

AC

Initiation of coverage

September 10, 2019

Focus on improving profitability

- **We initiate coverage of Arca Continental (AC) with a PT 2020 of MXN\$129.00 per share, which represents an 8.9x 2020E FV/EBITDA multiple similar to the current level. Our rating is BUY**
- **Arca Continental is the second largest bottler in Latin America; it operates in a defensive industry in which it stands out for its financial strength and attractive valuation**
- **Along with its synergy program, the company's diversification and digitalization strategy should boost profitability going forward. AC estimates an EBITDA CAGR of 8%-10% over the next five years**

A defensive story with attractive valuation. AC is the second largest bottler in Latin America with presence in Mexico, the U.S., Peru, Argentina, and Ecuador. Arca operates in a defensive industry and has implemented diversification and digitalization strategies that should be reflected in improved profitability levels in the coming years. In 2017, the company expanded its operations to the U.S. with a subsidiary of The Coca-Cola Company, this integration should yield US\$90m in potential synergies by end 2020. AC is forecasting an EBITDA CAGR of 8%-10% over the next five years, which we believe is feasible. As for 2019, we anticipate an EBITDA growth of 8.3% yoy, while it would increase 10.8% for 2020 with a margin expansion of 60pb to 18.7%. According to our valuation model, we obtain a PT 2020 of MXN\$129.00, which represents an 8.9x 2020E FV/EBITDA multiple similar to the current level. AC's shares trade at an 11.8% discount to the average FV/EBITDA multiple of comparable companies. In our opinion, the company's solid fundamentals and expectations of better profitability would boost a higher valuation going forward.

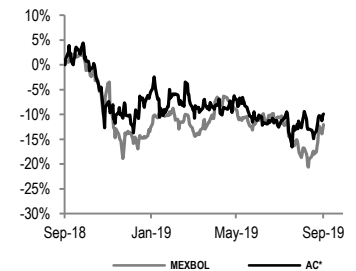
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BUY	
Current price	MXN\$105.41
PT 2020	MXN\$129.00
Dividend 2020e	MXN\$2.40
Dividend (%)	2.3%
Upside potential	24.7%
Max – Min LTM	122.17 – 97.62
Market Cap (US\$m)	9,462.7
Shares outstanding (m)	1,764.3
Float	22%
Daily turnover (MXN\$m)	129.2
Valuation metrics LTM*	
FV/EBITDA	8.9x
P/E	20.2x

Relative performance to MEXBOL (LTM)



Financial Statements

	2017	2018	2019E	2020E
Revenue	139,487	158,953	164,038	176,176
Operating Income	22,406	18,571	20,574	23,669
EBITDA	25,993	27,467	29,746	32,950
EBITDA Margin	18.63%	17.28%	18.13%	18.70%
Net Income	13,090	8,703	10,479	12,937
Net Margin	9.38%	5.48%	6.39%	7.34%
Total Assets	240,285	237,879	246,333	260,104
Cash	23,842	15,941	19,355	25,437
Total Liabilities	98,708	98,350	98,972	101,645
Debt	55,123	55,827	57,578	59,092
Common Equity	110,473	111,802	117,566	126,420

Source: Banorte

Valuation and Financial metrics

	2017	2018	2019E	2020E
FV/EBITDA	9.6x	9.2x	8.5x	7.6x
P/E	14.2x	21.4x	17.7x	14.4x
P/BV	1.7x	1.7x	1.6x	1.5x
ROE	11.8%	7.8%	8.9%	10.2%
ROA	5.4%	3.7%	4.3%	5.0%
EBITDA/ Interest	10.9x	8.8x	11.6x	16.1x
NetDebt/EBITDA	1.2x	1.5x	1.3x	1.0x
Debt/Equity	0.5x	0.5x	0.5x	0.5x

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Document for distribution among public

AC- Financial Statements

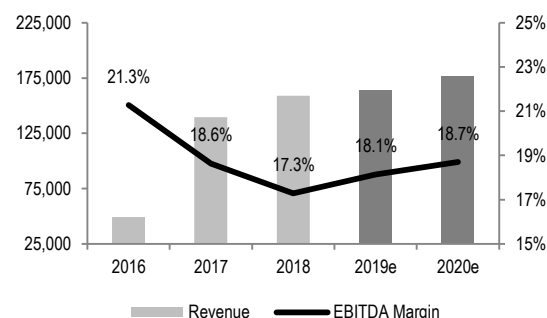
MXN, million

Year	2017	2018	2019e	2020e	TCAC
Net Revenue	139,487	158,953	164,038	176,176	8.1%
Cost of goods sold	77,025	89,712	92,249	98,672	8.6%
Gross profit	62,461	69,241	71,789	77,505	7.5%
General expenses	44,127	50,813	51,086	53,272	6.5%
Operating Income	22,406	18,571	20,574	23,669	1.8%
Operating Margin	16.1%	11.7%	12.5%	13.4%	-5.8%
Depreciation	6,651	7,942	8,795	9,282	11.7%
EBITDA	25,993	27,467	29,746	32,950	8.2%
EBITDA Margin	18.6%	17.3%	18.1%	18.7%	
Interest income (expense) net	(2,537)	(4,113)	(3,033)	(2,130)	-5.7%
Interest expense	3,149	3,924	3,508	3,330	1.9%
Interest income	767	820	940	1,281	18.7%
Other income (expenses)	(655)	(568)	(688)	(644)	-0.6%
Exchange Income (loss)	500	(441)	223	562	4.0%
Unconsolidated subsidiaries	178	223	210	204	4.5%
Net Income before taxes	20,048	14,681	17,747	21,743	2.7%
Provision for Income taxes	3,259	3,860	5,170	6,523	26.0%
Discontinued operations					
Consolidated Net Income	16,789	10,821	12,582	15,220	-3.2%
Minorities	3,698	2,118	2,102	2,283	-14.9%
Net Income	13,090	8,703	10,479	12,937	-0.4%
Net Margin	9.4%	5.5%	6.4%	7.3%	
EPS	7.420	4.933	5.940	7.333	-0.4%
Balance Sheet (Million pesos)					
Total Current Assets	43,781	37,568	42,294	50,857	5.1%
Cash & Short Term Investments	23,842	15,941	19,355	25,437	2.2%
Long Term Assets	196,503	200,312	204,038	209,247	2.1%
Property, Plant & Equipment (Net)	71,664	74,079	77,334	82,299	4.7%
Intangible Assets (Net)	60,225	60,784	60,344	60,344	0.1%
Total Assets	240,285	237,879	246,333	260,104	2.7%
Current Liabilities	23,318	23,827	25,492	26,861	4.8%
Short Term Debt	1,785	2,672	5,002	5,212	42.9%
Accounts Payable	17,140	19,729	18,426	17,859	1.4%
Long Term Liabilities	75,391	74,523	73,480	74,784	-0.3%
Long Term Debt	53,338	53,155	52,576	53,880	0.3%
Total Liabilities	98,708	98,350	98,972	101,645	1.0%
Common Stock	141,576	139,530	147,361	158,459	3.8%
Non-controlling Interest	31,103	27,727	29,795	32,039	1.0%
Total Equity	110,473	111,802	117,566	126,420	4.6%
Liabilities & Equity	240,285	237,879	246,333	260,104	2.7%
Net Debt	31,281	39,886	38,223	33,656	2.5%
Cash Flow (Million pesos)					
	2017	2018	2019e	2020e	
Cash flow from operating activities	18,231	20,614	21,481	22,935	
Cash flow from investing activities	(11,156)	(10,483)	(9,432)	(9,289)	
Cash flow from financing activities	11,495	(17,217)	(8,291)	(7,564)	
FX effect on cash	(274)	(815)	(344)		
Change in cash balance	18,295	(7,901)	3,414	6,082	

