

# GCC

Initiation of Coverage

October 4, 2018

## Solid foundations for a better profitability

- **Grupo Cementos de Chihuahua (GCC) is a company mainly engaged in the production and sale of hydraulic cement, concrete and aggregates in Mexico and the US**
- **GCC is market leader with solid fundamentals. The company has positive growth and profitability expectations, given its strong positioning and vertical integration**
- **We are initiating coverage of GCC with a BUY rating and a PT 2019E of MXN\$155. We expect a 13.4% (proforma) growth (USD) in 2018E EBITDA (margin 29.5%) and 9.3% in 2019E (margin 30.1%)**

**GCC is well positioned to take advantage of favorable market prospects.** Its operations are vertically integrated (cost management) and have a contiguous geographical presence and a sophisticated distribution network. The latter backs its business strategy which focuses on increasing revenues and profitability, through the implementation of a pricing strategy and a wide portfolio of products and tailor-made services. The cash flow generation has allowed it to distribute dividends to its shareholders. We anticipate that GCC will continue posting solid advances based on the sector positive outlook and its healthy financial balance that would allow it to continue growing inorganically. **We are initiating coverage of GCC with a BUY rating and a PT 2019E of MXN\$155** obtained through a discounted cash flow valuation methodology. Such PT implies an EV/EBITDA 2019E multiple of 10.2x, similar to the current one and above the two-year average multiple (9.1x), which we believe could be maintained due to solid growth in its operating results. Our PT represents a potential return of 26.2% therefore we are rating it BUY.

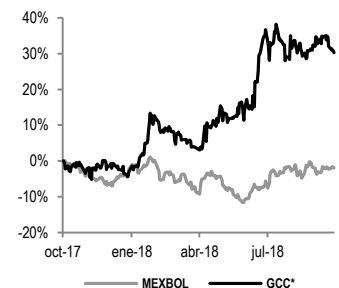
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**BUY**

Current Price	\$122.81
<b>PT 2018</b>	<b>\$155.00</b>
Dividend 201e	\$0.82
Dividend Yield (%)	0.6%
Upside Potential	26.2%
Max – Min LTM (P\$)	134.98 – 86.91
Market Cap (US\$m)	2,181.8
Shares Outstanding (m)	332.5
Float	48.4%
Daily Turnover (P\$ m)	73.8
<b>Valuation metrics TTM</b>	
EV/EBITDA	10.0x
P/E	37.0x

**Relative performance to Mexbol**  
 LTM

**Financial Statements**

USD, million	2016	2017	2018E	2019E
Revenues	748	925	944	988
Operating Income	120	151	178	203
EBITDA	189	250	272	297
EBITDA Margin	25.2%	27.0%	28.9%	30.1%
Net Income	69	84	70	128
Net Margin	9.2%	9.0%	7.4%	12.9%
Total Assets	1,864	1,908	1,946	2,122
Cash	164	233	311	381
Total Liabilities	993	979	910	923
Debt	690	683	648	648
Common Equity	871	929	1,036	1,199

Source: Banorte

**Valuation and financial metrics**

	2016	2017	2018E	2019E
EV/EBITDA	13.3x	10.1x	9.3x	7.8x
P/E	28.7x	24.9x	31.4x	16.2x
P/Book	2.3x	2.2x	2.1x	1.7x
ROE	7.9%	9.2%	7.2%	11.2%
ROA	4.2%	4.3%	3.7%	6.2%
EBITDA/ Interest exp	5.1x	4.6x	5.7x	6.3x
Net Debt/EBITDA	2.8x	1.8x	1.2x	0.9x
Debt/Equity	0.8x	0.7x	0.6x	0.5x

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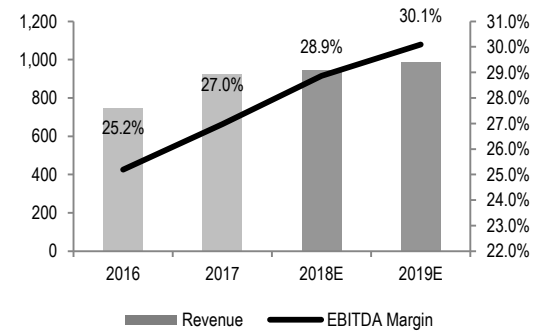
## GCC –Financial Statements

USD, million

Income Statement					
Year	2016*	2017*	2018E	2019E	CAGR
<b>Net Revenue</b>	<b>748</b>	<b>925</b>	<b>944</b>	<b>988</b>	<b>9.7%</b>
Cost of goods sold	546.6	671.2	668.2	688.9	8.0%
Gross profit	202	254	275	299	13.9%
General expenses	82	103	97	96	5.5%
<b>Operating Income</b>	<b>120</b>	<b>151</b>	<b>178</b>	<b>203</b>	<b>19.0%</b>
<b>Operating Margin</b>	<b>16.1%</b>	<b>16.3%</b>	<b>18.8%</b>	<b>20.5%</b>	<b>8.5%</b>
Depreciation	62	82	84	84	10.8%
<b>EBITDA</b>	<b>189</b>	<b>250</b>	<b>272</b>	<b>297</b>	<b>16.4%</b>
<b>EBITDA Margin</b>	<b>25.2%</b>	<b>27.0%</b>	<b>28.9%</b>	<b>30.1%</b>	<b>6.1%</b>
<b>Interest income (expense) net</b>	<b>(36)</b>	<b>(56)</b>	<b>(49)</b>	<b>(46)</b>	<b>8.8%</b>
Interest expense	39	57	53	52	10.3%
Interest income	2	4	5	5	39.3%
Other income (expenses)					
Exchange Income (loss)	1	2	(1)	1	-1.2%
Unconsolidated subsidiaries	1	2	3	3	35.0%
<b>Net Income before taxes</b>	<b>86</b>	<b>97</b>	<b>131</b>	<b>160</b>	<b>23.0%</b>
Provision for Income taxes	17	14	21	32	24.1%
Discontinued operations			(40)		
<b>Consolidated Net Income</b>	<b>69</b>	<b>84</b>	<b>70</b>	<b>128</b>	<b>22.7%</b>
Minorities	0	0	0	0	-62.0%
<b>Net Income</b>	<b>69</b>	<b>84</b>	<b>70</b>	<b>128</b>	<b>22.8%</b>
<b>Net Margin</b>	<b>9.2%</b>	<b>9.0%</b>	<b>7.4%</b>	<b>12.9%</b>	<b>12.0%</b>
<b>EPS</b>	<b>0.207</b>	<b>0.251</b>	<b>0.210</b>	<b>0.384</b>	<b>22.8%</b>
Balance Sheet (MXN, Million)					
<b>Total Current Assets</b>	<b>397</b>	<b>496</b>	<b>602</b>	<b>690</b>	<b>20.2%</b>
Cash & Short Term Investments	164	233	311	381	32.5%
<b>Long Term Assets</b>	<b>1,468</b>	<b>1,412</b>	<b>1,344</b>	<b>1,433</b>	<b>-0.8%</b>
Property, Plant & Equipment (Net)	925	936	364	419	-23.2%
Intangible Assets (Net)	65	61	55	46	-10.8%
<b>Total Assets</b>	<b>1,864</b>	<b>1,908</b>	<b>1,946</b>	<b>2,122</b>	<b>4.4%</b>
<b>Current Liabilities</b>	<b>155</b>	<b>183</b>	<b>159</b>	<b>166</b>	<b>2.3%</b>
Short Term Debt	4	17	0	0	-53.1%
Accounts Payable	71	89	81	84	5.7%
<b>Long Term Liabilities</b>	<b>839</b>	<b>796</b>	<b>751</b>	<b>757</b>	<b>-3.3%</b>
Long Term Debt	686	666	648	648	-1.9%
<b>Total Liabilities</b>	<b>993</b>	<b>979</b>	<b>910</b>	<b>923</b>	<b>-2.4%</b>
Common Stock	871	929	1,036	1,199	11.2%
Preferred Stock	0	0	0	0	-50.0%
<b>Total Equity</b>	<b>871</b>	<b>929</b>	<b>1,036</b>	<b>1,199</b>	<b>11.3%</b>
<b>Liabilities &amp; Equity</b>	<b>1,864</b>	<b>1,908</b>	<b>1,946</b>	<b>2,122</b>	<b>4.4%</b>
<b>Net Debt</b>	<b>526</b>	<b>450</b>	<b>338</b>	<b>267</b>	<b>-20.2%</b>
Cash Flow (MXN, Million)					
	2016	2017	2018E	2019E	
<b>Cash Flow from Operating Activities before Taxes</b>			126	248	
Cash Flow from Operating Activities	152	220	97	(10)	
Cash Flow from Investing Activities	(336)	(71)	(94)	(83)	
Cash Flow from Financing Activities	210	(79)	(51)	(85)	
<b>Change in Cash Balance</b>	<b>25</b>	<b>69</b>	<b>78</b>	<b>70</b>	

