# EBRO 2012

# FINANCIAL INFORMATION

# CORPORATE SOCIAL RESPONSABILITY

# CORPORATE GOVERNANCE

## CONSOLIDATED DIRECTORS' REPORT

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# EBRO FOODS GROUP
# CONSOLIDATED DIRECTORS' REPORT FOR 2012
# (EXPRESSED IN THOUSANDS OF EUROS)

## 1. ANALYSIS OF 2012

### BACKDROP

As announced at 2011 year-end, the macroeconomic backdrop was complex in 2012. The euro zone experienced significant financial instability in the first half of the year, closing with an annual contraction of its GDP and an overall rise in the unemployment rate which affected Southern European countries to a larger degree and threatens to spread to France (in particular) and Germany. The US economy maintained a precarious balance between a highly expansive monetary policy driven by the US Federal Reserve, which spurred consumer demand and a recovery in the property market, and the need to overcome the so-called "fiscal cliff". Lastly, the developing economies (particularly China and Brazil) continued to gain momentum, albeit hesitantly, benefiting other exporting economies dependent on raw material prices.

Against this complex backdrop, there are nevertheless grounds for optimism due to the increased financial stability of the euro zone and the endeavours made towards fiscal consolidation, which have enabled the most depressed economies to increase their competitiveness. In parallel, there are signs of improvement in consumer confidence indicators, although this has not yet been reflected in changes in activity.

In general, analysts agree that, although many steps must be taken to be able to affirm that the crisis has effectively been overcome, the risk of it deepening or of the main risk factors worsening is lower.

The slowdown in consumption in the euro zone and strong pressure on brands and prices continued. In the US, despite an improvement in private consumption and household indebtedness, price continued to be an essential factor in purchase decisions.

Grain markets remained fairly stable, with prices falling until the summer, when certain tensions were unleashed by the drought in the US and uncertainties about crop yields. This situation led to an increase in the price of certain products, particularly soy beans and corn, although it also affected the price of wheat. Lastly, the confirmation that the wheat harvest reached the expected level and the good level of ending wheat stocks eased the upward pressure on prices towards the end of the year.

Rice prices dropped slightly with some exceptions depending on the type or origin of grain arising from the policies of certain governments (Thailand) or the devastating drought in Texas which has affected harvests in recent years although, in general, expectations are favourable and final stock forecasts point to all-time highs. Favourable aspects worthy of note include the opening of borders in Egypt and a good harvest of Australian medium-size grain, which drove down the prices for this type of rice. There is complete uncertainty with regard to the situation in Thailand, with out-of-market prices and a considerable amount of subsidised grain -around 18.5 million tonnes of paddy rice- in the warehouses.

## GROUP EARNINGS

Net profit from continuing operations grew by 4.5%. The double-digit rise in the AAGR over the last three years (+10.8%) and the growth in the main income statement aggregates has ensured profit levels remained strong and stable despite the complex backdrop.

Revenue grew by 13.1% year-on-year due to the full inclusion for the entire year of the acquisitions made in 2011. The change also reflects the adjustments made to the prices and discounts of the new brand portfolio adapted to the Group's profit structure and the disposal of the Nomen brand and other smaller brands as a result of the conditions established by the Spanish National Competition Commission on approving the acquisition of the SOS rice business in Spain.

EBITDA increased by 9.7% with respect to 2011, with an AAGR of 5.8% during the period 2010-2012. This was mainly driven by the rice business, where the inclusion of the acquisition of SOS contributed EUR 27 million and where the Riviana business in the US achieved more than satisfactory growth of 19.4%.

The Group's most significant economic aggregates are as follows:

CONSOLIDATED FIGURES

| (Thousands of euros) | 2010 | 2011 | *2011-2010* | 2012 | *2012-2011* | *AAGR 2012-2010* |
|---|---|---|---|---|---|---|
| Net Sales | 1,688,957 | 1,804,111 | *6.8%* | 2,041,266 | *13.1%* | ***9.9%*** |
| EBITDA | 267,479 | 273,106 | *2.1%* | 299,576 | *9.7%* | ***5.8%*** |
| *% of net sales* | *15.8%* | *15.1%* | | *14.7%* | | |
| EBIT | 211,573 | 224,022 | *5.9%* | 242,295 | *8.2%* | ***7.0%*** |
| *% of net sales* | *12.5%* | *12.4%* | | *11.9%* | | |
| Profit before tax | 192,504 | 222,393 | *15.5%* | 247,901 | *11.5%* | ***13.5%*** |
| *% of net sales* | *11.4%* | *12.3%* | | *12.1%* | | |
| Income tax | (63,532) | (70,750) | *(11.4%)* | (89,450) | *(26.4%)* | ***18.7%*** |
| *% of net sales* | *(3.8%)* | *(3.9%)* | | *(4.4%)* | | |
| Consolidated profit for the year (continuing operations) | 128,972 | 151,643 | *1.6%* | 158,451 | *4.5%* | ***10.8%*** |
| *% of net sales* | *7.6%* | *8.4%* | *0.0%* | *7.8%* | *0.0%* | |
| Net profit | 259,970 | 0 | *(100.0%)* | 0 | | ***(100.0%)*** |
| *% of net sales* | *15.4%* | *0.0%* | *0.0%* | *0.0%* | *0.0%* | |
| Net profit | 388,797 | 151,542 | *(61.0%)* | 158,592 | *4.7%* | ***(36.1%)*** |
| *% of net sales* | *23.0%* | *8.4%* | | *7.8%* | | |
| Average working capital | 237,222 | 252,916 | *(6.6%)* | 337,378 | *(33.4%)* | |
| Capital employed | 995,309 | 1,007,686 | *(1.2%)* | 1,212,424 | *(20.3%)* | |
| ROCE **(1)** | 21.3 | 22.2 | | 20.0 | | |
| Capex | 69,617 | 66,596 | (4.3%) | 52,930 | *(20.5%)* | |
| Average headcount | 4,850 | 4,920 | *1.4%* | 4,884 | *(0.7%)* | |
| | **12-31-10** | **12-31-11** | ***2011-2010*** | **12-31-12** | ***2012-2011*** | |
| Equity | 1,592,743 | 1,587,298 | *(0.3%)* | 1,692,209 | *6.6%* | |
| Net debt | 17,600 | 390,073 | *2116.3%* | 244,804 | *(37.2%)* | |
| Average net debt | 378,336 | 139,157 | *(63.2%)* | 294,114 | *111.4%* | |
| Leverage **(2)** | 0.24 | 0.09 | | 0.17 | | |
| Total assets | 2,885,030 | 2,710,608 | | 2,719,717 | | |

