

ALSEA

Quarterly Report
July 30, 2019

A quarter of positive surprises

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- We rate Alsea's 2Q19 report as positive, highlighting a higher-than-expected dynamism in revenue and deleveraging, as well as lower pressures in profitability
- Revenue rose 30.2% yoy to MXN\$14.5 billion, boosted by acquisitions (SSS +8.0%), while EBITDA practically doubled to MXN\$3.0 billion (+94.9%) due to the IFRS 16 effect
- After assuming a more conservative stance in the company's valuation, we have lowered our PT2019 to MXN\$47.00, but upgrading our rating to BUY

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BUY

Current Price	MXN\$34.03
PT 2019	MXN\$47.00
Dividend 2019	
Dividend Yield (%)	
Upside Potential	38.1%
Max – Min LTM (MXN\$)	69.88 – 33.50
Market Cap (US\$m)	1,481.2
Shares Outstanding (m)	835.6
Float	48.52%
Daily Turnover (MXN\$m)	78.0
Valuation metrics TTM	
FV/EBITDA	8.7x
P/E	37.8x

Solid performance in Mexico's operations. Alsea reported 2Q19 figures that overshot our estimates, resulting from an improved dynamic in revenue growth and lower-than-expected pressures in profitability. Sales rose 30.2% year-on-year to MXN\$14.5 billion (+4.2% vs BNTe), driven by the acquisitions of Grupo Vips in Spain and Portugal and Starbucks operations in France and Benelux, although the solid top-line 8.0% increase reported in SSS also stood out positively. Meanwhile, the company's gross margin surprisingly expanded by 100bps to 70.5%, boosting gross profit by 32.1%. Expenses, in turn, grew 30.4% yoy from the acquisitions effect and certain pressures due to wage increments and higher electricity rates, which were partially offset by operating efficiencies and, especially, by IFRS 16. Accordingly, EBITDA practically doubled by growing 94.9% yoy to stand at MXN\$3.0 billion (+8.5% vs BNTe), leading the corresponding margin to expand 700bps to 21%. It should be noted that, on an adjusted basis by the accounting changes, such growth totaled 16.7%. Finally, net income slumped 36.4% to MXN\$173 million, hit by a 142.9% higher net interest expense.

Relative performance to Mexbol

Financial Statements

MXN, million	2017	2018	2019E	2020E
Revenues	42,529	46,157	57,809	62,316
Operating Income	3,715	3,294	4,120	5,740
EBITDA	6,466	6,408	11,761	12,453
EBITDA Margin	15.2%	13.9%	20.3%	20.0%
Net Income	1,089	953	739	1,509
Net Margin	2.6%	2.1%	1.3%	2.4%
Total Assets	39,659	53,750	80,406	85,034
Cash	1,540	1,988	2,188	2,184
Total Liabilities	29,056	40,101	65,583	67,540
Debt	15,063	25,901	49,105	48,283
Common Equity	10,603	13,649	14,823	17,494

Source: Banorte with data from MSE

Valuation and financial metrics

	2017	2018	2019E	2020E
FV/EBITDA	6.7x	8.5x	6.6x	6.2x
P/E	26.0x	29.8x	38.3x	18.7x
P/Book	3.0x	2.4x	2.3x	2.0x
ROE	10.6%	7.9%	5.2%	9.3%
ROA	2.7%	1.8%	0.9%	1.8%
EBITDA/ Interest exp	6.9x	6.9x	6.9x	6.9x
Net Debt/EBITDA	2.1x	3.7x	4.0x	3.7x
Debt/Equity	1.4x	1.9x	3.3x	2.8x

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ALSEA – Results 2Q19

MXN, million

Concept	2Q18	2Q19	Var %	2Q19e	Diff% vs Estim.
Revenue	11,194	14,581	30.2%	13,992	4.2%
Operating Income	829	1,130	36.4%	841	34.4%
Ebitda	1,571	3,062	94.9%	2,821	8.5%
Net Income	272	173	-36.4%	118	46.5%
Margins					
Operating Margin	7.4%	7.8%	0.3pp	6.0%	1.7pp
Ebitda Margin	14.0%	21.0%	7.0pp	20.2%	0.8pp
Net Margin	2.4%	1.2%	-1.2pp	0.8%	0.3pp
EPS	\$0.32	\$0.21	-35.8%	\$0.14	47.3%

