

11. Financial risk management

The Entity is exposed to market, operating and financial risks as a result of its use of financial instruments, these include interest rate, credit, liquidity and exchange rate risks, which are managed in a centralized manner by the corporate treasury. The Entity seeks to minimize its exposure to these risks by contracting hedges based on derivative financial instruments. The use of financial derivatives is governed by the Entity policies approved by the board of directors, which provide written principles of recruiting them. Compliance with policies and exposure limits is reviewed by the internal auditors on a continuous basis.

The different financial instrument categories and amounts at December 31, 2014 and 2013, are detailed below:

	2014	2013
Financial assets		
Cash and cash equivalents	\$ 7,777,439	\$ 6,898,520
At amortized cost:		
• Held-to-maturity financial assets	6,313,231	3,654,983
• Accounts receivable in the short and long-terms, Net	18,482,150	21,479,049
• Due from related parties	2,672,542	3,813,538
Measured at fair value:		
• Derivative financial instruments	214,006	255,585
Financial liabilities		
At amortized cost:		
• Loans with financial institutions and long-term debt	\$ 7,720,326	\$ 8,882,871
• Payables to suppliers	8,535,817	9,086,008
• Due to related parties	1,211,685	2,014,008
• Other payables, accrued liabilities, long-term provisions and the fair value adjustment as part of the gain on the sale of stock PMM	5,670,962	4,944,222
Measured at fair value:		
• Derivative financial instruments	671,170	841,098

The Board of Directors establishes and monitors the policies and procedures used to measure risks, which are described below:

- a. **Capital risk management** - The Entity manages its capital to ensure that it will continue as a going concern, while it maximizes returns to its shareholders through the optimization of the balances of debt and equity. The capital structure of the Entity is composed by its net debt (mainly the bank loans, in and debt securities detailed in Note 19) and stockholders' equity (issued capital, capital reserves, retained earnings and non-controlling equity detailed in Note 22). The Entity is not subject to any kind of capital requirement.

Management reviewed monthly its capital structure and borrowing costs and their relation to EBITDA (defined in this case as earnings before taxes, interest, exchange rate fluctuations, valuation of derivative financial instruments, depreciation and amortization) in connection with the preparation of financial projections as part of the business plan submitted to the Board of Directors and shareholders. The Entity's policy is to maintain a net debt ratio of no more than three times EBITDA, determined as the ratio of net debt to EBITDA of the last 12 months.

The net debt ratio of the Entity is presented below:

	2014	2013
Loans with financial institutions and other	\$ 7,720,326	\$ 8,882,871
Cash and cash equivalents	(7,777,439)	(6,898,520)
Investments in securities held to maturity	(6,313,231)	(3,654,983)
Cash surplus with financial institutions	\$ (6,370,344)	\$ (1,670,632)
EBITDA	10,606,017	18,699,382
Net debt ratio	(0.60) times	(0.09) times
EBITDA	\$ 10,606,017	\$ 18,699,382
Interest expense on debt	440,199	581,374
Interest coverage ratio	24.09 times	32.16 times

- b. **Interest rate risk management** - The Entity is exposed to interest rate risks from customer loans and financial debt contracted at variable rates. The Entity has short-term loans primarily for working capital and in some cases has long-term loans that are intended for certain projects whose completion will meet their obligations, and in some cases, depending on the proportion of short-term debt and long term, are contracted interest rate hedges (swap contracts). Hedging activities are regularly evaluated to ensure that they are properly aligned with interest rates and the respective risks and to facilitate the application of more profitable hedge strategies. Hedge contracts are detailed in Note 13.

The Entity's exposure to interest rate risks is primarily based on the Mexican Interbank Equilibrium Offered rate (TIIE) applicable to financial liabilities and its customer portfolio. Accordingly, it periodically prepares a sensitivity analysis by considering the cost of the net exposure from its customer portfolio and financial liabilities derived that earn and bear interest at variable interest rates; it also prepares an analysis based on the amount of outstanding credit at the end of the period.

