

Ternium S.A.  
Form 20-F  
June 29, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 20-F**

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(Mark One)

- Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934  
or
- Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006  
or
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
or
- Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission file number: 001-327734

**TERNIUM S.A.**

(Exact Name of Registrant as Specified in its Charter)

N/A

(Translation of registrant's name into English)

**Grand Duchy of Luxembourg**

(Jurisdiction of incorporation or organization)

**46a, Avenue John F. Kennedy 2<sup>nd</sup> floor**

**L-1855 Luxembourg**

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(Address of registrant's principal executive offices)

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

| Title of Each Class  | Name of Each Exchange On Which Registered                         |
|--|---|
| <b>American Depositary Shares</b><br><b>Ordinary Shares, par value USD1.00 per share</b> | <b>New York Stock Exchange</b><br><b>New York Stock Exchange*</b> |

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\* Ordinary shares of Ternium S.A. are not listed for trading but only in connection with the registration of American Depositary Shares which are evidenced by American Depositary Receipts.

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

**None**

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

**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

**2,004,743,442 ordinary shares, par value USD1.00 per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Note checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated Filer  Non-accelerated filer

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

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Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

*Please send copies of notices and communications from the Securities and Exchange Commission to:*

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**Mitrani Caballero Ojam Abogados**

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**New York, New York 10004**

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**CERTAIN DEFINED TERMS**

In this annual report, unless otherwise specified or if the context so requires:

References to the Company , we , us or our are exclusively to Ternium S.A., a joint stock corporation (*société anonyme* holding) organized under the laws of the Grand Duchy of Luxembourg;

References to Ternium refer to the flat and long steel manufacturing, processing and distribution businesses of various companies under the common control of San Faustín N.V. As part of a corporate reorganization, these companies were reorganized as our subsidiaries. See notes 1 and 2 to our consolidated financial statements included elsewhere in this annual report and Item 4.

Information on the Company History and Corporate Organization ;

References to Siderar are to Siderar S.A.I.C., a corporation (*sociedad anónima industrial y comercial*) organized under the laws of the Republic of Argentina ( Argentina ) and a subsidiary of the Company;

References to Amazonia refer to Consorcio Siderurgia Amazonia Ltd., a holding company organized under the laws of the Cayman Islands and a subsidiary of the Company that holds a 59.73% interest in Sidor;

References to Sidor are to Sidor C.A., a corporation (*compañía anónima*) organized under the laws of the Bolivarian Republic of Venezuela ( Venezuela ) and a subsidiary of the Company;

References to Hylsamex are to Hylsamex, S.A. de C.V., a corporation (*sociedad anónima de capital variable*) organized under the laws of the United Mexican States ( Mexico ) and a subsidiary of the Company;

References to Ylopa are to Ylopa Serviços de Consultadoria Lda., a company established under the laws of Portugal and registered in the Madeira Free Zone;

References to the Ternium companies are to Ternium's manufacturing subsidiaries, namely Siderar, Sidor and Hylsamex and their respective subsidiaries;

References to Usiminas are to Usinas Siderurgicas de Minas Gerais S/A USIMINAS, a company organized under the laws of Brazil and a shareholder of the Company;

References to Tenaris are to Tenaris S.A., a joint stock corporation (*société anonyme holding*) organized under the laws of Luxembourg and a shareholder of the Company;

References to ISL are to Inversora Siderurgica Limited, a company organized under the laws of Gibraltar and the Company's principal direct shareholder;

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References to San Faustín are to San Faustín N.V., a corporation organized under the laws of the Netherlands Antilles and the Company's indirect controlling shareholder;

References to the Ternium internacional commercial network, the Ternium network or Ternium Internacional are to an international group of companies, formerly known as Techintrade or the Techintrade network, that markets and provides worldwide distribution services for products offered primarily by Ternium.

References to ADSs are to the American Depositary Shares which are evidenced by American Depositary Receipts;

References to tons are to metric tons; one metric ton is equal to 1,000 kilograms, 2,204.62 pounds or 1.102 U.S. (short) tons; and

References to billions are to thousands of millions, or 1,000,000,000.

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**PRESENTATION OF CERTAIN FINANCIAL AND OTHER INFORMATION**

**Accounting Principles**

We prepare our consolidated financial statements in conformity with International Financial Reporting Standards, or IFRS. IFRS differ in certain significant respects from generally accepted accounting principles in the United States, commonly referred to as U.S. GAAP. See note 34 to our audited consolidated financial statements included in this annual report, which provides a description of the principal differences between IFRS and U.S. GAAP as they relate to the Company and a reconciliation of net income and shareholders' equity for the years and at the dates indicated.

Our audited consolidated financial statements as of, and for the years ended December 31, 2006, 2005 and 2004 included in this annual report consolidate, in addition to the consolidated results and other financial data of Siderar, Ylopa, and Ternium Internacional, the results and other financial data of Amazonia and Hylsamex, which companies came under the control of San Faustín on February 15, 2005 and August 22, 2005, respectively. As a result of the consolidation of Amazonia's and Hylsamex's results and other financial data, Ternium's results and other financial data for the year ended December 31, 2006 varied significantly from the results and other financial data for the years ended December 31, 2005 and 2004. For a list of our subsidiaries, see note 2 to our audited consolidated financial statements included in this annual report. For comparative purposes, the audited combined consolidated financial data of Ternium as of December 31, 2005 and 2004 and for the years then ended included in this annual report combine and consolidate the results and other financial data of each of Siderar, Ylopa and Ternium Internacional, and recognize the investment in Amazonia under the equity method, as of each such dates and for each of the years then ended, on the basis that such companies were under the common control of San Faustín as of each such dates and for each such years. The effect of this presentation is to show the combined historical results, financial condition and other data of the various companies under the common control of San Faustín as though these companies had been our subsidiaries at the dates and during the periods presented. For more information, see notes 1, 2 and 3 to our audited consolidated financial statements included in this annual report.

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**Currencies**

In this annual report, unless otherwise specified or the context otherwise requires:

dollars , U.S. dollars or USD each refers to the United States of America dollar;

, EUR or euros each refers to the Euro;

Argentine pesos or ARP each refers to the Argentine peso;

Venezuelan bolívars or VEB each refers to the Venezuelan bolívar; and

Mexican pesos or MXN each refers to the Mexican peso.

On December 29, 2006, the exchange rate between the Argentine peso and the U.S. dollar (as published by *Banco Central de la República Argentina*, or the Argentine Central Bank), was  $ARP3.0695=USD1.00$ ; the noon buying rate for the Venezuelan bolívar as certified for customs purposes by the Federal Reserve Bank of New York was  $VEB2,144.60=USD1.00$ ; and the noon buying rate for the Mexican peso as published by the Federal Reserve Bank of New York was  $MXN10.7995=USD1.00$ . Those rates may differ from the actual rates used in preparation of Ternium's consolidated financial statements. We do not represent that any of these currencies could have been or could be converted into U.S. dollars or that the U.S. dollars could have been or could be converted into any of these currencies.

**Rounding; Comparability of Data**

Certain monetary amounts, percentages and other figures included in this annual report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be the arithmetic aggregation of the figures that precede them, and figures expressed as percentages in the text may not total 100% or, as applicable, when aggregated may not be the arithmetic aggregation of the percentages that precede them.

**Our Internet Site is Not Part of This Annual Report**

We maintain an Internet site at [www.ternium.com](http://www.ternium.com). Information contained in or otherwise accessible through this website is not a part of this annual report. All references in this annual report to these Internet sites are inactive textual references to these URLs, or uniform resource locators and are for your informational reference only. We assume no responsibility for the information contained on these sites.



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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This annual report and any other oral or written statements made by us to the public may contain forward-looking statements within the meaning of and subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This annual report contains forward-looking statements, including with respect to certain of our plans and current goals and expectations relating to Ternium's future financial condition and performance.

Sections of this annual report that by their nature contain forward-looking statements include, but are not limited to, Item 3. Key Information, Item 4. Information on the Company, Item 5. Operating and Financial Review and Prospects and Item 11. Quantitative and Qualitative Disclosures About Market Risk.

We use words such as aim, will likely result, will continue, contemplate, seek to, future, objective, goal, should, will pursue, expect, project, intend, plan, believe and words and terms of similar substance to identify forward-looking statements, but they are not the way we identify such statements. All forward-looking statements are management's present expectations of future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to the risks related to Ternium's business discussed under Item 3. Key Information D. Risk Factors, other factors could cause actual results to differ materially from those described in the forward-looking statements. These factors include, but are not limited to:

our ability to successfully implement our business strategy;

our ability to successfully integrate the operations of future acquisitions (for example, Grupo Imsa) into the operations of Ternium;

uncertainties about the degree of growth in the number of consumers in the markets in which Ternium operates and sells its products;

the impact of existing and new competitors in the markets in which Ternium operates, including competitors that may effect Ternium's customer mix, profitability and revenue and/or offer less expensive products and services, desirable or innovative products, or have extensive resources or better financing;

other factors or trends affecting the flat and long steel industry generally and our financial condition in particular;

general economic and political conditions in the countries in which Ternium operates or other countries which have an impact on Ternium's business activities or investments;

the monetary and interest rate policies of the countries in which Ternium operates;

inflation or deflation in the countries in which Ternium operates;

unanticipated volatility in interest rates;

foreign exchange rates;

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the performance of the financial markets globally and in the countries in which Ternium operates;

changes in domestic and foreign laws, regulations and taxes;

changes in competition and the pricing environments in the countries in which Ternium operates;

regional or general changes in asset valuations; and

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raw material and energy price increases or difficulties in acquiring raw materials or energy supply cut-offs. By their nature, certain disclosures relating to these and other risks are only estimates and could be materially different from what actually occurs in the future. As a result, actual future gains or losses that may affect Ternium's financial condition and results of operations could differ materially from those that have been estimated. You should not place undue reliance on the forward-looking statements, which speak only as of the date of this annual report. Except as required by law, we are not under any obligation, and expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

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**PART I**

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

Not applicable.

**Item 2. Offer Statistics and Expected Timetable**

Not applicable.

**Item 3. Key Information**

**A. Selected Financial Data**

**The selected consolidated financial data set forth below have been derived from our audited consolidated financial statements for each of the years and at the dates indicated. Our consolidated financial statements were prepared in accordance with IFRS and were audited by Price Waterhouse & Co. S.R.L., Argentina, an independent registered public accounting firm and a member firm of PricewaterhouseCoopers. IFRS differ in certain significant respects from U.S. GAAP. See note 34 to our audited consolidated financial statements included in this annual report, which provide a description of the principal differences between IFRS and U.S. GAAP as they relate to the Company and a reconciliation to U.S. GAAP of net income and shareholders' equity for the years and at the dates indicated therein.**

The audited consolidated financial statements of Ternium as of December 31, 2006, 2005 and 2004 and for the years then ended included in this annual report consolidate, in addition to the consolidated results and other financial data of each of Siderar, Ylopa and Ternium Internacional, the results and other financial data of Amazonia and Hylsamex, which companies came under the control of San Faustín on February 15, 2005 and on August 22, 2005, respectively. As a result of the consolidation of Amazonia's and Hylsamex's results and other financial data, Ternium's results and other financial data for the year ended December 31, 2006 varied significantly from the results and other financial data for the years ended December 31, 2005 and 2004. The audited combined consolidated financial data of Ternium as of December 31, 2005 and 2004 and for the years then ended included in this annual report combine and consolidate the results and other financial data of each of Siderar, Ylopa and Ternium Internacional, and recognize the investment in Amazonia under the equity method, as of each such dates and for each of the years then ended, on the basis that such companies were under the common control of San Faustín as of each such dates and for each such years. The effect of this presentation is to show the combined historical results, financial condition and other data of the various companies under the common control of San Faustín as though these companies had been our subsidiaries at the dates and during the years presented. For more information, see notes 1, 2 and 3 to our audited consolidated financial statements included in this annual report. For a discussion of the currencies used in this annual report, exchange rates and accounting principles affecting the financial information contained in this annual report, see Presentation of Certain Financial and Other Information Accounting Principles and Currencies.

**Table of Contents***In thousands of U.S. dollars***For the year ended December 31,***(except number of shares and per share data)*

|  | <b>2006</b>   | <b>2005<sup>(1) (2)</sup></b> | <b>2004<sup>(1) (2)</sup></b> | <b>2003<sup>(1) (2)</sup></b> |
|--|---------------|-------------------------------|-------------------------------|-------------------------------|
| <b>Selected consolidated income statement data</b>   |               |                               |                               |                               |
| IFRS   |               |                               |                               |                               |
| Net sales  | 6,568,975     | 4,447,680                     | 1,598,925                     | 1,056,566                     |
| Cost of sales  | (4,301,384)   | (2,488,980)                   | (965,004)                     | (671,720)                     |
| Gross profit   | 2,267,591     | 1,958,700                     | 633,921                       | 384,846                       |
| Selling, general and administrative expenses   | (623,772)     | (500,590)                     | (116,626)                     | (115,662)                     |
| Other operating expenses, net  | (7,250)       | (65,949)                      | (3,124)                       | (4,402)                       |
| Operating income   | 1,636,569     | 1,392,161                     | 514,171                       | 264,782                       |
| Interest expense   | (112,918)     | (81,608)                      | (18,257)                      | (39,980)                      |
| Interest income  | 52,554        | 32,324                        | 8,911                         | 6,036                         |
| Other financial (expenses) income, net   | (322,417)     | (261,452)                     | 211,635                       | 109,550                       |
| Excess of fair value of net assets acquired over cost  |               | 188,356                       |                               |                               |
| Equity in earnings of associated companies   | 4,534         | 21,524                        | 209,201                       | 110,250                       |
| Income before income tax expense   | 1,258,322     | 1,291,305                     | 925,661                       | 450,638                       |
| Income tax expense   | (262,356)     | (218,492)                     | (177,486)                     | (94,087)                      |
| Net income for the year <sup>(3)</sup>   | 995,966       | 1,072,813                     | 748,175                       | 356,551                       |
| Attributable to:   |               |                               |                               |                               |
| Equity holders of the Company  | 795,424       | 704,406                       | 457,339                       | 218,215                       |
| Minority interest  | 200,542       | 368,407                       | 290,836                       | 138,336                       |
|  | 995,966       | 1,072,813                     | 748,175                       | 356,551                       |
| Depreciation and amortization  | 424,495       | 316,405                       | 99,192                        | 85,479                        |
| Weighted average number of shares outstanding <sup>(4)</sup>   | 1,936,833,060 | 1,209,476,609                 | 1,168,943,632                 | 1,168,943,632                 |
| Basic earnings per share for profit attributable to the equity holders of the Company <sup>(4)</sup>   | 0.41          | 0.58                          | 0.39                          | 0.19                          |
| Diluted earnings per share for profit attributable to the equity holders of the Company <sup>(5)</sup> | 0.41          | 0.54                          | 0.39                          | 0.19                          |
| Dividends per share declared <sup>(6)</sup>  | 0.05          |                               |                               |                               |
| <b>U.S. GAAP</b>   |               |                               |                               |                               |
| Net sales  | 6,568,975     | 4,447,680                     | 1,598,925                     | 1,056,566                     |
| Net income for the year <sup>(7)</sup>   | 841,018       | 559,305                       | 424,655                       | 264,173                       |
| Weighted average number of shares outstanding <sup>(4)</sup>   | 1,936,833,060 | 1,209,476,609                 | 1,168,943,632                 | 1,168,943,632                 |
| Basic earnings per share for profit attributable to the equity holders of the Company <sup>(4)</sup>   | 0.43          | 0.46                          | 0.36                          | 0.23                          |
| Diluted earnings per share for profit attributable to the equity holders of the Company <sup>(5)</sup> | 0.43          | 0.43                          | 0.36                          | 0.23                          |

- (1) Combined consolidated financial information on the basis of common control. See note 2 to our audited consolidated financial statements.
- (2) Certain comparative amounts for 2005, 2004 and 2003 have been reclassified to conform to changes in presentation in the current period.
- (3) For IFRS purposes, net income for the year is shown gross of the interest of minority shareholders in controlled subsidiaries. The portion of net income attributable to the equity holders of the Company and to minority shareholders is disclosed separately. Under U.S. GAAP, net income for the year is shown net of minority interest.
- (4) As discussed in note 29 to our audited consolidated financial statements, in October 2005, Usiminas exchanged its 5.3% equity interest in Siderar, its 16.6% equity interest in Amazonia and its 19.1% equity interest in Ylopa and other items for 227,608,254 new shares of the Company. Upon the consummation of this exchange, capital increased to USD1,396.6 million, represented by 1,396,551,887 shares of

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USD1.00 nominal value each. Pursuant to certain provisions contained in a subordinated convertible loan agreement, on February 6, 2006 the Company exchanged certain subordinated convertible loans (including interest accrued through January 31, 2006) held by ISL and converted them into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006. As provided in the Corporate Reorganization Agreement, on February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly-issued shares of the Company after the settlement of its initial public offering. In connection with the over-allotment described in note 1 to our audited consolidated financial statements, on March 1, 2006, the Company issued 22,981,360 new shares. Upon consummation of the transactions discussed above, as of December 31, 2006, the capital of the Company was increased to USD2,004.7 million, represented by 2,004,743,442 shares, each having a nominal value of USD1.00. Ternium's combined earnings per share for the year ended December 31, 2004 and 2003 have been calculated based on the assumption that 1,168,943,632 shares were issued and outstanding in each of the periods presented. For fiscal years 2006 and 2005, the weighted average of shares outstanding totaled 1,936,833,060 shares and 1,209,476,609 shares, respectively.

- (5) Diluted earnings per share have been calculated giving effect to the conversion of the Subordinated Convertible Loans. See note 1 to our audited consolidated financial statements.
- (6) On June 6, 2007, at the Ternium's annual general shareholders meeting a dividend of USD0.05 per share (USD0.50 per ADS), or approximately USD100 million, was approved. Ternium paid the dividend on June 12, 2007.
- (7) We are not presenting net income from continuing operations since it is identical to net income for all periods presented.

**Table of Contents***In thousands of U.S. dollars***At December 31,***(except number of shares and per share data)*

|  | <b>2006</b>   | <b>2005<sup>(2)</sup></b> | <b>2004<sup>(1) (2)</sup></b> | <b>2003<sup>(1)</sup></b> |
|--|---------------|---------------------------|-------------------------------|---------------------------|
| <b>Selected consolidated balance sheet data</b>                                  |               |                           |                               |                           |
| <b>IFRS</b>  |               |                           |                               |                           |
| <b>Non-current assets</b>  | 6,117,284     | 6,116,423                 | 1,728,410                     | 1,610,810                 |
| Property, plant and equipment, net   | 5,420,683     | 5,463,871                 | 1,244,691                     | 1,275,699                 |
| Other non-current assets <sup>(3)</sup>  | 696,601       | 652,552                   | 483,719                       | 335,111                   |
| <b>Current assets</b>  | 2,653,255     | 2,543,558                 | 918,220                       | 576,078                   |
| Cash and cash equivalents  | 643,352       | 765,630                   | 194,875                       | 129,020                   |
| Other current assets   | 2,002,861     | 1,774,768                 | 723,345                       | 447,058                   |
| Non-current assets classified as held for sale                                   | 7,042         | 3,160                     |                               |                           |
| <b>Total assets</b>  | 8,770,539     | 8,659,981                 | 2,646,630                     | 2,186,888                 |
| Capital and reserves attributable to the Company's equity holders <sup>(4)</sup> | 3,757,558     | 1,842,454                 | 1,026,725                     | 701,821                   |
| Minority interest  | 1,729,583     | 1,733,465                 | 745,126                       | 550,264                   |
| <b>Non-current liabilities</b>   | 1,875,894     | 3,691,288                 | 359,510                       | 677,649                   |
| Borrowings   | 548,401       | 2,399,878                 | 1,008                         | 283,914                   |
| Deferred income tax  | 985,155       | 1,048,188                 | 337,473                       | 374,907                   |
| Other non-current liabilities  | 342,338       | 243,222                   | 21,029                        | 18,828                    |
| <b>Current liabilities</b>   | 1,407,504     | 1,392,774                 | 515,269                       | 257,154                   |
| Borrowings   | 508,694       | 516,399                   | 121,998                       | 80,238                    |
| Other current liabilities  | 898,810       | 876,375                   | 393,271                       | 176,916                   |
| <b>Total liabilities</b>   | 3,283,398     | 5,084,062                 | 874,779                       | 934,803                   |
| <b>Total equity and liabilities</b>  | 8,770,539     | 8,659,981                 | 2,646,630                     | 2,186,888                 |
| Number of shares outstanding <sup>(5)</sup>                                      | 2,004,743,442 | 1,396,551,887             | 1,168,943,632                 | 1,168,943,632             |
| <b>U.S. GAAP</b>   |               |                           |                               |                           |
| Total assets   | 8,181,931     | 7,938,086                 | 2,115,271                     | 1,201,734                 |
| Non-current liabilities  | 1,938,505     | 3,699,842                 | 44,647                        | 311,054                   |
| Total shareholders' equity   | 3,435,516     | 1,436,638                 | 954,255                       | 382,703                   |

(1) Combined consolidated financial information on the basis of common control. See note 2 to our audited consolidated financial statements.

(2) Certain comparative amounts for 2005 and 2004 have been reclassified to conform to changes in presentation in the current period.

(3) As of December 31, 2006 and 2005, includes goodwill related to the acquisition of Hylsamex for a total amount of USD397.9 million and USD399.7 million, respectively. See note 3(e) to our audited financial statements.

(4) The Company's common stock as of December 31, 2006, 2005, 2004 and 2003 was represented by 2,004,743,442, 1,396,551,887, 1,168,943,632 and 1,168,943,632, par value USD1.00 per share, for a total amount of USD2,004.7 million, USD1,396.6 million, USD1,168.9 million and USD1,168.9 million, respectively.

(5) As described in note 29 to our audited consolidated financial statements, after the completion of the Company's initial public offering, the conversion of the subordinated convertible loans, the exercise of the over-allotment option granted to the underwriters of the initial public offering and the consummation of the transactions contemplated in the Corporate Reorganization Agreement, 2,004,734,442 shares were outstanding. In October 2005, Usiminas exchanged its 5.3% equity interest in Siderar, its 16.6% equity interest in Amazonia and its 19.1% equity interest in Ylopa and other items for 227,608,254 new shares of the Company. Upon the consummation of this exchange, capital increased to USD1,396.6 million, represented by 1,396,551,887 shares of USD1.00 nominal value per share. Pursuant to certain provisions contained in a subordinated convertible loan agreement, on February 6, 2006 the Company exchanged certain subordinated convertible loans (including interest accrued through January 31, 2006) held by ISL and converted them into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006. As provided in the Corporate Reorganization Agreement, on February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly-issued shares of the Company after the settlement of its initial public offering. In connection with the over-allotment described in note 1 to our audited consolidated financial statements, on March 1, 2006, the Company issued 22,981,360 new shares. Upon consummation of the transactions discussed above, as of December 31, 2006, the capital was increased to USD2,004.7 million, represented by 2,004,743,442 shares, each having a nominal value of USD1.00.

**B. Capitalization and Indebtedness**

Not applicable.





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

Not applicable.

**D. Risk Factors**

*You should carefully consider the risks and uncertainties described below, together with all other information contained in this annual report, before making any investment decision. Any of these risks and uncertainties could have a material adverse effect on our business, financial condition and results of operations, which could in turn affect the price of the Company's shares and ADSs.*

**Risks Relating to the Steel Industry**

*The demand for Ternium's products is cyclical.*

The steel industry is highly cyclical in nature and is characterized by intense competition. The financial condition and results of operations of steel companies are generally affected by various factors, including fluctuations in gross domestic product, related market demand, global production capacity, tariffs, cyclicalities in the industries that purchase steel products and other factors beyond Ternium's control. The demand for and prices of Ternium's products are directly affected by these fluctuations. For example, the Ternium companies depend on construction activity within their primary markets for a large proportion of their sales. Construction activity is cyclical and significantly affected by changes in global and local economic conditions. A prolonged recession in the construction sector, or in any of the other industry sectors that purchase Ternium's products, in Argentina, Venezuela or Mexico, where most of Ternium's operations are conducted and domestic sales are targeted, could result in a significant decrease in Ternium's operational and sales performance. In addition, like other manufacturers of steel-related products, the Ternium companies have fixed and semi-fixed costs that cannot adjust rapidly to fluctuations in the demand for their products. If demand for Ternium's products falls significantly, the impossibility of rapidly adjusting these costs could adversely affect Ternium's profitability.

Like other steel companies, Ternium is vulnerable to events affecting the steel industry as a whole, such as imbalances between supply and demand. For example, the impact of new production facilities could result in imbalances between supply and demand. Moreover, due to high start-up costs, the economics of operating a steel mill continuously could encourage mill operators to maintain high levels of output, even in times of low demand, which exacerbates the pressures on industry profit margins. Although the demand for steel has grown in recent years, the world steel industry has been affected in the past by generally sluggish demand and substantial excess worldwide steel production. As a result of the general excess capacity in the industry, the world steel industry was subject to substantial downward pricing pressure, which negatively impacted the results of steel companies in the second half of 2000 and the entire year of 2001. For example, as a result of these adverse trends, Sidor experienced significant financial losses and consequently restructured its debt in 2000 and again in 2003. International steel prices generally improved beginning in 2003. However, this new period of high prices for steel has encouraged reactivation of and investment in production capacity and, consequently, oversupply has led to a decline in steel prices beginning in the last quarter of 2004 and continuing through 2005. Nevertheless, prices in 2005 reached generally higher levels than those prevailing in 2001 through 2003. Steel prices began to recover in 2006, exceeding those of 2005, as a result of better global economic performance, but slightly decreasing towards the second half of the year. If an event occurs that has a negative effect on the steel industry, such as excess production capacity or increased competition in the main steel markets, Ternium's ability to expand sales and increase production in general will be constrained, and as a result, it may not be able to maintain its recent rate of growth in revenues. Furthermore, due to the highly cyclical nature of the steel industry, recent results may not be indicative of future performance, and historical results may not be comparable to future results. Investors should not rely on the results of a single period, particularly a period of peak prices, as an indication of Ternium's annual results or future performance.

*Demand for Ternium's products could decline as a result of fluctuations in Ternium's customers' inventory levels which could, in turn, cause a decline in Ternium's sales and revenue.*

Inventory levels of steel products held by companies that purchase Ternium's products can vary significantly from period to period. These fluctuations can temporarily affect the demand for Ternium's products, as customers draw from existing inventory during periods of low investment in construction and the other industry sectors that purchase Ternium's

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products and accumulate inventory during periods of high investment and, as a result, these companies may not purchase additional steel products or maintain their current purchasing volume. Accordingly, Ternium may not be able to increase or maintain its current levels of sales volumes or prices.

***Price fluctuations or shortages in the supply of raw materials and energy could adversely affect Ternium's profits.***

Like other manufacturers of steel-related products, Ternium's operations require substantial amounts of raw materials and energy from domestic and foreign suppliers. In particular, the Ternium companies consume large quantities of iron ore, scrap, ferroalloys, electricity, coal, natural gas, oxygen and other gases in operating their blast and electric furnaces. The availability and price of a significant portion of the raw materials and energy Ternium requires are subject to market conditions and government regulation affecting supply and demand. For example, shortages of natural gas in Argentina and the consequent supply restrictions imposed by the government could lead to higher costs of production and eventually to production cutbacks at Ternium's facilities in Argentina. See [Risks Relating to the Countries in Which We Operate](#). Argentina Restrictions on the supply of energy to Ternium's operations in Argentina could curtail Ternium's production and negatively impact Ternium's results of operations. In the past, Ternium has been able to procure sufficient supplies of raw materials and energy inputs to meet its production needs; however, it could be unable to procure adequate supplies in the future. Any protracted interruption, discontinuation or other disruption of the supply of principal inputs to the Ternium companies (including as a result of strikes, lockouts or other problems) would result in lost sales and would have a material adverse effect on Ternium's business. For further information related to raw materials and energy requirements, see Item 4. [Information on the Company Raw Materials and Energy](#).

Furthermore, estimated amounts of reserves of iron ore from Hylsamex's mines or from those of Ternium's suppliers may not be recovered, and these suppliers may revise their reserve estimates based on actual production experience. Reserves may not conform to geological, metallurgical or other expectations, and the volume and quality of iron ore recovered may be below the expected levels.

As the steel industry is highly competitive with respect to price, product quality, customer service and technological advances, worldwide competition in the steel industry has frequently limited the ability of steel producers to raise the price of finished products to recover higher raw material and energy costs. Moreover, in some cases, the governments of some countries are reluctant (as is currently the case in Argentina) to accept price increases of products which are used as raw materials for the manufacture of other goods, as such increases could ultimately impact the inflation rate and in the prices paid by end consumers of those goods (e.g., tinplate for cans). Accordingly, increased purchase costs of raw materials and energy might not be recoverable through increased product prices, which would reduce Ternium's gross profit and revenues. Furthermore, limited availability could cause Ternium to curtail production, which could adversely affect Ternium's sales and profitability. For further information related to raw materials, see Item 4. [Information on the Company Raw Materials and Energy](#).

***The Ternium companies depend on a limited number of key suppliers.***

The Ternium companies depend on certain key suppliers for their requirements of raw materials and energy. The Ternium companies have entered into long-term contracts for the supply of a substantial portion of their principal inputs, and it is expected that they will maintain and, depending on the circumstances, renew these contracts. However, if any of the key suppliers fails to deliver or there is a failure to renew these contracts, the Ternium companies could face limited access to raw materials and energy, higher costs and delays resulting from the need to obtain their raw material and energy requirements from other suppliers.

For example, expenditures for iron ore constitute one of Sidor's largest individual raw material costs. Currently, Sidor purchases all of its iron ore from a single producer in Venezuela at agreed-upon formula prices under a long-term supply agreement expiring in 2017. If Sidor is not able to continue this long-term relationship or to continue purchasing iron ore from such supplier at the agreed-upon prices, it could be unable to obtain sufficient quantities of iron ore from alternative suppliers at prices comparable to those offered by its current supplier and, accordingly, its gross profit could decline. In 2005, following a public announcement by the Venezuelan government that sought to pressure Sidor to renegotiate the terms of the agreement for the supply of iron ore, as permitted under the contract's hardship provision, Sidor and Venezuelan state-owned CVG Ferrominera del Orinoco, C.A. ( FMO ) amended the pricing terms of the contract. The amended formula increased Sidor's cost of iron ore for 2006 by 63% and for 2007 by 9.5%. Furthermore, under the revised contract, the

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pricing formula may be adjusted every two years, on the basis of public policy, Sidor's competitiveness and the evolution of international steel prices. See Risks Relating to the Countries in Which We Operate Venezuela and Item 4. Information on the Company Raw Materials and Energy Venezuela Iron Ore, Electricity and Natural gas.

*Intense competition could cause Ternium to lose its share in certain markets and adversely affect its sales and revenues.*

Ternium's subsidiaries have a substantial market share in their countries of operation where they maintain long-term relationships with their clients. Any fall in demand in these markets due to weak economic conditions or other reasons could adversely affect the operations of these subsidiaries and could redirect sales and the focus of Ternium's business to other markets. Competition in the global and regional markets could also be affected by antidumping and countervailing duties imposed on some producers in major steel markets and by the removal of barriers to imported products in those countries where the Ternium companies direct their sales. For further information please refer to Item 4. Information on the Company Regulation Trade regulations. Also, Ternium's foreign competitors would benefit from any fall in the value of their domestic currencies relative to the U.S. dollar, reducing their operating costs and making their products more competitive.

The market for Ternium's steel products is highly competitive, particularly with respect to price, quality and service. In both the global and regional markets, Ternium competes against other global and local producers of flat and long steel products, which in some cases have greater financial and operating resources. In addition, several competitors are implementing modernization programs and expanding their production capacity for products that could compete with those of Ternium. To the extent that these producers become more efficient, Ternium could confront stronger competition and could fail to preserve its current shares of the relevant geographic or product markets. See Item 4. Information on the Company Competition. Moreover, competition from alternative materials (including plastic, aluminum, ceramics, glass, wood and concrete) could adversely affect the demand for, and consequently the market prices of, certain steel products and, accordingly, could affect the sales volume and revenue of Ternium and its subsidiaries.

In addition, there has been a trend in recent years toward steel industry consolidation among Ternium's competitors, and smaller competitors in the steel market today could become larger competitors in the future. For example, Aceralia, Arbed and Usinor merged in February 2002 to create Arcelor, and LNM Holdings and Ispat International merged in October 2004 to create Mittal Steel, which subsequently acquired International Steel Group. Furthermore, in June 2006, Mittal Steel and Arcelor merged to create the world's largest steel company, Arcelor Mittal. In April 2007, Tata Steel completed the acquisition of Corus. Competition from global steel manufacturers with expanded production capacity such as Arcelor Mittal and new market entrants, especially from China, could result in significant price competition, declining margins and reductions in revenue. Ternium's larger competitors could use their resources against Ternium in a variety of ways, including by making additional acquisitions, investing more aggressively in product development and capacity and displacing demand for Ternium's products in certain markets. As a result of such increased competition, Ternium may also lose market share and its sales and revenues could decline.

*The steel industry is capital intensive and if Ternium is not able to obtain the capital resources required to continue to modernize and upgrade its facilities, Ternium's results of operations and growth prospects may be adversely affected.*

The production of steel is capital intensive and some of Ternium's competitors have announced plans to make substantial investments in new equipment and to upgrade existing production facilities. In order to maintain its competitive strengths, Ternium would typically be expected to continue to modernize its production processes, plant and equipment, which would require on-going capital investments. Moreover, as a result of its acquisitions and internal growth, Ternium's business may require capital expenditures in the future. Ternium may not have adequate sources of funds for any future capital expenditures, and additional financing, if needed, may not be available to Ternium or, if available, may not be obtained on terms acceptable to Ternium and within the limitations contained in Ternium's existing debt instruments or any future financings. Failure to obtain the required funds could delay or prevent the completion of some of Ternium's capital projects, which could result in decreased sales.

**Table of Contents****Risks Relating to our Business**

*If Ternium does not successfully implement its business strategy, its opportunities for growth and its competitive position could be adversely affected.*

Ternium plans to continue implementing its business strategy of further integrating the operating and marketing activities of the Ternium companies, developing value-added products, providing services to a wider range of clients in the local and export markets and continuing to pursue strategic acquisition opportunities. Any of these components or Ternium's overall business strategy could be delayed or abandoned or could cost more than anticipated, any of which could impact its competitive position and reduce its revenue and profitability. For example, Ternium could fail to develop its commercial network and lose market share in its export markets. Even if Ternium successfully implements its business strategy, it may not yield the desired goals.

*Recent and future acquisitions, significant investments and strategic alliances could disrupt Ternium's operations and adversely affect its profits. Ternium may not realize the benefits it expects from these business decisions.*

A key element of Ternium's business strategy is to identify and pursue growth-enhancing strategic opportunities. As part of this growth strategy, Ternium has acquired interests in various companies and engaged in strategic alliances, such as the acquisition of a 49.8% participation in Matesi, Materiales Siderúrgicos S.A. ( Matesi ), an iron ore briquette producer that supplies Sidor with part of its raw material requirements; the acquisition of Hylsamex, one of the main steel producers in Mexico, the acquisition of the assets and facilities of Acindar Industria Argentina de Aceros S.A. ( Acindar ), related to the production of welded steel pipes in the province of Santa Fe in Argentina; the acquisition of 100% of the issued and outstanding shares of Impeco S.A. ( Impeco ), which in turn owned a plant located in the province of San Luis in Argentina, and the acquisition of the 50% interest not previously owned by Hylsamex in Acerex S.A. de C.V. ( Acerex ), a service center in Mexico that processes steel to produce short length and thin steel sheets in various widths.

On April 29, 2007, we entered into a definitive agreement, pursuant to which Ternium, or any of its subsidiaries, is expected to obtain control over Grupo Imsa S.A.B. de C.V., or Grupo IMSA ( Grupo Imsa ), a steel manufacturer with operations in Mexico, United States and Guatemala. The transaction is subject to Mexican and U.S. antitrust clearances and other customary conditions, and is expected to close in the third quarter of 2007. For more information, see Item 5. Operating and Financial Review and Prospects G. Recent Developments (a) Agreement to obtain control over Grupo Imsa .

We will continue actively to consider other strategic acquisitions and partnerships from time to time. We must necessarily base any assessment of potential acquisitions and alliances on assumptions with respect to operations, profitability and other matters that may subsequently prove to be incorrect. Our Grupo Imsa acquisition, if and when consummated, and other future acquisitions, significant investments and alliances may not perform in accordance with our expectations and could adversely affect our operations and profitability. Furthermore, we may fail to find suitable acquisition targets or fail to consummate our acquisitions under favorable conditions, or could be unable to successfully integrate any acquired businesses into our operations.

These risks, and the fact that integration of any acquired businesses will require a significant amount of the time and resources of Ternium's management and employees, could disrupt Ternium's ongoing business and could have a material adverse effect on its business, financial condition and results of operations.

*Ternium may be required to record a significant charge to earnings if it must reassess its goodwill or other amortizable intangible assets.*

In accordance with IFRS, management must test all of Ternium's assets, including goodwill and other intangibles, annually for impairment, or more frequently if there are indicators of impairment, and recognize a non-cash charge in an amount equal to the impairment. In connection with the acquisition of Hylsamex completed on August 22, 2005, Ternium recorded USD397.9 million in goodwill as of December 31, 2006. If Ternium's management were to determine in the future that the goodwill from its acquisition of Hylsamex was impaired, Ternium would be required to recognize a non-cash charge

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to write down the value of this goodwill, which would adversely affect Ternium's financial condition and results of operations. If we complete the acquisition of Grupo Imsa referred to elsewhere in this annual report, we are likely to record additional goodwill or other intangibles, which would be subject to the same accounting treatment and potential consequences.

***Ternium's related party transactions with companies controlled by San Faustin may not always be on terms as favorable as those that could be obtained from unaffiliated third parties.***

Some of Ternium's sales and purchases are made to and from other controlled by San Faustin. These sales and purchases are primarily made in the ordinary course of business, and Ternium believes that they are made on terms no less favorable than those it could obtain from unaffiliated third parties. Ternium will continue to engage in related party transactions in the future, and these transactions may not be on terms as favorable as those that could be obtained from unaffiliated third parties. For information concerning the principal transactions between Ternium and related parties, see Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions.

***Ternium's transactions with certain business partners and shareholders may not always be on terms as favorable as those that could be obtained from unaffiliated third parties.***

Some of Ternium's sales and purchases are made to and from certain partners and shareholders of its subsidiaries. For example, Sidor has a variety of trade and services-related contractual relationships with entities owned by its minority shareholder, the government of Venezuela, including the purchase of iron ore from, and the sale of pellets to, the state-owned steel company Corporación Venezolana de Guayana ( CVG ). Although we believe that each of its business relationships with business partners and shareholders is on an arm's length basis, any of these arrangements may not provide terms to Ternium that are substantially similar to, or as favorable as, those that might have been obtained from unaffiliated third parties.

***Labor disputes at Ternium's operating subsidiaries could result in work stoppages and disruptions to Ternium's operations.***

A substantial majority of Ternium's employees at its manufacturing subsidiaries are represented by labor unions and are covered by collective bargaining or similar agreements, which are subject to periodic renegotiation. Strikes or work stoppages could occur prior to or during the negotiations leading to new collective bargaining agreements, during wage and benefits negotiations or, occasionally, during other periods for other reasons.

The various measures that Ternium's subsidiaries Siderar and Hylsamex have taken in order to become more competitive have not resulted in significant labor unrest. However, its subsidiary Sidor has from time to time suffered labor disruptions, including the plant stoppages in 2003, 2004 and the strikes and work slowdowns in 2006. Ternium could suffer additional plant stoppages or strikes as a result of future workforce reductions in connection with its productivity improvement and cost reduction plans. Ternium may not be able to maintain a satisfactory relationship with its employees, and any future stoppage, strike, disruption of operations or new collective bargaining agreements could result in lost sales and could increase Ternium's costs. For more information on labor relations, see Item 6. Directors, Senior Management and Employees D. Employees.

***The Ternium companies' ability to hedge risks could be limited by contractual and regulatory restrictions.***

The international operations of the Ternium companies expose them to a variety of financial risks, including the effects of changes in foreign currency, exchange rates and interest rates. A portion of Ternium's business is carried out in currencies other than the U.S. dollar. As a result of this foreign currency exposure, exchange rate fluctuations impact the Ternium companies' results as reported in their income statements in the form of both translation risk and transaction risk. In addition, interest rate movements create a degree of risk by affecting the amount of the Ternium companies' interest payments. Other than those imposed by legal or monetary control entities (like the Argentine Central Bank or the exchange and transfer control entity CADIVI in Venezuela), Ternium's subsidiaries (other than Sidor) have no restrictions on the use of derivative agreements for hedging purposes. Sidor, however, is limited by both contractual and regulatory restrictions for these types of derivatives contracts. These restrictions and regulations could cause the Ternium companies to be more vulnerable to market fluctuations than they would be if their hedging activities were unlimited. In the ordinary course of business, the Ternium

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companies (other than Sidor) from time to time enter into exchange rate and interest rate derivatives agreements to manage their exposure to exchange rate and interest rate changes. Future regulatory or financial restrictions in the countries where Ternium operates may affect its ability to mitigate its exposure to financial risks, and thus cause an adverse impact on Ternium's results of operations and financial condition.

*Ternium's results of operations and financial condition could be adversely affected by movements in exchange rates.*

The revenues of the Ternium companies are primarily U.S. dollar-denominated (other than revenues from domestic sales in Mexico), while a significant portion of their costs are denominated in local currency in the markets where they operate. As a result, movements in the exchange rate of the U.S. dollar against these local currencies can have a significant impact on Ternium's revenue, results and financial condition. A rise in the value of the local currencies relative to the U.S. dollar will increase Ternium's relative production costs, thereby creating a competitive disadvantage for Ternium relative to some of its competitors. Conversely, a decrease in the value of the local currencies relative to the U.S. dollar will decrease their relative production costs.

Volatility in the exchange rates between the U.S. dollar and the Argentine peso and between the U.S. dollar and the Mexican peso as well as changes to the exchange rate between the U.S. dollar and the Venezuelan bolívar are likely to continue in the future. Such fluctuations will affect Ternium's production costs, revenues and financial results

*A significant rise in interest rates could adversely affect Ternium's business and results.*

Changes in interest rates affect the amount of Ternium's interest payments as well as the value of its fixed rate debt. Most of Ternium's long-term borrowings are at variable rates, and accordingly, Ternium is exposed to the risk of increased interest expense in the event of a significant rise in interest rates. Moreover, a substantial rise in interest rates in developed economies such as the United States of America could adversely affect the economies in the countries where Ternium conducts its operations and markets its products and would increase Ternium's debt service requirements for its floating rate debt.

### **Risks Relating to the Structure of the Company**

*As a holding company, our ability to pay dividends and obtain financing depends on the results of operations and financial condition of our subsidiaries and could be restricted by legal, contractual or other limitations.*

We conduct all of our operations through our subsidiaries. Dividends or other intercompany transfers of funds from our subsidiaries are expected to be our primary source of funds to pay our expenses, debt service and dividends. We will not be conducting operations at the holding company level.

The ability of our subsidiaries to pay dividends and make other payments to us will depend on their results of operations and financial conditions and could be, including in the circumstances described below, restricted by, among other things, applicable corporate and other laws and regulations, including those imposing foreign exchange controls, and agreements and commitments of such subsidiaries. In addition, our ability to pay dividends is subject to legal and other requirements and restrictions at the holding company level. For example, we may only make distributions out of net profits, retained earnings and available reserves and premiums, each as defined under Luxembourg regulations.

*The Company's controlling shareholder may be able to take actions that do not reflect the will or best interests of other shareholders.*

As of March 30, 2007, San Faustín beneficially owned 59.06% of our outstanding voting stock. San Faustín is controlled by Rocca & Partners. As a result, Rocca & Partners is indirectly able to elect a substantial majority of the members of our board of directors and has the power to determine the outcome of most actions requiring shareholder approval, including, subject to the requirements of Luxembourg law, the payment of dividends by us. The decisions of the controlling shareholder, may not reflect the will or best interests of other shareholders. For example, our articles of

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association permit our board of directors to waive, limit or suppress preemptive rights in certain cases. Accordingly, our controlling shareholder may cause our board of directors to approve an issuance of shares for consideration without preemptive rights, thereby diluting the minority interest in the Company. See Risk Factors Risks Relating to our ADSs Holders of our shares and ADSs in the United States may not be able to exercise preemptive rights in certain cases.

### ***Remaining minority interests in the Company's subsidiaries could delay or impede our ability to complete our strategy.***

We do not own one hundred percent of the interests in our subsidiaries. As of May 31, 2007, approximately 32.6% of Siderar was publicly held and approximately 6.5% was held by certain Siderar employees. As of the same date, approximately 20.4% of Sidor was held by the Venezuelan government and *Banco de Desarrollo Económico y Social de Venezuela*, or BANDES (a bank owned by the Venezuelan government), and approximately 19.9% was held by certain Sidor employees. To the extent that other interests in Siderar, Sidor and Hylsamex remain outstanding, those remaining minority shareholders could prevent Ternium from taking actions that, while beneficial to us at the holding company level, might not be beneficial at the level of any of our individual subsidiaries. As a result, we could be delayed or impeded in the full implementation of our strategy or the maximization of Ternium's competitive strengths.

### ***We will be subject to a capital duty on any capital increase in connection with our corporate reorganization if the relief obtained from the Luxembourg tax authorities is successfully challenged.***

Under Luxembourg law, any increase in the capital of a Luxembourg company is subject to a 1% capital duty. Capital contributions to a Luxembourg company involving all of the assets and liabilities of a company organized in a European Union, or EU, member country are exempt from such capital duty. Our corporate reorganizations in late 2005 and early 2006, consisting of a series of such contributions of assets and liabilities by EU companies, including ISL (which is organized in Gibraltar), to the Company had qualified for such exemption and we obtained confirmation from the Luxembourg tax authorities on the availability of the exemption with respect to each such contribution. However, if the relief granted is successfully challenged, we will be subject to a 1% capital duty on the amount of the corresponding capital increase, plus any applicable penalties.

### ***Our tax-exempt status will terminate on December 31, 2010. If we are unable to mitigate the consequences of the termination of our preferential tax regime, we or our shareholders may be subject to a higher tax burden in the future.***

We were established as a société anonyme holding under Luxembourg's 1929 holding company regime and the billionaire provisions relating thereto. 1929 holding companies are exempt from certain business taxes on earnings and on payments. Following a decision by the European Commission, the Grand-Duchy of Luxembourg has terminated its 1929 holding company regime, effective January 1, 2007. However, under the implementing legislation, pre-existing publicly-listed companies -including us- are entitled to continue benefiting from their current tax regime until December 31, 2010. If we are unable to mitigate the consequences of the termination of our preferential tax regime by that year, we or our shareholders may be subject to a higher tax burden in the future.

## **Risks Relating to the Countries in Which We Operate**

### ***Negative economic, political and regulatory developments in certain markets where Ternium has a significant portion of its operations and assets could hurt Ternium's financial condition, revenues and sales volume and disrupt its manufacturing operations, thereby adversely affecting its results of operations and financial condition.***

The results of Ternium's operations are subject to the risks of doing business in emerging markets, including Argentina, Mexico and Venezuela, and have been, and could in the future be, affected from time to time to varying degrees by political developments, events, laws and regulations, such as forced divestiture of assets; restrictions on production, imports and exports; interruptions to essential energy inputs; exchange and/or transfer restrictions; inflation; devaluation; war or other international conflicts; civil unrest and local security concerns that threaten the safe operation of company facilities; direct and indirect price controls; tax increases; changes in interpretation or application of tax laws and other retroactive tax claims or challenges; expropriation of property; changes in laws, or regulations; cancellation of contract rights; delays or denial of government approvals; and environmental regulations. Both the likelihood of such occurrences and their overall effect upon Ternium vary greatly from country to country and are not predictable. Realization of these risks could have an adverse impact on the results of operations and financial condition of Ternium's subsidiaries located in the affected country.

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**Argentina**

Ternium has significant manufacturing operations and assets located in Argentina and a significant portion of its sales are made in Argentina. Ternium's main revenues from its Argentine operations, therefore, are indirectly related to market conditions in Argentina and to changes in Argentina's gross domestic product, or GDP, and per capita disposable income. Accordingly, Ternium's business could be materially and adversely affected by economic, political, fiscal and regulatory developments in Argentina.

***Economic and political instability resulted in a severe recession in 2002, which has had a lasting effect on Argentina's economy.***

In 2001, a sustained period of economic contraction culminated in severe social, monetary and financial turmoil and the resignation of President Fernando de la Rúa. An interim administration adopted a series of emergency measures affecting Argentina's monetary and fiscal policies, as a result of which the Argentine peso experienced significant devaluation in 2002.

President Kirchner, who was elected in 2003, and enjoys high levels of popular support and the economy, has recovered to levels last attained in 1998, with growth of the country's gross domestic product, or GDP, averaging 9% per annum since 2003. During 2005, the Argentine government restructured most of the country's defaulted debt, and unemployment rates have dropped to 8.7% in 2006 from a peak of 24.1% in 2002. Furthermore, the Argentine economy continues to benefit strongly from high international commodity prices, low international interest rates and high levels of global liquidity.

Siderar's business and results of operations has closely followed macroeconomic conditions in Argentina. Siderar's sales in the domestic market were severely affected by Argentina's recession during 2001 and 2002. Domestic sales as a percentage of total sales decreased to 47% in 2001 and 35% in 2002. The domestic economic recovery over the 2003-2006 period, with sustained growth in industrial activity, agriculture, construction and a significant improvement in the automobile industry, increased Siderar's domestic sales as a percentage of total sales to 55% in 2003, 72% in 2004, 71% in 2005 and 85% in 2006.

Despite the progress to date, several significant issues remain to be addressed by the government. Inflation increased significantly during 2005 to 12%, and the economy has been affected by supply constraints as capacity idled during the economic crisis has been utilized. In 2006 the rate of inflation decreased to 9.8%, in part due to several actions implemented by the Argentine government to control inflation and monitor prices for most relevant goods and services, which included price support arrangements agreed to by the Argentine government and private sector companies in several industries and markets. Uncertainty surrounding future inflation and the status of the price support agreements implemented in 2006 could slow the rebound in the economy.

In addition, capital investment in general has lagged due to political uncertainties and government's actions, including price controls and other measures limiting the private conduct of business. Decline capital investment may affect growth and, accordingly, cause the demand for Siderar's products in the domestic market to drop.

Economic conditions in Argentina have deteriorated rapidly in the past and may deteriorate rapidly in the future. Should the current favorable conditions reverse, inflation becomes a problem or supply constraints hinder future growth, the Argentine economy may not continue to grow at current rates. Our business and operations in Argentina could be adversely affected by rapidly changing economic conditions in Argentina or by the Argentine government's policy response to such conditions.



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***The Argentine Central Bank has imposed restrictions on the transfer of funds outside of Argentina and other exchange controls in the past and may do so in the future, which could prevent Ternium from paying dividends or other amounts from cash generated by its Argentine operations.***

In 2001 and 2002 and until February 7, 2003, the Argentine Central Bank restricted Argentine individuals and corporations from transferring U.S. dollars abroad without its prior approval. In 2003 and 2004, the government reduced some of these restrictions, including those requiring the Argentine Central Bank's prior authorization for the transfer of funds abroad in order to pay principal and interest on debt obligations. Nevertheless, significant government controls and restrictions remain in place, and the Argentine government may impose new restrictions on foreign exchange in the future. On June 10, 2005, the Argentine government issued Decree No. 616/2005 establishing certain restrictions on capital inflows into Argentina. The existing controls and restrictions, and any additional restrictions of this kind that may be imposed in the future, could impair Ternium's ability to transfer funds generated by Ternium's Argentine operations in U.S. dollars outside Argentina to fund the payment of dividends or other amounts and to undertake investments and other activities that require payments in U.S. dollars. Furthermore, these restrictions could affect Ternium's ability to finance its investments and operations in Argentina. For additional information on current Argentine exchange controls and restrictions, see Item 10. Additional Information D. Exchange Controls.

In addition, Ternium is currently required to repatriate U.S. dollars collected in connection with exports from Argentina (including U.S. dollars obtained through advance payment and pre-financing facilities) into Argentina and convert them into Argentine pesos at the market-based floating exchange rate applicable on the conversion date. This requirement and any similar requirement that may be imposed in the future, subjects Ternium to the risk of losses arising from an abrupt devaluation of the Argentine peso.

***The Argentine government has increased taxes on Ternium's operations in Argentina and could further increase the fiscal burden on its operations in Argentina in the future.***

Since 1992, the Argentine government has not permitted the application of an inflation adjustment on the value of fixed assets for tax purposes. Since the substantial devaluation of the Argentine peso in 2002, the amounts that the Argentine tax authorities permit Ternium to deduct as depreciation for its past investments in plant, property and equipment have been substantially reduced, resulting in a higher effective income tax charge. In addition, in 2002, the Argentine government imposed a 5% tax on the export of manufactured products. If the Argentine government continues to increase the tax burden on Ternium's operations in Argentina, Ternium's results of operation and financial condition could be adversely affected.

***Restrictions on the supply of energy to Ternium's operations in Argentina could curtail Ternium's production and negatively impact Ternium's results of operations.***

As a result of several years of recession, the forced conversion into Argentine pesos at the one-to-one exchange rate and the subsequent freeze of gas and electricity tariffs, there has been a lack of investment in gas and electricity supply and transport capacity in Argentina in recent years. Over the course of the last several years, demand for natural gas has increased substantially, driven by a recovery in economic conditions and low prices in comparison with alternative fuel sources.

Although the Argentine government is taking a number of measures to alleviate the short-term impact of supply restrictions on residential and industrial users (including measures to limit the growth of residential consumption, to increase the price of compressed natural gas and to import natural gas from Bolivia, electricity from Brazil and Uruguay and fuel oil from Venezuela) and has announced several measures intended to address the situation in the medium- and long-term (including creating a new state-owned energy company to fund, or otherwise promote, investments in expanding existing pipeline transportation capacity and building new pipelines and additional power generation capacity and entering into negotiations with electricity and gas producers) supply restrictions and shortages are likely to continue. Two new power plants are currently under construction, which are expected to increase the system capacity by 8%, if and when they become operative in 2009. If the measures that the Argentine government is taking to alleviate the short-term impact of the crisis prove to be insufficient, or if the investment that is required to increase natural gas generation, energy production and transportation capacity and power generation capacity over the medium- and long-term fails to materialize on a timely basis, Ternium's production in Argentina (or that of its main suppliers), could be curtailed, and Ternium's sales and revenues could

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decline. Although Ternium is taking measures, like the purchase of alternative fuels such as fuel oil, to limit the effect of supply restrictions on its operations in Argentina, such efforts may not be sufficient to avoid any impact on Ternium's production in Argentina (or that of its main suppliers) and Ternium may not be able to similarly limit the effect of future supply restrictions. See Risks Relating to the Steel Industry Price fluctuations or shortages in the supply of raw materials and energy could adversely affect Ternium's profits above.

**Venezuela**

Ternium has manufacturing operations and assets located in Venezuela and a significant portion of its sales are made in Venezuela. Ternium's revenues derived from its Venezuelan operations, therefore, are indirectly related to market conditions in Venezuela and to changes in its GDP and per capita disposable income. Ternium's business could be materially and adversely affected by economic, political and regulatory developments in Venezuela.

***In prior years, events in Venezuela produced significant social and political tensions, which could worsen and have an adverse effect on us.***

Between 2002 and 2004, Venezuela experienced intense political and social turmoil involving groups that opposed and those that supported the administration of President Hugo Chávez. Although the political scene remains divided, President Chávez won the December 2006 presidential elections with 63% of the popular vote and controls all the seats in the National Assembly (formerly the Venezuelan Congress), as well as most state governments, and enjoys broad support. There can be no assurance that the significant domestic instability evident during 2002 through 2004 will not reemerge. Such instability could have a material adverse effect on Venezuela's economic growth and as a result on Sidor (and consequently Ternium's) financial condition and results of operations.

***The Venezuelan government could take measures related to the Venezuelan steel industry in general, or Sidor in particular, that could affect Ternium's operations in Venezuela.***

The Venezuelan government traditionally has exercised, and continues to exercise, significant influence over many other aspects of the Venezuelan economy. Venezuelan governmental actions (including those related to taxes, price and exchange controls and transfer restrictions) have had in the past, and could have in the future, significant effects on the financial condition and results of operations of Venezuelan companies, including Sidor.

On January 31, 2007, the Venezuelan National Assembly passed an enabling law, or the Enabling Law, granting President Chávez the power to govern by decree with the force of law in various matters, including the industrial and energy sectors, for 18 months.

Following the December 2006 elections and the enactment of the Enabling Law, the Venezuelan government threatened expropriations and took a number of significant measures, including the cancellation of mining concessions, the re-nationalization of public utilities, such as CANTV and Electricidad de Caracas, and forced renegotiation of contracts with oil and gas companies. In this context, officials in the Venezuelan administration have made statements about the possibility of Sidor's re-nationalization, without adopting, as of the date of this annual report, a definitive resolution on this matter. If political or economic measures such as expropriation, nationalization, price controls or renegotiation or nullification of contracts (like those for the supply of raw materials or energy) were implemented on or in connection with Sidor, its operations and revenues, and consequently Ternium's financial results, could be adversely affected.

In addition, the Venezuelan government owns a minority stake in Sidor, and, as a minority shareholder, could be able to intervene in Sidor's business. For example, the approval of the Venezuelan government is required for (i) investments worth USD85 million or more, (ii) dispositions of material assets, (iii) guarantees in an amount of USD15 million or more, (iv) related-party transactions other than on an arm's length basis, (v) certain material amendments of Sidor's articles of association. In exercising any such rights, the Venezuelan government could delay the implementation of Ternium's business strategies in Venezuela or otherwise affect Sidor's operations.

Other actions by the Venezuelan government may have an impact on Sidor. For example, the Venezuelan government has announced its decision to finance and form state-controlled industrial companies that could have direct or indirect effect on Sidor, including a plant dedicated to concentration or iron ore mined by the state-owned company Ferrominera del

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Orinoco or FMO, a seamless pipe production facility, an integrated steel production facility and a scrap distribution company. If any of these governmental projects were to be implemented, Sidor's revenues, and consequently Ternium's results, could be affected.

Furthermore, Sidor's operations rely on a number of trade- and services-related contractual relationships with entities owned by the Venezuelan government, including the purchase of iron ore from FMO, the purchase of electricity from Electricidad del Caroní, C.A. ( EDELCA ) and the purchase of natural gas from PDVSA Gas, S.A. ( PDVSA Gas ). Accordingly, Sidor could suffer from any potential increase in the prices of other raw materials or supplies. In 2005, following a public announcement by the Venezuelan government that sought to pressure Sidor to renegotiate the terms of the agreement for the supply of iron ore, as permitted under the contract's hardship provision, on November 11, 2005, Sidor and FMO amended the pricing terms of the contract, increasing its prices payable by Sidor by approximately 9.5%. Any subsequent price increases could affect Sidor's costs and, consequently, Ternium's results of operations. See Risks relating to the steel industry The Ternium companies depend on a limited number of key suppliers. and Item 4. Information on the Company Raw Materials and Energy Venezuela .

While Sidor and the Venezuelan government have engaged in conversations regarding the price and other conditions at which Sidor will supply its domestic market, it is not possible to predict the outcome of such conversations or to determine what effect existing or future government decisions could have on Sidor's current ownership or its business.

***Several measures imposed by the Venezuelan government, such as exchange controls and transfer restrictions, have affected and may further affect the operations of Ternium's subsidiaries in Venezuela and could prevent Ternium from paying dividends or other amounts from cash generated by its Venezuelan operations.***

In February 2003, after a significant devaluation in 2002 and a sharp decline in economic activity, the Venezuelan government and the Central Bank of Venezuela suspended the trading of foreign currencies and adopted a series of exchange regulations that established a new exchange control regime. A new commission, referred to as the *Comisión de Administración de Divisas*, or CADIVI, was created for establishment and administration of the new exchange control regime. Under the new regime, the Ministry of Finance, together with the Central Bank of Venezuela, sets the exchange rate with respect to the U.S. dollar and other currencies and has discretion to modify, at any time, the existing exchange control regime or the free float of the bolívar. The new regime centralizes the purchase and sale of foreign currencies, by permitting such sales to be made only through the Central Bank.

Under current regulations, entities that incur or maintain indebtedness denominated in foreign currencies and wish to obtain U.S. dollars from the Central Bank of Venezuela to pay principal, interest and other amounts in respect of such indebtedness must obtain approval from, and have the indebtedness registered with, CADIVI. In accordance with these regulations, Sidor has registered its external indebtedness and trade account payables. Any modification to the registered use of proceeds at CADIVI will require additional approval. If Sidor fails to obtain any required approvals or to register any debt under these regulations, CADIVI could impose penalties which could negatively affect its business.

In addition to the foregoing approval, Sidor must obtain from CADIVI a separate approval for the purchase from the Central Bank of foreign currency necessary to make payments under their registered indebtedness. These approvals may only be obtained at or around the time each payment becomes due under such indebtedness. Pursuant to the current regulations, CADIVI's approval for the purchase or sale of foreign currency from the Central Bank is subject to the availability of such foreign currency at the time of such request, and any foreign currency obtained may only be utilized for the purposes previously approved by CADIVI. If CADIVI fails to issue such approvals with respect to amounts due under the indebtedness or if Sidor fails to obtain such approval prior to the dates on which such amounts are due and payable, it may not be able to pay its debt under the agreed conditions. Moreover, if timely payments in respect of the indebtedness cannot be made due to delays in obtaining the CADIVI approvals, certain of Sidor's creditors will have the right to accelerate its indebtedness. A delay in payments made to suppliers could also result in requests for additional payment guarantees from Sidor or other assurances of payment, or could otherwise adversely affect Sidor's commercial relationship with suppliers and affect its business opportunities.

## Mexico

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Ternium has significant manufacturing operations and assets located in Mexico and a significant portion of its sales are made in Mexico. Ternium's main revenues derived from its Mexican operations, therefore, are indirectly related to market conditions in Mexico and to changes in its GDP and per capita disposable income. Ternium's business could be materially and adversely affected by economic, political and regulatory developments in Mexico.

### ***Economic conditions and government policies in Mexico could negatively impact Ternium's business and results of operation.***

In the past, Mexico has experienced several periods of slow or negative economic growth, high inflation, high interest rates, currency devaluation and other economic problems. Furthermore, the Mexican national economy tends to reflect changes in the economic environment in the United States. If problems such as deterioration in Mexico's economic conditions, social instability, political unrest, reduction in government spending or other adverse social developments reemerge in the future, they could lead to increased volatility in the foreign exchange and financial markets, and, depending on their severity and duration, could adversely affect the business, results of operations, financial condition, liquidity or prospects of Ternium. For example, adverse economic conditions in Mexico could result in higher interest rates accompanied by reduced opportunities for refunding or refinancing, foreign exchange losses associated with dollar-denominated debt, increased raw materials and operating costs, reduced domestic consumption of Ternium's products, decreased operating results and delays in capital expenditures dependent on U.S. dollar purchases of equipment. Severe devaluation of the Mexican peso may also result in disruption of the international foreign exchange markets, hindering Ternium's ability to convert Mexican pesos into U.S. dollars and other currencies for the purpose of making purchases of raw materials or equipment.

### ***Mexican government policies will likely significantly affect the economy and as a result, Ternium's Mexican operations.***

Future actions of the Mexican government or the effect in Mexico of international events could adversely affect Ternium's results and financial condition. The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy. Mexican government actions concerning the economy could have adverse effects on private sector entities in general and on Ternium in particular. Economic plans of the Mexican government in the past have not always fully achieved their objectives. Beginning in 1994, and continuing through 1995, Mexico experienced an economic crisis characterized by exchange rate instability, a devaluation of the Mexican peso, high inflation, high domestic interest rates, economic contraction, a reduction of international capital flows, reduced consumer purchasing power and high unemployment. In response to the economic crisis, the Mexican government implemented broad economic reform programs, which improved economic conditions until growth declined again in 2001, accompanied by increased inflation rates in 2000, 2001 and 2002. It is not possible to determine what effect existing or future government economic plans or their implementation could have on the Mexican economy or on Ternium's financial condition or results of operations.

## **Certain Regulatory Risks and Litigation Risks**

### ***International trade actions or regulations and trade-related legal proceedings could adversely affect Ternium's sales, revenues and overall business.***

International trade-related legal actions and restrictions pose a constant risk for Ternium's international operations and sales throughout the world. Additionally, increased global trade liberalization, with many countries forming free trade blocs or otherwise reducing restrictions on imported goods, including flat steel products, and persistent excess global steel capacity have increased competition in many markets in which Ternium sells flat steel products. Such risks and increased competition are likely to continue into the foreseeable future.

Increased trade liberalization has reduced certain of Ternium's imported input costs and increased Ternium's access to many foreign markets. However, greater trade liberalization has also increased competition for Ternium in its domestic markets. Consequently, Ternium's domestic market share could be eroded in the face of foreign imports if tariffs and other barriers are reduced or eliminated in Ternium's domestic markets. Ternium's increased exports to foreign markets where

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import barriers have been reduced may not completely offset domestic market share losses resulting from increased foreign competition.

Countries can impose restrictive import duties and other restrictions on imports under various national trade laws. The timing and nature of countries' imposition of trade-related restrictions potentially affecting Ternium's exports are unpredictable. Ternium's international operations are vulnerable to such trade actions or restrictions that surface in any country to which Ternium exports or potentially could export. Trade restrictions on Ternium's exports could adversely affect Ternium's ability to sell products abroad and, as a result, Ternium's profit margins, financial condition and overall business could suffer.

One significant source of trade restrictions results from countries' imposition of so-called antidumping and countervailing duties, as well as safeguard measures. These additional duties can be quite high and, as a result, severely limit or altogether impede an exporter's ability to export to important markets such as the United States of America and Europe. In several of Ternium's major export destinations, such as the United States of America or Europe, safeguard duties and other protective measures have been imposed against a broad array of steel imports in certain periods of excess global production capacity. Furthermore, certain domestic producers have filed antidumping and/or countervailing duty actions against particular steel imports. Some of these actions have led to restrictions on Ternium's exports of certain types of steel products to some steel markets. As domestic producers' filing of such actions is largely unpredictable, additional antidumping, countervailing duty or other such import restrictions could be imposed in the future, limiting Ternium's export sales to and potential growth in those markets. See Item 4.

Information on the Company Regulation Trade regulations.