Source: Banorte

Income Statement (Million pesos)

Year	2018	2019	2019	Change	Change
Quarter	2	1	2	% YoY	% QoQ
Net Revenue	11,194.3	13,690.6	14,580.5	30.2%	6.5%
Costs of goods sold	3,414.1	4,104.5	4,300.5	26.0%	4.8%
Gross profit	7,780.2	9,586.1	10,280.1	32.1%	7.2%
General expenses	6,961.3	8,752.2	9,077.9	30.4%	3.7%
Operating Income	829.0	829.3	1,130.4	36.4%	36.3%
Operating Margin	7.4%	6.1%	7.8%	0.3pp	1.7pp
Depreciation	741.6	1,918.6	1,931.1	160.4%	0.7%
EBITDA	1,570.6	2,747.9	3,061.5	94.9%	11.4%
EBITDA Margin	14.0%	20.1%	21.0%	7.0pp	0.9pp
Interest Income (Expense) net	(322.2)	(622.3)	(782.7)	142.9%	25.8%
Interest expense	376.4	498.8	501.9	33.3%	0.6%
Interest income	13.0	8.4	20.5	57.6%	145.4%
Other income (expense)	(82.7)	(166.6)	(289.4)	249.8%	73.7%
Foreign exchange gain (loss)	123.9	34.8	(11.9)	N.A.	N.A.
Unconsolidated subsidiaries			(1.9)	N.A.	N.A.
Income before taxes	506.8	207.0	345.8	-31.8%	67.1%
Income taxes	192.8	72.9	131.6	-31.7%	80.5%
Discontinued operations					
Consolidated Net Income	313.9	134.1	214.2	-31.8%	59.8%
Non-controlling interest	41.5	27.6	40.9	-1.4%	48.2%
Net Income	272.4	106.5	173.3	-36.4%	62.8%
Net Margin	2.4%	0.8%	1.2%	(1.2pp)	0.4pp
EPS	0.325	0.127	0.208	-35.8%	63.6%

Balance Sheet (Million pesos)

Total Current Assets	6,553.3	5,906.6	6,512.3	-0.6%	10.3%
Cash & Short Term Investments	2,307.9	1,722.9	1,852.7	-19.7%	7.5%
Long Term Assets	33,612.3	71,646.3	69,913.3	108.0%	-2.4%
Property, Plant & Equipment (Net)	15,702.7	18,567.9	18,622.6	18.6%	0.3%
Intangible Assets (Net)	8,263.7	25,934.3	25,909.2	213.5%	-0.1%
Total Assets	40,165.6	77,552.8	76,425.6	90.3%	-1.5%
Current Liabilities	12,400.0	21,399.6	15,762.3	27.1%	-26.3%
Short Term Debt	1,545.7	10,442.3	4,553.1	194.6%	-56.4%
Accounts Payable	4,832.1	5,576.9	5,300.8	9.7%	-5.0%
Long Term Liabilities	17,278.7	44,906.8	49,693.1	187.6%	10.7%
Long Term Debt	15,008.5	42,728.8	47,259.0	214.9%	10.6%
Total Liabilities	29,678.7	66,306.4	65,455.4	120.5%	-1.3%
Common Stock	10,486.8	11,246.4	10,970.2	4.6%	-2.5%
Non-controlling interest	1,147.3	1,885.1	1,919.6	67.3%	1.8%
Total Equity	9,339.5	9,361.3	9,050.7	-3.1%	-3.3%
Liabilities & Equity	40,165.6	77,552.8	76,425.6	90.3%	-1.5%
Net Debt	14,246.3	51,448.2	49,959.4	250.7%	-2.9%

