymers Capital Corporation issued $350.0 million aggregate principal amount of 6.75% senior notes that mature on March 1, 2019 pursuant to an indenture dated February 11, 2011 ($250.0 million senior notes) and supplemental indenture thereto dated March 20, 2012 ($100.0 million senior notes). The indenture provides that the notes are general

unsecured, senior obligations and will be unconditionally guaranteed on a senior unsecured basis. We pay interest on the notes at 6.75% per annum, semi-annually in arrears on March 1 and September 1 of each year.

Capital Lease. In January 2014, we entered into a 10 year capital lease with a principal amount of $7.0 million to fund a portion of our capital expenditures. In March 2015, this capital lease increased by $0.7 million based on final project construction costs.

KFPC Loan Agreement. On July 17, 2014, KFPC executed a syndicated loan agreement (the "KFPC" Loan Agreement") in the amount of 5.5 billion New Taiwan Dollars ("NTD"), or $176.3 million (converted at the March 31, 2015 exchange rate), to provide additional funding to construct the HSBC facility in Taiwan and to provide funding for working capital requirements and/or general corporate purposes.

The KFPC Loan Agreement is comprised of a NTD 4.29 billion Tranche A, or $137.5 million (converted at the March 31, 2015 exchange rate), to fund KFPC's capital expenditures, and a NTD 1.21 billion Tranche B, or $38.8 million (converted at the March 31, 2015 exchange rate), to fund working capital requirements and/or general corporate purposes. As of March 31, 2015, NTD 0.6 billion, or $20.1 million (converted at the March 31, 2015 exchange rate) was drawn on the KFPC Loan Agreement. The facility period of the KFPC Loan Agreement is five years from January 17, 2015 (the first drawdown date). KFPC may continue to draw on the KFPC Loan Agreement for the first 28 months following the first drawdown date. Subject to certain conditions, KFPC can request a two-year extension of the facility period of the KFPC Loan Agreement.

The total outstanding principal amount is payable in six semi-annual installments with the first payment due upon the expiry of a thirty-month period commencing on the date of the first drawing of loans and each subsequent payment due every six months thereafter. The first five installments shall be in an amount equal to 10% of the outstanding principal amount and the final installment shall be in an amount equal to the remaining 50% of the outstanding principal amount. In the event the extension period is granted, the final 50% of the outstanding principal amount shall be repaid in five equal semi-annual installments with the first installment due on the original final maturity date.

The KFPC Loan Agreement is subject to a variable interest rate composed of a fixed 0.8% margin plus the three-month or six-month fixing rate of the Taipei Interbank Offered Rate (depending on the interest period as selected by KFPC in the drawdown request or the interest period notice), subject to a floor of 1.7%. Interest is payable on a monthly basis. For the three months ended March 31, 2015, our effective interest rate for borrowings on the KFPC Loan Agreement was 1.8%.

The KFPC Loan Agreement contains certain financial covenants which change during the term of the KFPC Loan Agreement. The financial covenants include a maximum debt to equity ratio of 3.0 to 1.0 commencing in 2014, which will decrease over time to 1.2 to 1.0 in 2018; a minimum tangible net worth requirement of $50.0 million commencing in 2014, which will increase to $100.0 million in 2019; and a minimum interest coverage ratio of 2.5 to 1.0 commencing in 2016, which will increase to 5.0 to 1.0 in 2017. In each case, these covenants are calculated and tested on an annual basis. Formosa Petrochemical Corporation and Kraton Polymers LLC are the guarantors of the KFPC Loan Agreement with each guarantor guaranteeing 50% of the indebtedness.

Debt Maturities. The remaining principal payments on our outstanding total debt as of March 31, 2015, are as follows:

	Principal Payments (In thousands)
March 31:	
2016	$135
2017	143
2018	24,179
2019	354,189
2020	12,252
Thereafter	971
Total debt	$391,869

See Note 8 Fair Value Measurements, Financial Instruments and Credit Risk for fair value information related to our long-term debt.

16

7. Debt Issuance Costs

We capitalize the debt issuance costs related to issuing long-term debt and amortize these costs using the effective interest method, except for costs related to revolving debt, which are amortized using the straight-line method. Amortization of debt issuance costs and the accelerated write-off of debt issuance costs in connection with refinancing activities are recorded as a component of interest expense. We had net debt issuance costs of $8.8 million and $9.5 million (of which $2.3 million and $2.3 million were included in other current assets) as of March 31, 2015 and December 31, 2014, respectively. During the year ended December 31, 2014, our consolidated joint venture, KFPC, capitalized $0.5 million of debt issuance costs related to the KFPC Loan Agreement executed in July 2014. We amortized $0.6 million and $0.6 million of debt issuance costs for the three months ended March 31, 2015 and 2014, respectively.

8. Fair Value Measurements, Financial Instruments and Credit Risk

ASC 820, “Fair Value Measurements and Disclosures” defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. ASC 820 requires entities to, among other things, maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions.

In accordance with ASC 820, these two types of inputs have created the following fair value hierarchy:

- Level 1—Inputs that are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability, including:
- Quoted prices for similar assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in markets that are not active
- Inputs other than quoted prices that are observable for the asset or liability
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means; and
- Level 3—Inputs that are unobservable and reflect our assumptions used in pricing the asset or liability based on the best information available under the circumstances (e.g., internally derived assumptions surrounding the timing and amount of expected cash flows).

Recurring Fair Value Measurements. The following tables set forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2015 and December 31, 2014. These financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, which judgment may affect the valuation of their fair value and their placement within the fair value hierarchy levels.

			Fair Value Measurements at Reporting Date Using		
	Balance Sheet Location	March 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		(In thousands)			
Retirement plan asset – current	Other current assets	$272	$272	$—	$—
Retirement plan asset – noncurrent	Other long-term assets	$2,127	$2,127	$—	$—
Total		$2,399	$2,399	$—	$—

	Balance Sheet Location	December 31, 2014	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)			
Retirement plan asset – current	Other current assets	$272	$272	$—	$—
Retirement plan asset – noncurrent	Other long-term assets	$2,055	$2,055	$—	$—
Total		$2,327	$2,327	$—	$—

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts, which we seek to minimize by limiting our counterparties to major financial institutions with acceptable credit ratings and by monitoring the total value of positions with individual counterparties. In the event of a default by one of our counterparties, we may not receive payments provided for under the terms of our derivatives.
The following table presents the carrying values and approximate fair values of our long-term debt.

	March 31, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)		(In thousands)	
6.75% unsecured notes (quoted prices in active market for identical assets – level 1)	$350,783	$358,750	$350,825	$358,750
Capital lease obligation (significant other observable inputs – level 2)	$1,734	$1,734	$1,047	$1,047

Financial Instruments
Foreign Currency Hedges. Periodically, we enter into foreign currency agreements to hedge or otherwise protect against fluctuations in foreign currency exchange rates. These agreements do not qualify for hedge accounting and gains/losses resulting from both the up-front premiums and/or settlement of the hedges at expiration of the agreements are recognized in the period in which they are incurred. For the three months ended March 31, 2015 and 2014, we settled these hedges and recorded a loss of $3.9 million and a loss of $0.2 million, respectively, which are recorded in cost of goods sold. These contracts are structured such that these gains/losses from the mark-to-market impact of the hedging instruments materially offset the underlying foreign currency exchange gains/losses to reduce the overall impact of foreign currency exchange movements throughout the period.
Credit Risk
We analyze our counterparties' financial condition prior to extending credit and we establish credit limits and monitor the appropriateness of those limits on an ongoing basis. We also obtain cash, letters of credit or other acceptable forms of security from customers to provide credit support, where appropriate, based on our financial analysis of the customer and the contractual terms and conditions applicable to each transaction.

9. Income Taxes

Our income tax expense was $0.1 million and $0.1 million for the three months ended March 31, 2015 and 2014, respectively. Our effective tax rate was a 0.7% expense and a 1.5% expense for the three months ended March 31, 2015 and 2014, respectively. Our effective tax rates differed from the U.S. corporate statutory tax rate of 35.0%, primarily due to the mix of pre-tax income or loss earned in certain jurisdictions and the change in our valuation allowance.

We record a valuation allowance when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. As of March 31, 2015 and December 31, 2014, a valuation allowance of $91.4 million and $90.4 million, respectively, has been provided for net operating loss carryforwards and other deferred tax assets. We increased our valuation allowance by $1.0 million for the three months ended March 31, 2015, which includes $2.6 million related to current period net operating losses, partially offset by a $1.6 million decrease related to changes in other comprehensive income (loss). We increased our valuation allowance by $0.5 million for the three months ended March 31, 2014, primarily due to current period net operating losses. Excluding the change in our valuation allowance, our effective tax rate would have been a 26.2% benefit and a 4.2% benefit for the three months ended March 31, 2015 and 2014, respectively.

As of March 31, 2015 and December 31, 2014, we had total unrecognized tax benefits of $4.4 million and $4.7 million, respectively, related to uncertain foreign tax positions, all of which, if recognized, would impact our effective tax rate. During the three months ended March 31, 2015 and 2014, we had a decrease in uncertain tax positions of $0.3 million and an increase of $0.3 million, respectively, primarily related to uncertain tax positions in Europe. We recorded interest and penalties related to unrecognized tax benefits within the provision for income taxes. We believe that no current tax positions that have resulted in unrecognized tax benefits will significantly increase or decrease within one year.

We file income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. For our U.S. federal income tax returns, the statute of limitations has expired through the tax year ended December 31, 2003. As a result of net operating loss carryforwards from 2004, the statute of limitations remains open for all years subsequent to 2003. In addition, open tax years for state and foreign jurisdictions remain subject to examination.

10. Commitments and Contingencies

(a) Legal Proceedings

We received notice from the tax authorities in Brazil assessing R$6.1 million, or $1.9 million (converted at the March 31, 2015 exchange rate), in connection with tax credits that were generated from the purchase of certain goods which were subsequently applied by us against taxes owed. We have appealed the assertion by the tax authorities in Brazil that the goods purchased were not eligible to earn the credits. While the outcome of this proceeding cannot be predicted with certainty, we do not expect this matter to have a material adverse effect upon our financial position, results of operations or cash flows.

On January 28, 2014, we executed a definitive agreement (the “Combination Agreement”) to combine with the styrenic block copolymer (“SBC”) operations of Taiwan-based LCY Chemical Corp. (“LCY”). The Combination Agreement called for LCY to contribute its SBC business in exchange for newly issued shares in the combined company, such that our existing stockholders and LCY would each own 50% of the outstanding shares of the combined enterprise.

On June 30, 2014, we notified LCY that our Board of Directors intended to withdraw its recommendation to our stockholders to approve the Combination Agreement unless the parties could agree upon mutually acceptable revised terms to the Combination Agreement. This notice cited the decline in operating results for LCY’s SBC business in the first quarter of 2014 and a related decline in forecasted results thereafter, together with the decline in our stock price and negative reactions from our stockholders. Following our notification of our Board’s intention to change its recommendation, the parties engaged in discussions to determine whether they could mutually agree to changes to the terms of the Combination Agreement that would enable our Board to continue to recommend that our stockholders approve the Combination Agreement. The parties engaged in numerous discussions subsequent to June 30, 2014

regarding possible revisions to the terms of the Combination Agreement.

On July 31, 2014, an explosion occurred in a pipeline owned by LCY in Kaohsiung, Taiwan, causing substantial property damage and loss of life, and numerous governmental and private investigations and claims have been initiated and asserted against LCY. On August 4, 2014, LCY notified us that it would no longer negotiate, and would not agree to, any revisions to the terms of the Combination Agreement. On August 6, 2014, our Board withdrew its recommendation that our stockholders approve the Combination Agreement. On August 8, 2014, we received notice from LCY that LCY had exercised its right to terminate the Combination Agreement.

The provisions of the Combination Agreement provide for us to pay LCY a $25 million break-up fee upon a termination of the Combination Agreement following a withdrawal of our Board's recommendation, unless an LCY material adverse effect has occurred and is continuing at the time of the withdrawal of our Board's recommendation. In LCY's notice terminating the Combination Agreement, LCY requested payment of such $25 million termination fee. On October 6, 2014, LCY filed a lawsuit against us in connection with our refusal to pay the $25 million termination fee. We believe that the impact upon LCY of the July 31, 2014 explosion in a gas pipeline in Kaohsiung, Taiwan, constitutes an LCY material adverse effect as defined in the Combination Agreement, and we have notified LCY that accordingly we are not obligated to pay the termination fee. While the ultimate resolution of this matter cannot be predicted with certainty, we do not expect any material adverse effect upon our financial position, results of operations or cash flows from the ultimate outcome of this matter.

We and certain of our subsidiaries, from time to time, are parties to various other legal proceedings, claims and disputes that have arisen in the ordinary course of business. These claims may involve significant amounts, some of which would not be covered by insurance. A substantial settlement payment or judgment in excess of our accruals could have a material adverse effect on our financial position, results of operations or cash flows. While the outcome of these proceedings cannot be predicted with certainty, we do not expect any of these existing matters, individually or in the aggregate, to have a material adverse effect upon our financial position, results of operations or cash flows.

(b) Asset Retirement Obligations.

The changes in the aggregate carrying amount of our ARO liability are as follows:

	Three months ended March 31,	
	2015	2014
	(In thousands)	
Beginning balance	$10,394	$10,497
Accretion expense	104	136
Obligations settled	—	(45)
Foreign currency translation, net	(439)	3
Ending Balance	$10,059	$10,591

For a portion of our ARO liability related to the decommissioning of the coal boilers at our Belpre, Ohio, facility, we have recorded a $3.5 million receivable from Shell Chemicals as of March 31, 2015 pursuant to the indemnity included in the February 2001 separation agreement, which serves to offset the related ARO asset which is included in property, plant and equipment.

(c) Production downtime

In the first quarter of 2014, we experienced weather-related downtime at our Belpre, Ohio, facility. In addition, our facility in Berre, France, experienced an operating disruption resulting from a small fire that impacted one of the production lines at this facility. We incurred $13.0 million of costs in the three months ended March 31, 2014 associated with these two events, of which $3.7 million was included in other payables and accruals at March 31, 2014 based on management's estimates of the remaining costs to be incurred.

There have been no other material changes to our Commitments and Contingencies disclosed in our most recently filed Annual Report on Form 10-K.

11. Employee Benefits

Retirement Plans.

The components of net periodic benefit cost related to U.S. pension benefits are as follows:

	Three months ended March 31,	
	2015	2014
	(In thousands)	
Service cost	$930	$753
Interest cost	1,613	1,510
Expected return on plan assets	(2,130)	(1,915)
Amortization of prior service cost	1,110	430
Net periodic benefit cost	$1,523	$778

We made no contributions to our pension plan in the three months ended March 31, 2015. For the three months ended March 31, 2014, we contributed $1.4 million to our pension plan.

The components of net periodic benefit cost related to other post-retirement benefits are as follows:

	Three months ended March 31,	
	2015	2014
	(In thousands)	
Service cost	$163	$125
Interest cost	320	320
Amortization of prior service cost	200	113
Net periodic benefit cost	$683	$558

12. Industry Segment and Foreign Operations

We operate in one segment for the manufacturing and marketing of engineered polymers. In accordance with the provisions of ASC 280, “Segment Reporting,” our chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire company. Since we operate in one segment and in one group of similar products, all financial segment and product line information required by ASC 280 can be found in the condensed consolidated financial statements.

Our products are manufactured and our commercial activities are organized in the following product groups based upon polymer chemistry and process technologies:

	Revenue for the three months ended March 31,	
	2015	2014
	(In thousands)	
Performance Products	$134,768	$167,852
Specialty Polymers	91,674	108,346
Cariflex	34,837	35,363
Other	150	95
	$261,429	$311,656

For geographic reporting, revenue is attributed to the geographic location in which the customers’ facilities are located. Long-lived assets consist primarily of property, plant and equipment, which are attributed to the geographic location

in which they are located and are presented at historical cost.

Following is a summary of revenue by geographic region:

	Three months ended March 31,	
	2015	2014
	(In thousands)	
Revenue:		
United States	$83,702	$101,662
Germany	30,676	40,641
China	18,372	18,992
Japan	16,435	17,681
Thailand	12,668	16,248
Brazil	9,591	14,143
France	8,909	12,479
Malaysia	7,881	6,482
Italy	7,304	10,221
Netherlands	7,121	7,027
Belgium	6,885	8,186
United Kingdom	6,794	8,152
South Korea	4,468	2,941
Canada	4,297	4,033
Taiwan	4,097	4,567
Mexico	3,662	3,747
Sweden	3,099	4,425
Turkey	2,936	3,307
Argentina	2,211	4,190
Austria	2,137	2,815
All other countries	18,184	19,717
	$261,429	$311,656

Following is a summary of long-lived assets by geographic region:

	March 31, 2015	December 31, 2014
	(In thousands)	
Long-lived assets, at cost:		
United States	$502,944	$495,313
France	108,948	115,987
Taiwan	73,004	56,994
Brazil	62,330	71,970
Germany	53,610	60,022
Netherlands	28,162	29,838
China	7,286	7,273
Japan	1,672	1,637
All other countries	170	194
	$838,126	$839,228

13. Related Party Transactions
We own a 50% equity investment in a SBC manufacturing joint venture in Kashima, Japan. Our due to related party liability on the condensed consolidated balance sheet is related to this joint venture and the purchases from the joint venture amounted to $6.5 million and $13.8 million for the three months ended March 31, 2015 and 2014, respectively.

