

BEVERAGE

Sector Note

December 22, 2020

Attractive valuations in view of recovery

- The beverage sector in 2021 is shaping up for a recovery in volumes, supported by economic reopening, although higher concentrate and raw material costs would pose some challenges
- Risk balance remains more benign for AC, given its geographic exposure and potential for additional efficiencies at the new Texas plant, so we continue to favor this issuer
- We establish our PT2021 at MXN 126.00 and MXN 114.00 for AC and KOF, respectively. Given the attractive valuation vs. the sector, our recommendation for both is BUY

Even with challenges, a recovery environment is in sight. Despite industry's historical resilience, bottlers have been no strangers to the onslaught of the COVID-19 pandemic and the complicated macroeconomic environment, primarily through drops in traditional South American channel and Food Service On-Premise (FSOP) volumes. In this context, given the imminent end of the sanitary crisis with the vaccines about to be distributed, 2021 is shaping up to be a year of [economic recovery](#), which we anticipate will result in a significant volume rebound (+4.2% y/y on average). However, the increase in the price of some raw materials such as PET (~15% of costs) – hand in hand with oil price– and sugar; but above all, the increase in concentrate costs in Mexico, could pose challenges for bottlers' profitability, even more so considering that concentrate represents ~28% of their costs. Still, it is worth noting that, taking advantage of the low raw material price environment we have seen this year, the bottlers have already covered part of the needs for 2021, which together with additional efficiencies, should help to partially offset the headwinds already described.

With room for a rerating. Bottlers' valuation in Latin America reflects a deeper impact of the pandemic, as they are priced at a discount of close to 25% compared to the average bottler in developed economies. In our opinion, this opens the door to more dynamic mergers and acquisitions, also motivated by the strong investment and logistical capabilities that will be required for the digitalization of the sector, which would lead to further consolidation. Meanwhile, we believe that the recent acquisition of *Coca-Cola Amatil Limited* (CCL) by *Coca-Cola European Partners* (CCEP) at a multiple of 11.3x FV/EBITDA 2021E, has shown that the valuation levels at which AC and KOF are quoted have room for a rerating, even more so considering the recovery outlook.

Factors that could pose challenges to profitability. As of July, a new agreement came into effect between both *Coca-Cola Femsa* and *Arca Continental* with *The Coca-Cola Company*. As a result, concentrate costs in

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Consumer and Telecom

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AC - BUY	
Current Price	\$97.67
PT 2021	\$126.00
Dividend 2021	\$5.38
Dividend Yield (%)	5.5%
Upside Potential	34.5%
Valuation metrics TTM	
FV/EBITDA	7.4x
P/E	17.1x
MSCI ESG Rating*	A

KOF - BUY	
Current Price	\$92.02
PT 2021	\$114.00
Dividend 2021	\$5.1
Dividend Yield (%)	5.5%
Upside Potential	29.4%
ADR Price	US\$46.40
PT2021 ADR	US\$57.60
Shares per ADR	10
Valuation metrics TTM	
FV/EBITDA	6.6x
P/E	20.9x
MSCI ESG Rating*	A

Index

Beverage Sector	1
AC	4
Financial Statements	5
2021 Estimates	6
Valuation	7
KOF	8
Financial Statements	9
2021 Estimates	10
Valuation	11
Relative Valuation	12

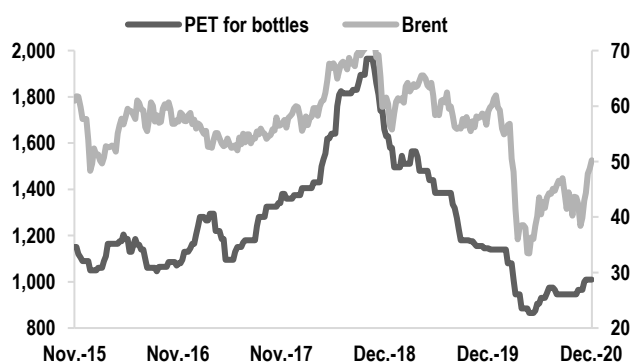
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Mexico increased again. Although none of the issuers shared details regarding this matter, based on comments made by AC's management team in the [3Q20](#) results call, we estimate that it could represent ~100bps of revenues. This increase is relevant for the impact it could have on the profitability of both bottling companies, considering that this input represents about 28% of the costs.