**(1)** ROCE = (Profit(Loss) from operations AAR over last twelve months / (Intangible assets - Property, plant and equipment - Working capital)

**(2)** Ratio of average net financial debt and borrowing costs divided by equity (excluding non-controlling interests)

The profitability measured using the EBITDA to Sales ratio dropped slightly to 14.7%, due mainly to the lower returns of the pasta business in the US and a worse sales ratio in the US of the ARI brands acquired in 2011 which we are repositioning in our product portfolio. Accordingly, the return on capital employed (ROCE) dropped to 20%. ROCE was calculated with annual average working capital at 2012 year-end considerably higher than in 2011. Therefore, despite this drop in the ratio at 2012 year-end, the slight improvement in working capital led to a reduction in indebtedness with respect to 31 December 2011.

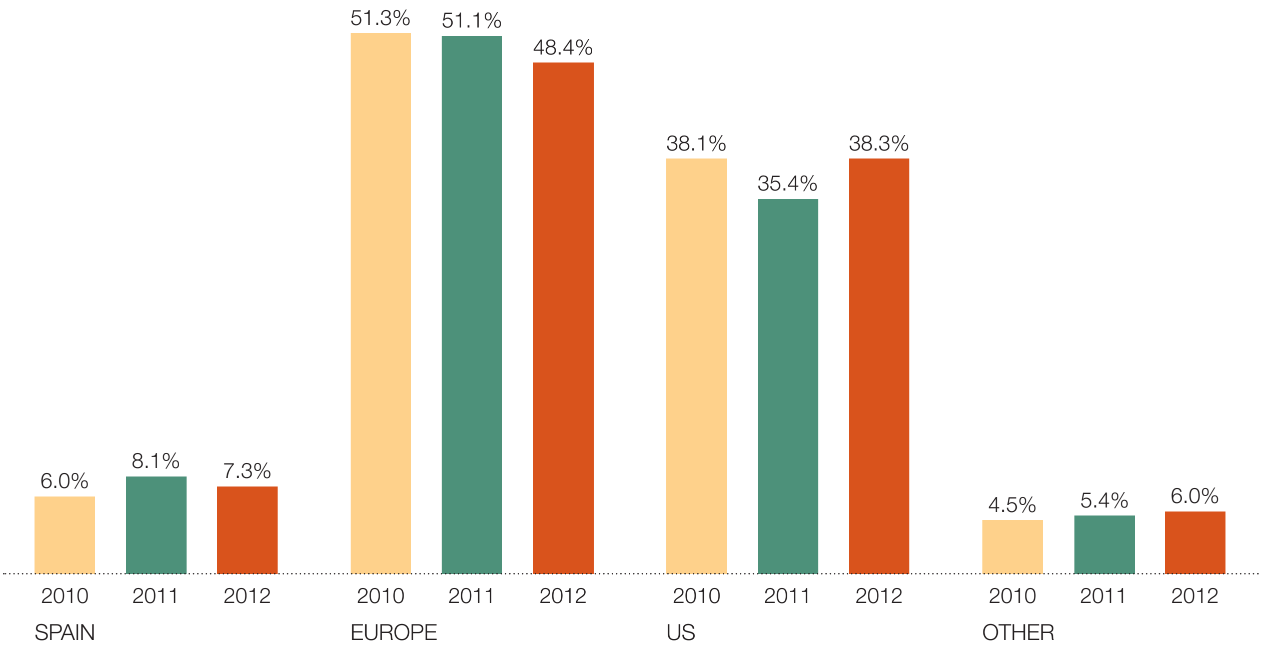
Profit from continuing operations improved due to the increase in resources generated in operations and the positive balance of the non-recurring transactions, although this was partially offset by the increase in finance charges on the borrowings required to purchase the SOS rice business.

Net profit from discontinued operations reflects the net gains arising from the sale of businesses and those relating to its operations until the effective sale date. Therefore, the most significant portion of this profit reflects the gain from the sale of the dairy product business in 2010.

### THE EBRO FOOD STRATEGY

- **Low risk exposure.** The Group's structure affords a geographically balanced source of income. The Group is present in developed countries that the management teams know well and where it is possible to share resources and develop synergies. The growth strategy places particular emphasis on these synergies: high value added products in countries with high consumer demand and seeking possible openings in developing countries with high potential. The detail of sales, by geographical area, is as follows:

**Geographical areas**




The recently announced acquisition of 25% of the share capital of the Italian company Riso Scotti Spa. -leader in the market for the special rice variety used to make risotto in Italy- accords well with this strategy. The company's portfolio includes many high value added products (rice and soy bean milk, rice biscuits, rice bran oil, ready meals, etc.) targeted at the premium segment.