14. Variable Interest Entity
The following table summarizes the carrying amounts of assets and liabilities as of March 31, 2015 and December 31, 2014 for KFPC before intercompany eliminations. See Note 6 Long Term Debt, for further discussion related to the KFPC Loan Agreement executed on July 17, 2014.

	March 31, 2015	December 31, 2014
	(In thousands)	
Cash and cash equivalents	$11,035	$7,993
Other current assets	3,315	2,533
Property, plant and equipment	72,891	56,904
Intangible assets	9,676	9,579
Other long-term assets	1,243	1,098
Total assets	$98,160	$78,107
Current liabilities	2,503	2,771
Long-term debt	20,135	—
Total liabilities	$22,638	$2,771

15. Subsequent Events
We have evaluated significant events and transactions that occurred after the balance sheet date and determined that there were no events or transactions that would require recognition or disclosure in our condensed consolidated financial statements for the period ended March 31, 2015.

16. Supplemental Guarantor Information
Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, (“the Issuers”), are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Performance Polymers, Inc. and Elastomers Holdings LLC, a U.S. holding company and wholly-owned subsidiary of Kraton Polymers LLC, collectively, (“the Guarantors”), fully and unconditionally guarantee on a joint and several basis, the Issuers’ obligations under the 6.75% senior notes. Our remaining subsidiaries are not guarantors of the 6.75% senior notes. We do not believe that separate financial statements and other disclosures concerning the guarantor subsidiaries would provide any additional information that would be material to investors in making an investment decision.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATING BALANCE SHEET
March 31, 2015
(Unaudited)
(In thousands, except par value)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$—	$271	$2,216	$ 37,304	$—	$39,791
Receivables, net of allowances	—	139	48,478	72,387	—	121,004
Inventories of products	—	200	176,403	102,835	—	279,438
Inventories of materials and supplies	—	—	9,202	1,580	—	10,782
Deferred income taxes	—	3,566	—	3,921	—	7,487
Other current assets	—	4,634	916	16,856	—	22,406
Total current assets	—	8,810	237,215	234,883	—	480,908
Property, plant and equipment, less accumulated depreciation	—	43,460	250,747	161,437	—	455,644
Intangible assets, less accumulated amortization	—	44,228	2,885	1,405	—	48,518
Investment in consolidated subsidiaries	509,606	1,384,102	—	—	(1,893,708)	—
Investment in unconsolidated joint venture	—	813	—	10,422	—	11,235
Debt issuance costs	—	4,330	1,153	990	—	6,473
Deferred income taxes	—	411	—	1,731	—	2,142
Other long-term assets	—	12,068	625,386	92,051	(702,973)	26,532
Total assets	$509,606	$1,498,222	$1,117,386	$ 502,919	$(2,596,681)	$1,031,452
LIABILITIES AND STOCKHOLDERS' AND MEMBER'S EQUITY						
Current liabilities:						
Current portion of long-term debt	$—	$—	$135	$ —	$—	$135
Accounts payable-trade	—	496	23,712	27,002	—	51,210
Other payables and accruals	—	13,403	14,278	13,488	—	41,169
Deferred income taxes	—	—	—	1,431	—	1,431
Due to related party	—	—	—	15,573	—	15,573
Total current liabilities	—	13,899	38,125	57,494	—	109,518
Long-term debt, net of current portion	—	350,783	21,599	20,135	—	392,517
Deferred income taxes	—	11,670	—	183	—	11,853
Other long-term liabilities	—	613,364	95,316	96,792	(702,973)	102,499
Total liabilities	—	989,716	155,040	174,604	(702,973)	616,387
Commitments and contingencies (note 10)						
Stockholders' and member's equity:						
Preferred stock, $0.01 par value; 100,000 shares authorized;	—	—	—	—	—	—

none issued						
Common stock, $0.01 par value; 500,000 shares authorized	314	—	—	—	—	314
Additional paid in capital	354,644	—	—	—	—	354,644
Member's equity	—	509,606	1,031,553	352,549	(1,893,708)	—
Retained earnings	154,648	—	—	—	—	154,648
Accumulated other comprehensive loss	—	(1,100)	(69,207)	(61,995)	—	(132,302)
Kraton stockholders' and member's equity	509,606	508,506	962,346	290,554	(1,893,708)	377,304
Noncontrolling interest	—	—	—	37,761	—	37,761
Total stockholders' and member's equity	509,606	508,506	962,346	328,315	(1,893,708)	415,065
Total liabilities and stockholders' and member's equity	$509,606	$1,498,222	$1,117,386	$ 502,919	$(2,596,681)	$1,031,452

(1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATING BALANCE SHEET
December 31, 2014
(In thousands, except par value)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$—	$646	$5,881	$ 47,291	$—	$53,818
Receivables, net of allowances	—	553	37,266	69,613	—	107,432
Inventories of products	—	35	201,146	125,811	—	326,992
Inventories of materials and supplies	—	—	9,092	1,876	—	10,968
Deferred income taxes	—	—	3,566	3,681	—	7,247
Other current assets	—	5,317	931	18,273	—	24,521
Total current assets	—	6,551	257,882	266,545	—	530,978
Property, plant and equipment, less accumulated depreciation	—	46,081	248,220	157,464	—	451,765
Intangible assets, less accumulated amortization	—	45,356	4,000	254	—	49,610
Investment in consolidated subsidiaries	529,701	1,382,584	—	—	(1,912,285)	—
Investment in unconsolidated joint venture	—	813	—	11,835	—	12,648
Debt issuance costs	—	4,674	1,297	1,182	—	7,153
Deferred income taxes	—	428	—	1,748	—	2,176
Other long-term assets	—	6,384	591,841	85,520	(655,623)	28,122
Total assets	$529,701	$1,492,871	$1,103,240	$ 524,548	$(2,567,908)	$1,082,452
LIABILITIES AND STOCKHOLDERS’ AND MEMBER’S EQUITY						
Current liabilities:						
Current portion of long-term debt	—	—	87	—	—	87
Accounts payable-trade	—	637	30,332	41,817	—	72,786
Other payables and accruals	—	21,913	14,017	14,958	—	50,888
Deferred income taxes	—	—	—	1,633	—	1,633
Due to related party	—	—	—	18,121	—	18,121
Total current liabilities	—	22,550	44,436	76,529	—	143,515
Long-term debt, net of current portion	—	350,825	960	—	—	351,785
Deferred income taxes	—	8,443	3,566	3,253	—	15,262
Other long-term liabilities	—	582,462	93,191	83,709	(655,623)	103,739
Total liabilities	—	964,280	142,153	163,491	(655,623)	614,301
Commitments and contingencies (note 10)						
Stockholders’ and member’s equity:						
Preferred stock, $.01 par value; 100,000 shares authorized; none issued	—	—	—	—	—	—

Common stock, $.01 par value; 500,000 shares authorized	318	—	—	—	—	318
Additional paid in capital	361,342	—	—	—	—	361,342
Member’s equity	—	529,701	1,030,294	352,290	(1,912,285)	—
Retained earnings	168,041	—	—	—	—	168,041
Accumulated other comprehensive loss	—	(1,110)	(69,207)	(28,901)	—	(99,218)
Kraton stockholders’ and member’s equity	529,701	528,591	961,087	323,389	(1,912,285)	430,483
Noncontrolling interest	—	—	—	37,668	—	37,668
Total stockholders’ and member’s equity	529,701	528,591	961,087	361,057	(1,912,285)	468,151
Total liabilities and stockholders’ and member’s equity	$529,701	$1,492,871	$1,103,240	$ 524,548	$(2,567,908)	$1,082,452

(1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended March 31, 2015
(Unaudited)
(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$—	$—	$ 144,486	$ 159,205	$ (42,262)	$ 261,429
Cost of goods sold	—	5,565	116,920	134,645	(42,262)	214,868
Gross profit	—	(5,565)	27,566	24,560	—	46,561
Operating expenses:						
Research and development	—	(651)	902	7,696	—	7,947
Selling, general and administrative	—	(6,085)	14,218	18,816	—	26,949
Depreciation and amortization	—	5,638	6,901	2,757	—	15,296
Total operating expenses	—	(1,098)	22,021	29,269	—	50,192
Earnings (loss) in consolidated subsidiaries	(9,741)	1,233	—	—	8,508	—
Earnings of unconsolidated joint venture	—	—	—	76	—	76
Interest expense (income), net	—	6,261	(131)	(10)	—	6,120
Income (loss) before income taxes	(9,741)	(9,495)	5,676	(4,623)	8,508	(9,675)
Income tax expense (benefit)	—	246	(537)	357	—	66
Consolidated net income (loss)	(9,741)	(9,741)	6,213	(4,980)	8,508	(9,741)
Net loss attributable to noncontrolling interest	—	—	—	(285)	—	(285)
Net income (loss) attributable to Kraton	$ (9,741)	$ (9,741)	$ 6,213	$ (4,695)	$ 8,508	$ (9,456)

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(1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended March 31, 2014
(Unaudited)
(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$—	$—	$ 156,838	$ 191,192	$ (36,374)	$ 311,656
Cost of goods sold	—	(15,114)	127,201	178,870	(36,374)	254,583
Gross profit	—	15,114	29,637	12,322	—	57,073
Operating expenses:						
Research and development	—	4,499	454	3,344	—	8,297
Selling, general and administrative	—	26,696	88	7,434	—	34,218
Depreciation and amortization	—	5,537	7,171	3,701	—	16,409
Total operating expenses	—	36,732	7,713	14,479	—	58,924
Earnings (loss) in consolidated subsidiaries	(8,194)	19,185	—	—	(10,991)	—
Earnings of unconsolidated joint venture	—	—	—	117	—	117
Interest expense (income), net	—	6,255	125	(42)	—	6,338
Income (loss) before income taxes	(8,194)	(8,688)	21,799	(1,998)	(10,991)	(8,072)
Income tax expense (benefit)	—	(494)	3	613	—	122
Consolidated net income (loss)	(8,194)	(8,194)	21,796	(2,611)	(10,991)	(8,194)
Net loss attributable to noncontrolling interest	—	—	—	(285)	—	(285)
Net income (loss) attributable to Kraton	$ (8,194)	$ (8,194)	$ 21,796	$ (2,326)	$ (10,991)	$ (7,909)

(1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

KRATON PERFORMANCE POLYMERS, INC.
CONDENSED CONSOLIDATING STATEMENT OF COMPREHENSIVE INCOME (LOSS)
Three Months Ended March 31, 2015
(Unaudited)
(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	(182,379)	(361,591)
Income tax recoverable (paid)	(6,922)	323,374	(217,285)		
Resources provided by operating activities	2,954,274	2,344,078	1,159,501		
Investing activities:					
Investment in shares (Note 3-m)	—	(187,433)	—		
Acquisition of property, plant and equipment	(432,000)	(496,361)	(263,207)		
Increase in other noncurrent assets	(34,200)	(8,794)	818		
Proceeds from sale of machinery and equipment			6,114		
Resources used in investing activities	(466,200)	(692,588)	(256,275)		
Financing activities:					
Financial debt payment	—	(8,656)	(8,800)		
Loans received from related parties	74,963	323,720	1,189,850		
Payments to related parties	(51,225)	(442,688)	(709,219)		
Interest collected (paid)	2,410	1,204	(2,494)		
Resources provided by (used in) financing activities	26,148	(126,420)	469,337		
Net increase in cash and cash equivalents	**2,514,222**	**1,525,070**	**1,372,563**		
Effect of exchange rate fluctuation on cash and cash equivalents	637,949	(89,053)	(404)		
Cash and cash equivalents at beginning of year	3,384,917	1,948,900	576,741		
Cash and cash equivalents at end of year	**Ps.** 6,537,088	**Ps.** 3,384,917	**Ps** 1,948,900		

See accompanying notes to consolidated financial statements.

F-8

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

Notes to the Consolidated Financial Statements
December 31, 2011, 2010 and 2010

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

1. Compliance with Mexican Financial Reporting Standards

The accompanying consolidated financial statements have been prepared in accordance with Mexican Financial Reporting Standards (hereinafter referred as "MFRS" or "Mexican Accounting Bulletin"), issued by the Mexican Financial Reporting Standards Board **(*Consejo Mexicano de Normas de Información Financiera, A.C*.**(*Spanish initials* CINIF).

2. Activity of the Company

The principal activities of Grupo Simec, S.A.B. de C.V. and its subsidiaries (the Company) are the manufacturing,, processing and distribution of special bar quality ("SBQ"), and structural steel in Mexico, United States of America (USA) and Canada. The Company is a subsidiary of Industrias CH, S.A.B. de C.V. (ICH).

3. Basis of consolidation and significant transactions

The consolidated financial statements include the assets, liabilities, and results of Grupo Simec, S.A.B. de C. V. and its subsidiaries, each of which the Company owns more than 50% of the capital stock. All significant intercompany balances and transactions have been eliminated in consolidation.

At December 31, 2011 and 2010 the subsidiaries of Grupo, Simec, S. A. B. de C. V. included in the consolidation are as follows.

Subsidiaries established in Mexico:	**Percentage of equity owned**	**Main activity**
Compañía Siderúrgica de Guadalajara, S.A. de C.V.	**99.99%**	**Leasing**
Arrendadora Norte de Matamoros S.A. de C.V. (1)	**100.00%**	**Leasing**
Arrendadora Simec, S.A. de C.V.	**100.00%**	**Leasing**
Simec International, S.A. de C.V.	**100.00%**	**Producer**
Compañía Siderúrgica del Pacífico, S.A. de C.V.	**99.99%**	**Leasing**
Coordinadora de Servicios Siderúrgicos de Calidad, S.A. de C.V.	**100.00%**	**Service provider**
Industrias del Acero y del Alambre, S.A. de C.V.	**99.99%**	**Trading**
Procesadora Mexicali, S.A. de C.V.	**99.99%**	**Purchase and sale of scrap**
Servicios Simec, S.A. de C.V.	**100.00%**	**Service provider**
Sistemas de Transporte de Baja California, S.A. de C.V.	**100.00%**	**Freight**
Operadora de Servicios Siderúrgicos de Tlaxcala, S.A. de C.V.	**100.00%**	**Service provider**
Operadora de Metales, S.A. de C.V.	**100.00%**	**Service provider**
Administradora de Servicios Siderúrgicos de Tlaxcala, S.A., de C.V.	**100.00%**	**Service provider**
Comercializadora Simec, S.A. de C.V.	**100.00%**	**Trading**
CSG Comercial, S.A. de C.V.	**99.95%**	**Trading**
Corporativos G&DL, S.A. de C.V.(2)	**100.00%**	**Service provider**
Comercializadora de Productos de Acero de Tlaxcala, S.A. de C.V.	**99.95%**	**Trading**
Siderúrgica de Baja California, S.A. de C.V.	**99.95%**	**Trading**
Operadora de Servicios de la Industria Siderúrgica ICH, S.A. de C.V.	**100.00%**	**Service provider**
Productos Siderúrgicos de Tlaxcala, S.A. de C.V.	**100.00%**	**Trading**
Comercializadora MSAN, S.A. de C.V.	**100.00%**	**Trading**
Simec International 2, Inc (3)	**99.99%**	**Producer**
Simec International 3, Inc. (3)	**99.99%**	**Producer**
Corporación Aceros DM, S. A. de C. V. and Subsidiaries (4)	**100.00%**	**Producer**
Simec International 4, Inc. (3) y (4)	**99.99%**	**Producer**
Simec International 5, Inc. (3) y (4)	**99.99%**	**Producer**
Acero Transportes San, S. A. de C. V. (4)	**100.00%**	**Freight**
Simec Acero, S.A. de C.V.	**100.00%**	**Trading**
Corporacion ASL, S. A. de C. V. (2)	**99.99%**	**Leasing**
Simec International 6, S. A. de C. V. (2)	**100.00%**	**Producer**
Simec International 7, S. A. de C. V. (2)	**99.99%**	**Producer**

Subsidiaries established in foreign countries:

SimRep Corporation and Subsidiaries (5) (6) y (7)	**50.22%**	**Production and sale**
Pacific Steel, Inc. (6)	**100.00%**	**Purchase and sale of scrap**
Pacific Steel Projects, Inc. (6)	**100.00%**	**Investment projects**
Simec Steel, Inc. (6)	**100.00%**	**Treasury**
Simec USA, Corp. (6)	**100.00%**	**Trading**
Undershaft Investments, NV. (8)	**100.00%**	**Holding**
GV do Brasil Industria e Comercio de Aco LTDA (9)	**100.00%**	**Production and sale**

(1) Company sold on May 2011.

(2) Entities incorporated in 2010.

(3) Entities that changed their address and fiscal authority, to the state of California, USA in 2011. Since the change, the main activity of these entities is the acquisition of new business or projects.

(4) This Subsidiaries are located in San Luis Potosi, in Mexico, which were acquired by Grupo Simec, S.A.B. de C.V. in 2008. For the purpose of these Notes to Consolidated Financial Statements, these companies are named as “Grupo San”.

(5) The parent Company ICH it’s the owner of 49.78% of capital stock of this subsidiary.

(6) Companies established in the United States of America, except for one facility that is established in Canada.

(7) SimRep does not have important transaction or assets, except for the investment on Republic Steel. Before September 2011 the name of this subsidiary was Republic Engineered Products, Inc.

(8) Subsidiary established in Curacao.