At the same time, after the sharp drop in commodity prices seen in the wake of the pandemic, those prices have recovered. According to *Polymerupdate*, the price of a PET metric ton for bottles on the US West Coast has rebounded 14.1% to US \$1,010 from its lowest point in April of this year. Meanwhile, Brent –which in the last 5 years has a correlation of 0.82 with PET price for bottles– has rebounded 54.7% from its April low. In this regard, Bloomberg's consensus estimates that Brent oil will continue to appreciate towards 2022, closing at \$48.00/barrel in 2021, and US\$55.00/barrel in 2022, which could pose upward risks to PET prices going forward.

PET bottle prices on the US West Coast and Brent

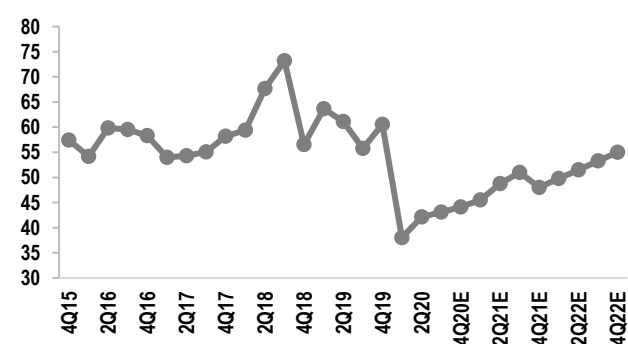
Left axis US\$/Metric Ton, Right axis US\$/barrel



Source: Refinitiv EIKON, Polymerupdate, Banorte

Price of Brent Barrel

US\$/barrel



Source: Bloomberg, Banorte

We still prefer AC. Even though we estimate interesting potential returns for both issuers (AC 34.5%; KOF 29.4%), and the valuation of KOF is more attractive, we continue to favor Arca Continental due to its geographic exposure to countries where a more vigorous economic recovery is anticipated, such as the United States, as well as emerging countries with greater growth amplitude after the pandemic's ravages, such as Peru and Argentina.

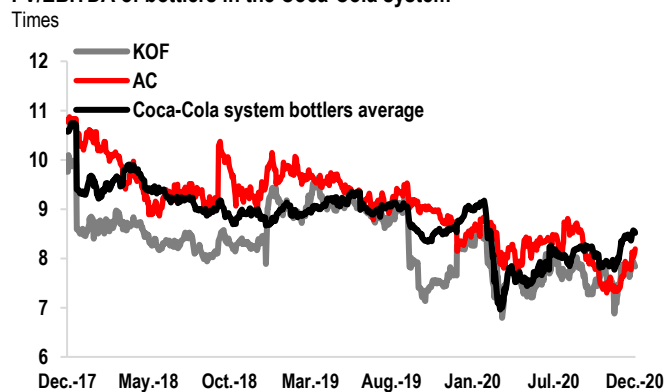
In our opinion, its income will also be enhanced by (1) the on-premise channel restoration (e.g. restaurants, pubs, movie theaters, etc.) upon activities resumption and the deployment of COVID-19 vaccines, recalling that this channel represents ~10% of company's consolidated volume –and in the US represents ~20%–; and (2) the development of its digital channel with significant growth in the US market that opened the door to direct sales to the final consumer (B2C). In this context, we estimate that its volume will grow by 4.4% in 2021E. Additionally, we believe that the production plant in Texas, which began operations in March of this year, will continue to offer the capacity to generate significant additional efficiencies, which would support company's profitability and neutralize the negative effect of the concentrate and raw material price increases. Notwithstanding the foregoing, it should

also be noted that the appreciation of the Mexican peso would result in an adverse FX conversion effect on US operations. As for KOF, our outlook for the end of 2021 is equally positive, despite its operation in regions where a more prolonged recovery is expected, we estimate a consolidated volume growth of 4.0% 2021E, supported by the greater extent of its operations, digital capabilities, and a solid omnichannel strategy.

Possible space for rerating. The recent acquisition of *Coca-Cola Amatil Limited* (CCL) by *Coca-Cola European Partners* (CCEP) for €6.5 billion, equivalent to a 11.3x FV/EBITDA 2021E multiple according to Bloomberg's consensus, set a breaking point in the sector on two fronts: (a) Coca-Cola Femsa ceased to be the largest bottler in the *Coca-Cola* system globally; and (b) it set a recent precedent over the valuation that the market is willing to assign to a resilient business model such as bottlers.

Clearly, Amatil's exposure to Oceania and Southeast Asia is not entirely comparable to KOF or AC, however, it revealed that the sector's discount in Latin America seems excessive, reflecting in our opinion, a deeper impact by the sanitary crisis, and a recovery that is outlined to be more prolonged. Consequently, we believe that current valuation for the bottlers under coverage (AC 7.4x FV/EBITDA LTM, and KOF 6.7x) presents an interesting space to be rerated, even more when considering the recovery outlook that we are foreseeing, which from our point of view would justify that, at least, both issuers be paid in line with the average bottlers of the *Coca-Cola* system (8.6x), as it has already happened before.