Source: Banorte, MSE

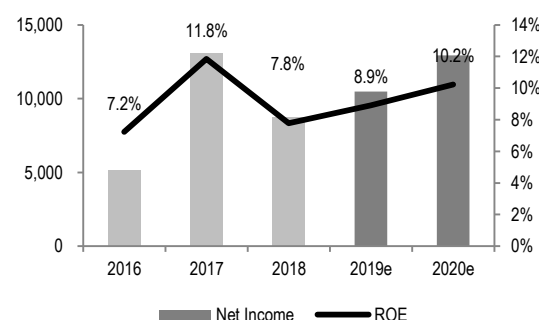
Revenue & EBITDA Margin

MXN, million



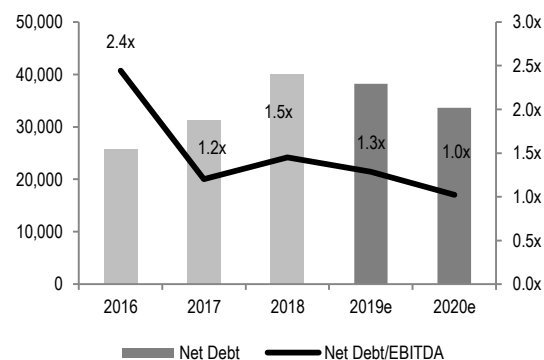
Net Income & ROE

MXN, million



Net Debt & Net Debt to EBITDA ratio

MXN, million



Discounted Cash Flow Valuation Model (DCF)

We used a discounted cash flow valuation to obtain the theoretical value of Arca Continental's shares. Based on our estimates and the valuation model, we obtain a theoretical value of MXN\$129.09, which represents an 8.9x 2020E FV/EBITDA multiple, similar to the current level. Our target price (MXN\$129.00) offers an upside potential of 24.7% including a 2.3% dividend yield over current prices. Therefore, our rating is BUY.

We calculated our theoretical value using a discount rate (WACC) of 10.0%, which assumes a cost of equity of 11.6%, a cost of debt of 6.7%, and a debt/capitalization ratio of 23%. We estimated the cost of equity using a risk free rate of 8.20% (which is the end-2020 estimate for Mexico's 10Y bond), a beta of 0.62 and a market risk premium of 5.5%. The terminal value (perpetuity) considers an FV/EBITDA multiple of 8.5x, in line with the average of comparable companies, although we note that AC is currently trading below multiples recorded in recent years. Thus the exit multiple presents a discount of 9.6% vs. the last year average multiple and 14% vs. the last-three-year average multiple. As a result, our approach is conservative taking into consideration the prevailing uncertainty in local and international markets.

Discounted Cash Flow Model (DCF)

MXN, million

	2020e	2021e	2022e	2023e	2024e	2025e
(+) EBITDA	32,950	34,486	37,245	40,225	43,443	46,918
(-) Change in working capit:	(3,114)	(3,073)	(3,538)	(3,821)	(4,127)	(4,457)
(-) Capex	(10,571)	(10,731)	(11,133)	(11,551)	(11,984)	(12,434)
(-) Taxes	(4,975)	(6,773)	(6,704)	(7,240)	(7,820)	(8,445)
(=) Free cash flow	14,291	13,908	15,869	17,612	19,512	21,582
(+) Perpetuity	0	0	0	0	0	398,804
(=) Total cash flow	14,291	13,908	15,869	17,612	19,512	420,386

Risk - free rate (RF)	8.2%	(+) Present value of cash flows	65,714
Equity risk premium	5.5%	(+) Present value of perpetuity	247,595
Beta	0.62	= Firm value	313,309
CAPM	11.6%	(-) Net debt	(33,656)
Cost of debt	6.7%	(-) Minority interest	(51,904)
Tax rate	30%	(=) Equity value	227,750
Net Cost of debt	4.7%	Shares outstanding	1,764
Debt / Capitalization	23%	Theoretical Value MXN\$	129.09
WACC	10.0%		
Exit EV/EBITDA multiple	8.5x		

Source: Banorte

In the tables below, we include a sensitivity exercise to reflect variations in the share price at different FV/EBITDA multiple levels for the terminal value, WACC, and Beta.

Sensitivity analysis FV/EBITDA vs. BETA

		FV/EBITDA			
		8.25x	8.50x	8.75x	9.00x
BETA	0.52	128.04	132.25	136.46	140.67
	0.57	126.49	130.66	134.83	139.00
	0.62	124.96	129.09	133.22	137.34
	0.75	121.21	125.24	129.27	133.30
	0.87	117.55	121.49	125.42	129.36

Sensitivity analysis EV/EBITDA vs. WACC

		FV/EBITDA			
		8.25x	8.50x	8.75x	9.00x
WACC	9.5%	128.62	132.84	137.06	141.29
	9.8%	126.78	130.95	135.13	139.30
	10.0%	124.96	129.09	133.22	137.34
	10.3%	123.17	127.25	131.33	135.41
	10.5%	121.40	125.44	129.47	133.51

Source: Banorte

The company's shares are currently trading at a LTM FV/EBITDA multiple of 8.9x, which is a discount of 5.3% to the last year average and 11.8% compared to the average of comparable companies. In our view, the discount reflects prevailing uncertainty in local and international markets. However, we consider that the company's solid fundamentals and expectations of profitability levels similar to the industry average could result in a higher multiple going forward.

Relative Valuation

ISSUER	PRICE	MKT CAP (US\$MM)	Enterprise Value (US\$MM)	P/BV	P/E	P/E 2019E	P/E 2020E	FV/EBITDA	FV/EBITDA 2019E	FV/EBITDA 2020E	DIVIDEND YIELD
EMBOTELLADORA ANDINA-PREF B	CLP 2,200	2,747	3,700	2.4x	17.9x	17.0x	15.5x	8.1x	7.9x	7.5x	3.2%
COCA-COLA EUROPEAN PARTNERS	USD 56	26,003	28,872	3.7x	22.0x	19.8x	18.2x	15.9x	12.7x	12.2x	2.5%
COCA-COLA AMATIL LTD	AUD 11.00	11,688	14,910	5.2x	19.7x	21.2x	20.1x	11.3x	11.1x	10.6x	4.8%
COCA-COLA HBC AG-DI	GBP 2,820.00	12,622	15,479	5.0x	26.9x	22.4x	20.1x	13.0x	11.3x	10.5x	
COCA-COLA ICECEK AS	TRY 37.84	1,691	2,409	1.6x	16.2x	15.2x	11.4x	6.7x	6.2x	5.5x	6.2%
COCA-COLA EMBONOR SA-A SHS	CLP 1,360	981	1,242	1.9x	15.1x	13.6x	13.5x	8.0x	7.4x	7.1x	1.9%
COCA-COLA FEMSA SAB DE CV	MXN 119	12,661	15,731	16.4x	38.6x	18.8x	16.6x	9.0x	8.1x	7.5x	3.0%
ARCA CONTINENTAL SAB DE CV	MXN 105	9,423	12,890	1.7x	20.2x	18.4x	15.8x	8.9x	8.5x	7.6x	2.2%
<i>Average</i>		9,727	11,904	4.7x	22.1x	18.3x	16.4x	10.1x	9.2x	8.6x	3.4%
<i>Median</i>		10,555	13,900	3.0x	19.9x	18.6x	16.2x	8.9x	8.3x	7.6x	3.0%