***Potential environmental, product liability and other claims could create significant liabilities for Ternium that could adversely affect its business, financial condition, results of operations and prospects.***

Some of the activities for which the Ternium companies supply products, such as canning for consumption, construction and the automotive industry are subject to inherent risks that could result in death, personal injury, property damage or environmental pollution. Furthermore, Ternium's products are also sold to, and used in, certain safety-critical appliances. Correspondingly, defects in Ternium's products or an inconsistency with the specifications of an order or the requirements of an application, could result in death, personal injury, property damage, environmental pollution, damage to equipment or disruption to a customer's production lines. Actual or claimed defects in the products of the Ternium companies could give rise to claims against Ternium or its subsidiaries for losses and expose it to claims for damages, including significant consequential damages. In addition, the Ternium companies are subject to a wide range of local, provincial and national laws, regulations, permits and decrees relating to the protection of human health and the environment, and remediation or other environmental claims could be asserted against Ternium. The insurance maintained by Ternium may not be adequate or available to protect it in the event of a claim or its coverage could be canceled or otherwise terminated. A major claim for damages related to products sold could have a material adverse effect on Ternium's business, financial condition, results of operations or prospects.

***Labor regulations in the countries in which Ternium operates could result in higher labor costs and mandatory allowances for employee participation, resulting in lower net income for Ternium.***

Certain legal obligations require Ternium's operating subsidiaries to contribute certain amounts to retirement funds and pension plans and restrict their ability to dismiss employees. The Ternium companies are also subject to other obligations, such as those in Venezuela and Mexico, under which such subsidiaries are required to distribute a percentage of their annual income calculated on a fiscal basis to their employees. In addition, certain Venezuelan courts have recently ruled in favor of an increase in benefits payable to retired employees of other Venezuelan companies. Future regulations or court interpretations established in the countries in which Ternium conducts its operations could increase its costs and reduce net income.

### **Risks Relating to our ADSs**

***The market price for our ADSs could be highly volatile.***

Volatility in the price of our ADSs may be caused by factors outside of our control and may be unrelated or disproportionate to Ternium's operating results. In particular, announcements of potentially adverse developments, such as

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proposed regulatory changes, new government investigations or the commencement or threat of litigation against Ternium, as well as announced changes in Ternium's business plans or those of its competitors could adversely affect the trading price of our ADSs, regardless of the likely outcome of those developments or proceedings. Broad market and industry factors could adversely affect the market price of our ADSs, regardless of its actual operating performance.

Furthermore, the trading price of our ADSs could suffer as a result of developments in emerging markets. Although the Company is organized as a Luxembourg corporation, all of its assets and operations are located in Latin America. Financial and securities markets for companies with a substantial portion of their assets and operations in Latin America are, to varying degrees, influenced by political, economic and market conditions in emerging market countries. Although market conditions are different in each country, investor reaction to developments in one country can have significant effects on the securities of issuers with assets or operations in other emerging markets, including Argentina, Venezuela and Mexico. Prices of Latin American securities were adversely affected by, among other things, the economic crises in Russia and in Brazil in the second half of 1998, by the collapse of the exchange rate regime in Turkey in February 2001 and by the Argentine crisis in 2001.

***In deciding whether to purchase, hold or sell our ADSs, you may not be able to access as much information about us as you would in the case of a U.S. company.***

There may be less publicly available information about us than is regularly published by or about U.S. issuers. Also, Luxembourg regulations governing the securities of Luxembourg companies may not be as extensive as those in effect in the United States, and Luxembourg law and regulations in respect of corporate governance matters might not be as protective of minority shareholders as state corporation laws in the United States. Furthermore, the accounting standards in accordance with which Ternium's consolidated financial statements, as well as the consolidated financial statements of its operating subsidiaries, are prepared differ in certain material aspects from the accounting standards used in the United States.

***Holders of our ADSs may encounter difficulties in the exercise of dividend and voting rights.***

You may encounter difficulties in the exercise of some of your rights with respect to shares if you hold ADSs rather than shares. If we make a distribution in the form of securities, the depositary is allowed, in its discretion, to sell on your behalf those securities and instead distribute the net proceeds to you. Also, under some circumstances, such as our failure to provide the depositary with voting materials on a timely basis, you may not be able to vote by giving instructions to the depositary.

***Holders of our shares and ADSs in the United States may not be able to exercise preemptive rights in certain cases.***

Pursuant to Luxembourg corporate law, existing shareholders of the Company are generally entitled to preemptive subscription rights in the event of capital increases and issues of shares against cash contributions. Under the Company's articles of association, the board of directors has been authorized to waive, limit or suppress such preemptive subscription rights until October 26, 2010. The Company, however, may issue shares without preemptive rights only if the newly-issued shares are issued:

for, within, in conjunction with or related to, an initial public offering of the shares of the Company on one or more regulated markets (in one or more instances);

for consideration other than cash;

upon conversion of convertible bonds or other instruments convertible into shares of the Company; provided, however, that the pre-emptive subscription rights of the then existing shareholders shall apply in connection with any issuance of convertible bonds or other instruments convertible into shares of the Company for cash; and

subject to a certain maximum percentage, as compensation to directors, officers, agents or employees of the Company, its direct or indirect subsidiaries or its affiliates, including without limitation the direct issuance of shares or the issuance of shares upon exercise of options, rights convertible into shares or similar instruments convertible or exchangeable into shares issued or created to provide compensation or incentives to directors, officers, agents or employees of the Company, its direct or indirect subsidiaries or its

affiliates.

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For further details, see Item 10. Additional Information B. Memorandum and Articles of Association.

Furthermore, holders of our shares and ADSs in the United States may, in any event, not be able to exercise any preemptive rights, if granted, for shares unless those shares are registered under the U.S. Securities Act of 1933, as amended (the Securities Act ) with respect to those rights or an exemption from registration is available. We intend to evaluate, at the time of any rights offering, the costs and potential liabilities associated with the exercise by holders of shares and ADSs of the preemptive rights for shares, and any other factors we consider appropriate at the time, and then to make a decision as to whether to register additional shares. We may decide not to register any additional share, requiring a sale by the depositary of the holders' rights and a distribution of the proceeds thereof. Should the depositary not be permitted or otherwise be unable to sell preemptive rights, the rights may be allowed to lapse with no consideration to be received by the holders of the ADSs.

### ***It may be difficult to obtain or enforce judgments against the Company in U.S. courts or courts outside of the United States.***

The Company is a corporation organized under the laws of Luxembourg, and most of its assets are located outside of the United States of America. Furthermore, most of the Company's directors and officers named in this annual report reside outside the United States of America. As a result, investors may not be able to effect service of process within the United States of America upon the Company or its directors or officers or to enforce against the Company or them in U.S. courts judgments predicated upon the civil liability provisions of U.S. federal securities law. There is doubt as to the enforceability in original actions in Luxembourg courts of civil liabilities predicated solely upon U.S. federal securities law, and the enforceability in Luxembourg courts of judgments entered by U.S. courts predicated upon the civil liability provisions of U.S. federal securities law will be subject to compliance with procedural requirements under Luxembourg law, including the condition that the judgment does not violate Luxembourg public policy.

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

### **Overview**

Ternium is one of the leading steel companies in the Americas, with a strategic presence in several major steel markets through a network of distribution, sales and marketing services. We believe Ternium is among the largest producers of crude steel in Latin America, with manufacturing, processing and finishing facilities, which produced nearly ten million tons of crude steel in 2006. The Company believes that it is one of the lowest cost steel producers in the Americas due to its integrated operations, state-of-the-art steel production facilities, access to diversified sources of low-cost raw materials and other production inputs and operating efficiencies.

Ternium produces and distributes a broad range of semi-finished and finished steel products, including value-added steel products such as tinplate, cold rolled coils and sheets, galvanized and electrogalvanized sheets, pre-painted sheets, welded pipes, hot rolled pickled and annealed and tailor-made flat products. Ternium also produces long steel products such as bars and wire rod.

Ternium primarily sells its steel products in the regional markets of North, Central and South America, where its manufacturing facilities are located, allowing it to provide specialized products and delivery services to its clients. We believe that Ternium is the leading supplier of flat steel products in Argentina and of flat and long steel products in Venezuela, a significant competitor in the Mexican market for flat and long steel products, and a competitive player in the international steel market for flat and long steel products. Ternium maintains a strategic presence in other major steel markets, such as Europe and Asia through its network of commercial offices, which allows it to reach clients outside its regional markets and place products in case of slower demand in domestic economies, achieve improved effectiveness in the supply of its products and maintain a fluid commercial relationship with its clients by providing continuous services and assistance.

Approximately 56.4% of Ternium's sales were made to South and Central America, 42.1% to North America and 1.5% to Europe and other markets.



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In 2006, Ternium's net sales were USD6.6 billion, gross profit was USD2,267.6 million, and net income attributable to equity holders was USD795.4 million, which amounts reflect the consolidation of all the subsidiaries for the full fiscal year.

### **A. History and Corporate Organization**

The Company's legal and commercial name is Ternium S.A. The Company was organized as a joint stock corporation (*société anonyme* holding) in the Grand Duchy of Luxembourg on December 22, 2003. Our registered office is located at 46a, Avenue John F. Kennedy 2nd floor, L-1855 Luxembourg and our telephone number is +352 2668 31 52. Its agent for U.S. federal securities law purposes is Ternium International Corp., located at 2200 West Loop South, 7<sup>th</sup> floor, Houston, TX 77027.

As a part of a multiple-step corporate reorganization in 2005, San Faustin reorganized its investments in flat and long steel manufacturing, processing and distribution businesses by contributing its controlling interests in Siderar, Sidor (through Amazonia and Ylopa) and Ternium Internacional to the Company.

On August 22, 2005, we acquired, together with Siderar, an indirect 99.3% interest in the Mexican company Hylsamex and its subsidiaries and the equity stakes owned by Hylsamex's former controlling shareholder, Alfa, S.A. de C.V., or Alfa, in Amazonia and Ylopa. We subsequently purchased additional shares of Hylsamex in the open market, subject to applicable law, thereby increasing our and Siderar's indirect interest in Hylsamex to 99.8%.

On September 9, 2005, Tenaris exchanged with ISL its 21.2% interest in Amazonia and its 24.4% interest in Ylopa for shares of the Company, and on October 27, 2005, Usiminas Europa A/S, a Danish wholly owned subsidiary of Usiminas, assigned and contributed to the Company all of its assets (then including a 5.3% interest in Siderar, a 16.6% interest in Amazonia and a 19.1% interest in Ylopa) and liabilities in exchange for shares of the Company.

Similarly, on November 17, 2005, Siderúrgica del Turbio S.A. SIDETUR ( Sidetur ), a subsidiary of Siderúrgica Venezolana SIVENSA, S.A. ( Sivensa ), exchanged with ISL its 3.4% interest in Amazonia for shares of the Company. As a result of the foregoing transactions, as of December 31, 2005, the Company owned a 56.07% interest in Siderar, a 59.73% interest in Sidor (through Amazonia and Ylopa), a 99.8% in Hylsamex and a 100% interest in Ternium Internacional.

On January 11, 2006 the Company launched an initial public offering of 24,844,720 American Depositary Shares, each representing 10 shares of the Company (each an ADS), in the United States. In connection with the offering, the Company granted the underwriters of the Company's initial public offering an option to purchase up to 3,726,708 additional ADSs to cover over-allotments in the sale of the ADSs. The offering was settled on February 6, 2006.

On December 28, 2006, we acquired an additional 4.85% interest in Siderar from CVRD Internacional S.A., a wholly-owned subsidiary of Companhia Vale do Rio Doce ( CVRD ), thereby increasing our ownership in Siderar to 60.93%.

On April 29, 2007, we entered into a definitive agreement pursuant to which, Ternium, or any of its subsidiaries, is expected to obtain control over Grupo Imsa, a steel manufacturer with operations in Mexico, United States and Guatemala. The transaction is subject to Mexican and U.S. antitrust clearances and other customary conditions, and is expected to close in the third quarter of 2007. For more information, see Item 5.

Operating and Financial Review and Prospects G. Recent Developments (a) Agreement to obtain control over Grupo Imsa .

### **B. Business Overview**

#### **Our Business Strategy**

Our main strategic objective is to enhance shareholder value by strengthening Ternium's position as a low cost producer of steel products in a manner consistent with minority shareholder rights, while further consolidating Ternium's position as a leading flat and long steel producer in Latin America and a strong competitor in the Americas with strategic presence in several other major steel markets.

The main elements of this strategy are:

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***Further integrate Ternium's operations.*** We have changed our functional organization from three independent companies to one company organized under business units with specific functional responsibilities, and if we consummate the Grupo Imsa transaction referred to elsewhere in this annual report, we expect to integrate Grupo Imsa into that functional organization. Integrating the operations of our subsidiaries has allowed Ternium to better serve its clients, to increase the diversification of its products, to benefit from enhanced flexibility and operative synergies and to rationalize its cost structure;

***Enhance Ternium's position as a low cost producer.*** We believe that further integration of Ternium's operating facilities should improve utilization levels of its plants, increase efficiency and further reduce production costs from levels that we already consider to be among the most competitive in the steel industry;

***Implementing Ternium's best practices.*** We believe that the implementation of Ternium's commercial and production best practices in acquired new businesses should generate additional benefits and savings. For example, the implementation of Ternium's cost control procedures and performance analysis in Hylsamex improved control over its production variables and led to higher cost savings;

***Focus on higher margin value-added products.*** We intend to continue to shift Ternium's sales mix towards higher margin value-added products, such as cold rolled sheets and coated and tailor-made products, and services, such as just-in-time delivery and inventory management. In this regard, the Hylsamex acquisition in 2005 allowed Ternium to expand its offerings of value-added products, such as galvanized products and panels, and the Grupo Imsa transaction referred to elsewhere in this annual report, if and when consummated, is expected to expand our offerings of flat and value-added products such as galvanized products;

***Maximize the benefits arising from Ternium's broad distribution network.*** We intend to maximize the benefits arising from Ternium's broad network of distribution, sales and marketing services to reach clients in major steel markets with a comprehensive range of value-added products and services and to continue to expand its customer base and improve its product mix. For example, the acquisition of Hylsamex allowed us to increase Ternium's participation in the North American market; and the Grupo Imsa transaction referred to elsewhere in this annual report, if and when consummated, is expected further to increase that participation; and

***Pursue strategic growth opportunities.*** San Faustin has a history of strategically growing its businesses through acquisitions. In addition to strongly pursuing organic growth, we intend to identify and pursue growth-enhancing strategic opportunities to consolidate Ternium's presence in its markets, expand its offerings of value-added products and increase its distribution capabilities. On April 29, 2007, we entered into a definitive agreement with Grupo Imsa, a steel manufacturer with operations in Mexico, United States and Guatemala. Pursuant to this transaction, Ternium, or any of its subsidiaries, is expected to obtain control over Grupo Imsa. The transaction is subject to Mexican and U.S. antitrust clearances and other customary conditions, and is expected to close in the third quarter of 2007. For more information, see Item 5. Operating and Financial Review and Prospects G. Recent Developments (a) Agreement to obtain control over Grupo Imsa .

### **Our Competitive Strengths**

We believe that the following competitive strengths distinguish Ternium from its competitors and enhance its leading market position:

***State-of-the-art, low cost producer.*** The combination of a portfolio of state-of-the-art, low cost steel production mills (some of which are located near proprietary iron ore mines), access to diversified sources of low-cost raw materials and cost-competitive energy and labor sources and other production inputs and operating efficiencies makes Ternium a low cost producer of steel and value-added products;

***Strong market position and extensive market reach.*** Ternium has leading market participation in Argentina and Venezuela and has a strong market position in Mexico. The location of its production facilities gives Ternium favorable access to some of the most

important regional markets in the Americas, including the North American

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Free Trade Agreement, or NAFTA, *Mercado Común del Sur*, or Mercosur, and the *Comunidad Andina de Naciones*, or Andean Community;

***Experienced and committed management team.*** Our management team has extensive experience in, and knowledge of, the steel industry, which enhances Ternium's reputation in the global steel markets. A large percentage of our senior managers have spent their entire careers working within the steel businesses of San Faustin and its affiliates. Our management team has substantial experience in increasing productivity and reducing costs, as well as in identifying, evaluating and pursuing growth opportunities and integrating acquisitions; and

***Strong financial position.*** We believe that, since the completion of our initial public offering in February 2006, Ternium has maintained a solid financial position. In particular, our relatively low debt to equity capital structure, together with our strong cash flow generation, provides us with the flexibility and resources to enhance existing businesses through investment projects and to make strategic investments and acquisitions.

### **Our Products**

The Ternium companies produce mainly finished and semi-finished flat and long steel products which are sold either directly to steel processors or to end-users, after different value-adding processes. Flat steel products include hot rolled coils and sheets, cold rolled coils and sheets, tin plate, hot dipped galvanized and electrogalvanized sheets and pre-painted sheets. Galvanized and pre-painted sheets can be further processed into a variety of corrugated sheets, trapezoidal sheets, corrugated and galvanized steel guard rails and drains and other tailor-made products to serve its customers' requirements. Long steel products include billets (steel in its basic, semi-finished state), wire rod and bars.

#### ***Flat steel products***

***Slabs:*** Slabs are semi-finished steel forms that are used as inputs for the production of flat steel products such as hot rolled coils, cold rolled coils, and the coated and tailor-made products described below. A slab is different from a billet (the semi-finished product used for long steel production) mainly in its dimensions. Both slabs and billets are generally continually casted. The use of slabs is determined by its dimensions and by its chemical and metallurgical characteristics.

***Hot rolled products:*** Hot rolled products are used by a variety of industrial consumers in applications such as the manufacturing of wheels, auto parts, pipes, gas cylinders and containers. They are also directly used for the construction of buildings, bridges and railroad cars, and for the chassis of trucks and automobiles. Hot rolled products can be supplied as coils or as sheets cut to a specific length. These products also serve as inputs for the production of cold rolled products.

***Cold rolled products:*** Cold rolled products are applied mainly to the automotive, home appliance and capital goods industries, as well as to galvanizers, drummers, distributors and service centers. Cold rolled coils are sold as coils or cut into sheets or blanks to meet customers' needs.

***Tin plate and tin free:*** Given its resistance to corrosion and its mechanical and chemical characteristics, tin plate is mainly sold to the packaging industry for food canning, sprays and paint containers. Tin plate and tin free are produced by coating cold rolled coils with a layer of tin and thin chrome, respectively, that is attached by an electroplating continuous process.

***Hot dipped galvanized and pre-painted sheets:*** The construction industry is the main market for hot dipped galvanized products. Hot dipped galvanized sheets are produced by adding a layer of zinc to cold rolled coils, which are afterwards cut into sheets. Galvanized sheets can also be pre-painted, resulting in a product that is mainly sold to the construction industry for building coverings, manufacturing of ceiling systems, panels, air conditioning ducts and several other uses. Ternium also offers a distinctive type of galvanized product with the trademark CINCALUM. This product is manufactured by adding layers of zinc and aluminum to cold rolled coils that improve product performance for construction industry, including rural, industrial and marine sites.

***Electrogalvanized and pre-painted sheets:*** Electro-galvanized and pre-painted sheets are sold not only to customers in the automotive and home appliance industries, but also to clients working in the construction of road-defenses, sewage systems, bridges and other infrastructure projects. Electro-galvanized and pre-painted sheets are produced from cold rolled coils by adding a layer of zinc that is attached by an electroplating continuous process, in one or both sides. The electro-galvanized



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coils are subsequently cut and sold either as sheets or are further processed with a color coating to produce pre-painted sheets. Electro-galvanization provides products with a longer useful life and more resistance to corrosion.

### ***Long steel products***

**Steel billets:** Billets are semi-finished steel forms that are used as inputs in the production of long steel products such as bars, channels or other structural shapes. A billet is different from a slab mainly in its dimensions. Both billets and slabs are generally cast using the continuous casting method.

**Wire rod:** Rods are round, thin, semi-finished steel products that are rolled from a billet and coiled for further processing. Rods are commonly drawn into wire products or used to make bolts and nails. Wire rod can be produced in different qualities according to clients' demands.

**Bars:** Bars are long steel products that are rolled from billets. Two of the most common types of bars produced are merchant bars and reinforcing bars (rebar). Merchant bars include specific shape features such as rounds, flats, angles, squares and channels that are used by clients to manufacture a wide variety of products such as furniture, stair railings and farm equipment. Rebar is used to strengthen concrete highways, bridges and buildings.

### ***Other products***

**Steel pipes and tubular products:** Welded steel pipe is typically used for the transport of water, air, gas and other liquids. Tubular products include galvanized pipes for liquid conduction, structural and industrial applications and light structural shapes which can be used for a variety of applications, including the transport of other forms of gas and liquids under high pressure, pipe for electrical cable conduits and also for oil and gas applications.

We also produce pig iron and pellets.

Within each of the basic product categories there is a range of different items of varying qualities and prices that are produced either to meet the particular requirements of end users or sold as commodity items.

## **Production Process and Facilities**

Ternium operates state-of-the-art steelmaking facilities. We consider Ternium to be among the lowest cost producers in the Americas, as a result of:

strategically located plants;

favorable access to raw materials, some purchased under long-term contracts and others available at proprietary mines, and access to cost competitive energy and labor sources;

operating history of almost 40 years, which translates into solid industrial know-how;

constant benchmarking and best-practices sharing among the different facilities; and

intensive use of information technology in its production processes.

Our main steel production facilities are located in Argentina, Venezuela and Mexico. If and when we consummate the Grupo Imsa transaction referred to elsewhere in this annual report, we will add production facilities in Mexico, the United States and Guatemala. The following map shows Ternium's manufacturing centers and commercial network offices around the world as of the date of this annual report.



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Ternium's aggregate production capacity of hot rolled steel products for the year ended December 31, 2006 was 8.1 million tons. Ternium's aggregate production capacity of long steel products (wire rod and rebar) was 2.1 million tons for the same year. In this annual report, annual production capacity is calculated based on standard productivity, estimated product mix allocations and considering the maximum number of possible working shifts and a continued flow of supplies to the production process.

***Argentina***

Ternium's subsidiary Siderar is located in Argentina and conducts its operations through production facilities at the five locations described below. Each facility is owned by Siderar and located in the Province of Buenos Aires, Argentina.

The following table presents the annual production capacity of the major operational units of the facilities located in Argentina as of December 31, 2006, the year in which operations started for the relevant units and the year of the last major overhaul:

|                          | Capacity<br>( <i>Thousand tpy</i> ) | Start year                               | Year of last<br>major overhaul           |
|--------------------------|-------------------------------------|--|--|
| Coke Plants              | 1,070                               | 1974                                     | 1996                                     |
| Sinter Plant             | 1,430                               | 1972                                     | 2006                                     |
| Blast Furnace No. 1      | 1,340                               | 1960                                     | 2006                                     |
| Blast Furnace No. 2      | 2,260                               | 1974                                     | 1995                                     |
| Continuous Casting       | 2,850                               | 1984                                     | 2003                                     |
| Hot Rolling Mills        | 2,750                               | 1962                                     | 2006                                     |
| Cold Rolling Mills       | 1,610                               | 1962 <sup>(1)</sup> /1969 <sup>(2)</sup> | 1998 <sup>(1)</sup> /1998 <sup>(2)</sup> |
| Tinning Mills            | 160                                 | 1966                                     | 2003                                     |
| Galvanizing Mills        | 530                                 | 1970 <sup>(3)</sup> /1976 <sup>(4)</sup> | 1998 <sup>(3)</sup> /2002 <sup>(4)</sup> |
| Electro-galvanizing Mill | 120                                 | 1993                                     | 2006                                     |
| Painting Facilities      | 65                                  | 1982                                     | 2000                                     |



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- (1) Ramallo
- (2) Ensenada
- (3) Haedo
- (4) Canning

**Ramallo.** Our principal manufacturing facility in Argentina is a fully integrated, strategically located plant on the banks of the Paraná River near the town of San Nicolás in the district of Ramallo, which is approximately 280 kilometers north of the city of Buenos Aires. This plant was acquired in the privatization of the state-owned company Somisa in 1992. The Ramallo facility produces all of Siderar's crude steel and has an effective annual production capacity of 2.8 million tons per year ( tpy ). The Ramallo facility includes:

two coke oven plants, one composed of two compound coke batteries, with a total of 80 ovens and the other with one battery of 45 ovens. The coke ovens have an aggregate capacity of 1.1 million tpy;

a continuous feed sinter plant with a total capacity of 1.4 million tpy;

two blast furnaces: No. 2 with a total capacity of 2.3 million tpy and No. 1 with a capacity of 1.3 million tpy. Blast Furnace No. 1 was fired up in October 2004, after 9 years of inactivity, to cover the production requirements of the steel complex during the relining of Blast Furnace No. 2;

a steel making plant, with three 200-ton basic oxygen converters, a ladle furnace and one two-strand slab continuous casting machine with a capacity of 2.8 million tpy;

a hot rolling mill, comprised of an 11-stand continuous wide hot strip roller with a total capacity of 2.75 million tpy;

a cold rolling mill, with a pickling line, a four-stand tandem cold reduction line with a capacity of 0.6 million tpy, an electrolytic cleaning line, two annealing bays, and two temper/skin pass lines;

an electrolytic tinning mill with a total capacity of 160 thousand tpy;

two service centers: one for tin plated products, with a current capacity of 155 thousand tpy and another for hot rolled product with a capacity of 130 thousand tpy;

a 27 foot deep, two-dock port on the Paraná river used for the reception of raw materials (mainly iron ore and coal) and for the shipment of finished products; and

auxiliary services such as a thermo-electric plant, an oxygen, nitrogen and argon gas-separation plant, lime kilns, a maintenance shop and computer and training centers.

**Ensenada.** The Ensenada plant has a capacity of up to 1.0 million tpy of cold rolled uncoated sheets and coils. The hot rolled coils it uses come from the Ramallo facility, located at a distance of 330 kilometers by land and approximately 300 kilometers by river. The plant is located on the bank of the River Plate at Ensenada, approximately 70 kilometers south of Buenos Aires. The facility includes:

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a cold rolling mill with a pickling line, a four-stand tandem cold reduction line, an annealing line, a one-stand temper/skin pass line, one tension flattening line and one inspection line for sheet and coil; and

a private port with one freight platform of 150 meters capable of unloading vessels of up to 35 thousand tons and other auxiliary installations for maintenance and administrative activities.

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***Florencio Varela.*** This facility is located in Florencio Varela, 30 kilometers south of Buenos Aires at a distance of 35 kilometers and 295 kilometers from Ensenada and Ramallo, respectively. This plant receives cold rolled coils from Ensenada and Ramallo as raw material for its own processes. The facility in this location includes:

Sidercolor, which is an electrolytic galvanizing plant with a capacity of 120 thousand tpy of electrogalvanized sheet and includes one soluble anode electrolytic galvanizing line, one cut-to-length line and auxiliary installations.

two service centers that produce blanks, skelp and sheets, which are customized steel shapes cut from flat steel products for use by customers in the manufacture of finished products. Ternium's production of customized products enables its customers to shorten their lead time for their own production. The service centers have a production capacity of 290 thousand tpy of blanks and customized products and operate cut-to-length lines, a flattening line, a slitting line and a packaging line for sheet and auxiliary installations comprised of a maintenance shop and an office building.

***Haedo.*** The Haedo plant is located at a distance of 90 kilometers from the Ensenada facility and 270 kilometers from Ramallo. Crude cold rolled sheets used at the plant are received from the Ramallo and Ensenada facilities. The Haedo plant includes a continuous hot dipped galvanizing line with a capacity of 180 thousand tpy of coated sheets. The facility also operates a cut-to-length line, four shapers and five presses. In addition, its auxiliary installations include a maintenance shop, a laboratory and an office building.

***Canning (formerly Comesi).*** This facility is located in Canning, approximately 40 kilometers south of the city of Buenos Aires. This facility includes:

a galvanizing line with a capacity of 350 thousand tpy used for the production of hot dipped galvanized steel and products under the trademark CINCALUM.

a continuous painting line for coils with a capacity of 65 thousand tpy fully dedicated to the construction and home appliance markets.

a cut-to-length line and corrugating machines for the production of a variety of corrugated products.

***Rosario (formerly Laminfer).*** This facility is located in Rosario, Santa Fe province, approximately 300 kilometers north of the city of Buenos Aires. This facility provides steel tubes welded by electrical resistance with a capacity of 95 thousand tpy for structural used.

***San Luis (formerly Impeco).*** This facility is located in San Luis, San Luis province approximately 800 kilometers north west of the city of Buenos Aires. This facility provides steel tubes welded by electrical resistance with a capacity of 45 thousand tpy for structural used.

### ***Venezuela***

Sidor is Ternium's Venezuelan integrated steel manufacturing complex with flat and long steel production capabilities. It is located close to the city of Puerto Ordaz, in the industrial zone of Matanzas on the banks of the Orinoco River. This prime location connects the facilities directly to the Atlantic Ocean.

The following table presents the annual production capacity of the major operational units of the complex located in Venezuela as of December 31, 2006, the year in which operations started for the relevant units and the year of the last major overhaul:

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|                        | Capacity<br>(Thousand tpy) | Start year                    | Year of last<br>major overhaul |
|------------------------|----------------------------|-------------------------------|--------------------------------|
| Pelletizing Plant      | 8,000                      | 1979                          | 2004                           |
| Direct Reduction Plant | 4,800                      | 1976/1978/1980 <sup>(1)</sup> | 2006                           |
| Slabs Steel Shop       | 3,600                      | 1978                          | 2004                           |
| Hot Rolling Mills      | 2,800                      | 1973                          | 2005                           |
| Cold Rolling Mills     | 1,700                      | 1974                          | 2005                           |
| Tinning Mills          | 200                        | 1973                          | 2005                           |
| Billets Steel Shop     | 1,400                      | 1979                          | 2003                           |
| Wire Rod               | 600                        | 1979                          | 2004                           |
| Bar Mill               | 460                        | 1979                          | 2000                           |

(1) The three years correspond to the start years of the three direct reduction modules. The complex includes:

a pellet plant that produces pellets used as raw materials in the production of direct reduction iron, or DRI, with a total capacity of 8.0 million tpy;

three types of direct reduction technologies to produce DRI: a continuous bed reduction technique using Midrex I (1.1 million tpy) and Midrex II (3.0 million tpy) technologies with an aggregate production capacity of 4.1 million tpy; and one fixed bed reduction technique using HYL II technology with a total production capacity of 0.7 million tpy;

a steel making plant, that comprises four 200-ton electric arc furnaces, two 190-ton electric arc furnaces for secondary metallurgy and three two-strand continuous slab casting machines with a capacity of 3.6 million tpy;

a hot rolling mill, that comprises a six-strand continuous hot strip roller with a capacity of 2.8 million tpy;

a cold rolling mill with a capacity of 1.7 million tpy, with two pickling lines, one electrolytic cleaning line, two five-stand tandem cold reduction lines, two annealing bays, three temper/skin pass scissors lines and finishing lines;

facilities for the production of billets that include two 150-ton electric arc furnaces and two six-stand continuous billets casting machines with a capacity of 1.4 million tpy;

facilities for the production of wire rod, that comprise an eight-stand rolling mill with two lines and finishing rolling facilities with a capacity of 0.6 million tpy;

facilities for the productions of bars that comprise a finishing four-stand rolling line with a capacity of 0.46 million tpy; and

a port located on the Orinoco River, 195 miles from the Atlantic Ocean, that operates 11 cranes for the loading and unloading of finished products and raw materials, respectively. The dock is 1,037 meters long and allows the docking of six ships of up to 20 thousand tons.

**Mexico**

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Ternium conducts operations through facilities located in the Mexican cities of Monterrey, Apodaca and Puebla. Furthermore, Ternium sources all of the iron ore used in its Mexican facilities from its mines located in Colima and Michoacán, and refines that iron ore into DRI using proprietary technology. If and when we consummate the Grupo Imsa transaction referred to elsewhere in this annual report, we will add additional production facilities in Mexico.

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**Monterrey.** Ternium's facilities at San Nicolás de los Garza, located in Monterrey's metropolitan area, include:

a steel making plant that comprises two electric arc furnaces, two ladle furnaces, two thin-slab continuous casters and a hot rolling mill (Mill No. 2);

a hot rolling mill (Mill No. 1);

two DRI facilities: one adjacent to Mill No. 2 that includes the latest DRI HYL® technology advances, such as Hytemp®, which permits the hot discharge of the DRI to the electric arc furnace generating significant energy savings and improving productivity;

two pickling lines, four reversing cold mills, annealing ovens, two temper mills, a skin-pass mill and tension leveling equipment, each of which is shared by both mills;

three galvanizing lines with a total annual capacity of 500,000 tons;

three painting lines with a total annual capacity of 300,000 tons;

ten tubing mills with an annual capacity of 290,000 tons;

three panel lines with a total annual capacity of 2.5 million square meters; and

a steel service center that produces a variety of specialized products, with a total annual capacity of 544,000 tons.

The following table summarizes the annual production capacity as of December 31, 2006 (which does not represent the combined capacity of all the lines operating simultaneously) for the different flat steel production lines at the Monterrey facilities:

| Facility                           | Product                               | Capacity<br>(Thousands tpy) |
|------------------------------------|---------------------------------------|-----------------------------|
| Direct Reduction Plants            | DRI                                   | 1,620                       |
| Mill No. 1 Hot Rolling Mill        | Hot rolled coils                      | 650                         |
| Mill No. 2 Continuous Casting Mill | Hot rolled coils, ultra-thin hot band | 1,850                       |
| 4 Cold Mills                       | Cold rolled coils                     | 790                         |
| 3 Galvanizing Lines                | Galvanized and coated sheets          | 510                         |
| 3 Painting Lines                   | Pre-painted sheets                    | 240                         |
| 10 Tubing Mills                    | Thin tubing                           | 320                         |
| 3 Panel Lines                      | Insulated steel panels                | 2,500 <sup>(1)</sup>        |

(1) Measured in square meters.

The primary raw materials required for the Monterrey facilities' production of steel include DRI, which Ternium produces in its own direct reduction facilities, and/or other iron material in combination with steel scrap that Ternium buys in the domestic or international markets. Ternium's materials procurement policy is described in greater depth in the section entitled "Raw Materials and Energy."

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Next to Ternium's Monterrey facilities is the Acerex service center dedicated to processing steel to produce slitted and cut to length products in various widths and lengths. Acerex has a total annual capacity of 544 thousand tons. Acerex was a joint venture and in April 2006, Ternium acquired (through its subsidiary Hylsa) the remaining 50% ownership interest. Hylsamex (through its subsidiary Hylsa) owns 100% of Acerex. Acerex functions as a cutting and processing plant for Ternium's Mexican operations and an independent processor for other entities.

***The North Plant Apodaca.*** Located in Apodaca, Nuevo León (near Monterrey, Mexico), the North Plant is dedicated exclusively to the production of rebar. This plant uses 100% steel scrap as metallic input for its operations, and includes an

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electric arc furnace, a continuous caster, a reheating furnace and a rolling mill. Installed production capacities for the different production lines of the North Plant are set forth in the following table:

| Facility            | Product | Capacity<br>(Thousands tpy) |
|---------------------|---------|-----------------------------|
| Billets Steel Plant | Billet  | 580                         |
| Rolling Mill        | Rebar   | 460                         |

**The Puebla Plant Xoxtla.** Located in Xoxtla, Puebla (120 km from Mexico City), the Puebla Plant produces both rebar and wire rod, including high-carbon, low-carbon and micro-alloyed wire rod. The Puebla Plant has a direct reduction facility to produce DRI, one electric arc furnace, a ladle furnace, a vacuum degassing station, one continuous caster, a reheating furnace and rolling and finishing mills. Installed production capacities for the different production lines of the Puebla Plant are set forth in the following table:

| Facility               | Product            | Capacity<br>(Thousands tpy) |
|------------------------|--------------------|-----------------------------|
| Direct Reduction Plant | DRI                | 840                         |
| Billets Steel Plant    | Billet             | 760                         |
| Rolling Mill           | Rebar and wire rod | 580                         |

**Las Encinas mines.** Las Encinas is composed of three separate iron ore mines: Aquila and Cerro Náhuatl, which are in operation and El Encino, which is currently idle. All of them are located near its pelletizing plant, in the Mexican State of Colima, with a maximum annual capacity of 1.8 million metric tons.

*Aquila* is an open-pit mine in Michoacán, Mexico, which began operations in 1998 and is the largest mine at the Las Encinas site. *Aquila* has the highest percentage of iron content among the Las Encinas mines, and has the option of producing raw iron ore lump that can be used directly in the DRI plants mixed with pellets. Ore mined at *Aquila* is transported to the pelletizing facility by rail and truck.

*Cerro Náhuatl* is an open-pit mine in Colima, Mexico, which began operations in 1988. *Cerro Náhuatl* has the lowest percentage of iron content among all of Ternium's mines at Las Encinas, and therefore has the lowest ore processing efficiency. Ore mined at *Cerro Náhuatl* is transported to Ternium's pelletizing facility through a seven kilometer slurry pipe and then 42 kilometers by rail.

*El Encino* is an underground mine in Jalisco, Mexico, which began operations in 1998 and is not currently in use, as the *Aquila* mine is a less expensive option for supplying iron ore. An open-pit mine called *El Encino* was previously operated on the same site from 1970 to 1998. Ore mined at *El Encino* is shipped to the pelletizing facility by gondola cable cars.

Ternium's mining operations at Las Encinas are flexible, giving Ternium the ability to halt production at one or more of its mines from month to month depending on market conditions. Annual production capacities for the different production lines of the Las Encinas mines are set forth in the following table:

| Facility            | Product      | Capacity<br>(Thousands tpy) |
|---------------------|--------------|-----------------------------|
| Crushing Plant      | Crushed ore  | 4,800                       |
| Concentration Plant | Concentrated | 1,920                       |
| Pelletizing Plant   | Pellet       | 1,900                       |

For further information please refer to [Production Process Mexico](#).





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**Peña Colorada mine.** The Peña Colorada mine consists of a single large mining site located in Minatitlán, Colima, Mexico. The mine is an open-pit mine which began operations in 1975, and has a production capacity of 8.5 million tons of crushed iron ore per year. There is one pelletizing plant serving the Peña Colorada mine, with a total installed production capacity of 4.0 million tons of iron ore pellets per year plus and additional 0.4 million tons per year of pellet feed. Peña Colorada has convenient access to seaport and railroad facilities that enables the distribution of the iron ore pellets to the domestic and international markets.

Peña Colorada is operated by Consorcio Minero Benito Juárez Peña Colorada, S.A. de C.V., which has two shareholders Hylsamex and Mittal Steel Lazaro Cárdenas ( MSLC ), a subsidiary of the Mittal Steel group. Through Hylsamex, Ternium holds 50% plus one share of Peña Colorada and MSLC holds the remainder. Hylsamex purchases one half of the mine's production. See Raw Materials and Energy Mexico Iron ore. Annual production capacities for the different production lines of the Peña Colorada mine are set forth in the following table:

| Facility            | Product      | Capacity<br>(Thousands tpy) |
|---------------------|--------------|-----------------------------|
| Crushing Plant      | Crushed ore  | 8,500                       |
| Concentration Plant | Concentrated | 4,400                       |
| Pelletizing Plant   | Pellet       | 4,000                       |

For further information please refer to Production Process Mexico.

**Production process**

Ternium specializes in manufacturing and processing flat and long steel products. In the case of flat products, slabs are reheated and taken to rolling temperature. This treatment removes minor superficial defects and softens the steel to permit its transformation in the hot rolling mill to defined specifications. Hot rolled coils and sheets can be processed with or without scaling, according to the clients' uses and needs.

Hot rolled products can also be put under a deformation process at normal temperature (cold rolling) to reduce their thickness and obtain cold rolled products. These products can be sold in crude form to the market (full hard) or processed in the reheating ovens, annealing bays and tempers lines, to modify their metallurgic and geometric characteristics. The tempered products can be sold as coils or sheets or processed with chromium or tin coverings.

In the production of long products, billets are reheated and taken to rolling temperature. As in the case of slabs, this treatment removes minor superficial defects and softens the steel to permit its transformation in the rolling trains to obtain wire rods and bars as final products.

The production processes in Ternium's facilities in Argentina, Venezuela and Mexico differ in certain respects. We include a brief description of the different processes below.

**Argentina**

Ternium's Argentine subsidiary, Siderar, is the primary integrated manufacturer of flat steel products in Argentina. Siderar produces crude steel through the use of blast furnaces, which are large chambers lined with refractory bricks used to make pig iron through the melting of pellets, sinter (a mixture of iron ore and limestone) and coke. The molten pig iron is then mixed with steel scrap and limestone in a basic oxygen furnace through a process that removes impurities from the pig iron by injecting pure oxygen at high pressure into the molten metal, burning-off carbon and other elements. The molten steel is then cast using the continuous casting method into slabs. The steel slabs are then sent to a hot rolling mill to be reheated and rolled into hot rolled coils.

Depending on its final use, the hot rolled coil is then scaled, tempered and pickled, before being sent for sale as coil or cut into steel sheet. Alternatively, the hot rolled coils may be sent to a cold rolling mill for use as an input in the production of

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cold rolled coils. In certain cases, cold rolled coils are processed in an electrolytic cleaning line, an annealing line and a two-stand temper mill to produce thin steel used to produce tin plate.

Cold rolled coils can be further processed into galvanized or electro galvanized sheets (by adding a thin layer of zinc to the products through different processes), tin plate (by adding a thin layer of tin) or pre-painted products. Siderar can also process its production into cut-to-length and tailor made products according to its customers' needs.

### ***Venezuela***

In Venezuela, Ternium's subsidiary Sidor manufactures a wide variety of steel products ranging from semi-finished products such as slabs and billets to finished products such as hot, cold and coated flat products and wire rod and bar long products.

Sidor produces steel through the direct reduction of iron ore, and the use of electric arc furnaces that are complemented by secondary metallurgy equipment to assure product quality.

The first step of the production process is the agglomeration of iron ore minerals in the pellet plant. The pellets obtained are further processed in the direct reduction furnaces, to obtain DRI that can be used as raw material in the electric arc furnaces to produce steel.

The resulting molten steel, which is obtained using primarily DRI, has a high quality and low content of residues and impurities. The molten steel is then refined in the secondary metallurgic facilities, where it is mixed with ferroalloys. The steel is afterwards casted into semi-finished products (slabs or billets) that are destined for the production of flat or long products, respectively.

### ***Mexico***

In Mexico, Ternium's subsidiary Hylsamex manufactures a variety of steel products, including hot rolled coils and sheets, cold rolled coils and sheets, rebar and wire rod, tubular products, such as welded pipes, and processed steel products including galvanized steel, pre-painted steel, mechanical tubular products and insulated panels.

The production process begins with the sourcing of iron ore from Ternium's own mines in Mexico. The extraction consists of drilling, loading and transporting the iron ore to a grinding facility in order to reduce it to a specified size and quality through the grinding process and the separation of ore with low iron content.

The ore is then shipped to the pelletizing plant, where is gradually fed into a grinding mill to be reduced to a certain size. After grinding, the ore goes through magnetic drums that separate the iron from the sterile material. The grinding and concentration processes are repeated two more times in order to eliminate all the possible sterile material, concentrate the iron to obtain a pellet with high iron content. These processes are carried out using water as an auxiliary element. Excess water is afterwards eliminated, leaving only the necessary humidity for the formation of pellets using pelletizing disks. Pellets are separated according to their size and are then hardened in ovens. The processed pellets are then shipped to the steel producing facilities for the DRI process. Next, the electric arc furnaces melt a combination of steel scrap and DRI to produce liquid steel.

For flat products, molten steel is casted into slabs using state-of-the-art technology that produces thin slabs, which then are rolled into hot and cold rolled coils. The steel is then further processed to higher value-added products such as galvanized and prepainted steels, as well as tubing, insulated panels and architectural panels, etc.

Finally, for long products, molten steel is cast into steel billets that are rolled into rebar and wire rod, such as tire cord and cold heading qualities.

One of Monterrey's DRI plants includes the latest DRI HYE<sup>®</sup> technological advances, such as Hytemp<sup>®</sup>, which permits the hot discharge of the DRI to the electric arc furnace generating significant energy savings and improving productivity. The use of state-of-the-art proprietary technology allows Hylsamex's production in Mexico to accommodate higher proportions of steel scrap and other metallic charge when high natural gas prices make DRI more expensive to produce.

**Table of Contents****Sales and Marketing***Net Sales*

Ternium primarily sells its steel products in the regional markets of North America and Central and South America, where it can leverage its strategically-located manufacturing facilities to provide specialized products and delivery services to its clients.

Our total net sales amounted to USD6.6 billion in 2006, USD4.4 billion in 2005 and USD1.6 billion in 2004. For further information on our net sales see Item 5. Operating and Financial Review and Prospects A. Results of Operations .

The following table shows Ternium's total consolidated net sales by product and geographical region in terms of U.S. dollars for the years indicated:

| <i>In thousands of U.S. dollars</i>    | <b>For the year ended December 31,</b> |                  |                  |
|--|--|------------------|------------------|
|  | <b>2006</b>                            | <b>2005</b>      | <b>2004</b>      |
| <b>Flat Steel Product Sales</b>        |  |                  |                  |
| South and Central America              | 3,038,369                              | 2,384,649        | 999,567          |
| North America                          | 1,960,793                              | 948,852          | 94,299           |
| Europe and Other                       | 48,365                                 | 326,926          | 172,331          |
| <b>Total Flat Steel Products Sales</b> | <b>5,047,527</b>                       | <b>3,660,427</b> | <b>1,266,197</b> |
| <b>Long Steel Product Sales</b>        |  |                  |                  |
| South and Central America              | 526,780                                | 370,634          |                  |
| North America                          | 735,823                                | 252,576          |                  |
| Europe and Other                       |  | 2,158            |                  |
| <b>Total Long Steel Product Sales</b>  | <b>1,262,603</b>                       | <b>625,368</b>   |                  |
| <b>Trading Sales<sup>(1)</sup></b>     |  |                  |                  |
| South and Central America              |  |                  | 116,624          |
| North America                          |  |                  | 136,530          |
| Europe and Other                       |  |                  | 72,073           |
| <b>Total Trading Sales</b>             |  |                  | <b>325,227</b>   |
| <b>Total Other Sales<sup>(2)</sup></b> | <b>258,845</b>                         | <b>161,885</b>   | <b>7,501</b>     |
| <b>Total Sales</b>                     | <b>6,568,975</b>                       | <b>4,447,680</b> | <b>1,598,925</b> |

(1) The item Trading Sales includes mainly trading activities for the year ended December 31, 2004. The consolidation of Amazonia's results since February 15, 2005 resulted in the elimination of intercompany sales between Sidor and Ternium's subsidiaries, following which trading activities are no longer material.

(2) The item Other Sales includes mainly sales of pig iron and iron ore.

*In thousands of tons*

| <i>(unaudited)</i>                     | <b>For the year ended</b> |             |             |
|--|---------------------------|-------------|-------------|
|  | <b>2006</b>               | <b>2005</b> | <b>2004</b> |
| <b>Flat Steel Product Sales Volume</b> |                           |             |             |
| South and Central America              | 4,361                     | 3,463       | 1,718       |

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|  |              |              |              |
|--|--------------|--------------|--------------|
| North America                                | 2,413        | 1,406        | 147          |
| Europe and Other                             | 88           | 514          | 311          |
| <b>Total Flat Steel Product Sales Volume</b> | <b>6,861</b> | <b>5,383</b> | <b>2,176</b> |
| <b>Long Steel Product Sales Volume</b>       |              |              |              |
| South and Central America                    | 948          | 709          |              |
| North America                                | 1,225        | 503          |              |
| Europe and Other                             |              | 5            |              |
| <b>Total Long Steel Product Sales Volume</b> | <b>2,174</b> | <b>1,218</b> |              |
| <b>Trading Sales Volume<sup>(1)</sup></b>    |              |              |              |
| South and Central America                    |              |              | 159          |
| North America                                |              |              | 246          |
| Europe and Other                             |              |              | 142          |
| <b>Trading Sales Volume</b>                  |              |              | <b>546</b>   |
| <b>Total Sales Volume<sup>(2)</sup></b>      | <b>9,035</b> | <b>6,600</b> | <b>2,722</b> |

- (1) The item Trading Sales Volume includes mainly trading activities for the year ended December 31, 2004. The consolidation of Amazonia's results since February 15, 2005 resulted in the elimination of intercompany sales between Sidor and Ternium's subsidiaries, following which trading activities are no longer material.
- (2) The Total Sales Volume does not include the tons of Other sales.

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### ***South and Central America***

Sales to customers in South and Central America accounted for 56.4% of Ternium's consolidated sales during 2006, 63.1% during 2005 and 70.3% during 2004. See Item 5. Operating and Financial Review and Prospects A. Results of Operations Fiscal year ended December 31, 2006 compared to fiscal year ended December 31, 2005 Net sales and Fiscal year ended December 31, 2005 compared to fiscal year ended December 31, 2004 Net sales.

Ternium's sales are oriented toward the construction and agriculture industry, the packaging and canning sector (especially for food, paints and sprays), the tube and pipe sector (related to liquids and gas transportation and distribution networks), the automotive industry, the home appliances sector and service centers that further process Ternium's steel products to attend to particular requirements of steel users.

Ternium serves industrial clients (such as those of the automotive industry) that require customized products that it can produce through its service centers and finishing facilities, as well as commercial clients that further process steel. The customer base in South and Central America consists primarily of independent small- and medium-sized companies and distributors, which in turn process or retail the products to their customers in different market sectors.

Ternium's principal clients in the region are located in Argentina and Venezuela. Its sales in these countries are sensitive to the general economic conditions and government actions and policies, such as the restrictions in Argentina and Venezuela on certain foreign currency transfers. For further information on the risks related to an investment in Argentina or Venezuela please refer to Item 3. Key Information Risk Factors Risks Relating to the Countries in Which We Operate. We also sell to clients in other South American countries, including Colombia, Ecuador, Chile and Peru.

### ***North America***

Sales to customers in North America accounted for 42.1% of Ternium's consolidated sales during 2006, 29.0% during 2005 and 14.4% during 2004. See Item 5. Operating and Financial Review and Prospects A. Results of Operations Fiscal year ended December 31, 2006 compared to fiscal year ended December 31, 2005 Net sales and Fiscal year ended December 31, 2005 compared to fiscal year ended December 31, 2004 Net sales.

Ternium's largest markets in North America are Mexico and the United States.

Most of Ternium's Mexican customers are located near its plants in Puebla and Monterrey. The main markets for flat steel in Mexico are the construction industry, industrial customers in the packaging, electric motors, service center industries, distributors and auto parts manufacturers. The principal segments in the Mexican coated steel market are construction, manufacturing (air conditioning, lamps and furniture), appliances and auto parts. Ternium generally serves industrial clients that require high quality specifications, as well as commercial clients through service centers and warehouses. The rebar and wire rod markets in Mexico are generally characterized by a large number of orders of small volume, and competition is largely based on price. The customer base for bar and rod products in Mexico consists primarily of independent dealers and

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distributors, who in turn retail the products to their customers in the construction industry. Ternium markets its tubular products mainly through Mexican independent distributors, and the balance is sold directly to industrial clients.

Clients in the United States of America are served directly through the commercial offices, distribution and service centers of Ternium, which manage transport and logistics issues and provide local services and assistance. The Gulf Coast and a large portion of the West Coast, in particular, are fast growing regions in which our Hylsa's facility is highly competitive. The main markets in the United States are the construction industry and the energy market and its related steel consumption.

### ***Europe and Other***

Sales to customers in Europe and other markets accounted for 1.5% of Ternium's consolidated sales during 2006, 7.9% during 2005 and 15.3% during 2004. See Item 5. Operating and Financial Review and Prospects A. Results of Operations Fiscal year ended December 31, 2006 compared to fiscal year ended December 31, 2005 Net sales and Fiscal year ended December 31, 2005 compared to fiscal year ended December 31, 2004 Net sales.

Ternium's largest markets in Europe are Spain and Italy. Clients in Europe are mainly independent, small- and medium-sized companies dedicated to steel processing. A large part of their purchases are of cold rolled coils and coated products, which are mainly produced in Argentina. Their production is generally directed toward the construction, furniture and appliance industries. Ternium's sales to Europe are carried out through the Ternium commercial network. While Ternium profits from a long-term relationship with most of its European clients, sales orders are in general received on a monthly basis at spot prices.

Sales to Asia are generally made on a spot basis and include overrolling materials.

### **Pricing**

The prices of our steel products generally reflect international market prices for similar products. We adjust prices for our products periodically in response to changes in the import prices of foreign steel, export prices, and supply and demand. See Item 5. Operating and Financial Review and Prospects Overview. The actual sales prices that we obtain for our products are also subject to the specifications, sizes and quantity of the products ordered.

### **Marketing**

Our marketing strategy is to:

continue to shift Ternium's sales mix towards higher margin value-added products and services. We expect to increase Ternium's offerings of value-added products such as cold rolled sheets and coated and tailor-made products, and services, such as just-in-time deliveries and inventory management. In order to do so, Ternium will continue to work with clients to anticipate their needs and develop customized products for particular applications; and

maximize the benefits arising from Ternium's broad network of distribution, sales and marketing services. We expect to continue to expand Ternium's customer base and to increase its services in major steel markets. We plan to develop Ternium's sales and logistic services through its commercial network, including import operations, stock administration, and delivery and storage programs.

Ternium maintains a strategic presence in several major steel markets through its network of commercial offices, which allows it to reach clients principally outside its regional markets.

Ternium adapts its strategy according to the different regions it serves. Its sales force specializes in different regional requirements ranging from product specifications to transport logistics.

In order to increase Ternium's participation in regional markets and improve services provided to customers, Ternium consolidated its international sales and marketing activities through Ternium Internacional's network of commercial offices. Ternium Internacional develops its services through branches, which are 100% fully owned by Ternium Internacional and are





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strategically located in the Ternium's key markets. Ternium Internacional has a strong presence in the main steel markets such as the Americas and Europe and has extensive experience promoting steel products. Its marketing expertise helps Ternium to expand its position in current markets and in developing new ones.

### ***South and Central America***

A principal component of Ternium's marketing strategy in South and Central America is establishing lasting and close relationships with customers. This allows Ternium to provide assistance to its customers in their use of steel products and to obtain downstream information that can be applied to future product development.

In 2003, Ternium's Argentine subsidiary Siderar established a department focused on the development of small- and medium-sized companies, under a program created by the Techint Group for the development of its clients and the local industry. The objective of the program is to improve the competitiveness of clients and suppliers, to increase their exports and allow them to substitute imports for local products. Nearly 140 companies are part of this program, which provides support for the commercial, financial, industrial and institutional requirements of these companies. Propymes was also implemented in Venezuela in 2004, with the same objective of promoting local industry.

Ternium's sales force in this region is oriented toward serving the specific needs of different market sectors, such as the construction industry, the packaging and canning sector (especially for food, paints and sprays), the tube and pipe sector (related to liquids and gas transportation and distribution), the automotive industry, the home appliances sector and steel processors. Through its service centers, Ternium can cut, paint or conform its products to specific client requirements. Customized products include metallic roofing, auto parts, steel for agricultural machinery, different types of tin used to produce sprays and food containers and cut-to-length products used in the home appliance and construction industries.

In addition to its offices located in Argentina and Venezuela, Ternium has commercial and administrative offices in Brazil, Colombia, Ecuador, Peru and Uruguay. These offices generally provide commercial services such as the development and maintenance of contacts with clients and end users, analysis of businesses opportunities, assistance to buyers before and after sales, participation in price negotiations, analysis of the market and competitors and assistance in the design and organization of the commercial and promotional strategy for sales in the respective countries.

### ***North America***

The North American steel market is highly competitive, since most major international steel producers direct part of their sales efforts to this region. The 2005 Hylsamex acquisition significantly increased North America's importance to Ternium's overall sales. We expect that our sales of flat steel products will increase significantly if we complete the acquisition of Grupo Imsa. On April 29, 2007, we entered into a definitive agreement pursuant to which we expect to obtain control over Grupo Imsa, a steel manufacturer with operations in Mexico, United States and Guatemala. The transaction is subject to Mexican and U.S. antitrust clearances, and other customary conditions. For more information, see Item 5. Operating and Financial Review and Prospects G. Recent Developments (a) Agreement to obtain control over Grupo Imsa.

In Mexico, where Hylsamex's production facilities are located, it can provide customized services and deliveries. Ternium's principal steel clients in Mexico are in the construction and manufacturing industries (including steel furniture, automotive and electric and home appliances).

Mexico's steel market is strongly oriented toward end users, representing 54% of Hylsamex's domestic sales in both 2005 and 2006. In addition, several Mexican steel producers compete with Hylsamex in the flat and long steel markets, including Ahmsa, Grupo Imsa, Arcelor Mittal, DeAcero S.A. de C.V., or DeAcero, and Aceros San Luis S.A. de C.V., or Aceros San Luis. Ternium's experienced sales force specializes in the needs of each market sector and focuses on value-added products and services. In this competitive and end-user oriented market, the extensive use of well-known commercial brands allows customers to clearly recognize Ternium's products. Ternium seeks to increase its competitive advantage by providing value-added services, including the Technical assistance related to steel use and production, and developing new steel products.

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Ternium has a commercial presence in the United States, including offices and warehouses in Houston, Atlanta, Laredo and Phoenix. From these locations, Ternium provides steel products and related services: logistics, stock management and customer assistance.

### ***Europe and Other***

Sales to Europe and the other markets are carried out through a commercial office located in Spain. This office is focused on activities such as trading. It is also responsible for the development of commercial and marketing activities in order to expand Ternium's client base, the organization of provision programs and activities to promote steel products and the assistance in the purchase process for finished and semi-finished steel for Ternium. It also provides services related to other commercial requirements, such as credit risk analysis and credit risk insurance, follow up on orders and other customer support.

### **Competition**

#### ***Global Market***

The steel industry operates predominantly on a regional basis, with large industry participants selling the bulk of their steel production in their home countries or regions, where they have natural advantages and are able to more effectively market value-added products and provide additional customized services. Despite the limitations associated with significant transportation costs, as well as the restrictive effects of protective tariffs and other trade restrictions, international trade of steel has generally increased in the last decade as production has shifted towards low-cost production regions. In addition, since 2002, several large steel manufacturers have merged with each other or acquired steel companies in other parts of the world. This wave of consolidation has resulted in a number of large, global producers with significant operations in several regions and/or continents, contributing to the increasing globalization of the steel industry. Considered as a whole, however, the steel industry still remains considerably fragmented, compared to certain key suppliers and customers, e.g. iron ore suppliers and the automotive industry.

Steel consumption has historically been centered in developed economies such as the United States of America, Western Europe and Japan. However, in recent years steel consumption in Asia, and in particular China, has increased significantly. Moreover, while production in Europe, Japan and the United States remains significant, steel producers in those regions have increasingly focused on the rolling and finishing of semi-finished products.

There has been a trend in recent years toward steel industry consolidation among Ternium's competitors. For example, Aceralia, Arbed and Usinor merged in February 2002 to create Arcelor, and LNM Holdings and Ispat International merged in October 2004 to create Mittal Steel, which subsequently acquired International Steel Group. Furthermore, in June 2006, Mittal Steel and Arcelor merged to create the world's largest steel company, Arcelor Mittal. In April 2007, Tata Steel completed the acquisition of Corus. Despite this trend, the global steel market remains highly fragmented. In 2004, the five largest producers (Mittal Steel, Arcelor, Nippon Steel, JFE and POSCO) accounted for approximately 19% of total worldwide steel production, with Arcelor Mittal, the largest, accounting for less than 10%. Also in 2006 and 2005, the five largest steel producers accounted for 19% and 18%, respectively, of total worldwide steel production (compared to 15% in 2000).

Steel prices in general, including for both flat and long products, have undergone significant volatility in recent years. From 2000 to 2002, the industry, especially in North America, experienced fluctuating capacity, low demand growth levels and other adverse conditions, which led to depressed steel prices and also adversely impacted many steel producers' profitability. In 2003 and 2004, steel prices increased worldwide, due to higher economic growth in most regions, particularly China and other developing countries, as well as higher raw material prices (iron ore, ferroalloys and energy). Prices decline in the last quarter of 2004 and the first half of 2005, partially due to inventory liquidation, but recovered in the second half. Although prices in 2005 were below the 2004 peak, they remained well above the ones from 2000 to 2002. In 2006, prices increased in the first half of the year due to better global economic performance and declined in the second half, but remained on average above 2005 levels. In 2007, the construction and automotive industry's activity in the United States of America experienced a slightly increase, which affected the international steel prices.

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Given the strong competition that characterizes the flat steel industry; several countries have imposed trade restrictions to protect their domestic steel industries from imports at below market conditions, commonly referred to as dumping. For a summary description of some of these regulations, see Regulation Trade regulations.

***South and Central America***

Ternium competes against importers of flat steel products in Argentina and Venezuela, countries in which Ternium is a leading domestic producer. Producers of flat steel products usually enjoy a strong competitive position in their domestic markets due to logistical and other advantages that allow them to offer value-added services and maintain strong relationships with domestic customers. Ternium's subsidiaries have established strong ties with major consumers of flat steel products in their home markets, which have been reinforced by customized delivery arrangements.

**Argentina.** Ternium's subsidiary Siderar is the main producer in Argentina of flat rolled steel products and faces little competition from domestic steel producers across the majority of its product lines. Its main competition in the Argentine flat steel market is limited to imports, mainly from Brazil. The main Brazilian producers of flat steel value-added products are Usiminas (a shareholder of the Company), Companhia Siderúrgica Nacional and Companhia Siderúrgica de Tubarão (part of the created Arcelor Brasil). In the market for intermediate products for the manufacture of structural pipes, Ternium competed in the past with Acindar, an Argentine company mainly dedicated to the production of long steel products which had a minor share in the flat steel market. On January 31, 2006, Siderar acquired assets and facilities of Acindar related to the production of welded steel pipes in the province of Santa Fe in Argentina and 100% of the issued and outstanding shares of Impeco S.A., which in turn owns a plant located in the province of San Luis in Argentina for a total purchase price paid of USD55.2 million. These two plants have an annual production capacity of 140 thousand tpy of tubes to be used in the construction, agricultural and manufacturing industries.

We believe that the threat of new competitors entering the Argentine flat steel market is mitigated by:

Ternium's substantial domestic market share;

the specialized service provided locally;

the high capital investment required to construct an integrated manufacturing facility;

the scarcity of good quality scrap in Argentina for use in an electric arc furnace mini-mill ;

Ternium's low production costs and its potential ability to expand capacity at a relatively low investment cost compared to building and installing an electric arc furnace mini-mill ; and

the significant freight costs in exporting to Argentina, and especially the Buenos Aires area, where most of the flat steel demand is concentrated.

Although Siderar has been the principal flat steel provider in Argentina since its foundation, its market share has been affected by the economic and trade conditions in the country. During the 1990s, Siderar faced increased competitive challenges from outside Argentina as a result of the Argentine government's trade liberalization policies. See Regulation Trade regulations.

We believe that Siderar has a competitive advantage over potential foreign competitors based on its ability to customize products to customer specifications, including size and quality. Its position was further improved by the Argentine crisis of 2002 and subsequent devaluation that benefited national industry competitiveness.

**Venezuela.** Ternium's subsidiary Sidor is the sole producer of flat steel products in Venezuela. Sidor's only source of competition in the flat steel markets comes from imports. However, imported flat steel products do not account for a significant portion of the Venezuelan market,

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representing only, on average, an 10% and 8% market share in Venezuela for the year ended December 31, 2006 and 2005, respectively.

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Sidor is the main producer in Venezuela of long steel products, but it faces competition from other domestic producers of long products. Sidetur, a subsidiary of Sivensa and a minority shareholder of the Company, is Ternium's primary competitor in the domestic long steel products market. Siderúrgica Zuliana C.A., or Sizuca, also competes, to a lesser extent, for Ternium's share of the domestic market for long products and, in particular, rebar.

We believe that the threat of new competitors entering the Venezuelan flat and long steel markets is mitigated by:

Ternium's substantial domestic market share;

the high capital investment required to construct an integrated blast furnace manufacturing facility;

the scarcity of good quality scrap metal in Venezuela for use in an electric arc furnace mini-mill; and

Sidor's low production costs and its long term agreements with local raw material suppliers. See Item 3. Key Information D. Risk Factors Risks Relating to the Steel Industry.

The Venezuelan government has announced that it will finance and build an integrated steel complex located in Ciudad Piar, 150 kilometers from Puerto Ordaz, where Sidor is located. The Venezuelan administration has stated that this project, which is still in a preliminary stage, will not compete against Sidor. To the date of this annual report, there have been no developments in connection with this announcement.

***North America***

**Mexico.** Ternium's subsidiary Hylsamex has strong domestic competitors in the Mexican steel market and faces increasing competition from imports. Total imports of flat steel products have increased sharply in recent years and according to Canacero, the Mexican chamber of the iron and steel industry, accounted for 32.7% and 28.8% of the Mexican market in 2006 and 2005, respectively.

The largest Mexican competitor in the flat products market is AHMSA, an integrated steel producer located in Monclova, Coahuila that produces a wide variety of steel products. Another significant domestic competitor in this sector is APM, S.A. de C.V., which is a subsidiary of Grupo Imsa. APM processes slabs purchased from third parties to produce hot and cold rolled products for the Mexican market and to supply Grupo Imsa's coating facilities. On April 29, 2007, we entered into a definitive agreement pursuant to which Ternium, or any of its subsidiaries is expected to obtain control over Grupo Imsa. The transaction is subject to Mexican and U.S. regulatory approvals and other customary conditions. If consummated, the transaction is expected to close in the third quarter of 2007. If and when the Grupo Imsa transaction is consummated, Grupo Imsa will no longer be a competitor in this market.

In the rebar market, Ternium's largest competitor is Siderúrgica Lázaro Cárdenas Las Truchas S.A. de C.V. (Sicartsa), that is currently part of Arcelor Mittal. To a lesser extent, Ternium also faces competition from Aceros San LuisDeAcero and Grupo Vigil. In the low-carbon wire rod market, Ternium's main competitors are DeAcero, Sicartsa, and to a lesser extent Aceros San Luis, Talleres y Aceros and imports.

The Mexican domestic market for small diameter welded pipe is regional, and competition from imported products is not significant. Orders are usually small and cover a wide range of product specifications. Hylsamex's leading competitors in this market are Regiopytsa, Arcometal and Tubería Nacional S.A. de C.V.

The primary customers in the Mexican coated steel market are the construction sector and manufacturing companies (e.g. of air conditioners, home appliances and lighting fixtures). Ternium's main competitors in this market are IMSA and to a lesser extent Zincacero S.A. de C.V. and Galvasid. If and when the Grupo Imsa transaction referred to elsewhere in this annual report is consummated, Grupo Imsa will no longer be a competitor in this market.

We believe that the threat of new competitors entering the Mexican flat steel market is mitigated by:

the specialized service provided locally;

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the scarcity of good quality scrap and high energy prices in Mexico for use in an electric arc furnace mini-mill ;

Ternium's low production costs, including its supply of iron ore from its own mines; and

Ternium's ability to expand capacity at a relatively low investment cost compared to building and installing an electric arc furnace mini-mill.

**Capital Expenditure Program**

The sum of the capital expenditures of Siderar, Sidor and Hylsamex in 2006 was approximately USD384 million. The main objectives of the capital expenditure program of Ternium are to:

reduce production costs;

improve product quality, equipment reliability and productivity;

comply with applicable environmental standards; and

provide enhanced customer services.

Ternium's plans for financing its capital expenditure program are described under Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources . No assurance can be made that Ternium will be able to obtain the financing necessary to fund its projected capital and environmental remediation expenditures.