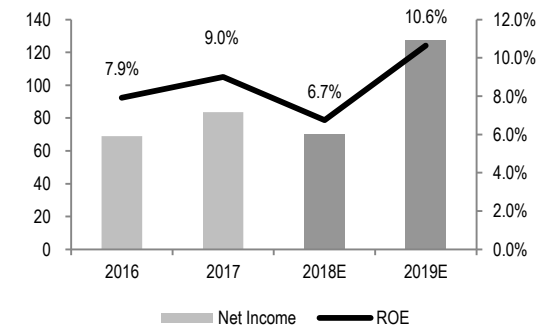
## Revenue & EBITDA Margin

USD, million



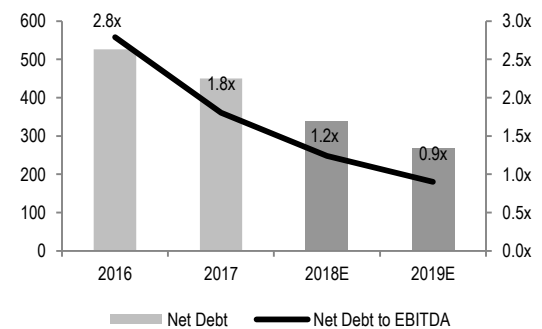
## Net Income & ROE

USD, million



## Net Debt & Net debt to EBITDA ratio

USD, million



Source: Banorte, MSE. / \* Audited Financial Statements (4Q17). Estimated Cash Flow due to change in Financial Statements.

## Valuation and PT 2019E of MXN\$155

In order to value GCC we used the DCF methodology because in our view it is the most appropriate way considering that the company is within a solid growth stage. We estimate that GCC will present USD growths (proforma) in EBITDA for 2018E and 2019E of 13.4% and 9.3%, respectively, mainly derived from volumes and prices hikes, as well as efficiencies that will allow it to raise its profitability level.

### DCF Valuation

Through a DCF methodology, our PT 2019E resulted in MXN\$155 per share, which represents a EV/EBITDA 2019E multiple of 10.2x, similar to the current one (10.0x) and above the 2-year average multiple (9.1x). In our view, the solid growth expectations and the sector positive outlook support a higher valuation compared with historical average. In our assumptions we consider a WACC rate of 9.8%; an average debt cost of 5.0%; Beta 1.1; Risk Free Rate of 3.5% plus Mexico's weighted country risk of 2.0%, a market risk premium of 5.5% and a terminal EV/EBITDA multiple of 8.0x for the perpetuity value (below the four-year average of 8.4x). Our results indicate an upside potential of 26.2% vs. current price (MXN).

#### GCC-DCF

USD, Million

	2019e	2020e	2021e	2022e	2023e	2024e	Perpetuity (2025e)
EBITDA	297	328	356	384	407	427	
Change in Working Capital (-)	2	3	2	2	1	2	
Capex (-)	75	78	81	85	88	92	
Taxes (-)	32	36	41	45	50	52	
Total Cash Flow	189	211	233	252	267	281	3,397
					Shares Outstanding		332.5
					PT DCF (dollar)		US\$7.8
					PP DCF (pesos)		P\$155.0
DCF Value	2,603				Current Price		P\$122.8
Current Market Cap.	2,182				Potential Return		26.2%

Source: Banorte

### Relative Valuation

We have prepared a relative valuation table with other sector peers listed on the Mexican Stock Exchange and in international financial markets. According to our projections, we estimate that GCC trades at a EV/EBITDA 2018E and 2019E multiples of 9.3x and 8.2x, which represent a premium of 5.4% and 5.2%, respectively vs. sample averages for each year. It is important to mention that GCC has a higher EBITDA margin (28.4% LTM), compared to sample's average (22.9%), which back a higher valuation level.

It should be noted that, given the geographical locations where GCC operates, we believe that a better comparison would exclude European companies. In this way, the company trades with a discount in its EV/EBITDA 2018E and 2019E multiples of 8.9% and 10.4%, respectively vs. the average of the

sample referred. Moreover, GCC's profitability is greater compared to the companies that comprise our Mexico, US and Latin America sample (27.0% LTM).

