

La nueva alternativa en calificación de valores.

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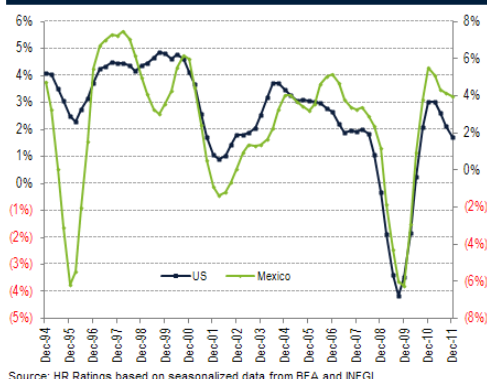
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Solid performance during 2011, perspective for 2012

Over the last few weeks Mexico has reported some very favorable numbers relative to its 2011 economic performance. The most salient of these are GDP growth, trade and fiscal policy. HR Ratings' interpretation of these and other numbers suggest that, although growth in 2012 is likely to be slower than in 2011, we expect it to continue to be strong and certainly above Mexico's long-term historical average. The biggest dangers going forward are inflation in Mexico, growth in the US, sovereign debt issues in the Eurozone and the significant geopolitical risk emanating from Iran's nuclear program.

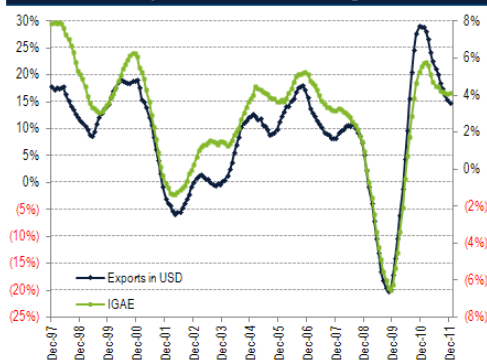
In this report we provide a quick overview of Mexico's performance on overall GDP growth, external trade and Federal Government fiscal results. Finally, we itemize the threats to our base scenario that we see for 2012.

GDP Growth: US and Mexico 12m change



The top graph shows that Mexican growth during 2011 did not show the same deceleration as did the US. In the bottom graph we show the close relationship between Mexico's non-petroleum exports and its GDP as measured by the monthly IGAE. Export growth decelerated sharply in the latter half of 2011 even while overall GDP held relatively firm. We expect greater convergence between the two during 2012.

Non-Petroleum Exports and IGAE: 12M change



- Mexican GDP growth for all of 2011 was a strong 4.0%, more than double the expected US growth of around 1.7%. However, seasonally adjusted growth in 4Q was relatively weak.
- Nevertheless, HR Ratings expects growth will accelerate in 1Q12 given some strong US reports in January and the evolution of Mexican trade in the last two months of 2011.
- We believe that manufacturing exports contributed substantially to 2011 growth.
- Our estimate of "net non-energy manufacturing exports" advanced a solid 15% last year. This was even stronger than the 10% rise in 2010.
- Although net energy exports expanded by an even stronger 20% HR Ratings believes that their net contribution to the balance of trade has in recent years declined relative to manufacturing exports.
- In terms of fiscal policy, Mexico's most widely defined public sector deficit declined not only relative to GDP but also in nominal terms.
- The RFSP¹ deficit measure fell to 2.8% of full year-year 2011 GDP vs. 3.45% in 2010.
- On the basis of the widest measure of federal public sector finances (the SHRFSP²), debt ended the year at 38.5% of GDP vs. 36.8% in 2010. This remains low by international standards and is even lower adjusting for the sharp but temporary depreciation of the peso at YE11
- HR Ratings expects GDP growth during 2012 to be in the 3.25%-3.5% range, substantially above Mexico's long-term historical average of approximately 2.5%
- The greatest internal threat to growth in 2012 is the continuation in the rebound in inflation reported during 4Q11.
- In the US the greatest threat is the weakness in the growth of personal income. This could limit the strength of consumer demand.
- The Euro zone sovereign debt crisis is another major threat.
- Perhaps the greatest danger is the deteriorating geopolitical situation in the Middle East.