***Argentina***

During 2006, Ternium carried out a significant investment program to increase its production capacity and improve the product quality of its facilities in Argentina. Siderar's investment in fixed assets amounted to USD208 million. The principal investments initiated or carried out were:

*the expansion of the coke oven plant.* The construction of battery No.5 began in 2004 and is expected to start production in September 2007 and increase capacity by 210,000 tpy;

*the relining of blast furnace No. 2.* The works in blast furnace No.2 began in 2005 and the relining started in October 2006. The start up was in January 2007;

*the revamping of sinter plant.* The work began in 2005 and was completed in September 2006, which resulted in an increased capacity of 4,000 tons per day and improved the environmental conditions;

*the installation of slab reheating furnace No.5 in the hot rolling mill.* The work carried out in the hot rolling mill allowed Siderar to roll all slabs in a single greater thickness of 200 millimeters. This work, together with the one carried out in the steel shop, enable Siderar to increase hot rolled coils production from 2.6 to 2.8 million tons per year. The start up was in October 2006.

Siderar investment plan contemplates a significant increase in crude steel production capacity from the current 2.9 million tons to 4.0 million tons to facilitate growth of the manufacturing sector in Argentina and, at the same time, allow Ternium to continue to play an active role in

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international markets. Besides completing those investments initiated in 2004, the principal investments of the plan are focused on the installation of a new continuous caster and metallurgy equipment, the relining of blast furnace No.1 in two steps, the increase of capacity in Siderar's sinter plant from 4,000 to 5,000 tons per day and the modernization of the facilities for storage and internal transportation of raw materials.

The plans also contemplate the upgrading of present production lines together with the incorporation of new production lines. We expect that the incorporation of automation systems and the use of available capacity in the services area will improve production efficiency by allowing for economies of scale and operating cost reductions.



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***Venezuela***

During 2006, Ternium's investments in fixed assets in Venezuela amounted to USD77.3 million. The most significant investments and projects carried out or initiated were:

*the revamping of module A of Midrex II.* This was carried out in September 2006 and resulted in an increase of the annual production up to 1.1 million tpy of DRI;

*the installation and start up of two deburring machines and a marking machine at the delivery side of the continuous casting mill No.3.* This project boosts the capacity of the plant for slab requiring proper finishing (deburring and marking);

*the second step of the Piso de Planta Project.* This project develops and implements an integrated real time management system (industrial and technological) for all of the production lines. This new system is already operative in all the main facilities;

*the installation of an oxygen plant.* This new plant consists of two modules of 300 oxygen tons each, which have been operative since October 2006. This new equipment provides the necessary gas to comply with the increases in liquid steel production.

During the next five years, we intend to carry out an investment plan for Ternium's subsidiary Sidor that would allow it to increase crude steel production capacity from 4.0 million tons to 5.5 million tons, to maintain its equipment and to automate control systems. Among the projects that we expect to carry out in the near future are the revamping of the HYL reduction plant, which is actually in the procurement stage, and it is expected to be operative by December 2008; the installation of a new ladle furnace No.3 in the steel mill, which is currently in progress and is expected to be operative in September 2007; the revamping of the steel shop material handling system, the modernization of the delivery side of the slab caster machines.

***Mexico***

Hylsamex's subsidiaries underwent a substantial modernization program prior to their acquisition by us. In the last 15 years, Hylsamex has spent approximately USD1.9 billion on projects focused on developing Hylsamex as an integrated manufacturer of value-added products. The main investments carried out were in flat steel mini-mills, the preparation and modernization of mines, the modernization of long steel facilities and the development of DRI plants and coated steel production lines.

During 2006, Hylsamex invested USD97.1 million to increase its hot rolling and galvanizing production capacity. The most significant investments and projects carried out or initiated were:

*the revamping of the hot rolling mill No.1.* This includes the installation of a new walking-beam slab furnace expected to start-up during September 2007, and that will provide an additional rolling capacity of 400 million tpy;

*the revamping of the galvanizing line No.3.* This project is expected to be operational during July 2007, will provide additional strip galvanizing capacity for 40 thousand tpy.

Some of the main investments planned for in the next five years are the modernization of hot rolling Mill No.1, the opening of the Colomera mine site at Las Encinas complex, the modernization of certain coating facilities and several information technology, or IT, systems projects. In addition to these investments, management is considering capital expenditures aimed at routine maintenance or replacement of equipment. If and when we consummate the Grupo Imsa transaction referred to elsewhere in this annual report, we will re-estimate the costs of our investments in Mexico.



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### ***Information technology investments***

In addition to capital expenditures at its plants, Ternium has invested in the integration of its production, commercial and managerial activities. Some of the main IT investments relate to the development of new software for its management platforms. The first project requires a significant technological change in Ternium's systems and will provide users with a new set of management tools on a proprietary platform for the manufacturing, selling and distribution of Ternium's products. Another project is expected to develop technological tools for related sectors such as human resources, finance and other administrative sectors. The Ternium companies invested an aggregate of approximately USD18.4 million in IT projects in 2006.

In 2007-2008, we expect to invest in IT projects that will facilitate the integration and synergies of Ternium's subsidiaries and improve the security measures over their IT systems, and to continue developing the projects indicated in 2006.

### **Raw Materials and Energy**

At Ternium's integrated steel facilities in Argentina and Venezuela, the principal raw materials Ternium consumes are iron ore, coal and ferroalloys. These are processed in blast or electric arc furnaces and afterwards in steel shops to obtain either slabs, which are further processed into value-added flat steel products, or billets, which are further processed into wire rods and bars. At Ternium's electric arc facilities in Mexico, the principal raw materials are pellets and scrap. Another important raw material for Ternium's production processes is energy. Below is a more complete description of the raw material and energy situation at Ternium's integrated facilities in these countries. For a description of some of the risks associated with Ternium's access to raw materials, see Item 3. Key Information D. Risk Factors Risk Relating to the Steel Industry Price fluctuations or shortages in the supply of raw materials and energy could adversely affect Ternium's profits.

#### ***Argentina***

In Argentina, Ternium's subsidiary Siderar produces crude steel through the use of blast furnace technology. Siderar is the primary integrated manufacturer of flat steel products in Argentina, with an installed capacity of 2.9 million tons of crude steel. The principal raw materials used to produce steel are iron ore and coal. Important amounts of electricity and natural gas are also used in the manufacturing process.

**Iron ore.** Iron ore is purchased under long-term agreements from suppliers in neighboring Brazil. Prices under these contracts are determined on an annual basis in accordance with market conditions and follow the prices agreed upon between the major iron ore exporters and their main steel industry clients. Siderar's aggregate annual consumption of iron ore in Argentina ranges between 3.2 and 3.5 million tons. Approximately 80% of Ternium's local requirements for iron ore in different forms, such as pellets and sinter feed (iron ore fines smaller than 6 mm) is supplied by Brazil's Companhia Vale Do Rio Doce, or CVRD. The remaining requirements consist of lump ore (i.e., iron ore within certain size specifications ranging from 6 to 38 mm) from other suppliers located in Brazil, such as Mineração Corumbaense Reunida S.A., or MCR, a Rio Tinto subsidiary. The main contracts for these raw materials are with CVRD and MCR. Siderar's geographic location provides favorable access to high quality lump produced in Brazil's iron ore mines which are located in the Pantanal Region (Mato Grosso do Sul state) through the Paraguay and Paraná Rivers. The use of barges to haul this lump ore, reduces the raw material costs associated with the provision of iron ore since those mines are outside of the international seaborne trade. The costs for iron ore in the seaborne trade, which represents imports from Brazil into Argentina, has steadily increased since 2003, with successive price hikes in the following years up to an increase of more than 71% for some types of iron ore. However, 2006 prices depicts the price correction operated in the international markets with significant increases of almost 20% for some types of iron ore and decreases of up to 3% for others.

**Coal.** Siderar obtains its coke through the processing of coking coal and petroleum coke in its coke ovens. Siderar requires different types of coal to produce coke. Coal is mainly purchased under annual renewable contracts with long term commercial suppliers. Siderar uses different international suppliers depending on the different types of coal used in the process, including Anglo Coal, BHP Billiton/Mitsui Alliance, Xstrata/Glencore and Jim Walter Resources Inc. The amount purchased from each supplier depends on mainly technical quality requirements of the blast furnace operations and to a lesser

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degree on commercial conditions. Estimated consumption of coal and petroleum coke is approximately 1.5 million tpy. Petroleum coke is sourced domestically from producers such as Exxon Mobil and Repsol YPF.

**Electricity.** Siderar consumes large quantities of electricity (approximately 135 Mw) for its manufacturing activities, particularly in its Ramallo and Ensenada facilities. The electricity required to cover most of Siderar's needs is self-generated by a wholly-owned thermoelectric plant with an installed capacity of 110 Mw located at the Ramallo facility. Most of the energy requirements of the thermoelectric plant are obtained from blast furnace and coke oven gases and from steam that is purchased from a power plant located at the Ramallo facility owned by Siderca S.A.I.C., a subsidiary of Tenaris. The rest of the requirements are covered through the purchase of natural gas from Repsol YPF and Tecpetrol S.A, or with alternative sources of energy such as fuel oil.

OPEL ( Operadora Eléctrica ), a subsidiary of Tenaris, currently manages Siderar's thermoelectric plant and the plant owned by Siderca. Siderar pays an administration fee for its services. This outsourcing contract is due to terminate in 2015.

Siderar covers electricity shortfalls or sells excesses, as the case may be, at spot prices in the wholesale market. In order to mitigate these shortfalls, Siderar entered into an electricity supply contract with Genelba Power Plant, which is owned by Petrobras, and that covers the Ramallo facilities shortfalls. In addition, Siderar has also entered into a supply contract with Central Puerto Plant, which covers the Ensenada, Florencio Varela and Canning facilities shortfalls.

**Natural gas.** Siderar also consumes substantial volumes of natural gas in Argentina, particularly to operate its blast furnace and power generation facilities. The average daily consumption of its facilities is approximately 1,700 thousand cubic meters of natural gas.

The relative cost of natural gas in Argentina decreased substantially in 2002 following the Argentine peso devaluation and subsequent freezing of tariffs in local currency terms. However, since 2003, this cost gradually increased due to governmental and private tariff negotiations and the appreciation of the Argentine peso against the U.S. dollar. Currently, the cost of gas and transportation is over 2001 levels, while the cost of distribution is still below the level of 2001. During the last four years, the continuing increase in natural gas demand in Argentina together with a substantial lack of investment in natural gas production and transportation have resulted in shortages of natural gas to industries and private consumers. See Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate Argentina Restrictions on the supply of energy to Ternium's operations in Argentina could curtail Ternium's production and negatively impact Ternium's results of operations.

Siderar has long-term supply arrangements with Repsol YPF and Tecpetrol S.A, a company controlled by San Faustin, for the purchase of natural gas. Repsol YPF is Siderar's main supplier. Tecpetrol supplies it with a significant portion of its natural gas requirements on terms and conditions that are equivalent to those governing the supply of natural gas by Repsol YPF. Siderar's supply agreement with Repsol YPF extends until December 2006 with prices revised on an annual basis. A new agreement is currently under negotiation, meanwhile YPF is delivering gas under spot basis. In March 2003, Siderar entered into an agreement with Tecpetrol under which Siderar paid USD17.3 million for the advance purchase of a total of 725 million cubic meters (up to 400 thousand daily cubic meters) of natural gas to be delivered over a period of 5 years on pricing terms that will enable it to share through discounts the impact of any increase in natural gas prices over that period with Tecpetrol. Under the terms of the agreement, Siderar will have a minimum guaranteed return on this advance payment equal to LIBOR plus 3.5%. In November 2006, the gas purchased to Tecpetrol covered the total amount paid in March 2003. Since then, no discount has been applied to gas price. Furthermore, in May 2007, Tecpetrol decided to cancel the contract pursuant to the termination clause that allows any party to terminate the contract after the USD17.3 million was paid. Up to date, Tecpetrol is delivering gas under spot basis. A new long-term supply contract is expected to be signed after the negotiations between the Argentine government and gas producers conclude. Siderar purchases from Tecpetrol in 2006 and 2005 amounted to USD8.9 million and USD7.4 million, respectively. Siderar covers any variation in its requirements for natural gas in the spot market.

Siderar also has separate transportation agreements with Transportadora de Gas del Norte S.A. (TGN), Transportadora de Gas del Sur S.A. (TGS), Camuzzi Gas Pampeana S.A. (Camuzzi), Gas Natural Ban S.A. (Gasban) and Metrogas. The main transportation contract is with TGN, which expires in April 2013. For the final distribution phase, Siderar has several distribution contracts with Litoral Gas (a company partially owned by Tecgas, an affiliate of San Faustin), Camuzzi, Gasban and Metrogas. The principal contract is with Litoral Gas, which after the renegotiation of the contract renewal, will expire in December 2008.

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**Other raw materials.** Ternium has an on site oxygen, nitrogen and argon separation plants in order to extract these gases for use in the steelmaking process. In December 1993, Ternium's subsidiary Siderar entered into a contract with Air Liquide Argentina S.A. for the operation and maintenance of an oxygen separation facility at Ramallo that supplies oxygen, nitrogen and argon. This contract initially had a term of 15 years and was renewable by mutual agreement. It was amended in 2000 and 2002, and its term has been extended until 2021. Under the terms of the contract, Siderar is required to take or pay certain minimum daily amounts of oxygen, nitrogen and argon, which amounts are consistent with Siderar's production requirements in Argentina. Since 1993, Air Liquide had invested in new equipment in order to increase the plant capacity.

### **Venezuela**

The principal raw materials and energy inputs used in Ternium's steelmaking activities in Venezuela are iron ore, scrap steel and natural gas. Other inputs used include electricity, oxygen and various other gases.

Venezuela is rich in reserves of raw materials used by Ternium. We believe that Venezuela's abundance of raw materials, the relatively low cost of these materials and the proximity of Sidor's facilities to such raw materials provide it with a significant advantage over other international steel producers.

Sidor currently purchases its iron ore, electricity and natural gas through long term arrangements with entities owned by the Venezuelan government which as of May 31, 2007, through CVG, owned 20.3% of the outstanding capital stock of Sidor. Sidor expects to continue to enter into long-term contracts to meet its raw material needs. See Item 3. Key Information D. Risk Factors Risks Relating to the Steel Industry Price fluctuations or shortages in the supply of raw materials and energy could adversely affect Ternium's profits.

**Iron ore.** On November 12, 1997, Sidor entered into a contract with FMO for the supply of iron ore. Sidor receives an average of 20,000 tons a day of iron ore at its facilities. The mines where the iron ore is extracted are San Isidro, Los Barrancos, Las Pailas and Altamira. Pursuant to this contract, FMO will supply Sidor with 100% of its annual iron ore requirements until 2017. After 2017, the contract is renewable for additional twenty-year periods unless Sidor or FMO object to its renewal at least 90 days prior to its expiration. Under the 1997 contract, prices were fixed on an annual basis according to a formula that resulted in the application of the lower of historical cost adjusted for U.S. inflation and certain market reference prices. The 1997 contract also included a hardship provision, in which each of Sidor and FMO agreed to use its best efforts to resolve inequities arising during the contract's term. Following a public announcement by the Venezuelan government that sought to pressure Sidor to renegotiate the terms of the 1997 contract, as permitted under the contract's hardship provision, Sidor and FMO entered into an amendment of the 1997 contract on November 11, 2005. The revised contract sets the iron ore price at the lower of:

the price charged by FMO to its customers (other than certain newly-created state-owned steel producers) in the Venezuelan domestic market; and

80% of a market reference price (which percentage may drop to 70%, as described below).

According to the new terms, the price of iron ore would follow the price of Carajas Fines. Due to the amended pricing formula, the cost of iron ore for fiscal years 2006 and 2007 increased by approximately 63% and 9.5%, respectively. Under the revised contract, the pricing formula may be adjusted every two years, on the basis of public policy, Sidor's competitiveness and the evolution of international steel prices. In conjunction with the changes in price conditions for the supply of iron ore to Sidor by FMO, the Venezuelan government is offering a price reduction on raw materials acquired from state-owned enterprises, such as FMO, that may reach 10% over the agreed market reference price. These preferential supply terms, as established in the applicable Venezuelan regulations, are conditioned on commitments by potential beneficiaries to assist development of the domestic industrial sector and to support certain community needs. In June 2006, Sidor was notified that it had been granted a 7.61% discount on its iron ore price in connection with the initial assessment of Sidor's proposed industrial development plan. The other terms and conditions of the 1997 contract remain in effect under the revised contract.

**Pellets.** In connection with the iron ore contract, in 1997 Sidor and FMO entered into another agreement under which Sidor committed to sell, upon the request of FMO, up to 2.0 million tpy of pellets to FMO, at a price based on the sale price at

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which FMO sells iron ore to Sidor plus a bonus paid to Sidor for the production of pellets, which is determined using market references.

**Briquettes.** In 2004, to guarantee its supply of raw materials, Sidor, together with Tenaris, organized Matesi, in which they had interests of 49.8% and 50.2%, respectively. In July 2004, Matesi purchased the assets of Posven for USD120 million. Posven owned an idled iron-briquette producing facility located in Ciudad Guayana, Venezuela, with an annual capacity of 1.5 million tons. Matesi began production in October 2004 and is expected to ensure that Sidor can rely on an additional source of high-quality, low-cost iron ore briquettes, enabling crude steel production to exceed 4.5 million tpy.

**Scrap.** Sidor's consumption of scrap is approximately 580,000 tpy. In 2006, approximately 61% of the scrap used was obtained internally from products with technological or qualitative defects.

**Electricity.** Sidor's production process requires a large amount of electricity. On August 21, 1997, Ternium entered into a twenty-year contract with EDELCA, a Venezuelan state-owned company, for the supply of all of Sidor's electricity needs. This contract will terminate in 2018. Pursuant to the terms of the contract, Sidor is committed to pay, subject to a most favored nations provision linked to the prevailing prices for other established steel and iron producers in the region, an annual purchase price starting at USD17.14 per MWh, subject to annual adjustments beginning in 2000 of up to 3% and increasing to a fixed price of USD20.06 per MWh for the years 2005 through 2009. The price to be paid after 2009 will be negotiated by Sidor and EDELCA in 2007. In addition, the terms of the contract impose a minimum annual fee equal to 75% of the average estimated fees for the year. The electricity is supplied from one electrical station in Macagua and three electrical stations in Guayana B located south of Sidor's facilities. The energy is transmitted through four lines primarily from the Guri hydroelectric plant, with a capacity of 10,000 megawatts. The inner lines are distributed in seven sub-stations. Two of these sub-stations distribute energy to the electric furnaces and the rest cover the needs of the facility.

**Natural gas.** Sidor's DRI production process is heavily reliant upon supplies of natural gas. Sidor buys 100% of its natural gas from PDVSA Gas, a Venezuelan state-owned natural gas supply company. In 1997, Sidor signed a twenty-year contract with PDVSA Gas for the supply, on a take or pay basis, of 230 million cubic meters per month of natural gas (the equivalent of 8.33 million cubic meters per day) of natural gas, and must pay for a minimum quantity of 83.3 million cubic meters of natural gas per month. Sidor and PDVSA Gas may, from time to time, revise the maximum amounts to accommodate Sidor's actual natural gas requirements and any plans for expansion. Under the terms of this contract, Sidor is required to purchase the gas at a formula price that is capped at the levels paid by other established steel and iron producers in the region. The contract expires in 2017, and is renewable thereafter in five year increments.

**Lime.** Sidor obtains the majority of its lime from its lime plant. The actual capacity of this plant is 500,000 tpy. The production of lime is subordinated principally to Sidor's demands and to clients' demands.

### **Mexico**

In Mexico, Ternium's process for producing steel relies on electric arc furnaces, which melt a combination of steel scrap and DRI to produce liquid steel, which is then further processed to make its steel products. Ternium's production process requires extensive use of natural gas and electricity, and energy costs are one of the largest components of production costs.

**Iron ore.** As described under Production Process and Facilities Mexico above, Ternium's subsidiary Hylsamex owns interests in two mining companies in Mexico: 100% of the equity of the Las Encinas mines, and a 50% controlling equity stake in Peña Colorada, which operates Mexico's largest iron ore mine. In 2006, Ternium's Mexican facilities sourced 100% of their iron ore requirements from its own mines. Under its arrangement with Peña Colorada, Hylsamex is committed to purchase 50% of the annual production of the mine, which represents approximately 54% of its overall requirements. From the combined iron ore output, approximately 80% went to Hylsamex's own direct reduction plants, while the remaining 20% was sold in the international market. Most of the iron ore exports were made pursuant to an agreement to supply 2.9 million metric tons of pellets to China over a five-year period until March 2009.

**DRI.** Hylsamex's vertical integration strategy in Mexico is centered on synergies created by mining its own iron ore and refining it to produce DRI with its proprietary HYL<sup>®</sup> direct reduction process. We believe that over the long-term, DRI is the preferable metallic input for the production of steel because under ordinary circumstances it is a less expensive, but better quality, input than steel scrap. Nonetheless, Ternium seeks to maintain flexibility in the mix of steel scrap and DRI that it

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uses in its electric arc furnaces in Mexico, in order to better respond to fluctuations in raw materials prices. Ternium has the ability to substitute alternative metallics for DRI in periods where economic conditions make DRI more expensive to produce.

**Scrap.** In keeping with its vertical integration strategy, Hylsamex sources 100% of its steel scrap through its own steel scrap collecting and processing companies. These include subsidiaries Transamerica E. & I., Corp. and Ferropak Comercial, S.A. de C.V. In 2006, most of the scrap used was purchased domestically, with approximately 20% coming from the United States.

**Electricity.** The electric arc furnaces consume large quantities of electricity. During 2006, 59% of Hylsamex's total consumption was supplied by the *Comisión Federal de Electricidad* (CFE), Mexico's state-owned electricity company. The remainder came from Iberdrola, a Spanish utility company with power plants around Monterrey. Hylsamex has a long-term contract for 143 megawatts of capacity.

**Natural gas.** Natural gas is one of the largest cost components of Ternium's Mexican production processes. Natural gas is used as a reducing agent for the production of DRI and for the reheating of slabs and billets before the hot rolling process. In Mexico, Hylsamex purchases all of its natural gas from Pemex, the Mexican state-owned oil and gas company that is Mexico's sole producer of natural gas. These prices are set monthly based on the spot price in southern Texas, adding only the equivalent surcharge for transportation costs plus a margin that is generally less than 5%. Hylsamex currently purchases the entirety of its natural gas requirements from Pemex at market prices and often enters into derivatives contracts with the intention of reducing the effects of volatility on a portion of its natural gas requirements.

Hylsamex's effective cost for natural gas in 2006 was MXN81.1/MMBtu, 28% higher than the MXN63.4/MMBtu registered in 2005, as a result of hedging most of its requirements for the year. In contrast, Hylsamex's reference price for natural gas—the South Texas index—decreased 8% on average (MXN68.2/MMBtu in 2006 compared to MXN74.1/MMBtu in 2005). Hylsamex's effective cost for natural gas increased less than the market price as a result of Hylsamex's hedging strategies. Hylsamex is constantly monitoring and studying the natural gas markets to manage this exposure.

The reference prices shown above benefited from a decree issued by the Mexican government on September 12, 2005 that temporarily modified the mechanism that sets the price of natural gas in the Mexican market. This mechanism consisted of a fixed price of MXN83.2/MMBtu for September 2005 and a fixed price of MXN78.02/MMBtu plus 21% of the difference between the south Texas price reference and MXN78.02/MMBtu for the following months, with a minimum price of MXN78.02/MMBtu. This decree was the response of the Mexican government to the spike in natural gas prices in the United States resulting from Hurricane Katrina, which affected Mexican natural gas market prices as well. The price fixing mechanism remained in place until January 2006, when the daily natural gas production in the Gulf of Mexico reached a level of 8.0 Bcfs for at least thirty days, which was the condition established by the Mexican government to end the decree.

**Product Quality Standards**

Ternium develops its products and services with a philosophy of continuous improvement and seeks to excel in its internal quality oversight its products and processes. Ternium's products are manufactured in accordance with the specifications of the International Organization for Standardization's specifications, or ISO, and they also must satisfy proprietary standards and customer requirements.

Ternium has designed, developed and implemented the Ternium Quality Management System based on the platform ISO 9001:2000 and ISO/TS 16949:2002 applied to those areas related to automotive supplies (Siderar/Florencio Varela and Hylsa/Coated shaped), which will be audited by the accredited organism Lloyd's Register Quality Assurance (LRQA) in order to obtain the ISO multisite certification for Ternium. This Ternium Quality System substitutes the individual Quality System and the individual certifications to align the Organization's Quality criteria and to be the foundation for the Ternium Quality.

On October 2006, LRQA audited and recommended the ISO multisite certification and the ISO/TS certification of Siderar/Florencio Varela facility. During the first months of 2007, Ternium obtained the multisite certification process and LRQA implemented the Ternium Quality Management System.

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Furthermore, each Ternium subsidiary has obtained the accreditations required by the national and international regulations on its specific products.

### **Product Development and Research**

Ternium's subsidiary, Sidor, has focused on the development of hot rolled steels for welded tubes used in the oil and gas industries. Sidor has supplied high strength API X65 ( American Petroleum Institute ) grade in heavy gauges to Venezuelan pipeline projects. Also, hot rolled coils for API X42 HIC corrosion resistant tubes and microalloyed ingots for seamless pipe were successfully applied by domestic market customers. For the industrial sector, Sidor, has introduced a hot rolled copper alloy weathering steel for hopper rail cars. Furthermore, high carbon wire rods manufactured according to the Society of Automotive Engineers ( SAE ) standards have been incorporated in the long products portfolio, covering wide spread uses such as wire mesh, barbed wire and coil spring for mattresses.

Ternium's subsidiary Siderar has focused in the automobile industry, introducing hot and cold rolled and electrogalvanized steels manufactured according to Ford, Toyota and Peugeot standards. In the home appliance sector, prepainted hot dip galvanized were introduced. Moreover, in order to attend modernization of customer's manufacturing technologies, prepainted materials to be supplied in coils are currently under development.

Ternium's subsidiary Hylsamex has designed medium carbon, low silicon, hot rolled steels for galvanized pipes production. For the automotive industry, hot rolled steels for chassis and crosspieces, hot rolled medium carbon according to Toyota standards and boron alloyed steels for bumpers supporting pieces, were developed. Furthermore, extra deep drawing and high resistance hot dip galvanized grades, were introduced, together with wire rod steels for suspension springs. Dual phase hot rolled steels are among the main new initiatives.

Research efforts were oriented to continue the extension of a thermo-metallurgical model of Siderar's hot rolling mill. Moreover, a model that reproduces cold rolling and annealing stages has been extended to allow prediction of mechanical properties of microalloyed steel products.

Regarding coil coated products, accelerated tests continue to be developed to predict service performance.

In the environmentally friendly products, research continues on Chrome VI in order to develop free surface treatment technologies for zinc coated products, and Chrome free tinplate passivation.

The Company continues its association with international consortiums for applied research, aiming to generate knowledge that sets the basis for new product development and improvement. Ternium at present participates at Steel Research Center-McMaster University, for wire rod, hot rolled and hot dip galvanized steel products, International Lead Zinc Research Organization (ILZRO), for hot dip galvanized and electrogalvanized steels, French Corrosion Institute, for hot dip galvanized and coil coated materials, Interzac, for 55% Aluminum-Zinc coated steels and Tin International for tin plate.

### **Research and Development**

As of December 31, 2006, Sidor applied to the Service of Intellectual Property of Venezuela (SAPI), for a total of 44 patents related to improvements in its equipment, processes and products. Sidor oversees and coordinates the different stages of the patent process, from the origin of the innovating idea and its evaluation and approval to the introduction of the patent application request.

Sidor strives to develop products that will allow its clients to fulfill their continuous changing requirements, such as the products made for PDVSA Gas. PDVSA Gas required special products for the construction of a 300 kilometer gas pipeline network. For this project, Sidor developed a stronger steel product that allows PDVSA Gas to construct a pipe with the thickness necessary to resist the high gas operating pressure.

Hylsamex has developed several types of products and services, with more than 100 registered brands. As an example, Hylsamex developed a proprietary technology, called HYL<sup>®</sup>, for the reduction of iron ore, which is protected by patents in Mexico, the United States of America and several other countries. In late 2005, Hylsamex transferred to Techint Compagnia



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Tecnica Internazionale S.p.A., a Techint Group company, ( Techint Technologies ) the rights to market and license the HYL technology to unaffiliated third parties for royalty fees.

We spent USD1.8 million for R&D in 2006, compared to USD2.1 million in 2005.

### **Regulation**

#### ***Environmental Regulation***

Ternium is subject to a wide range of local, provincial and national laws, regulations, permits and decrees in the countries where it has manufacturing operations concerning, among other things, human health, discharges in the air and water and the handling and disposal of solid and hazardous wastes. Compliance with these environmental laws and regulations is a significant factor in Ternium's business.

Ternium's environmental system is supported by a network of people with responsibilities in different areas of the Ternium companies (especially engineering, operations and maintenance sectors), as well as on the corporate level. This network is responsible for environmental permit administration, technical studies and evaluation of environmental aspects for projects, contractors, products, services, processes and raw materials, among others. The environmental area also works closely with Ternium's health and safety, planning, human relations and communications departments (both internal and external).

Ternium has not been fined for any material environmental violations in 2006, and we are not aware of any current material legal or administrative proceedings pending against it with respect to environmental matters which could have an adverse material impact on Ternium's financial condition or results of operations.

Hylsamex's activities in Mexico are subject to Mexican federal and state laws and regulations relating to the protection of the environment. The fundamental environmental law in the Mexican federal system is the Mexican General Law of Ecological Balance and Environmental Protection (the Ecological Law). The Ministry of Environment and Natural Resources (Secretaría del Medio Ambiente y Recursos Naturales or SEMARNAT) oversees compliance with the federal environmental laws and has the authority to enforce federal environmental laws, concerning water, land, air and noise pollution and hazardous substances.

Under the Ecological Law, a company may request an inspection of its facilities and voluntarily enter into an agreement with the Federal Environment Protection Office (Procuraduría Federal de Protección al Ambiente or PROFEPA) through the Programa Nacional de Auditoría Ambiental Voluntaria or Voluntary Environmental Audit National Program pursuant to which the company would agree to bring its facilities into compliance with law.

Hylsamex achieved the recertification condition for Clean Industry Certificate for its Monterrey plant. The Puebla Plant is currently certified as a clean industry, and the Galvak Plant, now identified as Hylsa Recubiertos, also reached the Clean Industry Certificate condition. Las Encinas mines and its facilities were voluntarily audited in September 2004. As a result, an improvement action plan was completed in June 2007 which is being implemented with capital expenditures of USD1.4 million in order to attain the clean industry condition. Regarding the North Plant, its improvement action plan was defined in December 2006. We believe that Hylsamex is currently in compliance with its obligations under such plans, and we are not aware of any current material legal or administrative proceedings pending against it with respect to environmental matters which could have an adverse material impact on our financial condition or results of operations.

#### ***Mining regulations in Mexico***

Because its operations in Mexico include mining, Hylsamex is also subject to Mexican regulations relating to mining and mining concessions. Under Mexican law, mineral resources belong to the Mexican nation and a concession from the Mexican federal government is required to explore for or exploit mineral reserves. Pursuant to the *Ley Minera* (Mining Law), mining concessions may only be granted to Mexican individuals and to legal entities incorporated under Mexican law. Foreign investors may hold up to 100% of the shares representing the capital stock of such entities. Ternium's mineral rights derive from concessions originally granted to Hylsamex.

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Mining concessions are either granted for exploration or for exploitation. An exploration concession permits its holder to explore for any mineral resources on a specified claim for a six-year period, which is nonrenewable and confers priority with respect to seeking an exploitation concession for the same claim. An exploitation concession permits its holder to extract minerals from a specified claim for a renewable period of up to 50 years, provided that its holder pays a nominal fee and complies with the Mining Law.

Mining concessions grant several specified rights to the concessionaire, including:

the right to dispose freely of mineral products obtained as a result of the exploitation of the concession;

the right to obtain the expropriation of, or an easement with respect to, the land where the exploration or exploitation will be conducted; and

the use of water in the mine to facilitate extraction.

In addition, a concessionaire of a mining concession is obligated, among other things, to explore or exploit the relevant concession, to pay for any relevant mining rights, to comply with all environmental and safety standards, and to provide information to the *Secretaría de Economía* ( Secretary of Economy or SE ) and permit inspections by SE. Mining concessions may be terminated if the obligations of the concessionaire are not satisfied.

A company that holds a concession must be registered with the Public Mining Registry. In addition, mining concessions and permits, assignments, transfers and encumbrances must be recorded with the Public Mining Registry to be enforceable. We believe that its material mining concessions are duly recorded with the Public Mining Registry.

### *Trade regulations*

Intense global competition in the flat steel products industry can lead many countries to impose higher duties or other restrictions on steel product imports to protect their domestic industries from trades that are not made under market conditions or that are otherwise unfair. Such measures protect domestic producers from increased imports sold at dumped or subsidized prices.

Some of the main regions to which Ternium sells its products, such as the United States and Europe, implemented these measures as well as general ones (safeguards) during a period of intense competition in 2001. All these safeguards were lifted in December 2003, but the same did not happen with antidumping and countervailing duties. At the same time, bilateral or regional free trade agreements have liberalized trade among some countries, providing for reduced or zero tariffs for many goods, including flat steel products.

Countries' imposition of trade remedy measures and the entry into force of various free trade agreements can and have both benefited and adversely affected Ternium's home market and export sales of flat steel products, as described below. See also Item 3. Key Information D. Risk Factors Certain Regulatory Risks and Litigation Risks International trade actions or regulations and trade-related legal proceedings could adversely affect Ternium's sales, revenues and overall business.

*Argentina: The Argentine government has imposed various antidumping measures on certain steel imports that compete directly with Ternium's sales in Argentina. Although, Ternium's operations have not been materially affected by the anti-dumping duties imposed by the Argentine government, the following measures are currently in effect:*

*Hot rolled products.* Since December 1999, the Argentine government has imposed anti-dumping measures requiring a minimum import price of USD410/ton for hot rolled steel imports from Brazil and of USD360/ton for hot rolled steel imports from the Russian Federation and Ukraine. Argentina accepted a price undertaking agreement from Brazilian exporters. Argentine authorities conducted a sunset review of these measures and decided to continue them for five more years. In its decision, the Argentine government determined anti-dumping duties for Russian, Ukrainian and Brazilian hot rolled steel exports to Argentina. A price undertaking for Brazilian exports was also accepted by the Argentine authorities.

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Argentina has also imposed antidumping measures on hot rolled steel imports from Kazakhstan (39.91%), Romania (40.48%), Slovak Republic (62.09%) and South Africa (55.26%) since April 2002. In May 2007, Argentine authorities initiated a sunset review for these measures, the review is expected to conclude in May 2008.

*Cold rolled products.* Since March 2001, the Argentine government has imposed anti-dumping measures requiring a minimum freight on board ( FOB ) price of USD534/ton for cold rolled steel imports from Brazil and USD521/ton for cold rolled steel imports from the Russian Federation. The Argentine government accepted a price undertaking from Brazilian exporters in accordance with an agreement with the main exporters. In June 2005, petitioners requested a sunset review but on June 13, 2006, petitioners withdrew their petition and the measures are no longer in effect.

Since January 2003, Argentina has also imposed antidumping measures on cold rolled steel imports from Korea (60.46%), South Africa (83.07%), Kazakhstan (80.61%) and Ukraine (71.22%). The measures are eligible for sunset review in 2008.

*Galvanized products.* Since May 2003, Argentina has imposed antidumping duties on galvanized steel sheets from South Korea (49.67%), South Africa (27.90%), Australia (70.37%) and Taiwan (33.09%). The Argentine government will conduct sunset review, if petitioner requests it, of these measures in 2008 to determine whether they should continue.

*Argentina has signed free trade agreements with several countries or trade blocs aimed at liberalizing trade between them:*

In early 1991, the Argentine government reduced import tariffs and eliminated most non-tariff restrictions on trade as part of an effort to open the Argentine economy to foreign competition. In March 1991, Argentina, Brazil, Uruguay and Paraguay established Mercosur, a common market organization whose four members have signed agreements that aim for eventual economic integration and the creation of a free trade zone and common external tariffs. Mercosur has eliminated or significantly reduced over time import duties, tariffs and other barriers to trade among the member nations. Zero tariffs have applied among Mercosur members to steel products since January 1, 2000. The current tariff applicable to flat and long steel products imported from outside Mercosur ranges from 2% to 14%, while the tariff for tubular steel products imported from outside Mercosur generally ranges from 14% to 16%.

In addition, Mercosur has a trade agreement with Chile, pursuant to which all tariffs on steel products have been eliminated. In 1996, Mercosur signed a free trade agreement with Bolivia, pursuant to which all steel products began receiving a 100% tariff preference on January 1, 2006.

In 2005, Mercosur and the Andean Community (Bolivia, Colombia, Ecuador, Peru and Venezuela), signed a free trade agreement aimed at reducing and eventually eliminating tariffs on steel products traded among member countries over a period of 8 to 12 years. Mercosur is also negotiating free-trade agreements with the EU, Mexico, India and South Africa, as well as participating in the Free Trade Area of the Americas, or FTAA, negotiations encompassing virtually all countries in the Americas. However, Venezuela has also announced that it will not be part of the FTAA being promoted by the United States.

In May 2006, Venezuela became a junior member of Mercosur and is currently seeking full membership in the group.

***Mexico:** The Mexican government has imposed certain anti-dumping measures on steel import products that are similar to the ones produced by Ternium in Mexico. The following anti-dumping measures are currently in effect.*

*Hot rolled products.* On March 28, 2000, the Mexican government imposed anti-dumping duties on the Russian Federation and Ukraine of 30.31% and 46.66%, respectively. On March 25, 2005 the first sunset review was initiated by the Mexican authorities. On March 17, 2006, the final resolution was issued which extended the anti-dumping duties for an additional five-year period.

Furthermore, since September 2005, Mexico has imposed anti-dumping measures against Ukraine (60.1%), Romania (67.60%) and Russia (36.80%) on cut-to length plate. Mexican authorities are expected to conduct a sunset review of the anti-dumping order in 2010.

*Cold rolled products.* Since June 1999, Mexico has imposed anti-dumping measures on cold rolled steel sheet from Bulgaria (44.0%-45.0%), the Russian Federation (85.0%-88%) and Kazakhstan (33.0%-34.0%). On December 12, 2005, and as a result of the first sunset review, the Mexican authorities extended the anti-dumping duties for an additional five-year period until June 2009.

*Plate in coil.* Since June 1996, an anti-dumping duty of 29.3% on imports from Russia has been imposed. In June 2003, the first sunset review resolution concluded the application of the anti-dumping duty. In June 2007, the Ministry of Economy issued the final resolution of the second sunset review, determining the continuation of the anti-dumping duties for an additional five year period.

*Long and pipe products.* Brazilian imports of reinforcing bars are currently subject to an anti-dumping duty of 57.69%. In June 2006, the first sunset review resolution determined the continuation of anti-dumping duties for an additional five year period. Wire rod imports from Ukraine

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are subject to a duty of 30.52%, which was imposed in September 2000. In August 2005, domestic producers announced their interest in a second sunset review to the government. Furthermore, a duty of 25.87% is in place over standard pipes imported from Guatemala since 2003. The initiation of the first sunset review is expected in January 2008.

*Mexico has signed trade agreements with several countries or trade blocs aimed at liberalizing trade between them:*

NAFTA was signed among Canada, Mexico and the United States and came into effect on January 1, 1994. NAFTA provided for the progressive elimination over a ten-year period of duties on, among other things, steel products traded between or among Mexico, the United States and Canada. As a result, zero tariffs currently apply to steel products traded within NAFTA countries. Ternium therefore has greater access to U.S. and Canadian markets but also faces increased competition in Mexico from U.S. and Canadian steel imports. NAFTA provides that NAFTA member companies (for example, Mexican steel producers) can challenge trade restrictions imposed by other NAFTA countries before a bi-national dispute resolution panel.

The Mexican-European Free Trade Agreement, or MEFTA, became effective on July 1, 2000. MEFTA provides for the phase-out and eventual elimination of Mexican duties on all industrial goods, including finished steel products, from the European Union by January 1, 2007. The EU eliminated all import duties on Mexican industrial goods, including finished steel products, as of January 1, 2003. Accordingly, Ternium has increased access to EU markets under MEFTA, but also could face increased competition in Mexico from EU steel imports.

In addition, the Mexican government has signed trade agreements with Venezuela, Colombia, EFTA (Liechtenstein, Norway, Iceland and Switzerland), Japan, Chile, Bolivia, Nicaragua, Costa Rica and Uruguay, among others. However, the Mexico-Venezuela FTA was cancelled in November 2006.

**Peru:** Since May 2002, the Peruvian government has imposed a 10% surcharge over CIF (cost, insurance, freight) prices on imports of steel bars from Venezuela, including Ternium's exports from Venezuela to Peru. Peru imposed the measure as a result of Venezuela's refusal to allow garlic imports from Peru, as agreed under the Andean Community regulations. Since December 2004, Peru has imposed a 5% surcharge over CIF prices on cold rolled coil imports and some coated products from Venezuela, including Ternium's exports to Peru, because of Venezuela's failure to apply agreed-upon import tariffs to Andean Community partners' goods.

**United States:** U.S. authorities have imposed some measures on flat and long steel products from Argentina, Mexico and Venezuela, which restrict Ternium's exports to that country. Measures that currently are in effect are the following:

**Argentina.** In August 2001, U.S. Department of Commerce, or DOC, imposed an anti-dumping duty of 44.59% and a CVD duty of 41.69% on hot rolled steel from Argentina following an affirmative injury finding by the U.S. International Trade Commission, or ITC. DOC and ITC initiated a sunset review of these measures in August 2006. A final finding by both of these agencies will result either in the termination or continuance of the duty. Also, cold rolled exports from Argentina to the United States were the subject of anti-dumping and countervailing duty investigations in 2002. These procedures were eventually resolved in favor of Siderar due to a finding of no injury. This decision is now final.

**Mexico.** Hylsamex's standard pipes are subject to an anti-dumping duty of 10.38%. This measure has been in place since 1992 and is currently under review as part of a sunset review procedure. Hylsamex's Oil Country Tubular Goods, or OCTG, products were subject to a 1.48% anti-dumping duty, but on May 31, 2007, ITC revoked the duties against Mexican OCTG. Pipe products were subject to anti-dumping duties since August 1995. This case is under review in two separate proceedings: a NAFTA panel and a World Trade Organization panel. Wire rod products are also currently subject to a duty of 1.81% as a result of the first administrative review.

**Venezuela.** In October 2001, the International Trade Commission (ITC) determined that wire rod imports from Venezuela were not materially injuring the U.S. steel industry. The ITC decision was appealed to the Court of International Trade (CIT). Upon remand from the CIT, the ITC issued a remand determination, finding again that imports from Venezuela were negligible. The case is now pending, awaiting a decision from the CIT approving the ITC remand determination.

**Venezuela:** *The Venezuelan government has imposed various antidumping measures on steel imports that compete directly with Ternium's sales in Venezuela. Although Ternium's operations have not been materially affected by the anti-dumping duties imposed by the Venezuelan government, the following measures are currently in effect:*

**Hot rolled products.** Since June 1999, Venezuela has imposed anti-dumping duties of 45.03%, 62.92% and 57.65% on hot rolled steel imported from the Russian Federation, Ukraine and Kazakhstan, respectively. These measures were continued in September 2005, following completion of a five-year review and will be in force until terminated by Venezuela's Anti-Dumping and Subsidies Commission (CASS) in accordance with Venezuelan trade law.

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*Cold rolled products.* Since September 1999, Venezuela has imposed anti-dumping duties of 45.41%, 55.01% and 58.47% on cold rolled steel imported from the Russian Federation, Ukraine and Kazakhstan, respectively. These measures were continued in October 2005, following completion of a five-year review, and will be in force until terminated by CASS in accordance with Venezuelan trade law.

*Venezuela has signed trade agreements with several countries or trade blocs aimed at liberalizing the trade between them:*

The Andean Community (formerly the Andean Pact) is a trading bloc established in 1969 by Bolivia, Colombia, Ecuador, Peru and Venezuela for the purpose of promoting trade relations among its members and between the Andean Community and the rest of the world (not only the European Community, now the EU). In 2004, Mercosur and the Andean Community merged the two blocs into a South American Free Trade Area. However, as a result of political tensions with member countries, Venezuela left the Andean Community. Venezuela also withdrew its membership from G-3 Trade Agreement, under which it had a free trade with Mexico and Colombia.

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**Insurance**

Our subsidiaries carry insurance policies covering property damage (including machinery breakdown and business interruption), general liability and other insurance such as, among others, automobile, marine cargo, life and workers' compensation insurance. These insurance policies include coverage and contract amounts which are customary in the steel products industry and in line with legal and domestic market requirements. General liability coverage typically includes third party, employers, sudden and accidental seepage and pollution and product liabilities within limits up to USD100 million.

**C. Organizational Structure**

The Company holds the San Faustin's investments in flat and long steel manufacturing, processing and distribution businesses, including its controlling direct and indirect equity interests in Argentina's largest steel company, Siderar, Venezuela's largest steel company, Sidor and one of Mexico's largest steel companies, Hylsamex, its controlling direct equity interests in Ternium Internacional and its recently acquired 50% equity interest in Exiros, a purchase agent.

Below is a simplified diagram of Ternium's corporate structure as of May 31, 2007.

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### Subsidiaries

Ternium operates entirely through subsidiaries. For a complete list of its subsidiaries and a description of its investments in other companies, see notes 1 and 2 to our consolidated financial statements included in this annual report.

#### *Siderar*

Siderar was created in 1993 and has become the main integrated manufacturer of flat steel products in Argentina with a current total annual production capacity of 2.9 million tons of crude steel.

Siderar operates one integrated steel manufacturing plant with 100% continuous casting capability, one hot strip rolling mill, two cold strip rolling mills, one tin plating plant, two galvanizing plants, one continuous painting plant, one electrolytic galvanizing plant for coils, a pre-painting plant for sheets and four service centers, all located in the province of Buenos Aires, Argentina.

Siderar's origins began in September 1961 with the founding of Propulsora Siderúrgica, or Propulsora. Propulsora began its operations as a producer of cold rolled coils in December 1969 and in the early 1990s began to evolve through a series of strategic investments oriented to transform Propulsora into an integrated steel producer. Propulsora acquired Aceros Parana, which was formed by the Argentine government in connection with the privatization of Somisa, at that time the main integrated producer of flat steel in Argentina. As part of this privatization, all of Somisa's productive assets were transferred to Aceros Parana, of which Propulsora acquired a controlling interest in late 1992. On November 29, 1993, Propulsora merged its operations with those of Aceros Parana and its subsidiary company, Sidercrom, a tin plate processing company, and two other steel industry subsidiaries of Propulsora (Aceros Revestidos and Bernal). After the merger, Propulsora changed its name to Siderar S.A.I.C.

As part of the privatization process in 1992, 20% of Siderar's shares were sold to former employees of state-owned Somisa under the *Programa de Propiedad Participada* (the Employee Stock Ownership Plan). These shares are administered by Inversora Siderúrgica Argentina. At the Siderar shareholders' meeting held on April 30, 2002, it was decided to convert the employee-held Class B shares to Class A shares that are authorized to be listed and to trade on stock exchanges.

The Company acquired a 56.1% participation in Siderar through the multiple-step reorganization of San Faustin's holdings in 2005. On October 27, 2005, Usiminas exchanged its 5.3% equity stake in Siderar for shares of the Company. On December 28, 2006, the Company acquired a 4.85% stake in Siderar from CVRD for total purchase price of USD107.5 million.

The main shareholders of Siderar as of May 31, 2007 are set out in the following table, together with the share percentage owned by each shareholder of Siderar:

| Siderar Shareholders                        | % Shares |
|---|----------|
| Ternium                                     | 60.9%    |
| Inversora Siderúrgica Argentina (employees) | 6.5%     |
| Public                                      | 32.6%    |
| Total                                       | 100.0%   |

Siderar's shares are listed on the Buenos Aires Stock Exchange, or BASE, under the symbol ERAR. The Buenos Aires Stock Market, which is affiliated with the BASE, is the largest stock market in Argentina. On June 25, 2007, the closing price of the Siderar shares on the BASE was AR\$22.75 per share, (approximately USD7.34 per share).

#### *Amazonia, Ylopa and Sidor*

**Amazonia.** In November 1997, San Faustin, together with several leading companies related to the steel industry, including Hylsamex, Usiminas and Sivensa, formed Amazonia. Amazonia was established in the Cayman Islands. The principal activity of Amazonia is the holding of long term investments in Sidor. The corporate purpose of Amazonia also





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includes the providing of technical and management assistance. Sidor is the largest steel company in the Andean Community and the main exporting private company in Venezuela. Sidor's Venezuelan facilities are one of the largest complexes of their kind in the world.

In December 1997, Amazonia won the bid in the privatization of 70% of the shares of Sidor. The Venezuelan government retained the remaining 30%. In January 1998, Amazonia paid USD1.2 billion for its stake in Sidor. This investment was financed through funds of each member of the consortium and a bank loan for USD500 million, guaranteed by the shares of Amazonia and those acquired from Sidor. Siderar's share in the investment was USD123 million.

The continuing world-wide steel production crisis, the deterioration of the financial markets, the appreciation of the Bolívar and other adverse factors negatively affected Sidor and Amazonia, which had to undergo debt restructurings in 2000 and 2003.

In June 2003, a restructuring agreement was reached among Sidor, Amazonia and its financial creditors. Pursuant to the restructuring:

Ylopa bought all the financial debt of Amazonia and part of the bank debt of Sidor for a total amount of USD127.6 million;

Sidor bought part of its own bank debt for a total amount of USD37.9 million;

the remaining debt was refinanced with a longer maturity and lower interest rates;

Ylopa assigned Amazonia all the debt it bought in exchange for a convertible debt of Amazonia representing 67.4% of the equity of Amazonia;

the Venezuelan government capitalized half its debt in Sidor, increasing the government's stake to 40.3% while Amazonia's stake decreased to 59.7%;

the rest of the government's debt was refinanced; and

Sidor would make payments to its creditors based on Sidor's ability to meet certain financial goals in accordance with the payment mechanism described below.

In connection with the restructuring of Sidor's debt, a payment mechanism was established that required Sidor to use certain future cash surpluses (calculated on the basis of a predetermined formula) to prepay the debt with BANDES and certain commercial bank creditors and to compensate CVG (the Venezuelan government) and certain partners of Amazonia (through Ylopa) pursuant to the agreements entered into by Sidor in the debt restructuring process that occurred in 2003. The payments were measured and paid semi-annually, until December 2004, when Sidor agreed to calculate the payments quarterly, and distribute the payments paid together with principal installments of its outstanding bank debt. The distribution of these payments began in 2003 and is scheduled to continue until the earlier of December 2016 and the fiscal year before the cancellation in full of the debt with BANDES. Under the agreements, Sidor's financial creditors receive 30% of the total payments made pursuant to this mechanism, and 70% is paid to Ylopa and CVG (with 59.7% apportioned to Ylopa and 40.3% to CVG). Any distribution collected by Ylopa that exceeds USD324 million must be transferred to Amazonia. This amount was exceeded in March 2005, and any subsequent distributions were transferred to Amazonia.

In February 2005, Ylopa converted the convertible debt it held in Amazonia into equity, and assigned such equity to its shareholders pro rata to their equity interests in Ylopa.

On June 29, 2005, ISL contributed its then-current direct and indirect interests in Siderar, Amazonia, Ternium Internacional and Ylopa to the Company. Through this contribution, the Company acquired a 39.4% indirect interest in Amazonia (including a 14.4% through Siderar's subsidiary Prosid). Furthermore, on August 22, 2005, with the acquisition of Hylsamex, Ternium acquired the 11.9% equity stake that Hylsamex

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held directly or indirectly, in Amazonia and the 7.5% that Hylsamex's former controlling shareholder, Alfa, held in Amazonia. On September 9, 2005, Tenaris transferred its 21.2% equity stake in Amazonia to ISL, which on September 15, 2005 contributed such shares to the Company. On October 27,

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2005, Usiminas exchanged its 16.6% equity stake in Amazonia for shares of the Company. On November 17, 2005, Sidetur, a subsidiary of Sivenza, exchanged with ISL its 3.4% interest in Amazonia for 33,800,735 shares of the Company. On February 9, 2006, ISL contributed to the Company the 3.4% interest in Amazonia acquired from Sidetur in exchange for Ternium shares. As of May 31, 2007, Ternium owned directly or through wholly owned subsidiaries 85.6% of Amazonia shares and 14.4% indirectly through Siderar (Prosid).

**Ylopa.** Ylopa is a company established in 2002 under the laws of Portugal and registered in the Madeira Free Zone. The sole purpose of its establishment was to participate in the debt restructuring process of Sidor and Amazonia. Ylopa was formed by the contributions of some of the private partners of Amazonia.

On June 29, 2005, ISL contributed its then-current direct and indirect interests in Siderar, Amazonia, Ternium Internacional and Ylopa to the Company. Through this contribution, Ternium acquired a 34.3% interest in Ylopa. Furthermore, on August 22, 2005, together with the acquisition of Hylsamex, Ternium acquired an 11.1% indirect interest that Hylsamex's former controlling shareholder, Alfa, held in Ylopa. On September 9, 2005, Tenaris transferred its 24.4% equity stake in Ylopa to ISL, which on September 15, 2005 contributed such shares to the Company. On October 27, 2005, Usiminas exchanged its 19.1% interest in Ylopa for shares of the Company. As of May 31, 2007, Ternium owned directly or through its wholly owned subsidiaries, 88.9% of Ylopa shares and 11.1% indirectly through Siderar (Prosid).

**Sidor.** Sidor is the main flat steel producer in Venezuela, the largest steel company in the Andean Community and the main exporting private company in Venezuela. The location of its steel plant close to the city of Puerto Ordaz in Venezuela, in the Matanzas industrial zone on the banks of the Orinoco River, provides Sidor with a prime location by connecting it directly to the Atlantic Ocean.

Sidor manufactures steel billets, slabs, wire rod, rebar, hot and cold rolled sheets, coated sheets and coils using direct reduction technology and electric arc furnaces with available natural resources. Sidor has an annual crude steel production capacity of 4.0 million tons.

The main shareholders of Sidor are set out in the following table, together with the share percentage owned by each shareholder of Sidor as of May 31, 2007:

| Sidor Shareholders                                  | % Shares      |
|---|---------------|
| Amazonia  | 59.7%         |
| CVG (Venezuelan government)                         | 20.3%         |
| Banco de Desarrollo Económico y Social de Venezuela | 0.1%          |
| Employees   | 19.9%         |
| <b>Total</b>  | <b>100.0%</b> |

In accordance with the Privatization Law, CVG and BANDES were required to transfer a maximum of 20% of their shares of Sidor to present and retired workers of Sidor, under the terms of a special plan called Program of Workers Participation (*Programa de Participación Laboral or PPL*) and an additional 10% to the plan called Program of Citizens Participation (*Programa de Participación Ciudadana or PPC*). The transfer of the PPL shares began in May 2004, and, as of the date of this annual report, it has assigned 19.9% of shares identified as Class B. As it relates to the PPC plan there is no certainty in connection with the commencement of the plan.

**Hylsamex**

Our Mexican subsidiary Hylsamex, acquired in August 2005, is a holding company with operating subsidiaries that manufacture and distribute steel products in Mexico. Hylsamex and its subsidiaries operate all of Ternium's mining and steel production activities in Mexico.

Hylsamex is one of the largest steel companies in Mexico using mini-mill technology and is a strong competitor in each of its principal flat and long steel products, including value-added finished steel products for use mainly in the construction, auto parts and appliance industries. Hylsamex is a holding company and, as such, does not engage directly in production operations. Instead, operations are conducted by Hylsamex's operating subsidiaries. The two principal subsidiaries of

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Hylsamex were Hylsa S.A. de C.V. ( Hylsa ) and Galvak, S.A. de C.V. ( Galvak ), of which Hylsamex held one hundred percent of the outstanding shares. Hylsa operated the principal divisions of steel production and Galvak was a leader in the production of coated steel. In the context of a corporate restructuring aimed at simplifying operations and eliminating unnecessary overlaps, on December 31, 2005 the other subsidiaries of Hylsamex (including Galvak) were merged into Hylsa, thereby consolidating under one operating company. As of the date of this annual report, the mergers are all registered in the Public Registry of Commerce.

Hylsa, originally named Hojalata y Lámina, S.A., was formed by investors in 1943 for the purpose of producing steel required in the manufacture of crown caps for local beer-bottling operations in Monterrey, Mexico. In the early 1950s, Hylsa developed a commercial process for making DRI in response to the scarcity of steel scrap that prevailed at the time and to tap its iron ore reserves. Initially, Hylsa was dedicated to the production of flat products, continuously revamping and expanding its operations and product lines. In the 1960s and 1970s, Hylsa expanded its operations by acquiring a rebar facility in Apodaca (the North Plant) and building a greenfield mill for the production of long products close to Puebla, about 200 kilometers away from Mexico City (the Puebla Plant). In the early 1990s, Hylsa initiated a comprehensive modernization and expansion program, disbursing over one billion dollars to bring its facilities to state-of-the-art status. At the core of Hylsa's modernization program is its Compact Strip Process (CSP) Flat Products Minimill, which commenced operations in 1995 and expanded in 1998 to its current annual capacity of hot rolled coils. Galvak resulted from the acquisition in 1979 of two local coating steel companies growing from a single galvanizing line into a leader in the processing, distribution and marketing of coated steel in Mexico, with an actual capacity of roughly 0.5 million tons of diversified coated products. In the early 1990s, Hylsamex was created by Alfa for the purpose of grouping all of Alfa's steel-related subsidiaries. Alfa is one of Mexico's largest companies, with significant holdings in the petrochemicals, food, telecommunications, automotive parts and steel industries. In February 2004, Alfa shareholders approved a two-stage divestiture of Hylsamex from Alfa's portfolio of businesses.

The main shareholders of Hylsamex are set out in the following table, together with the share percentage owned by each shareholder as of May 31, 2007:

| Hylsamex Shareholders  | % Shares      |
|--|---------------|
| Ternium  | 99.9%         |
| Indirectly through I.I.I. BVI                                      | 70.0%         |
| Indirectly through Siderar and its wholly-owned subsidiary Basilea | 29.9%         |
| Minority   | 0.1%          |
| <b>Total</b>   | <b>100.0%</b> |

On December 19, 2005, Hylsamex's shares were deregistered. As of the date of this annual report, Siderar continues to acquire shares held by the public. Mexican law does not provide for an automatic acquisition of any remaining Hylsamex shares at the expiration of the fiduciary account and does not allow us or Siderar to proceed with such an acquisition unilaterally.

***Ternium Internacional Commercial Network***

Ternium Internacional and its subsidiaries include eight incorporated companies (Uruguay, Spain, Holland, Panama, Peru, USA and Ecuador), three representative offices (Colombia, Argentina and Mexico) and other assets around the world that market and provide services in relation to the sales of Ternium's products worldwide. The headquarters of the network are located in Uruguay.

Given its presence in main steel markets, Ternium Internacional is able to provide its clients with marketing assistance for their export sales by aiding in consolidating their position in their present markets and developing new markets according to a jointly defined global strategy. Ternium Internacional services include sales and trading, communication systems, offices and human resources dedicated to export trading, technical assistance, commercial back office and credit analysis.

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Exiros, with presence in USA, Canada, Mexico, Italia, Brazil and Argentina, provides with purchase agency services in connection with Ternium's purchases of raw materials and other products or services. Until October 2006, Exiros was a wholly-owned subsidiary of Tenaris. In October 2006, Ternium acquired a 50% interest in Exiros, while Tenaris retained the remaining 50%. The objectives of the acquisition are to obtain better purchase conditions and prices as a result of the combined demand of products and services by both companies' demand, as well as to secure joint control over the purchase process.

**D. Property, Plants and Equipment**

See Business Overview Production Process and Facilities.

**Item 4A. Unresolved Staff Comments**

None.

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

The following discussion and analysis of our financial condition and results of operations is based on, and should be read in conjunction with, our audited consolidated financial statements and the related notes included elsewhere in this annual report. This discussion and analysis presents our financial condition and results of operations on a consolidated basis. We prepare our consolidated financial statements in conformity with IFRS, which differ in certain significant respects from U.S. GAAP. See note 34 to our audited consolidated financial statements included in this document, which include a description of the principal differences between IFRS and U.S. GAAP as they relate to the Company and a reconciliation of net income and shareholders' equity for the years and at the dates indicated.

Certain information contained in this discussion and analysis is presented elsewhere in this annual report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. See Cautionary Statement Concerning Forward-Looking Statements. In evaluating this discussion and analysis, you should specifically consider the various risk factors identified in this annual report and others that could cause results to differ materially from those expressed in such forward-looking statements.

**Overview**

Ternium is one of the leading steel companies in the Americas, offering a wide range of flat and long steel products. Ternium has operating locations in México, Argentina and Venezuela, that provide it with a strong position form which to serve its core markets. In addition, Ternium reaches the regional markets through its own network of distribution, sales and marketing offices.

Ternium primarily sells its steel products in the regional markets of North, Central and South America, where it can leverage its strategically-located manufacturing facilities to provide specialized products and delivery services to its clients. We believe that Ternium is the leading supplier of flat steel products in Argentina, through its subsidiary Siderar, and of flat and long steel products in Venezuela, through Amazonia's subsidiary Sidor and a significant competitor in Mexico through its subsidiary Hylsamex. Amazonia became a subsidiary of Ternium on February 15, 2005, after the capitalization of certain debt instruments convertible into shares of Amazonia. Ternium also maintains a strategic presence in other major steel markets, such as Europe and Asia, through its network of commercial offices, which allows it to reach clients outside its regional markets with a comprehensive range of products and services and place products in case of slower demand in domestic economies, achieve improved effectiveness in the supply of its products and maintain a fluid commercial relationship with its clients by providing continuous services and assistance. In addition, Ternium is a competitive player in the international trade market for flat and long steel products. With the acquisition of Hylsamex, the Mexican steel company acquired in August 2005, Ternium has become a significant competitor in the Mexican market for flat and long steel products and has enhanced its position as an international steel producer, and is expected to increase its presence in these markets if and when the Grupo Imsa transaction referred to elsewhere in this annual report is completed.

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Ternium's revenues are affected by general global trends in the steel industry and more specifically by the economic conditions in the countries in which it has manufacturing operations and where its clients are located. Ternium's revenues are also impacted by events that affect the price and availability of raw materials and energy inputs needed for its operations. Furthermore, due to the highly cyclical nature of the steel industry, recent results may not be indicative of future performance, and historical results may not be comparable to future results. Investors should not rely on the results of a single period, particularly a period of peak prices, as an indication of Ternium's annual results or future performance. The variables and trends mentioned below could also affect the results of its investments in steel related companies. See Item 4. Information on the Company B. Business Overview Our Business Strategy .

***Ternium's primary source of revenue is the sale of flat and long steel products.*** Management expects sales of flat and long steel products to continue to be Ternium's primary source of revenue. The global market for such steel products is highly competitive, with the primary competitive factors being price, cost, product quality and customer service. Ternium sells its products in several countries worldwide; however, the majority of such sales are concentrated in the Americas. Specifically, Ternium's largest markets are concentrated in Argentina and Venezuela, where its manufacturing subsidiaries are located. After the acquisition of Hylsamex, Mexico also became one of its primary markets, and is expected to become even more significant if and when the Grupo Imsa transaction referred to elsewhere in this annual report is completed.

***Ternium's results are sensitive to economic activity, steel consumption, prices in the international steel markets and trends in the steel industry.*** Ternium's results of operations primarily depend on economic conditions in Argentina and Venezuela (where Ternium is a leading manufacturer and supplier), and, to a lesser extent, on economic conditions in international and regional markets such as Mercosur, the Andean Community and NAFTA. Historically, annual steel consumption in the countries where Ternium operates has varied at a rate that is linked to the annual change in each country's gross domestic product and per capita disposable income. Recently, worldwide economic growth and favorable economic developments throughout the Americas resulted in increases in investments and in per capita disposable income, which in turn contributed to increased overall demand for Ternium's products. For example, apparent consumption of finished steel products in Argentina increased by 3.2% and 20.5% during 2005 and 2006, respectively, due to the sustained recovery in the Argentine economy, mainly in the industrial activity, agriculture, construction and automotive sectors.

In addition, steel prices worldwide are determined by global trends of supply and demand. A decline in global steel prices generally leads to a decrease in the prices of Ternium's products and, consequently, to a decline in revenues and profitability. As a result of the general excess capacity in the industry, the world steel industry was subject to substantial downward pricing pressure, which negatively impacted the results of steel companies in the second half of 2000 and the entire year of 2001. International steel prices generally improved beginning in 2003, driven by a strong increase in global demand fostered by economic growth in Asia and an indication of economic recovery in the United States. However, this new period of high prices for steel has encouraged reactivation of and investment in production capacity and, consequently, oversupply has led to a decline in steel prices beginning in the last quarter of 2004 and continuing through 2005. Nevertheless, prices in 2005 reached generally higher levels than those prevailing in 2001 through 2003. Steel prices began to recover in 2006, exceeding those of 2005, as a result of better global economic performance, but slightly decreased toward the second half of the year.

Furthermore, there has been a trend in recent years toward steel industry consolidation among Ternium's competitors. For example, Aceralia, Arbed and Usinor merged in February 2002 to create Arcelor, and LNM Holdings and Ispat International merged in October 2004 to create Mittal Steel, which subsequently acquired International Steel Group. Furthermore, in June 2006, Mittal Steel and Arcelor merged to create the world's largest steel company, Arcelor Mittal. In April 2007, Tata Steel completed the acquisition of Corus. Consolidation has enabled steel companies to lower their production costs and allowed for more stringent supply-side discipline, including through selective capacity closures. Competition from global steel manufacturers with expanded production capacity such as Mittal Steel and Arcelor, and new market entrants, especially from China, could result in significant price competition, declining margins and reductions in revenue.

***Ternium's production costs are generally sensitive to the international prices of raw materials and energy, which reflect supply and demand factors in the global steel industry.*** Ternium purchases substantial quantities of raw materials, including iron ore, coal, ferroalloys and scrap, for use in the production of its steel products. The availability and price of

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these inputs vary according to general market and economic conditions and thus are influenced by industry cycles. Since 2003, the recovery of the U.S. economy, an unprecedented demand for steel in China and shortage of shipping capacity resulted in a tight market for raw materials globally. These factors contributed to a strong boost in the prices of raw materials globally. In addition to raw materials, natural gas and electricity are both important components of Ternium's cost structure. In 2003 and 2004, international energy prices rose substantially from the levels that had prevailed in the previous four years, reflecting higher demand for energy inputs. Moreover, an energy crisis, like that affecting Argentina since 2003, or any other disruption in the supply of natural gas or electricity, could force Ternium to acquire energy from alternative sources and could negatively impact Ternium's costs.