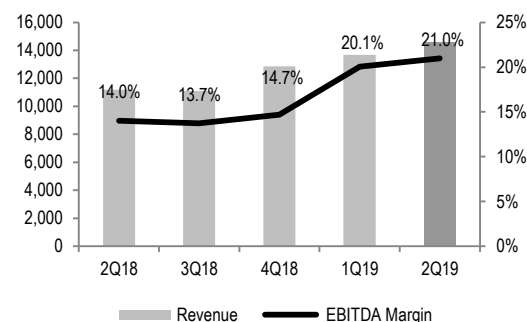
Cash Flow

FX difference in cash & equivalents	1,564.7	1,601.1	2,429.3		
CF from Operating Activities	(964.1)	(1,912.9)	(266.1)		
CF from Investing Activities	(180.4)	53.6	(1,991.4)		
CF from Financing Activities	(176.9)	(6.8)	(41.9)		
Change in Cash Balance	243.4	(264.9)	129.8		

Source: Banorte, MSE.

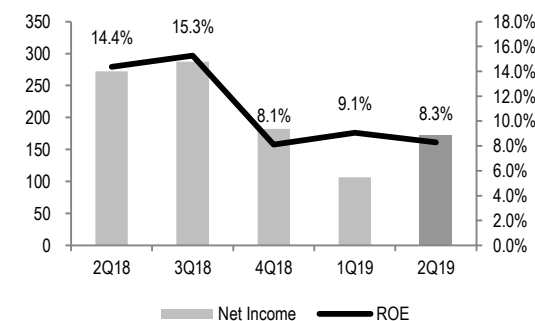
Revenue & EBITDA Margin

MXN, million



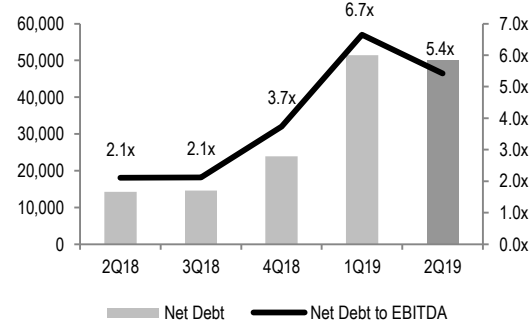
Net Income & ROE

MXN, million



Net Debt & Net debt to EBITDA ratio

MXN, million



Revenue grew more than expected. Alsea's sales reached MXN\$14.5 billion in 2Q19, up 30.2% year-on-year, above our estimates (+4.2% vs BNTE). Such performance is explained, mainly, by the incorporation of 622 corporate units in the LTM. From these, 367 correspond to those acquired from Grupo Vips in Spain and Portugal, and 83 to Staburcks' operations in France and Benelux, to which we would have to add the organic opening of 172 restaurants and coffee shops in the different territories. Moreover, on this occasion, a solid top-line 8.0% increase in SSS stood out positively, also contributing to the company's income, yet these were partially offset by an adverse FX effect in operations in Latam (due to a sharp depreciation of the Argentinean peso) and in Europe (from the same effect in EUR/MXN). By region, TU sales in Mexico rose 10.5% yoy to MXN\$6.8 billion (+6.3% vs BNTE) and 6.3% in LfL (vs +1.2%e), resulting from the opening of 76 units, a positive performance by Burger King, an improvement in the performance of other important brand names in Alsea's portfolio, such as Starbucks and Vips and the positive Easter Week effect, which offset a lower dynamism in Domino's Pizza given a competitive environment in the home delivery segment. In turn. In Europe, revenue rose 122.3% year-on-year to MXN\$5.2 billion (129.4% in local currency and +2.2% vs BNTE), explained by the consolidation effect and a 5.3% growth in SSS. Finally, in South America, sales dropped 10.7% yoy to MXN\$2.3 billion (vs MXN\$2.3Me) hit by the sharp depreciation of ARS and Argentina's hyperinflation, even despite a 16.4% SSS growth.

Surprising 100bps expansion in gross margin. In the quarter, the company's gross profitability expanded 100bps yoy to 70.5% translating into a 32.1% yoy profit growth to MXN\$10.2 billion (+1.9pp vs the revenue growth pace). Such result is outstanding considering the pressure exerted, over the profits of their corresponding regions, by tariffs applied to some raw materials imported from the U.S., the negative effect from the depreciation of the Argentinean peso and the hyperinflation in said country.