	PRECIO	Valor Mercado (US\$MM)	Valor Empresa (US\$MM)	Margen EBITDA	P/M	P/U	P/U 2018E	P/U 2019E	FV/EBITDA	FV/EBITDA 2018E	FV/EBITDA 2019E
<b>MEXICO</b>											
CEMEX SAB-CPO	MXN 13.14	10,680	22,900	15.5%	1.0x	17.8x	13.0x	11.5x	10.3x	8.4x	7.8x
CORP MOCTEZUMA-SER *	MXN 78.00	3,695	3,577	48.1%	7.1x	14.6x	-	-	9.6x	8.8x	-
<b>EE.UU.</b>											
EAGLE MATERIALS INC	USD 85.24	4,073	4,671	26.6%	2.9x	17.3x	14.2x	12.1x	12.4x	9.1x	8.2x
VULCAN MATERIALS CO	USD 111.20	19,159	23,165	24.6%	2.9x	41.6x	25.9x	21.1x	17.5x	15.2x	12.9x
MARTIN MARIETTA MATERIALS	USD 181.95	14,934	19,099	25.3%	2.4x	24.9x	19.3x	16.0x	14.3x	12.2x	10.7x
<b>LATAM.</b>											
CEMENTOS ARGOS SA	COP 7,700.00	3,448	5,915	17.5%	1.4x	217.3x	38.5x	18.3x	12.0x	10.5x	9.2x
UNION ANDINA DE CEMENTOS SAA	PEN 2.30	1,146	2,470	31.3%	0.9x	20.7x	13.5x	10.7x	7.1x	6.8x	6.5x
<b>EUROPA</b>											
LAFARGEHOLCIM LTD-REG	CHF 48.46	29,907	49,512	4.0%	1.1x	-	15.4x	13.1x	-	8.0x	7.6x
VICAT	EUR 52.00	2,709	4,021	16.5%	1.1x	14.5x	14.5x	12.6x	8.1x	7.4x	6.8x
HEIDELBERGCEMENT AG	EUR 67.78	15,606	28,663	18.7%	0.9x	12.8x	10.7x	9.3x	-	7.6x	7.1x
BUZZI UNICEM SPA	EUR 18.31	4,005	4,853	17.7%	1.3x	9.5x	12.2x	10.9x	8.5x	7.1x	6.5x
TITAN CEMENT CO. S.A.	EUR 21.10	2,031	3,003	17.3%	1.4x	31.7x	20.3x	14.9x	10.4x	9.0x	8.3x
	<i>Promedio</i>	8,037	13,988	22.9%	2.1x	30.6x	16.0x	12.7x	10.2x	8.8x	7.8x
	<i>Mediana</i>	4,005	5,915	20.4%	1.4x	17.6x	14.3x	12.3x	9.6x	8.4x	7.6x
<b>GCC* (Precio actual)</b>	<b>MXN 122.81</b>	<b>2,182</b>	<b>2,656</b>	<b>28.4%</b>	<b>2.3x</b>	<b>37.0x</b>	<b>31.4x</b>	<b>16.2x</b>	<b>10.0x</b>	<b>9.3x</b>	<b>8.2x</b>
Premio (Descto) vs promedio							96.6%	27.7%		5.4%	5.2%
Premio (Descto) vs promedio ex. Europa							51.5%	8.1%		-8.9%	-10.4%

Source: Banorte, Bloomberg (09/28/18).

## Investment thesis

### Leader in markets with solid fundamentals and growth expectations.

GCC has a presence in markets with good fundamentals, including favorable growth expectations and high entry barriers for new participants. It should be noted that the company ranks 1<sup>st</sup> or 2<sup>nd</sup> in markets where it operates. GCC has commented that it ranks first in terms of market share (cement) at South Dakota, New Mexico and West Texas, and second place in Colorado and Wyoming. Additionally, it is one of the leading producers of ready-mix concrete in the US, as it participates in the states of Arkansas, North Dakota, South Dakota, Iowa, Minnesota, Nebraska, New Mexico and Texas. Regarding Mexico-based operations, GCC is the leader in all the businesses in which it participates in Chihuahua: cement, ready-mix concrete, aggregates, concrete block, prefabricated concrete products, mortar and gypsum.

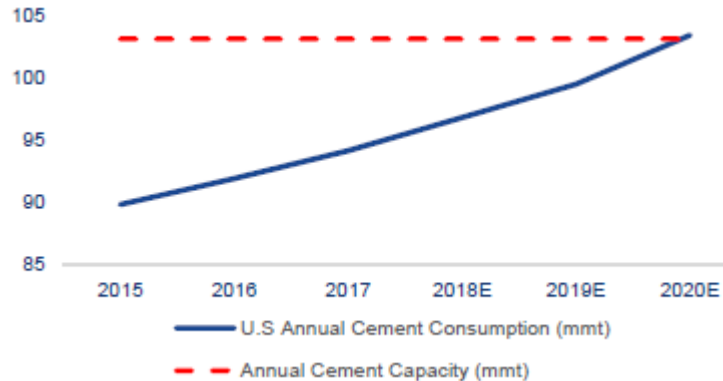
Its participation in US (74% of total sales and ~ 62% of EBITDA LTM) keeps it well positioned in order to take advantage of the recovery process amid the construction industry and the greater infrastructure investment. Therefore, the outlook is positive in terms of demand for its products and considering that the upward price trend that began in 2013 could continue. Domestically, the strong US-Chihuahua economic relationship allows GCC to benefit from the economic recovery of that country. GCC anticipates that these favorable

macroeconomic conditions will boost the demand for its products and growth opportunities in such markets (refer to section “Sector with interesting growth potential in GCC markets” at page. 16).

**US cement demand is very close to exceeding supply.** US cement consumption has increased 38% since 2010 and the Portland Cement Association (“PCA”) estimates an annual growth of 3.4% for the 2018-2022 period. In this sense, the demand curve is expected to reach the domestic production curve by approximately 2020, as shown in the following chart. This would lead to positive dynamics for GCC products both in terms of volume and prices, thus the market holds favorable expectations.

**US cement demand and supply**

Million metric tons



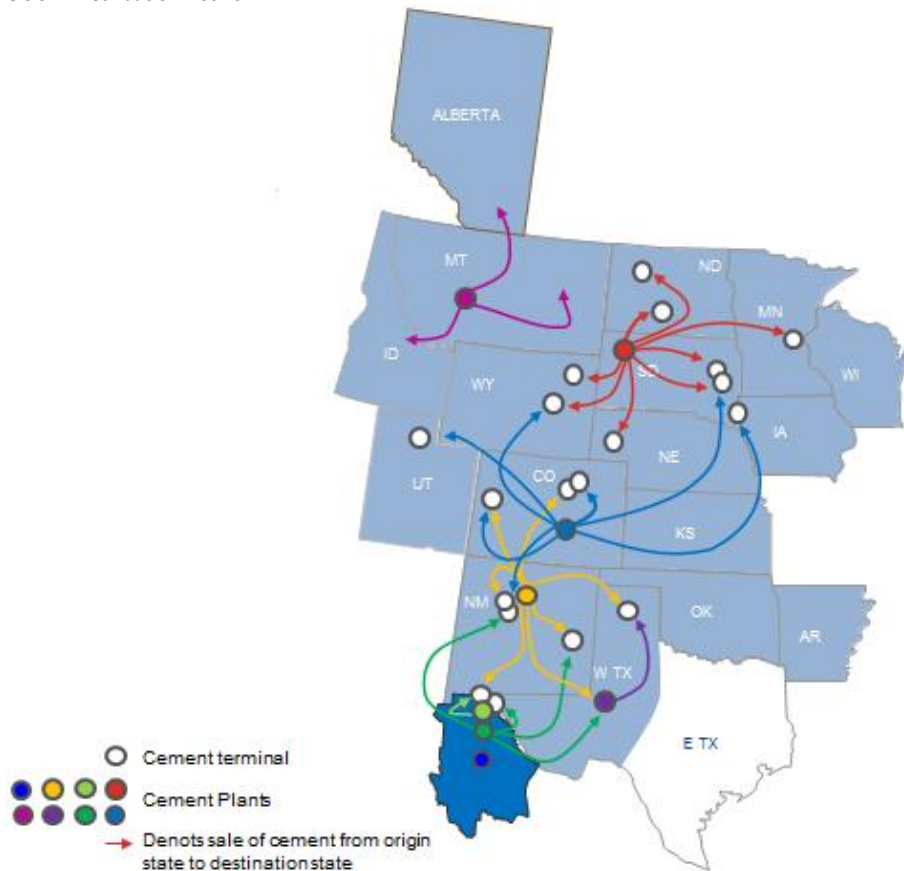
Source: GCC / PCA.