***Ternium's revenues could be affected by competition from imports and dumping conditions.*** Ternium's ability to profitably access the export markets varies with the value of the local currencies where it operates, the strength of the economies of the countries to which it exports and overall steel prices. Ternium's ability to sell its products is influenced to varying degrees by trends in global trade for steel products, particularly trends in imports of steel products into its principal markets. During 2001, a period of strong over-supply, several anti-dumping measures were imposed in several countries in which Ternium operates (including Argentina, Venezuela and Mexico) to prevent foreign steel producers from dumping certain steel products in local markets. The recovery in global economic conditions since 2003 and strong Chinese demand reduced the previously strong competition in the international exports markets. As a consequence, several countries reduced or eliminated the protective measures established in prior years. However, a number of other trade restrictions, both in Ternium's local and export markets, remain in place.

***Prevailing exchange rates have had an impact on Ternium's results in the past and could impact results again in the future.*** Ternium's operating subsidiaries have primarily U.S. dollar-denominated revenues (other than revenues from domestic sales in Mexico), while a significant portion of their costs are denominated in local currency in the markets where they operate. As a result, Ternium's income is affected by the fluctuation of each local currency against the U.S. dollar. If the local currency appreciates, Ternium receives less local currency for each U.S. dollar of export revenue and imports become cheaper in local currency terms; these factors tend to place a ceiling on domestic prices. However, if the local currency depreciates, as occurred in Argentina in 2002, local costs become cheaper, while imported raw materials become more expensive. Ternium manages this risk through specific hedges to the extent management considers appropriate. The Argentine peso/U.S. dollar exchange rate was relatively stable throughout 2006, with frequent interventions by the Argentine Central Bank to maintain the exchange rate at a level close to ARP3.1/USD. The Venezuelan bolívar/U.S. dollar exchange rate was set by the Venezuelan government at a rate of VEB1,917/USD in February 2004 and remained unchanged until March 2005, when it was set at VEB2,147/USD. The Mexican peso fluctuated during 2006, averaging MXN10.9/USD.

***Ternium's net income in 2006 does not benefit from a non-recurring gain recognized in 2005.*** As discussed elsewhere in this annual report, in February 2005, Ylopa exercised its option to convert the outstanding balance of the Amazonia convertible debt instrument into newly issued shares of that company. As a result, Ternium's indirect participation in Amazonia increased from 31.03% to 53.4%. At the time of conversion, the shares had a fair value that exceeded the book value of the convertible debt due to the improvement of Sidor's business conditions and, accordingly, Ternium recognized a USD188.4 million non-recurring gain.

***The consolidation of Amazonia's results beginning on February 15, 2005 changes the treatment of compensation payable to participants in Sidor's and Amazonia's 2003 debt restructuring.*** As discussed elsewhere in this annual report in connection with their participation in Sidor's and Amazonia's 2003 debt restructuring, the Venezuelan government and certain partners of Amazonia (through Ylopa) are entitled to receive compensation in the form of cash payments made by Sidor on a quarterly basis pursuant to a participation agreement. Prior to February 15, 2005, the cash payments received by Ternium were part of its financial income. Following the consolidation of Amazonia's results beginning on February 15, 2005, such financial income is eliminated in consolidation; however, the cash amounts paid or payable in the future to the Venezuelan government are part of Ternium's financial expense. See Item 4. Information on the Company C. Organizational Structure Subsidiaries Amazonia, Ylopa and Sidor Amazonia.

***Our sales of steel products and our financial expenses are expected to increase significantly if and when we complete the Grupo Imsa transaction.*** On April 29, 2007, we entered into a definitive agreement, pursuant to which Ternium, or any of its subsidiaries, is expected to obtain control over Grupo Imsa, a steel manufacturer with operations in Mexico, United States and Guatemala. The transaction is subject to Mexican and U.S. regulatory approvals, and other customary conditions.

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Grupo Imsa has an annual production capacity of 2.2 million tons of hot rolled coils, 1.8 million tons of cold rolled products, 1.7 million tons of galvanized products, and it also produces panels and other steel products, with net sales of USD3.4 billion in 2006, according to Grupo Imsa's 2006 Annual Report. For more information, see Item 5. Operating and Financial Review and Prospects G. Recent Developments (a) Agreement to obtain control over Grupo Imsa. If and when the transaction is consummated, we expect that our sales of steel products will increase significantly. In addition, if and when the transaction is consummated, we expect to incur additional debt up to USD2.1 billion under one or more term loan facilities, in which case our financial expenses will increase significantly.

### **Critical Accounting Estimates**

This discussion of our operating and financial review and prospects is based on our audited consolidated financial statements, which have been prepared in accordance with IFRS. The use of IFRS (as opposed to U.S. GAAP) has an impact on our critical accounting policies and estimates. The application of U.S. GAAP would have affected the determination of consolidated net income for the years ended December 31, 2006, 2005 and 2004, and the determination of consolidated shareholders' equity as of December 31, 2006 and 2005. See note 34 to our audited consolidated financial statements included in this annual report, for a reconciliation of our results of operations and shareholders' equity presented under IFRS to U.S. GAAP.

The preparation of financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its accounting estimates and assumptions, including those related to doubtful accounts, obsolescence of inventory, impairment of long-term investments, impairment of other assets and contingencies, and revises them when appropriate. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Although management believes that its estimates and assumptions are reasonable, they are based upon information available when the estimates and assumptions are made. Actual results may differ significantly from these estimates under different assumptions or conditions.

Our most critical accounting estimates are those that are most important to the portrayal of our financial condition and results of operations, and which require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. We believe that changes in these assumptions and estimates are not likely to have a material impact on our consolidated financial statements. Our most critical accounting estimates and judgments are set forth below.



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### **Useful Lives and Impairment of Property, Plant and Equipment and Other Long-lived Assets**

As permitted under IFRS 1 – First Time Adoption of IFRS, management has elected to use the fair value of its property, plant and equipment as at January 1, 2003 as its deemed cost. In determining useful lives and impairment estimates, management considered, among others, the following factors: age, operating condition and level of usage and maintenance. Management conducted visual inspections for the purpose of (i) determining whether the current conditions of such assets are consistent with normal conditions of assets of similar age; (ii) confirming that the operating conditions and levels of usage of such assets are adequate and consistent with their design; (iii) establishing obsolescence levels and (iv) estimating expectancy, all of which were used in determining useful lives and impairment estimates. Management believes, however, that it is possible that the periods of economic utilization of property, plant and equipment may be different than the useful lives so determined. Impairments may result from, among other factors, changes in usage level and maintenance capital expenditure policies, obsolescence and external factors (including increases in input prices that would affect the profitability of the selected fixed assets). Any such impairment charges could have a material adverse effect on Ternium's results of operations, financial condition and net worth. Under IFRS, assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and the present value of estimated future cash flows. For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Management believes that this accounting policy involves a critical accounting estimate because it is subject to change from period to period as a result of variations in economic conditions and business performance.

### **Allowances for Doubtful Accounts**

Management makes estimates of the uncollectibility of our accounts receivable. Management analyzes our trade accounts receivable on a regular basis and, when aware of a third party's inability to meet its financial commitments to us, management impairs the amounts due by means of a charge to the allowance for doubtful accounts. Management specifically analyzes accounts receivable and historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

In addition, a charge to the allowance for doubtful accounts is recognized when a customer makes a claim in connection with an order that has been invoiced and management estimates that, despite its efforts, we are unlikely to collect the full amount of the invoice.

Allowances for doubtful accounts are adjusted periodically in accordance with the aging of overdue accounts. For this purpose, trade accounts receivable overdue by more than 90 days, and which are not covered by a credit collateral, guarantee or similar surety, are fully provisioned.

Historically, losses due to credit failures, aging of overdue accounts and customer claims have been within expectations and in line with the provisions established. If, however, circumstances were to materially change (*e.g.*, higher than expected defaults), management's estimates of the recoverability of amounts due to us could be materially reduced and our results of operations, financial condition and net worth could be materially and adversely affected.

### **Allowance for Obsolescence of Supplies and Spare Parts and Slow-Moving Inventory**

Management makes estimates of the recoverability of our inventories of supplies and spare parts based on the following criteria:

- analysis of the aging of the supplies and spare parts; and

- analysis of the capacity of materials to be used according to their level of preservation and of their potential obsolescence due to technological changes in the mills.

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In addition, in our manufacturing facilities an allowance for slow-moving inventory is made in relation to finished goods based on management's analysis of their aging and market conditions. For this purpose, stocks of finished goods held in inventory for more than six months before the applicable reporting date are valued at their estimated recoverable value.

Historically, losses due to obsolescence and scrapping of inventory have been within expectations and the provisions established. If, however, circumstances were to materially change (*e.g.*, significant changes in market conditions or in the technology used in the mills), management's estimates of the recoverability of these inventories could be materially reduced and our results of operations, financial condition and net worth could be materially and adversely affected.

### **Loss Contingencies**

We are subject to various claims, lawsuits and other legal proceedings that arise in the ordinary course of our business, including customer claims in which a third party is seeking reimbursement or indemnity. Our liability with respect to such claims, lawsuits and other legal proceedings cannot be estimated with certainty. Periodically, management reviews the status of each significant matter and assesses potential financial exposure. If the potential loss from the claim or proceeding is considered probable and the amount can be reasonably estimated, a liability is recorded. Management estimates the amount of such liability based on the information available and the assumptions and methods it has concluded are appropriate, in accordance with the provisions of IFRS. Accruals for such contingencies reflect a reasonable estimate of the losses to be incurred based on information available, including the relevant litigation or settlement strategy, as of the date of preparation of the applicable financial statement. As additional information becomes available, management will reassess its evaluation of the pending claims, lawsuits and other proceedings and revise its estimates.

With respect to the loss contingencies described in our financial statements, we do not expect to incur any losses exceeding the amounts accrued as of December 31, 2006 that would be material relative to our consolidated financial position, results of operations or liquidity as of such date. However, if reserves prove to be inadequate and we incur a charge to earnings, such charge could have a material adverse effect on our results of operations, financial condition and net worth.

### **Impairment of Long-term Investments**

Management records an investment impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of these investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future.

As a consequence of certain adverse economic and financial factors experienced by Amazonia in connection with its investment in Sidor, as of December 31, 2003, Ternium recorded an allowance of USD148.3 million to account for potential losses in the value of this investment. In 2004, due to improved performance, Ternium (based on estimates prepared by its management) reversed the impairment provision recorded in previous years on its investment in Sidor. For the purpose of conducting impairment tests, the fair value of the subsidiary was determined using the discounted cash flow method, based on financial projections and on a discount rate using market parameters. Therefore, the impairment on our investment in Amazonia was reversed. In 2006 and 2005 there were no impairment charges. See note 11 to our consolidated financial statements for further reference regarding our investment in Amazonia.

### **Impairment of Deferred Tax Assets**

Management calculates current and deferred income taxes according to the tax laws applicable to our subsidiaries in the countries in which such subsidiaries operate. However, certain adjustments necessary to determine the income tax provision are finalized only after the balance sheet is issued. In cases in which the final tax outcome is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made. When assessing the recoverability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies. Based on those estimates, management did not record a valuation allowance at December 31, 2006.

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Although we believe our estimates are appropriate, significant differences in actual performance of the asset or group of assets may materially affect our asset values and results of operation.

**Net Income and Shareholders' Equity Information on a U.S. GAAP Basis**

IFRS differ in significant respects from U.S. GAAP. Under U.S. GAAP, we recorded net income of USD841.0 million for fiscal year ended December 31, 2006 (compared to net income attributable to equity holders of USD795.4 million under IFRS), USD559.3 million for the fiscal year ended December 31, 2005 (compared to net income attributable to equity holders of USD704.4 million under IFRS), and net income of USD424.7 million for the fiscal year ended December 31, 2004 (compared to net income attributable to equity holders of USD457.3 million under IFRS). The principal differences between IFRS and U.S. GAAP that affected our results of operations are as follows:

differences in the valuation (at fair value) of property, plant and equipment and in the capitalization of interest on property, plant and equipment under construction;

differences in the accounting for excess of the fair value of assets acquired over cost;

differences in accounting for acquisition of minority interest in controlled subsidiaries;

differences in accounting for changes in the fair value of financial assets; and

the effects on deferred taxes and minority interest of the above reconciling items.

Shareholders' equity determined in accordance with U.S. GAAP was USD3,435.5 million as of December 31, 2006, compared to USD3,757.6 million under IFRS and USD1,436.6 million as of December 31, 2005, compared to USD1,842.5 million under IFRS. The principal differences affecting the determination of shareholders' equity are those described above.

For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to our consolidated net income and shareholders' equity, see note 34 to our audited consolidated financial statements included in this annual report.

**A. Results of Operations**

The following discussion and analysis of our financial condition and results of operations are based on our audited consolidated financial statements included elsewhere in this annual report. Accordingly, this discussion and analysis present our financial condition and results of operations on a consolidated basis. See "Presentation of Certain Financial and Other Information Accounting Principles" and notes 2 and 4 to our audited consolidated financial statements included in this annual report. The following discussion should be read in conjunction with our audited consolidated financial statements and the related notes included in this annual report.

**Table of Contents***In thousands of U.S. dollars***For the year ended December 31,***(except number of shares and per share data)*

|  | <b>2006</b>   | <b>2005<sup>(1) (2)</sup></b> | <b>2004<sup>(1) (2)</sup></b> | <b>2003<sup>(1) (2)</sup></b> |
|--|---------------|-------------------------------|-------------------------------|-------------------------------|
| <b>Selected consolidated income statement data</b>   |               |                               |                               |                               |
| <b>IFRS</b>  |               |                               |                               |                               |
| Net sales  | 6,568,975     | 4,447,680                     | 1,598,925                     | 1,056,566                     |
| Cost of sales  | (4,301,384)   | (2,488,980)                   | (965,004)                     | (671,720)                     |
| Gross profit   | 2,267,591     | 1,958,700                     | 633,921                       | 384,846                       |
| Selling, general and administrative expenses   | (623,772)     | (500,590)                     | (116,626)                     | (115,662)                     |
| Other operating expenses, net  | (7,250)       | (65,949)                      | (3,124)                       | (4,402)                       |
| Operating income   | 1,636,569     | 1,392,161                     | 514,171                       | 264,782                       |
| Interest expense   | (112,918)     | (81,608)                      | (18,257)                      | (39,980)                      |
| Interest income  | 52,554        | 32,324                        | 8,911                         | 6,036                         |
| Other financial (expenses) income, net   | (322,417)     | (261,452)                     | 211,635                       | 109,550                       |
| Excess of fair value of net assets acquired over cost  |               | 188,356                       |                               |                               |
| Equity in earnings of associated companies   | 4,534         | 21,524                        | 209,201                       | 110,250                       |
| Income before income tax expense   | 1,258,322     | 1,291,305                     | 925,661                       | 450,638                       |
| Income tax expense   | (262,356)     | (218,492)                     | (177,486)                     | (94,087)                      |
| Net income for the year <sup>(3)</sup>   | 995,966       | 1,072,813                     | 748,175                       | 356,551                       |
| Attributable to:   |               |                               |                               |                               |
| Equity holders of the Company  | 795,424       | 704,406                       | 457,339                       | 218,215                       |
| Minority interest  | 200,542       | 368,407                       | 290,836                       | 138,336                       |
|  | 995,966       | 1,072,813                     | 748,175                       | 356,551                       |
| Depreciation and amortization  | 424,495       | 316,405                       | 99,192                        | 85,479                        |
| Weighted average number of shares outstanding <sup>(4)</sup>   | 1,936,833,060 | 1,209,476,609                 | 1,168,943,632                 | 1,168,943,632                 |
| Basic earnings per share for profit attributable to the equity holders of the Company <sup>(4)</sup>   | 0.41          | 0.58                          | 0.39                          | 0.19                          |
| Diluted earnings per share for profit attributable to the equity holders of the Company <sup>(5)</sup> | 0.41          | 0.54                          | 0.39                          | 0.19                          |
| Dividends per share declared <sup>(6)</sup>  | 0.05          |                               |                               |                               |
| <b>U.S. GAAP</b>   |               |                               |                               |                               |
| Net sales  | 6,568,975     | 4,447,680                     | 1,598,925                     | 1,056,566                     |
| Net income for the year <sup>(7)</sup>   | 841,018       | 559,305                       | 424,655                       | 264,173                       |
| Weighted average number of shares outstanding <sup>(4)</sup>   | 1,936,833,060 | 1,209,476,609                 | 1,168,943,632                 | 1,168,943,632                 |
| Basic earnings per share for profit attributable to the equity holders of the Company <sup>(4)</sup>   | 0.43          | 0.46                          | 0.36                          | 0.23                          |
| Diluted earnings per share for profit attributable to the equity holders of the Company <sup>(5)</sup> | 0.43          | 0.43                          | 0.36                          | 0.23                          |

- (1) Combined consolidated financial information on the basis of common control. See note 2 to our audited consolidated financial statements.
- (2) Certain comparative amounts for 2005, 2004 and 2003 have been reclassified to conform to changes in presentation in the current period.
- (3) For IFRS purposes, net income for the year is shown gross of the interest of minority shareholders in controlled subsidiaries. The portion of net income attributable to the equity holders of the Company and to minority shareholders is disclosed separately. Under U.S. GAAP, net income for the year is shown net of minority interest.
- (4) As discussed in note 29 to our audited consolidated financial statements, in October 2005, Usiminas exchanged its 5.3% equity interest in Siderar, its 16.6% equity interest in Amazonia and its 19.1% equity interest in Ylopa and other items for 227,608,254 new shares of the Company. Upon the consummation of this exchange, capital increased to USD1,396.6 million, represented by 1,396,551,887 shares of

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USD1.00 nominal value each. Pursuant to certain provisions contained in the Subordinated Convertible Loan Agreement, on February 6, 2006 the Company exchanged the Subordinated Convertible Loans (including interest accrued through January 31, 2006) held by ISL and converted them into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006. As provided in the Corporate Reorganization Agreement, on February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly-issued shares of the Company after the settlement of its initial public offering. In connection with the over-allotment described in note 1 to our audited consolidated financial statements, on March 1, 2006, the Company issued 22,981,360 new shares. Upon consummation of the transactions mentioned above, as of December 31, 2006, the capital of the Company was increased to USD2,004.7 million, represented by 2,004,743,442 shares, each having a nominal value of USD1.00. Ternium's combined earnings per share for the years ended December 31, 2004 and 2003 have been calculated based on the assumption that 1,168,943,632 shares were issued and outstanding in each of the periods presented. For fiscal years 2006 and 2005, the weighted average of shares outstanding totaled 1,936,833,060 shares and 1,209,476,609 shares, respectively.

- (5) Diluted earnings per share have been calculated giving effect to the conversion of the Subordinated Convertible Loans. See note 1 to our audited consolidated financial statements.
- (6) On June 6, 2007, at Ternium's annual general shareholders meeting a dividend of USD0.05 per share (USD0.50 per ADS), or approximately USD100 million was approved. Ternium paid the dividend on June 12, 2007.
- (7) We are not presenting net income from continuing operations since it is identical to net income for all years presented.

**Table of Contents***In thousands of U.S. dollars***At December 31,***(except number of shares and per share data)*

|   | <b>2006</b>   | <b>2005<sup>(2)</sup></b> | <b>2004<sup>(1)(2)</sup></b> | <b>2003<sup>(1)</sup></b> |
|---|---------------|---------------------------|------------------------------|---------------------------|
| <b>Selected consolidated balance sheet data</b>                   |               |                           |                              |                           |
| <b>IFRS</b>   |               |                           |                              |                           |
| <b>Non-current assets</b>   | 6,117,284     | 6,116,423                 | 1,728,410                    | 1,610,810                 |
| Property, plant and equipment, net                                | 5,420,683     | 5,463,871                 | 1,244,691                    | 1,275,699                 |
| Other non-current assets <sup>(3)</sup>                           | 696,601       | 652,552                   | 483,719                      | 335,111                   |
| <b>Current assets</b>   | 2,653,255     | 2,543,558                 | 918,220                      | 576,078                   |
| Cash and cash equivalents   | 643,352       | 765,630                   | 194,875                      | 129,020                   |
| Other current assets  | 2,002,861     | 1,774,768                 | 723,345                      | 447,058                   |
| Non-current assets classified as held for sale                    | 7,042         | 3,160                     |                              |                           |
| <b>Total assets</b>   | 8,770,539     | 8,659,981                 | 2,646,630                    | 2,186,888                 |
| Capital and reserve attributable to equity holders <sup>(4)</sup> | 3,757,558     | 1,842,454                 | 1,026,725                    | 701,821                   |
| Minority interest   | 1,729,583     | 1,733,465                 | 745,126                      | 550,264                   |
| <b>Non-current liabilities</b>                                    | 1,875,894     | 3,691,288                 | 359,510                      | 677,649                   |
| Borrowings  | 548,401       | 2,399,878                 | 1,008                        | 283,914                   |
| Deferred income tax   | 985,155       | 1,048,188                 | 337,473                      | 374,907                   |
| Other non-current liabilities                                     | 342,338       | 243,222                   | 21,029                       | 18,828                    |
| <b>Current liabilities</b>  | 1,407,504     | 1,392,774                 | 515,269                      | 257,154                   |
| Borrowings  | 508,694       | 516,399                   | 121,998                      | 80,238                    |
| Other current liabilities   | 898,810       | 876,375                   | 393,271                      | 176,916                   |
| <b>Total liabilities</b>  | 3,283,398     | 5,084,062                 | 874,779                      | 934,803                   |
| <b>Total equity and liabilities</b>                               | 8,770,539     | 8,659,981                 | 2,646,630                    | 2,186,888                 |
| Number of shares outstanding <sup>(5)</sup>                       | 2,004,743,442 | 1,396,551,887             | 1,168,943,632                | 1,168,943,632             |
| <b>U.S. GAAP</b>  |               |                           |                              |                           |
| Total assets  | 8,181,931     | 7,938,086                 | 2,115,271                    | 1,201,734                 |
| Non-current liabilities   | 1,938,505     | 3,699,842                 | 44,647                       | 311,054                   |
| Total shareholders' equity  | 3,435,516     | 1,436,638                 | 954,255                      | 382,703                   |

- (1) Combined consolidated financial information on the basis of common control. See note 2 to our audited consolidated financial statements.
- (2) Certain comparative amounts for 2005, 2004 and 2003 have been reclassified to conform to changes in presentation in the current period.
- (3) As of December 31, 2006 and 2005 includes goodwill related to the acquisition of Hylsamex for a total amount of USD397.9 million and USD399.7 million, respectively. See note 3(e) to our audited consolidated financial statements.
- (4) The Company's common stock as of December 31, 2006, 2005, 2004 and 2003 was represented by 2,004,743,442, 1,396,551,887, 1,168,943,632 and 1,168,943,632, par value USD1.00 per share, for a total amount of USD2,004.7 million, USD1,396.6 million, USD1,168.9 million and USD1,168.9 million, respectively.
- (5) As described in note 29 to our audited consolidated financial statements, in October 2005, Usiminas exchanged its 5.3% equity interest in Siderar, its 16.6% equity interest in Amazonia and its 19.1% equity interest in Ylopa and other items for 227,608,254 new shares of the Company. Upon the consummation of this exchange, capital increased to USD1,396.6 million, represented by 1,396,551,887 shares of USD1.00 nominal value per share. As per the provisions contained in the Subordinated Convertible Loan Agreement, on February 6, 2006 the Company exchanged the Subordinated Convertible Loans (including interest accrued through January 31, 2006) held by ISL and converted them into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006. As provided in the Corporate Reorganization Agreement, on February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly-issued shares of the Company after the settlement of its initial public offering. In connection with the over-allotment described in note 1 to our audited consolidated financial statements, on March 1, 2006, the Company issued 22,981,360 new shares. Upon consummation of the transactions mentioned above, as of December 31, 2006, the capital of the Company was increased to USD2,004.7 million, represented by 2,004,743,442 shares, each having a nominal value of USD1.00.

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The following table sets forth our operating and other costs and expenses as a percentage of net sales for the years indicated:

| <i>Percentage of net sales</i>                        | <b>For the year ended December 31,</b> |             |             |             |
|---|--|-------------|-------------|-------------|
|   | <b>2006</b>                            | <b>2005</b> | <b>2004</b> | <b>2003</b> |
| Net sales   | 100.0%                                 | 100.0%      | 100.0%      | 100.0%      |
| Cost of sales   | (65.5)%                                | (56.0)%     | (60.4)%     | (63.6)%     |
| Gross profit  | 34.5%                                  | 44.0%       | 39.6%       | 36.4%       |
| Selling, general and administrative expenses          | (9.5)%                                 | (11.3)%     | (7.3)%      | (10.9)%     |
| Other operating expenses, net                         | (0.1)%                                 | (1.5)%      | (0.2)%      | (0.4)%      |
| Operating income                                      | 24.9%                                  | 31.3%       | 32.2%       | 25.1%       |
| Interest expense                                      | (1.7)%                                 | (1.8)%      | (1.1)%      | (3.8)%      |
| Interest income                                       | 0.8%                                   | 0.7%        | 0.6%        | 0.6%        |
| Other financial (expense) income, net                 | (4.9)%                                 | (5.9)%      | 13.2%       | 10.4%       |
| Excess of fair value of net assets acquired over cost |  | 4.2%        |             |             |
| Equity in earnings of associated companies            | 0.1%                                   | 0.5%        | 13.1%       | 10.4%       |
| Income before income tax expense                      | 19.2%                                  | 29.0%       | 57.9%       | 42.7%       |
| Income tax expense                                    | (4.0)%                                 | (4.9)%      | (11.1)%     | (8.9)%      |
| Net income for the year                               | 15.2%                                  | 24.1%       | 46.8%       | 33.7%       |
| Attributable to:                                      |  |             |             |             |
| Equity holders of the Company                         | 12.1%                                  | 15.8%       | 28.6%       | 20.7%       |
| Minority interest                                     | 3.1%                                   | 8.3%        | 18.2%       | 13.1%       |

***Fiscal Year Ended December 31, 2006 compared to Fiscal Year Ended December 31, 2005***

Due to the consolidation of Amazonia and Hylsamex since February 15, 2005 and August 22, 2005, respectively, the results and other financial data for the year ended December 31, 2006 varied significantly from the results and other financial data for the years ended December 31, 2005 and 2004. Fiscal year ended December 31, 2006 figures consolidate the results of Hylsamex, Siderar and Sidor together with all other consolidating subsidiaries for the full year.

***Overview***

Ternium's net income attributable to equity holders increased to USD795.4 million for the year ended December 31, 2006, from USD704.4 million for the year ended December 31, 2005.

The results in 2006 were attributable to:

a positive environment for improved volumes and strong steel prices;

the consolidation for the full fiscal year of Hylsa's and Sidor's results;

the absence of the non-recurring gain of USD188.4 million recorded in 2005 upon the conversion, in February 2005, of a convertible loan granted by Ylopa into Amazonia shares;

all of which was partially offset by increases in cost of sales, selling, general and administrative expenses, and financial expense. The increase in cost of sales was principally due to higher iron ore and coal costs in 2006 related to the annual increases in the international prices for those commodities; but also the result of three items that affected the year's cost of sales: a charge related to an increase in pension plan benefits at Sidor; lower efficiencies that resulted from the work slowdowns and strikes at Sidor; and costs associated with the relining of blast furnace No.1 at Siderar. The increase in selling, general and



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administrative expenses was mainly due to higher freight and transportation expenses attributable to an increase in sales. Finally, the increase in financial expenses was principally attributable to higher interest expense resulting from the indebtedness under the facilities entered into in connection with the Hylsamex acquisition and to the recognition of Sidor's excess cash payments that resulted in a financial loss of USD270.2 million.

Cash and cash equivalents as of December 31, 2006 were USD633.0 million (not including USD10.4 million of restricted cash), compared to USD755.0 million (not including USD10.7 million of restricted cash) in the previous year. This 16.2% decrease was mainly due to the performance of the operating activities which provided USD1,245.0 million, offset mainly by capital expenditures of USD405.8 million, acquisition of business of USD210.5 million and the net cash used in financing activities of USD756.3 million.

**Net Sales**

Net sales in 2006 totaled USD6,569.0 million, a 47.7% increase from USD4,447.7 million in 2005. This significant increase was primarily due to the consolidation for the full fiscal year of Amazonia and Hylsamex's sales of USD239.9 million (net of intercompany transactions) and USD1,760.4 million (net of intercompany transactions), respectively, together with an increase in Siderar's sales of USD305.1 million, which was partially offset by a decrease in Ternium Internacional's sales of USD184.2 million. Both Amazonia and Hylsamex had strong sales consistent with the solid pricing environment and the positive economic activity in the markets in which they participate.

The following table shows Ternium's total consolidated net sales by product and geographical region for the years indicated:

| <i>In thousands of U.S. dollars</i>    | <b>For the year ended<br/>December 31,</b> |                  |
|--|--|------------------|
|  | <b>2006</b>                                | <b>2005</b>      |
| <b>Flat Steel Product Sales</b>        |  |                  |
| South and Central America              | 3,038,369                                  | 2,384,649        |
| North America                          | 1,960,793                                  | 948,852          |
| Europe and Other                       | 48,365                                     | 326,926          |
| <b>Total Flat Steel Products Sales</b> | <b>5,047,527</b>                           | <b>3,660,427</b> |
| <b>Long Steel Product Sales</b>        |  |                  |
| South and Central America              | 526,780                                    | 370,634          |
| North America                          | 735,823                                    | 252,576          |
| Europe and Other                       |  | 2,158            |
| <b>Total Long Steel Product Sales</b>  | <b>1,262,603</b>                           | <b>625,368</b>   |
| <b>Total Other Sales<sup>(1)</sup></b> | <b>258,845</b>                             | <b>161,885</b>   |
| <b>Total Sales</b>                     | <b>6,568,975</b>                           | <b>4,447,680</b> |

(1) The item "Total Other Sales" includes mainly sales of pig iron and iron ore.

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In 2006, Ternium derived the majority of its revenues (approximately 76.8 %) from sales of flat steel products. Total sales of flat steel products increased significantly from USD3,660.4 million in 2005 to USD5,047.5 million in 2006. USD95.2 million (net of intercompany transactions) and USD1,142.7 million (net of intercompany transactions) resulted from the consolidation of Amazonia's and Hylsamex's results for the full year, respectively, together with an increase in Siderar's sales of USD290.2 million, partially offset by a decrease in Ternium International's sales. After the consolidation of Amazonia and Hylsamex's results in 2005, long steel product sales increased significantly from USD625.4 million in 2005 to USD1,262.6 million in 2006. The variation was as a consequence of an increase in Amazonia and Hylsamex's sales of USD135.6 million and USD530.0 million respectively.

The other sales increased from USD161.9 million in 2005 to USD258.8 million in 2006, mainly as a consequence of the consolidation of Hylsamex, which exported iron ore pellets and fines to China, as well as sales of iron ore pellets from Amazonia.

*Sales Volume*

The following table shows our sales volume by product and market for the years indicated:

| <i>In thousands of tons</i>                  | <b>For the year ended December 31,</b> |              |
|--|--|--------------|
| (unaudited)                                  | <b>2006</b>                            | <b>2005</b>  |
| <b>Flat Steel Product Sales Volume</b>       |  |              |
| South and Central America                    | 4,361                                  | 3,463        |
| North America                                | 2,413                                  | 1,406        |
| Europe and Other                             | 88                                     | 514          |
| <b>Total Flat Steel Product Sales Volume</b> | <b>6,861</b>                           | <b>5,383</b> |
| <b>Long Steel Product Sales Volume</b>       |  |              |
| South and Central America                    | 948                                    | 709          |
| North America                                | 1,225                                  | 503          |
| Europe and Other                             |  | 5            |
| <b>Total Long Steel Product Sales Volume</b> | <b>2,174</b>                           | <b>1,218</b> |
| <b>Total Sales Volume<sup>(1)</sup></b>      | <b>9,035</b>                           | <b>6,600</b> |

(1) The Total Sales Volume does not include the tons related to Other sales.

Total sales volume increased by 36.9% to 9,035 thousand tons in 2006 from 6,600 thousand tons in 2005. The increase of Sidor's and Hylsamex's sales volume of 201 thousand tons and 2,202 thousand tons (net of intercompany transactions), respectively, for the fiscal year 2006 mainly reflects the consolidation of these companies, together with an increase in Siderar's sales volume of 341 thousand tons, which was partially offset by a decrease in Ternium International's sales volume of 309 thousand tons.

In 2006, flat steel product sales volume increased by 27.5% to 6,861 thousand tons from 5,383 thousand tons in 2005. The increase of 1,383 thousand tons (net of intercompany transactions) of Hylsamex's sales volume was mainly due to the effect of the consolidation for the full year. Sales in South and Central America increased by 898 thousand tons, or 26.0%, from 3,463 thousand tons in 2005 to 4,361 thousand tons in 2006. The variation was attributable to an increase of Sidor's and Siderar's sales of 468 thousand tons and 471 thousand tons, respectively. Sales to North America increased by 71.7% to 2,413 thousand tons in 2006 from 1,405 thousand tons in 2005. The substantial difference was due to an increase of Hylsamex's sales volume of 1,351 thousand tons, partially offset by a decrease in Sidor's sales of 411 thousand tons. Sales to Europe and Other markets decreased by 426 thousand tons, or 82.9%, from 514 thousand tons in 2005 to 88 thousand tons in 2006 due to the shift in sales to Ternium's traditional markets.

In 2006, long steel product sales volume increased by 78.5% to 2,174 thousand tons from 1,218 thousand tons in 2005, due to the effect of the consolidation for the full year of Sidor and Hylsamex's sales volume of 200 thousand tons and 819 thousand tons, respectively. Sales in South and Central America increased by 239 thousand tons, or



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33.7%, from 709 thousand tons in 2005 to 948 thousand tons in 2006, as a consequence of an increase of Sidor's sales of 207 thousand tons. Sales to North America increased by 722 thousand tons, or 143.5%, from 503 thousand tons in 2005 to 1,225 thousand tons in 2006, as a result of the consolidation for the full year of Hylsamex's sales of 802 thousand tons. Sales to Europe and other markets were not recorded during 2006.

The following table shows the percentage of market distribution of Ternium's total sales by region for the years indicated:

| <i>Percentage of total sales</i> | <b>For the year ended December 31,</b> |             |
|----------------------------------|--|-------------|
|                                  | <b>2006</b>                            | <b>2005</b> |
| South and Central America        | 56.4%                                  | 63.1%       |
| North America                    | 42.1%                                  | 29.0%       |
| Europe and Other                 | 1.5%                                   | 7.9%        |
|                                  | 100.0%                                 | 100.0%      |

Sales destined to the Americas increased to 98.5% of the net sales in 2006 from 92.1% of net sales in 2005 primarily due to the effect of the consolidation of Hylsamex's sales for the full year in 2006. During the same period, sales destined to South and Central America decreased slightly as percentage of net sales, while sales destined to North America increased sharply from 29.0% of net sales in 2005 to 42.1% of net sales in 2006. This variation was mainly due to the consolidation of Hylsamex for the full fiscal year in 2006, which is located in Mexico and channeled most of its shipments in the North America Region. Sales to Europe and other markets decreased to 1.5% of net sales in 2006 from 7.9% of net sales in 2005, due to the shift in sales to Ternium's traditional markets.

**Sales prices**

Revenue per ton of flat steel products increased by 8.2% to USD736 in 2006 from USD680 in 2005. Revenue per ton for long steel products increased by 13.0% to USD581 in 2006 from USD514 in 2005. While prices remained relatively stable throughout 2006 in the South and Central America region, steel prices in the North America region grew during the first part of 2006, peaked in August and softened later in the year due to increased imports pressure in the U.S. and a de-stocking process in Mexico and in the U.S.

**Cost of sales**

Total cost of sales increased by 72.8%, from USD2,489.0 million in 2005 to USD4,301.4 million in 2006. The variation was mainly an increase of Hylsamex's cost of sales of USD1,401.8 million due to the consolidation for the full fiscal year in 2006, together with an increase in Sidor's and Siderar's cost of sales of USD347.0 million and 249.6 million, respectively. Ternium experienced higher iron ore and coal costs in 2006 related to the annual increases in the international prices for those commodities. Furthermore, 2006 results included three items that affected the year's cost of sales: a charge related to an increase in pension plan benefits at Sidor; lower efficiencies that resulted from the work slowdowns and strikes at Sidor that ended on November 8, 2006; and costs associated with the relining of blast furnace No.1 at Siderar, which resumed operations on January 31, 2007.

Natural gas and electricity prices for the South and Central America operations were relatively stable. Energy for the Venezuelan operations is tied to long-term contracts, and prices of electricity and natural gas under such contracts were relatively stable. Operations in Argentina are largely self-sufficient in electricity through their self-generation capabilities. Most of the energy input at this operation is obtained from metallurgical coal and pet coke, the balance being fulfilled with fuel oil and natural gas. Natural gas prices in Argentina showed only slight fluctuations.

The natural gas consumption for the operations in Mexico was largely fixed through hedging mechanisms, which prevented major cost changes associated with natural gas prices. Electricity prices in Mexico experienced slight increases due to the higher finished steel production that required the use of additional electricity at higher peak hour rates.

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Average cost of sales per ton of flat steel products increased by 28.8% from USD372 per ton in 2005 to USD479 per ton in 2006 largely due to additional processing cost associated with Hylsamex's richer product mix and also to overall increases in raw materials and energy, such as, iron ore, coal and coke, costs related to the annual increases in the international prices for those commodities. The average cost of sales per ton of long steel products increased by 24.2% from USD318 per ton in 2005 to USD395 per ton in 2006, mainly due to the same reasons expressed previously for flat steel products.

Cost of sales, expressed as a percentage of net sales, increased to 65.5% during 2006, compared to 56.0% in 2005. The increase was due to higher costs of supplies, raw materials and labor costs, together with a product mix with a lower gross margin, and also due to Hylsamex's consolidation for the full fiscal year.

***Selling, general and administrative expenses***

Selling, general and administrative expenses in 2006 were USD623.8 million, or 9.5% of net sales, compared to USD500.6 million, or 11.3% of net sales in 2005.

The consolidation of Sidor and the acquisition of Hylsamex increased the absolute figure for selling, general and administrative expenses, which reflected higher freight associated with the increased volume of sales and higher personnel costs due to the integration of the three main companies into Ternium. Despite the increase in selling, general and administrative expenses, the reduction in the ratio of selling, general and administrative expenses to net sales in 2006 as compared to the previous year reflects a significant rationalization in white collar head count and improved efficiencies.

***Other operating expenses, net***

Other operating income and expenses decreased by USD58.7 million, from a net loss of USD65.9 million for the fiscal year ended December 31, 2005 to a net loss of USD7.3 million in 2006. This variation was mainly due to a decrease of USD41.0 million in the de-recognition property, plant and equipment, together with a decrease of USD4.9 million in the charge accounted for 2006 related to the provisions for legal claims.

***Operating income***

Operating income totaled USD1,636.6 million in 2006, 17.6% higher than the operating income of USD1,392.2 million in 2005. This variation was mainly due to a positive environment for improved volumes and strong steel pricing, partially offset by higher input costs. Operating income as a percentage of sales was 24.9% in 2006, compared to 31.3% in 2005.

***Financial expenses, net***

Net financial expense resulted in a net financial loss of USD382.8 million in 2006, compared to a net financial loss of USD310.7 million in 2005. The significant change was due to:

an increase of USD31.3 million in interest expense, from USD112.9 million in 2006 to USD81.6 million in 2005, due to higher interest costs resulting from the indebtedness under the facilities entered into in connection with the Hylsamex acquisition;

an increase in net financial losses from the participation account in an amount of USD49.0 million. Until February 15, 2005, Ternium accounted for its investment in Amazonia under the equity method of accounting. Thus, income arising from the Participation Account Agreement has been recorded under Income from Participation Account within Financial income, net. Upon the conversion of the Amazonia convertible debt instrument, on February 15, 2005, Ternium acquired indirect control of Amazonia and began accounting for such investment on a consolidated basis. Following the consolidation of Amazonia's results, income resulting from Ternium's share of the Participation account has been offset against Amazonia's loss for the same concept and shown net under loss from participation account line item;

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an increase of USD10.5 million in the debt issuance costs, mainly in connection with the Hylsamex's acquisition in 2005; and

an increase of USD13.7 million in other charges due to the issuance of letters of credit, payment of commissions and other financial costs associated to the higher level of activity;

all of which was partially offset by an USD20.2 million increase in interest income and a USD12.3 million decrease in losses related to net foreign exchange transactions and changes in the fair value of derivatives.

***Equity in earnings of associated companies***

Ternium's share in the results of associated companies during 2006 was a gain of USD4.5 million, compared to a gain of USD21.5 million for 2005. The decrease was mainly due to the earnings of associated companies recorded under the equity method until February 15, 2005, relating to Ternium's investment in Amazonia.

***Income tax expense***

During 2006, Ternium recorded an income tax expense of USD262.4 million, compared to an income tax expense of USD218.5 million for the fiscal year ended December 31, 2005. The effective tax rate of Ternium is calculated as income tax on income (before equity in earnings of associated companies, income tax and excess of fair value of net assets acquired over cost and minority interest). Ternium's effective tax rate for 2006 was 20.9%, compared to 20.2% in 2005.

***Net income attributable to minority interest***

Net income attributable to minority interest for the fiscal year ended December 31, 2006 was USD200.5 million compared to USD368.4 million in 2005. The decrease was mainly due to an increase in Siderar's minority interest results of USD10.6 million and a decrease of USD165.7 million related to Amazonia's acquisition in February 15, 2005, and the Usiminas and ISL's exchanges.

***Fiscal Year Ended December 31, 2005 compared to Fiscal Year Ended December 31, 2004***

Due to the consolidation of Amazonia and Hylsamex since February 15, 2005 and August 22, 2005, respectively, the results and other financial data for the year ended December 31, 2005 varied significantly from the results and other financial data for the previous year. The consolidation of Amazonia resulted, among other things, in the elimination of intercompany sales between Sidor and Ternium's subsidiaries, following which trading activities are no longer material.

***Overview***

Ternium's net income attributable to equity holders increased to USD704.4 million for the year ended December 31, 2005, from USD457.3 million for the year ended December 31, 2004.

The improved results in 2005 were also the result of:

the acquisition of Amazonia and Hylsamex, since February 15, 2005 and August 22, 2005, respectively;

a non-recurring gain of USD188.4 million recorded upon the conversion, in February 2005, of a convertible loan granted by Ylopa into Amazonia shares;

which were partially offset by an increase in financial expenses principally attributable to higher interest expense resulting from the indebtedness under the facilities entered into in connection with the Hylsamex acquisition, and also attributable to the effect of the change in the recognition of Sidor's excess cash payments that resulted in a financial loss of USD265.2 million.



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Cash and cash equivalents as of December 31, 2005 were USD755.0 million (not including USD10.7 million of restricted cash), compared to USD194.9 million in the previous year. This 287.4% increase was mainly due to the consolidation of Amazonia and Hylsamex in 2005.

**Net Sales**

Net sales in 2005 totaled USD4,447.7 million, a 178.2% increase from USD1,598.9 million in 2004. This significant increase was primarily due to the consolidation of Amazonia and Hylsamex's sales of USD1,863.5 million (net of intercompany transactions) and USD723.8 million (net of intercompany transactions), since February 15, 2005 and August 22, 2005, respectively, together with an increase in Siderar's sales of USD292.8 million, which was partially offset by a decrease in Ternium Internacional's sales of USD31.0 million. Both Amazonia and Hylsamex enjoyed strong sales consistent with the solid pricing environment and the positive economic activity in the markets in which they participate.

The following table shows Ternium's total combined consolidated net sales by product and geographical region for the years indicated:

| <i>In thousands of U.S. dollars</i>    | <b>For the year ended December 31,</b> |                  |
|--|--|------------------|
|  | <b>2005</b>                            | <b>2004</b>      |
| <b>Flat Steel Product Sales</b>        |  |                  |
| South and Central America              | 2,384,651                              | 999,567          |
| North America                          | 948,852                                | 94,299           |
| Europe and Other                       | 326,926                                | 172,331          |
| <b>Total Flat Steel Products Sales</b> | <b>3,660,429</b>                       | <b>1,266,197</b> |
| <b>Long Steel Product Sales</b>        |  |                  |
| South and Central America              | 370,634                                |                  |
| North America                          | 252,576                                |                  |
| Europe and Other                       | 2,157                                  |                  |
| <b>Total Long Steel Product Sales</b>  | <b>625,367</b>                         |                  |
| <b>Trading Sales<sup>(1)</sup></b>     |  |                  |
| South and Central America              |  | 116,624          |
| North America                          |  | 136,530          |
| Europe and Other                       |  | 72,073           |
| <b>Total Trading Sales</b>             |  | <b>325,227</b>   |
| <b>Total Other Sales<sup>(2)</sup></b> | <b>161,885</b>                         | <b>7,501</b>     |
| <b>Total Sales</b>                     | <b>4,447,680</b>                       | <b>1,598,925</b> |

(1) The item "Trading Sales" includes mainly trading activities for the year ended December 31, 2004 and 2003. The consolidation of Amazonia's results since February 15, 2005 resulted in the elimination of intercompany sales between Sidor and Ternium's subsidiaries, following which trading activities are no longer material.

(2) The item "Total Other Sales" includes mainly sales of pig iron, iron ore pellets and steel tubes.



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In 2005, Ternium derived the majority of its revenues (approximately 82.3%) from sales of flat steel products. Total sales of flat steel products increased significantly from USD1,266.2 million in 2004 to USD3,660.4 million in 2005. USD1,569.5 million (net of intercompany transactions) and USD429.8 million (net of intercompany transactions) resulted from the consolidation of Amazonia's and Hylsamex's results, respectively, together with an increase in Siderar's sales.

After the consolidation of Amazonia and Hylsamex's results in 2005, long steel product sales totaled USD625.4 million. Because Amazonia and Hylsamex are the only Ternium subsidiaries that manufacture long steel products, no such sales were recorded in 2004.

Due to the consolidation of Amazonia's results since February 15, 2005, the intercompany sales between Sidor and Ternium's subsidiaries were eliminated, following which trading activities are no longer material. Furthermore, other sales increased from USD7.5 million in 2004 to USD161.9 million in 2005, mainly as a consequence of the consolidation of Hylsamex, which exported iron ore pellets and fines to China, as well as sales of iron ore pellets from Amazonia and steel tubes from the tubing facilities located in Mexico.

*Sales Volume*

The following table shows our sales volume by product and market for the years indicated:

| <i>In thousands of tons</i>                  | <b>For the year ended December 31,</b> |              |
|--|--|--------------|
| <i>(unaudited)</i>                           | <b>2005</b>                            | <b>2004</b>  |
| <b>Flat Steel Product Sales Volume</b>       |  |              |
| South and Central America                    | 3,463                                  | 1,718        |
| North America                                | 1,406                                  | 147          |
| Europe and Other                             | 514                                    | 311          |
| <b>Total Flat Steel Product Sales Volume</b> | <b>5,383</b>                           | <b>2,176</b> |
| <b>Long Steel Product Sales Volume</b>       |  |              |
| South and Central America                    | 709                                    |              |
| North America                                | 503                                    |              |
| Europe and Other                             | 5                                      |              |
| <b>Total Long Steel Product Sales Volume</b> | <b>1,218</b>                           |              |
| <b>Trading Sales Volume<sup>(1)</sup></b>    |  |              |
| South and Central America                    |  | 159          |
| North America                                |  | 246          |
| Europe and Other                             |  | 142          |
| <b>Trading Sales Volume</b>                  |  | <b>546</b>   |
| <b>Total Sales Volume<sup>(2)</sup></b>      | <b>6,600</b>                           | <b>2,722</b> |

(1) The item Trading Sales Volume includes mainly trading activities for the year ended December 31, 2004 and 2003. The consolidation of Amazonia's results since February 15, 2005 resulted in the elimination of intercompany sales between Sidor and Ternium's subsidiaries, following which trading activities are no longer material.

(2) The Total Sales Volume does not include 130 thousand tons and 26 thousand tons of other sales item in 2005 and 2004, respectively. Total sales volume increased by 142.5% to 6,600 thousand tons in 2005 from 2,722 thousand tons in 2004. The increase mainly reflects the consolidation of Sidor's and Hylsamex's sales volume of 3,037 thousand tons and 770 thousand tons (net of intercompany transactions) for the fiscal year 2005, which was partially offset by a decrease of 36 thousand tons of Siderar's sales volume.

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In 2005, flat steel product sales volume increased by 147.4% to 5,383 thousand tons from 2,176 thousand tons in 2004. The increase was mainly due to the effect of the consolidation of 2,550 thousand tons (net of intercompany transactions) and 429 thousand tons (net of intercompany transactions) of Sidor and Hylsamex's sales volume, respectively. The difference was mainly attributable to increases in Siderar's sales volume. Sales in South and

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Central America increased by 1,744 thousand tons, or 101.5%, from 1,718 thousand tons in 2004 to 3,463 thousand tons in 2005. The increase was attributable to the consolidation of Sidor's sales, which occurred primarily in the South and Central America region. Sales to North America increased by 856.1% to 1,406 thousand tons in 2005 from 147 thousand tons in 2004. The substantial increase was due to the consolidation of Hylsamex's sales volume. Sales to Europe and Other markets increased by 65.6% from 311 thousand tons in 2004 to 514 thousand tons in 2005 due to the strong demand in the European market.

Long steel product sales were recorded in 2005 as a result of the consolidation of Sidor and Hylsamex's results and reached a total of 1,218 thousand tons in 2005. In 2004, no such sales were recorded because Ternium did not offer long steel products. Of the 1,218 thousand tons of long steel products volume sold in 2005, 758 thousand tons (net of intercompany transactions) and 340 thousand tons (net of intercompany transactions) corresponded to Sidor and Hylsamex, respectively, while the difference corresponded mostly to Ternium Internacional. The long steel product markets are traditionally more local, particularly reinforcing bar, with Sidor volumes corresponding largely to South and Central America and those of Hylsamex to North American markets. In addition, Sidor sold wire rod to North America.

The following table shows the percentage of market distribution of Ternium's total combined sales by region for the years indicated:

| <i>Percentage of total sales</i> | <b>For the year ended December 31,</b> |             |
|----------------------------------|--|-------------|
|                                  | <b>2005</b>                            | <b>2004</b> |
| South and Central America        | 63.1%                                  | 70.3%       |
| North America                    | 29.0%                                  | 14.4%       |
| Europe and Other                 | 7.9%                                   | 15.3%       |
|                                  | 100.0%                                 | 100.0%      |

Sales destined to the Americas increased to 92.1% of net sales in 2005 from 84.7% of net sales in 2004 primarily due to the effect of the consolidation of Sidor's and Hylsamex's sales. During the same period, tons destined to South and Central America decreased slightly as percentage of net sales, while tons destined to North America increased from 14.4% of net sales in 2004 to 29.0% of net sales in 2005. This variation was mainly due to the consolidation of Hylsamex, which is located in Mexico and channeled most of its shipments in the North America Region. Sales to Europe and other markets decreased to 7.9% of net sales in 2005 from 15.3% of net sales in 2004, due to the shift in sales to Ternium's traditional markets.

*Sales prices*

Revenue per ton of flat steel products increased by 16.8% to USD680 in 2005 from USD582 in 2004. Although international steel prices receded from the peak levels observed during the second half of 2004 and early 2005, international reference prices remained at very strong levels. The healthy sales figure in 2005 was due to better pricing in emerging economies, as well as to an improvement in the product mix resulting from the consolidation of Hylsamex (which has a higher value added product mix) in the latter part of 2005. Revenue per ton for long steel products reached USD513 per ton in 2005. Due to the consolidation of Amazonia's results in 2005, sales between Sidor and Ternium's subsidiaries were eliminated, following which trading activities are no longer material.

*Cost of sales*

Total cost of sales rose by 157.9%, from USD965.0 million in 2004 to USD2,489.0 million in 2005 primarily due to the consolidation of Sidor's and Hylsamex's cost of sales amounting to USD809.5 million and USD530.6 million, respectively, together with an increase of USD228.6 million in Siderar's cost of sales. The increase, however, was partially offset by a decrease in Ternium Internacional's cost of sales. The increase was mainly due to higher prices for metallurgic coal, coke and iron ore for Siderar. Also, labor costs for Siderar increased from USD89.4 million in 2004 to USD104.7 million in 2005, and freight and transportation costs increased from USD18.7 million to USD22.7 million for the same period.

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The consolidation of Hylsamex's resulted in additional costs associated with processing raw steel into value added products. Costs for iron ore were relatively stable as iron ore was supplied entirely from Hylsamex's mines. Energy costs experienced a significant increase, mainly in natural gas, which rose throughout the year. The increase in gas prices was partially offset by hedging and a price rebate offered by the Mexican government late in 2005 as a response to the effect of hurricane Katrina on gas prices. Conversely, Sidor's consolidation resulted in lower costs for raw materials due to its favorable access to energy resources and proximity to premier sources of iron ore.

Average cost of sales per ton of flat steel products increased by 24.8% from USD298 per ton in 2004 to USD372 per ton in 2005 largely due to additional processing cost associated with Hylsamex's richer product mix and also to overall increases in raw materials and energy, such as, iron ore, coal, coke, natural gas and electricity. The average cost of sales per ton of long steel products was USD318 in 2005.

Cost of sales, expressed as a percentage of net sales, decreased to 56.0% during 2005, compared to 60.4% in 2004. The decrease was due to an increase in revenue per ton, due to a combination of improved mix and better product pricing, which more than compensated for the increases in costs of supplies, raw materials and labor costs.

***Selling, general and administrative expenses***

Selling, general and administrative expenses in 2005 were USD500.6 million, or 11.3% of net sales, compared to USD116.6 million, or 7.3% of net sales in 2004.

Selling expenses in 2005 increased by USD210.0 million to USD268.2 million, or 6.0% of net sales, compared to USD58.2 million, or 3.6% of net sales, in 2004. The increase was mainly due to the consolidation of Amazonia and Hylsamex's expenses, in an amount of USD151.9 million and USD42.8 million, respectively. Also, Siderar's selling expenses increased due to higher freight and transportation and services and fees expenses.

General and administrative expenses in 2005 were USD232.4 million, or 5.2% of net sales, compared to USD58.4 million, or 3.7% of net sales in 2004. The increase was mainly due to the consolidation of Sidor's and Hylsamex's expenses, in an amount of USD86.8 million and USD62.5 million, respectively. Siderar's expenses increased by USD20.6 million in 2005 due to higher labor costs, taxes and services and fees. The higher level of general and administrative expenses as a percentage of sales also reflected one-time charges of USD22.5 million in 2005 related to the administrative reorganization of Hylsamex.

***Other operating expenses, net***

Other operating income and expenses showed a net loss of USD65.9 million for the fiscal year ended December 31, 2005, compared to a net loss of USD3.1 million in 2004. This variation was mainly due to a loss of USD54.3 million from the disposal of property, plant and equipment that was recognized in 2005 in connection with the closure of Hylsamex's ingot casting mill and other facilities.

***Operating income***

Operating income totaled USD1,392.2 million in 2005, 170.8% higher than the operating income of USD514.2 million in 2004. The large increase was primarily due to the consolidation of Amazonia and Hylsamex in 2005, which amounted to USD808.7 million and USD35.7 million, respectively (net of intercompany transactions). Operating income as a percentage of sales was 31.3% in 2005, compared to 32.2% in 2004.

***Financial (expenses) income, net***

Net financial expense resulted in a net financial loss of USD310.7 million in 2005, compared to a net financial gain of USD202.3 million in 2004. The significant change was due to:

a significant increase in interest expense, which totaled USD81.6 million in 2005 from USD18.3 million in 2004. The increase was mainly due to the consolidation of Amazonia and Hylsamex's results in 2005, in

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amounts of USD20.9 million and USD18.5 million, respectively, as well as to increased indebtedness in Siderar and Ternium under the Ternium Credit Facility and the Siderar Credit Facility, related to the acquisition of Hylsamex on August 22, 2005; and

the effect of the change in the recognition of Sidor's excess cash distribution related to the participation account established as a result of its 2003 debt restructuring. On February 15, 2005, Ternium acquired indirect control of Sidor and began accounting for such investment on a consolidated basis. Accordingly, any excess cash payments received by Ternium were eliminated in the consolidation process, while any excess cash payments made by Sidor to third parties were recorded as a financial loss. This resulted in a financial loss of USD265.2 million in 2005.

### ***Excess of Fair Value of Net Assets Acquired Over Cost***

Excess of fair value of net assets acquired over cost was USD188.4 million in 2005, while no amount was recorded in 2004. This non-recurring gain is related to the conversion of Amazonia's convertible debt instruments into Amazonia's shares in February 2005. At the time of conversion, the shares had a fair value that exceeded the value of the convertible debt due to the improvement of Sidor's business conditions. Amazonia is the direct controlling shareholder of Sidor.

### ***Equity in earnings of associated companies***

Ternium's share in the results of associated companies during 2005 was a gain of USD21.5 million, compared to a gain of USD209.2 million for 2004. The variation was mainly due to the consolidation of Ternium's investment in Amazonia, which was accounted for under the equity method until February 15, 2005. In 2004, equity in earnings of associated companies reached a gain of USD60.9 million mainly due to the performance of Ternium's investment in Amazonia and the considerable upturn experienced by Sidor, its operating subsidiary, and in addition, the reversal of the impairment provision for USD148.3 million in connection with the Amazonia investment recorded in 2003.

### ***Income tax expense***

During 2005, Ternium recorded an income tax provision of USD218.5 million, compared to an income tax provision of USD177.5 million for the fiscal year ended December 31, 2004. The effective tax rate of Ternium is calculated as income tax on income (before equity in earnings of associated companies, income tax and excess of fair value of net assets acquired over cost and minority interest). For the year 2005, Ternium's effective tax rate was 20.2%, compared to 24.8% in 2004. This effective tax rate reduction is attributable to the following reasons:

in 2005, Sidor absorbed taxable income by using tax loss carryforwards, that were previously impaired; and

while Sidor's payments to Ylopa as compensation for its participation in Sidor and Amazonia's 2003 debt restructuring are tax deductible, Ylopa's income is tax-free as a result of the application of the Venezuela-Portugal tax treaty and Ylopa's status as a company organized in the Madeira tax-free zone.

### ***Net income attributable to minority interest***

Net income attributable to minority interest for the fiscal year ended December 31, 2005 was USD368.4 million compared to USD290.8 million in 2004. The increase was primarily due to the consolidation of Amazonia since February 15, 2005, which triggered the recognition of the minority interest in the subsidiary. Lower results at Siderar in 2005, with the consequent effect on the minority interest, partially offset the mentioned increase.

### ***Foreign Currency Fluctuations***

See Item 11. Quantitative and Qualitative Disclosure About Market Risk Foreign Exchange Exposure Risk .

**Table of Contents****Governmental Economic, Fiscal, Monetary or Political Policies or Factors**

See Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate .

**B. Liquidity and Capital Resources**

We obtained funds from our operations and short-term as well as long-term borrowings from banking institutions. These funds are primarily used to finance our working capital and capital expenditures requirements, acquisitions and dividend payments to our shareholders. We hold money market investments and variable-rate or fixed-rate securities from investment grade issuers. During 2006, we significantly reduced our financial indebtedness, from USD2,308.8 million to USD1,054.9 million using our strong liquidity position. At the beginning of 2006, Ternium made a prepayment in an aggregate principal amount of USD500 million on the credit facility incurred by the Company in connection with the Hylsamex acquisition, mainly with the proceeds from its initial public offering. In addition, in 2006 we prepaid other indebtedness in aggregate principal amount of USD544.5 million.

Management believes that funds from operations and our access to external borrowing will be sufficient to satisfy our current working capital needs and to service our debt in the foreseeable future. Management also believes that our liquidity and capital resources give us adequate flexibility to manage our planned capital spending programs and to address short-term changes in business conditions.

The following table shows the changes in our cash and cash equivalents, excluding funds placed in trust, for each of the periods indicated below:

| <i>In thousands of U.S. dollars</i>                    | <b>For the year ended December 31,</b> |                            |                            |
|--|--|----------------------------|----------------------------|
|  | <b>2006</b>                            | <b>2005 <sup>(1)</sup></b> | <b>2004 <sup>(1)</sup></b> |
| Net cash provided by operating activities              | 1,244,973                              | 1,262,455                  | 517,565                    |
| Net cash used in investing activities                  | (610,353)                              | (2,351,984)                | (91,701)                   |
| Net cash (used in) provided by financing activities    | (756,283)                              | 1,163,368                  | (359,887)                  |
| (Decrease) Increase in cash and cash equivalents       | (121,663)                              | 73,839                     | 65,977                     |
| Acquisition of business Amazonia                       |  | 305,342                    |                            |
| Acquisition of business Hylsamex                       |  | 215,411                    |                            |
| Effect of exchange rate changes                        | (315)                                  | (34,487)                   | (122)                      |
| Cash and cash equivalents at the beginning of the year | 754,980                                | 194,875                    | 129,020                    |
| Cash and cash equivalents at the end of the year       | 633,002 <sup>(2)</sup>                 | 754,980 <sup>(2)</sup>     | 194,875                    |

- (1) Cash and cash equivalents do not include certain funds that Ternium placed in a trust established to ensure that the financial needs for the normal development of Siderar's operations were met. As of December 31, 2005 and 2004, the amounts placed in the trust totaled USD5.2 million and USD88.8 million, respectively, and were presented as Other Current Investments as described in note 21 of Ternium's consolidated financial statements.
- (2) As of December 31, 2006 and 2005, cash and cash equivalents do not include USD10.4 million and USD10.7 million, respectively, of restricted cash.

**Fiscal Year Ended December 31, 2006 compared to Fiscal Year Ended December 31, 2005****Overview**

During 2006, Ternium's primary source of funding was cash flows from its operating activities.

Cash and cash equivalents decreased by 16.2%, or USD122.0 million, from USD755.0 million as of December 31, 2005 (not including USD10.7 million of restricted cash) to USD633.0 million as of December 31, 2006 (not including USD10.4 million of restricted cash). This amount includes an increase in the initial cash and cash equivalent of USD305.3 million and USD215.4 million, attributable to the consolidation of Amazonia and Hylsamex, respectively. In addition to cash and cash equivalents, as of December 31, 2005, we held other current



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investments totaling USD5.2 million, which were primarily financial resources placed in a trust established to ensure that the financial needs for the normal development of Siderar's operations were met.

### ***Operating activities***

Net cash provided by operations during 2006 was USD1,245.0 million compared to USD1,262.5 million in 2005.

The main reasons for the variation in operating cash flow were:

the absence of gain of excess of net assets acquired over cost recognized in 2005 of USD188.4 million and a loss accounted for in 2006 related to changes in Sidor's pension plan for an amount of USD46.9 million;

a strong increase in working capital needs of USD330.6 million that mainly reflects greater requirements for inventories and trade receivables, partially offset by a decrease in other receivables and other assets.

### ***Investing activities***

Net cash used in investing activities in 2006 was USD610.4 million, compared to USD2,352.0 million in 2005. The variation was mainly due to:

a capital expenditures increase from USD244.9 million in 2005 to USD405.8 million in 2006, as a result of the consolidation of Amazonia and Hylsamex for the full fiscal year in 2006. During 2006, the main capital expenditures, were the installation of facilities for storing and handling slabs, a new reheating furnace and the upgrading of the hot strip mill No.1 in Hylsa; the relining of blast furnace No.1, as well as, improvements and enhancements in the areas of sinter production, coking facilities and the hot strip mill in Siderar; and new oxygen production facilities, the revamping and expansion of the Midrex direct reduction of iron modules and disbursements associated with the installation of a new ladle furnace in Sidor; and

a decrease in the acquisitions of businesses in the amount of USD1,986.1 million, that in 2005 were invested principally in the acquisition of Hylsamex. In 2006, Ternium made principally the following transactions for an amount of USD207.3 million: the purchase of the remaining 50% equity interest in Acerex for USD44.6 million; the acquisition of tube manufacturing assets from Acindar by Siderar for USD55.2 million; and the purchase of CVRD's 4.85% equity stake in Siderar for USD107.5 million.

### ***Financing activities***

Net cash used in financing activities was USD756.3 million in 2006, compared to USD1,163.4 million of net cash provided by financing activities in 2005. The variation was mainly due to:

net proceeds of USD525.0 million from Ternium's initial public offering in January 2006;

a decrease in proceeds from borrowings of USD1,968.1 million, that comprised the loans in which we entered into in 2005 for the acquisition of Amazonia and Hylsamex;

an increase in the repayments of borrowings of USD766.9 million, due to Ternium's use of its strong liquidity position to reduce its financial indebtedness; and



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a decrease in dividends paid to the Company's and minority's shareholders of USD342.0 million.

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### ***Fiscal Year Ended December 31, 2005 compared to Fiscal Year Ended December 31, 2004***

#### ***Overview***

During 2005, Ternium's primary source of funding was cash flows from its operating activities. In the third quarter of 2005, we significantly changed the mix of financial resources as a result of the credit facilities obtained in connection with the acquisition of Hylsamex.

Cash and cash equivalents increased by 287.4%, or USD560.1 million, from USD194.9 million as of December 31, 2004 to USD755.0 million as of December 31, 2005. This amount includes an increase in the initial cash and cash equivalent of USD305.3 million and USD215.4 million, attributable to the consolidation of Amazonia and Hylsamex, respectively. In addition to cash and cash equivalents, we held other current investments totaling USD5.2 million, which were primarily financial resources placed in a trust established to ensure that the financial needs for the normal development of Siderar's operations were met.

#### ***Operating activities***

Net cash provided by operations during 2005 was USD1,262.5 million compared to USD517.6 million in 2004. The main reasons for the variation in operating cash flow were:

the consolidation of Amazonia and Hylsamex since February 15, 2005 and August 22, 2005, respectively;

the strong increase in business activity, with higher prices and sales volumes, which resulted in a net income increase of USD324.6 million; and

a reduction in working capital needs of USD259.1 million that mainly reflects a decrease in cash requirements for receivables and prepayments of USD141.4 million and trade receivables for USD153.1 million. The reductions were partially offset by an increase in requirements for inventories for USD19.3 million and lower sources provided by trade payables and other liabilities of USD16.0 million.

#### ***Investing activities***

Net cash used in investing activities in 2005 was USD2,352.0 million, compared to USD91.7 million in 2004. The variation was mainly due to the:

capital expenditures increase from USD92.6 million in 2004 to USD244.9 million in 2005, as a result of the consolidation of Amazonia and Hylsamex, in amounts of USD71.1 million and USD42.7 million, respectively, together with an increase of USD37.2 million in Siderar's capital expenditures;

a USD2,196.7 million payment applied to the acquisition of Hylsamex; and

the liquidation of the trust fund of USD83.6 million, which provided cash but was partially offset by the applications described above.

#### ***Financing activities***

Net cash provided by financing activities was USD1,163.4 million in 2005, compared to USD359.9 million of net cash used in financing activities in 2004. The variation reflects the dividends paid in cash and other distributions to the Company's shareholders and to the minority shareholders made in 2005 of USD238.7 million and USD130.6 million, respectively, compared to USD80.9 million and USD70.3 million, respectively, in 2004, and a net increase in borrowings of USD1,477.8 million in 2005 compared to USD208.7 million in 2004, as a result of the

Hylsamex acquisition.