(9) Subsidiary established in Brazil. (See paragraph k, below)

Significant transactions

a) In February 2011, Republic, through two of its wholly owned subsidiaries (Solon Wire Processing LLC, formerly REP Acquisition LLC, and the newly formed Republic Memphis LLC) acquired certain land, plants, machinery and equipment from BCS Industries LLC and affiliates ("Bluff City Steel") for cash of US$ 2.5 million and the essential forgiveness of US$ 6.0 million of net receivables due from Bluff City Steel to Republic. Prior to the acquisition, Bluff City Steel was a vendor to the Company that performed certain production processes. The Company made the acquisition to make these processes part of its internal production process.

b) In November 2011, 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 has an initial term of one year and is automatically extended for additional periods of one year each unless either party provides written notice of cancellation.

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 US$30 million. Proceeds on the transfer reflect the face value of the account less 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 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 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 Income.

The purchaser shall have no recourse against Republic 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 (as defined by the Uniform Commercial Code).

For the year ended December 31, 2011, the Company sold a face amount of US$11.0 million of accounts receivable to the purchaser. Discount fees incurred pursuant to this agreement were approximately US$0.2 million for the year ended December 31, 2011. There was US$ 0.9 million of accounts receivable factored which had not been collected by the purchaser at December 31, 2011, and therefore was subject to charge-back to the Company.

c) 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 in Incorporated Companies in accordance with the laws and regulations of the State of California, USA.

d) On May 31, 2011 Grupo Simec S.A.B. de C.V. (Simec) sold their share capital in Arrendadora Norte de Matamoros, S.A. de C.V. to Perfiles Comerciales Sigosa, S.A. de C.V. (a subsidiary of ICH) in Ps. 42.5 million. This amount was paid in cash.

e) 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), it was authorized the merger of the two subsidiaries. Acero Transportes, S.A. de C.V. was merged into Acero Transportes San, S.A. de C.V. using the financial statements of April 30, 2011.

f) On September 1, 2011 in Extraordinary Shareholders Meetings of Procesadora Industrial San, S.A. de C.V. and Malla San, S.A. de C.V. (subsidiaries of Grupo San), it was authorized the merger of the two subsidiaries. Procesadora Industrial San, S.A. de C.V. merged into Malla San, S.A. de C.V. using the financial statements of July 31, 2011.

g) On December 30, 2011 Simec International 7, S.A. de C.V. sold to Corporación ASL, S.A. de C.V. all the shares held in on Corporación Aceros DM, S.A de C.V., totalling 627,305,446 shares (99.9% of the common stock) with a value of Ps. 3,200 million, with a down payment of Ps. 63 million and the remaining of Ps. 3,137 million will be paid with a security with a due date on April 30, 2012. This transaction generate a tax loss of Ps.7,860 million. According with actual Mexican Tax Law (Ley de Impuesto Sobre la Renta) this amount only its deductible against future gains related to shares sales. On January 30, 2012 Simec International 7, S.A. de C.V. filed a demand against the actual law which limit the deduction of this tax loss related to shares sales.

h) On May 31, 2010 in the Extraordinary Shareholders Meeting of Arrendadora Simec, S.A. de C.V., it was authorized to split certain assets, liabilities and equity to a newly formed entity, Corporacion ASL, S.A. de C.V. This new Company assumed the operation of Arrendadora Simec, S.A. de C.V.

i) On June 28, 2010, Simec International 6, S.A. de C.V. was incorporated The activity of this new company is the production of steel and started operations in November of 2010.

j) On June 30, 2010, in the Extraordinary Shareholders Meeting of Simec International, S.A. de C.V., it was authorized to split certain assets and equity, to a newly incorporated entity, Simec International 7, S.A. de C.V. The asset transferred was the investment in the shares of Corporacion Aceros DM, S.A. de C.V.

k) On September 3, 2010 a Brazilian entity GV do Brazil Industria e Comercio de Aco LTDA, was incorporated. On August 5, 2011 that company acquired 1,300,000 square meters of land on Pindamonhangaba, Sao Paulo State, Brazil, in the amount of US$8 million, where is going to be built a new steel facility that it is in the process of construction and it will start operations approximately on August, 2013. Grupo Simec as holding of 100% of the shares of GV do Brazil, its acquiring the machinery and will transfer it to the subsidiary as a contribution of common stock, when those assets are shipped. The budget for the project will be US$ 236 million (Integrated for US$ 171 million and $ 65 million as foreign investment incentives granted by the Brazil Government. The facility will have a production capacity of 520,000 tons of billet and 400,000 tons of finish goods of rebar and wire in the beginning, this production will be marketed to the construction sector and the company will have approximately 800 workers.

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

m) On November 2, 2010, the Company acquired 100% of the shares of Lipa Capital, LLC. (Lipa Capital) from Sbq Partners, LLC., owner of the intellectual property of interest to the Company. The total cost of this acquisition amounted to Ps. 187,433 (US$ 15.2 million) and the equity amounted to Ps. 69, 976. This acquisition resulted in the recording of an intangible asset of Ps. 117,457 related to a patent of the acquired entity. This intangible asset was subsequently written off and expensed in the consolidated income statement for the year ended December 31, 2010 because the Company ultimately concluded that such patent would not be generating additional cash flows. This amount is part of other expenses included in the consolidated statement of income. The Company transferred Lipa Capital’s jurisdiction from the United States of America to the United Mexican States on December 7, 2010 and merged it with Simec International 6, S.A. de C.V., on December 9, 2010.

4. Summary of significant accounting policies.

The significant accounting policies followed by the Company are summarized below:

a. Recognition of the effects of inflation on the financial information

According with the MFRS B-10, the effects in the inflation are recognized only when the economic environment has been qualified as inflationary (cumulative inflation equal or more to 26% in the last three years previous).

Since the accumulated inflation in the previous three years of the financial statements attached hereto was lower than 26%, the economic environment has been qualified as non-inflationary, therefore, the financial statements for years 2011, 2010 and 2009 attached hereto are presented in nominal pesos, except for the non-monetary items acquired before 2008, which include their restatement to constant pesos as of December 31, 2007. Accumulated inflation in the last three years prior to 2011 and 2010 rose to 15.2% and 14.5%, respectively.

The application of Bulletin B-10 “Recognition of Inflation Effects in Financial Information” was effective until December

31, 2007, therefore the amounts of capital stock, additional paid in capital and retained earnings were restated in Mexican pesos with purchasing power at December 31, 2007, applying factors derived from the Mexican National Consumer Price Index (NCPI). See note 4-h.

b. Foreign currency translation

Transactions in foreign currencies are recorded at the exchange rates prevailing at the celebration and liquidation dates. The assets and liabilities in foreign currencies are translated at the exchange rates prevailing at the date of the consolidated balance sheet. The exchange gains or losses incurred in connection with those assets or liabilities are included in the consolidated statements of income, as part of the comprehensive financing cost. Note 5 shows the consolidated position in foreign currencies at the end of each year and the exchange rates used in the translation.

The functional and reporting currency of the Company is the Mexican peso. The financial statements of foreign subsidiaries were translated to Mexican pesos in accordance with MFRS B-15 “Conversion of foreign currencies”. 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. This rule incorporates the concepts of recording currency that is the currency in which the entity maintains its accounting records, whether for legal or information purposes and the reporting currency, which is the currency chosen by the Company to report its financial information.

The U.S. dollar (US Dollar or US$) was considered as the functional currency of the U.S. subsidiaries, SimRep Corporation and Subsidiaries and Pacific Steel Inc., and the Brazilian real for GV do Brasil Industria e Comercio de Aco LTDA.; therefore the financial statements of these foreign 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 for stockholders’ equity accounts, revenues, costs and expenses.

The historical exchange rate for revenues, costs and expenses of the year reported.

The difference resulting from the translation processes, is recognized as accumulative translation adjustment as part of translation effect in foreign subsidiaries in stockholders’ equity.

The Mexican Peso was considered the functional currency of the subsidiaries Simec USA, Corp., Pacific Steel Projects, Inc., Simec Steel, Inc. and Simec International 2, 3, 4 and 5, these last established in the United State of America in 2011, while the U.S. dollar as its recording currency; therefore the financial statements were translated to Mexican pesos as follows:

- z Monetary assets and liabilities by applying the exchange rates at the balance sheet date.
- z Non-monetary assets and liabilities, as well as stockholders' equity accounts, at the historical exchange rate,
- z Revenues, costs and expenses at the historical exchange rate. The effect of non-monetary assets and liabilities in the income of the year, such depreciation and cost of sales, are translate at historical exchange rate corresponding to the balance sheet date.

Translation differences were carried directly to the income statement as part of the comprehensive financing cost under the caption foreign exchange gain, net. As of December 31 2011 the gain amounted to Ps. 813,146 (loss in 2010 amounting Ps. 106,768).

c. Cash and cash equivalents

Cash consists of deposits in bank accounts that do not generate interest. Cash equivalents consists in temporary investments whose original maturity is less than three months. These investments are valued at cost plus accrued yields. The value so determined is similar to their fair value. As of December 31, 2011 and 2010, those investments amounted to Ps. 5,310,217 and Ps. 2,615,518, respectively.

d. Derivative financial instruments

During 2011, 2010 and 2009 the Company used derivative financial instruments for hedging risks associated with natural gas prices, and this commodity its 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.

The risks associated with changes in natural gas prices occurring naturally as a result of the supply and demand on international markets, are covered through the use of 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 cost of sales.

The derivative financial instruments are presented in the Consolidated Financial Balance sheets at fair value, based on the original agreement. In a monthly basis fair value is recalculated and the related assets or liabilities are restated based on a new estimation. . 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. As of December 31, 2011, 2010 and 2009, the fair value of derivative instruments that did not qualify as hedging instruments were adjusted through the income statement of the year. For the derivatives that qualified for hedge accounting cash flow their fair value was adjusted through the Stockholders' equity in the caption of comprehensive income, net of the effect of the deferred income tax. See note 13.

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%. To the end of 2011, 2010 and 2009 the fair value of derivatives was effective.

e. Allowances for doubtful accounts

Allowances for doubtful accounts are maintained to provide for estimated losses resulting from the inability of customers to make required payments. If the financial condition of these customers deteriorates, resulting in their inability to make payments, additional allowances may be required. The Company also records allowances for accounts receivable for customers based on a variety of factors, including pricing adjustments, length of time receivables are past due, and historical experience.

f. Inventories and cost of sales

Inventories are recorded at the acquisition cost and production, which do not exceed the market value. The allocation of cost used is the average cost. Cost of sales its determined using that formula.

Before January 1, 2011 the inventories were determined with the direct costing system. In that valuation system, indirect cost of production were not included in the production cost, and are recorded directly in the income statement as operating expense, based on the consideration that the cost should not be affected by the fixed expenses.

From January 1, 2011 the amendment to MFRS C-4 ("inventories") prohibits the use of direct costing to determine the value of inventories, from this date, the indirect cost of production have to be included as part of the production cost (full absorption cost), therefore, for comparison purposes and according with the MFRS B-1 "Accounting changes and

error corrections", the financial statement of 2010 and 2009 here included were restructured. . The cumulative effect derived from this change amounted to Ps. 160,675, Ps 96,658 and Ps. 142,740 as of December 31, 2010, 2009 and 2008, respectively, net of the deferred income tax. The effect to the controlling interest amounted to Ps. 101,030, Ps. 68,072 and Ps. 88,879, respectively.

As a result of this adoption, the indirect cost previously presented in the Consolidated Income Statement in the caption Indirect overhead, selling, general and administrative expenses in 2010 and 2009, amounting Ps. 1,809,976 and Ps. 1,673,421 were reclassified to cost of sales.

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

As of December 31, 2011 and 2010, the Company has inventory of raw materials (coke) which, due to low production in one facility of Republic, has not been used in the past 3 years, for these reason this inventories are classified in the long term. The amount at this date, included in long-term inventories, totaled Ps.1,651,875 and Ps. 1,450,352 respectively. The inventory balance includes a provision to lower of cost market amounting to Ps. 765,848 and Ps. 671,287 as of December 31, 2011 and 2010, respectively.

g. Reserve for slow-moving inventory

The Company follows the practice of providing a reserve for slow-moving inventory, considering the totality of products and raw materials that show impairment or degradation for future use.

h. Property, plant and equipment

Property, plant and equipment are recorded at acquisition cost. Assets acquired in 2007 and prior years include a restatement determined by applying factors derived from the NCPI as of December 31, 2007, to the acquisition cost, except machinery and equipment of foreign origin which was updated using the inflation rates in the country of origin and fluctuation in exchange rates in relation to Mexican peso.

Depreciation of property, plant and equipment is computed using the straight-line method, based on the estimated remaining useful lives of the related assets determined by the Company. The mentioned restatement is debited to results of operations as the related asset is depreciated or disposed.

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

	Years
Buildings	10 to 65
Machinery and equipment	5 to 40
Transportation equipment	4
Furniture, mixtures and computer equipment	3 to 10

i. Comprehensive Financing Cost (CFC)

In the case of assets who require a substantial period of time for its use, comprehensive financing cost is capitalized as incurred during the period of construction and installation of property, plant and equipment during the construction process. The amount of capitalized financing costs results from the application of the financial weighted average capitalization rate to the investment in qualified assets over the period of acquisition. In the case of foreign currency financing, the comprehensive financing cost includes in addition the corresponding exchange gains and losses, net of valuation effects of hedging instruments associated with such loans. The comprehensive financing cost includes (i) the interest cost, (ii) any foreign currency fluctuations, and (iii) the related monetary position. Until December 31, 2007, such costs were restated based on the NCPI factors from the date capitalized through year-end and amortized over the average depreciation period of the related assets.

j. Leases

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

When the lesser retains the risks or benefits inherent to the ownership of the leased asset, the agreements are classified as operating leases and rent is charged to results of operations.

k. Intangible assets and goodwill

Intangible assets and goodwill are recorded at acquisition cost. Those acquired in 2007 and prior years include a restatement determined by applying factors derived from the NCPI as of December 31, 2007, to the acquisition cost. Intangibles assets that have definite life are amortized based on their estimated useful life through the straight-line method by the Company. (see note 11). The restatement referred above is charged to expense as the asset is amortized or disposed. Intangible assets indefinite life and goodwill (generated in the acquisition of Grupo San) are not subject to amortization.

Impairment tests are made on an annual basis on intangible assets with indefinite lives, including goodwill, as well as over those intangibles with finite life whose amortization period exceeds 20 years from the date on which it was available for use.

l. Impairment of long-live assets and their disposal

The Company and its subsidiaries review the book value of their long-lived assets, including the goodwill to detect any impairment evidence that could indicate that their book value could be non-recoverable, in accordance with Bulletin C-15, "Impairment in the Value of Long-Lived Assets and Their Disposal". To determine if an impairment exists, is considered the greater of present value (using a discount rate) of the expected net cash flows that will be yielded during the estimated useful lives of the assets or its fair value. Impairment loss is recorded considering the amount of book value that exceeds the greater of the values mentioned above. When there is an intention of sell assets, these must be presented in the financial statements at lower of historical (or restated value as of December 31, 2007 if the asset was acquired in prior years) or fair value.

m. Environmental Costs

Based on information currently available, Republic established a liability for an amount considered appropriate to cover costs of environmental remediation that are probable of being incurred in the future. The amount was determined based on information currently available, current technology, applicable environmental laws and current regulations, and also considered the effects of inflation and other social and economic factors that could have an effect, in accordance with accounting Bulletin C-9, "Liabilities, Provisions, Contingent Assets and Liabilities and Commitments" of MFRS. See note 20

n. Use of estimates

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

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

o. Accruals and contingencies

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

Accruals are recognized only when a cash disbursement to settle the contingent obligation is probable.

p. Employee benefits

The subsidiaries of the Company that have employees recognize the criteria established in MFRS D-3 “Employee benefits”. This MFRS establishes three types of benefits to employees: direct short and long-term benefits, at the end of the labor relation and upon retirement.

The liabilities due to employee benefits granted by the entity are determined as follows:

z The liabilities for direct short-term benefits are recognized as incurred, based on the current salaries, expressed at their nominal value. As of December 31, 2011, 2010 and 2009 there are no direct long-term benefits.

z The liabilities due to termination benefits of the labor relation before reaching retirement age are determined by considering the present value of the obligation due to benefits defined as of the date of the balance sheet, using for said purpose certain assumptions and hypotheses determined by independent actuaries. The remunerations included in the determination of these liabilities correspond to severance indemnities and seniority premium attributable to death, disability, severance and voluntary retirement before retirement date, all of these determined in accordance with the applicable labor laws. Actuarial gains and losses are immediately recognized in the results of the year. Transition liabilities and the changes to the plan pending amortization as of December 31, 2007 are amortized through the straight-line method in five years.

z The liabilities due to post-employment benefits are determined by considering the present value of the obligation due to benefits defined as of the date of the balance sheet. The remunerations included in the determination of these liabilities correspond to seniority premium for retirement. See Note 14.

Actuarial gains and losses, as well as the changes to the plan pending to be amortized are amortized on the basis of the remaining average work life of the workers that are expected to receive the benefits. Transition liabilities as of December 31, 2007 are amortized through the straight-line method in five years.

- The liabilities due to the retirement and termination of the labor relation before reaching retirement age, as well as the related net costs are determined according to the unit credit method, based on projected salaries, using for that purpose certain assumptions and hypotheses determined by independent actuaries. See Note 14.