Related to the previous idea, the percentage of capacity used in the US has shown an important advance to stand at 89% in 2017 vs. slightly more than 60% in 2009. On the other hand, although at a more moderate pace, the percentage of capacity used in Mexico sits at 78% in 2017 vs. around 60% in 2009. It is worth mentioning that in Mexico the percentage of used capacity in recent years has increased to a greater extent as it also supplies US customers.

**Contiguous geographical presence supported by a sophisticated network distribution.** GCC has a contiguous geographic presence that stretches from the state of Chihuahua in Mexico to Montana, North Dakota, Minnesota and Wisconsin in northern US. This allows it to have operational flexibility and cost efficiency within its markets, as well as being a key region, since in the states where it operates, expansion prospects are limited for new plants, as it maritime access is null and is protected from maritime imports. The company has developed an extensive and sophisticated distribution network, which operates through advanced logistics systems. Its distribution network includes approximately 1,900 railroad cars (mostly leased), which transport their products through 19 cement terminals and 2 distribution centers, along the corridor that goes from northern Mexico to the US-Canada border. Additionally, no other competitor has facilities for cement production in Chihuahua, which represents an important competitive advantage in terms of transportation costs. Since products from GCC plants in the US and Mexico share the same technical specifications, the firm has the capacity to meet the demand in certain markets in the US from different production facilities, including those in Chihuahua.

Precisely, through the use of its logistics network, GCC has satisfied the additional cement demand for construction and drilling of oil wells in West Texas markets through exports from the Samalayuca plants in Mexico and shipments from its plants in Tijeras, New Mexico, and Pueblo, Colorado. The result is a stronger market share in this new territory, which has great growth potential, as well as better customer service and higher margins.

**GCC – Distribution network**



Source: GCC.

**Solid business strategy.** GCC's strategy is focused on increasing its revenues and margins by enhancing its geographical presence through an active pricing strategy and with its vertically integrated operations that reflect cost efficiencies. Likewise, its strategy focuses on customer service, product offerings, as well as on the people who implement such business strategy.

**Vertically integrated operations that lead to greater profitability.** GCC's operations in Mexico and most of the US markets where it operates are vertically integrated, and the company is practically involved in each process of the cement and ready-mix concrete supply chain. This allows GCC to manage costs in each production, distribution and sale stage of its products. The company owns different quarries from which it supplies the necessary raw material for the cement production, including most limestone supply required, as well as all the clay and gypsum necessary Mexico's operations. These materials represent 94% of the raw material required for the cement production. Likewise, the firm self-supplies efficiently, through its distribution network, 98% of the cement required for the ready-mix concrete production

from its plants. The company's distribution network enables the possibility of having cement inventories closer to its customers, which reduces delivery times and allows it to meet customers' needs in a better way. In addition, GCC has a coal mine, which meets fuel needs for 5 cement plants.

In addition to costs efficiency that translates into greater profitability, it is important to mention that GCC also implements initiatives for the use of alternative fuels that generate advantages in cost terms. In fact, these are 50% cheaper on average than coal. In 2017, the company saved more than USD\$5m due to the use of alternative fuels.

**Discipline in the continuous search for operational expansion and acquisitions.** GCC will continue to consolidate and expand in the markets in which it operates through organic growth, the acquisition and integration of new businesses and profitability increase of its operations. Stemmed from the difficulty of developing new projects (greenfields), GCC regularly evaluates the possibility of acquiring operating cement plants and that are easy to integrate into its existing distribution network. The company also actively seeks opportunities to acquire concrete and aggregate operations that are complementary to current operations and that have solid business bases. GCC has extensive experience in acquisitions, which it uses to ensure successful integration and obtain synergies that increase the company's profitability in any transaction it carries out.

**Vast portfolio of products and tailored services.** GCC offers its customers a wide range of products aimed at satisfying their needs. With more than 75 years in the industry, the firm has developed a broad portfolio composed of various brands of cement, ready-mix concrete and other products. The company also sells specialized products that have added value for its customers in order to meet required construction specifications. The latter allows it to obtain added value in its prices.

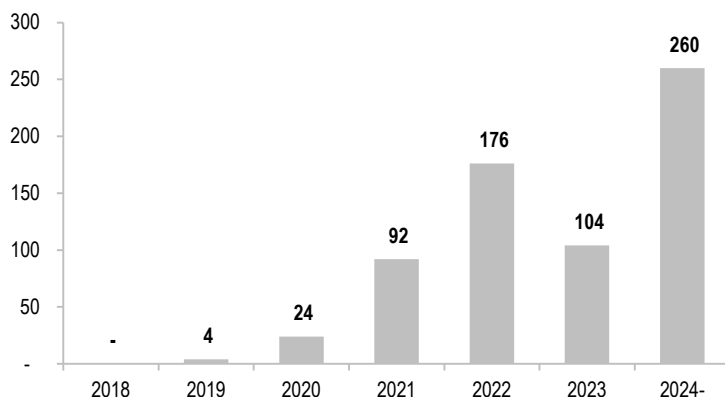
**Solid growth trajectory and resistance to economic crises.** Since its inception, the company has expanded through organic growth and strategic acquisitions. GCC has sought to make its growth strategy tailored to market conditions, which has contributed to an increase in its revenues and EBITDA at annual rates of 10.9% and 14.8%, respectively, from 2015 to 2017, and with greater profitability by showing an EBITDA margin of 27% in 2017 vs. 22% in 2015. The company has consistently achieved favorable EBITDA and margins, even during times of economic uncertainty, and believes that its financial resilience is the result of a mix of tailored products, customer loyalty, its extensive and sophisticated distribution network, as well as the ability to make sharp decisions. All the previous facts have even allowed GCC to pay dividends to its shareholders since 2013 (although it does not have an established policy). The average annual dividend yield sits at 0.9%.

**Healthy financial structure.** As of 2Q18, the company's cash totaled USD \$174m while debt posted a figure of USD \$662m, so the Net Debt/EBITDA ratio is 1.8x. Currently, its debt is USD-denominated and its average cost is 5.0%. About 61% of its debt is at a variable rate and the rest at a fixed rate.