**Table of Contents****Principal Sources of Funding***Funding Policies*

Management's policy is to maintain a high degree of flexibility in operating and investment activities by maintaining adequate liquidity levels and ensuring access to readily available sources of financing. We obtain financing primarily in U.S. dollars. Whenever feasible, management bases its financing decisions, including the election of term and type of the facility, on the intended use of proceeds for the proposed financing.

*Financial Liabilities*

Our financial liabilities currently consist of loans with banks and related parties and overdrafts. These facilities are mainly denominated in U.S. dollars. As of December 31, 2006, U.S. dollar-denominated financial liabilities represented 91% of total financial liabilities. Total financial debt decreased from USD2,916.3 million as of December 31, 2005 to USD1,057.1 million as of December 31, 2006. During 2006, Ternium's bank borrowings decreased by USD1,253.9 million, principally due to the repayment of a significant portion of the credit facility of USD1.0 billion entered into by Ternium to fund the Hylsamex's acquisition and the prepayment of several syndicated loans in Hylsa and Hylsamex. Also, in 2006, borrowings with related parties were reduced from USD607.5 million in 2005 to USD2.2 million in 2006, as a result of the conversion of the Subordinated Convertible Loans. As of December 2006, current borrowings were 48% of total borrowings, of which less of 1% corresponded to borrowings with related parties. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Financial Operations and Administrative Services.

The following table shows Ternium's financial liabilities as of December 31 of each of the last three years:

| <i>In thousands of U.S. dollars</i> | 2006                     | 2005                     | 2004           |
|-------------------------------------|--------------------------|--------------------------|----------------|
| Borrowings with related parties     | 2,161                    | 607,472                  | 75,927         |
| Bank borrowings                     | 1,054,934 <sup>(1)</sup> | 2,308,805 <sup>(1)</sup> | 46,636         |
| Other                               |                          |                          | 443            |
| <b>Total borrowings</b>             | <b>1,057,095</b>         | <b>2,916,277</b>         | <b>123,006</b> |

(1) Net of debt issuance costs

The weighted average interest rates at December 31, 2006, 2005 and 2004 shown below were calculated using the rates set for each instrument in its corresponding currency and weighted using the dollar-equivalent outstanding principal amount of those instruments at December 31, 2006, 2005 and 2004, respectively.

|                 | 2006  | 2005  | 2004  |
|-----------------|-------|-------|-------|
| Bank borrowings | 6.82% | 6.08% | 2.25% |

The maturity of our financial liabilities is as follows:

|                                 | 1 year<br>or less | 1 - 2<br>years | 2 - 3<br>years | 3 - 4<br>years | 4 - 5<br>years | Over 5<br>Years | Total            |
|---------------------------------|-------------------|----------------|----------------|----------------|----------------|-----------------|------------------|
| <b>At December 31, 2006</b>     |                   |                |                |                |                |                 |                  |
| Borrowings with related parties | 2,161             |                |                |                |                |                 | 2,161            |
| Borrowings <sup>(1)(2)</sup>    | 506,533           | 290,804        | 120,021        | 94,923         | 1,358          | 41,295          | 1,054,934        |
| <b>Total borrowings</b>         | <b>508,694</b>    | <b>290,804</b> | <b>120,021</b> | <b>94,923</b>  | <b>1,358</b>   | <b>41,295</b>   | <b>1,057,095</b> |

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- (1) Borrowings are primarily bank borrowings with third parties. See Liquidity and Capital Resources Principal Sources of Funding Financial Liabilities .
- (2) Net of debt issuance costs.

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For information on our derivative financial instruments, please see Item 11. Quantitative and Qualitative Disclosures About Market Risk and note 26 to our audited consolidated financial statements.

*Principal Borrowings*

Our credit agreements and other debt instruments contain covenants, financial tests and cross-default provisions. As of December 31, 2006, we were in compliance with all of our financial covenants. Management believes that current covenants allow us a high degree of operational and financial flexibility and do not impair our ability to obtain additional financing at competitive rates. For further information on our financial liabilities, borrowings and commitments please see notes 27 and 28(iii) to our audited consolidated financial statements.

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

See Item 4. Information on the Company B. Business Overview Research and Development .

**D. Trend Information**

See Overview.

**E. Off-Balance Sheet Arrangements**

Ternium does not use off-balance sheet arrangements as such term is defined by applicable SEC rules. However, as described above Ternium has various off-balance sheet commitments for the provision of raw materials (iron ore, entered into by Sidor, Amazonia s operating subsidiary) and energy (gas, gas transportation and steam for the production of electricity, entered into by Siderar). Off-balance sheet commitments are discussed in note 28(iii) to Ternium s audited consolidated financial statements included in this annual report.

**F. Contractual Obligations**

The following table summarizes our contractual obligations at December 31, 2006, and the effect such obligations are expected to have on our liquidity and cash flow in future periods:

| <i>In millions of U.S. dollars</i>         | <b>Payments Due by Period<br/>as of December 31, 2006</b> | <b>Less than</b> |                   |                      |                      |
|--|---|------------------|-------------------|----------------------|----------------------|
|  |   | <b>Total</b>     | <b>1<br/>year</b> | <b>1-3<br/>years</b> | <b>4-5<br/>years</b> |
| <b>Contractual Obligations</b>             |   |                  |                   |                      |                      |
| Borrowings <sup>(1)</sup>                  | 1,057.1   | 508.7            | 505.7             | 1.4                  | 41.3                 |
| Estimated interest payments <sup>(2)</sup> | 112.0   | 54.9             | 44.6              | 2.9                  | 9.6                  |
| Purchase Obligations <sup>(3)</sup>        | 2,570.5   | 278.9            | 798.9             | 484.0                | 1,008.8              |
| Sales Obligations <sup>(4)</sup>           | 1,087.6   | 110.9            | 332.7             | 221.8                | 422.3                |
| <b>Total Contractual Obligations</b>       | <b>4,827.2</b>  | <b>953.4</b>     | <b>1,681.9</b>    | <b>710.1</b>         | <b>1,482.0</b>       |

(1) Borrowings are primarily bank borrowings with third parties. See Liquidity and Capital Resources Principal Sources of Funding Financial Liabilities .

(2) Variable rates used in the projection are the ones settled in the current interest period and are considered to be fixed over the years.

(3) Includes contracts with T.G.N. (gas transportation), PDVSA GAS, ALASA (industrial gases), Siderca (steam), Iberdrola and Edelca (electricity), Peña Colorada (mines) and Matesi.

(4) Includes a contract for the sale of pellets by Sidor to FMO and a contract for the sale of blooms to TAVSA. For further information see Item 4. Information on the Company Business Overview Raw Materials and Energy Venezuela and Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Sales of Steel Products and Raw Materials.

**G. Recent Developments**

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### *(a) Agreement to obtain control over Grupo Imsa*

On April 29, 2007 Ternium entered into a definitive agreement under which it expects to obtain control of Grupo Imsa for a total consideration of approximately USD1.7 billion. Under the agreement, Ternium, or any of its

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subsidiaries, will make a tender offer in accordance with applicable Mexican law for all of the issued and outstanding share capital of Grupo Imsa at a price of USD6.40 per share. Concurrently with the consummation of the tender offer, Grupo Imsa's majority shareholders, owning approximately 90.4% of Grupo Imsa's issued and outstanding share capital, will have their shares redeemed in cash at the same price per share.

Ternium currently expects to finance the transactions primarily through debt, for which bank commitments have been secured.

The transaction is subject to Mexican and U.S. regulatory approvals, and other customary conditions. If consummated, the transaction is expected to close in the third quarter of 2007.

Grupo Imsa is a steel manufacturer with operations in Mexico, the United States and Guatemala. Grupo Imsa has an annual production capacity of 2.2 million tons of hot rolled coils, 1.8 million tons of cold rolled products and 1.7 million tons of galvanized products. In addition, Grupo Imsa produces panels and other steel products. Grupo Imsa had net sales of USD3.4 billion in 2006.

*(b) Annual General Shareholders Meeting*

On June 6, 2007, the Company's shareholders re-elected the eleven of the twelve members of the Company's board of directors to each serve a one-year term ending at the Company's next annual general shareholders meeting to be held on June 4, 2008 and appointed Pedro Pablo Kuczynski as a member of the board of directors.

The board of directors subsequently re-appointed Paolo Rocca and Rinaldo Campos Soares as chairman and vice chairman, respectively, of the Company's board of directors; Daniel Novegil as chief executive officer; and re-appointed Ubaldo Aguirre as chairman of the audit committee of the Company's board of directors, with Adrián Lajous Vargas and Pedro Pablo Kuczynski being the other members of such committee.

At the annual general shareholders' meeting, the Company's shareholders approved a dividend of USD0.05 per share (USD0.50 per ADS), or approximately USD100 million. The Company paid the dividend on June 12, 2007.

The Company's shareholders also approved the Company's consolidated financial statements as of and for the fiscal year ended December 31, 2006 and re-appointed PricewaterhouseCoopers (acting, in connection with the Company's annual accounts required under Luxembourg law, through PricewaterhouseCoopers S.ár.l., and, in connection with the Company's annual and interim financial statements required under the laws of other relevant jurisdictions, through Price Waterhouse & Co. S.R.L.) as the Company's independent auditors for the fiscal year 2007.

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

**A. Directors and Senior Management**

**Board of Directors**

Our articles of association provide for a board of directors consisting of a minimum of five (5) members (when the shares of the Company are listed on a regulated market as they currently are) and a maximum of fifteen (15) members. The board of directors is vested with the broadest powers to act on behalf of the Company and accomplish or authorize all acts and transactions of management and disposal which are within its corporate purpose and which are not specifically reserved in the articles of association to the general shareholders' meetings.

The board of directors is required to meet as often as required by the interests of the Company. A majority of the members of the board of directors in office present or represented at each board of directors' meeting constitutes a quorum, and resolutions may be adopted by the vote of a majority of the directors present or represented. In case of a tie, the chairman is entitled to cast the deciding vote.



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Directors are elected at the annual ordinary general shareholders meeting to serve one-year renewable terms, as determined by the shareholders. Our current board of directors is comprised of 12 directors and an audit committee, which is comprised entirely of independent directors.

The shareholders may dismiss all or any one director at any time, with or without cause, by resolution passed by majority vote, irrespective of the number of shares present or represented at the general shareholders meeting. Pursuant to the terms of a shareholders agreement, dated July 20, 2005, between Usiminas and I.I.I.-Industrial Investments Inc., a wholly-owned subsidiary of San Faustín organized in the Cayman Islands and the Company's indirect controlling shareholder ( I.I.I. CI ), Usiminas is entitled to designate two directors, one of whom shall be the vice-chairperson of the board of directors, and I.I.I. CI is entitled to designate the chief executive officer of the Company and seven directors (and, in the case of an increase in the total number of directors, a majority of such directors), one of whom shall be the chairperson of the board of directors. The shareholders agreement will remain in full force and effect so long as Usiminas and I.I.I. CI each hold at least 5% of the shares of the Company or until it is terminated by either of Usiminas or I.I.I. CI pursuant to its terms. Rinaldo Campos Soares and Bertoldo Machado Veiga were nominated as directors pursuant to this agreement.

In addition, on January 9, 2006, Tenaris and ISL entered into a shareholders agreement, pursuant to which ISL will take all actions in its power to cause one of the members of the Company's board of directors to be one nominated by Tenaris and any directors nominated by Tenaris only be removed pursuant to written instructions by Tenaris. Tenaris and ISL also agreed to cause any vacancies on the board of directors to be filled with new directors nominated by either Tenaris or ISL, as applicable. On April 27, 2007, ISL assigned all of its rights and obligations under the shareholders agreement to its sole shareholder I.I.I. C.I. The shareholders agreement will remain in effect so long as each of the parties holds at least 5% of the shares of the Company or until it is terminated by either Tenaris or I.I.I. C.I. pursuant to its terms. Carlos A. Condorelli was nominated as a director pursuant to this agreement.

Under the Company's articles of association, an independent director is a director who:

- (i) is not employed, and has not been employed in an executive capacity by the Company or any of its subsidiaries within the five years preceding the ordinary general shareholders meeting at which the candidate for the board of directors was voted upon;
- (ii) does not receive consulting, advisory or other compensatory fees from the Company or any of its subsidiaries (other than fees received as a member of the board of directors of any committee thereof and fees received as a member of the board of directors or other governing body, or any committee thereof, of any of the Company's subsidiaries);
- (iii) is not a person who directly or indirectly controls the Company;
- (iv) does not have, and does not control a business entity that has, a material business relationship with the Company, any of its subsidiaries or a person who directly or indirectly controls the Company, if such material business relationship would reasonably be expected to adversely affect the director's ability to properly discharge his or her duties;
- (v) does not control, and is not and has not been, within the five years preceding the ordinary general shareholders meeting at which the candidate for the board of directors was voted upon, employed by a present or former internal or external auditor of the Company, any of its subsidiaries or a person who directly or indirectly controls the Company; and
- (vi) is not a spouse, parent, sibling or relative up to the third degree of, and does not share a home with, any of the persons above described.

Within the limits of applicable law, the board of directors of the Company may delegate to one or more persons, whether or not members of the board of directors, the Company's day-to-day management and the authority to

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represent the Company, provided that such delegation shall be subject to prior authorization by the general shareholders meeting. On September 14, 2005, following the requisite authorization at the general shareholders meeting, the board of directors delegated such day-to-day management and authority to Daniel A. Novegil. On June 6, 2007, the Company's shareholders re-elected Mrs. Ubaldo Aguirre, Roberto Bonatti, Rinaldo Campos Soares, Carlos Condorelli, Adrian Lajous, Bertoldo Machado Veiga, Bruno Marchettini, Gianfelice Mario Rocca, Paolo Rocca and Daniel Novegil as members of the Company's board of directors and appointed Mr. Pedro Pablo Kuczynski as a member of the board of directors to each serve a one-year term ending at the Company's next annual general shareholders meeting to be held in June 4, 2008. The board of directors subsequently re-appointed Paolo Rocca and Rinaldo Campos Soares as chairman and vice chairman, respectively, of the Company's board of directors and Daniel Novegil as chief executive officer.

The following table sets forth the current members of the board of directors of the Company, their respective offices on the board, their principal occupation, their years of service as board members and their age.

| Name                                  | Position      | Principal Occupation  | Years as Director | Age at December 31, 2006 |
|---------------------------------------|---------------|---|-------------------|--------------------------|
| Paolo Rocca <sup>(1)</sup>            | Chairman      | Chairman and C.E.O. of Tenaris and Chairman of Ternium        | 1                 | 54                       |
| Rinaldo Campos Soares                 | Vice-chairman | President of Usiminas   | 1                 | 68                       |
| Ubaldo Jose Aguirre                   | Director      | Managing Director of Aguirre, Gonzalez, Marx & Asociados S.A. | 1                 | 58                       |
| Roberto Bonatti <sup>(1)</sup>        | Director      | President of San Faustín                                      | 1                 | 57                       |
| Carlos Condorelli                     | Director      | C.F.O. of Tenaris   | 1                 | 55                       |
| Adrián Lajous                         | Director      | Energy advisor at McKinsey & Company                          | 1                 | 63                       |
| Bertoldo Machado Veiga                | Director      | Chairman of the board of Usiminas                             | 1                 | 64                       |
| Bruno Marchettini                     | Director      | Member of the board of San Faustín, Tenaris and Siderar.      | 1                 | 65                       |
| Daniel Novegil                        | Director      | C.E.O. of the Company   | 1                 | 54                       |
| Gianfelice Mario Rocca <sup>(1)</sup> | Director      | Chairman of the board of directors of San Faustín             | 1                 | 58                       |
| Pedro Pablo Kuczynski                 | Director      | Partner of Westfield Capital                                  |                   | 68                       |

(1) Paolo Rocca and Gianfelice Rocca are brothers, and Roberto Bonatti is Paolo and Gianfelice Rocca's first cousin.

**Paolo Rocca.** Mr. Rocca has served as our chairman since 2005. He is also chairman and chief executive officer of Tenaris S.A., director and vice president of San Faustín N.V. and director of Techint Financial Corporation N.V. Mr. Rocca currently serves as the chairman of Tubos de Aceros de México S.A. (Tamsa) and Dalmine S.p.A.; vice president of Confab Industrial S.A. and honorary president of the Board of Directors of Siderar. Mr. Rocca is member of the executive committee of the IISI (International Iron and Steel Institute) and member of the International Advisory Committee of the NYSE (New York Stock Exchange). Mr. Rocca is an Italian citizen.

**Rinaldo Campos Soares.** Mr. Campos Soares has served as our vice-chairman since 2005. Mr. Campos Soares currently serves as the president of Usiminas and as a member of its board of directors, as the president of Cosipa, chairman of the board of directors of Rio Negro Comércio e Indústria de Aço, chairman of the board of directors of Usiparts Sistemas Automotivos, president of Usiminas Mecânica and president of Fundação São Francisco Xavier. In addition, he serves as vice president of the Brazilian Steel Institute and a member of the Brazilian National Council for Economic and Social Development. Mr. Campos Soares also serves as the general honorary consul of Japan for the State of Minas Gerais. Mr. Campos Soares has served in various positions at Usiminas throughout his career, including plant general manager, executive director of operations, head of production, head of the industrial engineering department, head of the hot strip mill, head of the cold strip mill, and head of metallurgy and inspection. He previously served as coordinator of industrial research at Fundação Gorceix and was formerly employed as a researcher at the Institute de Recherches de la Siderurgie de France. To date, Mr. Soares has 38 years of experience in the steel industry. Mr. Campos Soares is a Brazilian citizen.

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**Ubaldo Aguirre.** Mr. Aguirre has served on our board of directors since January 12, 2006. Mr. Aguirre is a managing director of Aguirre, Gonzalez and Marx S.A., an Argentine investment banking firm, and also serves as a member of the board of directors of Juan Minetti S.A., a subsidiary of Holcim, the Swiss cement producer. Since 2005, he also serves as chairman of the board of directors of Permasur S.A. since 2000 as member of the board of directors of URS Argentina S.A. Mr. Aguirre formerly served as director and chairman of the audit committee of Siderar. Mr. Aguirre began his career at the World Bank in Washington, D.C. In addition, Mr. Aguirre has been a member of the boards of each of Argentina's Central Bank where he was responsible for that country's external borrowing program and financial negotiations Banco de la Nación Argentina and Banco Nacional de Desarrollo. He also served as the Republic of Argentina's financial representative for Europe in Geneva and negotiator on behalf of the Republic of Argentina with the Paris Club. Mr. Aguirre is an Argentine citizen.

**Roberto Bonatti.** Mr. Bonatti has served as a director since 2005. Mr. Bonatti is the grandson of Agustín Rocca and has been involved in businesses of the companies controlled by San Faustín, or the Techint Group, specifically in the engineering and construction and corporate sectors, throughout his career. He was first employed by the Techint Group in 1976, as deputy resident engineer in Venezuela. In 1984, he became a director of San Faustín, and, since 2001, he has served as its president. In addition, Mr. Bonatti currently serves as president of Tecpetrol and Techint Compañía Técnica Internacional S.A.C.I. of Argentina and as a director of Tenaris and Siderar. Mr. Bonatti is an Italian citizen.

**Carlos Condorelli.** Mr. Condorelli has served as a director since 2005. Mr. Condorelli currently serves as Director since 2007 and chief financial officer of Tenaris, a position that he assumed in October 2002. Mr. Condorelli began his career within the Techint Group in 1975, as an analyst in the accounting and administration department of Siderar. Mr. Condorelli has held several positions within Tenaris and other Techint Group companies, including finance and administrative director of Tamsa and president of the board of directors of Empresa Distribuidora La Plata S.A., or Edelap, an Argentine utilities company. He is an Argentine citizen.

**Adrián Lajous.** Mr. Lajous has served on our board of directors since January 12, 2006. Mr. Lajous currently serves as the senior energy advisor to McKinsey & Company, chairman of the Oxford Institute for Energy Studies, president of Petrométrica, S.C. and non-executive director of Schlumberger, Ltd. Mr. Lajous began his career teaching economics at El Colegio de México and in 1977 was appointed director general for energy at Mexico's Ministry of Energy. Mr. Lajous joined Pemex in 1983, where he held a succession of key executive positions including executive coordinator for international trade, corporate director of planning, corporate director of operations and director of refining and marketing. From 1994 until 1999, he served as chief executive officer of Pemex and chairman of the boards of the Pemex Group of operating companies. Mr. Lajous is a Mexican citizen.

**Bertoldo Machado Veiga.** Mr. Machado Veiga has served on our board of directors since January 12, 2006. Mr. Machado Veiga currently serves as chairman of the board of Usiminas and as a director at Fasal S/A Comércio e Indústria de Produtos Siderúrgicos. He was first employed by Usiminas as a lawyer in 1968 and was appointed head of its legal department in 1986. Mr. Machado Veiga has served as the representative of the employees on the board of directors of Usiminas since its privatization in 1991. Mr. Machado Veiga is a Brazilian citizen.

**Bruno Marchettini.** Mr. Marchettini has served on our board of directors since January 12, 2006. He has retired from executive positions but continues to be an advisor to the Techint Group in steel technology matters. He is a member of the board of San Faustín, Tenaris and Siderar. Mr. Marchettini is an Italian citizen.

**Daniel A. Novegil.** Mr. Novegil has served as a director and as our chief executive officer. Mr. Novegil joined Siderar in 1978 and was appointed as its general director in 1991. In 1993, following the merger of the privatized company Somisa with Propulsora, he was appointed managing director of Siderar. In 1998, after the acquisition of Sidor, Mr. Novegil was appointed chairman and chief executive officer of Sidor. In March 2003, Mr. Novegil was designated executive vice-president of the Techint Flat and Long Steel Division, with executive responsibilities over Siderar and Sidor. He became president of Siderar in May 2005. He is an Argentine citizen.

**Gianfelice Mario Rocca.** Mr. Rocca has served in our board of directors since January 12, 2006. Mr. Rocca is chairman of the board of directors of San Faustín, a director of I.I.I. Industrial Investments Inc., Techint Financial

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Corporation N.V., Tenaris, Dalmine S.p.A., Tamsa, president of the Humanitas Group and president of the board of directors of Techint-Compagnia Tecnica Internazionale S.p.A. and Techint S.A. de C.V. In addition, he sits on the board of directors or executive committees of several companies, including Sirti S.p.A., Riunione Adriatica di Sicurtà, RCS Quotidiani, Fastweb, Buzzi Unicem and Cam Finanziaria S.p.A. He is vice president of Confindustria, the leading association of Italian industrialists. He is also a member of the European Advisory Board of the Harvard Business School, the Trilateral Commission. Mr. Rocca is an Italian citizen.

**Pedro Pablo Kuczynski.** Mr. Kuczynski was appointed as Director in the shareholders' meeting held on June 6, 2007 and took office on June 7, 2007. He was Prime Minister of Peru in 2005-2006 and prior to that he was the Minister of Economy and Finance from 2001. He was the Republic of Peru's Minister of Energy and Mines in 1980-82. He was president until 2001 of a private equity firm he founded in 1992 after spending ten years as Chairman of First Boston International (today Credit Suisse) in New York. Since 2007, he is Senior Advisor to the Rohatyn Group, a firm specializing in emerging markets. He ran a bauxite mining company affiliated with Alcoa between 1977 and 1980. He began his career at the World Bank in 1961 and was in the 1970s head of its Policy Planning Division, Chief Economist for Latin America and Chief Economist of IFC. He was born in Peru in 1938 and educated in Peru and at Oxford and Princeton. He is a U.S. and Peruvian citizen.

### ***Director Liability***

Under Luxembourg law, a director may be liable to the Company for any damage caused by management errors, such as wrongful acts committed during the execution of the mandate granted to them by the Company, and to the Company, its shareholders and third parties in the event that the Company, its shareholders, or third parties suffer a loss due to an infringement of either the Luxembourg Company Law or the Company's articles of association. A shareholder may in certain circumstances have rights to damages if a duty owed by the directors is breached.

Under Luxembourg law, related party transactions involving directors and giving rise to personal conflicts of interest are subject to approval procedures established by Luxembourg law requiring the abstention of the relevant director and are to be reported at the next shareholders' meeting. Any director may be removed from or reappointed to office at any time by a shareholders' resolution passed by simple majority vote, irrespective of the number of shares present or represented at the meeting.

A director will not be liable for acts committed in accordance with a resolution if, notwithstanding his presence at the meeting at which such a resolution was adopted, such director advised the board of directors that he opposed the resolution and caused a record of his statement of opposition to be included in the minutes of the meeting.

Causes of action against directors for damages may be initiated by the Company upon a resolution of the shareholders passed by a simple majority vote, irrespective of the number of shares present or represented at the meeting. Causes of action against directors who misappropriate corporate assets (for example, by using corporate assets for their own benefit) or commit a breach of trust (for example, by breaching their fiduciary duties to the Company) may be brought by any shareholder for personal losses different from those of the Company. In general, claims must be brought within five years from the occurrence of an action for which liability may apply, or in the case of fraud, from the date the fraud is discovered.

It is customary in Luxembourg that the shareholders expressly discharge the members of the board of directors from any liability arising out of or in connection with the exercise of their mandate when approving the annual accounts of the Company at the annual shareholders' meeting. However, such discharge will not release the directors from liability for any damage caused by wrongful acts committed during the execution of their mandate or due to an infringement of either the Luxembourg Company Law or the Company's articles of association.

### **Auditors**

Our articles of association require the appointment of at least one independent auditor chosen from among the members of the Luxembourg Institute of Independent Auditors. The primary responsibility of the independent auditor is to audit our annual accounts and to submit a report on the accounts to shareholders at the annual general shareholders' meeting. Following a recommendation from our Audit Committee, auditors are appointed by the

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shareholders through a resolution passed by a simple majority vote irrespective of the number of shares present or represented. Shareholders can determine the number and the term of office of the auditors at the general shareholders meeting. Luxembourg law does not allow directors to serve concurrently as independent auditors. An auditor's term may not exceed one year and they may be reappointed and dismissed at any time.

PricewaterhouseCoopers (acting, in connection with the Company's annual accounts required under Luxembourg law, through PricewaterhouseCoopers S.à.r.l., and, in connection with the Company's annual and interim financial statements required under the laws of other relevant jurisdictions, through Price Waterhouse & Co. S.R.L.) are the Company's independent auditors for the year ending December 31, 2006.

## Senior Management

The following table sets forth certain information concerning our senior management:

| Name                   | Age at            | Position                                 |
|------------------------|-------------------|--|
|                        | December 31, 2006 |  |
| Daniel Novegil         | 54                | Chief Executive Officer; Director        |
| Roberto Philipps       | 60                | Chief Financial Officer                  |
| Alfredo A. Indaco      | 53                | International Commercial Officer         |
| Regulo Salinas         | 51                | North Region Area Manager                |
| Martín Berardi         | 49                | South Region Area Manager                |
| Julián Eguren          | 43                | Central Region Area Manager              |
| Oscar Montero Martínez | 46                | Planning and Operations General Director |
| Luis Andreozzi         | 56                | Engineering and Environment Director     |
| Miguel Punte           | 59                | Human Resources Director                 |
| Rubén Bocanera         | 50                | Chief Information Officer                |

**Daniel A. Novegil.** Mr. Novegil has served as our Chief Executive Officer. Mr. Novegil joined Siderar in 1978 and was appointed as its general director in 1991. In 1993, following the merger of the privatized company Somisa with Propulsora, he was appointed managing director of Siderar. In 1998, after the acquisition of Sidor, Mr. Novegil was appointed chairman and chief executive officer of Sidor. In March 2003, Mr. Novegil was designated executive vice-president of the Techint Flat and Long Steel Division, with executive responsibilities over Siderar and Sidor. He became president of Siderar in May 2005. To date, Mr. Novegil has 28 years of experience in the Techint Group. He is an Argentine citizen.

**Roberto Philipps.** Mr. Philipps currently serves as our Chief Financial Officer. He joined Siderar in 1988 and has held the position of chief financial officer of Siderar and chief financial officer of Amazonia. He oversaw the restructuring of Sidor's debt in 2000 and 2003 and of Siderar's debt in 2002. From 2003 until August 2005, he was the chief executive officer of TGN. He assumed his current position at the Company in September 2005. He is also past president of the Argentine Financial Executives Institute (IAEF). Mr. Philipps is an Argentine citizen.

**Alfredo Indaco.** Mr. Indaco currently serves as our International Commercial Officer. He began his career with the Techint Group in 1982 as an employee of the Marketing and Export Department of Siderca. In 2001, he left his position as export director of Siderca to serve as commercial director of Siderar, a position that he held until he assumed his present position at the Company. Mr. Indaco is an Argentine citizen.

**Régulo Salinas.** Mr. Salinas currently serves as our North Region Area Manager. He is responsible for all our operations within Mexico. He began his career with our subsidiary in Mexico in 1978 as budget and cost analyst in Hylsa. He has held several executive positions, including managing director of the Flat Products Division and the Bar and Rod Division of the former Hylsa and vice-president of sales and marketing, vice-president of administration and vice-president of planning. He is President of Canacero (Camara Nacional de la Industria del Hierro y el Acero) in Mexico and vice-chairman of the AISI (American Iron and Steel Institute) and member of the executive committee of the board of the SMA (Steel Manufacturers Organization) in the United States. Mr. Salinas is a Mexican citizen.

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**Martín Berardi.** Mr. Berardi currently serves as our South Region Area Manager. He began his career with the Techint Group in 1980 as a trainee in Propulsora Siderúrgica. He has held several positions within the Techint Group including in Propulsora Siderúrgica, Siat S.A.I.C. and Siderca. He served as managing director of Siat (1992-1995), managing director of Tamsa (1995-2000), president and chief executive officer of Sidor (2000-2004) and became managing director of Siderar in October 2004, a position which he held until he assumed his present position at the Company. He was president of the Instituto Venezolano de Siderurgia between 2002 and 2004 and he has also been vice-president of Centro Industriales Siderurgicos de Argentina since 2004. Mr. Berardi is an Argentine citizen.

**Julián Eguren.** Mr. Eguren currently serves as our Central Region Area Manager. Since July 2005, he has been the chief executive officer of Ternium's Venezuelan subsidiary Sidor. Prior to that he served as commercial director of Sidor. He has held several other executive positions since joining the Techint Group in 1987, such as chief executive officer of Tavsa, general manager of Socominter (Venezuela), economic planning manager and treasurer of Tamsa and commercial planning manager of Siderca. He is also director of IVES (Venezuelan Steel Institute), ILAFA (Latin-American Institute of Iron and Steel) and Matesi, and president of CAVEARG (Venezuelan Argentinean Chamber). Mr. Eguren is an Argentine citizen.

**Oscar Montero Martínez.** Mr. Montero currently serves as our Planning and Operations General Director. He began his career with the Techint Group in 1984 as a commercial analyst in Siderar. Since then, he has held several positions within Siderar in the planning, commercial and procurement areas. In 1998 he assumed the position of strategic planning director in Sidor. Since 2005, he serves as planning and operations general director of the Company. Mr. Montero is an Argentine citizen.

**Luis Andreozzi.** Mr. Andreozzi currently serves as our Engineering and Environment Director. He began his career with the Techint Group in 1968 as a trainee in Siderca. He has held several positions within other Techint Group companies including Techint Engineering Company, or TEING, Siderar and Sidor. Most recently, he served as construction manager of TEING (1986-1992), construction manager of Siderar (1992-1998), engineering and environment general manager of Sidor (1998-2004) and technology manager of the Techint Flat and Long Steel Division, a position he held until he assumed his present position at the Company. Mr. Andreozzi is an Italian citizen.

**Miguel Punte.** Mr. Punte currently serves as our Human Resources Director. In 1970, Mr. Punte joined Siderar, where he held several positions within Human Resources Department. In 1984, he joined Finma S.A., or Finma, an affiliate of the Techint Group that provides human resources services to Techint Group companies. At Finma, Mr. Punte served first as human resources manager and later as human resources director until 2005, when he was appointed human resources director of Siderar, a position that he held until he assumed his present position at the Company. Mr. Punte is an Argentine citizen.

**Rubén Bocanera.** Mr. Bocanera currently serves as our Chief Information Officer. He joined the Techint Group in 1983 as a junior analyst for Siderca. Since then he has held several positions in different Techint Group companies, including project manager and automation and control manager of Siderca and Sidor and chief information officer of Siderar. Since 2002, he has been responsible for the information technology unit of the Techint Flat Steel Division. Mr. Bocanera is an Argentine citizen.

**B. Compensation**

The compensation of the Company's directors is approved annually at the ordinary general shareholders' meeting. The aggregate compensation earned by directors and executive officers during 2006 amounted to approximately USD10,276 thousand.

On January 1, 2007, Ternium adopted an employee retention and long term incentive program. Pursuant to this program, certain senior executives may be granted a number of units, with the value of such units being determined based in the Company's equity value (excluding minority interest). Each unit entitles the holder thereof to receive

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cash amounts equal to the amount of dividends paid from time to time to the Company's shareholders. Units vest over a four-year period and we will redeem vested units on the tenth anniversary of the grant date, or when the employee ceases employment if that should be sooner; provided, however, that we are required to repurchase the units at full value (regardless of vesting) within ten business days of the death or permanent disability of the relevant beneficiary. Compensation under this program is not expected to exceed 35% of the total annual compensation of the beneficiaries.

### **C. Board Practices**

See Directors and Senior Management .

There are no service contracts between any director and Ternium that provide for benefits upon termination of employment.

### **Audit Committee**

On June 6, 2007, our board of directors re-appointed Ubaldo Aguirre (chairman) and Adrián Lajous, and appointed Pedro Pablo Kuczynski, as members of its audit committee. All three members of the audit committee are independent directors. The members of the audit committee are not eligible to participate in any incentive compensation plan for employees of the Company or any of its subsidiaries.

Under our articles of association and the audit committee charter, the audit committee is required, among other things, to report to the board of directors on its activity and the adequacy of the Company's systems of internal control over financial reporting. In addition, the charter of the audit committee sets forth, among other things, the audit committee's purpose and responsibilities. The audit committee assists the board of directors in its oversight responsibilities with respect to the integrity of the Company's financial statements and is responsible for making recommendations regarding the appointment, dismissal, compensation, retention and oversight of, and assess the independence of the Company's independent auditors (see Item 16.C for additional information about the audit committee's procedures with respect to our independent auditors). The audit committee also performs other duties entrusted to it by the Company's board of directors.

In addition, the audit committee is required by the Company's articles of association to review Material Transactions, as such term is defined by the Company's articles of association, to be entered into by the Company or its subsidiaries with Related Parties, as such term is defined by the Company's articles of association (other than transactions reviewed and approved by the independent members of the board of directors of the Company or through any other procedures that the board of directors may deem substantially equivalent to the foregoing), in order to determine whether their terms are consistent with market conditions or are otherwise fair to the Company and/or its subsidiaries. In the case of Material Transactions entered into by the Company's subsidiaries with Related Parties, the Company's audit committee will review those transactions entered into by those subsidiaries whose boards of directors do not have independent members, or that have not been reviewed and approved by such independent directors or through any other procedures that the board of directors of the Company may deem substantially equivalent to the foregoing.

Under the Company's articles of association, as supplemented by the audit committee's charter:

a Material Transaction is (i) any transaction with or involving a Related Party (x) with an individual value equal to or greater than ten million U.S. dollars or (y) with an individual value lower than ten million U.S. dollars, when the aggregate sum of any series of transactions reflected in the financial statements of the four fiscal quarters of the Company preceding the date of determination (excluding any transactions that were reviewed and approved by any of the audit committee of the Company, or any of its subsidiaries, the board of directors of the Company, the independent members of the board of directors or other governing body of any subsidiary of the Company, or a majority of the members of the board of directors or similar governing body of any subsidiary of the Company that were not nominated by or at the request of the Company or any entity that directly or indirectly controls or is under common control with the Company) exceeds 1.5% of the Company's consolidated net sales made in the fiscal year preceding the year on

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which the determination is made; or (ii) any corporate reorganization transaction (including a merger, spin-off or bulk transfer of a business) involving the Company or any of its direct or indirect subsidiaries for the benefit of or involving a Related Party; and

a Related Party is, in relation to the Company or its direct or indirect subsidiaries, any of the following persons: (i) a member of the board of directors of the Company or of the board of directors or other governing body of any of the Company's subsidiaries; (ii) any member of the board of directors or other governing body of an entity that directly or indirectly controls the Company; (iii) any entity that directly or indirectly controls or is under common control with the Company (other than the Company's subsidiaries); (iv) any entity controlled directly or indirectly by any member of the board of directors of the Company, or of the board of directors or other governing body of any subsidiary of the Company; and (v) any spouses, parents, siblings or relatives up to the third degree of, and any person that shares a home with, any person referred to in (i) or (ii).

The audit committee has the power (to the maximum extent permitted by applicable laws) to request that the Company or relevant Subsidiary provide any information necessary for it to review any Material Transaction. A Related Party transaction shall not be entered into unless (i) the circumstances underlying the proposed transaction justify that it be entered into before it can be reviewed by the Company's audit committee or approved by the board of directors and (ii) the Related Party agrees to unwind the transaction if the Company's audit committee or board of directors does not approve it.

The audit committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and has direct access to the Company's internal and external auditors as well as Ternium's management and employees and, subject to applicable laws, its subsidiaries.

**D. Employees**

The following table shows the number of persons employed by Ternium and its consolidated subsidiaries:

|                        | At<br>December 31,<br>2006  |
|------------------------|-----------------------------|
| Argentina              | 5,072                       |
| Venezuela              | 5,660                       |
| Mexico                 | 7,469                       |
| Other                  | 70                          |
| <b>Total employees</b> | <b>18,271<sup>(1)</sup></b> |

(1) It does not include 3,983 outsourced employees. We expect that during 2007 some outsourced personnel will be incorporated in Ternium as direct employees.

At December 31, 2006, number of persons employed by Ternium was 18,271. During 2006, previously outsourced personnel became direct employees of Ternium, while the aggregate number of employees decreased compared to 2005.

**Argentina**

Most of Siderar's employees are members of the *Unión Obrera Metalúrgica de la República Argentina* ( UOM ), the union of employees related to the steel industry. Employees are covered by a collective agreement that includes all workers in Argentina in the steel and metalmech industry. The employees are also covered by certain complementary collective agreements signed between Siderar and UOM that define specific issues related to any plant in particular or Siderar as a whole, such as working structures, salary levels related to performance, productivity, production quantity and quality and the results of Siderar. These agreements are subject to periodic modification according to changing circumstances and are updated in relation to competitiveness, quality, security and efficiency goals.



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As part of the privatization process in 1992, 20% of Siderar's shares were sold to former employees of state-owned Somisa under the Programa de Propiedad Participada (the Employee Stock Ownership Plan). For further information see Item 4. Information on the Company C. Organizational Structure Subsidiaries Siderar.

Many foremen of Siderar are affiliated with the *Asociación de Supervisores de Industria Metalmeccánica de la República Argentina* (ASIMRA), the union of supervisors of different activities in the metal manufacturing industry. ASIMRA-affiliated employees are subject to an agreement signed with Siderar that establishes regulations relating to salaries, working organization, absences, vacations, benefits and labor relations. We believe that Siderar maintains good relations with its unions, and the measures that it has taken in order to make Siderar more competitive have not resulted in significant labor unrest.

Basic salaries remained stable during the 1989-2001 period when Argentina had its Convertibility Law. The peso devaluation produced a significant reduction in salary values in U.S. dollar terms. Since then, salaries in nominal terms have slowly increased, mainly due to a revaluation of the peso against the U.S. dollar and increases in salaries resulting from private agreements and government regulation.

Under Argentine law, Siderar is required to contribute up to 23% of its employees' base salaries to various national and privately-run health, pension and retirement plans. Siderar must also withhold an additional percentage from salaries for contribution to such funds. The amount to be withheld for the pension fund has varied according to emergency measures imposed by the government to cope with the Argentine crisis of 2002. As of December 2004, the withholding percentage was 13% for those employees affiliated with the privately-run pension funds and 17% for those affiliated with the public plan. During 2006, the latter percentage increased to 16.3%. Furthermore, as of 2003, there was a maximum of ARP4,800 over which Siderar must contribute and withhold the percentage for the pension fund. From this year, this maximum was progressively increased for the employer's contributions for the middle and superior personnel and finally completely eliminated in 2005.

Under Argentine law, in order to terminate an employee without cause, Siderar must indemnify the employee based on the employee monthly salary per each year of employment. For the UOM unionized employees (as agreed with the union) the maximum monthly salary is ARP3,681 while for the ASIMRA unionized employees is ARP8,916. However, for the non-unionized employees the maximum compensation prescribed by law is higher and variable. Since January 2002, the Argentine government established an emergency regime under which employees that are terminated without cause are entitled to an extra 50% over the legally required indemnification amount. In addition to its legal obligations, in 1995 Siderar established a benefit program for its senior management that is applied in certain cases of employment termination.

### ***Venezuela***

In Venezuela, approximately two-thirds of Sidor's employees are organized in the *Sindicato Único de Trabajadores de la Industria Siderúrgica y sus Similares del Estado Bolívar* (Sole Union of Steel and Related Industry Workers of Bolivar State or SUTISS). Sidor has from time to time suffered labor disruptions. Social conflicts in Venezuela and in particular conflicts with SUTISS have affected Sidor's results during recent years. The main labor-related incidents were the Civic National Strike initiated in December 2002 that lasted 63 days and that heavily impacted natural gas provision due to the stoppage by PDVSA; and the general strikes initiated by SUTISS lasting 21 days in October 2003 and 20 days in 2004. During 2005, there were no important labor disruptions. In 2006, a claim related to the interpretation of the modifications of the regulation of the labor law was interposed, resulting in an illegal strike that heavily impacted the Sidor's operation due to the 9 days full stoppage.

In October 2004, a collective bargaining agreement was reached with the union which terminated in February 2007. As of the date of this annual report, Sidor is negotiating a new collective bargaining agreement with the union. See Item 3. Key Information D. Risk Factors Risks Relating to our Business Labor disputes at Ternium's operating subsidiaries could result in work stoppages and disruptions to Ternium's operations. Although Ternium has reached this agreement with SUTISS, Ternium may suffer additional plant stoppages or strikes as a result of future work force reductions in connection with its productivity improvement and cost reduction plans. No assurance can be given that any future stoppage or strikes would not have a material adverse effect on Ternium's financial condition, cash flows and results of operations.

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Sidor established a labor participation program ( *Programa de Participación Laboral* or PPL ) in 1997, under which current and retired workers of Sidor were entitled to receive 20% of the Sidor s shares. From May 2004 to date, BANDES and CVG transferred 6,335,648 Class B shares, representing 19.9% of Sidor s share capital to employees and eligible former employees pursuant to the terms of the PPL. The remaining 29,694 shares are also expected to be transferred to the PPL.

Under Venezuelan law, Ternium employees who are laid-off are entitled to the following benefits:

indemnification for seniority of up to 150 days salary;

severance pay for seniority that ranges from two to five days salary for every month of seniority accumulated after June 1997, up to a maximum amount equivalent to 90 days salary;

payment of unused vacation days during the year preceding the employee s termination and a proportional allocation in the year in which the employee is terminated; and

compensation/profit sharing equivalent to four months salary (this benefit is also accrued annually for the services provided). In some specified situations, like death, accident, work-related disease or retirement under the pension plan of the company, employees who had been covered by the collective bargaining agreement with SUTISS are entitled to additional indemnification equal to indemnification for seniority of up to 150 days salary, whereas employees not covered by the collective bargaining agreement are entitled to additional indemnification ranging from 50% to 100% of the amount of such additional indemnification.

**Mexico**

In Mexico, approximately two-thirds of Ternium employees are unionized, and the rest are not. The majority of its unionized workers in Mexico are members of FENASA ( Federación Nacional de Asociaciones Sindicales Autónomas ), the national federation of independent union associations. The unionized employees of Peña Colorada, however, are members of *Sindicato de Trabajadores Mineros, Metalúrgicos y Similares de la República Mexicana*. The applicable collective bargaining agreements are negotiated every two years and salary adjustments are made on an annual basis. Despite some minor social and union problems, Ternium s subsidiary Hylsamex maintains good relations with its labor force in Mexico and has never experienced a strike or work stoppage.

Under Mexican law, Ternium s Mexican subsidiaries are required to pay their employees an annual benefit of approximately 10% of pre-tax income, calculated using a methodology similar to the methodology used for the calculation of the income tax.

**E. Share Ownership**

To our knowledge, the total number of the Company s shares (in the form of ordinary shares or ADSs) owned by our directors and executive officers as of April 30, 2007 was 693,900, which represents 0.03% of our outstanding shares. The following table provides information regarding share ownership by our officers and directors.

| Director or Officer | Number of Shares Held |
|---------------------|-----------------------|
| Adrián Lajous       | 42,000                |
| Daniel Novegil      | 503,000               |
| Roberto Philipps    | 74,600                |
| Martín Berardi      | 60,000                |
| Alfredo Indaco      | 14,300                |
| Total               | 693,900               |



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

#### **A. Major Shareholders**

The following table shows the beneficial ownership of our shares, as of March 30, 2007, by (1) our principal shareholders (persons or entities that own beneficially 5% or more of the Company's shares), (2) our directors and executive officers as a group and (3) non-affiliated public shareholders.

| <b>Identity of Person or Group</b>          | <b>Number</b> | <b>Percent</b> |
|---|---------------|----------------|
| San Faustín, ISL, I.I.I. CI <sup>(1)</sup>  | 1,184,069,232 | 59.06%         |
| Tenaris <sup>(2)</sup>                      | 229,713,194   | 11.46%         |
| Usiminas <sup>(3)</sup>                     | 285,731,726   | 14.25%         |
| Directors and executive officers as a group | 693,900       | 0.03%          |
| Public                                      | 304,535,390   | 15.19%         |

- (1) ISL is controlled by I.I.I. CI, which is controlled by San Faustín and holds 959,482,775 shares of the Company. In addition, San Faustín, which is ultimately controlled by Rocca & Partners, owns 224,586,457 shares of the Company through I.I.I. C.I.
- (2) Tenaris is controlled by I.I.I. CI, which is controlled by San Faustín and ultimately by Rocca & Partners.
- (3) Usiminas holds its shares through a wholly-owned subsidiary.

As of May 31, 2007, 30,300,511 ADSs (representing 303,005,110 shares of common stock, or 15.11% of all outstanding shares of common stock of the Company) were registered in the name of 106 holders resident in the United States.

The voting rights of our principal shareholders do not differ from the voting rights of other shareholders. None of our directors or officers is a legal or beneficial owner of any of our shares. We are not aware of any arrangement which may at a later date result in a change of control of the Company.

#### **B. Related Party Transactions**

Ternium is party to several related party transactions as described below. These related party transactions are subject to the review of the audit committee of the Company's board of directors and the requirements of Luxembourg law. For further detail on the approval process for related party transactions, see Item 6. Directors, Senior Management and Employees A. Directors and Senior Management Director Liability and C. Board Practices Audit Committee .

Amazonia (Sidor's controlling shareholder) and Hylsamex became subsidiaries of the Company on February 15, 2005, and August 22, 2005, respectively, and consolidation of their results began on those dates. Accordingly, transactions between Sidor or Hylsamex for the year 2005, as applicable, with related parties are only shown as related-party transactions for the Company to the extent attributable to periods beginning on or after the respective consolidation dates.

#### **Purchases of Raw Materials**

In the ordinary course of business, Ternium buys raw materials and other production inputs from the subsidiaries of Tenaris. These purchases are made on similar terms and conditions to those purchases made by the Ternium companies from unrelated third parties. These transactions include:

purchase of ferrous scrap and other raw material, which amounted to USD19.2 million in 2006 and USD9.7 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 the additional purchases amounted to USD0.1 million).

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purchase of steam and operational services from the Argentine electric power generating facility of Tenaris for Siderar in San Nicolás. These purchases amounted to USD6.4 million in 2006 and USD2.6 million in 2005. In addition, Siderar recorded an income of USD6.1 million in 2005 due to a penalty charge paid by a subsidiary of Tenaris for the failure to deliver contractual volumes of steam.

### **Sales of Steel Products and Raw Materials**

In the ordinary course of business, Ternium sells flat steel products, steel bars and raw materials to the subsidiaries of Tenaris. These transactions include:

Sales of flat steel products to be used in the production of welded pipes and accessories, which amounted to USD35.9 million in 2006 and USD29.2 million in 2005.

Sales of steel bars to be used in the seamless pipe operation of the subsidiaries of Tenaris in Venezuela, which amounted to USD30.5 million in 2006 and USD31.8 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 the complementary sales amounted to USD4.9 million)

Sales of pig iron, DRI and scrap to be used in the production of seamless pipes, which amounted to USD23.7 million in 2006 and USD11.7 million in 2005.

In certain circumstances, Ternium sells steel products to other companies in the Techint Group. These sales amounted to USD0.6 million in 2006 and USD0.2 million in 2005.

All these sales are made on similar terms and conditions to those sales made by Ternium to unrelated third parties.

### **Transactions involving Matesi**

Sidor established Matesi jointly with a subsidiary of Tenaris to operate an HBI production facility in Venezuela. Sidor holds 49.8% of Matesi and the subsidiary of Tenaris holds 50.2%. Transactions associated with this operation include:

purchases of HBI (Hot Briquette Iron) pursuant to an off-take agreement, which amounted to USD77.3 million in 2006 and USD79.0 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 the additional purchases amounted to USD8.1 million). The agreement establishes that Matesi is required to sell to Sidor, on a take-or-pay basis, 29.9% of Matesi's HBI production, or up to 49.8% at the election of Sidor.

Sidor entered into a Management Assistance Agreement with Matesi. As part of this agreement, Matesi paid fees to Sidor amounting USD1.1 million in 2006 and USD1.2 million in 2005, related to the provision of managerial services (during the period beginning on January 1, 2005 and ending on February 14, 2005 the complementary fees amounted to USD0.1 million). Additionally, Sidor purchased goods and services on behalf of Matesi for an amount of USD15.1 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 the complementary transactions amounted to USD1.1 million).

as part of the investment agreement to finance the acquisition of Matesi's assets and its start-up, in July, 2004 Sidor granted a loan to Matesi for an outstanding amount at December 31, 2006 of USD58.4 million. This loan bears interest at a rate of LIBOR plus 2%. Interest earned on this loan amounted to USD3.6 million in 2006 and USD2.9 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 the additional interest amounted to USD0.4 million).

## Edgar Filing: Ternium S.A. - Form 20-F

Hylsa earned royalties and technical assistance fees in respect of licensed technology to Matesi. These royalties and fees amounted to USD1.6 million in 2006 and USD1.6 million in 2005.

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during 2006, Sidor entered into a Service Agreement with Matesi under which Sidor recycles by-products from Matesi's operations into raw materials. During 2006, Sidor provided services to Matesi for an amount of USD1.5 million.

### **Purchase Agency Services**

Until September 2006, Ternium entered into agreements with Exiros, a subsidiary of Tenaris, to act as purchase agent. In October 2006, Ternium and Tenaris entered into a joint venture through which each of them hold 50% of Exiros, and continue acting as purchase agent. This acquisition amounted to USD2.3 million. Ternium paid fees amounting to USD11.5 million in 2006 and USD4.8 million in 2005.

### **Supply of Natural Gas**

Siderar is party to contracts with Tecpetrol, TGN, Litoral Gas and Energy Consulting Services relating to the supply of natural gas to Siderar's operations. Tecpetrol is a Techint group company engaged in oil and gas exploration and production and has rights to various oil and gas fields in Argentina and elsewhere in Latin America. TGN operates two major pipelines in Argentina connecting the major gas basins of Neuquén and Noroeste-Bolivia to the major consumption centers in Argentina. Litoral Gas is a company that distributes gas in the Province of Santa Fé and in the northeastern section of the Province of Buenos Aires. Energy Consulting Services is a company engaged in energy and management consulting, representing one of the major and most reliable natural gas traders in Argentina. The Techint group holds significant but non-controlling interests in TGN, Litoral Gas and Energy Consulting Services.

In March 2003, Siderar entered into an agreement with Tecpetrol under which Siderar paid USD17.3 million for the purchase of a total 725 million cubic meters of natural gas to be delivered to Siderar's facilities over a period of five years. Under this agreement, the prices are equivalent or more competitive than those charged by Repsol YPF (Siderar's principal gas supplier) to Siderar. Tecpetrol's sales to Ternium amounted to USD8.9 million in 2006 and USD7.4 million in 2005.

TGN charges Siderar a price to transport its natural gas supplies that is equivalent on a comparable basis to prices paid by other industrial users. The Argentine government regulates the general framework under which TGN operates and prices its services. TGN's sales to Ternium amounted to USD4.0 million in 2006 and USD2.4 million in 2005.

Litoral Gas and Energy Consulting Services provide Siderar with natural gas. Litoral Gas sales to Ternium totaled USD0.7 million in 2006 and USD0.9 million in 2005, while Energy Consulting Services sales amounted to USD1.4 million in 2006 and USD1.5 million in 2005.

### **Provision of Engineering and Labor Services**

Ternium contracts with certain Techint group companies engineering, construction, specialized labor and supervision services for civil and electromechanical works and non-specialist manual labor services, such as cleaning, general maintenance and handling of by-products. These services can usually be provided by other Techint group companies at more competitive prices than if Ternium performed them and are contracted out at market rates. Fees accrued for these services amounted to USD135.9 million in 2006 and USD63.8 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 Sidor paid additional fees amounting USD0.4 million).

### **Sales and Purchases of Other Products and Services**

Ternium entered into other transactions with Techint group companies, the most important ones including:

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payment of commissions to Techintrade Corp. owing to commercial agency services, which amounted to USD10.2 million in 2005. On May 17, 2005 this contract was transferred to a full owned subsidiary of Ternium.

purchase of plant equipment and spare parts to Techint Compagnia Tecnica Internazionale and other related companies, which amounted to USD19.8 million in 2006 and USD9.5 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 Sidor additional purchases amounted to USD8.2 million).

purchases of steel products from Tenaris's subsidiaries, which amounted to USD3.3 million in 2006 and USD2.4 million in 2005.

in July 2006, Siderar entered into a contract with Information Systemas & Technologies, a subsidiary of Tenaris, for the provision of technology and information services. Fees paid under this contract amounted to USD1.6 million.

in late 2005, Hylsamex transferred to Techint Compagnia Tecnica Internazionale the rights to market and license the HYL technology to unaffiliated third parties for royalty fees.

### **Financial Operations and Administrative Services**

In order to finance the acquisition of Hylsamex, Ternium entered into Subordinated Convertible Loans with related parties. Interest paid amounted to USD1.8 million in 2006 and USD9.7 million in 2005. For a description of these loans, see Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Principal Sources of Funding Financial Liabilities .

Finma S.A., a company owned by various Techint group companies, provides administrative and legal support services to Techint group companies, including Siderar and Sidor. In August 2006, Finma was reorganized and Ternium acquired 33.33% of its share capital. Fees accrued under this agreement amounted to USD4.0 million in 2006 and USD3.5 million in 2005 (during the period beginning on January 1, 2005 and ending on February 14, 2005 Sidor paid additional fees amounting USD0.1 million).

### **Other Transactions**

In the ordinary course of business, from time to time, Ternium carries out other transactions and enter into other arrangements with Techint group companies, none of which are believed to be material.

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

Not applicable.

## **Item 8. Financial Information**

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

See Item 18 and pages F-1 through F-51 for our audited consolidated financial statements.

### **Legal Proceedings**

Ternium is involved in litigation arising from time to time in the ordinary course of business. Based on management's assessment and the advice of legal counsel, it is not anticipated that the ultimate resolution of existing litigation will result in amounts in excess of recorded provisions that would be material to Ternium's consolidated financial position or results of operations.



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In June 2004, the arbitration proceedings brought by Sidor against PDVSA Gas, C.A. (on the basis that PDVSA Gas had charged Sidor higher than agreed-upon prices in its supplies of gas against the application of the most favored client clause) were resolved in Sidor's favor. Accordingly, in its financial statements at December 31, 2004, Sidor reversed the USD41.4 million provision it had recorded at December 31, 2003. In July 2004, PDVSA Gas, C.A. filed an appeal with the Venezuelan courts seeking to void an arbitral award. Sidor believes that applicable Venezuelan law does not allow the courts to void this arbitral award under the circumstances and that the likelihood of loss thereunder is remote. Accordingly, Sidor did not record any liabilities in connection with the appeal. At December 31, 2006, Sidor's potential exposure under this litigation amounted to USD125.7 million. As a consequence of the commercial transactions entered into by Sidor and PDVSA Gas during the three-month period ended March 31, 2007, Sidor's potential exposure under this litigation increased by USD9.0 million, thus reaching a total amount of USD134.7 million.

Sidor recorded a provision for a total amount of USD26.3 million in connection with tax matters arising from compensations of tax credits made by the Company since the implementation of the V.A.T. law in June 1999. The SENIAT, the Venezuelan tax and customs authority, is claiming the interest accrued on the application of those tax credits as payment on account of tax obligations.

The Argentine tax authority, the *Administración Federal de Ingresos Públicos* (the AFIP), has challenged the income tax treatment of certain disbursements that Siderar has treated as expenses necessary to maintain industrial installations, which as such should be deducted in the year in which they take place. The AFIP considered the treatment given by Siderar to these expenses asserted that they should be treated as investments or improvements that must be capitalized and, therefore, the AFIP made a reassessment of income tax due on a nominal tax basis plus fines and interest in fiscal years 1995 to 1999 amounting to approximately USD20.4 million.

Siderar appealed these assessments before the Argentine Tax Court. On April 13, 2005, Siderar was notified of a ruling issued by the Argentine Tax Court reducing the assessments made by the AFIP for fiscal years 1995 and 1996 by USD13.9 million and instructing that the taxes be recalculated in accordance with this ruling. Siderar recorded a provision amounting to USD4.6 million as of December 31, 2006, as management of the Company considers there is a probable outflow of benefits. The ruling issued by the Argentine Tax Court regarding fiscal years 1995 and 1996 has been appealed by both AFIP and Siderar, but Siderar is required to pay the amounts (capital and interests) due to the AFIP, pursuant to this ruling (once the recalculation ordered by the Argentine Tax Court has been approved by said Tribunal) even if, at that time, Siderar's appeal has not been resolved.

### **Dividend Policy**

We do not have, and have no current plans to establish, a formal dividend policy governing the amount and payment of dividends or other distributions. The amount and payment of dividends will be determined by a simple majority vote at a general shareholders' meeting, typically, but not necessarily, based on the recommendation of our board of directors. All shares of our capital stock rank *pari passu* with respect to the payment of dividends.

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On June 6, 2007, the Company's shareholders approved a dividend of USD0.05 per share (USD0.50 per ADS), or approximately USD100 million. The Company paid the dividend on June 12, 2007. This is the first dividend distribution made by the Company since its formation.

We will conduct all of our operations through subsidiaries and, accordingly, our main source of cash to pay dividends will be the dividends received from our subsidiaries. See Item 3. Key Information D. Risk Factors Risks Relating to the Structure of the Company As a holding company, our ability to pay dividends and obtain financing depends on the results of operations and financial condition of our subsidiaries and could be restricted by legal, contractual or other limitations. These dividend payments will likely depend on our subsidiaries' results of operations, financial condition, cash and capital requirements, future growth prospects and other factors deemed relevant by their respective boards of directors, as well as on any applicable legal restrictions. See Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate Argentina and Venezuela and Item 10. Additional Information B. Memorandum and Articles of Association Dividends for a discussion of the current Argentine and Venezuelan restrictions on the payment of dividends.

Pursuant to our articles of association, the board of directors has the power to distribute interim dividends in accordance with applicable Luxembourg law, but dividend payments must be approved by our shareholders at the annual general meeting, subject to the approval of our annual accounts. Dividends may be lawfully declared and paid if our net profits and distributable reserves are sufficient under Luxembourg law.

Under Luxembourg law, at least 5% of our net profits per year must be allocated to the creation of a legal reserve until such reserve has reached an amount equal to 10% of our issued share capital. If the legal reserve later falls below the 10% threshold, at least 5% of net profits again must be allocated toward the reserve. The legal reserve is not available for distribution.

**B. Significant Changes**

Except as otherwise disclosed in this annual report, there has been no undisclosed significant change since the date of the annual financial statements.

**Item 9. The Offer and Listing**

**A. Offer and Listing Details**

The Company's ADSs are listed on the NYSE under the symbol TX. Trading on the NYSE began on February 1, 2006. As of March 30, 2007, a total of 2,004,743,442 shares were registered in the Company's shareholder register.

As of May 31, 2007, a total of 303,005,110 shares were registered in the name of the depositary for the Company's ADR program. On June 28, 2007, the closing sales price for the Company's ADSs on the NYSE was USD30.38.

*New York Stock Exchange*

As of May 31, 2007, a total of 30,300,511 ADSs were registered of record. Each ADS represents 10 shares of the Company's stock. The Bank of New York acts as the Company's depositary for issuing ADRs evidencing the ADSs. Fluctuations between the Argentine peso and the U.S. dollar will affect the U.S. dollar equivalent of the price of the ADSs on the NYSE. The following table sets forth, for the periods indicated, the high and low quoted prices for the Company's shares, in the form of ADSs, traded on the NYSE.

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|                                   | Price per ADS |            |
|-----------------------------------|---------------|------------|
|                                   | High          | Low        |
| <b>2006</b>                       |               |            |
| First quarter                     | 30.00         | 20.00      |
| Second quarter                    | 29.00         | 19.91      |
| Third quarter                     | 26.00         | 21.07      |
| Fourth quarter                    | 30.50         | 21.40      |
| <b>Last Six Months</b>            | <b>High</b>   | <b>Low</b> |
| January 2007                      | 29.50         | 23.00      |
| February 2007                     | 30.74         | 25.25      |
| March 2007                        | 28.89         | 24.52      |
| April 2007                        | 30.00         | 26.00      |
| May 2007                          | 27.69         | 25.28      |
| June 2007 (through June 28, 2007) | 30.90         | 30.09      |

**B. Plan of Distribution**

Not applicable.

**C. Markets**

See Offer and Listing Details .

**D. Selling Shareholders**

Not applicable.

**E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

**Item 10. Additional Information****A. Share Capital**

Not applicable.

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

The following is a summary of certain rights of holders of our shares. These rights are set out in our articles of association or are provided by applicable Luxembourg law, and may differ from those typically provided to shareholders of U.S. companies under the corporation laws of some states of the United States of America. This summary is not exhaustive and does not contain all information that may be important to you. For more complete information, you should read our articles of association, which are attached as an exhibit to this annual report.

The Company is a joint stock corporation (*société anonyme holding*) organized under the laws of Luxembourg. Its object and purpose, as set forth in Article 2 of its articles of association, is the taking of interests, in any form, in corporations or other business entities, and the administration, management, control and development thereof. The Company is registered under the number B98 668 in the *Registre du Commerce et des Sociétés*.



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We have an authorized share capital of a single class of 3.5 billion shares having a nominal value of USD1.00 per share. There were 2,004,743,442 shares issued as of May 31, 2007. All issued shares are fully paid.

Our articles of association currently authorize our board of directors, for a period commencing on June 17, 2005 and ending on October 26, 2010, to issue shares within the limits of our authorized share capital at such times and on such terms and conditions as the board of directors or its delegates may determine. Accordingly, until October 26, 2010, shares may be issued up to the authorized share capital limit of USD3.5 billion by a decision of the board of directors.

Our shareholders have authorized the board of directors to waive, suppress or limit any pre-emptive subscription rights of shareholders provided for by law to the extent it deems such waiver, suppression or limitation advisable for any issue or issues of shares within the authorized share capital. However, if and from the date our shares are listed on a regulated market (and only for as long as they are so listed), any issuance of shares for cash within the limits of the authorized share capital shall be subject to the pre-emptive subscription rights of the then existing shareholders (as set out in the articles of association), except in the following cases (in which cases no pre-emptive rights shall apply):

- (a) any issuance of shares for, within, in conjunction with or related to, an initial public offering of our shares on one or more regulated markets (in one or more instances);
- (b) any issuance of shares against a contribution other than in cash;
- (c) any issuance of shares upon conversion of convertible bonds or other instruments convertible into our shares; provided, however, that the pre-emptive subscription rights of the then existing shareholders shall apply by provision of our articles of association in connection with any issuance of convertible bonds or other instruments convertible into our shares for cash; and
- (d) any issuance of shares (including by way of free shares or at a discount), up to an amount of 1.5% of the issued share capital of the Company, to our directors, officers, agents or employees, to the directors, officers, agents or employees of our direct or indirect subsidiaries or of our affiliates, including without limitation the direct issue of shares upon the exercise of options, rights convertible into shares, or similar instruments convertible or exchangeable into shares issued for the purpose of, or in relation to, compensation or incentive of any such persons.

Our authorized share capital is fixed by our articles of association, as amended from time to time, with the approval of shareholders at an extraordinary general shareholders meeting.

## **Dividends**

Subject to applicable law, all shares (including shares underlying ADSs) are entitled to participate equally in dividends when, as and if declared by the shareholders at the ordinary general shareholders meeting out of funds legally available for such purposes. Under Luxembourg law, claims for dividends will lapse five years after the date such dividends are declared. However, we may elect to pay a declared dividend after such period. The shareholders may, at the ordinary general shareholders meeting, which every shareholder has the right to attend in person or by proxy, declare a dividend under Article 21 of our articles of association.

Under Article 21 of the articles of association, our board of directors has the power to distribute interim dividends in accordance with the conditions that apply to commercial companies set forth in particular in Section 72-2 of the Luxembourg law of August 10, 1915 on commercial companies.

## **Voting Rights; Shareholders Meetings; Election of Directors**

Each share (including shares underlying ADSs) entitles the holder to one vote at the Company's general shareholders meetings. Shareholder action by written consent is not permitted, but proxy voting is permitted. Notices of general shareholders meetings are governed by the provisions of Luxembourg law and the Company's



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articles of association. Notices of such meetings must be published twice, at least at eight-day intervals, the second notice appearing at least eight days prior to the meeting, in the Luxembourg Official Gazette and in a leading newspaper having general circulation in Luxembourg. If an extraordinary general shareholders meeting is adjourned for lack of a quorum, notices must be published twice, in the Luxembourg Official Gazette and two Luxembourg newspapers, at 15-day intervals, the second notice appearing at least 15 days prior to the meeting. In case our shares are listed on a foreign regulated market, notices of general shareholders meetings shall also be published in accordance with the publicity requirements of such regulated market. At an ordinary general shareholders meeting, there is no quorum requirement, and resolutions are adopted by a simple majority vote of the shares present or represented and voted. An extraordinary general shareholders meeting must have a quorum of at least 50% of the issued and outstanding shares. If a quorum is not reached, such meeting may be reconvened at a later date with no quorum requirements by means of the appropriate notification procedures provided for by Luxembourg company law. In both cases, Luxembourg company law and the Company's articles of association require that any resolution of an extraordinary general shareholders meeting be adopted by a two-thirds majority vote of the shares present or represented. If a proposed resolution consists of changing the Company's nationality or of increasing the shareholders' commitments, the unanimous consent of all shareholders is required. Directors are elected at an ordinary meeting. Cumulative voting is not permitted. As our articles of association do not provide for staggered terms, directors are elected for a maximum of one year and may be reappointed or removed at any time, with or without cause, by a majority vote of the shares present or represented and voted.