- The deferred employee profit sharing (EPS) is recognized on the basis of the assets and liabilities method established in MFRS D-4, “Income taxes”, which is determined based on the temporary differences between accounting and tax values of the assets and liabilities of the entity, in those cases where it is likely to realize the liability or benefit that may be originated and there are no signs that this situation will change in such a way that the liabilities or benefits cannot materialize in the future. As of December 31, 2011 and 2010, temporary differences are not material and consequently no provision was recorded.

q. Comprehensive income

The amount of the comprehensive income or loss is shown in a single line within the statement of changes in stockholders' equity, which is the result of the total operation of the company in the year and it is represented by the net profit or loss for the year, plus the effects of the translation of foreign entities and the changes in the fair value of derivative financial instruments, according with the MFRS applied

directly in stockholders equity, as well as the effect of minority interest.

r. Income Statement

Costs and expenses showed in the statements of income are derived from primary activities of the Company and that represent its main source of revenues. Considering the practices of the industry were operates, the Company considers the best way to present its costs and expenses in the statement of income is by function. This classification shows in generic headings, the types of costs and expenses based on the contribution to the different levels of income or loss of such statements.

Operating income is presented in the consolidated income statement, considering that this disclosure contributes to a better understanding of economic and financial performance of the entity, determined according to the Guidance to Financial Reporting Standards (ONIF-1) issued by the CINIF.

s. Concentration risk

Cash amounts in excess of current requirements are deposited in bank institutions with qualified credit ratings, which are located in different geographical regions. Practice of the company is designed not to limit exposure to a single financial institution. The Company uses derivative instruments as mentioned in Note 4-d and these contracts contain the risk that the counterparty does not fully comply with its obligations, which could result in a material loss. The Company sells its products in the domestic market to a large base, which is geographically diverse; consequently, there is no significant concentration in a specific customer or region. In the case of the U.S. market, in 2011 and 2010, the five largest customers of Republic accounted for approximately 24.3% and 23.4%, respectively, of consolidate revenue in the United States.

t. Revenue recognition

Revenue is recognized in the period in which the risks and benefits of inventories are transferred to the customer that acquired them, which usually occurs 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.

u. Income taxes

The income taxes (Income Tax and/or Business Flat Tax) recorded in the year's results are based on criteria established in MFRS D-4 "Income Taxes". According to that MFRS, the current tax determined on the basis of the tax provisions in force is recorded in the income of the year to which it is attributable. The deferred taxes are determined on the basis of the assets and liabilities method established in mentioned MFRS, which consists of comparing the accounting and tax values of the assets and liabilities of the entity, from which both deductible and accruable temporary differences arise. The respective tax rate is applied to all the resulting temporary differences and they are recognized as a deferred asset or liability. The deferred asset tax, is recorded only when there is a possibility for their recovery.

The Company follows the practice of recognizing the benefits for the amortization of income tax carry forward losses in the year that the amortization occurred except when the losses arise from expenses in excess and it is considered that these carry forward tax losses will be amortized in future years.

The Company applied on a supplementary basis to MFRS, ASC 740-10-25 “Income taxes” Acquired Temporary Differences in Certain Purchases Transactions that are not Account for as Business Combinations of the Generally Accepted Accounting Principles in the USA, for the acquisition of companies with tax losses carry-forward (NOLs). The deferred credit is amortized to result of operations in the same proportion to the realization of the tax benefits that gave rise to the deferred credit.

v. Earnings (loss) per share

Income per share is calculated by dividing controlling net income or loss, by the weighted average shares outstanding during each year presented.

w. Segments Information

Segment information is presented in accordance with the region and due to the operation business is presented in accordance with the information used by management for decision making purposes. See Note 19.

5. Foreign Currency Position

As of December 31, 2011 and 2010 financial statements include foreign currency denominated assets and liabilities as follows:

	(Figures in thousands of dollars)	
	2011	2010
Current Assets:		
Cash and cash equivalents	US$423,746	US$239,943
Accounts receivable trade	135,093	130,446
Other accounts receivable	29,849	14,464
Total Assets	588,688	384,853

Current liabilities:		
Suppliers	132,197	152,589
Related parties	50,567	48,524
Other accounts payable and accrued expenses	47,297	22,742
	230,061	223,855
Long term liabilities	3,444	4,128
Total liabilities	233,505	227,983
Net assets	US$355,183	US$156,870

The exchange rates used to translate U.S. currency amounts were Ps. 13.99 and Ps. 12.36 per U.S. dollar as of December 31, 2011 and 2010, respectively. As of April 24, 2012, issuance date of the financial statements in Mexico, the exchange rate was Ps. 13.21 per one US dollar.

A summary of transactions carried out for the years ended December 31, 2011, 2010 and 2009, in U.S. dollars, excluding transactions of foreign subsidiaries is as follows:

	Thousands of U. S. Dollars		
	2011	**2010**	**2009**
Sales	US$147,754	US$207,271	US$81,465
Purchases (raw material)	3,655	36,056	4,230
Other expenses (spare parts)	20,111	11,913	11,719
Paid interest		488	2,765

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

	Thousands of U.S. dollars	
	2011	**2010**
Monetary current assets	US$ 533,342	US$ 294,778
Inventories and prepaid expenses	281,456	266,972
Short-term liabilities	(221,699)	(219,317)
Working capital	593,099	342,433
Property, plant and equipment	142,303	146,561
Other assets and deferred charges	12,032	12,806
Long-term inventory	118,072	117,370
Long-term liabilities	(62,546)	(52,172)
Stockholder´s equity	US$ 802,960	US$ 566,998

6. Balances and transactions with related parties

Balances with related parties a as of December 31, 2011 and 2010 were as follows:

Accounts receivable:	**2011**	**2010**
Industrias CH, S. A. B. de C. V (1).	Ps. 104,207	Ps. 112,952
Compañíа Laminadora Vista Hermosa, S.A. de C.V.	1,029	2,854
Operadora Construalco, S. A. de C. V.	483	321
Ferrovisa, S.A. de C.V.	11,084	9,755
Compañíа Manufacturera de Tubos, S.A. de C.V.	39,943	263
Operadora Industrial de Herramientas, S.A. de C.V.	1,423	0
Joist del Golfo, S.A. de C.V.	7,033	0
Perfiles Comerciales Sigosa, S.A. de C.V.	3,625	0
Others	191	0
Total	Ps. 169,018	Ps. 126,145
Accounts payable:		
Industrias CH, S. A. B. de C. V. (2)	Ps. 172,513	Ps. 154,750
Tuberias Procarsa, S. A. de C. V. (2)	416,107	366,615
Procarsa Tube and Pipe (2)	41,665	13,251
Pytsa Industrial de Mexico, S. A. de C. V. (2)	71,206	62,685
Aceros y Laminados Sigosa, S.A. de C.V. (2)	1,825	19,099
Perfiles y Comerciales Sigosa, S. A. de C. V.	0	3,084
Nueva Pytsa Industrial, S.A. de C.V.	0	7,520
Pytsa Industrial, S.A. de C.V.	2,154	1,985

Others	915	687
Total	Ps. 706,385	Ps. 629,676

(1) This account receivable with ICH consists in recoverable income tax derived from the fact that some of the companies determine consolidated income tax. See note 18.

(2) As of December 31, 2011 and 2010, the amount payable to these companies is related to loans that are denominated in US dollar. These promissory notes do not specify a maturity date and bear annual interest at 0.25%.

Other accounts receivable and payable are generated by purchase and sale of finished goods as part of the normal operations.

At the years ended December 31, 2011, 2010 and 2009, the significant transactions carried out with related parties are:

	2011	**2010**	**2009**
Sales	Ps. 30,613	Ps. 42,927	Ps. 149,682
Purchases	65,966	80,792	38,483
Interest expense	1,474	1,862	3,916
Administrative services expenditures	14,449	14,284	15,071
Direct short-term benefits	31,120	21,024	28,900

7. Recoverable taxes

As of December 31, 2011 and 2010, the amount of recoverable taxes was as follows:

	2011	2010
Value Added Tax	Ps. 291,693	Ps. 562,746
Income Taxes	181,836	81,562
Business Flat Tax	27,159	33,674
	Ps. 500,688	Ps. 677,982

8. Inventories

As of December 31, 2011 and 2010 inventories are comprised of the following:

	2011	2010
Finished goods	Ps. 2,300,861	Ps. 1,907,746
Work in process	67,318	199,215
Billet	1,381,204	1,447,574
Raw materials and supplies	1,470,682	1,215,045
Materials, spare parts and rollers	640,794	363,885
	5,860,859	5,133,465
Less allowance for slow moving	(130,924)	(3,808)
	5,729,935	5,129,657
Materials in transit	30,185	88,647
	Ps. 5,760,120	Ps. 5,218,304

9. Prepaid expenses.

In compliance with the MFRS C-4 “Inventories” and MFRS C-5 “Prepaid expenses” the down payment paid to supplier in 2010 that were originally presented as part of inventories amounting Ps. 166,488 were reclassified to prepaid expenses. The balances of down payment as of December 31, 2011 and 2010 amounted Ps.193,985 and Ps. 262,708, respectively.

10. Property, plant and equipment (in millions of pesos)

	Buildings	Machinery and equipment	Transportation equipment	Furniture and computer equipment	Land	Construction in progress	Total
Investment:							
Amount as of December,31 2009	Ps. 2,914	Ps. 12,974	Ps. 105	Ps. 127	Ps. 820	Ps. 359	Ps. 17,299
Additions	84	268	2	2		141	497
Disposals			(1)				(1)
Conversion effect	(13)	(130)		(1)	(5)	(13)	(162)
Amount as of December 31, 2010	2,985	13,112	106	128	815	487	17,633
Additions	200	93	32		137	-	462
Disposals		(31)		(1)	(17)	-	(49)
Transfers		415				(415)	-
Conversion effect	39	347		3	13	6	408
Amount as of December 31, 2011	Ps. 3,224	Ps. 13,936	Ps. 138	Ps. 130	Ps. 948	Ps. 78	Ps. 18,454
Accumulated depreciatión:							
Amount as of December 31, 2009	Ps. 743	Ps. 6,668	Ps. 43	Ps. 51	Ps.	Ps.	Ps. 7,505
Depreciation of the year	66	661	2	2			731
Conversion effect	(1)	(54)		(1)			(56)
Amount as of December 31, 2010	808	7,275	45	52			8,180
Depreciation of the year	44	600	2	1			647
Disposals		(19)					(19)
Conversion Effect	3	166		1			170
Amount as of December 31, 2011	Ps. 855	Ps. 8,022	Ps. 47	Ps. 54	Ps.	Ps.	Ps. 8,978
Net Value:							
December 31, 2009	Ps. 2,171	Ps. 6,306	Ps. 62	Ps. 76	Ps. 820	Ps. 359	Ps. 9,794
December 31, 2010	Ps. 2,177	Ps. 5,837	Ps. 61	Ps. 76	Ps. 815	Ps. 487	Ps. 9,453
December 31, 2011	Ps. 2,369	Ps. 5,914	Ps. 91	Ps. 76	Ps. 948	Ps. 78	Ps. 9,476

Constructions in progress are primarily improvements to increase the installed capacity and yield of machinery and equipment. The estimated completion date of these constructions in progress is 2012 and the amount pending to be invested is Ps. 9 approximately.

As of December 31, 2011 and 2010, balances in property, plant and equipment include capitalized comprehensive financial cost as a complement to the acquisition cost amounting Ps. 524.

11. Intangible and other noncurrent assets

As of December 31, 2011 and 2010, the item is comprised as follows.

	2011			2010	
	Cost	**Accrued amortization**	**Net value**	**Net Value**	**Amortization Period**
Recorded trade mark	Ps. 75,352		Ps. 75,352	Ps. 66,489	*
Kobe Tech Contract	87,818	Ps. 46,952	40,866	39,586	12
Customer list	46,001	14,760	31,241	28,694	20
Total Republic (1)	209,171	61,712	147,459	134,769	
Customers list	2,205,700	878,196	1,327,504	1,572,582	9
Non compete contract	394,700	353,585	41,115	139,790	4
Trademark San 42 (2)	329,600	0	329,600	329,600	*
Technological platform	8,800	6,307	2,493	4,253	5
Goodwill Grupo San (2)	1,814,160	0	1,814,160	1,814,160	*
Total Grupo San (3)	4,752,960	1,238,088	3,514,872	3,860,385	
	4,962,131	1,299,800	3,662,331	3,995,154	
Advance to suppliers of machinery and equipment. See Note 20	42,070		42,070		
Other assets	96,602	0	96,602	105,987	
	Ps. 5,100,803	Ps. 1,299,800	Ps. 3,801,003	Ps. 4,101,141	

* Intangibles assets with undefined life.

(1) Intangible assets from acquisition of Republic.

(2) In the period ended December 31, 2009, the Company recognized an impairment loss of Ps. 2,368,000, and decreased the value of the trademark San 42 and Goodwill in the amount of Ps. 16,000 and Ps. 2,352,000,

respectively.

(3) Intangible assets from acquisition of Grupo San.

Pursuant to the adoption of the new MFRS C-8 “intangible assets”, in 2009 the preoperative expenses amounting Ps. 151,826 were charged to retained earnings, net of its corresponding deferred income tax liability of Ps. 42,511. The net amount charged to retained earnings was $ 109,315.

The amortization of these assets recorded in the income statements for the years ended December 31, 2011, 2010 and 2009, amounted Ps. 354,098, Ps. 367,178 and Ps. 365,625, respectively.

12. Medium Term Notes and Notes Payable

Medium Term Notes

On October 22, 1997 and August 17, 1998, the Company offered to holders of medium-term notes, to exchange their bonds at par, for new bonds denominated senior subordinated notes. The new notes bonds bear semi-annual interest each at an annual rate of 10.5% interest and capital repayments were semiannual from May 15, 2000 and until November 15, 2007. As of December 31, 2011, the amount of new notes not exchanged totaled US$ 0.3 plus accrued interest. As of December 31, 2011 and 2010 liabilities in pesos for the new notes not exchanged amounted to Ps. 4,225 and Ps. 3,732 respectively.

13. Derivative financial instruments

The Company used derivative financial instruments, primarily to offset the exposure to variability in the price of natural gas. Derivative financial instruments used by the Company consist of natural gas swap contracts. These contracts are recognized on the balance sheet at fair value. The swaps from the Mexican operations are highly effective in mitigating the exposure to natural gas fluctuations, therefore those swaps are considered as cash flow hedges, and thus, the fair value of the swap is recorded in comprehensive income in stockholders' equity.

In Mexico, as of December 31, 2011, the Company has contracted natural gas swaps with PEMEX Gas and Basic Petrochemicals (PGBP). In case of Republic the agreements were celebrated with Hess Corporation.

The following table shows the existing natural gas swap as of December 31, 2011:

Date of Contract	**Starting Date**	**Ending Date**	**Type Swap**	**Price (US$) / MMBTU / G. CAL**	**Quantity**	**Units**	**Fair Value**
10/09/2008	01/07/2011	30/06/2012	D.S. Swap	8.33	22,500	MMBTU	Ps. 8,447
29/10/2010	01/07/2011	30/06/2012	D.S. Swap	4.50	80,000	MMBTU	8,710
02/09/2008	01/07/2011	30/06/2012	D.S. Swap	8.47	4,000	MMBTU	1,541
04/11/2010	01/07/2011	30/06/2012	D.S. Swap	4.50	7,500	MMBTU	817
02/09/2008	01/07/2011	30/06/2012	D.S. Swap	8.47	6,875	MMBTU	2,648
04/11/2010	01/07/2011	30/06/2012	D.S. Swap	4.50	15,000	MMBTU	1,633
22/11/2011	01/01/2012	31/01/2012	Future	3.57	527,000	MMBTU	0
22/11/2011	01/01/2012	29/02/2012	Future	3.59	493,000	MMBTU	4,133
22/11/2011	01/01/2012	31/03/2012	Future	3.58	527,000	MMBTU	4,146
22/11/2011	01/01/2012	30/04/2012	Future	3.62	150,000	MMBTU	1,132
22/11/2011	01/01/2012	31/05/2012	Future	3.66	155,000	MMBTU	1,144
22/11/2011	01/01/2012	30/06/2012	Future	3.71	150,000	MMBTU	1,105
			Net derivative instruments liability				35,456
			Net liability booked in accounts payable				7,306

Ps. 42,762

F-24

The following table shows the existing natural gas swap as of December 31, 2010:

Date of Contract	**Starting Date**	**Ending Date**	**Type Swap**	**Price (US$) / MMBTU / G. CAL**	**Quantity**	**Units**	**Fair Value**
25/06/2008	01/07/2008	30/06/2011	Swap	11.45	85,000	G.CAL.	Ps. 37,578
25/06/2008	01/07/2008	30/06/2011	Swap	11.45	45,000	MMBTU	19,894
25/06/2008	01/01/2009	30/06/2011	Swap	11.12	8,000	MMBTU	3,373
02/09/2008	01/01/2009	30/06/2011	Swap	8.44	4,000	MMBTU	1,025
02/09/2008	01/07/2011	30/06/2012	D.S. Swap	8.47	4,000	MMBTU	2,210
25/06/2008	01/01/2009	30/06/2011	Swap	11.12	24,000	MMBTU	10,121
02/09/2008	01/01/2009	30/06/2011	Swap	8.44	1,750	MMBTU	449
02/09/2008	01/07/2011	30/06/2012	D.S. Swap	8.47	6,875	MMBTU	3,799
November and December 2010	November and December 2010	January to April, 2012	Future	4.00 to 4.41	200,000 to 350,000	MMBTU	1,259
			Net derivative instruments liability				79,708
			Net liability booked in accounts payable				12,067
							Ps. 91,775

As of December 31, 2011, the Company recognized a liability amounting to Ps. 42,762 and deferred income tax asset amounting to Ps. 13,429. The amount recorded in equity as part of comprehensive income in the year 2011 represented an income amounting to Ps. 34,017, which Ps.37,904 were related to the controlling interest.