¹ Requerimientos Financieros del Sector Público

² Saldo Histórico de los Requerimientos Financieros del Sector Público

Strong but reduced growth in 2011

Growth in Mexico during 2011 was a strong 3.97%. Of course, this is much lower than the 5.54% increase for 2010. However, that was largely a rebound from the 6.25% decline in 2009. Furthermore, the near 4% advance would be more than double the anemic 1.7% (preliminary) rise in US GDP for last year. The two largest sectors of the Mexican economy on the basis of sales are manufacturing and retail. These advanced 5.1% and 7.6% in 2011.

On the negative side, annualized seasonally adjusted GDP growth in the fourth quarter was a relative modest 1.6% which follows the 6% and 5% advances in 2Q11 and 3Q11. Quarter over quarter growth in 4Q was by far the weakest of any quarter during 2011. This reinforces HR Ratings' view that the deceleration seen in 2011 vs. 2010 will continue on into 2012. However, HR Ratings expects that growth for full year 2012, between 3.25% and 3.5%, will be much stronger than the weak 4Q performance would suggest. Furthermore, an expansion of this order would be stronger than our estimate of Mexico's average annual growth of approximately 2.5% since 1980.

Notably, Mexico's strong economic performance has come with relatively limited fiscal stimulus. This means that the debt hangover is relatively small reducing the danger to future growth. Manufacturing exports have played a major role in the rebound and we expect that will continue in the first months of 2012. In Table 1 below we show the evolution of Mexico GDP in real terms and the change reported for 2011. We comment on the evolution of GDP throughout the year in a latter section of this report.

Table 1

Mexico GDP by industry in billions of real 2003 pesos								
	2005	2006	2007	2008	2009	2010	2011	Annual Change 2011 vs. 2010
Primary	285	303	310	314	304	313	311	-0.61%
Secondary	2,511	2,655	2,709	2,705	2,498	2,651	2,753	3.85%
Manufacturing	1,448	1,534	1,560	1,549	1,396	1,532	1,610	5.10%
Construction	514	554	578	596	553	553	579	4.83%
Mining	448	454	453	445	432	437	427	-2.26%
Electricity	101	113	118	115	117	129	136	5.49%
Tertiary	5,057	5,324	5,561	5,694	5,393	5,692	5,930	4.19%
Commerce	1,222	1,301	1,367	1,380	1,183	1,346	1,448	7.62%
Transportation	562	595	617	617	580	624	646	3.47%
Financial Services	261	304	346	390	373	419	439	4.77%
Real Estate	846	881	908	935	918	935	954	2.07%
Information & Telecommunications	242	267	298	322	325	330	352	6.61%
Professional, & Technical Services	281	290	299	308	292	289	306	5.87%
Other Services, excl. Government	215	222	231	232	230	232	241	3.99%
Government Activities	319	320	325	329	341	350	347	-0.83%
Subtotal	7,854	8,283	8,581	8,714	8,196	8,656	8,994	3.91%
Less Imputed Bank Serv.	(162)	(195)	(230)	(264)	(273)	(297)	(306)	3.16%
Gross Value Added	7,691	8,088	8,351	8,450	7,923	8,359	8,688	3.94%
Plus Net Taxes	423	444	459	465	436	461	479	3.94%
GDP not-seasonalized	8,114	8,532	8,810	8,915	8,359	8,820	9,167	3.94%
GDP Seasonalized	8,112	8,530	8,807	8,911	8,352	8,815	9,164	3.97%

Source: HR Ratings based on data from INEGI

Foreign Trade: Manufacturing exports continued to lead the way

We believe that manufacturing has played a major role in supporting Mexico's rebound from the 2009 recession. In turn, gains in manufacturing have been made possible by manufacturing exports, to which we would add other non-petroleum exports such as agricultural and mining. On the trade front 2011 was a strong year for Mexico with a deficit of only US\$1.2bn, the third consecutive years in which the shortfall has declined and significantly below the levels prior to the recession of 2009.