Our annual ordinary general shareholders meeting is held at 2:30 P.M., Luxembourg time, on the first Wednesday of June of each year at the place indicated in the notices of meeting. If that day is a legal or banking holiday in Luxembourg, the meeting shall be held on the following business day.

Any shareholder who holds one or more of our shares on the fifth calendar day preceding the general shareholders meeting (the Record Date) shall be admitted to a general shareholders meeting. Those shareholders who have sold their shares between the Record Date and the date of the general shareholders meeting, may not attend or be represented at the meeting.

In the case of shares held through fungible securities accounts, each shareholder may exercise all rights attached to his shares and, in particular, may participate in and vote at shareholders meetings of the Company upon presentation of a certificate issued by the financial institution or professional depository holding the shares, evidencing such deposit and certifying the number of shares recorded in the relevant account on the Record Date. Such certificate must be filed at least five days before the meeting with the Company at its registered address or at the address stated in the convening notice or, in case the shares of the Company are listed on a regulated market, with an agent of the Company located in the country of the listing and designated in the convening notice. In the event that the shareholder votes by proxy, he shall file the required certificate and a completed proxy form within the same period of time at the registered office of the Company or with any local agent of the Company duly authorized to receive such proxies.

The board of directors and the shareholders meeting may, if they deem so advisable, reduce these periods of time for all shareholders and admit all shareholders (or their proxies) who have filed the appropriate documents to the general shareholders meeting, irrespective of these time limits.

### **Access to Corporate Records**

Luxembourg law and our articles of association do not generally provide for shareholder access to corporate records. Shareholders may inspect the annual accounts and auditors' reports at our registered office during the fifteen-day period prior to a general shareholders meeting.

### **Appraisal Rights**

In the event the shareholders approve any of the following:

the delisting of our shares from all regulated markets where our shares are listed at that time, excluding a delisting made pursuant to an offer to all of our shareholders made by a business entity subject to

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common control with us, whereby such business entity offers to issue, in exchange for our shares, shares to be listed on the same regulated market(s) on which our shares are listed;

a merger in which we are not the surviving entity (unless the shares or other equity securities of such entity are listed on the New York or London stock exchanges);

a sale, lease, exchange or other disposition of all or substantially all of our assets;

an amendment to our articles of association that has the effect of materially changing our corporate purpose;

the relocation of our domicile outside the Grand Duchy of Luxembourg; or

amendments to our articles of association that restrict the rights of our shareholders (excluding any amendments in relation with, or to, the authorized share capital and/or the waiver or suppression of any preferential subscription rights relating thereto); dissenting or absent shareholders have the right to have their shares repurchased by the Company at (i) the average market value of the shares over the 90 calendar days preceding the applicable general shareholders meeting or (ii) in the event that our shares are not traded on any regulated market, the amount that results from applying the proportion of our equity that the shares being sold represent over our net worth as determined in our last consolidated financial statements approved by the shareholders or in our last interim consolidated financial statements approved by the board of directors, whichever is more recent. Shareholders who voted in favor of the relevant resolution are not entitled to exercise this right.

Dissenting or absent shareholders must present their claim within one month following the date of the applicable general shareholders meeting and supply the Company with evidence of their shareholding at the time of such meeting. We must (to the extent permitted by applicable laws and regulations and in compliance therewith) repurchase our shares within six months following the date of the applicable general shareholders meeting. If delisting from one or more, but not all, of the regulated markets where our shares are listed is approved by the shareholders, only dissenting or absent shareholders with shares held through participants in the local clearing system for that market or those markets can exercise this appraisal right if:

they held the shares as of the date of the announcement by us of our intention to delist or as of the date of publication of the first convening notice for the general shareholders meeting that approved the delisting;

they present their claim within one month following the date of the general shareholders meeting and supply evidence of their shareholding as of the date of the Company's announcement or the publication of the first convening notice to the meeting; and

the delisting is not being made pursuant to an offer to all of our shareholders made by a business entity subject to common control with us, whereby such business entity offers to issue, in exchange for our shares, shares to be listed on the same regulated market(s) on which such dissenting or absent shareholders hold their shares through participants in the local clearing system for that market or markets.

In the event a shareholder exercises its appraisal right, applicable Luxembourg law provisions shall apply.

### **Distribution of Assets on Winding-up**

In the event of our liquidation, dissolution or winding-up, the net assets remaining after allowing for the payment of all debts, charges and expenses shall be paid out to holders of our shares in proportion to their respective holdings.





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### **Transferability and Form**

Our articles of association do not impose restrictions on the transfer of our shares. The shares are issuable in registered form.

Pursuant to our articles of association, the ownership of registered shares is evidenced by the inscription of the name of the shareholder, the number of shares held by him and the amount paid on each share in our shareholders' register. In addition, our articles of association provide that our shares may be held through fungible securities accounts with financial institutions or other professional depositaries. Shares held through fungible securities accounts have the same rights and obligations as shares recorded in our shareholders' register.

Shares held through fungible securities accounts may be transferred in accordance with customary procedures for the transfer of securities in book-entry form. Shares that are not held through fungible securities accounts may be transferred by a written statement of transfer signed by both the transferor and the transferee or their respective duly appointed attorney-in-fact and recorded in our shareholders' register. The transfer of shares may also be made in accordance with the provisions of Article 1690 of the Luxembourg Civil Code. As evidence of the transfer of registered shares, we may also accept any correspondence or other documents evidencing the agreement between transferor and transferee as to the transfer of registered shares.

Fortis Banque Luxembourg S.A. maintains our shareholders' register.

### **Limitation on Securities Ownership**

There are no limitations currently imposed by Luxembourg law or the articles of association on the rights of non-resident shareholders to hold or vote our shares.

### **Change in Control**

Our articles of association do not contain any provision that would have the effect of delaying, deferring or preventing a change in control of the Company and that would operate only with respect to a merger, acquisition or corporate restructuring involving the Company. In addition, the Company does not know of any significant agreements or other arrangements to which the Company is a party and which take effect, alter or terminate in the event of a change of control of the Company.

There are no rights associated with the Company's shares other than those described above.

### **C. Material Contracts**

For a summary of any material contract entered into by us outside of the ordinary course of business during the last two years, see Item 4. Information on the Company's Raw Materials and Energy .

### **D. Exchange Controls**

Many of the countries which are important markets for us or in which we have substantial assets have a history of substantial government intervention in currency markets, volatile exchange rates and government-imposed currency controls. These include Argentina, Mexico and Venezuela. Currently, only Venezuela and Argentina have exchange controls or limitations on capital flows, including requirements for the repatriation of export earnings, in place.

#### *Argentina*

On January 11, 2002, the exchange rate began to float for the first time since April 1991. Heightened demand for scarce U.S. dollars caused the Argentine peso to trade well above the one-to-one parity under the Convertibility

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Law. However, beginning in the second half of 2002, the adjustments in Argentina's balance of payments and the stabilization in the value of the peso allowed the Argentine Central Bank to more effectively manage the level of liquidity and, as income from trade increased and the demand for pesos began to recover, it was able to begin replenishing its international reserves.

Starting in 2004 and during 2005 the Argentine Central Bank has, from time to time, purchased U.S. dollars in the open market in order to maintain the value of the U.S. dollar around ARP2.9 and ARP3.0, respectively, per U.S. dollar. Additionally, and in order to restrict the inflows of U.S. dollars and avoid volatility in the U.S. dollar market, on June 10, 2005 the Argentine government issued Decree No. 616/2005 establishing certain restrictions on capital inflows into Argentina. During 2006 and the first half of 2007, the Argentine Central Bank maintained the value of the U.S. dollar around ARP3.0 and ARP3.1, per U.S. dollar. Transfers of foreign currency into Argentina are only permitted upon compliance with the following requirements:

a nominative non-transferable deposit denominated in U.S. dollars for an amount equal to 30% of the relevant transaction must be made with the resulting proceeds of the relevant transaction. This deposit shall be held for a period of 365 calendar days, shall not bear interest (nor yield any other type of profit) and may not be used as collateral in any credit transaction;

inflows must remain in Argentina for a minimum term of 365 calendar days to be computed starting on the day they were converted into Argentine pesos in the local exchange market;

inflows and outflows of foreign currency into the local exchange market, and indebtedness transactions by local residents that may result in a foreign currency denominated payment to non-residents, must be registered with the Argentine Central Bank; and

the funds involved in the transactions covered by the Decree shall be credited in a local banking account.

Such requirements do not apply to foreign trade and export finance related transactions (provided that pre-export financings are repaid exclusively with export proceeds), foreign direct investment, loans granted by multilateral organizations, loans used to fund the purchase of certain fixed assets, or long-term investments overseas or to the primary placement of publicly traded securities listed in one or more exchange markets, among others.

For additional information regarding factors affecting the value of the Argentine peso, see Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate Argentina.

The market exchange rate of the Argentine peso against the U.S. dollar continues to be determined by the forces of supply and demand in the foreign exchange market, although the Argentine government, acting through the Argentine Central Bank, has a number of means by which it may act to maintain exchange rate stability. See Item 3. Key Information D. Risk Factors Risks Relating to our Business Ternium's results of operations and financial condition could be adversely affected by movements in exchange rates.

*Mexico*

Between November 1991 and December 1994, the Mexican Central Bank maintained the exchange rate between the U.S. dollar and the Mexican peso within a prescribed range through intervention in the foreign exchange market. The Mexican Central Bank intervened in the foreign exchange market as the exchange rate reached either the minimum or the maximum of the prescribed range in order to reduce day-to-day fluctuations in the exchange rate. On December 20, 1994, the Mexican government modified the prescribed range within which the Mexican peso was permitted to float by increasing the maximum Mexican peso price of the U.S. dollar by MXN0.53, equivalent to an effective devaluation of 15.3%. On December 22, 1994, the Mexican government suspended intervention by the Mexican Central Bank and allowed the Mexican peso to float freely against the U.S. dollar. Factors that contributed to this decision included the size of Mexico's current account deficit, a decline in the Mexican Central Bank's foreign exchange reserves, rising interest rates for other currencies (especially the U.S. dollar) and reduced confidence in the Mexican economy on the part of investors due to political uncertainty associated with events in the

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state of Chiapas and presidential and congressional elections in that year. The value of the Mexican peso against the U.S. dollar rapidly declined by 42.9% from December 19, 1994 to December 31, 1994. The Mexican government has since allowed the Mexican peso to float freely against the U.S. dollar.

Historically, the Mexican economy has suffered balance of payment deficits and shortages in foreign exchange reserves. While the Mexican government does not currently restrict the ability of Mexican or foreign persons or entities to convert Mexican pesos to U.S. dollars and the terms of NAFTA, to which Mexico is a signatory, generally prohibit exchange controls, the Mexican government could institute a restrictive exchange control policy in the future.

For additional information regarding factors affecting the value of the Mexican peso, see Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate Mexico.

*Venezuela*

Beginning in 2001, Venezuela experienced intense political and social turmoil involving groups that oppose and those that support the Chávez administration. Between December 2001 and February 2003, the opposition staged four nationwide work stoppages to protest against the Chávez administration, the latest of which began on December 2, 2002 and ended on February 3, 2003. Since that date, pro-government and opposition forces have taken steps towards resolving the political crisis through the electoral process.

The general work stoppage that began in December 2002, however, resulted in a significant decrease in the amount of foreign currency generated from the sale of oil. This decrease was coupled with an extraordinary increase in the demand for foreign currency, resulting in a significant decline in the level of Venezuela's international reserves and a substantial depreciation of the Venezuelan bolívar against the U.S. dollar during the first few weeks of 2003. From December 2, 2002 until January 23, 2003, on which date Venezuela suspended foreign exchange trading in an attempt to stem the depreciation of the Venezuelan bolívar, the Venezuelan bolívar/U.S. dollar exchange rate depreciated from VEB1,322.75 = USD1.00 to VEB1,853.00 = USD1.00. The substantial reduction of oil exports resulting from the work stoppage also damaged the country's trade balance. These problems disrupted Venezuela's economy and threatened to affect negatively Venezuela's ability to service its external debt. In response to those developments, Venezuela suspended foreign exchange trading on January 23, 2003. On February 5, 2003, the government adopted a series of exchange agreements, decrees and regulations establishing a new exchange control regime.

A commission, referred to as the Comisión de Administración de Divisas, or CADIVI, was created for the administration, control and establishment of the new exchange control regime. CADIVI is composed of five members appointed by the President of Venezuela. Under the new regime, the Ministry of Finance, together with the Central Bank of Venezuela, sets the exchange rate with respect to the U.S. dollar and other currencies and has discretion to modify, at any time, the existing exchange control regime or the free float of the bolívar. The new regime centralizes the purchase and sale of foreign currencies by permitting such sales to be made only through the Central Bank.

On February 5, 2003, the Ministry of Finance and the Venezuelan Central Bank fixed the U.S. dollar exchange rate at VEB1,596 = USD1.00 for purchase operations and VEB1,600 = USD1.00 for sale operations. The exchange rate for the payment of the public foreign debt was set at VEB1,600 = USD1.00 on February 7, 2003.

In February 2004, the Venezuelan government reset the exchange rate to VEB1,917 to USD1.00, a devaluation of 16.5%. In addition, in March 2005, the Venezuelan bolívar suffered a subsequent devaluation of 12%, leaving the exchange rate at VEB2,147 to USD1.00.

For additional information regarding factors affecting the value of the Venezuelan bolívar, see Item 3. Key Information D. Risk Factors Risks Relating to the Countries in Which We Operate Venezuela.

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**E. Taxation**

The following discussion of the material Luxembourg and United States federal income tax consequences of an investment in our ADSs is based upon laws and relevant interpretations thereof in effect as of the date of this annual report, all of which are subject to change. This discussion does not address all possible tax consequences relating to an investment in our ADSs, such as the tax consequences under United States state and local tax laws.

**Grand Duchy of Luxembourg**

This section describes the material Luxembourg tax consequences of owning or disposing of ADSs.

*You should consult your own tax adviser regarding the Luxembourg tax consequences of owning and disposing of ADSs in your particular circumstances.*

***Holding company status***

The tax treatment described below results from the tax status of the Company as a holding company under the law of July 31, 1929 and the billionaire provisions relating there.

Following a decision by the European Commission, the Grand-Duchy of Luxembourg has terminated its 1929 holding company regime, effective January 1, 2007. However, under the implementing legislation, pre-existing publicly-listed companies including us are entitled to continue benefiting from their current tax regime until December 31, 2010.

During the transitional period, the Company must comply with certain reporting requirements to maintain its right to benefit from the special tax exempt status transition period, including an annual certification and submission such certification to the tax.

***Ownership and disposition of the Company's ADSs***

Holders of the Company's ADSs will not be subject to Luxembourg income tax, wealth tax or capital gains tax in respect of those ADSs, except for:

- (i) individual residents of Luxembourg, entities organized in Luxembourg or foreign entities domiciled or having a permanent establishment in Luxembourg. For purposes of Luxembourg tax law, you are deemed to be an individual resident in Luxembourg, subject to treaty provisions, if you have your domicile or your usual place of residence in Luxembourg, or
- (ii) non-resident holders are taxed with respect to the disposition of the Company's ADSs held for less than six months if such non-resident holder has owned alone, or if such non-resident holder is an individual, together with his spouse or minor children, directly or indirectly at any time during the five years preceding the date of disposition more than 10% of the Company's share capital, or
- (iii) non-resident holders are taxed with respect to the disposition of the Company's ADSs held for more than six months(x) if such non-resident holder has owned alone, or together with his spouse or minor children, directly or indirectly, at any time during the five years preceding the date of disposition, more than 10% of the Company's share capital and (y) was a Luxembourg resident taxpayer for more than 15 years and has become a non-resident tax payer less than 5 years before the moment of disposition of the ADSs.

No inheritance tax is payable by a holder of the Company's ADSs except if the deceased holder was a resident of Luxembourg at the time of death.

There is no Luxembourg transfer duty or stamp tax on the purchase or disposition of the ADSs.

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***Dividends received on the Company's ADSs by non-Luxembourg resident holders***

No withholding tax applies in Luxembourg on dividends distributed by the Company. No taxes apply in Luxembourg on dividends received by holders who are not resident in Luxembourg and who do not maintain a permanent establishment in Luxembourg to which the holding of the ADSs is effectively connected. Dividends received by holders who are individual residents of Luxembourg, entities organized in Luxembourg or entities domiciled or having a permanent establishment in Luxembourg are subject to tax.

**United States federal income taxation**

This section describes the material United States federal income tax consequences to a U.S. holder (as defined below) of owning ADSs. It applies to you only if you hold your ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

a dealer in securities,

a bank,

a trader in securities that elects to use a mark-to-market method of accounting for securities holdings,

a tax-exempt organization,

a person who invests through a pass-through entity, including a partnership,

a life insurance company,

a person liable for alternative minimum tax,

a person that actually or constructively owns 10% or more of the Company's voting stock or its ADSs,

a person that holds ADSs as part of a straddle or a hedging or conversion transaction, or

a person whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, as well as on the Income Tax Treaty between Luxembourg and the United States (the "Treaty"). These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the depository and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms.

If a partnership holds the ADSs, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. Each such partner holding the ADSs is urged to consult his, her or its own tax advisor.

You are a U.S. holder if you are a beneficial owner of ADSs and you are:

a citizen or resident of the United States of America,

a domestic corporation,

an estate whose income is subject to United States of America federal income tax regardless of its source, or

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a trust if a United States of America court can exercise primary supervision over the trust's administration and one or more United States of America persons are authorized to control all substantial decisions of the trust.

In general, and taking into account the earlier assumptions, for United States of America federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States of America federal income tax.

### ***Taxation of dividends***

Under the United States federal income tax laws, and subject to the passive foreign investment company, or PFIC, rules discussed below, if you are a U.S. holder, the gross amount of any dividend the Company pays out of its current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a noncorporate U.S. holder, dividends paid to you in taxable years beginning before January 1, 2011 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that you hold the shares or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends the Company pays with respect to the ADSs generally will be qualified dividends.

You must include any Luxembourg tax withheld from the dividend payment in this gross amount even though you do not in fact receive it. The dividend is taxable to you when you, in the case of shares, or the depository, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States of America corporations. Distributions in excess of current and accumulated earnings and profits, as determined for United States of America federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the ADSs and thereafter as capital gain.

Subject to certain limitations, any Luxembourg tax withheld in accordance with the Treaty and paid over to Luxembourg will be creditable against your United States federal income tax liability. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate. To the extent a refund of the tax withheld is available to you under Luxembourg law or under the Treaty, the amount of tax withheld that is refundable will not be eligible for credit against your United States federal income tax liability.

Dividends will be income from sources outside the United States of America, but dividends paid in taxable years beginning before January 1, 2007 generally will be passive or financial services income, and dividends paid in taxable years beginning after December 31, 2006 will, depending on your circumstances, be passive or general income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

### ***Taxation of capital gains***

Subject to the PFIC rules discussed below, if you are a U.S. holder and you sell or otherwise dispose of your ADSs, you will recognize capital gain or loss for United States of America federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your ADSs. Capital gain of a noncorporate U.S. holder that is recognized before January 1, 2011 is generally taxed at a maximum rate of 15% where the holder has a holding period greater than one year. The gain or loss will generally be income or loss from sources within the United States of America for foreign tax credit limitation purposes.



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### ***PFIC rules***

Based on the Company's expected income and assets, it is highly unlikely that the ADSs will be treated as stock of a PFIC for United States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change. If the Company were to be treated as a PFIC, unless a U.S. holder elects to be taxed annually on a mark-to-market basis with respect to the ADSs, gain realized on the sale or other disposition of your ADSs would in general not be treated as capital gain. Instead, if you are a U.S. Holder, you would be treated as if you had realized such gain and certain excess distributions ratably over your holding period for the ADSs and would be taxed at the highest tax rate in effect for each such year to which the gain was allocated, together with an interest charge in respect of the tax attributable to each such year. With certain exceptions, your ADSs will be treated as stock in a PFIC if the Company were a PFIC at any time during your holding period in your ADSs. Dividends that you receive from the Company will not be eligible for the special tax rates applicable to qualified dividend income if the Company is treated as a PFIC with respect to you either in the taxable year of the distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

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

Not applicable.

### **G. Statement by Experts**

Not applicable.

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

We are required to file annual and special reports and other information with the SEC. You may read and copy any documents filed by the Company at the SEC's public reference room at 100 Fifth Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC also maintains a website at <http://www.sec.gov> which contains reports and other information regarding registrants that file electronically with the SEC.

We are subject to the reporting requirements of the Exchange Act of 1934, as applied to foreign private issuers. Because we are a foreign private issuer, the SEC's rules do not require us to deliver proxy statements or to file quarterly reports. In addition, our insiders are not subject to the SEC's rules that prohibit short-swing trading. We prepare quarterly and annual reports containing consolidated financial statements in accordance with IFRS. Our annual consolidated financial statements are certified by an independent accounting firm. We submit quarterly financial information to the SEC on Form 6-K simultaneously with or promptly following the publication of that information in Luxembourg or any other jurisdiction in which our securities are listed, and will file annual reports on Form 20-F within the time period required by the SEC, which is currently six months from the close of the fiscal year on December 31. These quarterly and annual reports may be reviewed at the SEC's Public Reference Room. Reports and other information filed electronically with the SEC are also available at the SEC's website.

As a foreign private issuer under the Securities Act, we are not subject to the proxy rules of Section 14 of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act) or the insider short-swing profit reporting requirements of Section 16 of the Exchange Act.

We have appointed The Bank of New York to act as depository for our ADSs. During the time the deposit agreement remains in force, we will furnish the depository with:

our annual reports; and

summaries of all notices of general meetings of shareholders and other reports and communications that are made generally available to our shareholders.

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The depositary will, as provided in the deposit agreement, if we so request, arrange for the mailing of summaries in English of the reports and communications to all record holders of our ADSs. Any record holder of ADSs may read the reports, notices, or summaries thereof, and communications at the depositary's office located at 101 Barclay Street, New York, New York 10286.

Whenever a reference is made in this annual report to a contract or other document, please be aware that such reference is not necessarily complete and that you should refer to the exhibits that are a part of this annual report for a copy of the contract or other document. You may review a copy of the annual report at the SEC's public reference room in Washington, D.C.

**I. Subsidiary Information**

Not applicable.

**Item 11. Quantitative and Qualitative Disclosures About Market Risk**

The multinational nature of our operations and customer base expose us to the risk of changes in interest rates, foreign currency exchange rates and, to a limited extent, commodity prices. We selectively manage these exposures through the use of derivative instruments to mitigate market risk. Otherwise, we do not use derivative financial instruments for trading, other speculative purposes or other exposures. In addition, in the ordinary course of business Ternium also faces risks with respect to financial instruments that are either non-financial or non-quantifiable. Such risks principally include country risk and credit risk and are not presented in the following analysis.

The following tables provide a breakdown of Ternium's debt instruments at December 31, 2006 and 2005, which included fixed and variable interest rate obligations detailed maturity date:

| At December 31, 2006<br><i>In thousands of U.S. Dollars</i> | Expected maturity date, as of December 31, |         |         |        |       |            | Total     |
|---|--|---------|---------|--------|-------|------------|-----------|
|   | 2007                                       | 2008    | 2009    | 2010   | 2011  | Thereafter |           |
| <b>Non-current Debt</b>                                     |  |         |         |        |       |            |           |
| Fixed Rate  |  |         |         |        |       | 7,206      | 7,206     |
| Floating Rate   |  | 290,804 | 120,021 | 94,923 | 1,358 | 34,089     | 541,195   |
| <b>Current Debt</b>   |  |         |         |        |       |            |           |
| Fixed Rate  | 150,918                                    |         |         |        |       |            | 150,918   |
| Floating Rate   | 357,776                                    |         |         |        |       |            | 357,776   |
| <b>Total</b> <sup>(1) (2)</sup>                             | 508,694                                    | 290,804 | 120,021 | 94,923 | 1,358 | 41,295     | 1,057,095 |

| At December 31, 2005<br><i>In thousands of U.S. Dollars</i> | Expected maturity date, as of December 31, |         |         |         |         |            | Total     |
|---|--|---------|---------|---------|---------|------------|-----------|
|   | 2006                                       | 2007    | 2008    | 2009    | 2010    | Thereafter |           |
| <b>Non-current Debt</b>                                     |  |         |         |         |         |            |           |
| Fixed Rate  |  | 3,256   |         |         |         | 6,752      | 10,008    |
| Floating Rate   |  | 543,687 | 735,640 | 267,655 | 210,462 | 632,426    | 2,389,871 |
| <b>Current Debt</b>   |  |         |         |         |         |            |           |
| Fixed Rate  | 46,249                                     |         |         |         |         |            | 46,249    |
| Floating Rate   | 470,149                                    |         |         |         |         |            | 470,149   |
| <b>Total</b> <sup>(1) (2)</sup>                             | 516,399                                    | 546,943 | 735,640 | 267,655 | 210,462 | 639,178    | 2,916,277 |

(1) Borrowings are primarily bank borrowings with third parties. See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Principal Sources of Funding Financial Liabilities .

(2) As most borrowings are subject to floating rates that approximate market rates, with contractual repricing that occurs every three to six months, the fair value of each borrowing approximates its carrying amount and is not disclosed separately.

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Our nominal weighted average interest rate for our debt instruments was 6.82% and 6.08% for 2006 and 2005, respectively. These rates were calculated using the rates set for each instrument in its corresponding currency and weighted using the dollar-equivalent outstanding principal amount of each instrument as of December 31, 2006 and 2005, respectively.

**Table of Contents****Total Debt by Currency**

| <i>In thousands of U.S. Dollars</i> | 2006      | 2005      |
|-------------------------------------|-----------|-----------|
| USD                                 | 961,150   | 2,809,836 |
| MXN                                 |           | 64,822    |
| VEB                                 | 40,100    | 41,161    |
| EUR                                 |           | 404       |
| ARS                                 | 55,845    | 54        |
| Total                               | 1,057,095 | 2,916,277 |

**Interest Rate Risk**

Interest rate movements create a degree of risk by affecting the amount of Ternium's interest payments and the value of Ternium's fixed rate debt. Most of Ternium's long-term borrowings are at variable rates, while its debt with related parties is at fixed rates. Ternium's total variable interest rate debt amounted to USD899.0 million (85% of total borrowings) for the year ended December 31, 2006 and USD2,860.0 million (98% of total borrowings) for the year ended December 31, 2005.

*Interest Rate Swaps*

Variable rate debts expose Ternium to the risk of increased interest expense in the event of increases in interest rates. From time to time, Ternium enters into interest rate swap agreements to manage its exposure to interest rate changes.

On September 1, 2005, III BVI entered into a USD250 million interest rate swap agreement with Citibank N.A., New York to manage the impact of the floating interest rate changes on the facilities entered into in connection with the Hylsamex acquisition by setting the interest rate to 4.235% per annum. This interest rate swap is due on August 22, 2010 and provides for semi-annual payments on February 22 and August 22 of each year, commencing on August 22, 2006 through and including the termination date. The notional amounts and schedule of payments provided by this agreement are as follows:

| <b>From and including</b> | <b>Calculation period</b> |                         | <b>Notional amount<br/>(In thousands of U.S. dollars)</b> |
|---------------------------|---------------------------|-------------------------|---|
|                           |                           | <b>To but excluding</b> |   |
| February 22, 2006         |                           | August 22, 2006         | 250,000   |
| August 22, 2006           |                           | February 22, 2007       | 226,250   |
| February 22, 2007         |                           | August 22, 2007         | 201,250   |
| August 22, 2007           |                           | February 22, 2008       | 176,250   |
| February 22, 2008         |                           | August 22, 2008         | 148,750   |
| August 22, 2008           |                           | February 22, 2009       | 121,250   |
| February 22, 2009         |                           | August 22, 2009         | 93,750  |
| August 22, 2009           |                           | February 22, 2010       | 66,250  |
| February 22, 2010         |                           | August 22, 2010         | 33,750  |

In addition, on September 1, 2005, Siderar entered into two interest rate swap agreements with JP Morgan Chase Bank N.A. and Deutsche Bank AG with a notional amount of USD100 million each to manage its exposure to changes in market rates associated with the Siderar Credit Facility by setting the interest rate to 4.18% and 4.20% per annum, respectively. These interest rate swaps are due on August 22, 2008 and provide for semi-annual payments on February 22 and August 22 of each year, commencing on August 22, 2006 through and including the termination date. The notional amount and schedule of payment provided by each of this two agreements are as follows:

| <b>From and including</b> | <b>Calculation period</b> |                         | <b>Notional amount<br/>(In thousands of U.S. dollars)</b> |
|---------------------------|---------------------------|-------------------------|---|
|                           |                           | <b>To but excluding</b> |   |
| February 22, 2006         |                           | August 22, 2006         | 100,000   |

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|                   |                   |        |
|-------------------|-------------------|--------|
| August 22, 2006   | February 22, 2007 | 80,000 |
| February 22, 2007 | August 22, 2007   | 60,000 |
| August 22, 2007   | February 22, 2008 | 40,000 |
| February 22, 2008 | August 22, 2008   | 20,000 |

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In March 2003, Hylsa entered into several interest rate cap agreements to manage the impact of the floating interest rate changes on its financial debt. As of December 31, 2006, Hylsa has an agreement, with a notional amount of USD179.9 million and a fixed interest rate of 7.00% per annum; and another agreement with a notional amount of USD24.5 million and a fixed interest rate of 5.0% per annum, both with Credit Suisse. These two agreements are due on January 2, 2008 and on January 22, 2007, respectively.

As of December 31, 2006, Ternium and its subsidiaries were party to interest rate swap and cap agreements as detailed in the table below:

| At December 31, 2006       | Total                                 | Fair Value |
|----------------------------|---------------------------------------|------------|
|                            | <i>(In thousands of U.S. Dollars)</i> |            |
| <b>Interest Rate Swaps</b> |                                       |            |
| Variable to Fixed          |                                       |            |
| Contract amount (USD)      | 386,250                               | 6,849      |
| Average fixed pay rate     | 4.22%                                 |            |
| Floating received rate     | US-LIBOR 6M                           |            |

| At December 31, 2006      | Total                                 | Fair Value |
|---------------------------|---------------------------------------|------------|
|                           | <i>(In thousands of U.S. Dollars)</i> |            |
| <b>Interest Rate Caps</b> |                                       |            |
| Variable to Fixed         |                                       |            |
| Contract amount (USD)     | 204,390                               | 8.0        |
| Average fixed pay rate    | 6.76%                                 |            |
| Floating received rate    | US-LIBOR 3M                           |            |

**Foreign Exchange Exposure Risk**

A portion of Ternium's business is carried out in currencies other than the U.S. dollar, Ternium's reporting currency. As a result of this foreign currency exposure, exchange rate fluctuations impact Ternium's results as reported in its income statement in the form of both translation risk and transaction risk. Translation risk is the risk that Ternium's consolidated financial statements for a particular period or as of a certain date may be affected by changes in the prevailing rates of the various functional currencies of the reporting subsidiaries against the U.S. dollar. Transaction risk is the risk that the value of transactions executed in currencies other than the subsidiary's functional currency may vary according to currency fluctuations.

*Foreign Currency Derivative Contracts*

Ternium aims to manage the negative impact of fluctuations in the value of other currencies with respect to the U.S. dollar. However, the fact that some subsidiaries have measurement currencies other than the U.S. dollar may, at times, distort the result of these efforts as reported under IFRS.

Ternium operates and sells its products in different countries, and as a result is exposed to foreign exchange rate volatility. Ternium's subsidiaries may use derivative contracts in order to mitigate their exposure to exchange rate risk derived from their trade and financial operations.

As of December 31, 2006 and 2005, Ternium's subsidiaries were party to foreign currency forward agreements as detailed in the table below:

**At December 31, 2006**

| <i>In thousands of U.S. Dollars</i>                        | 2007          | Thereafter | Total         | Fair Value |
|--|---------------|------------|---------------|------------|
| <b>Non-Deliverable forwards</b>                            |               |            |               |            |
| ARS/USD (Argentine Peso non-deliverable forward purchases) |               |            |               |            |
| Notional amount  | ARS100,000    |            | ARS100,000    | USD178     |
| Average contractual exchange rate                          | 3.0918ARS/USD |            | 3.0918ARS/USD |            |
| MXN/USD (Mexican Peso forward purchases) <sup>(1)</sup>    |               |            |               |            |
|  |               |            |               | USD817     |

- 
- (1) Hylsa has a contract for half of its electricity purchases with an affiliate of Iberdrola, S.A., a Spanish utility company, pursuant to a 25-year contract that began in April 2002. Prices in this contract are mostly denominated in U.S. dollars, while payments to its alternative provider CFE are in Mexican pesos. Under the contract, Hylsa is allowed to terminate this agreement under specified price-related circumstances. The fair value of this embedded derivative as of December 31, 2006, was USD0.8 million.

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At December 31, 2005

| <i>In thousands of U.S. Dollars</i> | 2006           | Thereafter | Total          | Fair Value |
|-------------------------------------|----------------|------------|----------------|------------|
| <b>Forwards</b>                     |                |            |                |            |
| USD/Euro (Euro forward sales)       |                |            |                |            |
| Notional amount                     | EUR1,400       |            | EUR1,400       | USD86      |
| Average contractual exchange rate   | 1.2484 USD/EUR |            | 1.2484 USD/EUR |            |
| <b>Commodity Price Sensitivity</b>  |                |            |                |            |

Ternium's subsidiaries use certain commodities and raw materials that are subject to price volatility caused by supply and weather conditions, political situations, financial variables and other unpredictable factors. As a result, they are exposed to the volatility in the price of these commodities and raw materials. Ternium's policy is to manage this risk by partially fixing the underlying price or limiting its volatility for defined period.

*Natural Gas*

As discussed in Item 4. Information on the Company Raw Materials and Energy, Siderar and Sidor have entered into long term agreements contracts for the supply of natural gas. On the other hand, Hylsamex purchases all of its natural gas from Pemex, the Mexican state-owned oil and gas company that is Mexico's sole supplier of natural gas. Natural gas is affected by commodity pricing and is, therefore, subject to price volatility caused by weather, production problems and other factors that are outside Hylsamex's control and which are generally unpredictable. Hylsamex constantly monitors the natural gas markets to manage this exposure.

During 2005 and 2006, Hylsamex entered into several derivatives contracts with the purpose of limiting the high volatility of natural gas prices. These contracts included options and forwards structures such as swaps, swaptions, calls and puts with different counterparties such as JPMorgan, Citibank NA and Deutsche Bank.

On September 12, 2005, the Mexican Government issued a decree that modified the mechanism that sets the natural gas price in the Mexican market. This mechanism consisted of a fixed price of MXN83.2/MMBtu for September 2005 and a fixed price of MXN78.02/MMBtu plus 21% of the difference between the south Texas price reference and MXN78.02/MMBtu for the following months, with a minimum price of MXN78.02/MMBtu. This decree was the response of the Mexican government to the spike in natural gas prices in the United States resulting from Hurricane Katrina, which affected Mexican natural gas market prices as well. The price fixing mechanism remained in place until January 2006 when the daily natural gas production in the Gulf of Mexico reached a level of 8.0 Bcfs for at least thirty days, which was the condition established by the Mexican government to end the decree.

Ternium does not anticipate any near-term changes in management's strategy regarding the monitoring and managing of these risk exposures.



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As of December 31, 2006, Hylsa's derivatives contracts to manage the impact of the fluctuation on the natural gas prices, are detailed in the table below:

| <i>At December 31, 2006</i>         |                      | <b>Notional amount in<br/>MMbtu</b> |                   |
|-------------------------------------|----------------------|-------------------------------------|-------------------|
| <i>In thousands of U.S. Dollars</i> | <b>Average price</b> | <b>at December 31, 2006</b>         | <b>Fair Value</b> |
| Call Purchases                      | 7.65/7.45            | 12,000                              | 13,167            |
| Call Sales                          | 9.00/10.00           | 18,000                              | (6,716)           |
| Put Sales                           | 7.65@KI /7.45@KI     | 12,000                              | (12,505)          |
| Swaps Purchases                     | 7.36                 | 6,000                               | (9,433)           |

Hylsamex's current effort to mitigate against commodity price risk is discussed further under Item 5. Operating and Financial Review and Prospects A. Results of Operations Year ended December 31, 2006 compared to year ended December 31, 2005 Cost of sales and Year ended December 31, 2005 compared to year ended December 31, 2004 Cost of sales .

*Other Commodities and raw materials*

In the past, management has used commodity derivative instruments to cover fluctuations in the market prices of certain raw materials used in the production processes, such as zinc, aluminium and tin. While these markets are monitored periodically, during 2005 and 2006, Ternium has not hedged any commodities positions other than those of natural gas.

**Item 12. Description of Securities Other Than Equity Securities**

Not applicable.

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**PART II**

**Item 13. Defaults, Dividend Arrearages and Delinquencies**

Not applicable.

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

Not applicable.

**Item 15. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-5(e) under the Securities Exchange Act of 1934) as of December 31, 2006. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2006, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at a reasonable assurance level.

**Change in Internal Control over Financial Reporting**

During the period covered by this report, there were no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

On June 6, 2007, our board of directors has determined that none independent member of the audit committee, meet the attributes defined in Item 16A of Form 20-F for audit committee financial experts. We do not have an audit committee financial expert because we have concluded that the membership of the audit committee as a whole has sufficient recent and relevant financial experience to properly discharge its functions. In addition, the audit committee, from time to time as it deems necessary, engages persons that meet all of the attributes of an audit committee financial expert as consultants.

**Item 16B. Code of Ethics**

We have adopted a code of ethics that applies specifically to our principal executive officers, and principal financial and accounting officer and controller, as well as persons performing similar functions. We have also adopted a code of conduct that applies to all company employees, including contractors, subcontractors and suppliers.

The text of our code of ethics for senior financial officers and code of conduct for employees is posted on our web site at: [www.ternium.com/en/Investor/corporategovernance.asp](http://www.ternium.com/en/Investor/corporategovernance.asp).

**Table of Contents****Item 16C. Principal Accountant Fees and Services***Fees Paid to the Company's Principal Accountant*

In 2006 PricewaterhouseCoopers served as the principal external auditor for the Company. Fees payable to PricewaterhouseCoopers in 2006 are detailed below:

| <i>In thousands of U.S. dollars</i> | <b>For the year ended December 31,</b> |              |
|-------------------------------------|--|--------------|
|                                     | <b>2006</b>                            | <b>2005</b>  |
| Audit Fees                          | 1,988                                  | 1,524        |
| Audit-Related Fees                  | 635                                    | 1,730        |
| Tax Fees                            | 81                                     | 421          |
| All Other Fees                      | 128                                    | 162          |
| <b>Total</b>                        | <b>2,832</b>                           | <b>3,837</b> |

*Audit Fees*

Audit fees were paid for professional services rendered by the auditors for the audit of the consolidated financial statements of the Company and the statutory financial statements of the Company and its subsidiaries.

*Audit-Related Fees*

Audit-related fees are typically services that are reasonably related to the performance of the audit or review of the consolidated financial statements and are not reported under the audit fee item above. This item includes fees for attestation services on financial information of the Company and its subsidiaries included in their annual reports that are filed with their respective regulators.

*Tax Fees*

Tax fees were paid for tax compliance and tax advice professional services.

*All Other Fees*

Fees disclosed in the table above under All Other Fees consisted primarily of fees paid for consulting services provided in connection with processing documentation. It also included fees paid for services provided to Siderar related to fiscal information that is filed with the tax regulators.

*Audit Committee's Pre-approval Policies and Procedures*

The Company's audit committee is responsible for, among other things, the oversight of the Company's independent auditors. The audit committee has adopted a policy of pre-approval of audit and permissible non-audit services provided by its independent auditors in its charter.

Under the policy, the audit committee makes its recommendations through the board of Directors to the shareholders' meeting concerning the continuing appointment or termination of the Company's independent auditors. On a yearly basis, the audit committee reviews together with management and the independent auditor, the audit plan, audit related services and other non-audit services and approves the related fees. Any changes to the approved fees must be reviewed and approved by the audit committee. In addition, the audit committee delegated to its Chairman the authority to consider and approve, on behalf of the Audit Committee, additional non-audit services that were not recognized at the time of engagement, which must be reported to the other members of the audit committee at its next meeting. No services outside the scope of the audit committee's approval can be undertaken by the independent auditor.

During 2006, the audit committee did not approve any fees pursuant to the *de minimis* exception to the pre-approval requirement provided by paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.



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

Not applicable.

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

In 2006, to our knowledge, there were no purchases of any class of registered equity securities of the Company by the Company or any affiliated purchaser (as such term is defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934) during 2006, other than those described below.

On February 6, 2006 ISL delivered for and on behalf of the Company, pursuant to the terms of the Corporate Reorganization Agreement, 224,586,451 Company shares to I.I.I. CI and 20,252,338 Company shares to Tenaris in satisfaction of the Company's obligation to deliver shares of the Company to those subordinated lenders pursuant to the terms of the respective subordinated convertible loan agreements.

On February 9, 2006, the Company issued 959,482,775 new shares to ISL in exchange for the contribution of all the assets and liabilities of ISL as of that date, in compliance with the obligations assumed by the Company under the Corporate Reorganization Agreement. The assets and liabilities of Inversora Siderurgica Limited that were contributed to the Company consisted of:

374,272,579 shares of the Company;

20,328,784 Class C shares of Amazonia, representing approximately 3.4% of the issued and outstanding share capital of Amazonia;

a note issued by the Company evidencing the Company's obligation to ISL for a value equal to USD 605,924,522;

a note issued by the Company evidencing the Company's obligation to ISL for a value equal to USD 496,894,400; and

USD 3,084,331.23 in cash.

In the future, we may, with the approval of our shareholders, initiate a stock repurchase or similar program or engage in other transactions pursuant to which we would repurchase, directly or indirectly, the Company's ordinary shares, ADSs or both. In addition, we or our subsidiaries may enter into transactions involving purchases of derivatives or other instruments with returns linked to the Company's ordinary shares, ADSs or both. The timing and amount of repurchase transactions under any such program, or purchases of derivatives or other instruments, would depend on market conditions as well as other corporate and regulatory considerations.

## **PART III**

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

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

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

See pages F-1 through F-51 of this annual report.



**Table of Contents****Item 19. Exhibits**

| Exhibit Number | Description   |
|----------------|---|
| 1.1            | Updated and Consolidated Articles of Association of Ternium S.A., dated as of March 17, 2006*   |
| 2.1            | Deposit Agreement entered into between Ternium S.A. and The Bank of New York**  |
| 8.1            | List of subsidiaries of Ternium S.A.  |
| 4.1            | Participation Agreement ( Contrato de Cuentas en Participacion ), dated June 20, 2003, between Sidor, C.A. and Ylopa Servicios de Consultoria, Lda., as amended and supplemented as of October 15, 2003 and November 18, 2004***                                    |
| 4.2            | Participation Agreement ( Contrato de Cuentas en Participacion ), dated June 20, 2003, between Sidor, C.A. and Corporacion Venezolana de Guayana, as amended and supplemented as of October 15, 2003 and November 18, 2004***                                       |
| 4.3            | Form of Corporate Reorganization Agreement, between Ternium S.A. and Inversora Siderurgica Limited****  |
| 4.4            | Shareholders Agreement, dated July 20, 2005, between I.I.I. Industrial Investments Inc. and Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS***   |
| 4.5            | Shareholders Agreement, dated January 9, 2006, between Tenaris S.A. and Inversora Siderurgica Limited****   |
| 4.6            | Contribution and Subscription Agreement, dated as of September 15, 2005, among Usinas Siderurgicas de Minas Gerais S.A. USIMINAS, SLP 11.785 A/S (to be renamed Usiminas Europa A/S ) and Ternium S.A. ***  |
| 4.7            | Convertible and Subordinated Loan Agreement, dated as of July 28, 2005, among I.I.I. Industrial Investments Inc., I.I.I. Industrial Investments Inc. and Ternium S.A. (formerly Zoompart Holding S.A. )***  |
| 4.8            | Convertible and Subordinated Loan Agreement, dated as of July 28, 2005, among I.I.I. Industrial Investments Inc., Tenaris S.A. and Ternium S.A. (formerly Zoompart Holding S.A. )***  |
| 4.9            | Second Convertible and Subordinated Loan Agreement, dated as of August 16, 2005, among I.I.I. Industrial Investments Inc., Tenaris S.A. and Ternium S.A. (formerly Zoompart Holding S.A. )***   |
| 4.10           | Convertible and Subordinated Loan Agreement, dated as of August 4, 2005, among I.I.I. Industrial Investments Inc., Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS and Ternium S.A. (formerly Zoompart Holding S.A. )***   |
| 4.11           | Second Convertible and Subordinated Loan Agreement, dated as of August 18, 2005, among I.I.I. Industrial Investments Inc., Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS and Ternium S.A. (formerly Zoompart Holding S.A. )***                                 |
| 4.12           | Convertible and Subordinated Loan Agreement, dated as of August 16, 2005, among I.I.I. Industrial Investments Inc., Techintrade Corp. and Ternium S.A. (formerly Zoompart Holding S.A. )** *  |
| 4.13           | Second Amended and Restated Credit Agreement, dated August 16, 2005, among I.I.I. Industrial Investments Inc., Citibank N.A., as administrative and collateral agent and the banks and financial institutions named therein, as amended as of September 21, 2005*** |
| 4.14           | Ternium Accession Agreement, dated as of September 22, 2005, between I.I.I. Industrial Investments Inc. and Ternium S.A.** *  |
| 12.1           | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 12.2           | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 13.1           | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 13.2           | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

\* Incorporated by reference to the Annual Report on Form 20-F, filed by Ternium S.A. on June 30, 2006 (File No. 001-32734).

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\*\* Incorporated by reference to the Registration Statement on Form F-6, filed by Ternium S.A. on January 11, 2006 (File No. 333-130952).

\*\*\* Incorporated by reference to the F-1 Registration Statement filed by Ternium S.A. on January 11, 2006 (File No. 333-130950).

\*\*\*\* Incorporated by reference to the F-1 Registration Statement filed by Ternium S.A. on January 27, 2006 (File No. 333-130950).



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**TERNIUM S.A.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**As of December 31, 2006 and 2005 and**

**for the years ended December 31, 2006, 2005 and 2004**

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**TERNIUM S.A.**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Ternium S.A.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of cash flows and of changes in shareholders' equity present fairly, in all material respects, the financial position of Ternium S.A. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with International Financial Reporting Standards. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

International Financial Reporting Standards vary in certain significant respects from the accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 34 to the consolidated financial statements.

Buenos Aires, Argentina

February 27, 2007

PRICE WATERHOUSE & CO. S.R.L.

by /s/ Marcelo D. Pfaff (Partner)  
Marcelo D. Pfaff

**Table of Contents****TERNIUM S.A.****Consolidated financial statements**

as of December 31, 2006 and 2005 and

for the years ended December 31, 2006, 2005 and 2004

(All amounts in USD thousands)

**CONSOLIDATED INCOME STATEMENTS**

|   | Notes              | Year ended December 31, |               |               |
|---|--------------------|-------------------------|---------------|---------------|
|   |                    | 2006                    | 2005          | 2004          |
| Net sales   | <b>30</b>          | 6,568,975               | 4,447,680     | 1,598,925     |
| Cost of sales   | <b>6 &amp; 30</b>  | (4,301,384)             | (2,488,980)   | (965,004)     |
| Gross profit  |                    | 2,267,591               | 1,958,700     | 633,921       |
| Selling, general and administrative expenses  | <b>7</b>           | (623,772)               | (500,590)     | (116,626)     |
| Other operating expenses, net   | <b>9</b>           | (7,250)                 | (65,949)      | (3,124)       |
| Operating income  |                    | 1,636,569               | 1,392,161     | 514,171       |
| Interest expense  | <b>30 &amp; 31</b> | (112,918)               | (81,608)      | (18,257)      |
| Interest income   | <b>30</b>          | 52,554                  | 32,324        | 8,911         |
| Other financial (expenses) income, net  | <b>10 &amp; 30</b> | (322,417)               | (261,452)     | 211,635       |
| Excess of fair value of net assets acquired over cost   | <b>3</b>           |                         | 188,356       |               |
| Equity in earnings of associated companies  | <b>11</b>          | 4,534                   | 21,524        | 209,201       |
| Income before income tax expense  |                    | 1,258,322               | 1,291,305     | 925,661       |
| Income tax expense  | <b>12</b>          | (262,356)               | (218,492)     | (177,486)     |
| Net income for the year   |                    | 995,966                 | 1,072,813     | 748,175       |
| Attributable to:  |                    |                         |               |               |
| Equity holders of the Company   | <b>29</b>          | 795,424                 | 704,406       | 457,339       |
| Minority interest   |                    | 200,542                 | 368,407       | 290,836       |
|   |                    | 995,966                 | 1,072,813     | 748,175       |
| Weighted average number of shares outstanding   | <b>29</b>          | 1,936,833,060           | 1,209,476,609 | 1,168,943,632 |
| Basic earnings per share for profit attributable to the equity holders of the Company, (expressed in USD per share)   |                    | 0.41                    | 0.58          | 0.39          |
| Diluted earnings per share for profit attributable to the equity holders of the Company, (expressed in USD per share) |                    | 0.41                    | 0.54          | 0.39          |

The accompanying notes are an integral part of these consolidated financial statements.

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as of December 31, 2006 and 2005 and

for the years ended December 31, 2006, 2005 and 2004

(All amounts in USD thousands)

**CONSOLIDATED BALANCE SHEETS**

|  | Notes   | December 31, 2006 | December 31, 2005 |
|--|---------|-------------------|-------------------|
| <b>ASSETS</b>  |         |                   |                   |
| <b>Non-current assets</b>  |         |                   |                   |
| Property, plant and equipment, net                                       | 13      | 5,420,683         | 5,463,871         |
| Intangible assets, net   | 14      | 551,587           | 552,882           |
| Investments in associated companies                                      | 15      | 16,285            | 9,122             |
| Other investments, net   | 16 & 30 | 13,387            | 12,607            |
| Deferred tax assets  | 24      | 36,439            | 29,126            |
| Receivables, net   | 17 & 30 | 78,903            | 48,815            |
|  |         | 6,117,284         | 6,116,423         |
| <b>Current assets</b>  |         |                   |                   |
| Receivables  | 18 & 30 | 175,818           | 291,302           |
| Derivative financial instruments   | 26      | 7,852             | 5,402             |
| Inventories, net   | 19      | 1,241,325         | 1,000,119         |
| Trade receivables, net   | 20 & 30 | 577,866           | 472,760           |
| Other investments  | 21 & 30 |                   | 5,185             |
| Cash and cash equivalents  | 21      | 643,352           | 765,630           |
|  |         | 2,646,213         | 2,540,398         |
| Non-current assets classified as held for sale                           |         | 7,042             | 3,160             |
| <b>Total assets</b>  |         | <b>8,770,539</b>  | <b>8,659,981</b>  |
| <b>EQUITY</b>  |         |                   |                   |
| <b>Capital and reserves attributable to the company's equity holders</b> |         | 3,757,558         | 1,842,454         |
| <b>Minority interest</b>   |         | 1,729,583         | 1,733,465         |
| <b>Total equity</b>  |         | <b>5,487,141</b>  | <b>3,575,919</b>  |
| <b>LIABILITIES</b>   |         |                   |                   |
| <b>Non-current liabilities</b>   |         |                   |                   |
| Provisions   | 22      | 60,543            | 54,138            |
| Deferred income tax  | 24      | 985,155           | 1,048,188         |
| Other liabilities  | 25      | 274,566           | 187,917           |
| Trade payables   |         | 7,229             | 1,167             |
| Borrowings   | 27      | 548,401           | 1,875,894         |
|  |         | 2,399,878         | 3,691,288         |
| <b>Current liabilities</b>   |         |                   |                   |
| Current tax liabilities  |         | 103,195           | 126,972           |
| Other liabilities  | 25 & 30 | 158,374           | 194,073           |

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|                                     |           |         |                  |         |                  |
|-------------------------------------|-----------|---------|------------------|---------|------------------|
| Trade payables                      | <b>30</b> | 621,754 |                  | 555,330 |                  |
| Derivative financial instruments    | <b>26</b> | 15,487  |                  |         |                  |
| Borrowings                          | <b>27</b> | 508,694 | 1,407,504        | 516,399 | 1,392,774        |
| <b>Total liabilities</b>            |           |         | 3,283,398        |         | 5,084,062        |
| <b>Total equity and liabilities</b> |           |         | <b>8,770,539</b> |         | <b>8,659,981</b> |

The accompanying notes are an integral part of these consolidated financial statements.

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**Table of Contents****TERNIUM S.A.****Consolidated financial statements**

as of December 31, 2006 and 2005 and

for the years ended December 31, 2006, 2005 and 2004

(All amounts in USD thousands)

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

|  | Attributable to the Company's equity holders (1) |                                  |                                |                                  |                                 |                   |           | Total             | Total                       | Total                       |                             |
|--|--|----------------------------------|--------------------------------|----------------------------------|---------------------------------|-------------------|-----------|-------------------|-----------------------------|-----------------------------|-----------------------------|
|  | Capital stock (2)                                | Initial public offering expenses | Revaluation and other reserves | Capital stock issue discount (3) | Currency translation adjustment | Retained earnings | Total     | Minority interest | Equity at December 31, 2006 | Equity at December 31, 2005 | Equity at December 31, 2004 |
| Balance at January 1   | 1,396,552  | (5,456)                          | 1,462,137                      | (2,298,048)                      | (92,691)                        | 1,379,960         | 1,842,454 | 1,733,465         | 3,575,919                   | 1,771,851                   | 1,252,085                   |
| Currency translation adjustment  |  |                                  |                                |                                  | (28,917)                        |                   | (28,917)  | (7,990)           | (36,907)                    | (120,246)                   | (77,246)                    |
| Net income for the year  |  |                                  |                                |                                  |                                 | 795,424           | 795,424   | 200,542           | 995,966                     | 1,072,813                   | 748,175                     |
| Total recognized income for the year                                   |  |                                  |                                |                                  | (28,917)                        | 795,424           | 766,507   | 192,552           | 959,059                     | 952,567                     | 670,929                     |
| Dividends paid in cash and other distributions                         |  |                                  |                                |                                  |                                 |                   |           |                   |                             | (238,652)                   | (80,887)                    |
| Dividends paid in cash and other distributions by subsidiary companies |  |                                  |                                |                                  |                                 |                   |           | (27,175)          | (27,175)                    | (130,571)                   | (70,276)                    |
| Acquisition of business (see Note 3)                                   |  |                                  | (32,429)                       |                                  |                                 |                   | (32,429)  | (122,261)         | (154,690)                   | 864,415                     |                             |
| Contributions from shareholders (see Note 1)                           | 33,801   |                                  | 43,100                         | (26,818)                         |                                 |                   | 50,083    | (46,998)          | 3,085                       | 54,758                      |                             |
| Conversion of Subordinated Convertible Loans (see Note 1)              | 302,962  |                                  | 302,962                        |                                  |                                 |                   | 605,924   |                   | 605,924                     |                             |                             |

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|                                      |                  |                 |                  |                    |                  |                  |                  |                  |                  |                  |                  |
|--------------------------------------|------------------|-----------------|------------------|--------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Initial Public Offering (see Note 1) | 271,429          | (17,839)        | 271,429          |                    |                  | 525,019          |                  | 525,019          | (5,456)          |                  |                  |
| Other reserves (see Note 3)          |                  |                 |                  |                    |                  |                  |                  |                  | 307,007          |                  |                  |
| <b>Balance at</b>                    |                  |                 |                  |                    |                  |                  |                  |                  |                  |                  |                  |
| <b>December 31</b>                   | <b>2,004,744</b> | <b>(23,295)</b> | <b>2,047,199</b> | <b>(2,324,866)</b> | <b>(121,608)</b> | <b>2,175,384</b> | <b>3,757,558</b> | <b>1,729,583</b> | <b>5,487,141</b> | <b>3,575,919</b> | <b>1,771,851</b> |

- 
- (1) Shareholders' equity determined in accordance with accounting principles generally accepted in Luxembourg is disclosed in Note 28 (iv).
  - (2) At December 31, 2006, the Capital Stock adds up to 2,004,743,442 shares at a nominal value of USD1 each.
  - (3) Represents the difference between book value of non-monetary contributions received from shareholders under Luxembourg GAAP and IFRS.

Dividends may be paid by Ternium to the extent distributable retained earnings calculated in accordance with Luxembourg law and regulations exist. Therefore, retained earnings included in these consolidated condensed financial statements may not be wholly distributable. See Note 28 (iv). The accompanying notes are an integral part of these consolidated financial statements.



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as of December 31, 2006 and 2005 and

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**CONSOLIDATED CASH FLOW STATEMENTS**

|  | Notes            | Year ended December 31, |                    |                  |
|--|------------------|-------------------------|--------------------|------------------|
|  |                  | 2006                    | 2005               | 2004             |
| <b>Cash flows from operating activities</b>                              |                  |                         |                    |                  |
| Net income for the year  |                  | <b>995,966</b>          | <b>1,072,813</b>   | <b>748,175</b>   |
| Adjustments for:   |                  |                         |                    |                  |
| Depreciation and amortization  | <b>13&amp;14</b> | 424,495                 | 316,405            | 99,192           |
| Income tax accruals less payments  | <b>31</b>        | (18,075)                | (44,008)           | 120,210          |
| Derecognition of property, plant and equipment                           | <b>9 (iii)</b>   | 13,323                  | 54,348             |                  |
| Excess of fair value of net assets acquired over cost                    | <b>3</b>         |                         | (188,356)          |                  |
| Changes to pension plan  | <b>25</b>        | 46,947                  |                    |                  |
| Equity in earnings of associated companies                               | <b>11</b>        | (4,534)                 | (21,524)           | (209,201)        |
| Interest accruals less payments  | <b>31</b>        | 4,197                   | 24,523             | 9,083            |
| Changes in provisions  | <b>22&amp;23</b> | 33,802                  | 19,046             | (798)            |
| Changes in working capital   | <b>31</b>        | (276,153)               | 54,420             | (204,670)        |
| Others   |                  | 25,005                  | (25,212)           | (44,426)         |
| <b>Net cash provided by operating activities</b>                         |                  | <b>1,244,973</b>        | <b>1,262,455</b>   | <b>517,565</b>   |
| <b>Cash flows from investing activities</b>                              |                  |                         |                    |                  |
| Capital expenditures   | <b>13&amp;14</b> | (405,817)               | (244,939)          | (92,563)         |
| Changes in trust funds   |                  | 5,185                   | 83,570             |                  |
| Acquisition of business  |                  | (210,548)               | (2,196,678)        |                  |
| Investments in associated companies                                      |                  | (2,598)                 |                    |                  |
| Proceeds from the sale of property, plant and equipment                  |                  | 3,425                   | 6,063              | 862              |
| <b>Net cash (used in) investing activities</b>                           |                  | <b>(610,353)</b>        | <b>(2,351,984)</b> | <b>(91,701)</b>  |
| <b>Cash flows from financing activities</b>                              |                  |                         |                    |                  |
| Dividends paid in cash and other distributions to company's shareholders |                  |                         | (238,652)          | (80,887)         |
| Dividends paid in cash and other distributions to minority shareholders  |                  | (27,175)                | (130,571)          | (70,276)         |
| Net proceeds from Initial Public Offering                                |                  | 525,019                 |                    |                  |
| Contributions from shareholders  |                  | 3,085                   | 54,758             |                  |
| Proceeds from borrowings   |                  | 167,283                 | 2,135,430          | 52,309           |
| Repayments of borrowings   |                  | (1,424,495)             | (657,597)          | (261,033)        |
| <b>Net cash (used in) provided by financing activities</b>               |                  | <b>(756,283)</b>        | <b>1,163,368</b>   | <b>(359,887)</b> |
| <b>(Decrease) Increase in cash and cash equivalents</b>                  |                  | <b>(121,663)</b>        | <b>73,839</b>      | <b>65,977</b>    |
| <b>Movement in cash and cash equivalents</b>                             |                  |                         |                    |                  |

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|  |          |                |                |                |
|--|----------|----------------|----------------|----------------|
| At January 1,(1)                                 |          | 754,980        | 194,875        | 129,020        |
| Acquisition of business                          | <b>3</b> |                | 520,753        |                |
| Effect of exchange rate changes                  |          | (315)          | (34,487)       | (122)          |
| (Decrease) Increase in cash and cash equivalents |          | (121,663)      | 73,839         | 65,977         |
| <b>Cash and cash equivalents at December 31,</b> |          | <b>633,002</b> | <b>754,980</b> | <b>194,875</b> |

**Non-cash transactions**

|  |  |         |         |  |
|--|--|---------|---------|--|
| Conversion of debt instruments into shares |  | 605,924 | 127,576 |  |
|--|--|---------|---------|--|

(1) In addition, the Company has restricted cash for USD 10,350 and USD 10,650 at December 30, 2006 and December 31, 2005, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

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**TERNIUM S.A.**

**Consolidated financial statements**

**as of December 31, 2006 and 2005 and**

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****1 Business of the Company, Initial Public Offering and corporate reorganization**

Ternium S.A. (the Company or Ternium), a Luxembourg Corporation (Société Anonyme), was incorporated on December 22, 2003 to hold investments in flat and long steel manufacturing and distributing companies.

Near the end of 2004, Ternium was acquired by its ultimate parent company San Faustín N.V. (San Faustín), a Netherlands Antilles company, to serve as a vehicle in the restructuring of San Faustín's investments in the flat and long steel manufacturing and distribution business. This restructuring was carried out by means of a corporate reorganization through which Ternium was assigned the equity interests previously held by San Faustín and its subsidiaries in various flat and long steel manufacturing and distributing companies (the Corporate Reorganization). The Corporate Reorganization took place in fiscal year 2005. Until that date, Ternium was a dormant company.

On January 11, 2006, the Company successfully completed its registration process with the United States Securities and Exchange Commission (SEC) and announced the commencement of its offer to sell 24,844,720 American Depositary Shares (ADS) representing 248,447,200 shares of common stock through Citigroup Global Markets Inc., Deutsche Bank Securities Inc., JP Morgan Securities Inc., Morgan Stanley & Co. Incorporated, BNP Paribas Securities Corp., Cylon Securities (USA) Inc. and Bayerische Hypo-und Vereinsbank AG (collectively, the Underwriters) and the offering thereunder, the Initial Public Offering. The Company's Initial Public Offering was priced at USD20 per ADS. The gross proceeds from the Initial Public Offering totaled USD 496.9 million and have been used to fully repay Tranche A of the Ternium Credit Facility (see Note 3 e)), after deducting related expenses.

Ternium's ADSs began trading on the New York Stock Exchange under the symbol TX on February 1, 2006. The Company's Initial Public Offering was settled on February 6, 2006.

In addition, during 2005, the Company entered into the Subordinated Convertible Loan Agreements for a total aggregate amount of USD594 million to fund the acquisition of Hylsamex. As per the provisions contained in the Subordinated Convertible Loan Agreements, the Subordinated Convertible Loans would be converted into shares of the Company upon delivery of Ternium's ADSs to the Underwriters. On February 6, 2006, the Subordinated Convertible Loans (including interest accrued through January 31, 2006) were converted into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006.

Furthermore, in November 2005, Siderúrgica del Turbio Sidetur S.A. (Sidetur), a subsidiary of Siderúrgica Venezolana Sivena S.A. (Sivena), exchanged with Inversora Siderúrgica Limited (ISL, a wholly-owned subsidiary of Ternium's majority shareholder) its 3.42% equity interest in Consorcio Siderurgia Amazonia Ltd. (Amazonia) and USD 3.1 million in cash for shares of the Company. On February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly issued shares of the Company after the settlement of the Initial Public Offering. The increase in equity resulting from this transaction is reflected under Contributions from shareholders line items in the Statement of changes in shareholders' equity and amounts to USD 50,083.

Also, the Company granted the Underwriters an option, exercisable for 30 days from January 31, 2006, to purchase up to 3,726,708 additional ADSs at the public offering price of USD20 per ADS less an underwriting discount of USD0.55 per ADS. On February 23, 2006 the Underwriters exercised partially this over-allotment option granted by the Company. In connection with this option, on March 1, 2006, the Company issued 22,981,360 new shares. The gross proceeds from this transaction totaled USD46.0 million.

After the completion of the Initial Public Offering, the conversion of the Subordinated Convertible Loans, the exercise of the option granted to the Underwriters and the consummation of the transactions contemplated in the Corporate Reorganization agreement, 2,004,743,442 shares (including shares in the form of ADSs) were outstanding.

**2 Basis of presentation**

These consolidated financial statements have been prepared in accordance with those IFRS standards and IFRIC interpretations issued and effective or issued and early adopted as at the time of preparing these statements (February 2007). The consolidated financial statements are presented in thousands of United States dollars (USD).