Also, the acquisition of the Abu Bint brand, which has expanded the Group's presence in the Middle East (representing 2.75% of total sales) and the recently announced acquisition of a rice processing plant in India evidence the firm steps taken in high-potential countries.

Also, a low-levered financial position makes growth possible without exposure to financial storms.

- **Differentiation and innovation.** Ebro Foods is firmly committed to investment in products along two lines; major innovation and development (R&D+i) and firm backing of leading brands in its business areas.

  In 2012 the Group expanded the distribution of frozen rice in the US (Minute Steamers) by introducing it at the country's largest distributor, which gave rise to 600% revenue growth for this product. New ready-to-serve rice varieties were introduced, for which there is already an extensive recipe database, recording steady 17% growth.

  In Europe, significant research and development efforts led to two major cutting-edge innovations: the confirmation of Sabroz (the first round rice that cannot be overcooked and absorbs all the flavour) as the fifth commercial brand in Spain and the launch of a new potato-based product line in France (Noisettes and Cubes) for pan-frying which has far exceeded sales forecasts.

- **Growth and consolidation of synergies.** Ebro Foods is a Group specialising in food with a large presence in the US and Europe and a growing presence in the markets where raw materials are sourced. Companies are acquired on the basis of selective criteria in areas that enable synergies to be amply integrated.

  No Yolks and Wacky Mac were added to the brands of the former SOS rice business discussed earlier, the full business potential of which, although fully integrated, will not be harnessed until 2013.

Growth and innovation depend on an investment strategy that requires that virtually all of the production capacity of the instant rice and fresh pasta segments be renewed. Comparable CAPEX (eliminating the investments of the discontinued businesses) in the last three years is as follows:

| YEAR | Amount (thousands of euros) |
|---|---|
| 2010 | 64,691 |
| 2011 | 66,596 |
| 2012 | 52,930 |

In 2012 the most significant investments relate to the fresh pasta plant located on the outskirts of Lyon, which is aimed at increasing the capacity of all dishes of this type (such as gnocchi) to be pan-fried or the new potato-based dish line. Another ambitious project that commenced at the end of 2012 and will require significant investments in the future is that of rice-based ingredients.

## FINANCIAL POSITION

The debt position continued to be highly satisfactory.

| NET DEBT | CONSOLIDATED FIGURES | | | | |
|---|---|---|---|---|---|
| (Thousands of euros) | 2010 | 2011 | *2011-2010* | 2012 | *2012-2011* |
| Equity | 1,592,743 | 1,587,298 | *(0.3%)* | 1,692,209 | *6.6%* |
| Net debt | 17,600 | 390,073 | *2116.3%* | 244,804 | *(37.2%)* |
| Average net debt | 378,336 | 139,157 | *(63.2%)* | 294,114 | *111.4%* |
| Leverage | 1.1% | 24.6% | *2123.9%* | 14.5% | *(41.1%)* |
| Leverage, average debt **(1)** | 23.8% | 8.8% | *(63.1%)* | 17.4% | *98.3%* |
| EBITDA | 267,479 | 273,106 | *2.1%* | 299,576 | *9.7%* |
| Hedge | 0.07 | 1.43 | | 0.82 | |

**(1)** Ratio of average net financial debt and borrowing costs divided by equity (excluding non-controlling interests)

Hedging ratios were very positive, enabling high investment capacity and organic or inorganic growth. The changes in the level of debt to free cash flow generation can be seen in the following table:

| CONSOLIDATED FIGURES | | | |
|---|---|---|---|
| (Thousands of euros) | 2010 | 2011 | 2012 |
| Cash flow from operating activities | 199,490 | 58,496 | 220,734 |
| Cash flow from investing activities | 531,126 | (253,662) | (37,029) |
| Cash flow from treasury share transactions | (95,401) | (177,232) | (44,296) |
| **Free cash flow** | **635,215** | **(372,398)** | **139,409** |

In 2011 the rise in the price of raw materials triggered a considerable increase in the use of operating cash due to the increase in working capital, although in 2012 the situation stabilised to normal levels. The major changes that took place in other lines related to the purchase or sale of businesses (investment) and the distribution of dividends or treasury share transactions (financing).

## MAIN BUSINESSES

The Ebro Foods Group is organised around the following business areas:

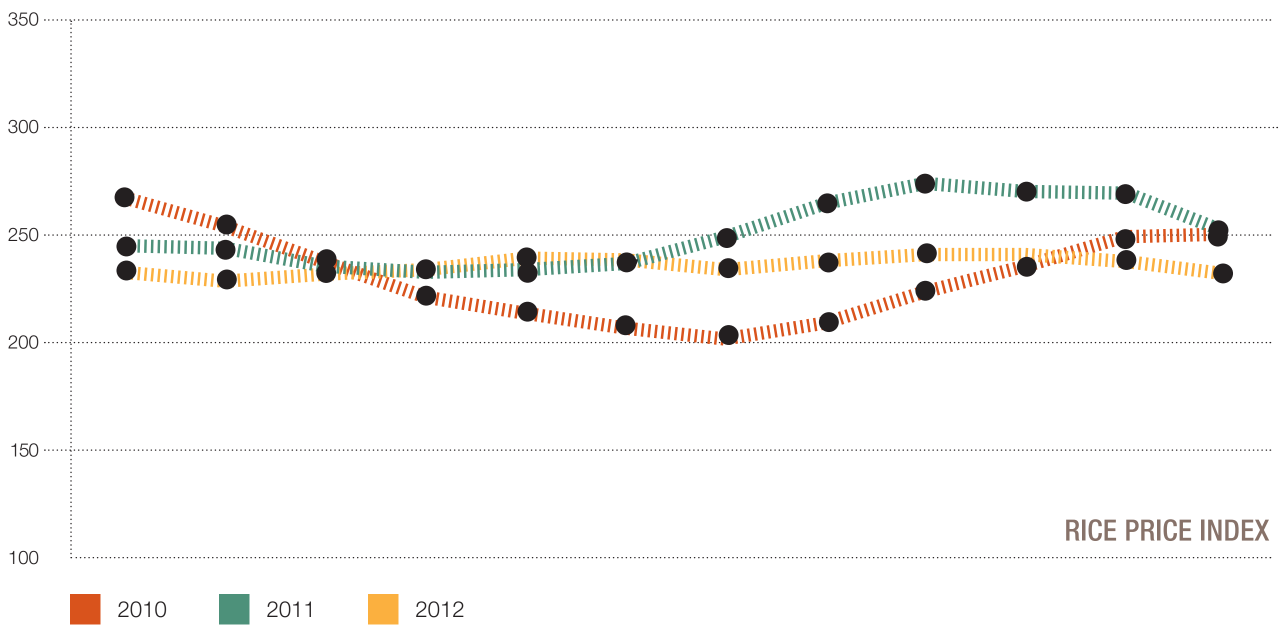
- **Rice Business:** includes the industrial and branding activities in relation to rice and other products. The Group operates throughout Europe, the Mediterranean region, the Middle East, North America and Thailand through Herba, Riviana and ARI (US).
- **Pasta Business:** includes the production and marketing of dry and fresh pasta, sauces and semolina carried on by the Panzani, New World Pasta and Birkel Groups.
- **Other Businesses:** include the management of real estate assets and other activities related to foodstuffs and the management of the various businesses.

## RICE

### RICE BUSINESS

| (Thousands of euros) | 2010 | 2011 | *2011-2010* | 2012 | *2012-2011* | *TAMI 2012-2010* |
|---|---|---|---|---|---|---|
| Net sales | 811,558 | 920,752 | *13.5%* | 1,105,738 | *20.1%* | ***16.7%*** |
| EBITDA | 123,263 | 135,953 | *10.3%* | 161,035 | *18.4%* | ***14.3%*** |
| EBIT | 99,019 | 113,698 | *14.8%* | 133,927 | *17.8%* | ***16.3%*** |
| Profit from operations | 103,024 | 103,056 | *0.0%* | 130,021 | *26.2%* | ***12.3%*** |
| Average working capital | 181,782 | 231,686 | *(27.5%)* | 298,822 | *(29.0%)* | |
| Capital employed | 506,347 | 582,158 | *(15.0%)* | 729,081 | *(25.2%)* | |
| ROCE | 19.6 | 18.8 | | 18.4 | | |
| Capex | 37,855 | 26,950 | *(28.8%)* | 19,105 | *(29.1%)* | |

- As indicated in the reflection on the overall climate in 2012, prices remained steady with record highs in world production. Although the last long-grain harvest in Europe, South America and the US was not as bountiful, the possibility of exporting from other origins calmed local tensions such as those triggered by the drought in the US, particularly in Texas, and price restrictions in Thailand.
- Changes took place in the list of major exporters, traditionally led by Thailand and currently exceeded by India, Vietnam and the inclusion of countries such as Egypt, which have brought stability to medium-grain prices.



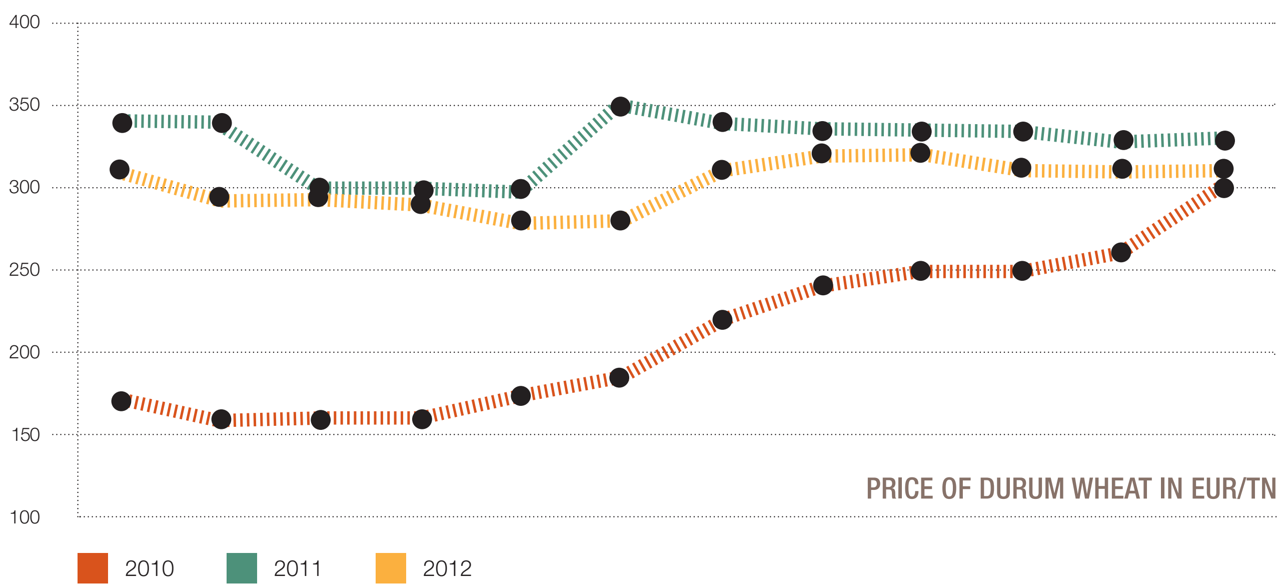
- Local sales increased due to the inclusion of the new businesses (EUR 196 million) and the impact of the exchange rate on sales made in US dollars, mitigated by the drop in industrial sales due to the scarcity of Spanish paddy rice varieties. Revenue from the retail area was practically identical to that of 2011 after discounting the smaller contribution of the Nomen brand.
- EBITDA grew 18.4% year-on-year or EUR 25 million, of which EUR 12 million related to the SOS brand and another EUR 12 million to the growth of Riviana, which recorded an all-time high. Conversely the contribution of the Nomen brand was lost -calculated at approximately EUR 5 million annually- although ARI's contribution increased by EUR 5 million with respect to 2011.
- Riviana's outstanding results were due to the improved efficiency of the Memphis factory, which is already working to full capacity, volume growth in the "Ready to Serve" line -with highly successful local production- and to improved profitability of wild rice varieties and rice-based products arising from advantageous positions in the supply thereof.
- The slight contraction in the area's ROCE was due to the lower profitability of ARI's business in the US, which has undoubted upside potential once its brands have been repositioned and taking into account the export potential of the Abu Bint brand.
- The main investments made in the area related to equipment for improving the productivity of the Memphis plant (USD 4 million) and to those made in the ingredients project in the Netherlands (EUR 3.5 million).