High prices of petroleum have also supported Mexico's trade although the gains in that sector are not as great as they might have been given the country's increasing need for imports of refined products. In Table 2 we show the absolute value of Mexico's merchandise trade while in Table 3 we show annual percentage changes.

Table 2

Mexico's merchandise trade in US\$(m)							
	2005	2006	2007	2008	2009	2010	2011
Total Exports	214,233	249,925	271,875	291,343	229,704	298,473	349,677
Petroleum	31,889	39,017	43,014	50,635	30,831	41,693	56,427
Crude	28,329	34,707	37,937	43,342	25,614	35,919	49,364
Others	3,559	4,310	5,077	7,294	5,217	5,775	7,063
Non-Petroleum	182,344	210,908	228,861	240,707	198,872	256,780	293,250
Agricultural	5,981	6,836	7,415	7,895	7,726	8,610	10,560
Extractive	1,168	1,321	1,737	1,931	1,448	2,424	4,063
Manufacturing	175,196	202,752	219,709	230,882	189,698	245,745	278,626
Total Imports	221,820	256,058	281,949	308,603	234,385	301,482	350,842
Consumer Goods	31,513	36,901	43,055	47,941	32,828	41,423	51,790
Petroleum	5,571	7,303	10,932	15,805	8,930	12,820	18,965
Non-Petroleum	25,942	29,598	32,123	32,136	23,898	28,602	32,826
Intermediate Goods	164,091	188,632	205,295	221,565	170,912	229,812	264,020
Petroleum	10,823	12,334	14,537	19,852	11,533	17,391	23,740
Non-Petroleum	153,268	176,299	190,758	201,714	159,379	212,422	240,281
Capital Goods	26,216	30,525	33,599	39,097	30,645	30,247	35,032
Energy Related Imports	16,394	19,637	25,469	35,657	20,462	30,211	42,704
Trade Balance	(7,587)	(6,133)	(10,074)	(17,261)	(4,681)	(3,009)	(1,166)
Net Energy Exports	15,495	19,380	17,545	14,978	10,369	11,482	13,723
Non-Energy Bal.	(23,081)	(25,513)	(27,618)	(32,239)	(15,050)	(14,491)	(14,889)
Net Non-Energy Man. Exports	21,927	26,453	28,951	29,168	30,320	33,324	38,345
Mexican crude mix (US\$p.b.)	42.70	53.01	61.59	84.64	57.40	72.33	101.09
MBPD	1.817	1.794	1.687	1.403	1.222	1.361	1.338
Energy Bal. per USD of p.p.b	363	366	285	177	181	159	136
Energy imports to exports	51.4%	50.3%	59.2%	70.4%	66.4%	72.5%	75.7%
Interm. Imports to Man. Exports	87.5%	87.0%	86.8%	87.4%	84.0%	86.4%	86.2%

Source: HR Ratings based on data from INEGI

HR Ratings believes that *non-petroleum exports* have been one of the major drivers behind Mexico's economic growth over the last two years. Non-petroleum exports advanced 14.2% in USD terms and are 21.8% over the pre-recession 2008 level.

Probably an even better indicator is *net non-energy manufacturing exports*. HR Ratings calculates this figure by deducting from manufacturing exports non-petroleum intermediate goods imports. These intermediate imports are substantially for processing into more value added exports. Over the last six years, these imports have averaged 86.3% of exports with little variation around that mean. In 2011 these net-manufacturing exports reached US\$38.3bn for a 15% rise over 2010, when they had increased by 10% vs. 2009.