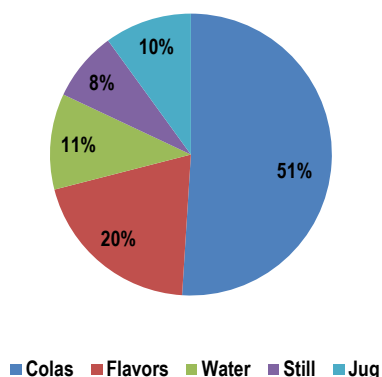
ISSUER	EBITDA MARGIN	ND/EBITDA	ROC	EBITDA Growth 2019E	EBITDA Growth 2020E	EBITDA Growth 2021E	EBITDA CAGR 2019-2021	EBITDA Margin 2019E	EBITDA Margin 2020E	EBITDA Margin 2021E
EMBOTELLADORA ANDINA-PREF B	18.5%	2.03x	9.2%	9.5%	5.5%	9.7%	7.6%	19.6%	19.7%	20.2%
COCA-COLA EUROPEAN PARTNERS	15.7%	2.93x	8.2%	8.2%	4.2%	5.3%	4.7%	19.0%	19.3%	19.9%
COCA-COLA AMATIL LTD	18.6%	2.02x	8.5%	6.6%	4.6%	4.0%	4.3%	18.3%	18.6%	18.7%
COCA-COLA HBC AG-DI	14.2%	1.16x	9.6%	13.5%	8.0%	7.0%	7.5%	15.8%	16.2%	16.5%
COCA-COLA ICECEK AS	17.4%	1.62x	5.8%	19.7%	13.4%	15.6%	14.5%	17.5%	17.1%	17.3%
COCA-COLA EMBONOR SA-A SHS	19.4%	1.68x	9.1%	9.6%	4.3%	7.8%	6.1%	20.0%	19.9%	19.8%
COCA-COLA FEMSA SAB DE CV	18.7%	1.55x	9.8%	2.5%	9.7%	9.2%	8.6%	19.5%	19.8%	20.4%
ARCA CONTINENTAL SAB DE CV	17.0%	1.47x	7.2%	8.3%	10.8%	4.7%	7.9%	18.1%	18.7%	19.3%
<i>Average</i>	17.4%	1.8x	8.4%	9.7%	7.6%	7.9%	7.6%	18.5%	18.7%	19.0%
<i>Median</i>	17.9%	1.6x	8.8%	8.9%	6.8%	7.4%	7.6%	18.6%	19.0%	19.5%

Source: Banorte, Bloomberg

Investment Fundamentals

Arca Contal is Latin America’s second largest Coca-Cola bottler with solid operations in the soft drinks industry. AC is engaged in the production, distribution, and sale of non-alcoholic beverages under The Coca-Cola Company (TCCC) brand as well as salty and sweet snacks under the Bokados (Mexico), Inalecsa (Ecuador), Wise (U.S.) and Deep River (U.S.) brands. Founded more than 93 years ago, AC is currently one of the world’s largest bottlers and the first bottler from Latin America with operations in the U.S. The company serves a population of more than 123 million in northern and western Mexico, Ecuador, and Peru, northern Argentina, and the southwest of the United States. Regarding the beverages business, AC has 42 production plants, 278 distribution centers (CEDIs), 183 production lines, and around 14,103 delivery vehicles. The snacks business consists of 7 production facilities, 43 production lines, 72 CEDIs, and 1,252 delivery vehicles.

Volume distribution by type of beverage
% at the end of 2018



Beverage business operating information
Units

	Mexico	U.S.	Argentina	Peru	Ecuador
Bottling plants	20	9	3	7	3
Distribution centers	116	37	25	67	33
Production lines	97	29	18	39	
Delivery Units	12,997	0	423		683

Source: AC, Banorte

The synergy program and new production facility in Texas should boost profitability. In 2017, Arca Contal reached an agreement with The Coca-Cola Company (TCCC) to be the sole franchise bottler of the southwest of the U.S. (including Texas and some parts of Oklahoma, New Mexico, and Arkansas). To carry out the agreement, AC contributed to its Mexican subsidiary named AC Bebidas, the shares of its beverage business operating in Mexico, Argentina, Peru, and Ecuador. In addition, Coca-Cola Refreshments USA, a subsidiary of TCCC, contributed 100% of the equity of Coca-Cola Southwest Beverages, a U.S.-based company, to AC Bebidas, giving it the exclusive right to bottle, distribute and sell within the territory the portfolio owned by or licensed to TCCC, and making it the owner of the assets for the operation of this business.

The inclusion of the U.S. in AC’s operations was expected to translate into initial synergies of between US\$60m and US\$80m. However, areas of opportunity were identified and the aim of the program, which is currently

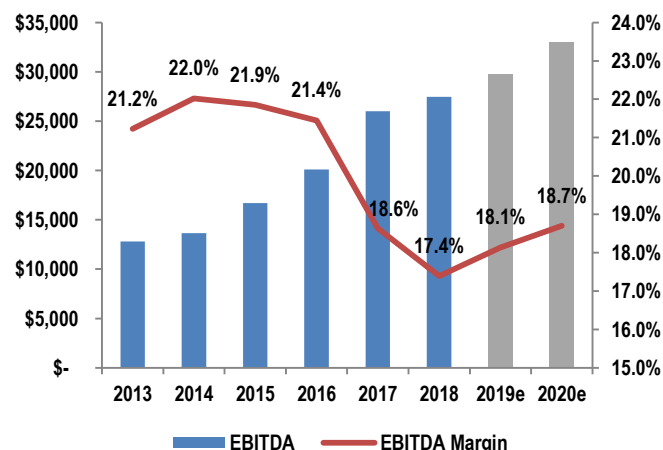
underway, is to generate accumulated savings of US\$90m by end-2020. If achieved, such savings would amount to 5.8% of estimated EBITDA. So far, 58% progress has been made with the synergy program, which is equivalent to around US\$52.2m in savings, so we believe the goal is achievable. Furthermore, in May 2018, management announced a US\$250m investment in a new production facility that will include a distribution center, five production lines, a warehouse, and a sales area and will enable the company to better serve the southwest Texas market. The facility is scheduled to start operations at the beginning of 2020 and contribute US\$30m in savings to the synergy program on the back of lower costs and operating efficiencies. Consequently, we expect savings to have a positive impact on U.S. operating margins as well as on consolidated margins.

Synergy program



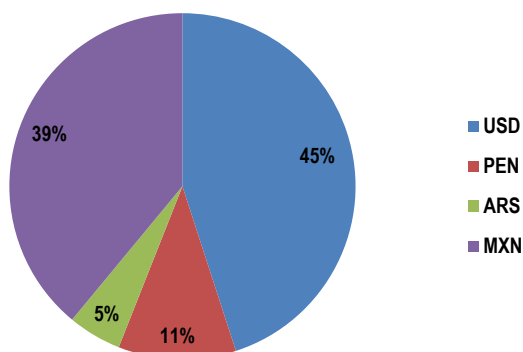
Historical and estimated EBITDA

MXN millions, %

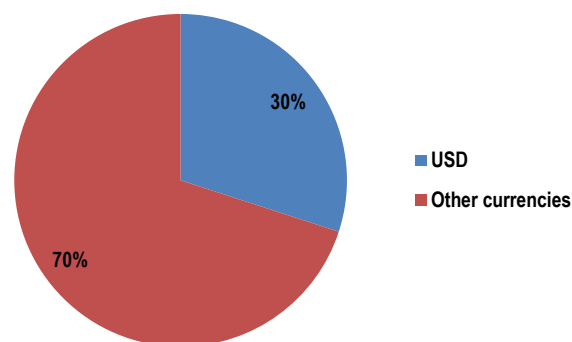


Dollar-denominated revenues and EBITDA. AC has a large exposure in dollars at the revenue and EBITDA levels. Around 45% of consolidated revenues are dollar-denominated while around 30% of EBITDA is generated in the same currency. Such exposure is fairly attractive in an environment of high local and international uncertainty. It should also be mentioned that around 15% of the cost of sales is dollar-denominated and therefore is more than offset by the percentage of revenue generated in this currency. Our Strategy team's end-2020 FX forecast (MXN\$21.30 per dollar) implies an approximate 4.7% depreciation of the Mexican peso to the U.S. dollar, which should have a positive impact on EBITDA and ease pressure on the dollar-denominated costs.