## PASTA

**PASTA BUSINESS**

| (Thousands of euros) | 2010 | 2011 | *2011-2010* | 2012 | *2012-2011* | *TAMI 2012-2010* |
|---|---|---|---|---|---|---|
| Net sales | 916,101 | 928,297 | *1.3%* | 982,226 | *5.8%* | ***3.5%*** |
| EBITDA | 160,484 | 144,457 | *(10.0%)* | 145,370 | *0.6%* | ***(4.8%)*** |
| EBIT | 133,741 | 119,064 | *(11.0%)* | 116,634 | *(2.0%)* | ***(6.6%)*** |
| Profit from operations | 122,806 | 107,798 | *(12.2%)* | 108,002 | *0.2%* | ***(6.2%)*** |
| Average working capital | 60,427 | 69,173 | *(14.5%)* | 90,115 | *(30.3%)* | |
| Capital employed | 442,061 | 456,917 | *(3.4%)* | 520,880 | *(14.0%)* | |
| ROCE | 30.3 | 26.1 | | 22.4 | | |
| Capex | 32,652 | 38,095 | *16.7%* | 33,574 | *(11.9%)* | |

- The price of durum wheat remained stable, albeit with a slight downward trend until the summer and the tensions created by other harvests such as soybean and corn. Nevertheless, a better harvest than in 2011 in the US and Canada returned prices to normal levels, narrowing the price difference with respect to other varieties. In any case, prices remained high.



- The two business units performed very differently. Whereas in Europe Panzani led the market, achieving volume growth across its product portfolio, NWP encountered the opposite strategy from its competitors in the US, which gave rise to a base price differential that also affected our shelf positioning.
- The market also witnessed opposing trends, growing in France (2.3% in dry pasta, 3.4% in fresh pasta) and shrinking in the US (3.4% in dry pasta). However, in both cases the market share of private brands and initial prices increased in relative terms.
- As a result of the situation mentioned in the preceding paragraphs, despite the growth in sales arising from the excellent performance of Panzani and the inclusion of the No Yolks and Wacky Mac brands, revenues from this area remained largely unchanged.
- EBITDA grew by 0.6%, although the Compound Average Growth Rate (CAGR) reflects a 4.8% decrease in revenue from New World Pasta in the last two years, which in 2010 had posted outstanding earnings. After a period of intense reflection, the current situation made it advisable to change strategy in order to narrow the gap in base prices that was eroding volumes in the US and leading to various costly promotional initiatives that are less effective in the long term.
- CAPEX was focused on facilities to improve the capacity and productivity of fresh products (EUR 8 million), the acquisition of land for a new fresh products factory on the outskirts of Lyon (EUR 5 million) and the work carried out to complete the assembly of the new pasta lines at Saint Louis.

## 2. OUTLOOK FOR THE GROUP

2013 does not herald radical changes in the current crisis situation, which has been ongoing for five years. Despite the fact that certain early indicators seem to suggest a degree of improvement in consumer confidence and that the worst-case scenarios for the financial system and the “fiscal cliff” appear to be receding, uncertainties nevertheless remain and unemployment rates and purchasing power continue to hold back recovery in most developed economies. As mentioned earlier with regard to 2012, “the price factor will foreseeably be considered to a greater extent by a certain percentage of the population and brands are likely to have to go the extra mile to stand out and achieve a price-quality balance”, i.e. the market is rife with difficulties and maintaining robust solvency levels is a triumph in itself.

Prices are expected to remain stable in the rice and wheat markets, particularly in the case of durum wheat, whereas certain aromatic rice varieties has suffered pricing pressures.

### RICE BUSINESS

The commitment to innovation will be extended to both sides of the Atlantic. There will be new developments in the Sabroz line, with new rice combinations and cooking stock. Riviana has an extensive assortment of products for its Minute microwave range and other healthy easy-to-cook products.