Table 3

Mexico's merchandise trade YoY chg							
	2005	2006	2007	2008	2009	2010	2011
Total Exports	14.0%	16.7%	8.8%	7.2%	-21.2%	29.9%	17.2%
Petroleum	34.8%	22.4%	10.2%	17.7%	-39.1%	35.2%	35.3%
Crude	33.3%	22.5%	9.3%	14.2%	-40.9%	40.2%	37.4%
Others	48.0%	21.1%	17.8%	43.7%	-28.5%	10.7%	22.3%
Non-Petroleum	11.0%	15.7%	8.5%	5.2%	-17.4%	29.1%	14.2%
Agricultural	5.6%	14.3%	8.5%	6.5%	-2.1%	11.4%	22.6%
Extractive	29.6%	13.1%	31.5%	11.2%	-25.0%	67.4%	67.6%
Manufacturing	11.0%	15.7%	8.4%	5.1%	-17.8%	29.5%	13.4%
Total Imports	12.7%	15.4%	10.1%	9.5%	-24.0%	28.6%	16.4%
Consumer Goods	24.0%	17.1%	16.7%	11.3%	-31.5%	26.2%	25.0%
Petroleum	111.0%	31.1%	49.7%	44.6%	-43.5%	43.6%	47.9%
Non-Petroleum	13.9%	14.1%	8.5%	0.0%	-25.6%	19.7%	14.8%
Intermediate Goods	10.3%	15.0%	8.8%	7.9%	-22.9%	34.5%	14.9%
Petroleum	26.0%	14.0%	17.9%	36.6%	-41.9%	50.8%	36.5%
Non-Petroleum	9.3%	15.0%	8.2%	5.7%	-21.0%	33.3%	13.1%
Capital Goods	16.0%	16.4%	10.1%	16.4%	-21.6%	-1.3%	15.8%
Energy related imports	46.0%	19.8%	29.7%	40.0%	-42.6%	47.6%	41.4%
Trade Balance	-13.9%	-19.2%	64.2%	71.3%	-72.9%	-35.7%	-61.3%
Net Energy Exports	24.6%	25.1%	-9.5%	-14.6%	-30.8%	10.7%	19.5%
Non-Energy Bal.	8.6%	10.5%	8.3%	16.7%	-53.3%	-3.7%	2.7%
Net Non-Energy Man. Exports	24.9%	20.6%	9.4%	0.7%	3.9%	9.9%	15.1%
Mexican crude mix (US\$p.b.)	37.1%	24.1%	16.2%	37.4%	-32.2%	26.0%	39.8%
MBPD	-2.8%	-1.3%	-5.9%	-16.9%	-12.9%	11.3%	-1.7%

Source: HR Ratings based on data from INEGI

Another positive during 2011 was the increase in *capital goods imports*. These advanced 15.8% following a disappointing 1.3% decline in 2010. HR Ratings believes that capital goods imports are positive and important as they indicate business confidence in the future, including Mexico's ability to serve as a manufacturing platform for exports. Recent news showing a decision by Nissan to expand facilities in Mexico is evidence of continuing foreign investor confidence in the country despite all the bad news on the public safety front. Problems there tend to be concentrated in certain regions in the country.

Continuing to modestly disappoint is the *petroleum sector*. Despite the 40% increase in the average price of crude oil (as measured by the price of Pemex crude exports) net energy related exports increased a relatively modest 20% reaching US\$13.7bn. Note that our measure of net manufacturing exports of US\$38.3bn was 2.8x larger. By comparison, back in 2005 net manufacturing exports were only 1.4x larger than the net

energy balance. Furthermore in 2005 the average price of Pemex's crude exports was only US\$42.70.

Over that time, Pemex's crude volume exports have declined by 26%. Fortunately, in 2011 the decline in exports was a comparatively modest 1.7%. Rising imports (e.g., gasoline and natural gas) also have helped to reduce the net contribution of the energy sector to Mexico's economy, at least in terms of the trade balance. It is important to point out that entities other than Pemex also import energy related products. HR Ratings estimates that non-Pemex energy imports reached roughly US\$12.1bn in 2011. Back in 2005 we estimate that the balance was US\$363 per every dollar at which Pemex sold its crude oil. In 2011 that number had declined to only US\$136 of surplus per every dollar at which a barrel of crude is sold.

Public Finance: Lowering the deficit, containing the debt

In the area of public finance, Mexico's Federal Public sector was able to reduce its deficit not only relative to GDP, but also in nominal peso terms. The total public sector deficit (as measured by the Public Sector Borrowings Requirements, or RFSP³) fell to 2.8% of HR Ratings' estimate of annual nominal 2011 GDP (P\$14,230bn). In 2010 the deficit had been 3.45%.