Revenue distribution by currency
As at 2Q19



EBITDA distribution by currency
As at 2Q19



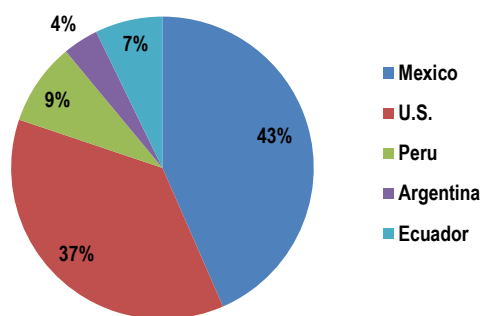
Source: AC, Banorte

A business operation in a defensive industry. Arca Continental operates in an industry that in the past has proven better able to weather the ups and downs of economic cycles than most others, undoubtedly a factor in the company's favor, the reason being that it sells basic consumer goods that are usually relatively less impacted by economic slowdowns. Furthermore, with the exception of Argentina, low inflation rates in AC's operating regions are another positive factor, as they increase consumer's purchasing power and could boost volumes.

Strategically-diversified operations. AC's operates in Mexico, the U.S., Peru, Ecuador, and Argentina. Interestingly, the high reward/low risk section of a BMI Research risk/reward matrix for the non-alcoholic beverage operations of a number of Latam countries mentions countries like Mexico, Peru, and Argentina, where AC has major operations. The risk/reward relationship is measured using an index that includes a number of variables, such as economic growth, population growth, consumer purchasing power, inflation levels, and political risk.

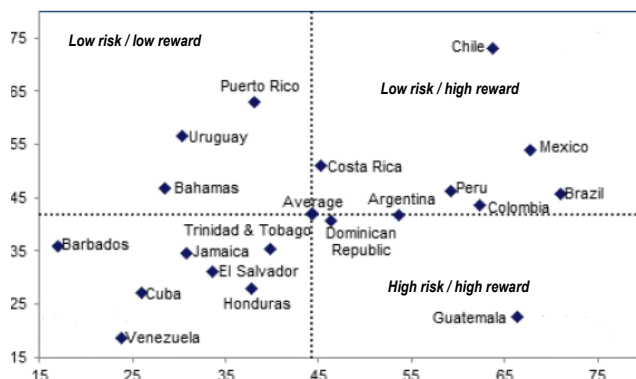
It is also important to mention that revenues are strategically diversified. AC's two largest markets are Mexico and the U.S., which together account for around 80% of consolidated income.

Revenue distribution by country
As at 2Q19



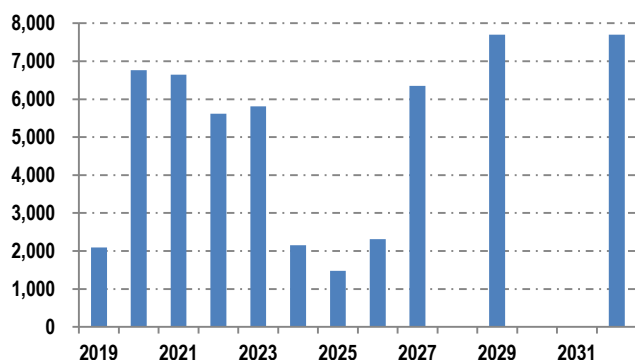
Source: AC and BMI Research

Risk/reward relationship by country

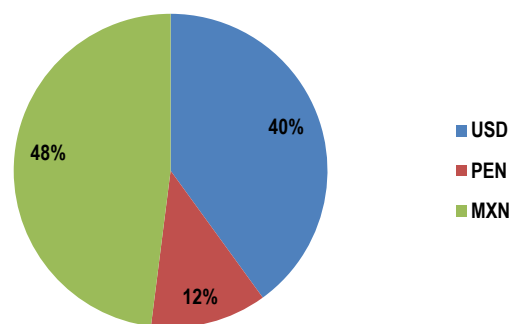


Solid financial structure. AC has a solid balance sheet with manageable debt levels and a ND/EBITDA ratio of 1.37x as at 2Q19. Moreover, 73% of total debt pays a fixed rate of interest while 97% is denominated in the local currencies of AC’s markets. Thus, around 48% of total debt is denominated in Mexican pesos, 40% in dollars, and 12% in Peruvian soles.

Debt maturity schedule
MXN, millions as at 2Q19



Debt distribution by currency
As at 2Q19



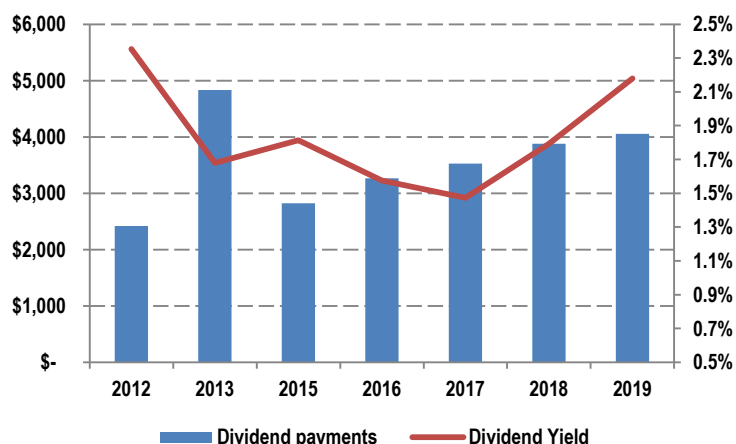
Source: AC, Banorte

Assuming no major acquisitions, debt levels should improve in 2020. Thus, the ND/EBITDA ratio should reach 1.0x on the back of solid EBITDA generation.

Stable dividend distribution. AC has made consistent dividend payments in recent years. The company has declared a dividend of MXN\$2.30 per share for 2019, which is equivalent to a dividend yield of 2.2% compared to an average yield of 1.8% in 2012-2019. Although future dividend payouts will depend on operating results and the company’s financial situation, we estimate that AC should be able to pay dividends amounting to at least 30% of net profit going forward. Thus, we forecast a MXN\$4,234m payout in 2020, which is equivalent to a dividend yield of 2.3% at current prices.

Historical dividend payout and dividend yield

MXN millions,%



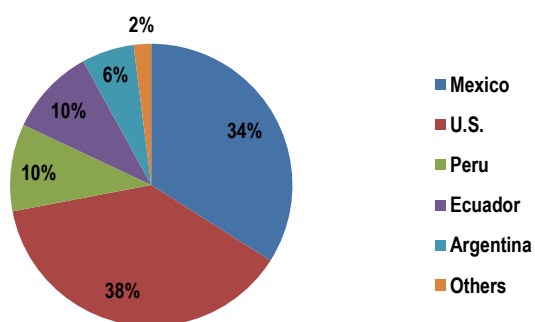
Source: AC, Bloomberg, Banorte

Disciplined approach to investments focused on driving revenue growth.

AC plans to make investments and undertake initiatives designed to drive sales growth. These initiatives contemplate investments in: (1) new production plants; (2) coolers; (3) returnable presentations; (4) vending machines; (5) production lines; and (6) delivery vehicles. Thus, 2019 Capex should be between 6.0% and 6.5% of total revenues, most of which will be focused on the Mexican and U.S. operations. The company also recently announced that over the next five years (2019 – 2024), Capex as a percentage of sales will be in a 5% - 6% range to ensure efficient capital allocation and higher cash flow generation with a view to strengthening the company’s financial structure.

