3. FINANCIAL RISK MANAGEMENT

3.1 FINANCIAL RISK FACTORS

The group's activities are exposed to a number of financial risk factors: market risk (including currency exchange risk, fair value risk associated to the interest rate and price risk), credit risk, liquidity risk and cash flow risks associated to the interest rate. The group maintains a risk management program that focuses its analysis on financial markets to minimise the potential adverse effects of those risks on the group's financial performance.

Financial risk management is headed by the Financial Department based on the policies approved by the Board of Directors. The treasury identifies, evaluates and employs financial risk hedging measures in close cooperation with the group's operating units. The Board provides principles for managing the risk as a whole and policies that cover specific areas, such as the currency exchange risk, the interest rate risk, the credit risk and the investment of surplus liquidity.

a) Market risk

i) Currency exchange risk

The currency exchange risk is very low, since the group operates mainly in the Iberian market. Bank loans are mainly in euros and acquisitions outside the Euro zone are of irrelevant proportions.

Although the Group holds investments outside the euro-zone in external operations, in Angola, due to the reduced size of the investment, there is no significant exposure to currency exchange risk. Angolan branch loans in the amount of 3.750.000 USD does not provide material exposure to currency exchange rate due to its reduced amount and to the strong correlation between USA dollar and local currency. The remaining loans are in local currency, the same as the revenues.

ii) Price risk

The group is not greatly exposed to the merchandise price risk.

iii) Interest rate risk (cash flow and fair value)

Since the group does not have remunerated assets earning significant interest, the profit and cash flow from investment activities are substantially independent from interest rate fluctuations.

The group's interest rate risk follows its liabilities, in particular long-term loans. Loans issued with variable rates expose the group to the cash flow risk associated to interest rates. Loans with fixed rates expose the group to the risk of the fair value associated to interest rates. At the current interest rates, in financing of longer maturity periods the group has a policy of totally or partially fixing the interest rates.

The unpaid debt bears variable interest rate, part of which has been the object of an interest rate swap. The interest rate swap to hedge the risk of a 20 million euros (commercial paper programmes) loan has the maturity of the underlying interest and the repayment plan identical to the terms of the loan. Moreover, the Group has cash and cash equivalents covering about 40% of the loans in which the remuneration covers interest rate changes on the debt.

Based on simulations performed on 31 December 2013, an increase of 100 basis points in the interest rate, maintaining other factors constant, would have a negative impact in the net profit of 118.000 euros.