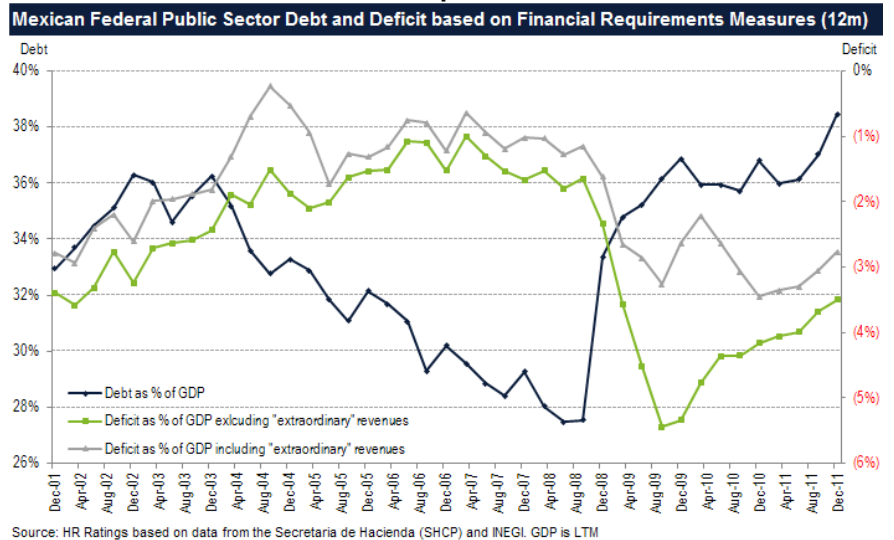
As for the debt (based on the equivalent Historical Balance of Borrowing Requirements, or SHRFSP⁴), this rose slightly to 38.5% of estimated 2011 GDP vs. 36.8% in 2010, an increase of 166bps of GDP. We estimate that assuming an exchange rate of 13 pesos per dollar (end of January 2012 levels) instead of 13.98 at YE11, the debt to GDP ratio would have been a smaller 37.7%. On this "adjusted" basis HR Ratings estimates that the debt to GDP ratio increased by only 89bps. In contrast, for the US Federal Government Public Debt, the increase was over 5x as much at 461bps, closing 2011 at 69.25% of GDP vs. 64.64% for 2010. Thus, US fiscal policy had to be substantially more stimulative, in order to achieve growth that was roughly one-half of Mexico's. In fact, Mexico could have been a major beneficiary of that stimulus, helping to support demand for its exports to the US.

In Graph 1 below we show the evolution of the Federal Public Sector's broadest measurement of its debt and deficit.

³ Requerimientos Financieros del Sector Público

⁴ Saldo Histórico de los Requerimientos Financieros del Sector Público

Graph 1



This does not mean that Mexico does not face its own fiscal challenges. High interest rates, for example, increase the cost of servicing the debt. Revenue collection is arguably low relative to infrastructure needs, rising pension costs and public safety requirements. Nevertheless, Mexican authorities in general have followed prudent fiscal policies leaving stimulus to the US with arguably positive implications for Mexican exports.