As of December 31, 2010, the Company recognized a liability amounting to Ps. 91,775 and income tax asset deferred amounting to Ps. 27,612. The amount recorded in equity as part of comprehensive income in the year 2010 represented an income amounting to Ps. 87,864, which Ps. 88,378 were related to the controlling interest.

Based on its inventory turnover, the Company believes that the natural gas burned and incorporated in its products during a given month is reflected in the cost of sales of the subsequent month; consequently, the realized effects of this hedge are reclassified from the comprehensive income account to results of operations in the following month. In

the years ended December 31, 2011, 2010 and 2009, the Company recorded an increase of Ps. 205,278, Ps. 298,647 and Ps. 419,200, respectively to its cost of sales resulting from settled transactions.

In the case of Republic, its gas future contracts are also used to cover changes in the cost of natural gas. The contracts are usually no longer than one year.

14. Employee benefits

Determination of the liability for employee benefits as of December 31, 2011, 2010 and 2009 is summarized below:

	Post-employment benefits	Termination benefits	2011 Total	2010 Total	2009 Total
Projected benefits obligation	Ps. 50,093	Ps.J9,800	Ps.O9,893	Ps.O5,325	Ps.O7,688
Net transition liability pending to be amortized	(16,709)	(2,235)	(18,944)	(26,423)	(37,751)
Prior service cost and plan amendments	(3,099)	(36)	(3,135)	(228)	(2,616)
Variations in assumptions and experience adjustments	10	(10)	-	(3,341)	(4,181)
Accumulated benefit obligation	Ps. 30,295	Ps.J7,519	Ps.M7,814	Ps.L5,333	Ps.K3,140

F-25

Components of net cost of benefits plan to employees are as follows:

	Post-employment benefits	**Termination benefits**	**2011 Total**	**2010 Total**	**2009 Total**
Service cost	Ps. 2,659	Ps. 3,155	Ps. 5,814	Ps. 6,554	Ps. 8,098
Financial Cost	3,474	1,926	5,400	5,962	9,609
Amortization of transition liability	4,662	1,906	6,568	6,903	1,342
Amortization of prior service cost and plan amendments	(994)	234	(760)	52	6,872
Anticipated reduction of Obligations	117	2,377	2,494	(4,568)	-
Variations amortization in assumptions and experience Adjustments	(304)	(1,408)	(1,712)	3,774	9,787
Net period cost	Ps. 9,614	Ps. 8,190	Ps. 17,804	Ps. 18,677.	Ps. 35,708

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

	2011	2010	2009
Discount rate	7.5%	7.5%	8.0%
Actual rate of future salary increases	6.2%	5.5%	5.0%

As of December 31, 2011, the Mexican subsidiaries with employees did not generate Employees Profit Sharing (EPS). In 2010 and 2009, the expense EPS was Ps. 95 and Ps. 7,261.

15. Other employment benefit plans

Republic is the only subsidiary of the Company which offers additional benefits and pension plans to their employees. Benefit plans to these employees are described below.

a) Defined Contribution Plans

Seventy-nine percent of the Republic´s employees are covered by a collective bargaining agreement with the United Steelworkers (USW).

The Company is required to make a contribution to the VEBA Benefit Trust for every hour worked by eligible employees. This welfare plan makes provision for retiree healthcare benefits, and is not a “qualified” plan under ERISA regulations. The labor agreement requires a contribution, by the Company, to the retirement healthcare plan of US$3.00 for every hour worked, not to be less than US$2.85 million per quarter, but not to exceed US$11.4 million per year. For the years ended December 31, 2011, 2010 and 2009, the Company recorded expenses amounting to US$8.5 million, US$11.4 million and US$ 11.4 million, respectively related to this welfare plan. Contributions are also made to the SWP Trust, a “qualified” pension benefit plan under ERISA regulations, at a rate of US$1.68 per hour as defined in the labor agreement. For the years ended December 31, 2011, 2010 and 2009, the Company recorded expenses amounting to US$6.0 million, US$7.1 million and US$ 7.1 million, respectively, related to this pension benefit plan. The Company recorded combined expenses amounting to US$14.5 million, US$18.5 million and US$ 18.5 million for the years ended December 31, 2011, 2010 and 2009, respectively, related to the funding obligations of the retirement healthcare and pension benefits.

On March 29, 2012, the USW and Republic ratified a new collective bargaining agreement. This collective bargain expires on august 15, 2016. The new labor agreement includes wage and benefit increases including two lump sum payments payable to active USW employees during 2012, and general wage increases in 2013, 2014, and 2015. Company contributions to fund the Republic Retirement VEBA Benefit Trust (Benefit Trust) were reduced by US$2.0 million per year beginning in 2012. In addition, the quarterly contribution amount was suspended effective the fourth quarter of 2011 and continuing through the third quarter of 2012. Contributions to the Benefit Trust will resume during four quarter 2012 at a quarterly rate of approximately US$2.4 million with an increase to a US$2.6 million quarterly rate beginning in the second quarter 2013.

The Company has a defined contribution 401K 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 participants age and service as of January first of each year. The amount of the Company’s contribution is equal to the monthly base salary multiplied by the appropriate percentage based on age and years of service. The contribution becomes 100% vested upon completion of three years of 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 100.0% vested in both their and the Company’s matching 401(k) contributions. For years ended December 31, 2011, 2010 and 2009, the Company recorded expense of US$2.1 million, US$2.0 million and US$ 1.9 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 401K retirement plan through voluntary deferrals of employees’ compensation. There are no Company contributions or employer matching contributions relating to these employees.

b) Profit Sharing Plans

The labor agreement includes a profit sharing plan to which the Company is required to contribute 2.5% of its quarterly pre-tax income, as defined in the labor agreement. At the end of the year, the contribution will be based upon annual pre-tax income up to US$50.0 million multiplied by 2.5%, US$50.0 million to US$100.0 million multiplied by 3.0%, and above US$100.0 million multiplied by 3.5%, less the previous payouts during the year. Profit sharing earned, accrued and expensed was US$1.0 million for the year ended December 31, 2011. There was no profit sharing earned, accrued or recorded for the years ended December 31, 2010 and 2009.

Republic Steel has a profit sharing plan for all salaried and nonunion hourly employees that is a function of achieving business plan EBITDA objectives. The Company paid US$0.3 million for profit sharing at December 31, 2011 related to 2011 performance. However, the amounts paid in 2011 were discretionary as the financial thresholds of the profit sharing plan had not been reached in any quarter or for the year. No profit sharing was accrued or expensed for the year ended December 31, 2010 and 2009.

c) Incentive Compensation Plans

The Company has various compensation plans that are based on attaining certain Business Plan and other performance targets for the financial calendar year. The objectives are measured on a quarterly basis. Individuals designated as participants in these plans are excluded from the Company's regular profit sharing plan. For the years ended December 31, 2011, 2010 and 2009, there were no incentives earned under these plans as the target thresholds for the respective years were not achieved.

16. Stockholder´s equity

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

a. Capital stock structure

As of December 31, 2011, the capital stock of Grupo Simec, S.A.B. de C.V., is represented by 497,709,214 common shares corresponding to "B" series of free circulation, without nominal value. The minimum fixed capital not subject to withdrawal is Ps. 441,786 (nominal amount).

b. Legal Reserve

The Company's net income is subject to the application of 5% to the legal reserve until it represents 20% of the nominal capital stock. The legal reserve is not subject to cash distribution, but may be capitalized and is included in retained earnings. At December 31, 2011, the legal reserve of the Company amounted to Ps. 484,045 (nominal pesos), representing 20% of nominal capital.

c. Dividends and capital refunds

Retained earnings are subject to taxes if distributions are paid in cash, except when they are paid from "net tax profit account" or "CUFIN". Also, the capital refunds that proportionally exceed the contributed capital account (CUCA), are considered dividends and subject to tax. As of December 31, 2011, the CUFIN of Grupo Simec, S. A.B. de C.V. and its subsidiaries amounted to Ps. 1,083,964. At that date the balance of the CUCA of Grupo Simec, S. A.B. de C.V. amounted to Ps. 8,568,530.

d. Comprehensive Income

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

	2011	**2010**	**2009**

Net income (loss)	Ps. 2,952,231	Ps. 668,954	Ps. (1,221,194)
Fair value of derivative financial instruments	48,200	124,464	159,453
Deferred taxes in fair value of derivative financial instruments	(14,183)	(36,600)	(40,312)
Translation effect of foreign subsidiaries, net	664,150	(216,945)	(158,317)
Total comprehensive income (loss)	3,650,398	539,873	(1,260,370)
Noncontrolling interest (1)	331,775	(375,861)	(956,259)
Controlling interest	Ps. 3,318,623	Ps. 915,734	Ps (304,111)

(1) The non-controlling interest is the due to the investment of Industrias CH, S.A.B. de C.V. (Holding Company) in SimRep Corporation and subsidiaries.

17. Non-controlling interest

As mentioned in Note 3, Grupo Simec, S. A. B. de C. V., owns practically 100% of the capital stock of its subsidiaries and 50.22% of SimRep Corporation and subsidiaries. The non-controlling interest represents the equity in this subsidiary owned by minority shareholders, and is presented in the consolidated balance sheet after the controlling interest. The consolidated income statement shows the total consolidated net income or loss and controlling and non-controlling interest portions are presented after the consolidated net income or loss.

18. Income taxes

The Company is subject to income tax (IT) and the Business Flat Tax (BFT)

Grupo Simec, S.A.B. de CV and some of its subsidiaries consolidate their taxable income with its parent company ICH. In accordance with the provisions of the Income Tax Law, ICH and each of the subsidiaries determine their taxes individually, and have the obligation to pay the minority portion of those taxes directly to the Mexican Tax Authorities. The majority income tax, for consolidation purposes, is covered by the holding company. Grupo Simec, S.A.B. de C.V. and its subsidiaries calculate and book its provision for taxes on a standalone basis.

BFT was incurred at the rate of 17.5%. The basis of the tax is determined by totaling the revenues collected, less certain deductions paid, including purchases of inventories and investments in fixed assets. The tax incurred may be decreased by certain credits related to wages and salaries, Social Security contributions, investments in fixed assets that were not deducted at the time the Law was enacted, part of the inventories, among others, as well as the income tax effectively paid in the year. On such basis, the BFT will be paid only for the difference between the income tax and the BFT incurred, when the latter is higher.

With the entry into force of the BFT Act, the Act of Asset Tax (IMPAC) was revoked, establishing a new procedure for requesting a refund of recoverable asset tax paid in the previous ten years during which in no instances exceeded 10% of the asset tax paid in 2005, 2006 and 2007. Based on these changes, the Company has determined that the cumulative recoverable IMPAC as of December 31, 2011 for Ps. 106,869 will not be recovered based on the prospective analysis of its results from operations and accordingly this amount has been reserved in its entirety.

In December 2009 some amendments to the Income Tax Act were published effective January 1, 2010. The most significant change is the change in the income tax rate, which for 2010, 2011 and 2012 is 30%, in 2013 the rate will be 29% and from 2014 and thereafter will return to 28%.

Based on financial projections made for the next years, and retrospectively on historical results, the Company has determined that certain subsidiaries of the Group will be subject to IT and others to BFT. The deferred tax for the year was determined based on specific rules for each tax.

The analysis of the income tax charged (credited) to the results of 2011, 2010 and 2009 is as follows:

	2011	2010	2009
Current Income Tax Mexican Subsidiaries	Ps. (4,548)	Ps. 128,176	Ps. 82,858
Business Flat Tax	5,945	2,898	100,212
Current Income Tax Foreign Subsidiaries	(88,234)	28,033	(824,812)
Deferred income Tax Mexican Subsidiaries	(38,627)	(148,928)	(1,250,496)
Deferred Business Flat Tax	180,465	9,501	-
Deferred Income Tax Foreign Subsidiaries	54,836	92,756	(172,914)
	Ps. 109,837	Ps. 112,436	Ps (2,065,152)

In 2011, 2010 and 2009, the income tax attributable to income before taxes, was different from the amount computed by applying the rate of 30% in 2011 and 2010, and 28% in 2009, to income before these provisions and non-controlling interest, as a result of the items listed below:

	2011	2010	2009
Expected tax expense (benefit)	Ps. 918,620	Ps. 234,417	Ps. (920,177)
Increase (decrease) resulting from:			
Net effect of inflation	(13,729)	8,826	(2,724)
Effect on Republic's effective income tax rate	(8,689)	16,871	(152,501)
Effect of NOLs generated during the year (1)	42,492	249,282	(43,414)
BFT paid in excess of income tax and BFT deferred	186,410	12,399	39,353
Benefit of amortization of tax losses and others	(1,021,174)	(507,726)	(334,622)
Change in the additional liability from other tax transactions			(1,142,882)
Amortization of deferred credit			(163,333)
Impairment loss		35,237	663,040
Other, net (including effect of permanent differences)	5,907	63,130	(7,892)
Income tax expense (benefit) tax	Ps. 109,837	Ps. 112,436	Ps (2,065,152)
Effective tax rate	3.6%	14.4%	(62.8%)

(1) According with MFRS D-4 "Income Taxes", those losses generated in a year, as well as carry-forwards, are temporary differences on which it should be recognize a deferred income tax. The Company follows the practice of recognizing the benefit from the amortization of tax loss carry-forwards in income for the period that are amortized, except when the losses come from over-expenditures and is considered that these losses will be amortized in future years. The amounts of Ps. 42,492 and Ps. 249,282 included in the caption "Effect of NOLs generated during the year" correspond to the income tax of the tax losses generated by certain subsidiaries in the years 2011 and 2010, respectively, which were reserved in those years. The amounts of Ps. 1,021,174 and Ps. 507,726 included in the caption "Benefit of amortization of tax losses and others" correspond to the income tax benefit obtained by those companies that amortized tax losses during 2011 and 2010, respectively.

The Company has tax losses that under the Income Tax Law in force, can be amortized against taxable income generated in the next ten years. Tax losses can be updated by following certain procedures set forth in the law.

At 31 December 2011 Grupo Simec, S. A. B. de C. V. and certain subsidiaries have tax losses carry forwards pending to be amortized as follows:

Year of Origin	Expiration	Tax Losses Carry Forward	
2004	2014	Ps. 226	
2005	2015	35,564	
2006	2016	20,669	
2007	2017	1,459	
2008	2018	55,965	
2009	2019	196,627	
2010	2020	2,407,796	
2011	2021	8,190,231	(1)
		Ps. 10,908,537	

(1) The loss includes $ 7,859,922, corresponding to tax loss obtained in the sale of shares mentioned in Note 3-g, which, according to the Income Tax Act, can only be deducted against profit on sale of shares that can be generated in the future.

At December, 31, 2011, Republic has US$ 103.9 million of US Federal Net Operating Losses which expire in 2030 and 2031, approximately US$ 239 million in US State and Local NOLs which mostly expire in years 2012 through 2026, and approximately US$ 1.9 million of Canadian Federal NOLs which expire in 2030 and 2031.

Below is a summary of the main temporary differences that comprise deferred tax liabilities included in the financial statement at December 31, 2011 and 2010:

	2011	2010
Deferred tax assets:		
Allowance for doubtful accounts	Ps. 63,826	Ps. 59,154
Accrued expenses	143,404	160,787
Advances from customers	643	25,907
Tax Losses Carry forwards (NOLs) (1)	3,893,413	851,269
Republic tax credits (AMT)	26,274	133,481
Recoverable asset tax	106,869	99,610
EPS provision	250	39

Derivative financial instruments	13,429	27,612
Deferred tax assets, net	4,248,108	1,357,859
Less:		
Valuation allowance for deferred tax asset	(3,650,815)	(747,113)
Deferred tax assets, net	597,293	610,746
Deferred tax liabilities:		
Inventories	843,836	663,095
Property, plant and equipment	2,069,841	1,873,599
Intangibles assets from Grupo San acquisition	510,214	613,868
Prepaid expenses	6,888	6,133
Others	7,033	138,751
Total deferred liabilities	3,437,812	3,295,446
Deferred tax liabilities, net	2,840,519	2,684,700
Deferred business flat tax	231,366	50,901
	Ps. 3,071,885	Ps. 2,735,601

(1) At December 31, 2011 and 2010 the deferred tax asset from tax loss carry forward includes Ps. 619,775 and Ps. 433,722, respectively originated in Federal and Local fiscal losses of Republic.

19. Segments Information

The Company segments its information by region, due to the operational structure and the organization of its business. The Company's sales are made mainly in Mexico and the United States of America. The Mexican segment includes the plants in Mexicali, Guadalajara, Tlaxcala and San Luis Potosi. The USA segment includes the six plants from Republic located in the State of Ohio, Indiana, New York and the last one in Ontario, Canada. The plant in Canada represents approximately 3% of the segment's total sales. Both segments are engaged in the manufacturing and sale of long steel products intended primarily for the building and automotive industries.