The average life is 4 years and its maturity profile is favorable according to the following graph.

**GCC – Maturity profile**

USD, million



Source: Banorte and GCC.

It should be mentioned that on May 21, 2018, the rating agency S&P Global Ratings revised upwards GCC's long-term global corporate rating from BB to BB+ with a stable outlook. S&P also upgraded the rating of unsecured senior notes due in 2024 to BB+.

**Experienced management team.** GCC's management team has extensive experience in the cement industry, and has vast technical, operational and financial knowledge. This experience and familiarity with the industry and its operations are important characteristics that have helped them to implement their business strategy, particularly in counter-cyclical economic environments. Additionally, top executives have relevant experience in acquisitions and their integration.

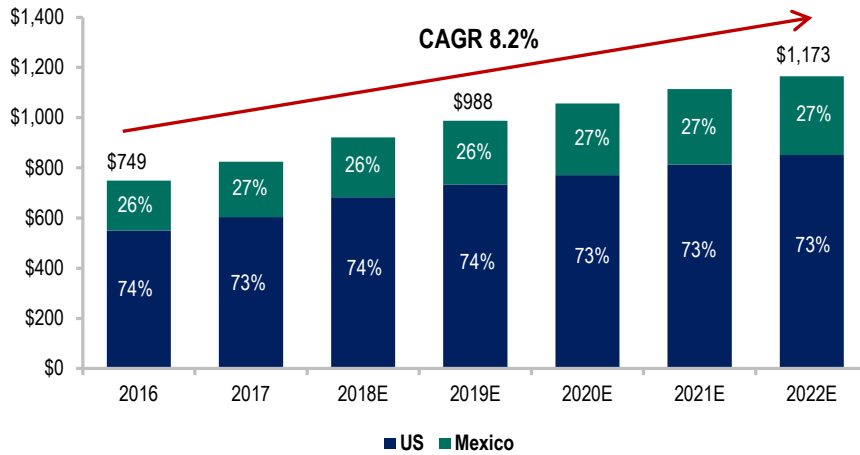
**2018 and 2019 estimates**

GCC' growth outlook for upcoming years is positive, mainly due to favorable perspectives in the US market stemmed from the higher government spending for infrastructure, and specifically for cement, in which demand is expected to exceed supply by 2020, thus it would result in positive dynamics for the volumes and prices of its products.

**Revenues advance driven by higher volumes and prices in US and Mexico.** In 2018, we expect GCC's total revenues to post a proforma USD increase of 11.8% yoy (considering GCC purchase and sale of GCC assets during 1H18). The aforementioned would be the result of annual increases in cement volumes of 6.9% and 1.5% for concrete and one-digit average gains in cement and concrete prices. As for US, we forecast revenues advance of 13.1% due to growth in cement volumes of 8.8% and 3.2% in terms of concrete, as well as an average price hike of just over 3% in their products. Domestically, we forecast an increase of 8.2% in revenues, derived from variations in volumes of cement and concrete of 2.1% and -0.2%, respectively, as well as an average increase in products prices of 5.6%

### GCC – Revenues

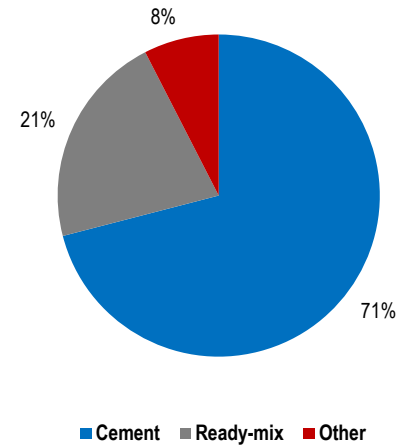
USD, million



Source: Banorte and GCC.

### Revenue per product 2019E

Percentage



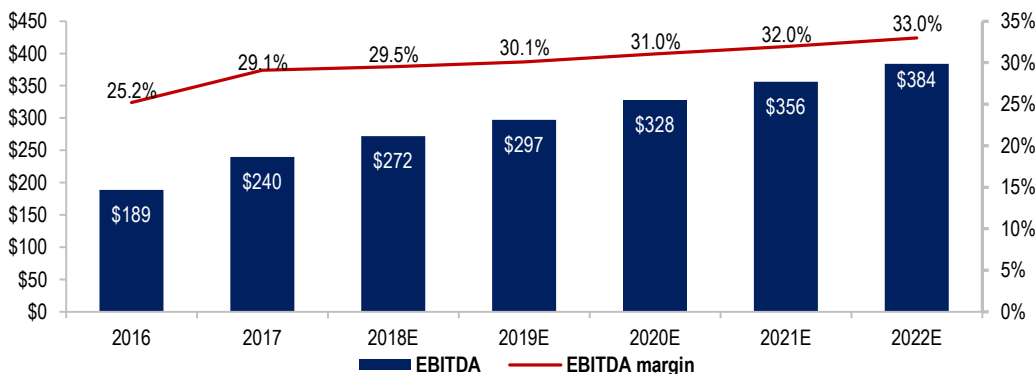
Source: Banorte.

For 2019 we estimate an increase in total proforma USD revenues of 7.2% yoy. Such increase would be the result of annual increases in cement volumes of 5.9% and 1.6% in the concrete item, as well as an average one-digit growth in cement and concrete prices. In the US we anticipate an increase in revenues of 7.5% due to growth in cement volumes of 7.4% and 2.4% for concrete, as well as hikes in average products prices of 3%. As for Mexico, we forecast a 6.4% increase in revenues, derived from increases in cement and concrete volumes of 2.0% and 0.8%, respectively, as well as an average 5% expansion in prices.

**Vertical integration to boost profitability.** We expect the company to continue showing efficiencies in its operations and we expect its EBITDA to present proforma USD increases for 2018 and 2019 of 13.4% and 9.3%, to stand at USD\$272m and USD\$297m, respectively. Thus, EBITDA margins (proforma) would be placed at 29.5% and 30.1%, respectively. It should be noted that our 2018 EBITDA growth forecast is in line with the company's guidance -an increase between 11% and 13%-. In the longer term, we estimate that GCC will post an average high-digit annual growth in total revenues and, derived from the efficiencies/ costs and expenses control, profitability would continue to soar, as seen in the following graph.

### GCC – EBITDA, EBITDA margin

USD, million/percentage

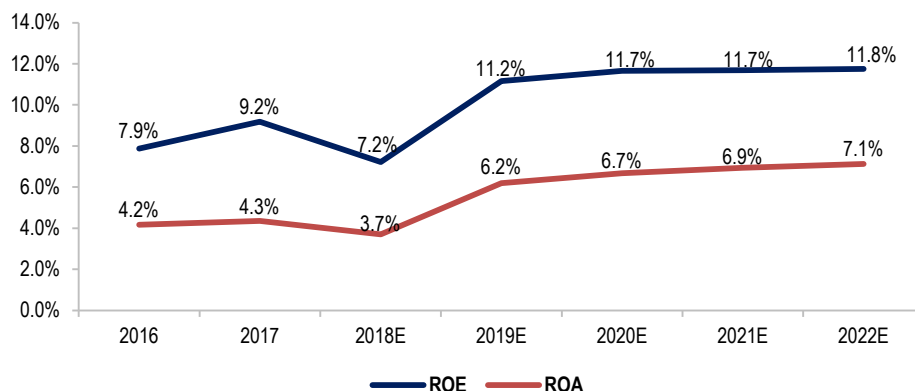


Source: Banorte and GCC.