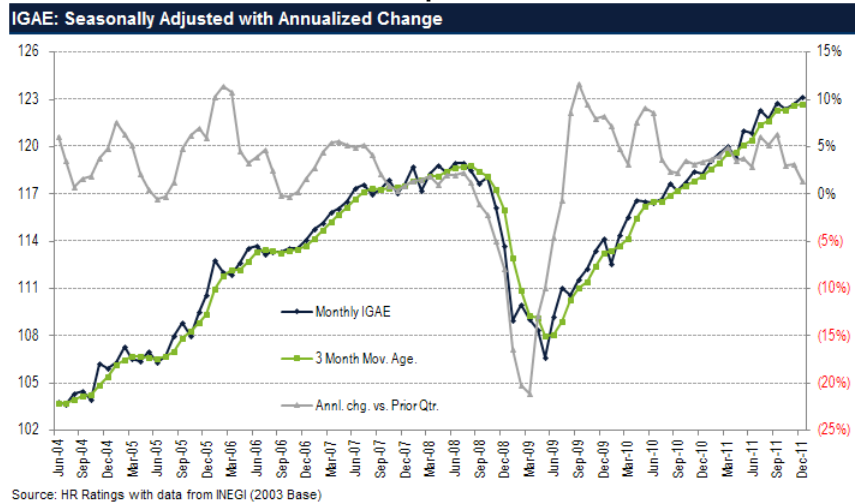
In the appendix at the end of this report we present a detailed presentation of the revenues and expenditures of the Federal Public Sector for 2010 and 2011 including real peso changes and size relative to GDP.

Prospects for 2012

Although GDP growth in 2011 at nearly 4% was relatively strong, 4Q seasonally adjusted annualized growth of only 1.7% was the weakest of the entire year. This is somewhat ironic given the strong rebound in US growth in 4Q. The monthly evolution of Mexico's economic activity as measured by the IGAE⁵ (which is a reasonably close proxy for quarterly GDP) is seen in Graph 2 below. The graph shows that the economy (in seasonally adjusted terms) has been experiencing a degree of deceleration since early 2010.

⁵ Indicador Global de la Actividad Económica

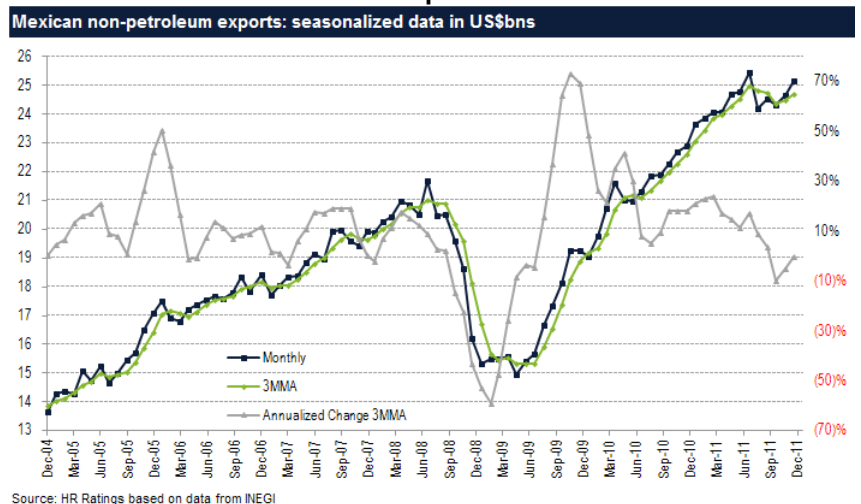
Graph 2



However, given the strong growth in the US in 4Q, and evidence that demand there remained strong in January (US job numbers and manufacturing production) and some positive late year trends in Mexican exports, we expect to see a reasonably positive beginning to 2012. On this last point, the seasonally adjusted trade data, as seen in Graph 3 below, shows the beginning of a rebound in the last two months of the year after weakness in late summer and early fall. The strong finish to 2011 in manufacturing exports appears consistent with the inventory buildup in the US in 4Q as seen in the recent GDP numbers.

Should Mexican non-petroleum exports continue to be strong, this would eventually have a broader impact on the rest of the economy and keep it on a solid albeit less robust (vs. 2011) growth path in 2012.