If benchmark interest rates had increased and/or decreased by 100 basis points in each reporting period and all other variables had remained constant, the pretax profit of 2014 and 2013 would have increased or decreased by approximately \$107,101 and \$135,367, respectively. At December 31, 2014 and 2013, there would have been no effect on other comprehensive income because the derivative financial instruments in effect at that date were designated as held-for-trading, thereby directly affecting the result of the year.

c. Exchange risk management -

- i. The functional currency of the entity is primarily the Mexican peso. Accordingly, it is exposed to currency risk Mexican peso against U.S. dollar that arises in connection with retail operations and financing. In some cases, these same operations give a natural hedge, while in other cases, currency forwards are entered into in order to hedge such operations. Because the Entity has investments in foreign subsidiaries, it is exposed to the risk of foreign currency translation. The foreign operations maintain monetary assets and liabilities denominated in various currencies, mainly the U.S. dollar, euro and Brazilian real, resulting in exposure to foreign exchange risk, which is naturally hedged by the same business operations. The carrying values of monetary assets and liabilities denominated in foreign currency and which primarily generate exposure for the Entity at the end of the reporting period, are as follows (figures in thousands):

	Liabilities		Assets	
	2014	2013	2014	2013
U.S. dollars (US)	416,226	409,437	414,307	551,387
Euro (EU)	4,466	9,945	9,163	9,499
Brazilian real (RA)	84,289	47,242	167,705	107,935
Colombian peso	22,120,084	27,461,721	30,529,342	35,665,325
Peruvian new sol	43,120	40,971	63,007	69,188

The following table indicates the Entity's sensitivity to a 10% increase or decrease of the Mexican peso versus the US dollar and other foreign currency. This percentage is the sensitivity rate used to internally report the exchange rate risk to key management personnel and also represents management's evaluation of the possible fair value change to exchange rates.

The sensitivity analysis only includes monetary items denominated in foreign currency and adjusts their conversion at the end of the period by applying a 10% fluctuation; it also includes external loans. A negative or positive figure, respectively (as detailed in the following table), indicates a (decrease) or increase in net income derived from a decrease in the value of the Mexican peso of 10% with regard to the US dollar (figures in thousands):

	Capital ⁽¹⁾		Liabilities		Assets	
	2014	2013	2014	2013	2014	2013
U.S. dollars	-	-	(41,623)	(40,944)	41,431	55,139
Euro	(1,898)	342	(447)	(995)	916	950
Brazilian real	-	-	(8,429)	(4,724)	16,771	10,794
Colombian peso	-	-	(2,212,008)	(2,746,172)	3,052,934	3,566,533
Peruvian new sol	-	-	(4,312)	(4,097)	6,301	6,919

⁽¹⁾ Represents the results of changes to the fair value of derivative instruments designated as cash flow hedges.

- ii. Forwards contracts denominated in foreign currency

The Entity designated certain forwards contracts denominated in foreign currency as cash flow hedges intended for the acquisition of raw materials.

The following table indicates the forwards contracts denominated in foreign currency in effect at the end of the reporting period:

	Average exchange		Notional		Fair value	
Cash flow hedges	2014	2013	2014	2013	2014	2013
Euro purchase						
Less than one month	17.6588	16.9644	\$ 869	\$ 232	\$ (1,506)	\$ (32)
More than 12 months	17.6588	16.9644	\$ 14,768	\$ 5,340	\$ (25,606)	\$ 4,922

- d. **Credit risk management** - The credit risk refers to the situation in which the borrower defaults on its contractual obligations, thereby generating a financial loss for the Entity and which is essentially derived from customer accounts receivable and liquid funds. The credit risk affecting cash and cash equivalents and derivative financial instruments is limited because the counterparties are banks with high credit ratings issued by credit rating agencies. The Entity's maximum credit risk exposure is represented by the balance in the statement of financial position. The other exposure to credit risk is represented by the balance of each financial asset principally in trade receivables. The Entity sells its products and /or services to customers, who have demonstrated financial solvency, and periodically assesses the financial condition of its customers and maintains billing insurance contracts for domestic and export sales. Therefore, the Entity does not believe there is a significant risk of loss due to a concentration of credit in its customer base in the retail sector, as they are diluted by more than 1,804,000 customers, which do not represent a concentration of risk. In regards to industrial and infrastructure and construction, although the credit concentration risk is higher accounts receivable are covered by collections insurance in some cases. The Entity also believes that potential credit risk is adequately covered by its allowance for doubtful accounts, which represents its estimate of incurred losses related to impairment of accounts receivable (see Note 8).