Capex distribution by country, 2019e

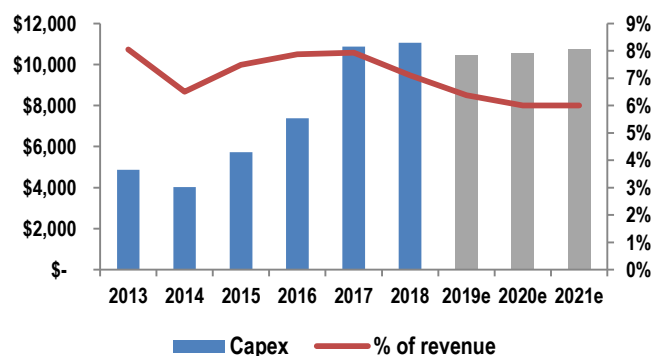
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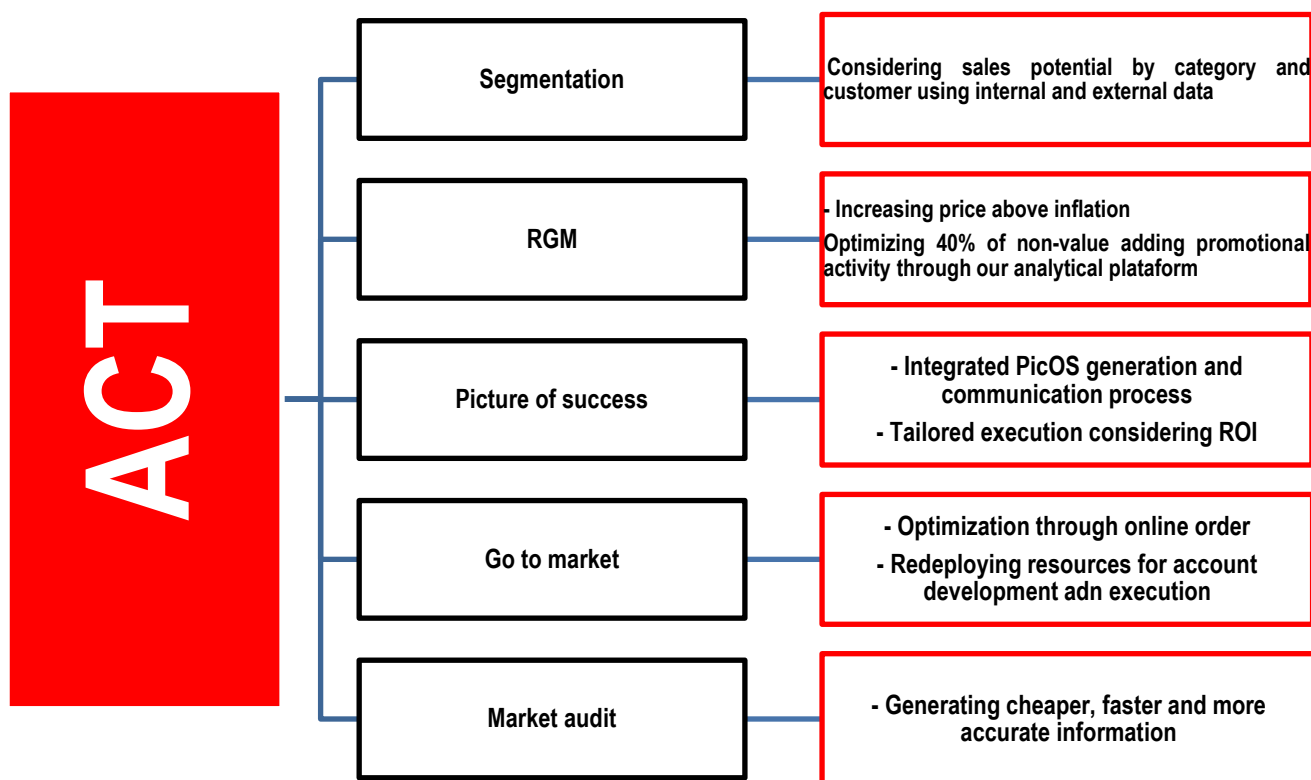
Source: AC, Banorte

Historical and estimated Capex

MXN millions,%



Implementation of data analysis tools for decision-making. AC has nurtured a decision-making culture based on data analysis designed to improve growth, profitability, and generate competitive edges. Management understands that the greater use of internal and external information to transform the business is essential to creating value and sustainable advantages. With that in mind, it has developed the Arca Continental Total Execution Model (ACT) which uses digitalization to improve the business operation.



Clients are segmented using two processes. The first consists of a static segmentation based on sales channel, geographical location, volume and size. The second is based on short-term market opportunities. Regarding *RGM*, AC is focused on improving the portfolio architecture to secure profitability, and constant price increases above inflation have been implemented with that in mind. Furthermore, “*Go to market*” has developed a number of strategies to bolster execution efficiency and profitability. Finally, the market audit should enable AC to generate and analyze information for assessing a strategy’s effectiveness at a faster, cheaper, and more efficient pace. The fact the company is committed to using technology to increase operational efficiency is attractive, while creating competitive advantages is fundamental to operate in a competitive industry, meeting consumer needs, and generating value.

Development of a digital ecosystem for exploiting opportunities in the traditional channel. Retail stores, which operate through the traditional sales channel, constitute one of AC’s main clients. Over many years, the company has developed a solid relationship with such clients and identified opportunities for improving sales channel capacity. Some examples of initiatives aimed at boosting traffic and the company’s relationship with end consumers that shop at retail stores are: (1) offer credit and debit card payment means to attract more sophisticated clients; and (2) modernize retail stores using technology platforms that offer consumers a variety of services, such as gas, electricity and cell phone recharge payments.

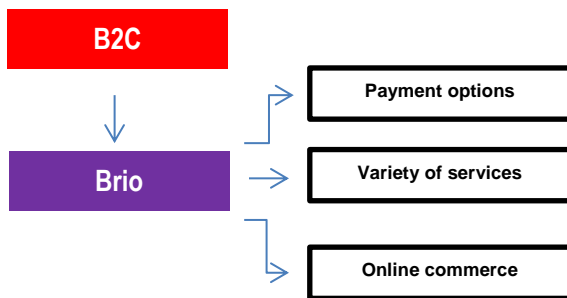
AC has also identified areas of opportunity for improving the operations of retailers and their relationship with suppliers. Some examples are: (a) the

creation of a digital platform for obtaining products that are not available from a single supplier and meeting demand from several retailers at once. Retailers currently obtain around half of their products directly from specific suppliers, while the rest obtain them from diverse wholesalers; (b) consolidation of thousands of retailers’ needs to increase negotiating power and obtain better prices; and (c) real time inventory analysis to replenish products and offer end clients an ideal product mix.

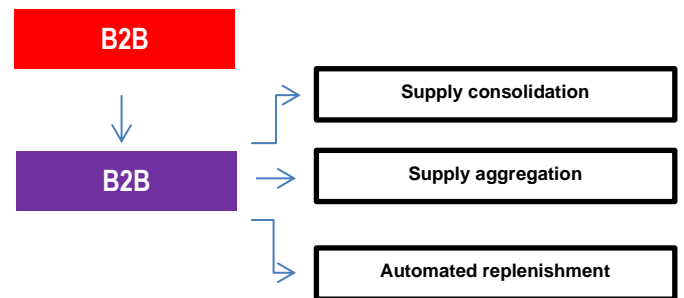
In that regard, AC has designed a strategy for providing retailers with a digital platform through the recent acquisition of the startup “Brio” and development of the digital ecosystem Bravos, which could generate value as follows:

- The capacity to send specific promotions to each retailer digitally
- Digital payments using platform balances
- Trend analysis based on ecosystem-generated data
- The capacity to audit transaction performance

Opportunities for improvement in the traditional channel



Opportunities for improvement in the traditional channel



Source: AC, Banorte

More efficient transactions driven by supply chain improvements. AC has said that adding value to the business is its priority. In that regard, the main objective of the evolution of the supply chain is to maintain a solid operational infrastructure while preserving Capex discipline in order to achieve the required business growth and efficiencies. Key supply chain initiatives AC is currently developing are:

Key supply chain initiatives

	Logistics	Manufacturing	Procurement
Commercial	-Transport and warehouse management system	- Asset management (maintenance)	- Global and collaborative negotiations
ACT	-Distribution and transportation telemetry	-Industry 4.0	-Packaging and ingredient optimization (reduce and recycle)
Data analytics		-QSE certification programs	
Service models			
Network and sales and operating planning process Supply chain digitalization Safety, quality and environmental culture People capabilities			

Source: AeC

The main supply chain challenge consists of developing low-medium turnover products in different categories and preparing processes to expand the product portfolio. In that regard, AC is seeking to transform operating planning by using data analysis to identify market trends and exploit opportunities. The aim of the supply chain digitalization strategy is to optimize processes and manufacturing costs, distribution and ongoing delivery. It is important to mention that the digitalization strategy would make some manufacturing processes in Mexico more efficient and underpin production capacity in that region. Finally, large scale collaboration with players like Coca-Cola Global Systems seeks to expand the portfolio with new categories and optimize the use of packaging and ingredients.