EBITDA practically doubled in 2Q19, from the effect of IFRS 16, and grew 16.7% on an adjusted basis. Alsea's operating expenses rose 30.4% yoy, due to the effect of the incorporation of recent acquisitions- which operate with a higher expense structure-, as well as to an increase in the minimum wage and higher electricity prices in Mexico, which offset the positive effect of operating efficiencies in our country and Latin America. Thus, EBITDA practically doubled to MXN\$3.0 billion (+8.5% vs BNTE), up 94.9% year-on-year, leading the corresponding margin to expand 7.0pp to 21.0% and beating our 20.2% estimate, as a stable profitability in Mexico-vs. our erosion expectation-, offset pressures reported in Europe (-250bps) and Latin America (-40bps). On an adjusted basis due to accounting changes, growth totaled 16.7%, reflecting pressures in Europe from the consolidation effect of the above-mentioned less profitable businesses, as well as in South America due to the complicated macroeconomic situation in Argentina.

Net profit fell 36.4% Alsea's net profit fell 36.4% year-on-year to MXN\$173 million, weaker than the performance reported for operating profit but still above our estimates, as a 142.9% higher net interest expense (from the effect of accounting changes and an increase in leverage) pressured the company's bottom line.

Leverage lowered. In line with the corporate focus to rapidly reduce leverage, the company's ND/EBITDA ratio fell to 5.4x from 6.7x in 1Q19. This is explained by a higher generation of LTM EBITDA U12M, a MXN\$1.3 billion qoq decline in interest-bearing debt (short-term) and a sequential MXN\$130 million cash increase.

Valuation parameters dropped following the report. After incorporating the figures from this quarter, ALSEA's multiples cheapened. On one hand, the FV/EBITDA fell to 8.7x from a previous 10.6x, due to EBITDA growth and leverage reduction, while P/E rose to 37.8x from 33.5x.

We have revised our estimates. We have adjusted our projections model reflecting the effects of IFRS 16. In addition, we have incorporated [the new economic growth forecasts estimated by our Economic Analysis department](#), as well as [recent FX rate projections from our Strategy department](#) into our model.

	Estimates					
	2019 (current)	2019 (previous)	Δ%	2020 (current)	2020 (previous)	Δ%
SSS*	2.0%	0.6%	+1.4%	0.8%	1.5%	-0.7%
Revenue+	57,809	58,165	-0.6%	62,316	64,742	-3.7%
EBITDA+	11,761	7,790	+51.0%	12,453	8,788	+41.7%
EBITDA Margin*	20.3%	13.4%	+6.9%	20.0%	13.6%	+6.4%
Net Income+	739	829	-10.9%	1,509	1,570	-3.9%

We have lowered our PT2019 but upgraded our rating to BUY. We adopted a more conservative stance in our valuation model for Alsea's shares. In view of local uncertainty and lower confidence among investors towards the Mexican equity market in general, and after including the effect of IFRS 16, by using a relative valuation model, we lowered our PT2019 to MXN\$47.00 from MXN\$60.00, which implies a 7.5x 2019E FV/EBITDA multiple, below the current level (8.7x), equaling a discount of nearly 30% against the 3-year average forward multiple (10.7x) considering a higher leverage risk. Nevertheless, we believe the current discount on the stock's valuation is excessive, making it highly attractive, even on our target which provides a 38% potential return; therefore, we are upgrading our recommendation to BUY from HOLD.

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, and Leslie Thalía Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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	Reference
BUY	<i>When the share expected performance is greater than the MEXBOL estimated performance.</i>
HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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History of PT and Ratings

Stock	Date	Rating	PT
ALSEA	25/07/2019	Buy	P\$47.00
ALSEA	25/01/2019	Hold	P\$60.00
ALSEA	18/10/2017	Buy	P\$77.00
ALSEA	27/04/2017	Buy	P\$76.00

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