FV/EBITDA of bottlers in the Coca-Cola system



Source: Bloomberg, Banorte

AC

Better positioned, due to its US business

- **A more vigorous recovery in South American volumes, in view of economic reopening, and operational efficiencies in the US would offset a more challenging cost environment**
- **Although concentrate increase would put pressure on profitability in Mexico, better operating leverage in Peru and Ecuador, and Texas plant benefits would boost EBITDA margin by 30bps**
- **We establish a MXN 126.00 PT2021 (8.1x FV/EBITDA 2021E, above current multiple and sector's average of 7.6x, upon the positive outlook). For its attractive valuation we recommend BUY**

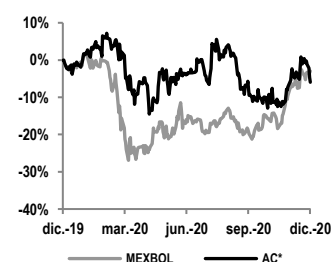
Growth throughout all the income statement. Arca Continental confirmed to be a resilient company during a complicated economic environment. Although we saw effects on sales volume –mainly during 2Q20 in the traditional channel in South America–, there has also been a recovery as economic activity has reopened. Looking ahead, we believe that its geographic exposure will allow it to recover more vigorously, due to its presence in both defensive countries and those in which growth is projected to be more accelerated given the deeper impact of the health crisis. With this in mind, we estimate that volume will recover 4.4% y/y, while the affordability strategy would result in price increases in line with inflation in most countries. Thus, we project consolidated revenues to grow 3.3% year-over-year to MXN 175.3 billion, impacted by a negative FX conversion effect in *Southwest*, due to US dollar weakening. Meanwhile, we estimate that Mexico's profitability pressures, due to higher concentrate costs, and higher PET and aluminum prices, would be offset by operating efficiencies, additional benefits from the new plant in Texas, and an improved operating leverage in South America.

Through a DCF valuation model, we set our PT2021 at MXN 126.00, which implies a FV/EBITDA 2021E multiple of 8.1x, above the current 7.4x valuation and the 7.6x estimated average of comparable companies for 2021 in light of the favorable outlook. For its attractive valuation we recommend BUY.

BUY

Current Price	\$97.67
PT 2021	\$126.00
Dividend 2021	\$5.38
Dividend Yield (%)	5.5%
Upside Potential	34.5%
Max – Min LTM (\$)	111.80 – 86.33
Market Cap (US\$m)	8,719.0
Shares Outstanding (m)	1,764.3
Float	22%
Daily Turnover US\$m	139.5
Valuation metrics TTM	
FV/EBITDA	7.4x
P/E	17.1x
MSCI ESG Rating*	A

Relative performance to Mexbol LTM



Financial Statements

	2018	2019	2020E	2021E
Revenue	158,953	162,728	169,663	175,274
Operating Income	18,571	20,200	21,446	24,029
EBITDA	27,467	30,403	31,867	33,560
EBITDA Margin	17.3%	18.7%	18.8%	19.1%
Net Income	8,703	9,548	10,379	12,026
Net Margin	5.5%	5.9%	6.1%	6.9%
Total Assets	237,879	238,895	264,099	266,420
Cash	15,941	22,038	33,953	38,179
Total Liabilities	98,350	97,615	105,876	106,536
Debt	55,827	54,444	57,034	56,018
Common Equity	139,530	141,281	158,223	159,884

Valuation and Financial metrics

	2018	2019	2020E	2021E
FV/EBITDA	8.7x	7.7x	7.2x	6.6x
P/E	19.8x	18.0x	16.6x	14.3x
P/BV	1.5x	1.5x	1.4x	1.4x
ROE	6.2%	6.8%	6.9%	7.6%
ROA	3.7%	4.0%	3.9%	4.5%
EBITDA/ interest	7.0x	8.5x	9.1x	11.3x
Net Debt/EBITDA	1.5x	1.1x	0.7x	0.5x
Debt/Equity	0.4x	0.4x	0.4x	0.4x