Also, the new facilities of Herba ingredients came into service, progressively integrating the capability dedicated to special flours and rice-based products from the plants located in Belgium and the Netherlands. The wide range of possibilities tested at the San José de la Rinconada pilot plant evidence the Group's long-term commitment to innovation.

The new rice processing plant in India will commence its activity as the Group's Basmati rice supply point.

**PASTA**

The Group is still committed to innovation and to making fresh products the focus of growth. Construction of the new Lyon fresh pasta factory will be under way in 2013, which will be a keystone of this strategy.

The change in strategy at New World Pasta has been underway since the beginning of 2013. The objective is to bring non-promotional prices into line with those of competitors at US retailers. The new strategy includes a marketing plan that increases advertising expenditure for the purpose of enhancing the value of our brands and launching a new range of sauces that completes our "meal solutions" offering.

## 3. R&D+I ACTIVITIES

Ebro Foods has always been a step ahead of new consumer trends and is an international benchmark in the research and development of products applied to the food industry. Aware that R&D+i is an essential tool for the implementation of its quality and differentiation strategy, in 2012 the Group continued its unwavering commitment in this connection.

The total investment made in 2012 amounted to EUR 5.5 million, which was distributed between internal resources (EUR 3.8 million) and external resources (EUR 1.7 million).

The Group has built its R&D+i engine around research centres in France, the US and Spain. These centres and the main projects carried out in the year are:

1. CEREC, located in St. Genis Laval (France), with eight employees, oriented towards developing the pasta division's range of fresh pasta, fresh pre-cooked meals and sauces. In 2012 the Group's activity focused on extending its potato-based product range (such as "cubes à rissoler"), developing and renewing the Bolognese sauce range, new stuffed products for pan frying and new cheese sauces.

2. CRECERPAL, located in Marseilles, with eight technicians working in a raw material testing and analysis laboratory, focuses research on the development of the category of durum wheat, dry pasta, couscous and new food processing technologies applied to cereals. In 2012 efforts were directed mainly towards improving pasta production processes and extending the pan-fried rice and quick-cooking rice ranges.

3. In the US, with four employees dedicated to the development of new products, processes and technologies or to the adaptation thereof for the rice and pasta divisions in the US. Their work is focused on the preparation of new healthy, gluten-free products, the launching and adaptation of new Healthy Harvest and Garden Delight sauces and fine tuning of the packaging production lines for new products which were previously manufactured in Spain.

4. Centres associated with the Herba Group in Moncada (Valencia), and the new plant in San José de Rinconada, with 15 researchers dedicated to developing new and/or improved products and technologies and to technical assistance in the areas of rice technology and rice-based products for the modern hospitality industry, i.e. fast-food and catering. The most important project under way is the development of a functional flour and rice-, cereal- and legume-based ingredients line which is the basis of a completely new line of business.

## 4. TREASURY SHARE TRANSACTIONS

In 2012, the Parent made treasury share purchases and sales pursuant to authorisations granted by the shareholders at the Annual General Meetings held on 15 June 2011 and 29 May 2012, and, in accordance with current legislation, the Spanish National Securities Market Commission (CNMV) was notified accordingly. In 2012 409,720 shares were purchased, 2,255,161 shares sold and 1,538,653 treasury shares delivered to shareholders as dividends payable (see Note 18.3). At 31 December 2012, the Company did not have any treasury shares.

## 5. EMPLOYEES

The number of employees at Ebro Foods continued to grow with the inclusion of new companies and businesses. This situation allows for the integration of diverse cultures and skills with a constant flow of information and knowledge.

## 6. RISK AND FINANCIAL INSTRUMENT MANAGEMENT OBJECTIVES AND POLICIES

The Ebro Foods Group, influenced by the conceptual framework of the “Committee of Sponsoring Organizations of the Treadway Commission” (COSO) report over internal control has implemented certain risk identification, measurement, management and reporting systems.

In 2011 the Group developed a risk map, managed with the aid of a software tool called GIRO. The risk map includes a risk matrix for the whole Group and by individual company, including the probability of occurrence of these risks, their related impact and the protocols to be put in place to mitigate these risks. The main risks, their associated processes and control mechanisms are reviewed each year.

The ultimate objective of these risk control systems is to safeguard the interests of our shareholders, customers, employees and our corporate environment. At the same time, these systems guarantee the corporate reputation and financial soundness of the Ebro Foods Group on an ongoing basis.

The main risks and the control systems in place to mitigate them are as follows.

### RISKS SPECIFIC TO THE INDUSTRY IN WHICH THE ACTIVITY IS CARRIED ON

**Legal/Regulatory risk.** The Group is subject to, and its operations are affected by, the legislation of numerous countries and international organisations. This legislation establishes rules ranging from production quotas to trading prices or tariff protection. To counter the related risk, the Group opted to apply a policy of geographical and product diversification.

The Group is also exposed to the risk of not being able to adequately protect is brands and intellectual property. Therefore, the Group exhaustively monitors its intellectual property and protects its use with the competent agencies, applying for the appropriate patents wherever necessary.

**Environmental and food quality risk.** The Group's environmental policy is based on the principle of compliance with the legislation in force at any given time, for which purpose the Group has defined, developed and implemented a quality, environmental and food safety management system that meets the requirements of the UNE-EN-ISO 9001:2000/8, UNE-EN-ISO 14001:2004 and ISO 22000:2005 standards under which many of the Group's production centres have been certified.