An experienced management team. One of Arca Continental’s strengths is its solid management team whose experience has enabled it to tackle major challenges and adapt to evolving industry trends. The company’s main officers are:

- **Jorge Humberto Santos Reyna:** Chairman of the Board; previously Vice Chairman of Arca Continental’s Board of Directors since 2007 and member of the Board since 2001. Chief Executive Officer of Grupo SanBarr and Chairman of the Board of Managers at the subsidiary AC Bebidas.
- **Arturo Gutiérrez Hernandez:** CEO/Managing Director. He has held a number of positions in the company over the last 18 years and sits on a number of industry boards.

- **Emilio Marcos Charur:** Chief Financial Officer; previously Director of beverage operations in Mexico and head of treasury and purchasing
- **José Borda Noriega:** Chief Commercial and Digital Officer; General Manager of Corporación Lindley since 2015; General Manager of Coca-Cola Central America and Vice President of carbonated beverage operations at Coca-Cola de México.

2019 – 2020 Estimates

2019 assumptions are: (1) average price increases in local currency above inflation in Mexico and the U.S., while in the case of the South American operation, our stance is more conservative; we forecast increases in line with or slightly below projected inflation rates; (2) regarding volume, we forecast an annual decrease of 0.4%, as second half growth rates will not be strong enough to offset the 1% accumulated decrease of 1H19. Strong first half decreases are due to Argentina (-14.5%), the U.S. (-3.2%) and Ecuador (-1.7%). In the case of Argentina, the difficult macroeconomic situation in that country continued to impact operations, while a change to third party distribution and adverse weather conditions affected growth in the U.S. Finally, soft domestic demand in Ecuador impacted volume; and (3) based on the exchange rate projections of our Strategy team (MXN\$20.3 per dollar), we assume that peso depreciation of 3.2% against the dollar will have a positive impact on AC's revenues and EBITDA. However, it is important to mention that depreciation of the Argentine peso and the Peruvian sol against the dollar could have a negative impact on dollar-denominated raw materials purchases.

Therefore, we estimate revenues of MXN\$164,037m and EBITDA of MXN\$29,746m, representing annual increases of 3.9% and 8.3%, respectively.

Regarding profitability, we expect a 70bp increase in the EBITDA margin to 18.1%, mainly due to our expectation of significant savings in 2H19 derived from the U.S. synergy program and lower aluminum and PET costs compared to 2018.

Our 2020 assumptions are: (1) average price increases in local currency above inflation in Mexico and the U.S.; again, we are more conservative about the South American operations and estimate increases in line with projected inflation rates; (2) regarding volume, we forecast an annual growth of 1.4% supported by relatively stronger volume at all three divisions: Mexico (+2.1%), South America (+1.4%) and the U.S. (+0.7%); and (3) based on the exchange rate forecasts of our Strategy team (MXN\$21.30 per dollar), we assume the peso will depreciate 4.7% against the dollar, which should positively impact the company's revenues and EBITDA. Nevertheless, the depreciation of the Argentine peso against the dollar could have an adverse impact on the purchase of dollar-denominated raw materials.

We expect revenue growth of 7.4% yoy totaling MXN\$176,176m on prospects of good dynamism in the three divisions: the U.S. (+9.7%), Mexico (+6.3%) and South America (+5.6%). Thus, relatively stronger consumption in Mexico driven by the resumption of government spending along with peso depreciation against the dollar and prices above the rate of inflation at AC's main divisions should translate into solid revenue growth.

At the gross profit level, we assume an environment in which sales costs as a percentage of revenues remain relatively stable. In that regard, we forecast gross profit annual growth of 8% totaling MXN\$77,505m. Cost efficiencies derived from the Texas production plant could begin to be reflected in results at the beginning of 2021.

Regarding EBITDA levels, we estimate annual growth of 10.8% for a total of MXN\$32,950m. By division, we expect U.S. EBITDA (around 25% of consolidated EBITDA) to grow 12.5% yoy, while for Mexico (around 50% of consolidated EBITDA) we are projecting a 7.7% increase and for South America 7.0% yoy. In that regard, we expect a 60bp increase in the EBITDA margin to 18.7%. Concerning profitability levels by division, we expect a 30bp improvement in the U.S. driven mainly by significant savings from the synergy program. We are also forecasting a 20bp expansion in Mexico on the basis of a stable outlook for raw materials costs, an improvement in operating leverage, and strict operating expense control. Finally, we estimate a 20bp improvement in South America's profitability derived from strict expense control, a positive outlook for input costs, and a stable Peruvian sol / dollar exchange rate.

Finally, in 2020, we expect an improvement in the company's financial structure. Thus we are forecasting an end-2020 ND/EBITDA ratio of 1.0x vs. 1.3x in 2019 boosted by expectations of solid cash generation assuming no large acquisitions.

Risks

A change in the cost of concentrate supplied by The Coca-Cola Company.

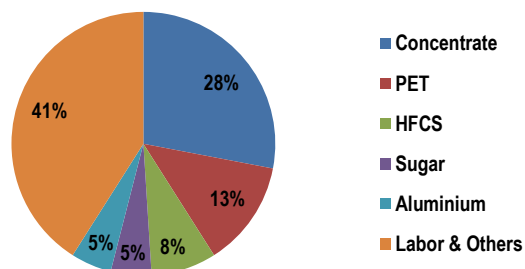
The concentrate used by AC is exclusively supplied by TCCC and prices are set unilaterally. An increase in the price of concentrate could have an adverse impact on the company's profitability because it accounts for around 28% of the cost of sales. It is important to mention that the last time concentrate costs rose was in 3Q18. However, an additional increase is projected for 2019, which could pressure the gross margin by 16bp.

An increase in PET, sweetener and aluminum prices. PET represents a large percentage of AC's cost of sales (around 13%). In that regard, a price increase or tariffs on any type of resin or PET containers could have a material impact on profitability. Furthermore, sugar and fructose are some of the main inputs used in soft drink production. According to company information, sugar represents around 5% of the cost of sales and fructose around 8%. This means that increases in the price of such products could have a negative impact on the company's performance and results. Finally, it should be emphasized that aluminum is also a relevant input that accounts for around 5% of the cost of

sales. Going forward, we expect a more stable raw material cost environment, but do not rule out volatility derived from financial market conditions and higher fructose prices due to possible increases in corn prices.

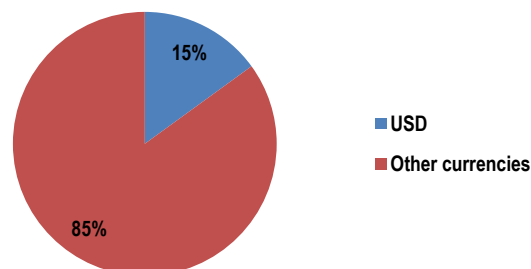
Consolidated costs structure

%



Costs structure by currency

%



Source: AC, Banorte

An increase in labor and other input costs. Costs related to labor and other inputs account for around 41% of the company’s cost of sales. Wage and other input cost pressure could have an adverse impact on profit. Indeed, the recent increase in the minimum wage in Mexico could have a negative impact. High inflation levels in Argentina could also have an adverse impact on operations if the company fails to achieve price increases that offset higher costs and expenses, a situation that could materialize as a result of a decrease in the population’s purchasing power.

Higher energy costs. The company’s operations are energy and fuel intensive and such costs have risen globally in recent years. Even if AC takes measures to mitigate energy cost volatility, they may not be enough with the consequent impact on results.