Graph 3

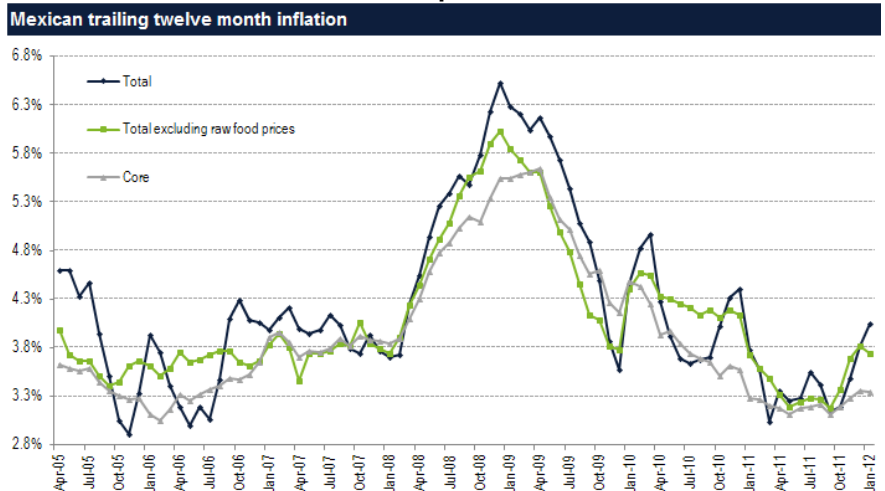


Threats

HR Ratings see four sets of threats to Mexico's continued growth this year. The sources of these threats are as follows: 1) internal (inflation), 2) U.S. growth, 3) the Euro zone and 4) geopolitical. The greatest downside risk is probably the geopolitical.

Inflation in Mexico needs to be monitored. Annual inflation rose sharply in the last quarter of 2011 and continued to advance in January. Much of that was driven by energy prices set by the Government. It is not clear whether the factors that led to those increases remain or whether going forward the pace of increases will decline substantially thanks to the adjustments made at year-end. Agricultural prices also rose sharply. HR Ratings expects that these will continue to be a problem throughout 2012. In contrast, core prices have advanced at a much more moderate pace. Still, at 3.34% YoY core inflation remains an element of concern. YoY headline inflation reached 4.05% in January. Excluding only agricultural products inflation reached 3.75%. In Graph 4 below we show the evolution of Mexican consumer inflation.

Graph 4



Source: HR Ratings based on data from INEGI

HR Ratings believes that the relatively positive public finance numbers for 2011, especially the strong 2H data, suggest reduced short-term problems on that front for 2012. We are not too concerned about the summer elections. There could be issues in 2013 as a new administration comes to power (December 2012) and determines what policies it will introduce and how to implement them.

We see the most serious threats for 2012 coming from external factors. First, the sustainability of the US rebound in 4Q11. That rebound was

derived from inventory build-up that presumably “stole” growth from 1Q12. Furthermore, a positive development for the US economy was the relative strength in consumer spending in 2H11 after a terrible performance in 2Q11. That recovery was based on falling personal savings rates and not on personal income growth. Thus for the US we need to see stronger and sustained increases in personal income, combined with a personal savings rate near late 2012 levels. The January employment numbers were extremely positive, as they should help to bolster personal income and provide more sustainability to personal consumption.

A second external threat emanates from the euro zone and its sovereign debt problems. We assume that the measures taken by the ECB in December will continue to have positive effects in stabilizing the situation through the first months of 2012. However, the situation remains a serious concern for the global economy.

The third external factor is the geopolitical environment in the Middle East that appears rapidly to be deteriorating. The outcomes are highly indeterminate but potentially very dangerous to economic stability. The developments in Egypt raise important concerns given the unknown role that will be played by the Muslim Brotherhood and the military. There is the uprising in Syria. Finally, the question of Iranian acquisition of nuclear weapons is extremely destabilizing. Some analysts suggest that Israel is seriously contemplating a strike against Iran, with unknown and potentially very destabilizing consequences.