- e. **Liquidity risk management** - Corporate Treasury has the ultimate responsibility for liquidity management, and has established appropriate policies to control this through monitoring of working capital, managing short, medium and long-term funding requirements, maintaining cash reserves and available credit lines, continuously monitoring cash flows (projected and actual), and reconciling the maturity profiles of financial assets and liabilities.

The following table details the remaining contractual maturities of the Entity's non-derivative financial liabilities, based on contractual repayment periods. The table has been designed based on un-discounted projected cash flows of financial liabilities based on the date on which the Entity must make payments. The table includes both projected cash flows related to interest and capital on financial debt in the statements of financial position. Where the contractual interest payments are based on variable rates, the amounts are derived from interest rate at the end of the period. The contractual maturities are based on the dates on which the Entity shall make each payment.

The amounts contained in the debt to credit institutions include interest rate instruments and fixed as detailed in Note 19. If changes in variable interest rates differ to those estimates of interest rates determined at the end of the reporting period under review, is presented at fair value.

The Entity expects to meet its obligations with cash flows from operations and resources received from the maturity of financial assets. Additionally, the Entity has access to credit lines with various banks and debt securities programs.

As of December 31, 2014	Weighted average effective interest rate	3 months	6 months	1 year	Between 1 and 3 years	Total
Loans with financial institutions and others	MN 4.36% US 0.69% EU 0.76% RA 5.50%	\$ 2,718,354	\$ 1,776	\$ 170	\$ 5,000,026	\$ 7,720,326
Payables to suppliers		8,346,821	140,162	48,834	–	8,535,817
Due to related parties		1,211,685	–	–	–	1,211,685
Other accounts payable and accrued liabilities		–	–	4,001,657	–	4,001,657
Fair value adjustment as part of the gain on the sale of stock PMM		–	–	1,669,305	–	1,669,305
Derivative financial instruments		11,644	3,485	13,600	642,441	671,170
Total		\$ 12,288,504	\$ 145,423	\$ 5,733,566	\$ 5,642,467	\$ 23,809,960

As of December 31, 2013	Weighted average effective interest rate	3 months	6 months	1 year	Between 1 and 3 years	More than 3 years	Total
Loans with financial institutions and others	MN 4.56% US 1.15% EU 0.71% RA 5.50%	\$ 3,108,300	\$ –	\$ 41,209	\$ 733,362	\$ 5,000,000	\$ 8,882,871
Payables to suppliers		8,904,682	145,117	36,209	–	–	9,086,008
Due to related parties		2,014,008	–	–	–	–	2,014,008
Other accounts payable and accrued liabilities		–	–	3,647,201	–	–	3,647,201
Derivative financial instruments		15,680	705	1,463	823,250	–	841,098
Long provisions		–	–	–	1,297,021	–	1,297,021
Total		\$ 14,042,670	\$ 145,822	\$ 3,726,082	\$ 2,853,633	\$ 5,000,000	\$ 25,768,207

f. Market risk - The Entity's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates and commodities. The Entity enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk and interest rate risk, including:

- Forward foreign exchange contracts to hedge the exchange rate risk arising on the export of products and loans in other currencies.
- Swaps interest rate swaps to mitigate the risk of rising financing cost.
- Forward foreign exchange contracts to hedge the exchange rate risk arising on translation of investment in a foreign operation with functional currency different from the Mexican peso.
- Commodities contracts to hedge risks of fluctuations in the prices of certain metals.

Exposure to market risk is measured using sensitivity analysis. There have been no changes in exposure to market risks or the manner in which those risks are being managed and measured.

If commodity prices had an increase and / or decrease of 10% in each reporting period and all other variables held constant, profit before tax for the years 2013 and 2012 for the next period would have (decreased) increased by approximately \$182,243 and \$187,327, respectively.