FX risk. Depreciation of the local currencies of AC’s markets against the U.S. dollar could have a direct material impact on its financial situation and operating results. Given that around 15% of the cost of sales is dollar denominated, a stronger dollar could increase the cost of sales, although it is worth remembering that around 30% of EBITDA is generated in dollars, which could offset the negative effect of exchange rate depreciation. Regarding our 2020 forecasts, we expect the Mexican peso and the Argentine peso to weaken against the dollar while the Peruvian sol should remain relatively stable.

Risk of additional taxes on carbonated beverages. Stricter tax regulations concerning the production, distribution, and/or sale of sweetened beverages could have a material impact on the company’s sales volumes. However, during ARCA DAY, several AC executives said that imposing higher taxes on carbonated beverages is not the right incentive for lowering long-term consumption. One example of this is how in January, 2014, soft drink bottlers were impacted by the imposition of a tax on sweetened beverages and other unhealthy foods in Mexico (tax –IEPS- of MXN\$1.00 per liter of soft drink).

In the short-medium term, sales volumes decreased, but operations gradually improved as impact was absorbed by prices.

Political risk. Political and social events in the company's markets could impact its financial situation, operating results, and estimates. The Argentine operation in particular could worsen due to expectations that the new government will implement policies that will further undermine the country's economic situation and thus dampen consumption.

Regulatory changes regarding the use of PET. If regulations become stricter or if the use of PET is prohibited in the regions where the company operates, cost of sales will significantly increase with the consequent impact on profitability. The cost of PET containers accounts for around 13% of the total cost of sales. However, it is important to mention that AC has a 49% interest in the recycled PET production plant PetStar, which supplies 30% of the PET needs of the Mexican operation. Finally, the company's objective is 50% recycled PET use in the coming years.

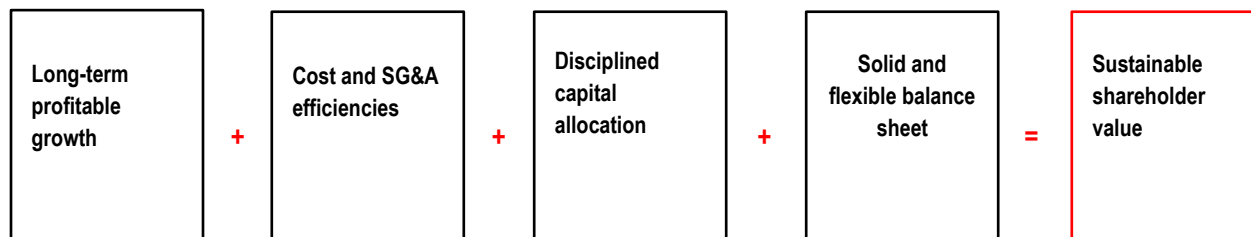
Risk of a delay with social programs. The last quarter of 2019 and during 2020 should see a more efficient distribution of the resources earmarked for the new government's social programs. We believe this could have a favorable impact on consumption and sales volumes in Mexico. On the other hand, a delay in social spending could stymie the performance of the company's Mexican operations.

Risk of delays with the synergy program and higher expenses at the Texas facility. So far 58% progress has been made with the synergy program and the production plant is scheduled to come on line at the beginning of 2020. Although we expect the company to achieve its stated objectives, delays with synergies and higher expenses related to the facility could materially impact profitability.

Changes in consumer preferences. Any change in consumer preferences that AC fails to anticipate could reduce demand for its products. Lower consumption stemming from health concerns could materially impact profitability.

Company strategy

Arca Continental has a well-defined strategy for generating value for investors. The main pillars of that strategy are:



Profitable and sustainable long-term growth. This pillar focuses on maximizing value through:

- Better market segmentation
- Business diversification based on a different product offering
- Using knowledge of AC's different markets to support a data-driven business model
- Improving market execution

In this context, AC's aim is to increase revenues organically at a compound annual rate of 6% - 8% over the next five years (2019 – 2024) on the back of sales volume growth and prices above inflation.

Cost and operating expense efficiencies and productivity improvements.

Actions taken to achieve this pillar's objectives are:

- Expand portfolio products and mixes to make them more affordable for consumers.
- Implement initiatives that generate operating efficiencies and lower costs
- Enhance distribution capacity through the use of technology
- Maximize scale through new emerging categories

Thus AC has set itself an organic EBITDA growth objective of 8% - 10% for the next five years (2019 – 2024) that is supported by a consistent focus on cost and operating expense efficiencies.

It is worth mentioning that if the company meets its compound sales and EBITDA growth objectives, low-range EBITDA margin expansion would be 178bp in 2024 compared to an estimated margin of 18.1% for 2019. High-range margin expansion would be 174bp.

Capital allocation discipline. AC has established the following conditions for allocating capital to attractive investment opportunities:

- Capex for projects that generate growth and productivity to improve ROIC levels.
- Improve the cash conversion cycle through negotiations with suppliers and clients

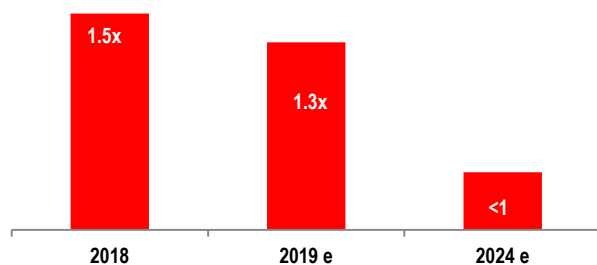
- Focus on acquisitions that generate value for the company
- An annual dividend payout of at least 30% of net profit

Thus, AC has stated that over the next five years (2019 – 2024), Capex as a percentage of sales will be in a 5% - 6% range in order to make capital allocation more efficient. This investment range is below the 7% - 8% of prior years.

Solid and flexible balance sheet. The measures required to meet those objectives are:

- A solid credit and liquidity profile
- Diversification of the debt schedule and low cost debt
- A conservative risk and solid EBITDA generation policy
- A high credit rating in Mexico that surpasses the ratings of its main peers

In our view, lower debt levels in the coming years are feasible. According to our estimates, the company should achieve ND/EBITDA ratios of 1.3x and 1.0x in 2019 and 2020, respectively, derived from solid cash generation, assuming no major acquisitions.



Source: AC, Banorte

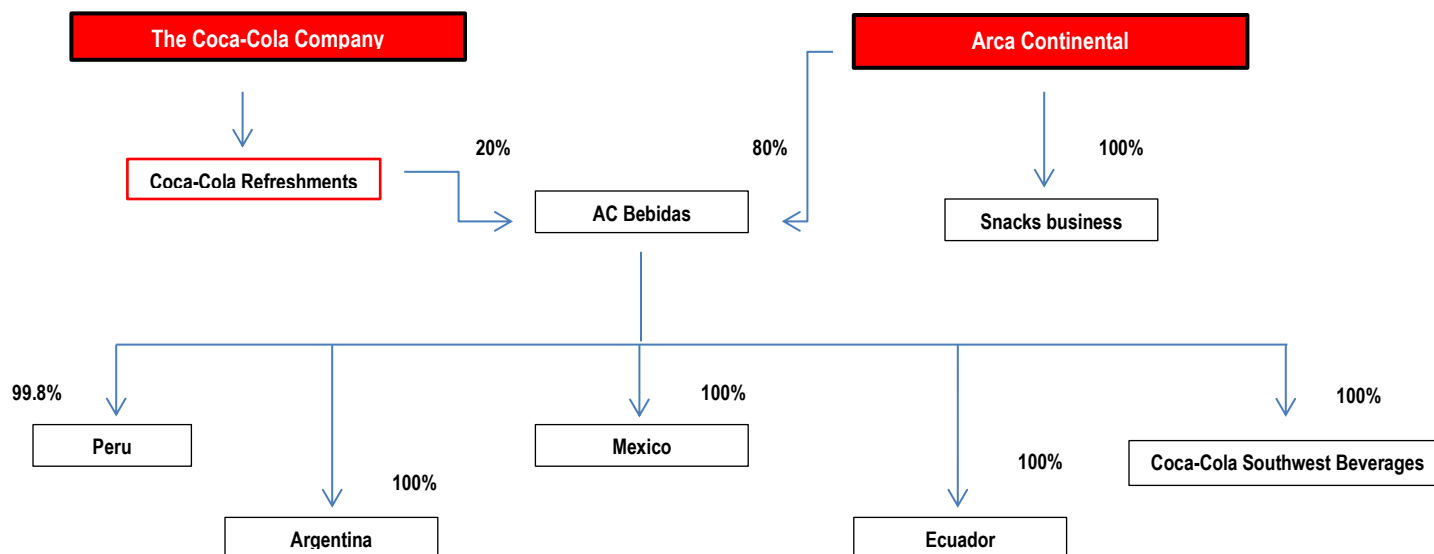
In sum, the pillars of the company’s strategy described above seek to achieve the following objectives over the course of the next five years (2019 – 2024):