Source: Banorte

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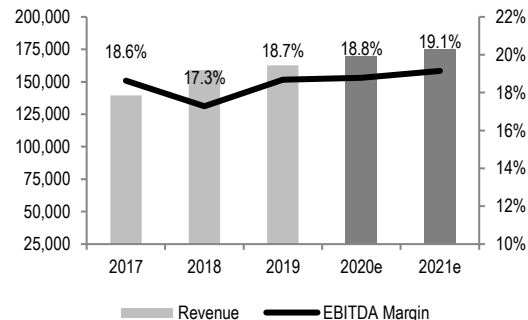
AC- Financial Statements

MXN, million

Income Statement					
Year	2018	2019	2020e	2021e	CAGR
Net Revenue	158,953	162,728	169,663	175,274	3.3%
Costs of goods sold	89,712	89,654	93,902	97,012	2.6%
Gross profit	69,241	73,073	75,761	78,262	4.2%
General expenses	50,813	52,278	53,728	53,592	1.8%
Operating Income	18,571	20,200	21,446	24,029	9.0%
Operating Margin	11.7%	12.4%	12.6%	13.7%	5.5%
Depreciation	7,942	8,937	9,752	9,531	6.3%
EBITDA	27,467	30,403	31,867	33,560	6.9%
EBITDA Margin	17.3%	18.7%	18.8%	19.1%	
Interest Income (Expense) net	(4,113)	(3,592)	(3,078)	(2,843)	-11.6%
Interest expense	3,924	3,589	3,502	2,970	-8.9%
Interest income	820	783	721	832	0.5%
Other income (expense)	(568)	(542)	(692)	(601)	1.9%
Foreign exchange gain (loss)	(441)	(244)	395	(104)	-38.2%
Unconsolidated subsidiaries	223	167	(130)	(230)	201.0%
Income before taxes	14,681	16,647	18,284	20,956	12.6%
Income taxes	3,860	5,052	5,721	6,571	19.4%
Discontinued operations					
Consolidated Net Income	10,821	11,723	12,516	14,385	10.0%
Non-controlling interest	2,118	2,175	2,137	2,358	3.6%
Net Income	8,703	9,548	10,379	12,026	11.4%
Net Margin	5.5%	5.9%	6.1%	6.9%	
EPS	4.933	5.412	5.883	6.817	11.4%
Balance Sheet					
Total Current Assets	37,568	41,808	53,301	57,151	15.0%
Cash & Short Term Investments	15,941	22,038	33,953	38,179	33.8%
Long Term Assets	200,312	197,087	210,799	209,269	1.5%
Property, Plant & Equipment (Net)	74,079	71,937	70,883	69,571	-2.1%
Intangible Assets (Net)	60,784	59,191	65,951	65,951	2.8%
Total Assets	237,879	238,895	264,099	266,420	3.8%
Current Liabilities	23,827	28,247	31,263	32,794	11.2%
Short Term Debt	2,672	7,015	7,196	7,051	38.2%
Accounts Payable	19,729	19,849	22,388	21,572	3.0%
Long Term Liabilities	74,523	69,368	74,613	73,742	-0.4%
Long Term Debt	53,155	47,429	49,838	48,967	-2.7%
Total Liabilities	98,350	97,615	105,876	106,536	2.7%
Common Stock	139,530	141,281	158,223	159,884	4.6%
Non-controlling interest	27,727	28,509	32,663	33,006	6.0%
Total Equity	111,802	112,771	125,560	126,878	4.3%
Liabilities & Equity	237,879	238,895	264,099	266,420	3.8%
Net Debt	39,886	32,406	23,081	17,839	-23.5%
Cash Flow					
	2018	2019	2020e	2021e	
CF from Operating Activities	20,614	28,741	28,452	26,371	
CF from Investing Activities	(10,483)	(12,134)	(5,776)	(9,684)	
CF from Financing Activities	(17,217)	(10,219)	(13,632)	(12,461)	
FX difference in cash & equivalents	(815)	(292)	2,857		
Change in Cash Balance	(7,901)	6,097	11,902	4,226	