	Year ended December 31, 2011			
	Mexico	**USA**	**Operations between segments**	**Total**
Net sales	Ps. 15,174,922	Ps. 14,127,627	Ps. (32,051)	Ps. 29,270,498
Cost of sales	12,032,028	13,624,635	(32,051)	25,624,612
Gross profit	3,142,894	502,992		3,645,886
Selling, general and administrative expenses	722,591	331,561		1,054,152
Operating income	2,420,303	171,431		2,591,734
Other expenses, net	103,670	10,036		113,706
Financial (income) expenses, net	(16,587)	14,177		(2,410)
Foreign exchange income (loss), net	(581,630)			(581,630)
Income before income taxes	2,914,850	147,218		3,062,068
Income taxes (benefit)	143,034	(33,197)		109,837
Net income	Ps. 2,771,816	Ps. 180,415	Ps.	Ps. 2,952,231

Other Data	**Mexico**	**USA**	**Operations between segments**	**Total**
Total assets	Ps. 23,497,561	Ps. 9,098,293	Ps. (1,326,388)	Ps. 31,269,466
Depreciation and amortization	777,117	223,981		1,001,098
Additions of property, plant and equipment, net	267,720	164,280		432,000
Total liabilities	3,485,345	4,841,686	(1,326,388)	7,000,643

	Year ended December 31, 2010			
	Mexico	USA	Operations between segments	Total
Net sales	Ps. 12,623,536	Ps. 11,952,900	Ps. -	Ps. 24,576,436
Cost of sales	10,328,758	11,920,745	-	22,249,503
Gross profit	2,294,778	32,155	-	2,326,933
Selling, general and administrative expenses	803,684	348,284	-	1,151,968
Operating income (loss)	1,491,094	(316,129)	-	1,174,965
Other expenses, net	124,126	61,952	-	186,078
Financial (income) expenses, net	(16,449)	16,706	-	257
Foreign exchange (loss) income, net	207,240	-	-	207,240
Income (loss) before income taxes	1,176,177	(394,787)	-	781,390
Income taxes (benefit)	(31,785)	144,221	-	112,436
Net income (loss)	Ps. 1,207,962	Ps. (539,008)	Ps. -	Ps. 668,954

Other Data	**Mexico**	**USA**	**Operations between segments**	**Total**
Total assets	Ps. 20,506,648	Ps. 7,830,653	Ps. (988,333)	Ps. 27,348,968
Depreciation and amortization	859,601	238,607	-	1,098,208
Additions of property, plant and equipment, net	434,910	61,451	-	496,361
Total liabilities	3,479,167	4,239,709	(988,333)	6,730,543

	Year ended December 31, 2009			
	Mexico	USA	Operations between segments	Total
Net sales	Ps. 11,366,780	Ps. 7,864,749	Ps. -	Ps. 19,231,529
Cost of sales	8,951,396	10,028,087	-	18,979,483
Gross profit	2,415,384	(2,163,338)	-	252,046
Selling, general and administrative expenses	582,226	521,859	-	1,104,085
Operating income (loss)	1,833,158	(2,685,197)	-	(852,039)
Other income (expenses), net	70,102	(40,111)	-	29,991
Impairment of intangibles assets	(2,368,000)	-	-	(2,368,000)
Financial (income) expenses, net	(21,726)	39,595	-	17,869

Foreign exchange (loss) income, net	(78,429)	-	-	(78,429)
Income (loss) before income taxes	(521,443)	(2,764,903)	-	(3,286,346)
Income taxes (benefit)	(1,065,363)	(999,789)	-	(2,065,152)
Net income (loss)	Ps. 543,920	Ps. (1,765,114)	Ps. -	Ps. (1,221,194)

Other Data	**Mexico**	**USA**	**Operations between segments**	**Total**
Total assets	Ps. 19,540,570	Ps. 8,663,405	Ps. (1,298,164)	Ps. 26,905,811
Depreciation and amortization	783,414	264,468	-	1,047,882
Additions of property, plant and equipment, net	176,249	86,958	-	263,207
Total liabilities	3,596,802	4,528,620	(1,298,164)	6,827,258

The Company's net sales to foreign or regional customers during 2011, 2010 and 2009 are as follows:

	2011	2010	2009
Mexico	Ps. 14,399,682	Ps. 10,799,739	Ps. 10,685,259
USA	13,709,807	13,078,357	7,829,024
Canada	766,318	470,643	502,286
Latin America	356,932	221,192	135,965
Other (Europe and Asia)	37,759	6,505	78,995
Total	Ps. 29,270,498	Ps. 24,576,436	Ps. 19,231,529

20. Commitments and contingencies

To December 31, 2011 the company has the following contingencies:

(a) Pacific Steel, Inc. ("Pacific Steel" or "PS"), a subsidiary Company located in National City in San Diego County, California, USA which their main activity is the sale and purchase of scrap has the following contingencies related to environment issues.

California Regional Water Control Board, CRWCB

On August 16, 2011, the California Regional Water Quality Control Board (CRWCB) and the California Environmental Protection Agency (CALEPA) made a inspection to Pacific Steel to verify the conditions of draining into the street waters. On September 1, 2011, PS received the "Order to Cease & Desist Clean and Abate"(OCDCA) from the CALEPA. On September 15, 2011 the CALEPA made a re-inspection visit, the CALEPA was satisfied with the compliance to the OCDCA of PS At December 31, 2011, the California Regional Water Quality Control Board (CRWCB) has not notified the conclusions of their inspection.

Department of Toxic Substances Control, DTSC

In September 2002, the Department of Toxic Substances Control (DTSC) inspected PS facilities based on an alleged complaint from neighbors due to PS' Steel's excavating to recover scrap metal on its property and on a neighbor's

property which it rents from a third party. In this same month, DTSC issued an enforcement order of imminent and substantial endangerment determination to PS, 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 sanctioned to PS for violating hazardous waste laws and the State of California Security Code and imposed the obligation to remediate the site. To give greater enforce this order July 2004, the DTSC, filed suit against PS at the Supreme Court of San Diego. On July 26, 2004, the Court issued a decision in which it was imposed PS to pay Ps. 3,288 (USD $ 0.2 million), which were paid.

On June 6, 2010 the DTSC and the "San Diego Department of Environmental Health" (DEH) made a inspection to PS, due to a general complaint. On August 10, 2010 this two authorities made a second inspection and found seven different deviations. The DEH is satisfied with the compliance. Nevertheless, on October 19, 2010 the technical area of the DTSC advice the legal area to impose important penalties. At December 31 ,2011 PS have not received the final resolution of the DTSC.

The soil treatment was suspended at the beginning of 2011 due to the ineffective results of the process, determined with several studies. Thus alternative, once the permits of the Mexican authorities were obtained, on November 2011 the Mexicali facility began the process of the lands for disposal in a landfill located on the State of Nuevo León, Mexico, after separation from their metal content, which are used as raw material in the casting process.

As consequence of two reports transmitted on a local TV channel about PS in support to two San Diego Bay environmental groups. The DTSC required on November 22, 2011 to PS a program for the handling and final disposition of the treated soils, due to the fact that the treatment process are now consider hazardous waste. PS is now reviewing the different alternatives for the final disposition of those soils.

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

The Company has prepared an estimate, based on prior years' experience, considering the same processes, volume costs, use of own equipment and personnel and assuming that an agreement will be reached with the DTSC in respect of defining the cleanliness levels, resulting in the amount that goes from between Ps. 11,000 and Ps. 23,784 (US$ 0.8 million to US$1.7 million). The Company on such bases created an allowance for this contingency at December 31, 2011, of Ps. 5,935 (US$ 0.4 million), which is included in other accounts payables in the Consolidated Financial Statement. We can´t guarantee, that no corrective action are more costly than estimated.

Community Development Commission, CDC

The Community Development Commission of National City, California CDC, has announced that it intends to develop the area where the plant is located in PS and is prepared to make a bid for the field of PS, at market price less the cost of remediation environmental and research costs incurred. In this connection, PS has told the CDC that the land voluntarily will not be sold unless there is another area where you can relocate your business. The CDC, in accordance with the laws of the State of California, has the authority to expropriate the land on payment of the price to market value and, if there is no other land available for relocation of the business, you must also PS pay the price to book value. The CDC did bid for the land to PSI for US$ 6.9 million, supported with a commercial appraisal, and began the process of expropriation, which was temporarily suspended by a contract between the parties in November 2006, giving more time to PS to see if you can complete the process of remediation of land and to propose an attractive alternative to the CDC which will remain in the area.

(b) As is the case with most steel manufacturers in the United States of America, Republic could incur significant costs related to environmental issues in the future, including those arising from the activities of environmental compliance activities and remediation stemming from historical waste management practices at the facilities in Republic. The undiscounted reserve to cover probable environmental liabilities totaling Ps. 43,370, Ps. 38,300 and Ps. 44,400 (US$ 3.1 million) was recorded as of December 31, 2011, 2010 and 2009, 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, 2011, the current and non-current portions amounted to Ps. 5,596 and Ps. 37,774, respectively (US$ 0.4 million and US$ 2.7 million, respectively) of the environmental reserve are included in other accrued expenses and accrued environmental liabilities, respectively, in the accompanying Consolidated Balance Sheets. The Company is not aware of any material environmental remediation liabilities or contingent liabilities relating to environmental matters with respect to the Company´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.

(c) The Company is involved in a number of lawsuits and claims that have arisen throughout the normal course of business. The management of the Company and its legal advisors do not expect the final outcome of these matters to have any significant adverse effects on the Company's financial position and results of operations, therefore no liability has been recognized.

(d) The Tax Authority have the right to review, at least, the previous five years and could determine differences in taxes due, plus its updates, surcharges and fines.

At December 31,2011 the company has the following commitments:

a) Republic leases certain equipment, office space and computer equipment under non-cancelable operating leases. The leases expire at various dates through 2017. During the years ended December 31, 2011 ,2010 and 2009, rental expense relating to operating leases amounted to US$ 5.4 million, US$4.8 million and US$5.9 million, respectively. At December 31, 2011, total future minimum lease payments under non-cancelable operating leases are $0.8 million in 2012, $ 0.4 million in 2013, $ 0.3 million in 2014, $0.4 million in 2015, and $ 0.3 million each in the years 2016 and 2017. There are no obligations after 2017.

F-35

b) On September 27, 2011 Grupo Simec S.A.B de C.V. (Simec) signed a contract with SMS Concast Ag., ("Concast") for the acquisition of the melt shop equipment for the subsidiary GV do Brasil Industria e Comercio de Aco LTDA with an annual production capacity of 520,000 tons of billet for the production of rebar and wire with an arc furnace of 65 tons. The amount of the transaction is $15 million of Euros at a fixed exchange rate of 1.3764 dollars per euro. The payments will be done in dollars at the exchange rate agreed in accordance to the contract and the following payment schedule:

- Down payment of 15% of the contract, fifteen days after the contract signature (Ps. 42,070 to December, 31, 2011) See note 11
- 15% to three months from contract signature,
- 15% to six months from contract signature,
- 15% to eight months from contract signature,
- 10% to 10 months from contract signature and
- The remaining 30% trough an irrevocable letter of credit on behalf of the vendor, valid for a minimum of 18 months. This letter of credit will be required payments of 10% of the contract value, starting with the last mayor shipment of the equipment, at the reception of the equipments and to the start- up tests.

The vendor gives a Warranty Bond of the 10% of the contract for a period of 24 months after the mayor shipment of the equipment.

c) On November 18, 2011 Grupo Simec S.A.B. de C.V. (Simec) signed a contract with SMS Meer S. P. A. ("Meer") for the acquisition of a rolling mill for its brazilian subsidiary with a production capacity of 400,000 tons of wire and rebar. The cost of the rolling mill will be $19.6 million of Euros at a fixed exchange rate of 1.3482 dollars per euro. The payments will be done in dollars at the exchange rate agreed in accordance to the contract and the following payment schedule:

- 80% of the contract trough an irrevocable letter of credit on behalf of Meer, this letter of credit will be valid for 14 months and will be required for payments in accordance with the shipments done by the vendor.

- 20% of the contract price shall be paid in US dollar, out of an irrevocable, non-transferable documentary letter of Credit and this shall be contractually correct and operative within 11.5 months from supply contract signature and shall have a minimum validity of 14.5 months and will be payable in two parts:

a) 10% of the contract once the cold tests are performed, Meer will give a Bank warranty or insurance on behalf of Simec for the same amount and will be valid for 8 months after the last mayor shipment.

b) 10% of the contract after the signing of the final acceptance certificate. The warranty period of the equipment will be 18 months after the last mayor shipment until the signing of the provisional acceptance certificate.

21. Other Business

a) In February 2008, Republic entered into an agreement with Integrys Energy Services (US Energy) which enables Republic Steel to receive payments for allowing reduction of electricity demands during identified time periods. This agreement term is currently on a year-to-year extension as per the original contract, running for a full year term from June 1 through May 31. The Company recognized income from this agreement in June 2011, 2010 and 2009 in the amounts of US$3.9 million, US$2.3 million and US$ 3.0 million, respectively. Income was recognized after the Company fulfilled its performance obligations under the terms of the agreement for the full twelve month period of the annual term. As of December 31, 2011, deferred income related to the term ending May 31, 2012 was recorded in the amount of US$0.6 million.

b) During 2009, the Company was awarded US$ 6.7 million resulting from a settlement with its predecessor owners relating to pre-acquisition contingency indemnification provisions contained in the 2005 purchase agreement. The full amount of this settlement was received and recognized during 2009 as a component of other operating expenses, net.

c) During 2009, the Company agreed to settle a dispute with a vendor of iron ore pellets by paying US$ 9.1 million. US$ 4.5 million was paid during 2009 and US$ 4.6 million was paid in January of 2010. The full amount of this settlement was expensed during 2009, US$4.6 million of which was accrued at December 31, 2009.

d) During 2009, the Company was required to pay back US$ 2.2 million in settlement of what was determined to be “preference payments” from a customer in bankruptcy. The full amount was expensed and paid during 2009.

22. Adoption of International Financial Reporting Standards (IFRS)

The Mexican Securities Commission (CNBV) establish the requirement to listed companies to disclose their financial information to the public trough the Mexican Stock Exchange (BMV) to that from 2012 to develop obligatory financial information based on Financial Reporting Standard (IFRS) hereinafter IFRS or IAS, issued by the International Accounting Standard Board (IASB).

The Financial Statements to be issued by the Company for the year ending December 31, 2012 will be its first annual financial statements comply with IFRS. The translation date is January 1, 2012 and therefore, the year ended December 31, 2011 will be the comparative period covered by the standard of adoption IFRS 1, “Initial Adoption of International Financial Reporting Standards”. According to IFRS 1 the Company will apply the relevant mandatory exceptions and certain optional exemption to retrospective application of IFRS.

a)

Mandatory exceptions - The Company will apply the following mandatory exceptions regarding the retrospective application of IFRS as follows:

Calculation of Estimates - Estimates of the date of transition are consistent with the estimates at that date under the MFRS, unless there was evidence of error in these estimates.

Hedge accounting - will apply hedge accounting only if the hedging relationship meets the criteria set out in the IFRS transition date.

Non-controlling interest - will be applied prospectively certain recognition and presentation requirements related to non-controlling, from the date of transition.

In addition, the Company believes that the mandatory exception “Disposal and transfer of assets and liabilities” will have no effect on its financial statements as of the date of transition to IFRS.

Optional Exemptions - The Company has elected the following optional exemptions to retrospective application of IFRS as follows:

Business combinations - the exemption will apply to business combinations.

Deemed Cost - the exemption will apply cost incurred. Therefore, we chose to use the revalued amount under MFRS to the transition date as the cost incurred for the item of property, plant and equipment.

Employee benefits - exemption will apply to benefits to employees. Therefore recognize all cumulative actuarial gains and losses at the transition date.

Cumulative differences for the effect of conversion - the exemption will apply cumulative differences for the translation effect in foreign subsidiaries. Therefore, it is set to zero the conversion effect at the time of transition.

Borrowing Costs - The Company will apply the transitional provisions of IAS 23, Borrowing Costs. Therefore, the Company designated the transition date as the starting date for capitalization of borrowing costs relating to qualifying assets, not retroactively change the capitalization made pursuant to MFRS.

b) Main Differences - The following summarizes the main differences have been identified in the transition from MFRS to IFRS at the date of these consolidated financial statements and an estimate of significant impacts:

Effects of inflation - Under IFRS, the inflationary effects are recognized in the financial statements when the economy of the currency used by the Company qualifies as hyperinflation. The Mexican economy ceased to be hyperinflationary as from 1999 and, consequently, inflationary effects that were recognized by the Company until December 31, 2007 under MFRS will be reversed, an increase to retained earnings of approximately Ps. 1,364,782 to date transition, which correspond primarily to the effects of inflation recognized in contributed capital.

Components - According to IFRS, the Company will determine the significant components of property, plant and equipment, and consequently readjust their useful lives and its corresponding effect on the accumulated depreciation from the date of transition, which represents a decrease to retained earnings of approximately Ps. 164.906 from the date of transition.

Employee Benefits - Under IFRS, provisions for severance labor recognized until the Company has a demonstrable commitment to end the relationship with the employee or has made an offer encouraging voluntary redundancy, therefore, will remove the liability recognized under MFRS than Ps. 10,750 to the transition date. Additionally, provisions for retirement is recalculated to recognize in the corresponding period the cost of past service, therefore, will recognize an additional liability of Ps. 24,550.

Deferred taxes - Under IFRS, deferred taxes will be recalculated with the adjusted book values of assets and liabilities under IFRS, which will result in an increase to retained earnings of approximately Ps. 79,582 to the transition date.

Other differences in presentation and disclosures in the financial statements - Generally, the disclosure requirements of IFRS are broader than those of MFRS, which can result in increased disclosures about accounting policies, significant judgments and estimates, financial instruments and management risks, among others. In addition, there may be differences in presentation.