Solid revenue growth driven by volume growth and prices above inflation	Revenue CAGR = 6% - 8%
Consistent focus on cost and SG&A efficiencies to boost growth	EBITDA CAGR = 8% - 10%
Disciplined investments to improve ROIC	Capex/revenues = 5% - 6%
Financial flexibility to sustain growth opportunities	Net Debt/EBITDA = <1x

Corporate Structure

In 2017, Arca Contal reached an agreement with The Coca-Cola Company (TCCC) to be the sole franchise bottler of the southwest of the U.S. (including Texas and some parts of Oklahoma, New Mexico, and Arkansas). To carry out the agreement, AC contributed to its Mexican subsidiary named AC Bebidas, the shares of its beverage business operating in Mexico, Argentina, Peru, and Ecuador. In addition, Coca-Cola Refreshments USA, a subsidiary of TCCC, contributed 100% of the equity of Coca-Cola Southwest Beverages, a U.S.-based company, to AC Bebidas, giving it the exclusive right to bottle, distribute and sell within the territory the portfolio owned by or licensed to TCCC, and making it the owner of the assets for the operation of this business.

In 2018, AC bebidas reached an agreement with Peru Beverage, a subsidiary of The Coca-Cola Company, to acquire 223,774,704 common shares from Corporación Lindley with voting rights representing 38.52% of the common shares which are unlisted in the Public Registry of the Peruvian Securities Market Superintendency. As a result of the purchase of these shares, AC Bebidas holds 99.78% of the Corporacion Lindley voting shares to date. AC Bebidas paid Peru Beverage a total of US\$506.8m in cash, equivalent to US\$2.26 per share, for the sale and transfer of the shares.



Source: AC

Share Ownership Structure

AC's capital stock is represented by a single series of common shares with no nominal value and holding restrictions. All of the shares representing AC's capital stock confer the same rights on holders. The table below shows the structure of the company's capital stock as at March 31st, 2019.

Series	Unique
Number of authorized shares:	1,764,283,156
Subscribed and paid shares	1,764,283,156
Fixed equity shares	902,816,289
Variable equity shares	861,466,867
Shares in treasury stock	0
Amount of authorized equity:	\$119,910,061.48
Equity	\$119,910,061.48
Fixed minimum amount	\$61,360,194.00
Variable	\$58,549,867.48

Source: AC

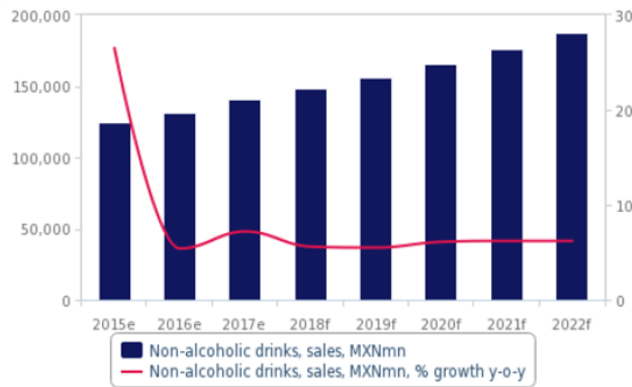
Industry

Mexico is among the countries with the largest per capita soft drink consumption in the world (480 8-ounce bottles on average per year), and the market is the second largest in terms of size only after the U.S. Such consumption levels can be mainly attributed to the fact the market covers all income levels, including people below the poverty line that are big consumers of soft drinks. It is worth mentioning that Arca Continental is a key bottler in Mexico. The company emerged from the 2001 merger of three local bottlers, Proyección Corporativa (Procor), Empresas El Carmen (Arma) and Embotelladoras Argos. Arca operates the Coca-Cola franchise and distribution in northern Mexico. Coca-Cola Femsa and Pepsi Bottling Group (PBG) are also large players in the Mexican market. PBG is engaged in local bottling operations through Pepsi México. The Mexican market represents around 18% of PBG's global sales. Coca-Cola, PepsiCo and Dr. Pepper Snapples (the owner of Schweppes) are estimated to represent around 90% of total non-alcoholic beverage sales in Mexico. Mexico is also one of the countries with relatively better growth prospects for carbonated beverages, as around 75% of Mexicans usually consume them because of their daily accessibility and availability. At the same time, Mexico is an attractive market for introducing a healthier beverages portfolio with a lower caloric content in line with current consumer health and sugar reduction trends.

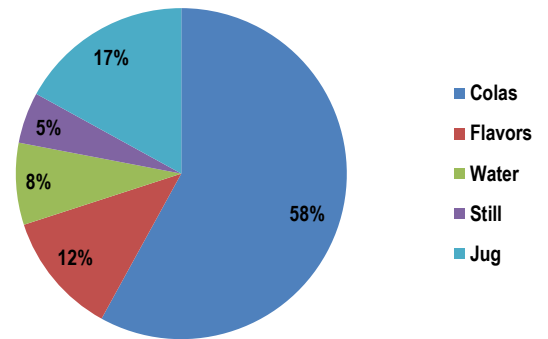
On the other hand, the beverages industry is continually exposed to higher taxes aimed at deterring consumption of unhealthy beverages. In January 2014, soft drink bottlers were impacted by the application of a tax on sweetened beverages and other unhealthy foods in Mexico (an excise tax of MXN\$1.00 per liter of soft drink). However, in the short-to-medium term, sales volumes tend to normalize and operations gradually improve. This risk is not restricted to one region in particular. Colombia recently introduced a multi-phase tax that replaces the current single-phase VAT regime. Single-phase VAT taxes only one stage of the soft drink production or sale process, while multi-phase VAT *taxes Colombia's entire sweetened beverages production process*. Approval of this tax would naturally have a material impact on sales volumes and could lead to higher prices.

Regarding consumer products, the industry has reached the point where offering healthier products is currently the trend. This has driven the search for and creation of new growth options, one example being the supply of healthier beverages in Mexico, such as ready-to-drink tea, milk, bottled water and sugarless or light carbonated beverages. Besides the Coca-Cola and PepsiCo bottlers, Danone, a company of French origin, is actively participating in Mexico's bottled water segment where it is experiencing rapid growth. It is a leading player in the bottled water segment through its Bonafont brands and makes and distributes cookies; it is also Mexico's largest producer of fresh dairy products.

Non-alcoholic beverage sales in Mexico
% at the end of 2018



Volume distribution by type of beverage in Mexico
% at the end of 2018



Source: BMI Research, AC, Banorte

The South American market is also migrating towards healthier beverages such as water and non-carbonated beverages. Countries like Chile, Peru, and Guatemala currently offer solid growth prospects, so more aggressive incursions into the water, sports beverage and non-carbonated segments could help boost AC’s market share. Finally, while the soft drinks category accounted for around 71% of AC’s consolidated sales volume at the end of 2018, ongoing efforts to expand and diversify the company’s product portfolio by offering healthier products is a positive sign that is aligned with the change of trend in the beverage industry.

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldivar, 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, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalia 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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

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Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte Ixe and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

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Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	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>

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

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Historial de PO y Recomendación

Stock	Date	Recommendation	PT
AC	September 6, 2019	BUY	MXN\$129.00

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