Appendix

Public Finance Evolution: In millions of nominal Pesos					
Period	2010	2011	Real Change	As % of GDP	
				2010	2011
Federal Government Revenues	2,080,013	2,320,324	7.87%	15.91%	16.30%
Non-Petroleum Revenues	1,492,412	1,613,764	4.55%	11.41%	11.34%
Tax Revenue	1,314,282	1,436,891	5.72%	10.05%	10.09%
Income Based Taxes	679,622	759,588	8.09%	5.20%	5.34%
Regular Income Tax*	634,553	712,425	8.58%	4.85%	5.00%
Cash Based Business Income Tax	45,069	47,163	1.21%	0.34%	0.33%
Value Added Tax	504,509	536,991	2.89%	3.86%	3.77%
Non-Petroleum Excise Taxes	60,617	69,228	10.47%	0.46%	0.49%
Other Taxes	69,534	71,084	(1.15%)	0.53%	0.50%
Non-Tax Revenue	178,130	176,873	(4.08%)	1.36%	1.24%
Petroleum Revenues	587,601	706,561	16.29%	4.49%	4.96%
Federal Government Expenditures	2,438,437	2,685,273	6.54%	18.65%	18.86%
Discretionary	1,762,880	1,948,666	6.95%	13.48%	13.69%
Non-Discretionary	675,556	736,607	5.46%	5.17%	5.17%
Financial	216,271	240,538	7.59%	1.65%	1.69%
Revenue Sharing	437,328	477,167	5.53%	3.34%	3.35%
ADEFAS & Others	21,958	18,902	(16.69%)	0.17%	0.13%
Fed. Gov. Financial Balance	(358,424)	(364,948)	(1.20%)	(2.74%)	(2.56%)
Pemex					
Revenues	385,437	393,710	(1.04%)	2.95%	2.77%
Expenditures	443,571	433,229	(5.61%)	3.39%	3.04%
Discretionary	410,132	407,981	(3.85%)	3.14%	2.87%
Investment	268,514	267,204	(3.87%)	2.05%	1.88%
Others	141,617	140,777	(3.82%)	1.08%	0.99%
Financial	33,439	25,249	(27.04%)	0.26%	0.18%
Pemex Financial Balance	(58,134)	(39,519)	(35.65%)	(0.44%)	(0.28%)
Non-Pemex Parastate					
Revenues	494,993	555,597	8.58%	3.79%	3.90%
Expenditures	451,941	511,348	9.54%	3.46%	3.59%
Discretionary	445,896	503,182	9.25%	3.41%	3.53%
Financial	6,045	8,166	30.54%	0.05%	0.06%
Non-Pemex Parastate Financial Balance	43,052	44,249	(1.36%)	0.33%	0.31%
Parastate Balance	(15,082)	4,730	(137.13%)	(0.12%)	0.03%
On-Budget Financial Balance	(373,505)	(360,219)	(6.60%)	(2.86%)	(2.53%)
Off-Budget Financial Balance	2,985	4,728	53.52%	0.02%	0.03%
Public Financial Balance	(370,520)	(355,491)	(7.09%)	(2.83%)	(2.50%)
Primary Balance					
Fed. Gov. Primary Balance	(142,153)	(124,411)	(14.65%)	(1.09%)	(0.87%)
Pemex Primary Balance	(24,695)	(14,271)	(47.19%)	(0.19%)	(0.10%)
Non-Pemex Parastate Primary Balance	49,097	52,415	2.52%	0.38%	0.37%
Parastate Primary Balance	24,403	38,144	52.69%	0.19%	0.27%
On-Budget Primary Balance	(117,750)	(86,267)	(28.96%)	(0.90%)	(0.61%)
Off-Budget Primary Balance	4,025	8,145	93.92%	0.03%	0.06%
Public Sector Primary Balance	(113,725)	(78,122)	(33.53%)	(0.87%)	(0.55%)
On-Budget Revenues & Expenditures					
On-Budget Revenues	2,960,443	3,269,631	6.83%	22.64%	22.97%
On-Budget Expenditures	3,333,948	3,629,850	5.33%	25.50%	25.50%
Non-Financial Expenditures	3,078,193	3,355,898	5.48%	23.54%	23.58%
Discretionary Expenditures	2,618,908	2,859,829	5.65%	20.03%	20.09%
Non-Discretionary Expenditures	459,286	496,069	4.46%	3.51%	3.48%
Financial Expenditures	255,755	273,952	3.60%	1.96%	1.92%

Source: HR Ratings based on data from SHCP and INEGI

Real changes based on quarterly calculation *Includes IMPAC & IDE



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