The food safety and quality programmes are based on the monitoring of protocols that aim to identify and control certain Hazard Analysis and Critical Control Points (HACCP) to ensure that residual risk is minimal. The main control points are grouped into:

- **Physical points.** Controls to detect materials unrelated to the product or the presence of metals.
- **Chemical points.** Detection of chemical elements or the presence of allergens.
- **Biological points.** Presence of elements such as salmonella or other types of pathogens.

Most of the handling processes have obtained IFS (International Food Security) certificates and the US pasta plants are on the verge of obtaining Global Food Safety Initiative (GFSI) compliance certification.

Furthermore, the Group has undertaken various initiatives to reduce gas emissions and atmospheric waste, improve water quality and reduce waste discharges, improve energy efficiency and water conservation, as well as recycling programmes for physical waste such as paper, aluminium and other materials.

The Group provides its employees with adequate and ongoing training in areas relating to food safety and occupational health and safety.

Lastly, the Group has taken out several insurance policies that cover the risks relating to food safety.

**Supply risk.** The business activities carried on by Ebro Foods depend on the supply of raw materials such as rice and durum wheat. The Group is exposed to the risk of not receiving sufficient raw materials of a quality that is in line with the Group's standards at an appropriate price. To cater for this risk the Group acts along two lines:

**a.** Diversifying the sources of supply, going to the main production markets if it is considered that in doing so a competitive advantage is gained. The Group currently has supply points in Thailand, India, Uruguay, the US, Spain and Italy.
**b.** Entering into long-term supply agreements and cooperation agreements with the suppliers that the Group considers to be important for the business.

**Competition / installed capacity-related risk.** The consumer goods industry is threatened by possible surplus installed capacity, which becomes more apparent at low points in the economic cycle and increased competition at low prices. Once more, the best guarantee against this type of risk is innovation and ongoing product differentiation. Also, the Group endeavours to keep up to date and renew its production structure by retiring the assets that it does not consider to be sufficiently efficient (restructuring in Germany) and by investing in new factories (Memphis, Haryana and Lyon).

### RISKS SPECIFIC TO THE EBRO FOODS GROUP

**Risks to production assets.** The exposure of the Group's principal assets to catastrophic natural events such as earthquakes and floods is limited. Also, all the Group companies insure all of their assets, capital goods and inventories by taking out the related policies.

**Country risk.** The Group carries on activities in certain countries classified as "developing countries". This situation means that certain investments are affected by the typical risks associated with these countries such as possible political changes that might affect market conditions, restrictions on the movement of capital, nationalisation of assets or devaluations of reference currencies. Ebro Food´s presence in these countries is limited and in most cases it is restricted to taking positions to optimise supply (primarily rice). In view of these possible contingencies, the Group opted to diversify the risks with a presence in Europe, the Americas, Asia (Thailand and India) and Africa (Morocco and Egypt).

**Risk related with the Group's growth strategy.** The Group's strategy to be leaders in "Meal Solutions" entails the possibility of making certain acquisitions. These acquisitions can have a negative impact if there is a failure to fully integrate the companies, brands and processes acquired both from a standpoint of possible interruptions in the generation of cash flow and from an accounting standpoint through impairment losses on the assets acquired. To combat this situation, Ebro Foods implements certain practices to minimise acquisition risk, most notably including:

- Performance of due diligence reviews with firms of renowned prestige.
- Negotiation of the end price based on risk analysis.
- Request for guarantees until the resolution of litigation or the definitive clarification of the risk.
- Deferred payment or bank guarantee in the event of possible contingencies.

Also, certain investment alternatives (organic growth) may represent a risk if the expected success is not achieved. In order to cater for these risks, all the investment projects include risk analysis, which enables them to be assessed on an economic and strategic basis, prior to taking any decisions. These decisions are taken by the corresponding body, on the basis of the established limits, and the most significant projects (those amounting to more than EUR 2 million) require the approval of the Board of Directors.

**Risk related with the R&D+I technological delay.** Through its research and development subsidiaries, the Group supports its main business lines by facilitating product and process development and innovation. The practical application is guaranteed through the constant launch of a broad line of products supported through sufficient advertising and promotional coverage.

**Occupational risk.** This relates to both attracting human resources and limiting labour risks. Accordingly, the Group promotes both personal incentive and remuneration schemes for the main executives tied to results and fosters the improvement of working conditions. There are also specific programmes designed to promote an enhanced working environment and to maximise protection levels, which most notably include training courses for Group employees.

## FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

The Group's principal financial instruments include bank loans, bank overdraft facilities, equity instruments, cash and short-term deposits. Also, the Group has other financial assets and liabilities such as trade receivables and payables.

These financial instruments give rise to market risks due to changes in interest rates, exchange rates or the fair value of certain financial instruments, liquidity risk and credit risk.

In order to manage the foreign currency and interest rate risk arising from the Group's operations and, on occasions, the risk relating to possible changes in the price of certain raw materials (gas), the Group arranges derivatives, basically in the form of interest rate and foreign currency forwards and options, or non-derivatives (financing in foreign currencies) to minimise or mitigate the risk.

The accounting policies used to measure these financial instruments are described in Note 3 to these consolidated financial statements.

The Board of Directors reviews and establishes policies for managing each of these risks, as summarised below.

### Cash flow interest rate risk

Interest rate risk arising on financing denominated in euros or foreign currency and at a floating interest rate, due to the potential changes in the cash flows associated with the interest payments on borrowings resulting from changes in interest rates. The Group is exposed to the risk of changes mainly in connection with its long-term payment obligations that bear floating interest rates.