**Solid financial structure.** GCC has a solid financial structure and balance sheet. As of 2Q18, the company posted a debt of USD\$662m while cash totaled USD\$174m. The adjusted Net Debt/EBITDA ratio sits at 1.8x. By the end of 2018, we expect this indicator to be located at 1.2x and in 2019 at 0.9x, which we consider a healthy leverage level that would allow the company to continue with its growth strategy.

#### GCC – ROE y ROA

Percentage



Source: Banorte and GCC.

## Risk factors

**Sensitivity to lower economic growth in the US and Mexico.** GCC holds US and Mexico-based operations and assets, thus a slowdown in these economies could affect demand for their products and its results. In Mexico (26% of GCC's sales in 2Q18), an economic growth of 2.1% is foreseen for 2018 and 1.8% for 2019. On the other hand, in the US (74% of sales), there is optimism regarding the evolution of economy, where we mention that government measures related to greater infrastructure expenditure.

**FX-related risks.** Most GCC's revenue and the total debt are USD-denominated. A MXN depreciation vs. USD could increase in dollar terms the amount of liabilities USD-denominated; however, the FX risk is mitigated as most of its revenues are expressed in terms dollars (74% in 2Q18).

**Variations in inputs prices / possible hikes related to energy costs.** Main materials for production are limestone, aggregates, sand, fuels and energy; so GCC is exposed to changes in the prices of such inputs. Since GCC's operations require large amounts of energy, mainly in the cement production process and, to a lesser extent, in the distribution operations - which are based on the use of gasoline and diesel for the delivery of their products, an increase in energy costs would impact the costs and expenses of the company. It is worth mentioning that the increase in fuel prices in Mexico would impact the distribution expenses. In order to mitigate exposure to high energy costs and volatility, the company has implemented technical improvements in all cement plants that allow the use coal or alternative fuels in practically all of GCC's installed cement production capacity. All cement plants can use natural gas for clinker production should the price of this fuel is more favorable or if coal supply is halted or its quality becomes a problem. Moreover, since 2005 GCC

has operated its coal mine in the state of Colorado, which supplies coal to all of its plants.

**Restrictions on debt instruments or contracts.** This could limit its ability to plan/react to changes in the sector. These restrictions also limit GCC ability to: pay obligations derived from securities or pay its subordinated debt; carry out investments or capital expenditures; sell assets; enter into contracts that restrict dividends payments; engage in transactions with affiliates, except for transactions in market terms; create or accept liens; carry out mergers or consolidations; perform early payments or debt modifications; and sell all or a substantial part of its assets.

**Possible conflicts of interest.** GCC has repeatedly participated in transactions with related parties, including Cemex, which has a stake in the share capital of the majority shareholder and has indirect participation in the company. In addition, some members of GCC Board of Directors were or are current chiefs, officers or employees at Cemex and have an ongoing professional relationship with its top management. These relationships may pose or appear to create conflicts of interest when such management needs to make decisions that may have implications for both companies.

**Unfavorable resolutions of certain disputes.** At the moment, GCC is being subject of legal proceedings, including a controversy related to the sale of its stake at Sociedad Boliviana de Cemento, S.A. (SOBOCE) where it has been required to pay USD\$36m (in accordance to Bolivian Law the execution of the final award has been suspended), which individually or collectively could pose a threat to the business.

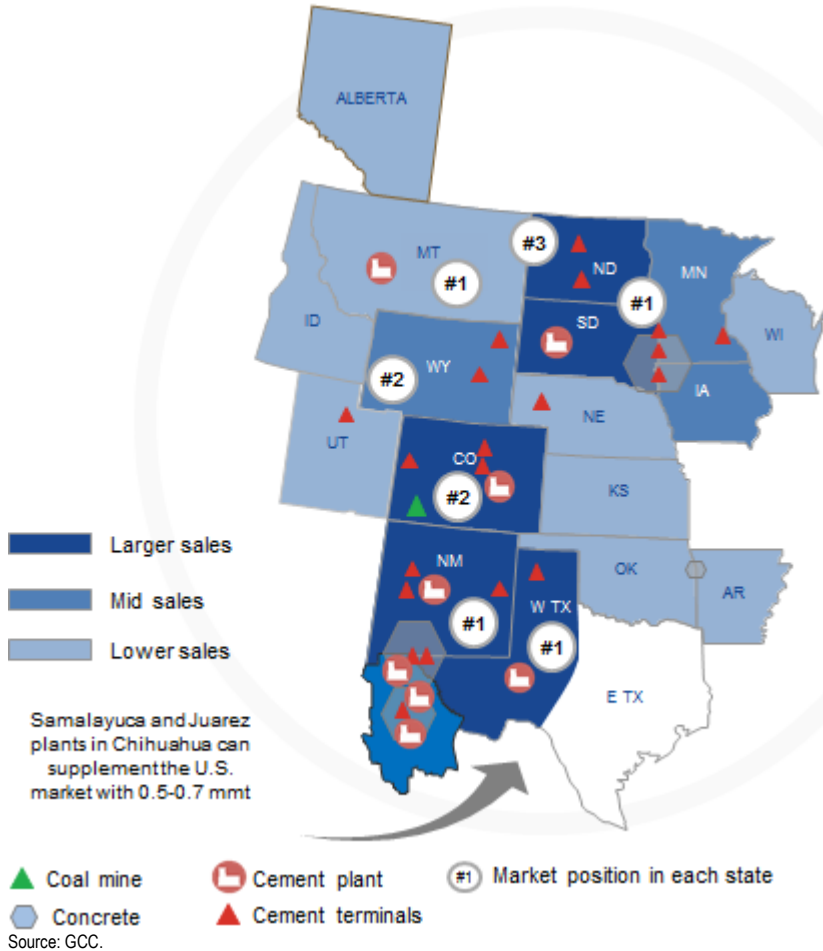
**Industry risks.** GCC is part of a competitive industry. Some other risks in the industry include: adverse weather conditions (extreme cold and rain); natural disasters affecting plants and/or distribution centers; and stricter environmental regulations (mainly in the US).

**Insecurity in Mexico** of which a large part takes place in the North of Mexico and could affect company's operations (Chihuahua).