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As mentioned in Note 1, Ternium was assigned the equity interests previously held by San Faustín and its subsidiaries in various flat and long steel manufacturing and distributing companies. As these transactions were carried out among entities under common control, the assets and liabilities contributed to the Company have been accounted for at the relevant predecessor's cost, reflecting the carrying amount of such assets and liabilities. Accordingly, the consolidated financial statements for the years ended December 31, 2005 and 2004 include the financial statements of the above-mentioned companies on a combined basis at historical book values on a carryover basis as though the contribution had taken place on January 1, 2003, and no adjustment has been made to reflect fair values at the time of the contribution.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****2 Basis of presentation (continued)**

Detailed below are the companies whose consolidated financial statements have been included in these consolidated financial statements.

| Company  | Country of Organization | Main activity  | Percentage of ownership at December 31, |         |
|--|-------------------------|--|---|---------|
|  |                         |  | 2006                                    | 2005    |
| Ternium S.A.   | Luxembourg              | Holding of investments in flat and long steel manufacturing and distributing companies | 100.00%                                 | 100.00% |
| Hylsamex S.A. de C.V. (1)  | Mexico                  | Holding company  | 88.22%                                  | 86.68%  |
| Siderar S.A.I.C.   | Argentina               | Manufacturing of flat steel products   | 60.93%                                  | 56.07%  |
| Sidor C.A. (2)   | Venezuela               | Manufacturing and selling of steel products  | 56.38%                                  | 53.20%  |
| Ternium Internacional S.A. (formerly Techintrade Uruguay S.A.)               | Uruguay                 | Holding company and marketing of steel products  | 100.00%                                 | 100.00% |
| III Industrial Investments Inc. (B.V.I.)                                     | British Virgin Islands  | Holding company  | 100.00%                                 | 100.00% |
| Inversiones Siderúrgicas S.A.  | Panama                  | Holding company  | 100.00%                                 | 100.00% |
| Ylopa Servicios de Consultadoria Lda. (3)                                    | Madeira -Free zone      | Participation in the debt restructuring process of Amazonia and Sidor C.A.             | 95.66%                                  | 95.12%  |
| Consorcio Siderurgia Amazonia Ltd.(4)  | Cayman Islands          | Holding of investments in Venezuelan steel companies                                   | 94.39%                                  | 89.07%  |
| Fasnet International S.A.  | Panama                  | Holding company  | 100.00%                                 | 100.00% |
| Alvory S.A.  | Uruguay                 | Holding of investment in procurement services companies                                | 100.00%                                 | 100.00% |
| Comesi San Luis S.A.I.C. (5)   | Argentina               | Production of cold or hot rold prepainted, formed and skelped steel sheets             | 61.32%                                  | 56.07%  |
| Inversiones Basilea S.A. (6)   | Chile                   | Purchase and sale of real estate and other   | 60.93%                                  | 56.07%  |
| Prosid Investments S.C.A.(6)   | Uruguay                 | Holding company  | 60.93%                                  | 56.07%  |
| Impeco S.A. (6)  | Argentina               | Manufacturing of pipe products   | 60.93%                                  | 60.93%  |
| Socominter de Guatemala S.A. (7)   | Guatemala               | Marketing of steel products  | 100.00%                                 | 100.00% |
| Ternium Internacional España S.A. (formerly Socominter de España S.A.U.) (7) | Spain                   | Marketing of steel products  | 100.00%                                 | 100.00% |
| Ternium Internacional Ecuador S.A. (formerly Socotrading S.A.) (7)           | Ecuador                 | Marketing of steel products  | 100.00%                                 | 100.00% |
| Ternium International USA Corporation (formerly Techintrade Corporation) (7) | USA                     | Marketing of steel products  | 100.00%                                 | 100.00% |
| Ternium Internationaal B.V. (formerly Techint Engineering Company B.V.)(7)   | Netherlands             | Marketing of steel products  | 100.00%                                 | 100.00% |

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****2 Basis of presentation (continued)**

| Company  | Country of Organization | Main activity   | Percentage of ownership |         |
|--|-------------------------|---|-------------------------|---------|
|  |                         |   | at December 31, 2006    | 2005    |
| Ternium Internacional Perú S.A.C. (formerly Techintrade del Perú S.A.C.) (7) | Peru                    | Marketing of steel products                           | 100.00%                 | 100.00% |
| Ternium Internacional Inc.(7)  | Panama                  | Marketing of steel products                           | 100.00%                 |         |
| Hylsa S.A. de C.V. (8)   | Mexico                  | Manufacturing and selling of steel products           | 88.22%                  | 86.68%  |
| Express Anahuac S.A. de C.V. (8)   | Mexico                  | Freight services                                      | 88.22%                  | 86.68%  |
| Ferropak Comercial S.A. de C.V. (8)  | Mexico                  | Scrap company   | 88.22%                  | 86.68%  |
| Ferropak Servicios S.A. de C.V. (8)  | Mexico                  | Services  | 88.22%                  | 86.68%  |
| Galvaccer America Inc (8)  | USA                     | Distributing company                                  | 88.22%                  | 86.68%  |
| Galvamet America Corp (8)  | USA                     | Manufacturing and selling of insulates panel products | 88.22%                  | 86.68%  |
| Transamerica E. & I. Trading Corp (8)  | USA                     | Scrap company   | 88.22%                  | 86.68%  |
| Galvatubing Inc. (8)   | USA                     | Manufacturing and selling of pipe products            | 88.22%                  | 86.68%  |
| Las Encinas S.A. de C.V. (8)   | Mexico                  | Exploration, exploitation and pelletizing of iron ore | 88.22%                  | 86.68%  |
| Técnica Industrial S.A. de C.V. (8)  | Mexico                  | Services  | 88.22%                  | 86.68%  |
| Acerex S.A. de C.V. (9)  | Mexico                  | Tooling services                                      |                         | 43.34%  |
| Acerex Servicios S.A. de C.V. (9)  | Mexico                  | Services  |                         | 43.34%  |
| Consorcio Minero Benito Juarez Peña Colorada S.A.de C.V. (9)                 | Mexico                  | Exploration, exploitation and pelletizing of iron ore | 44.11%                  | 43.34%  |
| Peña Colorada Servicios S.A. de C.V. (9)                                     | Mexico                  | Services  | 44.11%                  | 43.34%  |

- (1) Indirectly through the participation of III BVI (70.00%) and Siderar S.A.I.C. (29.91%). Total voting rights held: 99.91%.
- (2) Indirectly through the participation in Amazonia (59.73%). Total voting rights held: 59.73%.
- (3) Directly (54.62%), indirectly through Inversiones Siderúrgicas S.A (34.27%) and Prosid Investments S.C.A. (11.11%). Total voting rights held: 100.00%.
- (4) Directly (60.63%) and indirectly through the participation in Prosid Investments S.C.A. (14.38%) and Inversiones Siderúrgicas S.A. (25.00%). Total voting rights held: 100.00%.
- (5) Indirectly through Siderar S.A.I.C. (99.00%) and Ternium Internacional Uruguay S.A. (1.00%). Total voting rights held: 100.00%.
- (6) Indirectly through Siderar S.A.I.C. Total voting rights held 100.00%.
- (7) Indirectly through Ternium Internacional S.A. Uruguay.
- (8) Indirectly through the participation in Hylsamex. Total voting rights held: 99.91%. See Note 3 e).
- (9) Indirectly through the participation in Hylsamex. Total voting rights held: 50.00%.
- At December 31, 2006, Hylsa Latin LLC (dissolved on January 9, 2006), Ternium Internazionale Italia S.R.L., Galvaccer Chile S.A. and Galvaccer Costa Rica were in process of liquidation.

Eliminations of all material intercompany transactions and balances between the Company and their respective subsidiaries have been made in consolidation.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.





**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****2 Basis of presentation (continued)**

The preparation of financial statements requires management to make estimates and assumptions that might affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the balance sheet dates, and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from these estimates.

These consolidated financial statements have been approved for issue by the board of directors on February 27, 2007.

**3 Acquisition of business****(a) Impeco S.A.**

On November 18, 2005, Ternium's Argentine subsidiary, Siderar, agreed to acquire assets and facilities of Acindar Industria Argentina de Aceros S.A. related to the production of welded steel pipes in the province of Santa Fe in Argentina, as well as 100% of the issued and outstanding shares of Impeco S.A., which in turn owns a plant located in the province of San Luis in Argentina. Purchase price paid totaled USD 55.2 million, subject to subsequent adjustments. These two plants have a production capacity of 140 thousand tons per year of tubes to be used in the construction, agricultural and manufacturing industries. The acquisition has been approved by the Argentine competition authorities and was completed on January 31, 2006. This acquisition did not give rise to goodwill.

The acquired business contributed revenues of USD 73.3 million in the year ended December 31, 2006. The fair value of assets and liabilities arising from acquisition are as follows:

|                                    | <b>USD thousands</b> |
|------------------------------------|----------------------|
| Property, plant and equipment      | 47,825               |
| Inventories                        | 8,180                |
| Deferred tax liabilities           | (875)                |
| Others assets and liabilities, net | 53                   |
| <b>Net</b>                         | <b>55,183</b>        |

**(b) Acerex S.A. de C.V.**

In April 2006, the Company acquired a 50% equity interest in Acerex S.A. de C.V. (Acerex) through its subsidiary Hylsa S.A. de C.V. for a total purchase price of USD 44.6 million. Upon completion of this transaction Hylsa S.A. de C.V. owns 100% of Acerex. Acerex is a service center dedicated to processing steel to produce short-length and steel sheets in various widths. Acerex operates as a cutting and processing plant for Ternium's Mexican operations and as an independent processor for other steel companies. On August 31, 2006 Acerex S.A. de C.V. was merged into Hylsa S.A. de C.V.

As permitted by IFRS 3 Business Combinations (IFRS 3), the Company accounted for this acquisition under the economic entity model, which requires that the acquisition of an additional equity interest in a controlled subsidiary be accounted for at its carrying amount, with the difference arising on purchase price allocation (amounting to USD 24.3 million) being recorded directly in equity.

**(c) Additional shares of Hylsamex bought by Siderar**

On June 19, 2006, Siderar completed the acquisition of 940,745 additional shares of Hylsamex, representing 0.2% of that company's issued and outstanding common stock, for a total consideration of USD 3.3 million. This acquisition was effected through a trust fund established by Siderar in 2005 in connection with the initial acquisition of Hylsamex (see note 3(e)). Goodwill resulting from this acquisition totaled USD 0.7

million.

(d) Additional shares of Siderar bought by Ternium S.A.

On December 28, 2006, Ternium S.A. acquired from CVRD International S.A. 16,860,000 shares of Siderar S.A.I.C, representing 4.85% of that company, for an aggregate purchase price of USD 107.5 million. After this acquisition Ternium has increased its ownership in Siderar to 60.93%.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****3 Acquisition of business (continued)**

As permitted by IFRS 3, the Company accounted for this acquisition under the economic entity model, which requires that the acquisition of an additional equity interest in a controlled subsidiary be accounted for at its carrying amount, with the difference arising on purchase price allocation (amounting to USD 8.1 million) being recorded directly in equity.

**(e) Hylsamex**

On May 18, 2005, III BVI, Hylsamex S.A. de C.V. and Alfa entered into the Hylsamex Acquisition Agreement. Pursuant to the terms of the Hylsamex Acquisition Agreement, on July 26, 2005, III BVI launched a cash tender offer in Mexico for the acquisition of all the outstanding shares of Hylsamex. On August 22, 2005, the acquisition by III BVI of a controlling interest in Hylsamex and of Alfa's minority interests in Amazonia, Ylopa and Hylsa Latin was consummated. The Company acquired an indirect controlling interest in Hylsamex and its subsidiaries, and the indirect equity stakes owned by Hylsamex's former controlling shareholder, Alfa, in Amazonia and Ylopa. III BVI and Siderar acquired 70.0% and 29.3% of the shares of Hylsamex, respectively by a total amount of USD 2,095 million. III BVI also acquired an additional 10.5% direct and indirect interest in Amazonia and an additional 11.1% interest in Ylopa by USD 91.9 million. Subsequently, Siderar purchased additional shares of Hylsamex in the open market for a total amount of USD 9.7 million, thus reaching a 29.9% equity interest in that company.

Hylsamex's main business is the production of flat and long steel products, with manufacturing plants located in the cities of Monterrey and Puebla, Mexico, and is a leader in the production of coated steel.

The acquired business contributed revenues of USD 723.8 million and net income of USD 25.4 million to the Company in the year ended December 31, 2005. The book value of net assets acquired totals USD 1,492 million. The fair value of assets and liabilities arising from acquisition are as follows:

|                                    | <b>USD thousands</b> |
|------------------------------------|----------------------|
| Property, plant and equipment      | 2,129,325            |
| Inventories                        | 345,053              |
| Cash and cash equivalents          | 215,411              |
| Deferred tax liabilities           | (449,537)            |
| Pension benefits                   | (116,860)            |
| Borrowings                         | (751,730)            |
| Others assets and liabilities, net | 488,297              |
| Minority interest                  | (156,651)            |
| <b>Net</b>                         | <b>1,703,308</b>     |

Goodwill, representing the excess of the purchase price paid over the fair value of identifiable assets, liabilities and contingent liabilities acquired, totaled USD 399.7 million.

As part of the financing for the acquisition, the Company and its affiliates entered into the following loan agreements:

- i) an amended and restated credit agreement, dated as of August 16, 2005 among I.I.I. BVI and lenders for an aggregate principal amount of USD1,000 million (the Ternium Credit Facility). The Ternium Credit Facility is comprised of two equal tranches:

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Tranche A with a maturity of three years and bearing interest at the annual rate of LIBOR plus an applicable margin that ranges from 75 to 400 basis points. This tranche has been fully repaid in February 2006.

Tranche B with a maturity of five years and bearing interest at the annual rate of LIBOR plus an applicable margin that ranges from 137.5 to 300 basis points. The outstanding debt amount is USD 233 million as of December 31, 2006.

- ii) an amended and restated credit agreement, dated as of August 16, 2005, for an aggregate principal amount of USD380 million among Siderar, as borrower, and the lenders (the Siderar Credit Facility ). The Siderar Credit Facility is payable in five equal and consecutive semi-annual installments with a grace period of 12 months and bears interest at LIBOR plus 200 basis points; and

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****3 Acquisition of business (continued)**

iii) several convertible and subordinated loan agreements, dated as of various dates, for an aggregate principal amount of USD594 million, each among the Company, I.I.I. BVI, as borrowers, and Usiminas, Tenaris, or other Techint Group companies (collectively, the Subordinated Lenders), the agreements, the Subordinated Convertible Loan Agreements and the loans thereunder, the Subordinated Convertible Loans). Pursuant to the terms of the Subordinated Convertible Loan Agreements, on February 6, 2006, the Subordinated Convertible Loans have been converted into shares of the Company at a price per share equal to the price per share paid by the investors in the offering.

Under the credit agreements mentioned in i) and ii) above, the Company and its affiliates are subject to certain covenants that limit their ability to, among other thing, pay dividends to their shareholders in excess of certain amounts or make other restricted payments, make capital expenditures in excess of certain amounts, grant certain liens, borrow additional money or prepay principal or interest on subordinated debt over certain limits, change their business or amend certain significant agreements, effect a change of control, merge, acquire or consolidate with another company, make additional investments or dispose of their assets.

These contracts also require Ternium and its subsidiaries to meet certain financial covenants, ratios and other tests, which could limit their operational flexibility and could prevent Ternium from taking advantage of business opportunities as they arise, growing its business or competing effectively. Moreover, a failure by Ternium and its subsidiaries to comply with applicable financial measures could result in defaults under those agreements or instruments. Ternium and its subsidiaries are in compliance with all of their financial covenants, ratios and tests.

**(f) Amazonia**

On February 3, 2005, Ylopa exercised its option to convert the outstanding balance of the Amazonia convertible debt instrument into newly issued shares of that company. On February 15, 2005, new shares of Amazonia were issued in exchange for the convertible instrument. As a result, Ternium's indirect participation in Amazonia increased from 31.03% to 53.47%, thereby increasing its indirect participation in Sidor from 18.53% to 31.94%. This acquisition has been accounted for following the provisions contained in IFRS 3 and, accordingly, assets acquired and liabilities assumed have been valued at fair value. Total purchase consideration, representing the carrying amount of the convertible debt instrument at the date of conversion, accounted for USD127.6 million, of which USD82.0 million correspond to the majority shareholders. The excess of Ternium's interest in the net fair value of Amazonia's identifiable assets, liabilities and contingent liabilities over the purchase price (amounting to USD 188.4 million) has been recognized in income for the year. The main factor that contributed to a purchase price significantly below the fair value of net assets acquired is the downturn experienced by steel prices until 2003. Thus, the convertible debt instrument was issued at a time when Amazonia was undergoing a severe crisis affecting its business and financial condition, this situation being opposite to the current business condition on the date the conversion feature was exercised and the business combination was effected. In addition, as also required by IFRS 3, the Company recorded in equity the excess of the fair value of its pre-acquisition interest in Amazonia's net assets over their corresponding carrying amounts.

The acquired business contributed revenues of USD 1,863.5 million to the Company in the year ended December 31, 2005. The book value of net assets acquired totals USD 928 million. The fair value of assets and liabilities arising from acquisition are as follows:

|                               | <b>USD<br/>Thousand</b> |
|-------------------------------|-------------------------|
| Property, plant and equipment | 2,444,289               |
| Inventories                   | 284,676                 |
| Cash and cash equivalents     | 305,342                 |
| Deferred Tax Liabilities      | (284,242)               |
| Pension Benefits              | (78,425)                |
| Provisions                    | (37,163)                |
| Borrowings                    | (656,658)               |

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|                                    |                  |
|------------------------------------|------------------|
| Others assets and liabilities, net | (13,459)         |
| Minority Interest                  | (795,178)        |
| <b>Net</b>                         | <b>1,169,182</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****4 Accounting policies**

The following is a summary of the principal accounting policies followed in the preparation of these consolidated financial statements:

**(a) Group accounting***(1) Subsidiary companies*

Subsidiary companies are those entities in which the Company has an interest of more than 50% of the voting rights or otherwise has the power to exercise control over the operating decisions. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of assets given up, shares issued or liabilities undertaken at the date of acquisition, plus costs directly attributable to the acquisition. The excess of the acquisition cost over the Company's share of the fair value of net assets acquired is recorded as goodwill. Acquisition of minority interests in subsidiaries is accounted for following the economic entity model and, accordingly, assets acquired and liabilities assumed are valued at book value and the difference arising on purchase price allocation is recorded in equity under "Revaluation and other reserves" line item. Material intercompany transactions, balances and unrealized gains on transactions among the Company and its subsidiaries are eliminated; unrealized losses are also eliminated unless cost cannot be recovered. However, the fact that the functional currency of some subsidiaries is their respective local currency, generates some financial gains (losses) arising from intercompany transactions, that are included in the consolidated income statement under Financial (expenses) income, net.

*(2) Associated companies*

Associated companies are entities in which Ternium generally has between 20% and 50% of the voting rights, or over which Ternium has significant influence, but which it does not control. Investments in associated companies are accounted for using the equity method of accounting. Under this method the Company's share of the post-acquisition profits or losses of an associated company is recognized in the income statement and its share of post-acquisition changes in reserves is recognized in reserves. The cumulative post-acquisition changes are adjusted against the cost of the investment. Unrealized gains on transactions among the Company and its associated companies are eliminated to the extent of the Company's interest in such associated company; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. When the Company's share of losses in an associated company equals or exceeds its interest in such associate, the Company does not recognize further losses unless it has incurred obligations or made payments on behalf of such associated company.

*(3) First-time application of IFRS*

The Company's transition date is January 1, 2003. Ternium prepared its opening IFRS balance sheet at that date.

In preparing its financial statements in accordance with IFRS 1, the Company has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS, as detailed below:

**3.1. Exemptions from full retrospective application elected by the Company**

The Company has elected to apply the following optional exemptions from full retrospective application.

*(a) Fair value as deemed cost exemption*

Ternium has elected to measure its property, plant and equipment at fair value as of January 1, 2003.

*(b) Cumulative translation differences exemption*

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Ternium has elected to set the previously accumulated cumulative translation to zero at January 1, 2003. This exemption has been applied to all subsidiaries in accordance with IFRS 1.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**4 Accounting Policies (continued)**

**(a) Group accounting (continued)**

**3.2 Exceptions from full retrospective application followed by the Company**

Ternium has applied the following mandatory exceptions from retrospective application.

*(a) Derecognition of financial assets and liabilities exception*

Financial assets and liabilities derecognized before January 1, 2003 are not re-recognized under IFRS. However, this exception had no impact on these financial statements as it was not applicable since the Company did not derecognize any financial assets or liabilities before the transition date that qualified for recognition.

*(b) Hedge accounting exception*

The Company has no derivatives that qualify for hedge accounting. This exception is therefore not applicable.

*(c) Estimates exception*

Estimates under IFRS at January 1, 2003 should be consistent with estimates made for the same date under previous GAAP.

*(d) Assets held for sale and discontinued operations exception*

Ternium did not have assets that met the held-for-sale criteria (as defined by IFRS 5) at the transition date (January 1, 2003).

**(b) Foreign currency translation**

*(1) Functional and presentation currency*

Items included in the financial statements of each of the Company's subsidiaries and associated companies are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of the Company is the U.S. dollar. Although Ternium is located in Luxembourg, it operates in several countries with different currencies. The USD is the currency that best reflects the economic substance of the underlying events and circumstances relevant to Ternium as a whole.

*(2) Subsidiary companies*

The results and financial position of all the group entities (none of which operates in a hyperinflationary economy) that have a functional currency different from the presentation currency, are translated into the presentation currency as follows:

(i) assets and liabilities are translated at the closing rate of each balance sheet;

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(ii) income and expenses for each income statement are translated at average exchange rates; and

(iii) all resulting translation differences are recognized as a separate component of equity.

In the case of a sale or other disposition of any such subsidiary, any accumulated translation differences would be recognized in the income statement as part of the gain or loss on sale.

### *(3) Transactions in currencies other than the functional currency*

Transactions in currencies other than the functional currency are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in currencies other than the functional currency are recognized in the income statement, including the foreign exchange gains and losses from intercompany transactions.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****4 Accounting policies (continued)****(c) Property, plant and equipment**

Land and buildings comprise mainly factories and offices. All property, plant and equipment are recognized at historical acquisition or construction cost less accumulated depreciation and accumulated impairment (if applicable), except for land, which is carried at acquisition cost less accumulated impairment (if applicable). Nevertheless, as mentioned in Note 4(a), property, plant and equipment have been valued at its deemed cost at the transition date to IFRS.

Major overhaul and rebuilding expenditures are recognized as a separate asset when future economic benefits are expected from the item, and the cost can be measured reliably.

Ordinary maintenance expenses on manufacturing properties are recorded as cost of products sold in the period in which they are incurred.

In accordance with IAS 23, borrowing costs that are attributable to the acquisition or construction of certain capital assets could be capitalized as part of the cost of the assets. Capital assets for which borrowing costs may be capitalized are those that require a substantial period of time to prepare for their intended use. At December 31, 2006, no borrowing costs recorded have been capitalized.

Where a tangible fixed asset comprises major components having different useful lives, these components are accounted for as separate items.

Leases where the lessor retains a significant portion of the risks and rewards of ownership are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Depreciation method is reviewed at each balance sheet date. Depreciation is calculated using the straight-line method to amortize the cost of each asset to its residual value over its estimated useful life as follows:

|  |                 |
|--|-----------------|
| Land   | No Depreciation |
| Buildings and improvements                           | 20-40 years     |
| Production equipment                                 | 15-25 years     |
| Vehicles, furniture and fixtures and other equipment | 5-15 years      |

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are determined by comparing the proceeds with the corresponding carrying amounts and are included in the income statement.

If the carrying amount of an asset were greater than its estimated recoverable amount, it would be written down to its recoverable amount. (see Note 4 (e) Impairment ).

**(d) Intangible assets***(1) Information systems projects*

Generally, costs associated with developing or maintaining computer software programs are recognized as an expense as incurred. However, costs directly related to the acquisition and implementation of information systems are recognized as intangible assets if they have a probable

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economic benefit exceeding the cost beyond one year.

Information systems projects recognized as assets are amortized using the straight-line method over their useful lives, not exceeding a period of 3 years. Amortization charges are included in cost of sales, selling, general and administrative expenses.

### *(2) Mining concessions and exploration costs*

Mining license was recognized as a separate intangible asset upon the acquisition of Hylsamex and comprises the right to exploit or explore the mines and is recognized at its fair value less accumulated amortization. Amortization charge is calculated according to the mineral extracted in each period and is included in cost of sales.

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**Table of Contents**

**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**4 Accounting policies (continued)**

**(d) Intangible assets (continued)**

Exploration costs are classified as intangible assets until the production begins. Exploration costs are tested for impairment annually.

*(3) Goodwill*

Goodwill represents the excess of the acquisition cost over the fair value of Ternium's participation in acquired companies' net assets at the acquisition date. Under IFRS 3, goodwill is considered to have an indefinite life and not amortized, but is subject to annual impairment testing.

*(4) Research and development*

Research expenditures are recognized as expenses as incurred. Development costs are recorded as cost of sales in the income statement as incurred because they do not fulfill the criteria for capitalization. Research and development expenditures for the years ended December 31, 2006, 2005 and 2004 totaled USD 1.8 million, USD 2.1 million and USD 0.3 million, respectively.

**(e) Impairment**

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization and investments in affiliates are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and the present value of estimated future cash flows. For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). For these purposes, each associate has been considered a cash generating unit.

At December 31, 2006 and 2005, no impairment provisions were recorded. The impairment provision recorded in previous years on the investment in Amazonia was reversed in 2004 and included in equity in earnings of associated companies, as explained in Note 11.

**(f) Other investments**

Other investments consist primarily of investments in financial debt instruments and equity investments where the Company holds less than 20% of the outstanding equity and does not exert significant influence.

Under IAS 39 Financial Instruments: Recognition and Measurement, investments have to be classified into the following categories: financial assets at fair value through profit or loss; held-to-maturity investments; loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

All purchases and sales of investments are recognized on the trade date, which is not significantly different from the settlement date, which is the date that Ternium commits to purchase or sell the investment.

Income from financial instruments is recognized in Financial (expenses) income, net in the income statement. Interest receivable on investments in debt securities is calculated using the effective rate. Dividends from investments in equity instruments are recognized in the income statement

when the Company's right to receive payments is established.

**(g) Inventories**

Inventories are stated at the lower of cost (calculated using the first-in-first-out (FIFO) method) or net realizable value. The cost of finished goods and goods in process comprises raw materials, direct labor, depreciation, other direct costs and related production overhead costs. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses. Goods acquired in transit at year end are valued at supplier's invoice cost.

For purposes of determining net realizable value, the Company establishes an allowance for obsolete or slow-moving inventory in connection with finished goods and goods in process. The provision for slow-moving inventory is recognized for finished goods and goods in process based on management's analysis of their aging.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**4 Accounting policies (continued)**

**(g) Inventories (continued)**

In connection with supplies and spare parts the calculation is based on management's analysis of their aging, the capacity of such materials to be used based on their levels of preservation and maintenance and the potential obsolescence due to technological change.

**(h) Trade receivables**

Trade and other receivables are carried at face value less a provision for impairment, if applicable. This amount does not differ significantly from fair value.

A provision for impairment is established when there is objective evidence that a financial asset or group of assets is impaired. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Company about a loss event, such as a significant financial difficulty of the obligor or a breach of contract. The amount of the impairment is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The amount of the loss is recognized in the income statement.

**(i) Cash and cash equivalents**

Cash and cash equivalents and highly liquid short-term securities are carried at fair market value.

For purposes of the cash flow statement, cash and cash equivalents comprise cash, bank current accounts and short-term highly liquid investments (original maturity of less than 90 days).

In the consolidated balance sheet, bank overdrafts are included in borrowings within current liabilities.

**(j) Non current assets (disposal group) classified as held for sale**

Non-current assets (disposal groups) are classified as assets held for sale and stated at the lower of carrying amount and fair value less cost to sell if their carrying amount is recovered principally through a sale transaction rather than through a continuing use.

The carrying value of non-current assets classified as held for sale at December 31, 2006, totals USD 7.0 million and includes principally land and other real estate items. Sale is expected to be completed within a one-year period.

**(k) Shareholders' equity**

The consolidated statement of changes in shareholders' equity for the years 2006, 2005 and 2004 was prepared based on the following criteria:

Currency translation differences arising from the translation of financial statements expressed in currencies other than the U.S. dollar are shown in a separate line.

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Expenses incurred in connection with the Initial Public Offering at December 31, 2006 and 2005 totaled USD 17.8 million and USD 5.5 million, respectively, and have been deducted from equity, since they directly relate to a transaction which itself is to be recorded in equity.

For purposes of preparing the combined statement of changes in shareholders' equity shown as comparative information, dividends include the dividends paid by III (BVI) to San Faustín, and dividends paid by Ylopa to Tenaris, as if they had been paid by Ternium to San Faustín or Tenaris. Other distributions comprise loans granted by Ylopa and Amazonia to its shareholders that are in substance capital nature transactions. These loans are non-interest bearing facilities granted by Ylopa to its shareholders based on their respective stockholdings. These loans mature in one year, although debtors are allowed to make partial or full prepayments at any time. However Ylopa's intention is to offset the outstanding balance of such facilities against future dividend distributions. Accordingly, these credits have been shown as a reduction to equity.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**4 Accounting policies (continued)**

**(l) Borrowings**

Borrowings are recognized initially for an amount equal to the proceeds received. In subsequent periods, borrowings are stated at amortized cost; any difference between proceeds and the redemption value is recognized in the income statement over the period of the borrowings.

Capitalized borrowing costs are amortized over the life of their respective debt.

**(m) Income taxes current and deferred**

Under present Luxembourg law, so long as the Company maintains its status as a holding company, no income tax, withholding tax (including with respect to dividends), or capital gain tax is payable in Luxembourg by the Company.

The Company is subject to subscription tax of 0.2%. The Company has qualified for, and was admitted to, the Billionaire holding company tax regime in conjunction with the financing holding company tax regime in Luxembourg starting January 1, 2006.

On December 29, 2006, the Grand-Duchy of Luxembourg announced the decision to terminate its 1929 holding company regime, effective January 1, 2007. However, under the implementing legislation, pre-existing publicly listed companies (including Ternium S.A.) will be entitled to continue benefiting from their current tax regime until December 31, 2010.

The current income tax charge is calculated on the basis of the tax laws in force in the countries in which Ternium's subsidiaries operate. Management evaluates positions taken in tax returns with respect to situations in which applicable tax regulation could be subject to interpretation. A liability is recorded for tax benefits that were taken in the applicable tax return but have not been recognized for financial reporting.

Deferred income taxes are calculated, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arise on fixed assets, originated in different valuation and useful lives considered by accounting standards and tax regulations, tax loss carry-forwards, inventories valuation and provisions for pensions. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted at the balance sheet date. Under IFRS, deferred income tax assets (liabilities) are classified as non-current assets (liabilities).

Deferred tax assets are recognized to the extent it is probable that future taxable income will be available to offset temporary differences.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associated companies, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Under Mexican law, Ternium's subsidiaries are required to pay their employees an annual benefit calculated on a basis similar to that used for local income tax purposes. Employee statutory profit sharing is calculated using the liability method, and is recorded in current other liabilities and non current other liabilities on the balance sheet. Because Mexican employee statutory profit sharing is determined on a basis similar to that used for determining local income taxes, the Company accounts for temporary differences arising between the statutory calculation and the reported expense determined under IFRS in a manner similar to calculation of deferred income tax.

**(n) Employee liabilities**

*(1) Pension obligations*

The Company has defined benefit and defined contribution plans. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognized in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognized actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****4 Accounting policies (continued)****(n) Employee liabilities (continued)**

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income over the employees' expected average remaining working lives.

Past-service costs are recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

*Sidor*

In compliance with the requirements established by the share purchase agreement subscribed in connection with the acquisition of Sidor, and as provided by the agreement entered into with the union representing Sidor's employees, on July 6, 1998, Sidor has established a defined contribution plan providing for certain pension and other post-retirement benefits for qualifying employees. This plan is financed through contributions made by that company and active employees. Although the plan does not provide for the amounts to be paid to employees upon retirement, for purposes of International Accounting Standard No. 19 Employee Benefits, Sidor's obligations have been calculated based on actuarial calculations prepared assuming this plan qualifies as a defined benefit plan.

*Hylsamex*

The valuation of the liabilities for employee retirement plans (pensions and seniority premiums) covers all employees and is based primarily on their years of service, their present age and their remuneration at the date of retirement.

The cost of the employee retirement plans (pension, health-care expenses and seniority premiums) is recognized as an expense in the year in which services are rendered in accordance with actuarial studies made by independent actuaries.

The formal retirement plans are congruent with and complementary to the retirement benefits established by the Mexican Institute of Social Security. Additionally, the Company has established a plan to cover health-care expenses of retired employees.

The Company has established irrevocable trust funds for the payment of pensions and seniority premiums, as well as for health-care expenses.

*Siderar*

Siderar implemented an unfunded defined benefit employee retirement plan for certain officers on August 1, 1995. The plan is designed to provide retirement, termination and other benefits to those officers.

For its main plan, Siderar is accumulating assets for the ultimate payment of those benefits in the form of investments that carry time limitations for their redemption. The investments are not part of a particular plan, nor are they segregated from Siderar's other assets, and therefore this plan is classified as unfunded under IFRS definitions. Benefits provided by the plan are denominated in U.S. Dollars and are calculated based on a seven-year salary average.

*(2) Termination benefits*

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either:

(i) terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or (ii) providing

termination benefits as a result of an offer made to encourage voluntary redundancy.

*(3) Other compensation obligations*

Employee entitlements to annual leave and long-service leave are accrued as earned.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**4 Accounting policies (continued)**

**(n) Employee liabilities (continued)**

*(4) Social security contributions*

Social security laws in force in Argentina, Mexico and Venezuela provide for pension benefits to be paid to retired employees from government pension plans and/or private fund managed plans to which employees may elect to contribute. As stipulated by the respective laws, Siderar, Hylsamex and Sidor make monthly contributions calculated based on each employee's salary to fund such plans. The related amounts are expensed as incurred. No additional liabilities exist once the contributions are paid.

**(o) Provisions and other liabilities**

Ternium has certain contingencies with respect to existing or potential claims, lawsuits and other proceedings. Unless otherwise specified, Ternium accrues a provision for a present legal or constructive obligation as a result of a past event, when it is probable that future cost could be incurred and that cost can be reasonably estimated. Generally, accruals are based on developments to date, Ternium's estimates of the outcomes of these matters and the advice of Ternium's legal advisors.

**(p) Revenue recognition**

Revenues are recognized as sales when revenue is earned and is realized or realizable. This includes satisfying all of the following criteria: the arrangement with the customer is evident, usually through the receipt of a purchase order; the sales price is fixed or determinable; delivery as defined by the risk transfer provision of the sales contracts has occurred, and collectibility is reasonably assured.

Interest income is recognized on an effective yield basis.

Income from participation account is recognized when earned according to its contractual terms (see Note 10).

**(q) Cost of sales, selling, general and administrative expenses**

Cost of sales and expenses are recognized in the income statement on the accrual basis of accounting.

**(r) Earnings per share**

Earnings per share are calculated by dividing the net income attributable to shareholders by the daily weighted average number of ordinary shares issued during the year (see Note 29).

**(s) Derivative financial instruments**

Information about accounting for derivative financial instruments and hedging activities is included in Note 33 Financial risk management .

**(t) Segment information**

Business segments: for management purposes, the Company is organized on a worldwide basis into the following segments: flat steel products, long steel products and others.

The flat steel products segment comprises the manufacturing and marketing of flat steel products. Flat steel products include hot rolled coils and sheets, cold rolled coils and sheets, tin plate, welded pipes, hot dipped galvanized and electrogalvanized sheets, pre-painted sheets and other tailor-made products to serve its customers' requirements.

The long steel products segment comprises the manufacturing and marketing of long steel products. Long steel products include billets (steel in its basic, semifinished state), wire rod and bars.

The other products segment includes the products other than flat and long steel, mainly pig iron and pellets.

The secondary reporting format is based on a geographical location. Ternium sells its products to three main geographical areas: South and Central America, North America, and Europe and Other. The North American segment comprises principally United States, Canada and Mexico. The South and Central American segment comprises principally Argentina, Brazil, Colombia, Venezuela and Ecuador.

Allocation of net sales is based on the customers' location. Allocation of assets, liabilities and capital expenditures is based on their corresponding location.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****5 Segment information****Primary reporting format business segments**

|  | <b>Flat steel<br/>products</b> | <b>Long steel<br/>products</b> | <b>Other</b> | <b>Unallocated</b> | <b>Total</b> |
|--|--------------------------------|--------------------------------|--------------|--------------------|--------------|
| <b>Year ended December 31, 2006</b>          |                                |                                |              |                    |              |
| Net sales                                    | 5,047,527                      | 1,262,603                      | 258,845      |                    | 6,568,975    |
| Cost of sales                                | (3,285,569)                    | (857,753)                      | (158,062)    |                    | (4,301,384)  |
| Gross profit                                 | 1,761,958                      | 404,850                        | 100,783      |                    | 2,267,591    |
| Selling, general and administrative expenses | (477,216)                      | (118,367)                      | (28,189)     |                    | (623,772)    |
| Other operating (expenses) income, net       | (9,837)                        | 803                            | 1,784        |                    | (7,250)      |
| Operating income                             | 1,274,905                      | 287,286                        | 74,378       |                    | 1,636,569    |
| Capital expenditures PP&E                    | 358,541                        | 17,730                         | 7,401        |                    | 383,672      |
| Depreciation PP&E                            | 356,518                        | 46,426                         | 1,240        |                    | 404,184      |
| Segment assets                               |                                |                                |              |                    |              |
| Inventories                                  | 1,078,954                      | 109,143                        | 53,228       |                    | 1,241,325    |
| Trade receivables                            | 407,684                        | 141,228                        | 28,954       |                    | 577,866      |
| PP&E   | 4,632,273                      | 732,131                        | 56,279       |                    | 5,420,683    |
| Other assets                                 |                                |                                |              | 1,530,665          | 1,530,665    |
| Segment liabilities                          | 592,734                        | 109,870                        | 24,820       | 2,555,974          | 3,283,398    |
|  | <b>Flat steel<br/>products</b> | <b>Long Steel<br/>products</b> | <b>Other</b> | <b>Unallocated</b> | <b>Total</b> |
| <b>Year ended December 31, 2005</b>          |                                |                                |              |                    |              |
| Net sales                                    | 3,660,427                      | 625,368                        | 161,885      |                    | 4,447,680    |
| Cost of sales                                | (2,002,299)                    | (386,757)                      | (99,924)     |                    | (2,488,980)  |
| Gross profit                                 | 1,658,128                      | 238,611                        | 61,961       |                    | 1,958,700    |
| Selling, general and administrative expenses | (403,815)                      | (80,444)                       | (16,331)     |                    | (500,590)    |
| Other operating (expenses), net              | (56,281)                       | (2,163)                        | (7,505)      |                    | (65,949)     |
| Operating income                             | 1,198,032                      | 156,004                        | 38,125       |                    | 1,392,161    |
| Capital expenditures PP&E                    | 208,772                        | 14,587                         |              |                    | 223,359      |
| Depreciation PP&E                            | 267,975                        | 32,604                         | 1,387        |                    | 301,966      |
| Segment assets                               |                                |                                |              |                    |              |
| Inventories                                  | 859,270                        | 126,536                        | 14,313       |                    | 1,000,119    |
| Trade receivables                            | 363,573                        | 74,925                         | 34,262       |                    | 472,760      |
| PP&E   | 4,653,192                      | 749,305                        | 61,374       |                    | 5,463,871    |
| Other assets                                 |                                |                                |              | 1,723,231          | 1,723,231    |
| Segment liabilities                          | 717,855                        | 193,247                        | 31,117       | 4,141,843          | 5,084,062    |

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****5 Segment information (continued)**

|  | Flat steel<br>products | Trading   | Other   | Unallocated | Total     |
|--|------------------------|-----------|---------|-------------|-----------|
| <b>Year ended December 31, 2004</b>          |                        |           |         |             |           |
| Net sales                                    | 1,266,197              | 325,227   | 7,501   |             | 1,598,925 |
| Cost of sales                                | (647,815)              | (312,447) | (4,742) |             | (965,004) |
| Gross profit                                 | 618,382                | 12,780    | 2,759   |             | 633,921   |
| Selling, general and administrative expenses | (110,232)              | (5,070)   | (1,324) |             | (116,626) |
| Other operating (expenses), net              | (2,953)                | (136)     | (35)    |             | (3,124)   |
| Operating income                             | 505,197                | 7,574     | 1,400   |             | 514,171   |
| Capital expenditures PP&E                    | 83,763                 |           |         |             | 83,763    |
| Depreciation PP&E                            | 92,596                 | 86        |         |             | 92,682    |
| Segment assets                               |                        |           |         |             |           |
| Inventories, net                             | 233,624                | 20,100    | 562     |             | 254,286   |
| Trade receivables                            | 111,945                | 58,877    | 783     |             | 171,605   |
| PP&E   | 1,244,294              | 397       |         |             | 1,244,691 |
| Investment in Amazonia                       | 309,195                |           |         |             | 309,195   |
| Other assets                                 | 468,673                | 95,047    |         | 103,133     | 666,853   |
| Segment liabilities                          | 635,461                | 143,629   |         | 95,689      | 874,779   |

**Secondary reporting format geographical segments**

|                                     | South and<br>Central<br>America | North<br>America | Europe and<br>other | Total     |
|-------------------------------------|---------------------------------|------------------|---------------------|-----------|
| <b>Year ended December 31, 2006</b> |                                 |                  |                     |           |
| Net sales                           | 3,704,294                       | 2,768,755        | 95,926              | 6,568,975 |
| Segment assets                      |                                 |                  |                     |           |
| Trade receivables                   | 202,784                         | 355,631          | 19,451              | 577,866   |
| Property, plant and equipment       | 3,450,176                       | 1,970,420        | 87                  | 5,420,683 |
| Depreciation PP&E                   | 270,453                         | 133,688          | 43                  | 404,184   |
| Capital expenditures PP&E           | 286,008                         | 97,662           | 2                   | 383,672   |
| <b>Year ended December 31, 2005</b> |                                 |                  |                     |           |
| Net sales                           | 2,805,214                       | 1,290,353        | 352,113             | 4,447,680 |
| Segment assets                      |                                 |                  |                     |           |
| Trade receivables                   | 64,837                          | 335,795          | 72,128              | 472,760   |
| Property, plant and equipment       | 3,409,045                       | 2,054,687        | 139                 | 5,463,871 |
| Depreciation PP&E                   | 249,808                         | 52,132           | 26                  | 301,966   |
| Capital expenditures PP&E           | 180,867                         | 42,473           | 19                  | 223,359   |



**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****5 Segment information (continued)**

|                                     | South and<br>Central<br>America | North<br>America | Europe and<br>other | Total     |
|-------------------------------------|---------------------------------|------------------|---------------------|-----------|
| <b>Year ended December 31, 2004</b> |                                 |                  |                     |           |
| Net sales                           | 1,123,692                       | 230,829          | 244,404             | 1,598,925 |
| Segment assets                      |                                 |                  |                     |           |
| Trade receivables                   | 50,956                          | 42,563           | 78,086              | 171,605   |
| Property, plant and equipment       | 1,244,428                       | 93               | 170                 | 1,244,691 |
| Depreciation PP&E                   | 92,626                          | 25               | 31                  | 92,682    |
| Capital expenditures PP&E           | 83,763                          |                  |                     | 83,763    |

**6 Cost of sales**

|  | Year ended December 31, |                  |                |
|--|-------------------------|------------------|----------------|
|  | 2006                    | 2005             | 2004           |
| <b>Inventories at the beginning of the year</b>        | 1,000,119               | 254,286          | 144,307        |
| Acquisition of business                                | 8,180                   | 629,729          |                |
| <b>Plus: Charges for the year</b>                      |                         |                  |                |
| Raw materials and consumables used and other movements | 3,019,408               | 1,642,793        | 781,337        |
| Services and fees                                      | 152,978                 | 119,155          | 42,277         |
| Labor cost   | 520,717                 | 306,215          | 89,362         |
| Depreciation of property, plant and equipment          | 377,808                 | 279,480          | 89,836         |
| Amortization of intangible assets                      | 14,470                  | 10,488           | 5,400          |
| Maintenance expenses                                   | 350,903                 | 207,490          | 62,488         |
| Office expenses  | 8,135                   | 8,020            | 1,145          |
| Freight and transportation                             | 25,451                  | 22,746           | 18,746         |
| Insurance  | 10,041                  | 4,749            | 815            |
| Provision for obsolescence                             | 30,320                  | 7,927            |                |
| Recovery from sales of scrap and by-products           | (48,488)                | (35,266)         | (23,315)       |
| Others   | 72,667                  | 31,287           | 6,892          |
| <b>Less: Inventories at the end of the year</b>        | (1,241,325)             | (1,000,119)      | (254,286)      |
| <b>Cost of Sales</b>                                   | <b>4,301,384</b>        | <b>2,488,980</b> | <b>965,004</b> |

**7 Selling, general and administrative expenses**

|  | Year ended December 31, |         |        |
|--|-------------------------|---------|--------|
|  | 2006                    | 2005    | 2004   |
| Services and fees                            | 52,169                  | 48,668  | 15,728 |
| Labor cost                                   | 157,155                 | 119,960 | 24,249 |
| Depreciation of property plant and equipment | 26,376                  | 22,486  | 2,846  |
| Amortization of intangible assets            | 5,841                   | 3,951   | 1,110  |

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|   |                |                |                |
|---|----------------|----------------|----------------|
| Maintenance and expenses                                  | 17,397         | 7,316          | 2,162          |
| Taxes   | 44,781         | 45,108         | 21,911         |
| Office expenses   | 29,722         | 24,529         | 1,540          |
| Freight and transportation                                | 271,286        | 217,368        | 42,354         |
| Insurance   | 1,234          | 475            | 529            |
| Recovery of provision for impairment of trade receivables | (5,207)        | (2,467)        | (2,326)        |
| Others  | 23,018         | 13,196         | 6,523          |
| <b>Selling, general and administrative expenses</b>       | <b>623,772</b> | <b>500,590</b> | <b>116,626</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****8 Labor costs (included in cost of sales, selling, general and administrative expenses)**

|   | Year ended December 31, |                |                |
|---|-------------------------|----------------|----------------|
|   | 2006                    | 2005           | 2004           |
| Wages, salaries and social security costs           | 558,800                 | 361,250        | 104,268        |
| Termination benefits                                | 18,176                  | 40,364         | 7,969          |
| Pension benefits defined benefit plan (Note 25 (i)) | 100,896                 | 24,561         | 1,374          |
|   | <b>677,872</b>          | <b>426,175</b> | <b>113,611</b> |

**9 Other operating expenses, net**

|   | Year ended December 31, |                 |                |
|---|-------------------------|-----------------|----------------|
|   | 2006                    | 2005            | 2004           |
| <b>(i) Other operating income</b>                           | <b>16,716</b>           | <b>6,543</b>    | <b>502</b>     |
| <b>(ii) Other operating expenses</b>                        |                         |                 |                |
| Provision for legal claims and other matters                | (8,645)                 | (13,586)        | (2,714)        |
| Others  | (1,998)                 | (4,558)         | (912)          |
| <b>Total other operating expenses</b>                       | <b>(10,643)</b>         | <b>(18,144)</b> | <b>(3,626)</b> |
| <b>(iii) Derecognition of property, plant and equipment</b> | <b>(13,323)</b>         | <b>(54,348)</b> |                |
| <b>Total other operating expenses, net</b>                  | <b>(7,250)</b>          | <b>(65,949)</b> | <b>(3,124)</b> |

**10 Other financial (expenses) income, net**

|   | Year ended December 31 |                  |                |
|---|------------------------|------------------|----------------|
|   | 2006                   | 2005             | 2004           |
| Debt issue costs  | (13,686)               | (3,171)          |                |
| Net foreign exchange transaction gains and change in fair value of derivative instruments | (16,541)               | (28,828)         | 9,845          |
| Income from Participation Account (i)   |                        | 44,050           | 203,429        |
| Loss from Participation Account (i)   | (270,161)              | (265,207)        |                |
| Others  | (22,029)               | (8,296)          | (1,639)        |
| <b>Other financial (expenses) income, net</b>   | <b>(322,417)</b>       | <b>(261,452)</b> | <b>211,635</b> |

- (i) As a result of the debt restructuring process carried out by Sidor in 2003, Ylopa became Sidor's creditors in a Participation Account Agreement. This agreement provides for a compensation in the form of cash payments to be paid on a quarterly basis and has a term of 14

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years, or until the fiscal year prior to the date of the settlement in full of certain bank borrowings (BANDES) due by Sidor. Until February 15, 2005, the Company accounted for its investment in Amazonia under the equity method of accounting. Thus, income arising from the Participation Account Agreement described in above has been recorded under Income from Participation Account within Financial income, net. Upon conversion of the Amazonia Convertible Debt Instrument on February 15, 2005, the Company acquired control over Amazonia and began accounting for such investment on a consolidated basis. Accordingly, income resulting from Ternium's share of the Participation Account has been offset against Amazonia's loss for the same concept and shown net under Loss from Participation Account line item.

### 11 Equity in earnings of associated companies

|  | Year ended December 31, |               |                |
|--|-------------------------|---------------|----------------|
|  | 2006                    | 2005          | 2004           |
| Equity in earnings of associated companies (Note 15) | 4,534                   | 21,524        | 60,908         |
| Impairments (i)                                      |                         |               | 148,293        |
| <b>Equity in earnings of associated companies</b>    | <b>4,534</b>            | <b>21,524</b> | <b>209,201</b> |

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- (i) The accumulated impairment loss over the Company's investment in Amazonia at December 31, 2003 (totaling USD 148,293) was fully reversed in fiscal year 2004.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****12 Income tax expense****Income tax**

Income tax expense for each of the years presented is as follows:

|   | Year ended December 31, |                  |                  |
|---|-------------------------|------------------|------------------|
|   | 2006                    | 2005             | 2004             |
| Current tax   | (387,741)               | (246,024)        | (209,147)        |
| Deferred tax (Note 24)  | 111,418                 | 24,990           | 31,661           |
| Utilization of previously unrecognized tax losses (see Note 24) | 13,967                  | 2,542            |                  |
|   | <b>(262,356)</b>        | <b>(218,492)</b> | <b>(177,486)</b> |

Income tax expense for the years ended December 31, 2006, 2005 and 2004 differed from the amount computed by applying the statutory income tax rate in force in each country in which the company operates to pre-tax income as a result of the following:

|   | Year ended December 31, |                  |                  |
|---|-------------------------|------------------|------------------|
|   | 2006                    | 2005             | 2004             |
| Income before income tax                          | 1,258,322               | 1,291,305        | 925,661          |
| Income tax expense at statutory tax rate          | (383,498)               | (271,953)        | (179,827)        |
| Non taxable income / (losses)                     | 156,008                 | 70,115           | 2,341            |
| Non deductible expenses                           | (36,050)                | (19,196)         |                  |
| Utilization of previously unrecognized tax losses | 13,967                  | 2,542            |                  |
| Provisions for tax loss carry-forwards            | (12,783)                |                  |                  |
| <b>Income tax expense</b>                         | <b>(262,356)</b>        | <b>(218,492)</b> | <b>(177,486)</b> |

**13 Property, plant and equipment, net**

| Year ended December 31, 2006        | Land    | Building and improvements | Production equipment | Vehicles, furniture and fixtures | Work in progress | Spare Parts | Total     |
|-------------------------------------|---------|---------------------------|----------------------|----------------------------------|------------------|-------------|-----------|
|                                     |         |                           |                      |                                  |                  |             |           |
| Values at the beginning of the year | 314,467 | 1,441,769                 | 5,257,096            | 187,207                          | 190,356          | 18,619      | 7,409,514 |
| Translation differences             | (3,807) | (11,287)                  | (43,129)             | (1,644)                          | (770)            | (155)       | (60,792)  |
| Acquisition of business             | 2,624   | 42,603                    | 2,598                |                                  |                  |             | 47,825    |
| Additions                           |         |                           | 21,275               | 3,424                            | 351,744          | 7,229       | 383,672   |
| Disposals / Consumptions            | (19)    | (40)                      | (1,374)              | (2,500)                          |                  | (106)       | (4,039)   |
| Derecognition                       |         |                           | (38,950)             | (17)                             | (192)            |             | (39,159)  |
| Transfers                           | (1,749) | 83,648                    | 87,448               | 5,588                            | (189,855)        |             | (14,920)  |
| Values at the end of the year       | 311,516 | 1,556,693                 | 5,284,964            | 192,058                          | 351,283          | 25,587      | 7,722,101 |

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**Depreciation**

|  |                |                  |                  |               |                |               |                  |
|--|----------------|------------------|------------------|---------------|----------------|---------------|------------------|
| Accumulated at the beginning of the year | (386,021)      | (1,442,682)      | (116,019)        | (921)         | (1,945,643)    |               |                  |
| Translation differences                  | 3,706          | 13,403           | 1,097            | 12            | 18,218         |               |                  |
| Depreciation charge                      | (83,357)       | (305,320)        | (15,397)         | (110)         | (404,184)      |               |                  |
| Disposals / Consumptions                 | 20             | 388              | 1,582            | 85            | 2,075          |               |                  |
| Derecognition                            |                | 25,836           |                  |               | 25,836         |               |                  |
| Transfers                                | 2,280          |                  |                  |               | 2,280          |               |                  |
| Accumulated at the end of the year       | (463,372)      | (1,708,375)      | (128,737)        | (934)         | (2,301,418)    |               |                  |
| <b>At December 31, 2006</b>              | <b>311,516</b> | <b>1,093,321</b> | <b>3,576,589</b> | <b>63,321</b> | <b>351,283</b> | <b>24,653</b> | <b>5,420,683</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****13 Property, plant and equipment, net (continued)**

| Year ended December 31, 2005             | Land           | Building and improvements | Production equipment | Vehicles, furniture and fixtures | Work in progress | Spare parts   | Total            |
|--|----------------|---------------------------|----------------------|----------------------------------|------------------|---------------|------------------|
| <b>Cost</b>                              |                |                           |                      |                                  |                  |               |                  |
| Values at the beginning of the year      | 23,427         | 682,576                   | 2,217,688            | 141,212                          | 36,865           | 16,331        | 3,118,099        |
| Translation differences                  | (6,243)        | (98,975)                  | (266,065)            | (6,484)                          | (10,094)         | (382)         | (388,243)        |
| Acquisition of business                  | 290,765        | 819,850                   | 3,230,621            | 47,863                           | 184,515          |               | 4,573,614        |
| Additions                                | 266            | 7,539                     | 42,747               | 2,633                            | 165,966          | 4,208         | 223,359          |
| Disposals / Consumptions                 |                | (52)                      | (8,021)              | (1,331)                          |                  | (1,538)       | (10,942)         |
| Derecognition                            |                | (28,977)                  | (75,331)             | (2,065)                          |                  |               | (106,373)        |
| Transfers                                | 6,252          | 59,808                    | 115,457              | 5,379                            | (186,896)        |               |                  |
| Values at the end of the year            | 314,467        | 1,441,769                 | 5,257,096            | 187,207                          | 190,356          | 18,619        | 7,409,514        |
| <b>Depreciation</b>                      |                |                           |                      |                                  |                  |               |                  |
| Accumulated at the beginning of the year |                | (392,996)                 | (1,368,813)          | (109,797)                        |                  | (1,802)       | (1,873,408)      |
| Translation differences                  |                | 61,210                    | 107,768              | 3,773                            |                  | (2)           | 172,749          |
| Depreciation charge                      |                | (68,442)                  | (221,566)            | (11,801)                         |                  | (157)         | (301,966)        |
| Disposals / Consumptions                 |                | 35                        | 3,086                | 796                              |                  | 1,040         | 4,957            |
| Derecognition                            |                | 14,172                    | 36,843               | 1,010                            |                  |               | 52,025           |
| Accumulated at the end of the year       |                | (386,021)                 | (1,442,682)          | (116,019)                        |                  | (921)         | (1,945,643)      |
| <b>At December 31, 2005</b>              | <b>314,467</b> | <b>1,055,748</b>          | <b>3,814,414</b>     | <b>71,188</b>                    | <b>190,356</b>   | <b>17,698</b> | <b>5,463,871</b> |

**14 Intangible assets, net**

| Year ended December 31, 2006             | Information System Projects | Mining Concessions and Exploration Costs | Goodwill | Total    |
|--|-----------------------------|--|----------|----------|
| <b>Cost</b>                              |                             |  |          |          |
| Values at the beginning of the year      | 50,385                      | 126,934                                  | 399,694  | 577,013  |
| Translation differences                  | (409)                       | (1,159)                                  | (2,426)  | (3,994)  |
| Additions                                | 18,350                      | 3,795                                    | 675      | 22,820   |
| Values at the end of the year            | 68,326                      | 129,570                                  | 397,943  | 595,839  |
| <b>Amortization</b>                      |                             |  |          |          |
| Accumulated at the beginning of the year | (19,807)                    | (4,324)                                  |          | (24,131) |
| Translation differences                  | 147                         | 43                                       |          | 190      |
| Amortization charge                      | (11,216)                    | (9,095)                                  |          | (20,311) |
| Accumulated at the end of the year       | (30,876)                    | (13,376)                                 |          | (44,252) |

|                             |               |                |                |                |
|-----------------------------|---------------|----------------|----------------|----------------|
| <b>At December 31, 2006</b> | <b>37,450</b> | <b>116,194</b> | <b>397,943</b> | <b>551,587</b> |
|-----------------------------|---------------|----------------|----------------|----------------|

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****14 Intangible assets, net (continued)**

| Year ended December 31, 2005             | Information<br>System<br>Projects | Mining<br>Concessions and<br>Exploration Costs | Goodwill       | Total          |
|--|-----------------------------------|--|----------------|----------------|
| <b>Cost</b>                              |                                   |  |                |                |
| Values at the beginning of the year      | 20,547                            |  |                | 20,547         |
| Translation differences                  | (1,767)                           | (603)  | (5,694)        | (8,064)        |
| Acquisition of business                  | 10,538                            | 127,101  |                | 137,639        |
| Additions                                | 21,144                            | 436  | 405,388        | 426,968        |
| Disposals                                | (77)                              |  |                | (77)           |
| <b>Values at the end of the year</b>     | <b>50,385</b>                     | <b>126,934</b>                                 | <b>399,694</b> | <b>577,013</b> |
| <b>Amortization</b>                      |                                   |  |                |                |
| Accumulated at the beginning of the year | (10,498)                          |  |                | (10,498)       |
| Translation differences                  | 806                               |  |                | 806            |
| Amortization charge                      | (10,115)                          | (4,324)  |                | (14,439)       |
| Accumulated at the end of the year       | (19,807)                          | (4,324)  |                | (24,131)       |
| <b>At December 31, 2005</b>              | <b>30,578</b>                     | <b>122,610</b>                                 | <b>399,694</b> | <b>552,882</b> |

**15 Investments in associated companies**

|  | Year ended December 31,<br>2006 | 2005         |
|--|---------------------------------|--------------|
| At the beginning of the year               | 9,122                           | 309,318      |
| Translation adjustment                     | 31                              | (3,554)      |
| Acquisition of associated companies        | 2,598                           |              |
| Equity in earnings of associated companies | 4,534                           | 21,524       |
| Consolidation of Amazonia (see Note 3)     |                                 | (318,166)    |
| <b>At the end of the year</b>              | <b>16,285</b>                   | <b>9,122</b> |

The principal associated companies, all of which are unlisted, are:

| Company                                 | Country of<br>incorporation | Voting rights           |        | Value at December 31, |       |
|---|-----------------------------|-------------------------|--------|-----------------------|-------|
|   |                             | at December 31,<br>2006 | 2005   | 2006                  | 2005  |
| Lomond Holdings BV. (1)                 | Holanda                     | 50.00%                  |        | 2,747                 |       |
| Matesi Materiales Siderúrgicos S.A. (2) | Venezuela                   | 49.80%                  | 49.80% | 12,866                | 9,002 |

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|  |           |        |        |               |              |
|--|-----------|--------|--------|---------------|--------------|
| Compañía Afianzadora de Empresas Siderúrgicas S.G.R. (3) | Argentina | 38.89% | 38.89% | 120           | 120          |
| Finma S.A.I.F. (4)                                       | Argentina | 33.33% |        | 552           |              |
|  |           |        |        | <b>16,285</b> | <b>9,122</b> |

- 
- (1) Holding Company. Indirectly through the participation in Alvory.
  - (2) Manufacturing and marketing of briquettes. Indirectly through the participation in Sidor.
  - (3) Granting of guarantees to participating partners to facilitate or permit access to credits for purchase of national raw material. Indirectly through the participation in Siderar.
  - (4) Consulting and financial services. Indirectly through the participation in Siderar.

### 16 Other investments, net non-current

|  | As of December 31, |               |
|--|--------------------|---------------|
|  | 2006               | 2005          |
| Investments in companies under cost method                               | 243                | 243           |
| Time deposits with related parties (i)                                   | 11,249             | 10,450        |
| Guarantee fund Compañía Afianzadora de Empresas Siderúrgicas S.G.R. (ii) | 2,978              | 3,402         |
| Provision for impairment of other investments (Note 22 )                 | (1,083)            | (1,488)       |
| <b>Total</b>   | <b>13,387</b>      | <b>12,607</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****16 Other investments, net non-current (continued)***(i) Time deposits with related parties*

The Company holds a savings fund denominated in U.S. dollars. Withdrawal of investments before certain dates is subject to penalties on amounts invested.

*(ii) Guarantee fund Compañía Afianzadora de Empresas Siderúrgicas S.G.R.*

Corresponds to the Company's portion of the risk funds sponsored by Compañía Afianzadora de Empresas Siderúrgicas S.G.R., which acts as guarantor of third parties' debts.

**17 Receivables, net non-current**

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2006</b>               | <b>2005</b>   |
| Receivables with related parties (Note 30)      | 63,323                    | 39,285        |
| Employee advances and loans                     | 12,616                    | 6,323         |
| Trade receivables                               | 1,373                     | 3,474         |
| Receivables from sale of fixed assets           | 1,542                     | 1,729         |
| Others  | 1,422                     | 1,028         |
| Provision for impairment receivables (Note 22 ) | (1,373)                   | (3,024)       |
|   | <b>78,903</b>             | <b>48,815</b> |

**18 Receivables current**

|  | <b>As of December 31,</b> |                |
|--|---------------------------|----------------|
|  | <b>2006</b>               | <b>2005</b>    |
| Value added tax                            | 8,513                     | 55,326         |
| Asset tax                                  | 15,892                    | 60,312         |
| Prepaid taxes                              | 3,550                     | 2,894          |
| Employee advances and loans                | 6,222                     | 5,943          |
| Advances to suppliers                      | 27,583                    | 58,839         |
| Expenses paid in advance                   | 12,175                    | 15,172         |
| Government tax refunds on exports          | 43,531                    | 36,425         |
| Receivables with related parties (Note 30) | 42,619                    | 35,548         |
| Others, net                                | 15,733                    | 20,843         |
|  | <b>175,818</b>            | <b>291,302</b> |

**19 Inventories, net**

|  | <b>As of December 31,</b> |                  |
|--|---------------------------|------------------|
|  | <b>2006</b>               | <b>2005</b>      |
| Raw materials, materials and spare parts | 519,530                   | 509,266          |
| Goods in process                         | 458,839                   | 298,847          |
| Finished goods                           | 262,873                   | 201,085          |
| Goods in transit                         | 78,862                    | 43,740           |
| Provision for obsolescence (Note 23)     | (78,779)                  | (52,819)         |
|  | <b>1,241,325</b>          | <b>1,000,119</b> |

**20 Trade receivables, net**

|   | <b>As of December 31,</b> |                |
|---|---------------------------|----------------|
|   | <b>2006</b>               | <b>2005</b>    |
| Current accounts                                      | 592,800                   | 487,952        |
| Trade receivables with related parties (Note 30)      | 10,149                    | 14,659         |
| Provision for impairment trade receivables (Note 23 ) | (25,083)                  | (29,851)       |
|   | <b>577,866</b>            | <b>472,760</b> |

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****21 Cash, cash equivalents and other investments**

|   | As of December 31, |                |
|---|--------------------|----------------|
|   | 2006               | 2005           |
| <b>(i) Other investments</b>                  |                    |                |
| Trust funds with specific objective (Note 30) |                    | 5,185          |
|   |                    | <b>5,185</b>   |
| <b>(ii) Cash and cash equivalents</b>         |                    |                |
| Cash at banks and in hand                     | 65,035             | 117,737        |
| Deposits and foreign private sector bonds     | 567,967            | 637,243        |
| Restricted cash                               | 10,350             | 10,650         |
|   | <b>643,352</b>     | <b>765,630</b> |

**22 Provisions non current**

|                                     | Deducted from assets<br>Provision for Impairment | Liabilities<br>Legal claims |               |
|-------------------------------------|--|-----------------------------|---------------|
|                                     |  |                             | and           |
|                                     | Receivables                                      | Other<br>investments        | other matters |
| <b>Year ended December 31, 2006</b> |  |                             |               |
| Values at the beginning of the year | 3,024  | 1,488                       | 54,138        |
| Translation differences             | (27)   | (17)                        | (137)         |
| Additional provisions               |  |                             | 9,966         |
| Reversals                           | (1,624)  | (388)                       | (1,321)       |
| Used                                |  |                             | (2,103)       |
| <b>At December 31, 2006</b>         | <b>1,373</b>                                     | <b>1,083</b>                | <b>60,543</b> |
| <b>Year ended December 31, 2005</b> |  |                             |               |
| Values at the beginning of the year | 3,404  | 2,001                       | 12,885        |
| Translation differences             | (47)   | (17)                        | (4,355)       |
| Acquisition of business             |  |                             | 37,163        |
| Additional provisions               |  |                             | 13,586        |
| Reversals                           | (333)  |                             |               |
| Used                                |  | (496)                       | (5,141)       |
| <b>At December 31, 2005</b>         | <b>3,024</b>                                     | <b>1,488</b>                | <b>54,138</b> |

## 23 Provisions current

|                                     | Deducted from assets |               |
|-------------------------------------|----------------------|---------------|
|                                     | Provision for        |               |
|                                     | impairment           | Provision for |
|                                     | trade receivables    | obsolescence  |
| <b>Year ended December 31, 2006</b> |                      |               |
| Values at the beginning of the year | 29,851               | 52,819        |
| Translation differences             | (420)                | (513)         |
| Reversals                           | (3,937)              | (19,300)      |
| Additional provisions               | 354                  | 49,620        |
| Used                                | (765)                | (3,847)       |
| <b>At December 31, 2006</b>         | <b>25,083</b>        | <b>78,779</b> |
| <b>Year ended December 31, 2005</b> |                      |               |
| Values at the beginning of the year | 10,754               | 12,524        |
| Translation differences             | (418)                | (1,802)       |
| Reversals                           | (3,987)              |               |
| Acquisition of business             | 30,617               | 37,897        |
| Additional provisions               | 1,853                | 7,927         |
| Used                                | (8,968)              | (3,727)       |
| <b>At December 31, 2005</b>         | <b>29,851</b>        | <b>52,819</b> |

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****24 Deferred income tax**

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rate of the applicable country.

Changes in deferred income tax are as follows:

|                                 | Year ended December 31, |                    |
|---------------------------------|-------------------------|--------------------|
|                                 | 2006                    | 2005               |
| At beginning of the year        | (1,019,062)             | (337,473)          |
| Acquisition of business         | (1,067)                 | (711,028)          |
| Translation differences         | 9,705                   | 4,449              |
| Uses of tax loss carry-forwards | (63,677)                |                    |
| Income statement credit         | 125,385                 | 24,990             |
| <b>At end of the year</b>       | <b>(948,716)</b>        | <b>(1,019,062)</b> |

The changes in deferred tax assets and liabilities (prior to offsetting the balances within the same tax jurisdiction) during the year are as follow:

|                                  | Fixed            |                 | Intangible      |                 | Total at           |
|----------------------------------|------------------|-----------------|-----------------|-----------------|--------------------|
|                                  | assets           | Inventories     | assets          | Other           | December 31,       |
|                                  |                  |                 |                 |                 | 2006               |
| At beginning of year             | (1,054,020)      | (107,175)       | (45,849)        | (43,476)        | (1,250,520)        |
| Acquisition of business          | (1,140)          | 3               |                 |                 | (1,137)            |
| Translation differences          | 9,876            | 1,816           | 684             | (48)            | 12,328             |
| Income statement credit (charge) | 78,056           | 20,908          | 3,902           | (27,468)        | 75,398             |
| <b>At end of year</b>            | <b>(967,228)</b> | <b>(84,448)</b> | <b>(41,263)</b> | <b>(70,992)</b> | <b>(1,163,931)</b> |

|                                 | Trade         |               | Tax loss      | Total at       |                |
|---------------------------------|---------------|---------------|---------------|----------------|----------------|
|                                 | Provisions    | Receivables   | carry-        | December 31,   |                |
|                                 |               |               | forwards      | Other          | 2006           |
| At beginning of year            | 36,312        | 20,322        | 98,213        | 76,611         | 231,458        |
| Acquisition of business         | 39            |               |               | 31             | 70             |
| Translation differences         | (385)         | (133)         | (1,486)       | (620)          | (2,624)        |
| Uses of tax loss carry-forwards |               |               | (63,677)      |                | (63,677)       |
| Income statement credit         | 1,533         | 3,394         | 13,967        | 31,094         | 49,988         |
| <b>At end of year</b>           | <b>37,499</b> | <b>23,583</b> | <b>47,017</b> | <b>107,116</b> | <b>215,215</b> |

Deferred tax assets and liabilities are offset when the entity a) has a legally enforceable right to set off the recognized amounts; and b) intends to settle the tax on a net basis or to realize the asset and settle the liability simultaneously.