The Group manages its borrowing costs by using, where necessary, a combination of floating and fixed interest rates. The Group minimises its exposure to this risk and to do so it closely monitors the changes in interest rates with the support of external experts. When it is deemed necessary, the Group arranges derivative financial instruments on interest rates. These derivative instruments are designed to hedge underlying payment obligations.

See Note 28 to the accompanying consolidated financial statements for information on the Group's financial instruments exposed to interest rate risk.

**Foreign currency risk**

Foreign currency risk due to assets, liabilities, net investment in foreign operations or transactions in currencies other than the euro and due to the potential changes in associated cash flows in euros as a result of changes in the spot rate.

As a result of the significant investments in the US, the Group's balance sheet could be significantly affected by fluctuations in the USD/EUR exchange rate.

The ultimate objective of the exchange-rate risk management policy is to offset (at least partially) the potential fall in the value of assets denominated in currencies other than the euro by savings due to decreases in value of the liabilities in these currencies.

The Group endeavours to mitigate the effect of its structural foreign currency risk by obtaining loans in US dollars and, accordingly, most of its investments in the US are hedged in this way.

At 31 December 2012, "Other Loans" included two loans totalling USD 301 million (31 December 2011: USD 374 million) (see Note 22) which were designated as hedges of net investments in the US subsidiaries and are used to hedge the Group's exposure to foreign currency risk on these investments. The gains or losses on the translation to euros of these loans are recognised in equity to offset any gains or losses on the translation of the net assets at these subsidiaries.

In addition, the Group is exposed to foreign currency risk on its transactions. This risk arises from purchases and sales made by the operating units in currencies other than the functional currency.

In relation to important transactions, the Group uses forward foreign currency contracts to eliminate or minimise foreign currency risk. These contracts must be stated in the same currency as the item that is being hedged and they must not be arranged until the definitive contract is entered into, in order to obtain the best possible correlation with the hedged underlying.

As indicated in the preceding paragraph, certain Rice Business companies (Herba, S&B Herba, TBA Sundra, Boost and Euryza) and Pasta Business companies (Panzani) have foreign currency forward contracts and foreign currency options (foreign currency swaps) to mitigate the exposure of their commercial transactions. These transactions are carried out in order to minimise foreign currency risk although they do not qualify for hedge accounting.

See Note 28 to the accompanying consolidated financial statements for information on the Group's financial instruments exposed to foreign currency risk.

**Price risk of other financial assets**

The Group is exposed to changes in the price of certain financial assets and liabilities. The most significant effect relates to the shares of Deoleo, S.A. and Biosearch, S.A., which are recognised as available-for-sale financial assets in the consolidated balance sheet for the year ended 31 December 2012 (see Note 12). Changes in their fair value are recognised in the income statement from 30 June 2012 onwards, when it is considered that they had suffered permanent impairment.

**Liquidity risk**

The Group's objective is to match the maturities of its payables to its ability to generate cash flows to settle these obligations. In order to achieve this, it maintains a balance between continuity of the financing and flexibility through the use of revolving credit policies, bank loans that may include grace periods to adapt them to the return on the related assets, and forward purchase contracts.

Note 22 to the accompanying consolidated financial statements includes a breakdown of the liabilities at 31 December 2012 and their maturities.

**Credit risk (counterparty)**

This risk arises when a counterparty fails to meet its contractual obligations resulting in a financial loss for the Group.

The risk is mitigated through an appropriate selection policy in relation to the transactions and banks that act as a counterparty in these transactions based on their credit ratings and obtaining sufficient guarantees to mitigate this risk.

The Group's policy with respect to commercial transactions has always been conservative and there are risk committees that regularly assess the situation, the open positions and the automatic alerts implemented in the systems, which historically have led to low bad debt rates. Also, the commercial and collection management departments work together on a coordinated basis and take into account the credit ratings awarded by the credit insurance companies with which the Group works, which provide the last line of guarantee. The Group's high level of geographical diversification reduces the concentrations of credit risk at the Group arising from this type of transaction.

## 7. INFORMATION ON THE ENVIRONMENT

The information on the environment is included in Note 29 to the accompanying consolidated financial statements.

## 8. EVENTS AFTER THE REPORTING PERIOD

On 15 February 2013, Ebro Foods, S.A. reached an agreement to acquire 25% of Riso Scotti S.p.A., the parent company of the Scotti Group. Scotti is an Italian group specialising in rice production and processing and is the leading risotto rice producer in Italy. It has a wide range of products which it markets under the Scotti trademark in more than 70 countries. Its portfolio includes numerous high value-added products (rice and soy milk, rice biscuits, rice bran oil, ready meals, etc.) which bring the tradition of Italian cuisine up to date and are targeted at the premium sector. The agreed-upon price for 25% of Riso Scotti amounted to EUR 18 million and, pending the completion of due diligence reviews, the transaction is expected to be completed prior to 31 May 2013.

On 13 March 2013, the Ebro Group entered into an agreement to acquire a rice production plant in Haryana, India, which was owned by Olam International, an integrated supplier of agricultural products and food ingredients based in Singapore. This modern, cutting-edge rice production plant has a capacity to process 18 tonnes of paddy per hour, more than 100,000 tonnes of rice per year. In addition to the industrial assets, all of its employees and its sales network will be transferred to the Ebro Group. The agreed-upon price for this transaction amounted to USD 14.5 million and is expected to be completed at the end of March 2013, subject to the approval of the regulatory authorities.

No other significant events took place between the reporting date and the authorisation for issue of this consolidated directors' report.