## **Company description**

GCC is a holding company and leading company that operates in the corridor that extends from northern Mexico to the US-Canada border, whose subsidiaries are mainly engaged in the production, distribution and sale of gray Portland cement, ready-mix concrete, aggregates and other materials for construction. In 2017, cement sales represented around 58% of total revenues, specifically 31%, and others (concrete block, aggregates and others) reported 11%. With 76 years in the cement business, GCC has a track record of organic growth and strategic acquisitions in the US. The company is a leader in the production and supply of cement and concrete in the markets in which it operates. The company's operations are vertically integrated, which helps them manage costs at each stage of the production, distribution and sale of their products.

**GCC – Geographic presence / Assets**



**Assets**

As of 2Q18, GCC operated 8 plants for the production of cement with an installed annual capacity of 5.4 million metric tons of cement, 92 ready-mix plants, 19 cement terminals and 2 distribution centers. GCC expects to strengthen its presence in the US main markets where it participates. The company prioritizes opportunities related to assets in cement followed by concrete and aggregates with vertical integration.

In the US, it operates mainly in 15 contiguous states. Its main markets are: Pueblo, Colorado; Rapid City, South Dakota; Tijeras, New Mexico, Odessa, Texas; North Dakota and Minnesota represent around 80% of their US sales. It has 5 cement plants with an annual production capacity of 3.0 million tons located in Pueblo, Colorado; Rapid City, South Dakota; Tijeras, New Mexico; Odessa, Texas; and Three Forks, Montana. It also has 19 cement distribution centers and transfer stations, located in the states of Colorado, North Dakota, South Dakota, Iowa, Minnesota, Nebraska, New Mexico, Texas, Utah and Wyoming. On the other hand, GCC is one of the leading producers of ready-mix concrete with participation Arkansas, North Dakota, South Dakota, Iowa, Minnesota, Nebraska, New Mexico, Oklahoma and Texas. Together, these operations have 52 concrete production plants and a fleet of 291 ready-mix

trucks and 236 trucks aimed for the transportation of cement and aggregates. In addition, GCC has 2 asphalt plants and 6 aggregates plants, with presence in New Mexico and Texas. The company has a coal mine in Colorado, which meets the fuel needs of 5 cement plants. It is estimated that this mine has sufficient coal reserves to supply GCC's operation of cement plants and cover sales to third parties up to the year 2057.

In Mexico, GCC operates in the state of Chihuahua, where it has 3 cement plants with an annual production capacity of approximately 2.26 million tons in the cities of Chihuahua and Juárez, and in the town of Samalayuca. Operations also include 40 ready-mix concrete plants, 247 mixer trucks, 6 concrete block plants, 4 aggregate plants, one gypsum plant, 2 prefabricated concrete products plants and a fleet of 157 trucks aimed for transporting cement and aggregates. In Chihuahua, GCC is a leader in each of the markets in which it participates: cement, ready-mix concrete, aggregates, concrete block, prefabricated concrete products, mortar and gypsum.

### **Recent events**

On June 1<sup>st</sup>, 2018 GCC was included for the first time among MSCI's stock indexes.

On June 15<sup>th</sup>, 2018, GCC reported that it successfully completed a bank debt refinancing, thus, it reduced interest expenses (USD\$10m in the next 12m), improving terms and conditions. The new USD\$400m loan has a 5-year term, with a margin of 1.25% to 2.00% over Libor, based on the Debt/EBITDA ratio. The initial margin is 1.75%. In addition, it includes an unsecured revolving credit line of USD\$50m. This refinancing occurs followed the debt rating upgrade by S&P to BB+ with stable outlook.

Last June 25<sup>th</sup>, 2018, it was announced that GCC and CRH completed transactions for the cement and ready-mix concrete assets announced on June 14<sup>th</sup>. GCC acquired the Trident cement plant in Three Forks, Montana, with a capacity of 315,000 metric tons, from CRH and it paid USD\$107.5m. CRH acquired most of the ready-mix concrete plants and transportation assets belonging to GCC in Oklahoma and northwest Arkansas for USD\$118.5m. GCC will continue to own and operate 4 ready-mix concrete plants in the Fort Smith, Arkansas area, and will own an office building in Tulsa, Oklahoma, which will lease to CRH.

On September 24<sup>th</sup>, 2018, GCC was included in the S&P/Mexican Stock Exchange's MEXBOL Index. It should be noted that the GCC stock is highly marketable and it ranks 38<sup>th</sup> within such index (August 2018).

## Business strategy

The main components of GCC's business strategy are:

- To continue increasing profitability through cost efficiency and a pricing strategy;
- To continue providing its clients with exceptional technical and logistic services;
- Expand its product offering through innovative solutions with higher margins;
- Promote sustainable development of its operations;
- To continue strengthening and expanding its operational capacity and geographical positioning through strategic and complementary acquisitions; and
- Develop its human capital and invest in the local community.

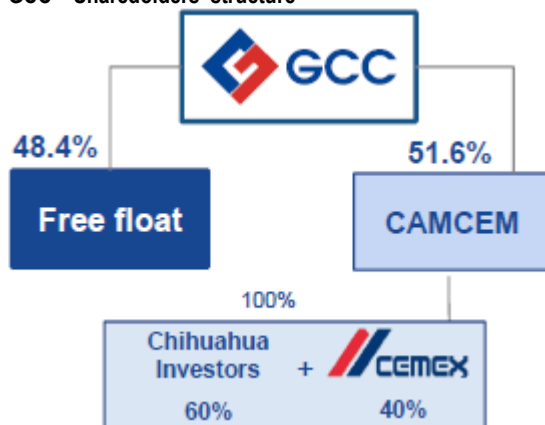
## Main shareholders

Some members of the Terrazas and Márquez families, who indirectly control CAMCEM, serve as members of the GCC Board of Directors. Therefore, through their right to vote at shareholders' meetings, they can appoint most members of the Board of Directors, and therefore maintain significant influence in GCC. Additionally, four of the current members of the Board of Directors and their respective alternates have been appointed by Cemex.

## Shareholding structure

The following image shows the ownership of GCC's capital stock. It is worth mentioning that the percentage of shares that belong to the investing public (float) is 48.4%. Cemex has a 40% stake in CAMCEM, so the holding in GCC is approximately 20% indirectly.

GCC – Shareholders' structure



Source: GCC.

The percentages exclude 4,862,492 shares in Treasury.

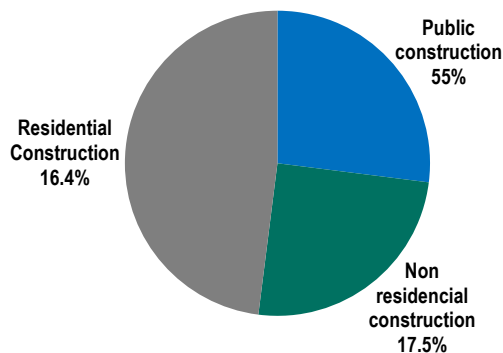
## Sector with growth potential in GCC markets

Sales of the main products, cement and ready-mix concrete, as well as other construction materials, are closely related to global economic conditions as they are highly dependent on building and construction industry costs as a whole, which fluctuates widely according to market cycles.