Stockholders' equity changes previously described will modify stockholders' equity and retained earnings as of the date of transition as shown below:

	Impact In:	
	Equity	Retained earnings
Employee benefits (actuarial gains and losses)	Ps. (3,520)	Ps. (3,520)
Translations effect in foreign subsidiaries		406,513
Inflation effects on stockholders' accounts		1,364,782
Components and parts	(164,906)	(164,906)
Employee benefits (providing compensation)	10,750	10,750
Employee benefits (past service cost)	(24,550)	(24,550)
Deferred taxes	79,582	79,582
Total adjustment	Ps. (102,644)	Ps. 1,668,651

The information presented in this Note has been prepared in accordance with the standards and interpretations issued and outstanding or issued and early adopted the date of preparation of these consolidated financial statements. The standards and interpretations that are applicable to December 31, 2012, including those that will be applicable on an

optional, are not known with certainty at the time of preparation of consolidated financial statements at December 31, 2011 and 2010 attachments. Additionally, the accounting policies selected by the Company may be modified as a result of changes in the economic or industry trends that are observable after the issuance of these consolidated financial statements. The information presented in this Note does not intend to comply with IFRS, as only one set of financial statements comprising the statements of financial position, comprehensive income, changes in stockholders' equity and cash flows, together with comparative information and explanatory notes can provide a fair presentation of the Company's financial position, results of operations, changes in stockholders' and cash flows under IFRS.

23. New pronouncements

They have issued amendments to IFRS and IAS by the IASB, which were enacted but not yet entered into force:

Amendments to IFRS 7	Disclosure - Transfers of financial assets
IFRS 9 (amended 2010)	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of investments in other entities
IFRS 13	Fair value measurements
Amendments to IAS 1	Presentation of other comprehensive income items
Amendments to IAS 12	Deferred tax - recovery of underlying assets
IAS 27 (revised 2011)	Financial Statements
IAS 28 (revised 2011)	Investments in associates

At the date of this report, the Company believes that adoption of these accounting pronouncements will not represent a significant effect on financial reporting.

24. Issuance of Financial Statements

The issuance of the financial statements and accompanying notes that are included, were authorized on April 24, 2011 by Mr. Luis Garcia Limon and Adolfo Luna Luna, Chief Executive Officer and Chief Financial Officer, respectively, which must be also approved by the Company's Board of Directors, Audit Committee and Stockholders at their next meetings.

25. Differences between Mexican financial reporting standards and United States accounting principles:

The Company's consolidated financial statements are prepared in accordance with Mexican financial reporting standards (Mexican

GAAP), which differ in certain significant respects from United States generally accepted accounting principles (US GAAP).

As described in Note 4 (a), effective January 1, 2008, the Company ceased to recognize the effects of inflation on its financial statements as required by MFRS B-10. However, as required by such new standard, the financial statement amounts that were previously reported remained unchanged, and the inflation adjustments previously recognized have been maintained in their corresponding caption. This new standard requires that the re-expressed amounts of non-monetary assets as reported at December 31, 2007 become the carrying amounts for those assets effective January 1, 2008. The carrying amounts will also affect net income in future periods. For example, depreciation expense after the adoption of MFRS B-10 will be based on carrying amounts of fixed assets that include inflation adjustments recorded prior to the adoption of MFRS B-10.

The Mexican and U.S. GAAP amounts included in this Note, as they relate to the years ended December 31, 2011 and 2010, are presented in the carrying amounts as required by MFRS B-10, and the effects of inflation that were recorded prior to 2008 have not been included in the reconciliations to U.S. GAAP.

Other significant differences between Mexican GAAP and US GAAP and the effects on consolidated net income and consolidated stockholders' equity are presented below, in thousands of Mexican pesos as of December 31, 2011, with an explanation of the adjustments.

Reconciliation of net income (loss):

	2011	2010	2009
Net income as reported under Mexican GAAP	Ps. 2,952,231	Ps. 668,954	Ps. (1,221,194)
Depreciation on restatement of machinery and equipment	(13,393)	(13,393)	(5,607)
Deferred income taxes	1,579	658	(38,854)
Amortization of gain from monetary position and exchange (loss) capitalized under Mexican GAAP	7,755	7,755	7,755
Implied goodwill impairment adjustment difference		(102,000)	102,000
Bargain purchase gain, net of tax	81,424		
Amortization of intangible assets proceeding from assets acquired by Republic	(2,618)		
	74,747	(106,980)	65,294
Net income (loss) under U.S. GAAP	Ps. 3,026,978	Ps. 561,974	Ps. (1,155,900)

Allocation of net income (loss) under U.S. GAAP:			
Non-controlling interest on Mexican GAAP	Ps. 89,804	Ps. (267,547)	Ps. (877,449)
U.S. GAAP adjustment on non- controlling interest	39,229		
Non-controlling interest under U.S. GAAP	129,033	(267,547)	(877,449)
Controlling interest under U.S. GAAP	2,897,945	829,521	(278,451)
	Ps. 3,026,978	Ps. 561,974	Ps. (1,155,900)
Weighted average shares outstanding	497,709,214	497,709,214	497,709,214
Net earnings (losses) per share (pesos) – controlling interest	Ps. 5.82	Ps. 1.67	Ps. (0.56)

In 2010 the Company recorded an impairment loss of Ps. 102,000 under U.S. GAAP. Under Mexican GAAP, the goodwill impairment is recorded in other expenses, whereas for U.S. GAAP, goodwill impairment is recorded as an operating expense. In 2010 and 2009, the Company recorded expense from employee profit sharing of Ps. 95 and Ps. 7,261, respectively, recorded as other expenses that were reclassified to operating expenses for U.S. GAAP purposes. In 2011 the Company didn´t record profit sharing. The Company record Ps. 7,000, under other income which was reclassified under operating income for U.S. GAAP purposes. The Company recorded in 2010 a cancellation of a patent acquired of $117,457 relating to the acquisition of Lipa Capital, LLC in other expenses (see Note 3-m). This amount was reclassified to operating expenses for U.S. GAAP purposes.

Reconciliation of stockholder's equity:

	2011	2010	2009
Total stockholders' equity reported under Mexican GAAP	Ps. 24,268,823	Ps. 20,618,425	Ps. 20,078,552
Bargain purchase gain, net of tax	81,424		
Restatement of machinery and Equipment	147,327	160,720	174,113
Deferred income taxes	502	(1,077)	(2,655)
Amortization of intangible assets	(2,618)		
Adjustment for implied goodwill			102,000
Gain from monetary position and exchange loss capitalized, net	(149,121)	(156,876)	(163,711)
Total US GAAP adjustment	77,514	2,767	109,747
Total stockholder's equity under US GAAP	Ps. 24,346,337	Ps. 20,621,192	Ps. 20,188,299

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

	Capital Stock and Paid-in Capital	Retained Earnings	Fair Value Derivative Financial Instruments	Translation effect of foreign subsidiaries	Cumulative Restatement Effect	Total Controlling Stockholders' Equity	Non-Controlling interest	Total Stockholders' Equity
Balance at December 31, 2008	7,771,687	9,106,144	(270,868)	595,165	981,302	18,183,430	3,177,545	21,360,975
Net comprehensive loss	-	(278,451)	119,141	(79,507)	-	(238,817)	(956,259)	(1,195,076)
Net effect at Adopting MFRS C-8	-	22,400	-	-	-	22,400		22,400
Balances at December 31, 2009	7,771,687	8,850,093	(151,727)	515,658	981,302	17,967,013	2,221,286	20,188,299
Net Comprehensive income (loss)	-	829,521	88,378	(109,145)	-	808,754	(375,861)	432,893
Balances at December 31, 2010	7,771,687	9,679,614	(63,349)	406,513	981,302	18,775,767	1,845,425	20,621,192
		2,897,945	37,904	418,292		3,354,141	371,004	3,725,145

Net Comprehensive income								
Balances at December 31, 2011	7,771,687	12,577,559	(25,445)	824,805	981,302	22,129,908	2,216,429	24,346,337

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

Issuance of capital stock

During 1993 and 1994 the Company recorded Ps. 99,214 and Ps. 31,794, respectively, corresponding to expenses related to the issuance of shares in a simultaneous public offering in the United States and Mexico as a reduction of the proceeds from the issuance of capital stock. In 1993 and 1994, these expenses were deducted for tax purposes resulting in a tax benefit of Ps. 34,478 and Ps. 10,812. These tax benefits were included in the statement of operations for Mexican GAAP purposes. For U.S. GAAP purposes these items were shown as a reduction of cost of issuance of the shares, thereby increasing the net proceeds from the offering.

F-40

Maritime operations and amortization of negative goodwill

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

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

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

Gain on extinguishment

On February 7, 2001, the Company's Board of Directors approved the issuance of 492,852,025 shares of Series "B" variable capital stock in exchange for the extinguishment of debt amounting to U.S.$ 110,257,012. Under Mexican GAAP, the increase in stockholders' equity resulting from the conversion or extinguishment of debt is equal to the carrying amount of the extinguished debt. The Company assigned a value of U.S.$ 110,257,012 to the Series "B" capital stock and, therefore, no difference existed between the equity interest granted and the carrying amount of the debt extinguished. Under U.S. GAAP, the difference between the fair value of equity interest granted and the carrying amount of extinguished debt is recognized as a gain or loss on extinguishment of debt in the statement of operations. For U.S. GAAP purposes, the fair value of the Series "B" capital stock was determined by reference to the quoted market price on March 29, 2001, the date the transaction was effected, and the difference between the fair value of the Series "B" capital stock and the carrying amount of the extinguished indebtedness was recognized as a gain in the statement of operations. The related restated effect as of December 31, 2010 is Ps. 626,203.

Reconciliation of Net Income (loss) and Stockholders' Equity:

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

Restatement of property, machinery and equipment

As explained in note 4(h), in accordance with Mexican GAAP, imported machinery and equipment has been restated until 2007 by applying devaluation and inflation factors of the country of origin.

Under US GAAP, until December 31, 2007 the restatement of all machinery and equipment, both domestic and imported, has been done in constant units of the reporting currency, the Mexican peso, using the inflation rate of Mexico.

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

Deferred income taxes and employee profit sharing

As explained in Note 4(u) under Mexican GAAP, the Company accounts for deferred income tax following the guidelines of MFRS D-4 “income taxes”. The main differences between ASC 740 Income taxes (formerly SFAS No. 109) and MFRS D-4, as they relate to the Company, which are included as reconciling items between Mexican and US GAAP are:

- the income tax effect of gain from monetary position and exchange loss capitalized that is recorded as an adjustment to stockholders’ equity for Mexican GAAP purposes until December 31, 2007,
- the income tax effect until December 31, 2008 of capitalized pre-operating expenses. With adoption of new MFRS C-8, in 2009 these capitalized expenses were cancelled to retained earnings. For US GAAP purposes, these are expensed when incurred,
- the effect on income tax of the difference between the indexed cost and the restatement through use of specific indexation factors of fixed assets which is recorded as an adjustment to stockholders’ equity for Mexican GAAP, and,

In addition, the Company is required to pay employee profit sharing in accordance with Mexican labor law. Deferred employee profit sharing under US GAAP has been determined following the guidelines of ASC 740 Income Taxes (formerly SFAS No. 109). Until December 31, 2007, under Mexican GAAP, the deferred portion of employee profit sharing is determined on temporary non-recurring differences with a known turnaround time. As mentioned in Note 4(p), beginning in 2008, the Company recognizes deferred employee profit sharing under the new MFRS D-3 “Employee benefits” for Mexican GAAP. There are no significant differences between ASC 740 Income Taxes (formerly SFAS No. 109) and MFRS D-3.

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

The effects of temporary differences giving rise to significant portions of the deferred assets and liabilities for Income Tax (IT) at December 31, 2011 and 2010, under US GAAP are present below:

	2011	**2010**
Deferred tax assets:		
Allowance for doubtful accounts	Ps. 63,826	Ps. 59,154
Accrued expenses	143,404	160,787
Advances from customers	643	25,907
Tax losses carry forwards	3,893,413	851,269
Republic tax credits	26,274	133,481
Recoverable asset tax	106,869	99,610
Employee profit sharing provision	250	39
Derivative financial instruments	13,429	27,612
Deferred tax assets	4,248,108	1,357,859
Less valuation allowance	(3,650,815)	(747,113)
Deferred tax assets, net (includes Ps. 528,445 in USA)	597,293	610,746
Deferred tax liabilities:		
Inventories, net	843,836	663,095
Property, plant and equipment	2,069,339	1,874,676
Intangible assets in acquisition of Grupo San	510,214	613,868
Deferred business flat tax	231,366	50,901
Prepaid expenses	6,888	6,133
Intangible assets in acquisition of Solon(bargain purchase gain)	52,212	
Others	7,033	138,751
Total deferred liabilities (includes Ps. 819,641 in USA)	3,720,888	3,347,424
Deferred tax liabilities, net	Ps. 3,123,595	Ps. 2,736,678

For the years ended December 31, 2011 and 2010, the classification of deferred income tax under U.S. GAAP is as follows:

	2011	2010
Deferred tax assets:		
Current portion of deferred income tax asset	Ps. -	Ps. -
Non-current portion of deferred income tax asset	-	-
Deferred tax liabilities:		
Current portion of deferred income tax liabilities	610,181	534,519
Long-term deferred income tax liability	2,513,414	2,202,159

The deferred income taxes of Ps. 2,069,339 and Ps. 1,874,676 result from differences between the financial reporting and tax bases of property, plant and equipment at December 31, 2011 and 2010, respectively. Beginning in 1997 the restatement of property, plant and equipment and the effects thereof on the statement of operations are determined by using factors derived from the NCPI or, in the case of imported machinery and equipment, by applying devaluation and inflation factors of the country of origin. Until 1996, for financial reporting purposes, property, plant and equipment were stated at net replacement cost based upon annual independent appraisals and depreciation was provided by using the straight-line method over the estimated remaining useful lives of the assets. For income tax reporting purposes, property, plant, and equipment and depreciation are computed by a method which considers the NCPI.

Pre-operating expenses

For Mexican GAAP purposes, the Company capitalized pre-operating expenses related to the production facilities at Mexicali, as well as costs and expenses incurred in the manufacturing and design of new products. In 2009, according to the adoption of the new MFRS C-8 the preoperative expenses were cancelled to retained earnings. For US GAAP purposes, these items are expensed when incurred.

Financial expense capitalized

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

Disclosure about Fair Value of Financial Instruments

In accordance with ASC 825 Financial Instruments (formerly SFAS No. 107 Disclosures about Fair Value of Financial Instruments), under U.S. GAAP it is necessary to provide information about the fair value of certain financial instruments for which it is practicable to estimate that value. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and short-term debt approximate fair value due to the short term maturity of these instruments.

Pension and other retirement benefits

The Company accrues for seniority premiums and termination payments based on actuarial computations as described in note 4(p).

ASC 715 Compensation – Retirement Benefits (formerly SFAS No. 158 Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, SFAS No. 87 Employer’s Accounting for Pensions, SFAS No. 88 Employer’s Accounting for Settlements and Curtailments of Defined Benefit Pension Plan and for Termination Benefits, SFAS No. 106 Employer’s Accounting for Post-retirement Benefits Other than Pensions and SFAS No. 132(R) Employers´ Disclosures about Pensions and Other Postretirement Benefits), requires the employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in

its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive (loss) income. ASC 715 also requires accrual of post-retirement benefits other than pensions during the employment period. ASC 715 is also applied for purposes of determining seniority premium costs. Adjustments to US GAAP for these benefits were not individually or in the aggregate significant for any period.

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

	2011	2010
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	Ps. 75,325	Ps. 77,688
Service cost	5,814	6,554
Financial cost	5,400	5,962
Actuarial losses (gains)	782	(794)
Benefits paid	(7,428)	(14,085)
Projected benefit obligation at end of year	Ps. 79,893	Ps. 75,325

In 2009 the Company terminated the pension plan from the Grupo San acquisition and the total amount of this fund was liquidated and paid to employees during the first and second quarter of 2009.

No Right of Redemption

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

Goodwill and intangibles

In assessing the recoverability of the goodwill and other intangibles the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. The Company performs an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of recorded goodwill is impaired. The impairment review process compares the fair value of the reporting unit in which goodwill resides to its carrying value. The Company estimates the reporting unit’s fair value based on a discounted future cash flow approach that requires estimating income from operations based on historical results and discount rates based on a weighted average cost of capital from a market participant perspective. Under U.S. GAAP, if the carrying amount of the reporting units exceeds its related fair value, the Company should apply a “second step” process by means of which the fair value of such reporting unit should be allocated to the fair value of its net assets in order to determine the reporting unit’s “implied” goodwill. The resulting impairment loss under US GAAP is the difference between the carrying amount of the related goodwill as of the valuation date and the implied goodwill amount. As of December 31, 2009, the implied goodwill under the second step process was Ps. 1,916 million. Additionally, the Company reconciles the aggregate fair value of the reporting units to its market capitalization. The Company’s market capitalization as of December 31, 2009 indicates an implied control premium of approximately 25% percent. This implied control premium is consistent with recent observed control premiums. Assumptions used in the analysis considered the current market conditions in developing short and long-term growth expectations. For U.S. GAAP purposes, in 2010, there was an adjustment for goodwill amounting Ps.102 million, in 2011 there are no additional impairments. Other intangible assets are mainly comprised by

trademarks, customer listings and non-competition agreements. When impairment indicators exists, or at least annually for indefinite live intangibles, the Company determines its 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 31,2011, 2010 and 2009 there was no impairment charge related to other intangible assets.

As a result of the downturn in the construction industry in Mexico during 2009 and the negative impact this downturn had in the Company's operations mainly at the San Luis facilities, in which goodwill resides, the Company adjusted the key assumptions used in the valuation model. As of December 31, 2009 the main key assumptions used in the valuation models of San Luis reporting unit are as follows:

z Discount rate: 18.1%

z Sales: the Company estimates sales will start a recovery in the years 2010, 2011 and 2012 to basically reach its 2008 sales level at the year 2012. After the year 2012 no sales increases in volume terms are considered in the valuation model.