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As December 31, 2006 and 2005, USD 36,439 and USD 29,126, respectively, have been classified as non-current assets and USD 985,155 and USD 1,048,188, respectively, have been classified as non-current liabilities.

The amounts shown in the balance sheet include the following:

|  | <b>As of December 31,</b> |
|--|---------------------------|
|  | <b>2006</b>               |
| Deferred tax assets to be recovered after more than 12 months    | 158,205                   |
| Deferred tax liabilities to be settled after more than 12 months | (1,078,181)               |
|  | <b>(919,976)</b>          |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****25 Other liabilities**

|  | <b>As of December 31,</b> |                |
|--|---------------------------|----------------|
|  | <b>2006</b>               | <b>2005</b>    |
| <b>(i) Other liabilities non-current</b> |                           |                |
| Termination benefits                     | 3,716                     | 3,118          |
| Pension benefits                         | 263,454                   | 177,899        |
| Related Parties (Note 30)                | 1,149                     |                |
| Other                                    | 6,247                     | 6,900          |
|  | <b>274,566</b>            | <b>187,917</b> |

*Pension benefits*

The amounts recognized in the consolidated balance sheet are determined as follows:

|                                       | <b>Year ended December 31,</b> |                |
|---------------------------------------|--------------------------------|----------------|
|                                       | <b>2006</b>                    | <b>2005</b>    |
| Present value of unfunded obligations | 304,922                        | 172,394        |
| Unrecognized actuarial (losses) gains | (16,282)                       | 8,594          |
| Unrecognized prior service costs      | (25,186)                       | (3,089)        |
| <b>Liability in the balance sheet</b> | <b>263,454</b>                 | <b>177,899</b> |

The amounts recognized in the consolidated income statement are as follows:

|   | <b>Year ended December 31,</b> |               |
|---|--------------------------------|---------------|
|   | <b>2006</b>                    | <b>2005</b>   |
| Current service cost                                | 8,079                          | 7,227         |
| Interest cost                                       | 36,549                         | 17,785        |
| Changes to pension plan (1)                         | 46,947                         |               |
| Amortization of prior service costs                 | 593                            | 443           |
| Net actuarial losses (gains) recognized in the year | 8,728                          | (894)         |
| <b>Total included in labor costs</b>                | <b>100,896</b>                 | <b>24,561</b> |

- (1) In December 2006, Sidor decided a change in the benefits associated to the pension plan which became effective on January 1, 2007. This change consists mainly of an increase of the minimum pension benefit to be provided to retired employees. Consequently, the pension plan actuarial liability was accordingly adjusted.

Changes in the liability recognized in the consolidated balance sheet are as follows:

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|  | <b>Year ended December 31,</b> |                |
|--|--------------------------------|----------------|
|  | <b>2006</b>                    | <b>2005</b>    |
| At the beginning of the year               | 177,899                        | 6,117          |
| Acquisition of business                    |                                | 195,285        |
| Transfers and new participants of the plan | (130)                          | (25,153)       |
| Total expense                              | 100,896                        | 24,561         |
| Translation differences                    | (1,355)                        | (9,550)        |
| Contributions paid                         | (13,856)                       | (13,361)       |
| <b>At the end of year</b>                  | <b>263,454</b>                 | <b>177,899</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****25 Other liabilities (continued)**

The principal actuarial assumptions used were as follows:

**Venezuela**

|                               | <b>Year ended December 31,</b> |             |
|-------------------------------|--------------------------------|-------------|
|                               | <b>2006</b>                    | <b>2005</b> |
| Discount rate                 | 26.81%                         | 23.32%      |
| Rate of compensation increase | 16.34%                         | 16.34%      |

**Mexico**

|                               | <b>Year ended December 31,</b> |             |
|-------------------------------|--------------------------------|-------------|
|                               | <b>2006</b>                    | <b>2005</b> |
| Discount rate                 | 9.50%                          | 8.67%       |
| Rate of compensation increase | 4.00%                          | 4.54%       |

**Argentina**

|                               | <b>Year ended December 31,</b> |             |
|-------------------------------|--------------------------------|-------------|
|                               | <b>2006</b>                    | <b>2005</b> |
| Discount rate                 | 7.00%                          | 7.00%       |
| Rate of compensation increase | 2.00%                          | 2.00%       |

|                                       | <b>As of December 31,</b> |                |
|---------------------------------------|---------------------------|----------------|
|                                       | <b>2006</b>               | <b>2005</b>    |
| <b>(ii) Other liabilities current</b> |                           |                |
| Payroll and social security payable   | 81,841                    | 67,639         |
| Termination benefits                  | 2,885                     | 18,966         |
| Participation account                 | 54,454                    | 90,186         |
| Related Parties (Note 30)             | 15,090                    | 17             |
| Others                                | 4,104                     | 17,265         |
|                                       | <b>158,374</b>            | <b>194,073</b> |

**26 Derivative financial instruments****Net fair values of derivative financial instruments**

The net fair values of derivative financial instruments at December 31, 2006 and 2005 were as follows:

|   | <b>Year ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2006</b>                    | <b>2005</b> |
| <b>Contracts with positive fair values:</b> |                                |             |

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|   |                 |              |
|---|-----------------|--------------|
| Interest rate swap contracts                | 6,857           | 5,316        |
| Foreign exchange contracts                  | 995             | 86           |
|   | <b>7,852</b>    | <b>5,402</b> |
| <b>Contracts with negative fair values:</b> |                 |              |
| Commodities contracts                       | (15,487)        |              |
|   | <b>(15,487)</b> |              |

Derivative financial instruments breakdown is as follows:

a) Interest rate contracts

Fluctuations in market interest rates create a degree of risk by affecting the amount of the Company's interest payments and the value of its fixed rate debt. As of December 31, 2006, most of the Company's long-term borrowings were at variable rates.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****26 Derivative Financial Instruments (continued)**

On September 1, 2005, III BVI entered into a USD 250 million interest rate swap agreement with Citibank N.A., New York to manage the impact of the floating interest rate changes on the Ternium Credit Facility by setting the interest rate to 4.235% per annum. This interest rate swap is due on August 22, 2010 and provides for semi-annual payments on February 22 and August 22 of each year, commencing on August 22, 2006 through and including the termination date. At December 31, 2006 the notional amount totaled USD 226.2 million.

On September 1, 2005, Siderar entered into two interest rate swap agreements with JP Morgan Chase Bank N.A. and Deutsche Bank AG with a notional amount of USD 100 million each to manage its exposure to changes in market rates associated with the Siderar Credit Facility by setting the interest rate to 4.18% and 4.20% per annum, respectively. These interest rate swaps are due on August 22, 2008 and provide for semi-annual payments on February 22 and August 22 of each year, commencing on August 22, 2006 through and including the termination date. At December 31, 2006 the notional amount totaled USD 160 million.

In March 2003, Hylsa entered into several interest rate cap agreements to manage the impact of the floating interest rate changes on its financial debt. As of December 31, 2006, Hylsa has an agreement, with a notional amount of USD 179.9 million and a fixed interest rate of 7.00% per annum; and another agreement with a notional amount of USD 24.5 million and a fixed interest rate of 5.0% per annum, both with Credit Suisse. These two agreements are due on January 2, 2008 and on January 22, 2007, respectively.

| Contract                             | Average rate | Notional amount      | Fair value at December 31, |       |
|--------------------------------------|--------------|----------------------|----------------------------|-------|
|                                      |              | at December 31, 2006 | 2006                       | 2005  |
| Interest rate contracts              | 5.10%        | 590,640              | 6,857                      | 5,316 |
| <i>b) Foreign exchange contracts</i> |              |                      |                            |       |

During 2006, Siderar entered into several exchange rate derivative contracts to manage its exposure to changes in the Argentine Peso against the US Dollar. As of December 31, 2006, Siderar had 10 non-deliverable forward agreements with JP Morgan Chase Bank N.A. with a notional amount of ARS 10 million each at an average exchange rate of 3.0918 Argentine Pesos per US Dollar. These forwards are due between January and March, 2007.

| Currencies | Contract                           | Notional amount      | Fair value at December 31, |           |
|------------|------------------------------------|----------------------|----------------------------|-----------|
|            |                                    | at December 31, 2006 | 2006                       | 2005      |
| USD/EUR    | Euro forward sales                 |                      |                            | 86        |
| MXN/USD    | Mexican peso forward purchases (1) |                      | 817                        |           |
| ARS/USD    | Argentine peso forward purchases   | ARS 100,000          | 178                        |           |
|            |                                    | <b>ARS 100,000</b>   | <b>995</b>                 | <b>86</b> |

- (1) Hylsa has a contract for half of its electricity purchases with an affiliate of Iberdrola, S.A., a Spanish utility company, up to the year 2027. Prices in this contract are mostly denominated in U.S. dollars, while payments to its alternative provider CFE are in Mexican pesos. Under the contract, Hylsa is allowed to terminate this agreement under specified price-related circumstances. The fair value of this embedded derivative as of December 31, 2006, was USD 0.8 million.

*c) Commodities contracts*

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Hylsa entered into several derivative contracts with JP Morgan Chase Bank N.A., Citibank N.A. and Deutsche Bank AG to manage the impact of the fluctuation on the natural gas price. The contracts outstanding at December 31, 2006, are due between January 2007 and March 2008.

| Contract        | Average price    | Notional amount in MMBtu | Fair value at December 31, |      |
|-----------------|------------------|--------------------------|----------------------------|------|
|                 |                  | at December 31, 2006     | 2006                       | 2005 |
| Call Purchases  | 7.65/7.45        | 12,000                   | 13,167                     |      |
| Call Sales      | 9.00/10.00       | 18,000                   | (6,716)                    |      |
| Put Sales       | 7.65@KI /7.45@KI | 12,000                   | (12,505)                   |      |
| Swaps Purchases | 7.36             | 6,000                    | (9,433)                    |      |
|                 |                  |                          | <b>(15,487)</b>            |      |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****27 Borrowings**

|   | Year ended<br>December 31, |                  |
|---|----------------------------|------------------|
|   | 2006                       | 2005             |
| <b>(i) Non-current</b>                    |                            |                  |
| Bank borrowings                           | 551,990                    | 1,810,910        |
| Borrowings with related parties (Note 30) |                            | 603,683          |
|   | <b>551,990</b>             | <b>2,414,593</b> |
| Less: debt issue costs                    | (3,589)                    | (14,715)         |
|   | <b>548,401</b>             | <b>2,399,878</b> |
| <b>(ii) Current</b>                       |                            |                  |
| Bank borrowings                           | 509,201                    | 518,629          |
| Borrowings with related parties (Note 30) | 2,161                      | 3,789            |
|   | <b>511,362</b>             | <b>522,418</b>   |
| Less: debt issue costs                    | (2,668)                    | (6,019)          |
|   | <b>508,694</b>             | <b>516,399</b>   |
| <b>Total Borrowings</b>                   | <b>1,057,095</b>           | <b>2,916,277</b> |

The maturity of borrowings is as follows:

|               | Expected Maturity Date |                |                |               |              |               | At December 31, (1) |                  |
|---------------|------------------------|----------------|----------------|---------------|--------------|---------------|---------------------|------------------|
|               | 2007                   | 2008           | 2009           | 2010          | 2011         | Thereafter    | 2006                | 2005             |
| Fixed Rate    | 150,918                |                |                |               |              | 7,206         | 158,124             | 56,257           |
| Floating Rate | 357,776                | 290,804        | 120,021        | 94,923        | 1,358        | 34,089        | 898,971             | 2,860,020        |
| <b>Total</b>  | <b>508,694</b>         | <b>290,804</b> | <b>120,021</b> | <b>94,923</b> | <b>1,358</b> | <b>41,295</b> | <b>1,057,095</b>    | <b>2,916,277</b> |

(1) As most borrowings incorporate floating rates that approximate market rates and the contractual repricing occurs every 3 to 6 months, the fair value of the borrowings approximates its carrying amount and is not disclosed separately.

The weighted average interest rates - which incorporate instruments denominated in various currencies - at the balance sheet date were as follows:

December 31,  
2006      2005

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|                 |       |       |
|-----------------|-------|-------|
| Bank borrowings | 6.82% | 6.08% |
|-----------------|-------|-------|

The nominal average interest rates shown above were calculated using the rates set for each instrument in its corresponding currency and weighted using the dollar-equivalent outstanding principal amount of said instruments at December 31, 2006 and 2005, respectively.

Breakdown of long-term borrowings by currency is as follows:

| Currency                     | Interest rates | December 31,     |                  |
|------------------------------|----------------|------------------|------------------|
|                              |                | 2006             | 2005             |
| USD                          | Floating       | 898,971          | 2,795,144        |
| USD                          | Fixed          | 62,179           | 14,692           |
| EUR                          | Fixed          |                  | 404              |
| ARS                          | Floating       |                  | 54               |
| ARS                          | Fixed          | 55,845           |                  |
| MXN                          | Floating       |                  | 64,822           |
| VEB                          | Fixed          | 40,100           | 41,161           |
| <b>Total bank borrowings</b> |                | <b>1,057,095</b> | <b>2,916,277</b> |

EUR: Euro; ARS: Argentine pesos; MXN: Mexican pesos; VEB: Venezuelan Bolivar



**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****28 Contingencies, commitments and restrictions on the distribution of profits**

Ternium is involved in litigation arising from time to time in the ordinary course of business. Based on management's assessment and the advice of legal counsel, it is not anticipated that the ultimate resolution of existing litigation will result in amounts in excess of recorded provisions that would be material to Ternium's consolidated financial position or results of operations.

*(i) Consorcio Siderurgia Amazonia Ltd.- PDVSA-Gas C.A. claim*

In June 2004, the arbitration proceedings brought by Sidor against PDVSA Gas, C.A. (on the basis that PDVSA Gas had charged Sidor higher than agreed-upon prices in its supplies of gas against the application of the most favored client clause) were resolved in Sidor's favor. Accordingly, in its financial statements at December 31, 2004, Sidor reversed the USD41.4 million provision it had recorded at December 31, 2003. In July 2004, PDVSA Gas, C.A. filed an appeal with the Venezuelan courts seeking to void the arbitral award. Sidor believes that applicable Venezuelan law does not allow the courts to void an arbitral award under the circumstances and that the likelihood of loss thereunder is remote. Accordingly, Sidor did not record any liabilities in connection with the appeal. At December 31, 2006, Sidor's potential exposure under this litigation amounted to USD125.7 million.

*(ii) Tax claims**(a) Siderar. AFIP Income tax claim for fiscal years 1995 to 1999*

The *Administración Federal de Ingresos Públicos* (AFIP - the Argentine tax authority) has challenged the charge to income of certain disbursements that Siderar has treated as expenses necessary to maintain industrial installations, which as such should be deducted in the year in which they take place. The AFIP asserts that these are investments or improvements that must be capitalized and, therefore, it made a jeopardy assessment of income tax due on a nominal tax basis plus fines and interest in fiscal years 1995 to 1999 amounting to approximately USD 20.4 million.

The Company appealed these assessments before the National Tax Court, as in the view of its legal and tax advisors, based on existing evidence and the work performed by the Tax Authorities, the Company would likely obtain a favorable ruling.

On April 13, 2005 the Company was notified of a ruling issued by the National Tax Court reducing the assessments made by the AFIP for fiscal years 1995 and 1996 by 13.9 million and instructing the recalculation of taxes in accordance with this ruling. The Company questioned the recalculation conducted by the AFIP, generating an incident that had favorable resolution to the criteria exposed by the Company. Consequently, in December, 2006 there was a payment of USD 0.1 million according to the Company's filing and the Fiscal Court's approval, which was then appealed by the AFIP.

Based on the above, the Company recognized a provision amounting to USD 4.6 million as of December 31, 2006 as management considers there is a probable cash outflow.

*(b) Sidor*

The Company recorded a provision for a total amount of USD26.3 million in connection with tax matters arising from compensations of tax credits made by the Company since the implementation of the V.A.T. law in June, 1999. The SENIAT, the Venezuelan tax and customs authority, is claiming the interest accrued on the application of those tax credits as payment on account of tax obligations.

*(iii) Commitments*

The following are the Company's main off-balance sheet commitments:

(a) In March 2003, Siderar entered into an agreement with Tecpetrol, a related company of Ternium, under which Siderar paid USD17.3 million for the advance purchase of a total of 725 million cubic meters (up to 400 thousand daily cubic meters) of natural gas to be delivered over a

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maximum period of 5 years on pricing terms that will enable it to share through discounts the impact of any increase in natural gas prices over that period with Tecpetrol. Under the terms of the agreement, Siderar will have a minimum guaranteed return on this advance payment equal to LIBOR plus 3.5%. At December 31, 2006 there is no residual advanced payment.

(b) Siderar entered into a contract with Tenaris, a related company of Ternium, for the supply of steam generated at the power generation facility that Tenaris owns in the compound of the Ramallo facility of Siderar. Under this contract, Tenaris has to provide 250 tn/hour of steam, and Siderar has the obligation to take or pay this volume. Tenaris detected technical problems at this facility that impeded the delivery of certain steam volume, between October 2004 and September 2005. This outsourcing contract is due to terminate in 2018.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****28 Contingencies, commitments and restrictions on the distribution of profits (continued)**

(c) On August 20, 2004, Sidor entered into a contract with its associated company Matesi Materiales Siderúrgicos S.A., for the supply of hot briquetted iron (HBI). Sidor commits to purchase 29.9% of Matesi's HBI production volume for the term of ten years. In addition, Sidor has the right to increase its proportion on Matesi's production by an extra 19.9 % until reaching a 49.8% of Matesi's HBI production. Under the contract, the sale price is determined on a cost-plus basis. The contract is renewable for additional three year periods unless Sidor or Matesi object to its renewal more than one year prior to its termination.

(d) Siderar entered into a contract with Transportadora de Gas del Norte (TGN) for gas transportation service. TGN charges Siderar a price that is equivalent on a comparable basis to prices paid by other industrial users, and the Argentine government regulates the general framework under which TGN operates. Siderar pays a monthly fee for reserved cubic meter (1,070 thousand m<sup>3</sup>/day), whether it uses it or not.

(e) Sidor's production process requires a large amount of electricity. On August 21, 1997, that company entered into a twenty-year contract with EDELCA, a Venezuelan state-owned company, for the supply of all of Sidor's electricity needs. This contract will terminate in 2018.

(f) Sidor's production process is heavily reliant upon supplies of natural gas. Sidor buys 100% of its natural gas from PDVSA-Gas, a Venezuelan state-owned natural gas supply company. In 1997, Sidor signed a twenty-year contract with PDVSA-Gas for the supply of natural gas.

(g) In 1998, Sidor signed a contract with Ternium's related company TAVSA Tubos de Acero de Venezuela S.A. (a Venezuelan seamless steel pipe producer controlled by Tenaris), under which it committed to sell up to 90,000 tons of blooms or 130,000 tons of liquid steel per year, until 2013. Purchase price varies in relation to changes in the costs of production.

(h) In 1997 Sidor entered into a twenty-year contract with Ferrominera del Orinoco ( FMO ) for the supply of iron ore. Pursuant to this contract, FMO will supply Sidor up to a maximum annual volume of iron ore needed to produce 6.6 million tons of pellets until 2017. Sidor and FMO entered into an amendment to the 1997 contract on November 11, 2005. The revised contract sets the iron ore price at the lower of the price charged by FMO to its customers (other than certain newly-created state-owned steel producers) in the Venezuelan domestic market, and 80% of a market reference price (that percentage may drop to 70%).

In connection with the iron ore contract, in 1997 Sidor and FMO entered into another agreement under which Sidor committed to sell, upon the request of FMO, up to 2 million tons per year of pellets to FMO, at a price based on the sale price at which FMO sells iron ore to Sidor plus an applicable margin paid to Sidor for the production of pellets, which is determined using market references.

(i) Hylsa's production process requires a large amount of electricity. On December 20, 2000, Hylsa entered into a 25-year contract with Iberdrola Energía Monterrey, S.A. de C.V. ( Iberdrola ), a Mexican subsidiary of the Spanish Company Iberdrola Energía, S.A., for the supply of a contracted electrical demand of 143.2 MW. This contract currently supplies approximately 42% of Hylsa's electricity needs with the remainder supplied by CFE, the Mexican state-owned utility. The contract with Iberdrola will terminate in 2027.

(j) Hylsamex S.A. de C.V. and subsidiaries entered into 21 long-term operating lease agreements for the rental of machinery, materials handling equipment, earth moving equipment, computers and assorted vehicles. Total amounts due, from 2007 to 2010, include USD24.9 million in lease payments. Total loss for lease payments recorded in the year ended December 31, 2006 accounts for USD 16.6 million.

Future minimum lease payments under non-cancellable operating leases are as follows:

| Year | USD<br>Thousands |
|------|------------------|
| 2007 | 12,394           |

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|              |               |
|--------------|---------------|
| 2008-2010    | 12,477        |
| <b>Total</b> | <b>24,871</b> |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****28 Contingencies, commitments and restrictions on the distribution of profits (continued)**

(k) On October 24, 2003, Siderar entered into a joint gas purchase agreement with Repsol-YPF. Under the agreement, which includes certain take-or-pay clauses, Siderar committed to purchase up to 400 million cubic meters of gas during the life of the four year contract, expiring at the end of 2006 at a price to be negotiated by the parties on an annual basis. At December 31, 2004, the parties to the joint agreement fulfilled the purchase commitments originated therein, as a result of which all outstanding obligations resulting from the take-or-pay provisions have ceased to exist. There is an agreement with Repsol-YPF to continue with the supply of natural gas up to February 28, 2007 under the same contractual conditions.

(l) On April 6, 2006, Sidor entered into a slag removal and raw material handling services contract with Sidernet de Venezuela C.A., for a total estimate amount of USD 155.9 million. The agreement is due to terminate in June 2016.

*(iv) Restrictions on the distribution of profits*

Under the credit agreements that financed the acquisition of Hylsamex, the Company and its affiliates have some restrictions to the payment of dividends in excess of certain amounts, among other limitations (see Note 3e)).

Under Luxembourg law, at least 5% of net income per year calculated in accordance with Luxembourg law and regulations must be allocated to a reserve until such reserve has reached an amount equal to 10% of the share capital.

Ternium may pay dividends to the extent that it has distributable retained earnings and distributable reserves calculated in accordance with Luxembourg law and regulations. Therefore, retained earnings included in the consolidated financial statements may not be wholly distributable.

Shareholders' equity under Luxembourg law and regulations comprises the following captions:

|  | <b>At December 31, 2006</b> |
|--|-----------------------------|
| Share capital  | 2,004,744                   |
| Legal reserve  | 200,474                     |
| Distributable reserves                                 | 402,149                     |
| Non distributable reserves                             | 1,414,122                   |
| Accumulated profit at January 1, 2006                  | 107,612                     |
| Profit for the year                                    | 392,230                     |
| <b>Total shareholders equity under Luxembourg GAAP</b> | <b>4,521,331</b>            |

**29 Earnings per share**

On December 30, 2004, the Company converted the currency in which its share capital is expressed from EUR to USD. The share capital of EUR 31,000, represented by 31 shares of EUR 1,000 nominal value each, was converted into USD 41,471.80, represented by 31 shares with no nominal value. On June 17, 2005, the share capital of the Company was restructured by setting the nominal value per share at USD 1 and dividing the 31 issued shares into 41,471 shares of USD 1 nominal value each, and further transferring USD 0.80 to the share premium account of the Company.

On June 29, 2005, ISL contributed all of its assets (including 41,470 shares of the Company) and liabilities to the Company, in exchange for 959,482,775 new shares of the Company.

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Upon consummation of this contribution, the 41,470 shares contributed by ISL to the Company were cancelled and the Company's issued share capital was increased to USD 959,482,776 represented by 959,482,776 shares of 1 USD nominal value each.

On September 15, 2005, ISL made a second contribution of all of its assets (including 750,021,919 shares of the Company) and liabilities to the Company, in exchange for 959,482,775 new shares of the Company.

Upon consummation of this second contribution, the 750,021,919 shares contributed by ISL to the Company were cancelled and the Company's issued share capital was increased to USD 1,168,943,632 represented by 1,168,943,632 shares of 1 USD nominal value each.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****29 Earnings per share (continued)**

In October 2005, Usiminas exchanged its 5.32% equity interest in Siderar, its 16.58% equity interest in Amazonia and its 19.11% equity interest in Ylopa and other items for 227,608,254 new shares of the Company.

Upon the consummation of this exchange, as of December 31, 2005 the capital was increased to USD 1,396,551,887 represented by 1,396,551,887 shares of 1 USD nominal value each.

Furthermore, in November 2005, Sidetur, a subsidiary of Sivensa, exchanged with ISL its 3.42% equity interest in Amazonia and USD 3.1 million in cash for shares of the Company.

As mentioned in Note 1, on January 11, 2006, the Company launched an Initial Public Offering of 24,844,720 ADSs (each representing 10 shares of the Company) in the United States. The Company's Initial Public Offering was settled on February 6, 2006.

As per the provisions contained in the Subordinated Convertible Loan Agreement, on February 6, 2006 the Company exchanged the Subordinated Convertible Loans (including interest accrued through January 31, 2006) held by ISL and converted them into shares at a conversion price of USD2 per share, resulting in the issuance of 302,962,261 new shares on February 9, 2006.

As provided in the Corporate Reorganization Agreement, on February 9, 2006, ISL contributed all of its assets and liabilities (including its interest in Amazonia) to the Company in exchange for 959,482,775 newly-issued shares of the Company after the settlement of the Initial Public Offering.

In connection with the over-allotment described in Note 1, on March 1, 2006, the Company issued 22,981,360 new shares.

Upon consummation of the transactions mentioned, as of December 31, 2006, the capital was increased to USD 2,004,743,442 represented by 2,004,743,442 shares, each having a nominal value of USD 1.00 each.

The Company's combined earnings per share for the year ended December 31, 2004 have been calculated based on the assumption that 1,168,943,632 shares were issued and outstanding in that period. For fiscal years 2006 and 2005, the weighted average of shares outstanding totaled 1,936,833,060 and 1,209,476,609 shares, respectively.

Earnings per share are calculated by dividing the net income attributable to equity holders of the Company by the daily weighted average number of ordinary shares outstanding during the year. The weighted average number of ordinary shares assumes that 1,168,943,632 shares were issued and outstanding as of January 1, 2003. Diluted earnings per share have been calculated giving effect to the conversion of the Subordinated Convertible Loans on the date each one was entered into.

|  | 2006          | 2005          | 2004          |
|--|---------------|---------------|---------------|
| Profit attributable to equity holders of the Company | 795,424       | 704,406       | 457,339       |
| Weighted average number of ordinary shares in issue  | 1,936,833,060 | 1,209,476,609 | 1,168,943,632 |
| Basic earnings per share (USD per share)             | 0.41          | 0.58          | 0.39          |
| Diluted earnings per share (USD per share)           | 0.41          | 0.54          | 0.39          |

**30 Related party transactions**

The Company is controlled by San Faustín, which at December 31, 2006 indirectly owned 70.52% of Ternium's shares and voting rights. The ultimate controlling entity of the Company is Rocca & Partners S.A., a British Virgin Island Corporation. For commitments with Related Parties

see Note 28.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****30 Related party transactions (continued)**

The following transactions were carried out with related parties:

|   | Year ended<br>December 31, |                |
|---|----------------------------|----------------|
|   | 2006                       | 2005           |
| <b>(i) Transactions</b>                                   |                            |                |
| <b>(a) Sales of goods and services</b>                    |                            |                |
| Sales of goods to associated parties                      | 1,650                      |                |
| Sales of goods to other related parties                   | 90,665                     | 36,978         |
| Sales of services to associated parties                   | 2,938                      | 2,905          |
| Sales of services to other related parties                | 1,608                      | 5,636          |
|   | <b>96,861</b>              | <b>45,519</b>  |
| <b>(b) Purchases of goods and services</b>                |                            |                |
| Purchases of goods from associated parties                | 75,751                     | 85,636         |
| Purchases of goods from other related parties             | 62,023                     | 71,205         |
| Purchases of services from associated parties             | 3,999                      |                |
| Purchases of services from other related parties          | 156,716                    | 21,792         |
|   | <b>298,489</b>             | <b>178,633</b> |
| <b>(c) Financial results</b>                              |                            |                |
| Income with associated parties                            | 3,820                      | 44,697         |
| Income with other related parties                         | 38                         | 89             |
| Expenses with other related parties                       | (1,815)                    | (10,043)       |
|   | <b>2,043</b>               | <b>34,743</b>  |
| <b>(ii) Year-end balances</b>                             |                            |                |
| <b>(a) Arising from sales/purchases of goods/services</b> |                            |                |
| Receivables from associated parties                       | 67,558                     | 71,317         |
| Receivables from other related parties                    | 48,533                     | 18,175         |
| Payables to associated parties                            | (5,588)                    | (13,644)       |
| Payables to other related parties                         | (48,032)                   | (17,914)       |
|   | <b>62,471</b>              | <b>57,934</b>  |
| <b>(b) Other investments</b>                              |                            |                |

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|   |         |           |
|---|---------|-----------|
| Time deposit                                    | 11,249  | 10,450    |
| <b>(c) Other balances</b>                       |         |           |
| Trust fund with other related parties (Note 21) |         | 5,185     |
|   |         | 5,185     |
| <b>(d) Financial debt</b>                       |         |           |
| Borrowings with other related parties (Note 27) | (2,161) | (607,472) |

**(iii) Officers and Directors compensation**

The aggregate compensation of Officers and Directors earned during the years ended December 31, 2006, 2005 and 2004 amounts to USD 10,276 thousand, USD 4,485 thousand and USD 3,050 thousand, respectively.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****31 Cash flow disclosures**

|   | At December 31,  |                 |                  |
|---|------------------|-----------------|------------------|
|   | 2006             | 2005            | 2004             |
| <b>(i) Changes in working capital (i)</b>     |                  |                 |                  |
| Inventories                                   | (271,480)        | (133,995)       | (114,686)        |
| Receivables and prepayments                   | 122,917          | 3,103           | (138,248)        |
| Trade receivables                             | (96,122)         | 97,814          | (55,273)         |
| Other liabilities                             | (93,472)         | 46,117          | 10,233           |
| Trade payables                                | 62,004           | 41,381          | 93,304           |
|   | <b>(276,153)</b> | <b>54,420</b>   | <b>(204,670)</b> |
| <b>(ii) Income tax accruals less payments</b> |                  |                 |                  |
| Tax accrued                                   | 262,356          | 218,492         | 177,486          |
| Taxes paid                                    | (280,431)        | (262,500)       | (57,276)         |
|   | <b>(18,075)</b>  | <b>(44,008)</b> | <b>120,210</b>   |
| <b>(iii) Interest accruals less payments</b>  |                  |                 |                  |
| Interest accrued                              | 112,918          | 81,608          | 18,257           |
| Debt issue costs                              | 13,686           | 3,171           |                  |
| Interest paid                                 | (122,407)        | (60,256)        | (9,174)          |
|   | <b>4,197</b>     | <b>24,523</b>   | <b>9,083</b>     |

(i) Changes in working capital are shown net of the effect of exchange rate changes.

**32 Recently issued accounting pronouncements****1. International Financial Reporting Standard 8, Operating Segments**

In November 2006, the International Accounting Standards Board issued International Financial Reporting Standard 8, Operating Segments (IFRS 8). IFRS 8 sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

An entity shall apply IFRS 8 in its annual financial statements for periods beginning on or after January 1, 2009. Earlier application is permitted. If an entity applies IFRS 8 in its financial statements for a period before January 1, 2009, it shall disclose that fact.

The Company's management has not assessed the potential impact that the application of IFRS 8 may have on the Company's financial condition or results of operations.

**2. IFRIC Interpretation 11, Group and Treasury Share Transactions**

In November 2006, IFRIC issued IFRIC Interpretation 11 Group and Treasury Share Transactions (IFRIC 11). IFRIC 11 gives guidance on how to account for certain transactions involving share-based payment arrangements and is effective for annual periods beginning on or after

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March 1, 2007, although earlier application is permitted. If an entity applies the Interpretation for an annual period beginning before March 1, 2007, it shall disclose that fact.

The Company's management estimates that the application of this Interpretation will not have a material effect on the Company's financial condition or results of operations.

### **3. IFRIC Interpretation 12, Service Concession Arrangements**

In November 2006, IFRIC issued IFRIC Interpretation 12 Service Concession Arrangements ( IFRIC 12 ). IFRIC 12 gives guidance on the accounting by operators for public-to-private service concession arrangements. This Interpretation sets out general principles on recognizing and measuring the obligations and related rights in service concession arrangements.

This Interpretation applies to public-to-private service concession arrangements if:

- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- (b) the grantor controls through ownership, beneficial entitlement or otherwise any significant residual interest in the infrastructure at the end of the term of the arrangement.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**32 Recently issued accounting pronouncements (continued)**

**3. IFRIC Interpretation 12, Service Concession Arrangements (continued)**

This Interpretation applies to both:

(a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and

(b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement.

An entity shall apply this Interpretation for annual periods beginning on or after January 1, 2008. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 January 2008, it shall disclose that fact.

The Company's management estimates that the application of this Interpretation will not have a material effect on the Company's financial condition or results of operations.

**33 Financial risk management**

**(1) Financial risk factors**

Ternium's activities expose the Company to a variety of risks, including the effects of changes in foreign currency exchange rates, interest rates and commodities prices. Ternium's subsidiaries may use derivative transactions to manage potential adverse effects of certain risk exposures on Ternium's financial performance.

*(i) Foreign exchange rate risk*

Ternium operates and sells its products in different countries, and as a result is exposed to foreign exchange rate volatility. Ternium's subsidiaries may use derivative contracts in order to hedge their exposure to exchange rate risk derived from their trade and financial operations.

Ternium aims to neutralize the negative impact of fluctuations in the value of other currencies with respect to the U.S. dollar. However, the fact that some subsidiaries have measurement currencies other than the U.S. dollar may, at times, distort the result of these efforts as reported under IFRS.

*(ii) Interest rate risk*

Ternium manages its exposure to interest rate volatility through its financing alternatives and hedging instruments. Borrowings issued at variable rates expose the Group to the risk of increased interest expense in the event of a raise in market interest rates, while borrowings issued at fixed rates expose the Group to a variation in its fair value. The Group's interest-rate risk mainly arises from long-term borrowings that bear variable-rate interest that is partially fixed through different derivative transactions, such as swaps and caps.

*(iii) Commodity price risk*

Ternium uses certain commodities and raw materials that are subject to price volatility caused by supply and weather conditions, political situations, financial variables and other unpredictable factors. As a result, the Company is exposed to the volatility in the prices of these

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commodities and raw materials. Ternium's policy is to manage this risk by partially fixing the underlying price or limiting its volatility for defined period.

### *(iv) Concentration of credit risk*

Ternium has no significant concentrations of credit risk from customers. No single customer accounts for more than five percent of Ternium's sales.

Ternium's subsidiaries have policies in place to ensure that sales are made to customers with an appropriate credit history, and that credit insurances, letters of credit or other instruments are requested to reduce credit risk whenever deemed necessary. These subsidiaries maintain allowances for potential credit losses.

Ternium's subsidiaries also have credit guidelines in place to ensure that derivative and treasury counterparties are limited to high credit quality financial institutions.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**33 Financial risk management (continued)**

**(1) Financial risk factors (continued)**

*(v) Liquidity risk*

Management maintains sufficient cash and marketable securities and credit facilities to finance normal operations. The company also has committed credit facilities to support its ability to close out market positions if needed.

**(2) Accounting for derivative financial instruments and hedging activities**

Derivative financial instruments are initially recognized in the balance sheet at cost and subsequently remeasured at fair value. Changes in fair value are disclosed under Financial income, net line item in the income statement. Ternium does not hedge its net investments in foreign entities.

Derivative transactions and other financial instruments, while providing economic hedges under risk management policies, do not qualify for hedge accounting under the specific rules in IAS 39. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting under IAS 39 are recognized immediately in the income statement. The fair value of derivative instruments is disclosed in Note 26.

**(3) Fair value estimation**

The estimated fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

For the purpose of estimating the fair value of financial assets and liabilities with maturities of less than one year, the Company uses the market value less any estimated credit adjustments. For other investments, including the trust fund, the Company uses quoted market prices.

As most borrowings include variable rates or fixed rates that approximate market rates and the contractual re-pricing occurs every 3 to 6 months, the fair value of the borrowings approximates its carrying amount and is not disclosed separately.

In assessing the fair value of derivatives and other financial instruments, Ternium uses a variety of methods, including, but not limited to, estimated discounted value of future cash flows using assumptions based on market conditions existing at each balance sheet date.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP****I. Differences in measurement methods**

The principal differences between IFRS and US GAAP as they relate to the Company are described below, together with an explanation, where appropriate, of the method used in the determination of the necessary adjustments.

|  | <b>For the year ended December 31,</b> |                |                |
|--|--|----------------|----------------|
|  | <b>2006</b>                            | <b>2005</b>    | <b>2004</b>    |
| Net income attributable to equity holders of the Company in accordance with IFRS | 795,424                                | 704,406        | 457,339        |
| US GAAP adjustments – income (expense)   |  |                |                |
| Valuation of fixed assets- PP&E (Note 34.a)                                      | 100,975                                | 123,824        | 79,493         |
| Troubled debt restructuring (Note 34.b)  | 8,923                                  | 14,820         |                |
| Accounting for pension plans (Note 34.c)   | (191)                                  | (991)          | (164)          |
| Inventory valuation (Note 34.d)  | 741                                    | (5,882)        | (1,628)        |
| Capitalization of interest cost- PP&E (Note 34.e)                                | 587                                    | (910)          | 152            |
| Capitalization of interest cost- Intangible assets (Note 34.e)                   | (185)                                  | (302)          | 313            |
| Changes in fair value of financial assets through profit and loss (Note 34.f)    |  | 50,819         | (1,361)        |
| Equity in investments in associated companies- Amazonia (Note 34.g)              |  |                | (76,926)       |
| Excess of fair value of assets acquired over cost (Note 34.h)                    | 20,395                                 | (170,510)      |                |
| Revaluation reserve over pre-acquisition interest in Amazonia (Note 34.i)        | 6,553                                  | 5,734          |                |
| Acquisition of minority interest in controlled subsidiaries (Note 34.j)          | (24,172)                               | (4,101)        |                |
| Valuation of intangible assets and other assets (Note 34.l)                      | (361)                                  | (674)          |                |
| Deferred income tax (Note 34.m)  | (39,004)                               | (51,315)       | (27,101)       |
| Minority interest (Note 34.n)  | (28,667)                               | (105,613)      | (5,462)        |
| <b>Net income in accordance with US GAAP</b>                                     | <b>841,018</b>                         | <b>559,305</b> | <b>424,655</b> |
| Weighted average number of shares outstanding (thousands)                        | 1,936,833                              | 1,209,477      | 1,168,944      |
| Consolidated basic earnings per share in accordance with U.S. GAAP               | 0.43                                   | 0.46           | 0.36           |
| Consolidated diluted earnings per share in accordance with U.S. GAAP             | 0.43                                   | 0.43           | 0.36           |

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2006</b>               | <b>2005</b> |
| Shareholders' equity in accordance with IFRS                              | 3,757,558                 | 1,842,454   |
| Valuation of fixed assets- PP&E (Note 34.a)                               | (1,300,420)               | (1,410,264) |
| Troubled debt restructuring (Note 34.b)                                   | (3,128)                   | (12,051)    |
| Accounting for pension plans (Note 34.c)                                  | (44,642)                  | 5,227       |
| Inventory valuation (Note 34.d)   | (14,596)                  | (14,854)    |
| Capitalization of interest cost- PP&E (Note 34.e)                         | 8,411                     | 7,083       |
| Capitalization of interest cost- Intangible assets (Note 34.e)            | 155                       | 344         |
| Excess of fair value of assets acquired over cost (Note 34.h)             | (247,147)                 | (267,542)   |
| Revaluation reserve over pre-acquisition interest in Amazonia (Note 34.i) | (79,409)                  | (85,962)    |
| Acquisition of minority interest in controlled subsidiaries (Note 34.j)   | 583,291                   | 470,850     |
| Equity securities issuance cost (Note 34.k)                               |                           | 5,456       |
| Valuation of intangible assets and other assets (Note 34.l)               | (1,871)                   | (1,300)     |
| Deferred income tax (Note 34.m)   | 448,134                   | 507,253     |
| Minority interest (Note 34.n)   | 329,180                   | 389,944     |



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|   |           |           |
|---|-----------|-----------|
| Shareholders' equity in accordance with US GAAP | 3,435,516 | 1,436,638 |
|---|-----------|-----------|

Changes in shareholders' equity under U.S. GAAP are as follows:

|   | Year ended December 31, |           |
|---|-------------------------|-----------|
|   | 2006                    | 2005      |
| Shareholders' equity at the beginning of the year in accordance with US GAAP                    | 1,436,638               | 954,255   |
| Net income for the year in accordance with US GAAP  | 841,018                 | 559,305   |
| Other comprehensive (loss) income   | (25,385)                | (424,116) |
| Capital increase  | 81,853                  | 54,758    |
| Conversion of Subordinated Convertible Loans  | 605,924                 |           |
| Initial public offering, net of offering costs of USD23,295                                     | 519,563                 |           |
| Cumulative effect adjustment due to the adoption of SFAS 158, net of tax and minority interests | (24,095)                |           |
| Usiminas exchange   |                         | 531,088   |
| Dividends paid in cash and other distributions  |                         | (238,652) |
| Shareholders' equity at the end of the year in accordance with US GAAP                          | 3,435,516               | 1,436,638 |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP (continued)***(a) Valuation of fixed assets - Property, plant and equipment*

Under IFRS, the Company applied the provisions of IFRS 1 for the revaluation of property, plant and equipment. Accordingly, the Company elected to use a technical revaluation as the deemed cost for its property, plant and equipment. This technical revaluation is not permitted under US GAAP and remains a difference between IFRS and US GAAP. Thus, no revaluations have been made for US GAAP purposes and historical cost has been used as the basis of accounting for these assets. The adjustment to net income represents the difference in depreciation expense under IFRS and U.S. GAAP.

*(b) Troubled debt restructuring*

In June 2003, Amazonia and Sidor concluded the restructuring of their financial indebtedness. Under IFRS, those companies accounted for their debt restructuring process in accordance with the guidelines set forth by IAS 39, which states that a substantial modification of the terms of an existing debt instrument (whether or not due to the financial difficulty of the debtor) should be accounted for as an extinguishment of the old debt. For purposes of IAS 39, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original debt instrument. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred are an adjustment to the carrying amount of the liability and are amortized over the remaining term of the modified loan. As the terms of Sidor's new debt were deemed to be substantially different (as this term is defined by IAS 39), that company recorded a USD59.5 million gain on restructuring in fiscal 2003.

Under US GAAP, Sidor followed the provisions contained in Statement of Financial Accounting Standards No. 15 - Accounting by Debtors and Creditors for Troubled Debt Restructurings (SFAS 15) which states that in the case of a troubled debt restructuring (as this term is defined by SFAS 15) involving a cash payment and a modification of terms, a debtor shall reduce the carrying amount of the payable by the total fair value of the assets transferred and no gain on restructuring of payables shall be recognized unless the remaining carrying amount of the payable exceeds the total future cash payments (including amounts contingently payable) specified by the terms of the debt remaining unsettled after the restructuring. Future interest expense, if any, shall be determined by applying the interest rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the payable. Based on the above, no gain on restructuring has been recorded by Sidor under US GAAP. The US GAAP adjustment to net income represents the difference in interest expense for the year arising from the application of a different effective interest rate under US GAAP as compared to IFRS.

*(c) Accounting for pension plans*

Under IFRS, the Company accounts for benefits granted to its employees in accordance with the provisions contained in International Accounting Standard No. 19 - Employee Benefits (IAS 19), which requires an enterprise to recognize (i) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and (ii) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Under US GAAP, the Company adopted Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158) effective December 31, 2006. SFAS 158 requires an employer to recognize the funded status of each of its defined pension and postretirement benefit plans as a net asset or liability in its consolidated balance sheet and to recognize as a component of accumulated other comprehensive (loss) income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost. Following the adoption of SFAS 158, additional minimum pension liabilities and related intangible assets are no longer recognized. The provisions of SFAS 158 are to be applied on a prospective basis; therefore, prior periods presented are not restated. The adoption of SFAS 158 resulted in the following impacts: the recognition of USD 46,243 in accrued pension liabilities, and a net charge of USD 24,095 (USD 51,279, net of income taxes of USD 17,801 and minority interest of USD 9,383) to accumulated other comprehensive (loss) income. Additionally, SFAS

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158 requires an employer to measure the funded status of each of its plans as of the date of its year-end balance sheet. This provision becomes effective for Ternium for its December 31, 2008 year-end. The funded status of Ternium's pension plans are currently measured as of December 31.

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**34 Reconciliation of net income and shareholders' equity to US GAAP (continued)**

Before the adoption of SFAS 158, as discussed above, the Company followed the guidance set forth by Statement of Financial Accounting Standard No. 87 - Employers' Accounting for Pensions ( SFAS No. 87 ), which contains provisions substantially consistent with those provided by IAS No. 19. Nevertheless, differences arose as a consequence of the following:

- a. Under IFRS Venezuela was considered a hyperinflationary country through December 31, 2002 while under US GAAP Venezuela ceased being hyperinflationary as from January 1, 2002. The effect of such a divergence gave rise to differences in the accounting for employee benefits.
- b. Under IFRS, past-service costs are recognized immediately as expenses, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period. Under US GAAP, past service costs are recognized over the remaining service lives of active employees.

*(d) Inventory valuation*

Under both IFRS and US GAAP, the Company values inventory at the lower of cost or net realizable value. Nevertheless, under IFRS, Venezuela was considered a hyperinflationary country through December 31, 2002, while, under US GAAP, Venezuela ceased being hyperinflationary as from January 1, 2002. Accordingly, for IFRS purposes, the historical cost of inventories has been adjusted to reflect the effects of inflation up to December 31, 2002, whereas under US GAAP, no inflation adjustment has been recorded.

As mentioned in Note 34.a above, under IFRS the value of property, plant and equipment has been determined based on a technical revaluation, while under US GAAP these assets have been stated at historical cost. Accordingly, the year-end balances and the annual depreciation charge under IFRS are higher than those determined under US GAAP. This US GAAP adjustment reflects the reversal of the difference between the amount of depreciation of property, plant and equipment allocated to inventories under IFRS and US GAAP.

*(e) Capitalization of interest cost*

Under IFRS, the Company follows the guidance set forth by International Accounting Standard No. 23 - Borrowing Costs ( IAS 23 ), which states that interest cost should be recognized as an expense in the period in which it is incurred. IAS 23 provides for an allowed alternative treatment under which interest cost that is directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. In case the allowed alternative treatment is applied, the amount of interest cost eligible for capitalization should be determined in accordance with IAS 23. However, for IFRS purposes, the Company elected to follow the general guidance contained in IAS 23 and interest cost has been expensed as incurred.

Under US GAAP, the Company applies the provisions of Statement of Financial Accounting Standards No. 34, Capitalization of Interest Cost ( SFAS No. 34 ), which requires interest capitalization on assets which have a period of time to get them ready for their intended use. In accordance with these requirements, interest was capitalized during the years ended December 31, 2006, 2005 and 2004. The net US GAAP adjustment also includes amortization of the interest cost capitalized.

*(f) Changes in fair value of financial assets through profit and loss*

The Company had certain investments in trust funds. Under IFRS, the Company carried these investments at fair value through profit or loss with unrealized gains and losses, if any, included in the statement of income.

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Under US GAAP, the Company carried these investments at market value with material unrealized gains and losses, if any, included in Other comprehensive income in accordance with Statement of Financial Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities ( SFAS No. 115 ). At December 31, 2005, the Company settled its available-for-sale investments and the unrealized gains recorded within other comprehensive (loss) income were reclassified into the statement of income.

### *(g) Equity in investments in associated companies*

Under both IFRS and US GAAP, investments in companies in which the Company exercises significant influence, but not control, are accounted for by the equity method. For purposes of the US GAAP reconciliation of net income and shareholders' equity for the year ended December 31, 2004, the Company included under this line item the effect of the differences mentioned in items a. to e. above related to its investment in Amazonia and Sidor, as well as the following:

Ternium recorded an impairment provision on its investment in Amazonia in previous years. In 2004, and due to better conditions in the economic environment market of Sidor and based on projections of future cash flows estimated by the Company's management, the impairment provision was reversed under IFRS. No impairment provision has been recorded under US GAAP.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP (continued)***(h) Excess of fair value of net assets acquired over cost*

As mentioned in Note 3(f), on February 3, 2005, Ylopa exercised its option to convert the outstanding balance of the Amazonia convertible debt instrument into newly issued shares of that company. As a result, Ternium's indirect participation in Amazonia increased from 31.03% to 53.47%. Under IFRS, this acquisition has been accounted for following the provisions contained in IFRS 3 Business Combinations (IFRS 3) and, accordingly, assets acquired and liabilities assumed have been valued at fair value. The excess of Ternium's interest in the net fair value of Amazonia's identifiable assets, liabilities and contingent liabilities over the purchase price (amounting to USD 188.4 million) has been recognized in income for the year.

Under US GAAP, the Company applied the provisions contained in Statement of Financial Accounting Standard No. 141 Business Combinations (SFAS No. 141), which states that the excess of fair value of acquired net assets over cost shall be allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired assets except (a) financial assets other than investments accounted for by the equity method, (b) assets to be disposed of by sale, (c) deferred tax assets, (d) prepaid assets relating to pension or other postretirement benefit plans, and (e) any other current assets. Accordingly, under US GAAP, the Company reversed the gain recognized for IFRS purposes. This adjustment also reflects the effect of the above-mentioned difference on the depreciation of fixed assets, totaling USD 20.4 million and USD 17.8 million, in 2006 and 2005, respectively.

*(i) Revaluation reserve over pre-acquisition interest in Amazonia*

As mentioned in Note 3(f), on February 3, 2005, the Company increased its equity interest in Amazonia from 31.03% to 53.47%. Under IFRS, this acquisition has been accounted for following the provisions contained in IFRS 3 and, accordingly, the Company recorded in equity (under Revaluation and other reserves line item) the excess of the fair value of its pre-acquisition interest in Amazonia's net assets over their corresponding carrying amounts.

For US GAAP purposes, the Company applied the provisions contained in SFAS No. 141. Under SFAS No. 141, when a company increases its shareholding interest in an equity investee, no fair value revaluation shall be made on the pre-acquisition equity interest held. This adjustment also reflects the effect of the above-mentioned difference on the depreciation of fixed assets.

*(j) Acquisition of minority interest in controlled subsidiaries*

As discussed in notes 1, 2 and 3 to the financial statements (i) in August 2005, the Company acquired an additional equity interest in Amazonia through the acquisition of Hylsamex; (ii) in October 2005, the Company acquired an additional equity interest in Ylopa, Amazonia and Siderar through the exchange transaction entered into with Usiminas; (iii) in February 2006, the Company acquired an additional equity interest in Amazonia through the issuance of shares to ISL, (iv) in April 2006, the Company acquired a 50% interest in Acerex S.A. de C.V. through its subsidiary Hylsa S.A. de C.V., and (v) in December 2006, the Company acquired an additional 4.85% equity interest in Siderar. Under IFRS, these acquisitions have been accounted for following the economic entity model, which requires that the acquisition of an additional equity interest in a controlled subsidiary be accounted for at its carrying amount at the acquisition date, with the difference resulting from the purchase price allocation being deducted from equity.

Under US GAAP, the acquisition of noncontrolling equity interests of a subsidiary should be accounted for using the purchase method, which requires the acquiring entity to allocate the cost of an acquired entity to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. Accordingly, under US GAAP, the Company (i) reversed the amounts charged to equity under IFRS in connection with the acquisition of additional equity interests in Amazonia, Ylopa, Siderar, and Acerex, and (ii) allocated the difference between fair value and carrying amount arising from the above mentioned acquisitions to net tangible and identifiable intangible assets and goodwill.

As discussed in Note 3(f), on February 3, 2005, the Company increased its equity interest in Amazonia from 31.03% to 53.47%. Under IFRS, this acquisition has been accounted for following the provisions contained in IFRS 3 and, accordingly, the Company recorded the interest

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attributable to minority equity holders of Amazonia at fair value. Under IFRS, the remaining minority interest in Amazonia (representing 5.6% and 10.9% of this company's share capital as of December 31, 2006 and 2005, respectively) has been valued at fair value. Under US GAAP, the interest of minority equity holders of Amazonia has been valued at pre-acquisition carrying amount of net assets. No reconciling item has been shown as the difference does not affect shareholders' equity or net income under US GAAP.

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP (continued)**

The chart below shows the net carrying amount of Property, plant and equipment and goodwill under IFRS and US GAAP after the application of all the above mentioned adjustments:

|  | Net carrying amount at December 31, |           |           |           |
|--|-------------------------------------|-----------|-----------|-----------|
|  | 2006                                |           | 2005      |           |
|  | IFRS                                | US GAAP   | IFRS      | US GAAP   |
| Property, plant and equipment              | 5,420,683                           | 4,122,749 | 5,463,871 | 3,967,401 |
| Goodwill                                   | 397,943                             | 659,818   | 399,694   | 610,330   |
| <i>(k) Equity securities issuance cost</i> |                                     |           |           |           |

Under IFRS, expenses incurred at December 31, 2005 in connection with the issuance of equity securities effected in 2006 (totaling USD 5.5 million) were deducted from shareholders' equity at that date.

Under U.S. GAAP, specific incremental costs directly attributable to a proposed or actual offering of securities may be deferred and charged against the gross proceeds of the offering. Accordingly, under US GAAP, this amount was deferred in 2005, and charged against the gross proceeds of the offering in 2006, together with additional costs of USD 17.8 million incurred in 2006, totaling USD 23.3 million.

*(l) Valuation of intangible assets and other assets*

Under both IFRS and US GAAP, the Company values intangible assets and other assets at historical cost. Nevertheless, as mentioned in Note 34.c above, under IFRS, Venezuela was considered a hyperinflationary country through December 31, 2002 while, under US GAAP, Venezuela ceased to be considered a hyperinflationary country as from January 1, 2002. Accordingly, for IFRS purposes, the historical cost of intangible assets and other assets has been adjusted to reflect the effects of inflation up to December 31, 2002, whereas under US GAAP, no inflation adjustment has been recorded.

*(m) Deferred income tax*

Under US GAAP the Company calculated the effect of all of the above mentioned adjustments on deferred income taxes.

*(n) Minority Interest*

This adjustment represents the effect on minority interest of all the foregoing differences between IFRS and US GAAP.

*(o) Net income*

Under US GAAP, net income is shown net of the portion of the Company's gain (loss) for the year attributable to minority shareholders. Accordingly, for US GAAP purposes, net income represents the gain (loss) attributable only to majority equity holders. Under IFRS, net income represents total gain (loss) obtained by the Company in a given period before offsetting the portion attributable to minority shareholders.

*(p) Cumulative translation differences exemption*

As mentioned in Note 4.(a), Ternium applied the cumulative translation differences exemption provided by IFRS 1 and, accordingly, has set the previously cumulative translation differences to zero at January 1, 2003. This exemption is not available under US GAAP. Nevertheless, this circumstance does not give rise to a difference between total shareholders' equity under IFRS and US GAAP, but to a reclassification within



shareholders' equity.

**II. Other significant US GAAP disclosure requirements**

The following is a summary of additional financial statement disclosures required under US GAAP:

*(a) Statement of consolidated comprehensive income under US GAAP*

Ternium applies the provisions contained in SFAS No. 130, Reporting Comprehensive Income, which requires that an enterprise (i) classify items of other comprehensive (loss) income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive (loss) income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position.

**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP (continued)**

|   | As of December 31, |           |
|---|--------------------|-----------|
|   | 2006               | 2005      |
| Net income for the year                               | 841,018            | 559,305   |
| Foreign currency translation adjustment               | (25,385)           | (39,247)  |
| Change in fair value of available for sale securities |                    | (384,869) |
| Total other comprehensive loss                        | (25,385)           | (424,116) |
| Comprehensive income                                  | 815,633            | 135,189   |

The accumulated balances related to each component of other comprehensive (loss) income were as follows:

|                                  | Foreign currency<br>translation<br>adjustment<br>for the year ended |           |
|----------------------------------|---|-----------|
|                                  | December 31,<br>2006  | 2005      |
| Balance at beginning of the year | (183,834)   | (144,587) |
| Decrease for the year            | (25,385)  | (39,247)  |
| Balance at end of the year       | (209,219)   | (183,834) |

|   | Changes in funded<br>status<br>of defined benefit<br>plans<br>for the year ended |      |
|---|--|------|
|   | December 31,<br>2006   | 2005 |
| Balance at beginning of the year  |  |      |
| Cumulative effect adjustment due to the adoption of SFAS 158, net of tax and minority interests | (24,095)   |      |
| Balance at end of the year  | (24,095)   |      |

Change in fair value  
of

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|                                  | financial assets   |           |
|----------------------------------|--------------------|-----------|
|                                  | for the year ended |           |
|                                  | December 31,       |           |
|                                  | 2006               | 2005      |
| Balance at beginning of the year |                    | 384,869   |
| Decrease for the year            |                    | (384,869) |
| Balance at end of the year       |                    |           |

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**Table of Contents****TERNIUM S.A.****Notes to the Consolidated Financial Statements (Contd.)****34 Reconciliation of net income and shareholders' equity to US GAAP (continued)***(b) Supplemental cash flow information***Details of acquisition of subsidiary companies and additional equity interests in controlled subsidiary companies:**

|   | For the year ended December 31, 2006 |              |               |                |         |
|---|--------------------------------------|--------------|---------------|----------------|---------|
|   | Impeco                               | Acerex       | Hylsamex      | Amazonia       | Siderar |
| <b>Non-cash assets acquired:</b>                                  |                                      |              |               |                |         |
| Inventories   | 8,180                                |              |               |                |         |
| Property, plant and equipment                                     | 47,825                               |              |               |                |         |
| Other assets  | 53                                   |              |               |                |         |
| <b>Total non-cash assets acquired</b>                             | <b>56,058</b>                        |              |               |                |         |
| <b>Liabilities assumed:</b>                                       |                                      |              |               |                |         |
| Deferred income tax   | (875)                                |              |               |                |         |
| <b>Total liabilities assumed</b>                                  | <b>(875)</b>                         |              |               |                |         |
| <b>Net non-cash assets acquired - Net assets acquired</b>         | <b>55,183</b>                        |              |               |                |         |
| <b>Net cash paid for acquired companies</b>                       | <b>55,183</b>                        |              |               |                |         |
| <b>Increase in shareholding interest in subsidiary companies:</b> |                                      |              |               |                |         |
| Minority interest   |                                      | 16,555       | 2,586         | 32,105         | 75,126  |
| Increase in fair value of net assets acquired                     |                                      |              |               | 23,473         | 32,374  |
| Goodwill  |                                      | 28,049       | 675           | 23,190         |         |
| <b>Purchase price paid</b>  | <b>44,604</b>                        | <b>3,261</b> | <b>78,768</b> | <b>107,500</b> |         |

|                                       | For the year ended December 31, 2005 |                  |         |
|---------------------------------------|--------------------------------------|------------------|---------|
|                                       | Hylsamex                             | Amazonia         | Siderar |
| <b>Non-cash assets acquired:</b>      |                                      |                  |         |
| Investments                           | 337,039                              | 9,875            |         |
| Trade accounts receivable             | 305,831                              | 188,978          |         |
| Other receivables                     | 72,069                               | 162,199          |         |
| Inventories                           | 345,053                              | 284,676          |         |
| Intangible assets                     | 133,079                              | 3,893            |         |
| Property, plant and equipment         | 2,129,325                            | 2,444,289        |         |
| Other assets                          | 7,032                                | 36,800           |         |
| <b>Total non-cash assets acquired</b> | <b>3,329,428</b>                     | <b>3,130,710</b> |         |

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**Liabilities assumed:**

|                         |           |           |
|-------------------------|-----------|-----------|
| Trade accounts payable  | (234,325) | (371,908) |
| Current tax liabilities | (19,000)  | (7,630)   |
| Borrowings              | (751,730) | (656,658) |
| Pension benefits        | (116,860) | (78,425)  |
| Deferred income tax     | (449,537) | (284,242) |
| Other liabilities       | (21,521)  | (35,666)  |
| Provisions              |           | (37,163)  |

**Total liabilities assumed** (1,592,973) (1,471,692)

**Net non-cash assets acquired** 1,736,455 1,659,018

Cash acquired 215,411 305,342

**Net assets acquired** 1,951,866 1,964,360

Minority interest (160,576) (1,338,320)

Pre-acquisition interest in Amazonia (323,229)

Goodwill (excess of fair value of net assets acquired over cost) 405,388 (220,767)

Non-cash assets surrendered (82,044)

**Purchase price paid for acquired companies** 2,196,678

Cash acquired (215,411) (305,342)

**Net cash paid (received) for acquired companies** 1,981,267 (305,342)

**Increase in shareholding interest in subsidiary companies:**

Minority interest 109,171 54,432

Increase in fair value of net assets acquired 116,424 38,404

Goodwill 149,391 61,244

**Purchase price paid** 374,986 154,080

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**TERNIUM S.A.**

**Notes to the Consolidated Financial Statements (Contd.)**

**34 Reconciliation of net income and shareholders' equity to US GAAP (continued)**

*(c) Recently issued accounting pronouncements*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on the consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 ( FIN 48 ), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires financial statement recognition of the impact of a tax position, if that position is more likely than not to be sustained on examination, based on the technical merits of the position. The provisions of FIN 48 will be effective for financial statements issued for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The company is currently evaluating the impact of FIN 48 on the consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140 (SFAS 156). SFAS 156 requires recognition of a servicing asset or liability at fair value each time an obligation is undertaken to service a financial asset by entering into a servicing contract. SFAS 156 also provides guidance on subsequent measurement methods for each class of servicing assets and liabilities and specifies financial statement presentation and disclosure requirements. This statement is effective for fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of SFAS 156 on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company on January 1, 2008. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

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**SIGNATURES**

The registrant hereby certifies that it meets all the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

June 29, 2007

TERNIUM S.A.

By: /s/ Roberto Philipps

Name: Roberto Philipps

Title: Chief Financial Officer

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| <b>Exhibit<br/>Number</b> | <b>Description</b>  |
|---------------------------|---|
| 1.1                       | Updated and Consolidated Articles of Association of Ternium S.A., dated as of March 17, 2006*   |
| 2.1                       | Deposit Agreement entered into between Ternium S.A. and The Bank of New York**  |
| 4.1                       | Participation Agreement ( Contrato de Cuentas en Participacion ), dated June 20, 2003, between Sidor, C.A. and Ylopa Servicios de Consultadoria, Lda., as amended and supplemented as of October 15, 2003 and November 18, 2004***                                  |
| 4.2                       | Participation Agreement ( Contrato de Cuentas en Participacion ), dated June 20, 2003, between Sidor, C.A. and Corporacion Venezolana de Guayana, as amended and supplemented as of October 15, 2003 and November 18, 2004***                                       |
| 4.3                       | Form of Corporate Reorganization Agreement, between Ternium S.A. and Inversora Siderurgica Limited****  |
| 4.4                       | Shareholders Agreement, dated July 20, 2005, between I.I.I. Industrial Investments Inc. and Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS***   |
| 4.5                       | Shareholders Agreement, dated January 9, 2006, between Tenaris S.A. and Inversora Siderurgica Limited****   |
| 4.6                       | Contribution and Subscription Agreement, dated as of September 15, 2005, among Usinas Siderurgicas de Minas Gerais S.A. USIMINAS, SLP 11.785 A/S (to be renamed Usiminas Europa A/S ) and Ternium S.A. ***  |
| 4.7                       | Convertible and Subordinated Loan Agreement, dated as of July 28, 2005, among I.I.I. Industrial Investments Inc., I.I.I. Industrial Investments Inc. and Ternium S.A. (formerly Zoompart Holding S.A. )***  |
| 4.8                       | Convertible and Subordinated Loan Agreement, dated as of July 28, 2005, among I.I.I. Industrial Investments Inc., Tenaris S.A. and Ternium S.A. (formerly Zoompart Holding S.A. )***  |
| 4.9                       | Second Convertible and Subordinated Loan Agreement, dated as of August 16, 2005, among I.I.I. Industrial Investments Inc., Tenaris S.A. and Ternium S.A. (formerly Zoompart Holding S.A. )***   |
| 4.10                      | Convertible and Subordinated Loan Agreement, dated as of August 4, 2005, among I.I.I. Industrial Investments Inc., Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS and Ternium S.A. (formerly Zoompart Holding S.A. )***   |
| 4.11                      | Second Convertible and Subordinated Loan Agreement, dated as of August 18, 2005, among I.I.I. Industrial Investments Inc., Usinas Siderurgicas de Minas Gerais, S.A. USIMINAS and Ternium S.A. (formerly Zoompart Holding S.A. )***                                 |
| 4.12                      | Convertible and Subordinated Loan Agreement, dated as of August 16, 2005, among I.I.I. Industrial Investments Inc., Techintrade Corp. and Ternium S.A. (formerly Zoompart Holding S.A. )** *  |
| 4.13                      | Second Amended and Restated Credit Agreement, dated August 16, 2005, among I.I.I. Industrial Investments Inc., Citibank N.A., as administrative and collateral agent and the banks and financial institutions named therein, as amended as of September 21, 2005*** |
| 4.14                      | Ternium Accession Agreement, dated as of September 22, 2005, between I.I.I. Industrial Investments Inc. and Ternium S.A.** *  |
| 8.1                       | List of subsidiaries of Ternium S.A.  |
| 12.1                      | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 12.2                      | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 13.1                      | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 13.2                      | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

\* Incorporated by reference to the Annual Report on Form 20-F, filed by Ternium S.A. on June 30, 2006 (File No. 001-32734).



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\*\* Incorporated by reference to the Registration Statement on Form F-6, filed by Ternium S.A. on January 11, 2006 (File No. 333-130952).

\*\*\* Incorporated by reference to the F-1 Registration Statement filed by Ternium S.A. on January 11, 2006 (File No. 333-130950).

\*\*\*\* Incorporated by reference to the F-1 Registration Statement filed by Ternium S.A. on January 27, 2006 (File No. 333-130950).