### *Characteristics and panorama of the US sector*

US cement industry is comprised by multiple producers and 78% of the installed capacity for the clinker manufacture is concentrated in 9 cement groups. According to the United States Geological Survey, in 2017, total cement consumption was 96.8 million tons, with an average used capacity of 79%. According to data published by the PCA in 2017, of total cement consumption in the US, 30% was made in residential construction, 19% in non-residential construction and the remaining 51% in public construction. With regard to GCC, the following graph shows cement consumption by sector during 2017 in the main markets where the company operates.

**Cement consumption by sector in the main markets of GCC in 2017**  
Percentage



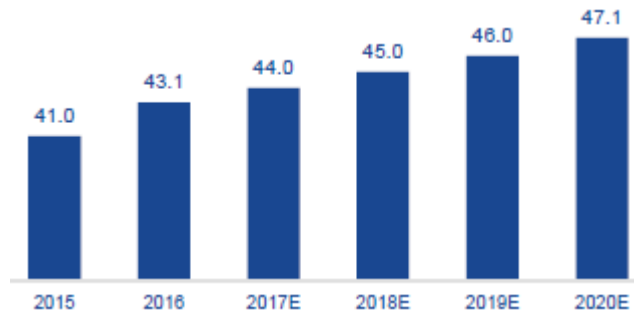
Source: GCC.

Amid the sector, producers face high entry barriers, including high capital investment requirements, investment of time necessary for the construction of a new plant, high transportation costs, obtaining permits for new plants is not easy, and high environmental standards. GCC competes mainly with LafargeHolcim, Cemex, Lehigh Portland Cement, Eagle Materials, Ash Grove Cement, Buzzi Unicem USA and Summit Materials.

It is estimated that US demand for cement will increase due to the current positive outlook for both the GDP and job creation, which can drive an increase in residential and non-residential construction spending and public infrastructure projects. Also, there are some factors that help predict a greater demand for cement in the market. One of them is the Permian oil basin in Texas, which is boosting the cement industry in that state. In 2017, 8% of total state cement consumption belonged to the oil well drilling sector, which meant an increase of 70% vs. 2016, and it is estimated that this demand will continue to grow due to the oil boom in this basin. On the other hand, there is a clear need for greater infrastructure spending in the country that leads to a positive outlook in cement demand. The following graphs show the highway budget

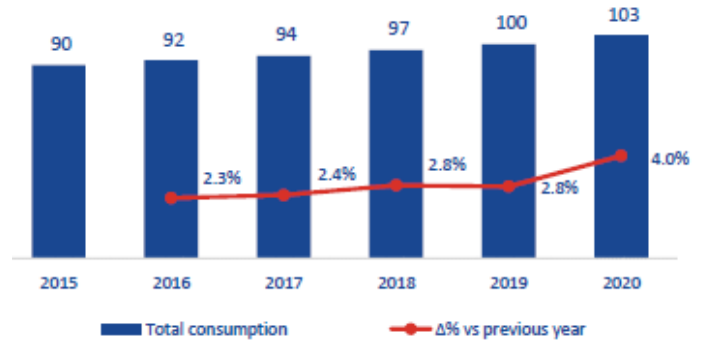
authorizations which was included in the Fixing America's Surface Transportation Act ("FAST Act"), as well as the forecast in terms of US cement consumption by the PCA, which expects advances of 2.8% yoy for 2018 and 2019.

**Highway budget authorizations included in the FAST Act**  
USD, billion



Source: GCC / U.S. DOT Federal Highway Administration, PCA, and DBA.

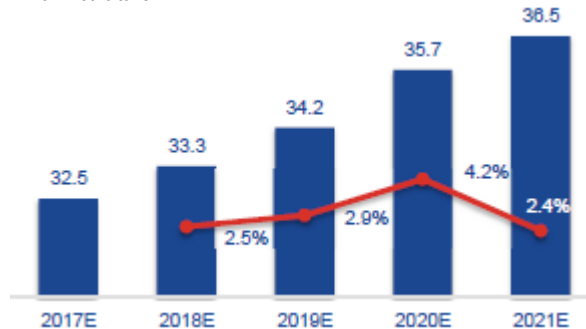
**Forecast total cement consumption in US**  
Million metric tons



Source: PCA Spring 2018 Forecast Analysis.

It is worth mentioning that consumption of cement in the main markets where GCC participates is expected to post a CAGR of 3.0% for the 2017-2021 period.

**Forecast cement consumption in all GCC US markets**  
Million metric tons



Source: GCC.

On the other hand, an additional increase in prices is expected in most of the states, since cement demand is expected to exceed supply around 2020, considering that capacity expansion will be moderate.

In relation to ready-mix, the versatility and durability of the material has led to it being the most used in the construction industry. In the US, the concrete industry is very fragmented and has a large variety of participants, and consumes about 75% of cement in that country.

### ***Characteristics and panorama of the sector in Mexico***

The cement industry in Mexico evolved from a regional fragmentation in the 1970s to the consolidation of some companies as of today. The 6 companies that compete in the cement industry in Mexico are: Cemex, Holcim, Corporación Moctezuma, Cooperativa La Cruz Azul, Cementos Fortaleza and GCC. Due to the constant modernization of the plants, the Mexican cement industry is one of the most competitive in terms of costs. Domestically, most cement sales (approximately 80% nationwide) are made at retail, who use it

for housing and other basic construction projects, which requires an efficient network of distributors and builders. The remaining amount is sold through ready-mix concrete producers, concrete products manufacturers and construction sector contractors.

The ready-mix concrete producers mix the concrete ingredients in their plants and supply it to the local works through revolving trucks that empty the concrete. We must remember that ready-mix concrete industry in Mexico is under development.

Unlike more developed economies where cement sales are concentrated in the industrial and retail sectors (with bulk sales), in Mexico, bagged cement sales represent a high percentage of private sector demand.

In Chihuahua, approximately 31% of cement volume is sold as ready-mix concrete. Since in this state approximately 32% of the cement is sold in bags, one of the main competitive advantages that GCC has is consumer loyalty to the brand "Cemento Chihuahua", which has a very important roots within the community.

The proximity of Chihuahua with the US means that there is a relationship between the economic growth of that country and that of the state. It is expected that Chihuahua will benefit from the US economy dynamism and that the private sector will stand as the main growth driver in terms of demand. Moreover, it should be noted that GCC has the capacity and flexibility to supply the demand of Texas and New Mexico from Samayaluca and Juárez.

Prices in the industry vary from region to region, influenced by supply and demand, the economic situation, plants locations, access to raw materials and the flexibility that plants have in terms of fuel consumption. The positive trend of GCC product prices is expected to resume given the favorable dynamics of the market, including exports as a relevant factor.

## 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, Francisco Duarte Alcocer 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.

## Last-twelve-month activities of the business areas.

**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.

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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.

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

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.

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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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## History of PT and Ratings

Stock	Date	Rating	PT
GCC	10/1/18	Buy	MXN\$155.00

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