The assumptions included in the valuation model for 2010 include an increase in sales in 2011 mainly attributable to the increase in the volume by the semi-finish products " billet" to a third party and the forecast of increase in sales price for the next years. The company forecast an increase of 4% for 2012, 2% for 2013 and the useful remaining live of the assets we keep the volume and sales prices. The Discount rate used in 2010 for the valuation was 11.8%

The assumptions included in the valuation model for 2011 include an increase in sales in 2012 mainly attributable to the increase in the volume by the mesh products, and the forecast of increase in sales price for the next years. The company forecast an increase of 10% for 2012 and 1.7% for 2013 and the useful remaining live of the assets we keep the volume and sales prices. The Discount rate used in 2011 for the valuation was 10.9%.

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.

Long-lived assets

The Company reviews the recoverability of our long-lived assets as required by ASC 360 Property, Plant and Equipment (formerly SFAS No. 144 Accounting for the Impairment or Disposal of Long – Lived Assets) and must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. As of December 31, 2011, 2010 and 2009 there was no impairment charges recorded for these type of assets. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges not previously recorded.

Business Combination

In February 2011, the Company, through two of its wholly owned subsidiaries (Solon Wire Processing LLC, formerly REP Acquisition LLC, and the newly formed Republic Memphis LLC) acquired certain land, plants, machinery and equipment from BCS Industries LLC and affiliates (Bluff City Steel) for cash of $2.5 million and the essential forgiveness of $6.0 million of net receivables due from Bluff City Steel to the Company. For accounting of Republic, this acquisition was deemed to be a business combination under Accounting Standards Codification (ASC) 805, *Business Combinations*. This accounting standard require that when the fair value of the net assets acquired exceeds the purchase price, resulting in a bargain purchase gain, the acquirer must reassess the reasonableness of the values assigned to all of the assets acquired, liabilities assumed and consideration transferred. The Company has performed such a reassessment and has concluded that the values assigned for the acquisition are reasonable. Consequently, for USGAAP purposes a bargain purchase gain must be recorded. This gain amounted to Ps. 81,424 (US$5.8 million). The Company determined to be reasonable because (a) the seller was financially distressed, (b) the business was not widely marketed for sale, (c) the machinery and equipment are specialized, and (d) an independent business valuation indicated that its fair value was in excess of the purchase price.

The methodology in allocating the total consideration to the acquired assets of Bluff City Steel is described as follows:

- An experienced, qualified, independent third party assisted in the valuation of the property, plant and equipment using the cost and market approaches based in part on assumptions provided by management;
- An experienced, qualified, independent third party assisted in the valuation of intangible assets.

Immediately after the acquisition, the Company leased back one of the acquired facilities to Bluff City Steel for a three year term. Due primarily to the bargain purchase option offered in that lease by the Company to Bluff City Steel, the Company recorded the lease as a sales-type lease whereby it allocated $1.3 million to Lease receivable representing the present value of the expected minimum lease payments. However, shortly after the acquisition, Bluff City Steel defaulted on the lease and the Company terminated the lease. Accordingly, using the remaining Lease receivable as its estimated value, the Company reclassified the asset into Property, plant and equipment in the above table, leaving the Lease Receivable as the amount actually collected prior to the default and termination. The Company is assessing the future use, lease or sale of the facility.

The final purchase price allocation was as follows:

	Thousands of	
	Dollars	Pesos
Total Consideration	8,503	118,960
Recognized fair value amounts of identifiable assets, acquired and liabilities assumed:		
Lease Receivable	289	4,042
Property, plant and Equipment,	8,249	115,407
Customer List intangible,	9,218	128,964
Other identifiable intangibles	299	4,183
Deferred Tax Liability	(3,732)	(52,212)

Net Assets acquired	14,323	200,384
Bargain purchase gain under USGAAP	5,820	81,424

In accordance with MFRS B-7 “Business acquisitions”, in the unusual case where the amount paid in a business acquisition is less than the value assigned to identifiable assets and liabilities assumed of the acquired business, assets value must be reviewed. If the effect persists, must be considered the net assets of the acquired business are valued at more than its value. In this case, must be adjusted the value of the assets at the amount paid in the transaction, due to this price is considered as the fair value of the transaction.

The adjustment to the values in such situation must be applied reducing the value of certain assets of the acquired business to exhaustion, adjusted in the following order:

a) the values of intangible assets, starting with those who are being recognized in the acquisition process. Subsequently, must be assigned to other intangible assets acquired that previously were recognized in the accounting of the company acquired.

b) the value of non-monetary assets long-term tangible, such as property, plant and equipment, applying the pro rata adjustment to the assigned values, except for available for sale, and

c) the value of other non-monetary assets in the long term, such as permanent investments.

For Mexican GAAP, the intangible assets recognized by Republic corresponding to the customer list amounting to Ps. 128,964 and the other identifiable intangibles amounting to Ps. 4,183 were reduce to zero, and was reduce the property, plant and equipment in Ps. 489, including its corresponding deferred tax of Ps. 52,212.

Statement of cash flows

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

	2011	2010	2009
Cash Flows From Operating Activities:			
Net Income (loss) under U.S. GAAP	Ps. 3,026,978	Ps. 561,974	Ps. (1,155,900)
Impairment loss on intangible assets	-	219,457	2,266,000
Unrealized foreign exchange (gain) loss	(664,023)	117,453	
Depreciation and Amortization	1,009,354	1,103,846	1,045,734
Deferred income taxes	195,095	(47,330)	(1,384,556)
Trade receivable, net	(424,197)	(451,876)	760,413
Other accounts receivable and prepaid expenses	358,095	591,118	(696,584)
Inventories	15,095	(176,173)	2,103,460
Accounts payable and accrued expenses	(599,404)	425,029	(1,832,455)
Other long-term liabilities	-	580	53,578
Allowance for inventories	118,705	-	
Gain on Bargain Purchase	(81,424)	-	
Funds provided by operating activities	2,954,274	2,344,078	1,159,690
Cash Flows From Investing Activities:			
Acquisition of property, plant and equipment	(432,000)	(496,361)	(263,207)
Acquisition of subsidiary		(187,433)	
(Increase) decrease in other non-current Assets	(34,200)	(8,794)	6,932
Funds used by investing activities	(466,200)	(692,588)	(256,275)
Cash Flows From Financing Activities:			
Financial debt repayment	2,410	(7,452)	(11,483)
Related party payable	74,963	323,720	1,189,850
Related party repayment	(51,225)	(442,688)	(709,219)
Funds (used by) obtained from financing activities	26,148	(126,420)	469,148
Increase (decrease) in cash and cash equivalents	2,514,222	1,525,070	1,372,563
Effect of exchange rate fluctuation on cash and cash equivalents	637,949	(89,053)	(404)
Cash and cash equivalents at beginning of the year	3,384,917	1,948,900	576,741
Cash and cash equivalents at end of the year	Ps. 6,537,088	Ps. 3,384,917	Ps. 1,948,900

F-48

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

	2011	2010	2009
Total interest paid	Ps. 2,410	Ps. 12,054	Ps. 33,441
Income taxes (recovery) paid	Ps. 6,922	Ps. (323,374)	Ps. 217,285

Accounting for uncertainty in income taxes-

The Company adopted the provisions of ASC 740 (formerly FASB Interpretation No. 48,"Accounting for Uncertainty in Income Taxes" "FIN 48") as of January 1, 2007. FIN 48 did not have a material impact on the Company's financial statements either upon adoption or for the years ended December 31, 2008-2011.

Under ASC 740 (formerly FIN 48), the Company has to establish reserves to remove some or all of the tax benefit of any of our tax positions when is determine that it becomes uncertain based upon one of the following conditions: (1) the tax position is not "more likely than not" to be sustained, (2) the tax position is "more likely than not" to be sustained, but for a lesser amount, or (3) the tax position is "more likely than not" to be sustained, but not in the financial period in which the tax position was originally taken.

For purposes of evaluating whether or not a tax position is uncertain, (1) we presume the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information, (2) the technical merits of a tax position are derived from authorities such as legislation and statutes, legislative intent, regulations, rulings and case law and their applicability to the facts and circumstances of the tax position, and (3) each tax position is evaluated without consideration of the possibility of offset or aggregation with other tax positions taken.

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

Recent accounting pronouncements in the US

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-09, Compensation – Retirement Benefits – Multiemployer Plans (ASU 2011-09), which amends the guidance in ASC 715-80. The amendments in ASU 2011-09 are intended to provide additional information relating to an employers' financial obligations to multiemployer pension plans and multiemployer other postretirement benefit plans. ASU 2011-09 is effective for annual periods ending after December 15, 2011. The Company plans to adopt this ASU and provide the required disclosures in 2012.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The amendments in ASU 2011-05 require entities to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, the amendments in ASU 2011-05 require an entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and components of other comprehensive income are presented. ASU 2011-05 is effective for interim and annual periods beginning after December 15, 2011. In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12), to defer the new requirement to present components of reclassifications of other comprehensive income on the face of the financial statements. The Company does not expect material financial statement implications relating to the adoption of these ASUs in 2012.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Testing Goodwill for Impairment (ASU 2011-08), which amends the guidance in ASC 350-20. The amendments provide entities with the option of performing a qualitative assessment before performing the first step of the two-step impairment test. If entities determine, based on qualitative factors, it is not more likely than not that the fair value of the reporting unit is less than the carrying amount, then performing the two-step impairment test would not be necessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step to measure the amount of the impairment loss, if any. ASU 2011-08 also provides entities with the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to the first step of the two-step impairment test. ASU 2011-08 is effective for interim and annual periods beginning after December 15, 2011. The Company does not expect material financial statement implications relating to the adoption of this ASU in 2012.

In December 2010, the FASB issued ASU No. 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations — a consensus of the FASB EITF". ASU No. 2010-29 amends accounting guidance concerning disclosure of supplemental pro forma information for business combinations. If an entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred in the current year had occurred as of the beginning of the comparable prior annual reporting period only. The accounting guidance also requires additional disclosures to describe the nature and amount of material, nonrecurring pro forma adjustments. ASU No. 2010-29 is effective for fiscal years beginning on or after December 15, 2010 and will apply prospectively to business combinations completed on or after that date. The Company has adopted ASU 2010-29 and included the required disclosures relating to the Bluff City Steel business combination which was completed in the first quarter of 2011 (see Reconciliation of net income under USGAAP).

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 was codified as a component of ASC 820.10 and it provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. ASC 820.10 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. ASC 820.10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820.10 are described below:

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

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

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

ASC 820.10 was adopted by the Company effective January 1, 2008, for financial assets and liabilities and January 1, 2009, for nonfinancial assets and liabilities. ASC 820.10 is applied prospectively. ASC 820.10 did not have a material impact on the Company's financial statements either upon adoption or for the years ended December 31, 2011, 2010 and 2009.

The Company is exposed to counterparty credit risk on all derivative financial instruments. Because the amounts are recorded at fair value, the full amount of the Company's exposure is the carrying value of these instruments. Since the Company has contracted the derivative financial instruments with Mexico and United States main Gas and Oil company the Credit Risk exposure is minimal

The following table provides a summary of significant liabilities at December 31, 2011 and 2010 that are measured at fair value on a recurring basis:

	2011			
	Fair Value Measurement			
	Level 1	**Level 2**	**Level 3**	**Total**
Liabilities				
Derivative financial instruments	-	Ps. 35,456	Ps. -	Ps. 35,456
Related party debt	-.	-	Ps. 703,316	Ps. 703,316

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Liabilities				
Derivative financial instruments	-	Ps. 79,708	-	Ps. 79,708
Related party debt	-.	-	Ps. 603,149	Ps. 603,149

As of December 31, 2011 and 2010, the estimated fair value approximates the carrying value of the related party debt.

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

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

Condensed Balance Sheets

December 31, 2011 and 2010

(In thousands of Mexican pesos)

	2011	**2010**
Assets		
Current assets:		
Cash and cash equivalents	Ps. 49,589	Ps. 25,988
Accounts receivable:		
Related parties	1,148,997	1,937,194
Other receivables	50,644	28,815
Recoverable taxes	5,610	1,528
Total accounts receivables, net	1,205,251	1,967,537
Total current assets	1,254,840	1,993,525
Investment in subsidiaries companies	22,905,032	19,447,171
Property, net	160,187	164,824
Other assets, net	109,358	118,268
Total assets	24,429,417	21,723,788
Liabilities and stockholders' equity		
Current liabilities:		
Short-term debt	4,225	3,732
Other accounts payable	8,065	18,370
Related parties	2,284,383	2,879,022
Taxes payable	25,669	30,077
Total current liabilities	2,322,342	2,931,201
Deferred income taxes	14,110	18,245
Total liabilities	2,336,452	2,949,446
Contingencies and Commitments		
Stockholders' equity:		
Capital stock	4,142,696	4,142,696
Additional paid-in capital	4,208,204	4,208,204
Retained earnings	12,942,705	10,080,278
Translation effect in foreign subsidiaries, net	824,805	406,513

Fair value of derivative financial instruments	(25,445)	(63,349)
Total stockholders’ equity	22,092,965	18,774,342
Total liabilities and stockholders’ equity	Ps. 24,429,417	Ps. 21,723,788

See accompanying notes to these condensed financial statements.

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

Condensed Statements of Operations

Years ended December 31, 2011, 2010 and 2009

(In thousands of Mexican pesos)

	2011	2010	2009
Income (expenses):			
Equity in results of subsidiaries companies	Ps. 2,834,437	Ps. 995,723	Ps. (719,792)
Leasing income	20,556	20,556	20,556
Total of income (expense)	2,854,993	1,016,279	(699,236)
Costs and expenses:			
Depreciation and amortization	13,789	17,422	13,590
Administrative	24,735	15,110	12,420
Total costs and expenses	38,524	32,532	26,010
Operating income (loss)	2,816,469	983,747	(725,246)
Other income (expenses), net	37,695	(107,972)	562
Comprehensive financing cost:			
Interest expense	(40,999)	(12,040)	(218,029)
Interest income			6,201
Foreign exchange gain (loss), net	45,127	(1,203)	3,430
Comprehensive financial result, net	4,128	(13,243)	(208,398)
Income (loss) before income tax	2,858,292	862,532	(933,082)
Income tax:			
Current		-	1,333
Deferred (benefit)	(4,135)	(73,969)	(590,670)
Net income (loss)	Ps. 2,862,427	Ps. 936,501	Ps. (343,745)

See accompanying notes to these condensed financial statements.

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

Condensed Statements of Cash Flows

Year ended December 31, 2011, 2010 and 2009

(In thousands of Mexican pesos)

	2011	2010	2009
Operating activities:			
Income (loss) before income tax	Ps. 2,858,292	Ps. 862,532	Ps. (933,082)
Depreciation and amortization	13,789	17,422	13,590
Equity in net results of subsidiaries companies	(2,834,437)	(995,723)	719,792
Interest income	(25,882)	(50,450)	(6,201)
Accrued interest	66,653	62,466	218,029
Other provisions	21,204	8,907	-
	99,619	(94,846)	12,128
Increase in related parties receivables	(107,202)	(448,017)	(746,331)
(Increase) decrease in other accounts receivable	(45,260)	(839)	3,324
(Decrease) increase in other accounts payable and accrued expenses	(12,160)	(11,792)	344
(Decrease) increase in related parties payable	(42,625)	246,667	(3,405,306)
Tax Payable	(4,408)	7,848	-
Resources used in operating activities	(112,036)	(300,979)	(4,135,841)
Investing activities:			
Investment in others assets, long-term	(205)	-	-
Acquisition of equipment	(37)	(17)	-
Interest collected	18,076	35,276	6,201
Collective from related intercompanies	1,231,881	1,822,189	-
Increase in capital stock of subsidiaries companies	(167,228)	(25,446)	(1,333)
Sales of shares of Grupo San to Simec International, subsidiary		-	4,351,882
Loan to related intercompanies	(328,676)	(2,274,352)	
Resources provided by (used in) investing activities	753,811	(442,350)	4,356,750
Financing activities:			
Exchange rate effect on financial debt	493	(212)	(111)
Loans obtained from related intercompanies	810,758	4,819,214	-
Payments of loans received from related intercompanies	(1,377,188)	(4,236,838)	-
Interest paid	(52,237)	(31,498)	(3,474)
Resources (used in) provided by financing activities	(618,174)	550,666	(3,585)
Net increase (decrease) in cash and cash equivalents	23,601	(192,663)	217,324
Cash and cash equivalents at beginning of year	25,988	218,651	1,327
Cash and cash equivalents at end of year	Ps. 49,589	Ps. 25,988	Ps. 218,651

See accompanying notes to these condensed financial statements.

S-3

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

Condensed Note to the Parent Only Financial Statements

Years ended December 31, 2011, 2010 and 2009

(In thousands of Mexican pesos)

1. Organization of the Company and certain other information:

The accompanying condensed financial statements of Grupo Simec, S.A.B. de C.V. (“the Company”) reflect its financial position at December 31, 2011 and 2010 and the related results from operations and cash flows for each of the years ended December 31, 2011, 2010 and 2009. The Company was incorporated in August 1990. These condensed financial statements do not reflect a complete set of financial statements nor do they include all the disclosures required under Mexican Financial Reporting Standards.

Information with respect to the Company’s material commitments and contingencies are presented in note 20 to the consolidated financial statements of Grupo Simec, S.A.B. de C.V. and subsidiaries.

These parent financial statements are presented in conformity with Mexican financial reporting standards.