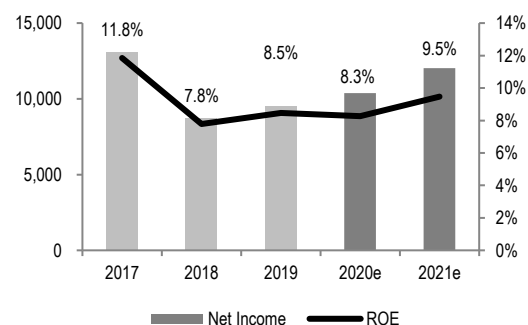
Revenue & EBITDA Margin

MXN, million



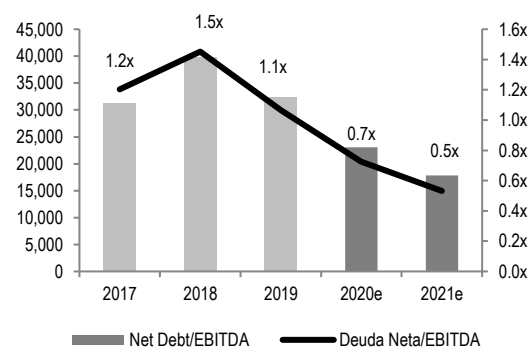
Net Income & ROE

MXN, million



Net Debt & Net Debt to EBITDA ratio

MXN, million



Source: Banorte, BMV.

2021 Estimates

Despite the relative resilience that AC showed during the pandemic, the company suffered a significant impact on its volumes, primarily in the traditional South American channel and in the one of Food Service On-Premise (FSOP) –the latter with a ~10% weighting in the consolidated volume, and ~20% in the US –. In this regard, it is worth noting that the effect on the issuer's results was exacerbated by the magnitude of the sanitary crisis, mainly in Ecuador and Peru, and that it was not only due to containment measures implemented at the global level. Nevertheless, we also observed a significant sequential recovery as economies reopened. With this in mind, looking ahead to a more encouraging 2021, and shaping up towards the end of the pandemic with the eventual deployment of COVID-19 vaccines, our estimates assume: (1) an increase in consolidated volume of 4.4% y/y, reaching 2.2 billion unit cases, which would be explained by a 10.9% recovery in the Southern Cone (Peru: +15.4% y/y; Ecuador: +7.7% y/y; Argentina: +3.9% y/y), and to a lesser extent by 2.8% and 2.4% growth, in the US and Mexico, respectively; (2) price increases in local currency in line with inflation; (3) a [USD/MXN FX trajectory closing at MXN \\$19.80 in 2021](#) that would have an unfavorable effect on the US operation; and (4) higher raw material costs (mainly PET), compared to the favorable environment observed in 2020, as well as an increase in the concentrate cost in Mexico –estimated at 100bps/sales– due to the new agreement with *The Coca-Cola Company*. As a result, we estimate that total revenue will reach MXN 175.3 billion, equivalent to a 3.3% y/y growth (Mexico: +6.0%e; US: -1.5%e; South America: +7.3%). Meanwhile, EBITDA would register an increase of 5.3% y/y, reaching MXN 33.6 billion, and with consolidated EBITDA margin expanding by 30bps to 19.1%, reflecting strict expense control in Mexico, the aforementioned US efficiencies, and volume rebound in the Southern Cone, thereby offsetting the increase in concentrate and raw material costs –although it is also worth noting that we assumed hedges for a good part of AC needs during 1H21 –. In this context, we expect profitability in our country to erode by 90bps to 23.1%, while in the US we project it to remain stable at 13.3%, and in South America to recover by 120bps to 19.6% (Peru: +0.5pp to 22.3%; Ecuador: +1.8pp to 18.6%; Argentina: +0.1pp to 13.8%). On a net level, we anticipate a MXN 12.0 billion income, with a solid 15.9% year-over-year growth, due to a decrease in CFC (-7.6%e) as a result of the favorable effect of the peso's strengthening on the company's debt (net debt -22.7% y/y), and lower interest rates. Finally, we expect CAPEX to reach MXN 10.5 billion (+54% y/y), as investments normalize after the implementation of prudential measures to preserve liquidity in the face of the complex economic environment.

Valuation and PT2021 of MXN 126.00

For the calculation of AC shares' theoretical value, we used a discounted cash flow (DCF) valuation model, based on free cash flow to the firm (FCFF), obtaining a PT2021 of MXN 126.00, which would represent an 8.1x FV/EBITDA 2021E multiple, above current valuation and the average of our Coca-Cola system bottler sample of 7.6x for 2021. In our model we assume an 8.8% weighted average cost of capital (WACC), for which we estimate a cost

KOF

Concentrate increase would pressure margins

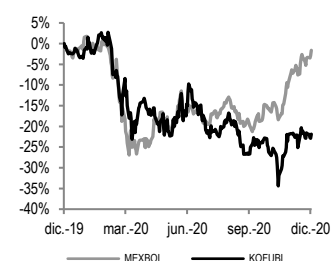
- Exposure to economies with a more modest recovery would be reflected in a slightly more moderate volume growth (+4.0%e), though with a slightly favorable exchange rate effect
- Meanwhile, higher concentrate cost in Mexico and increased raw material prices, such as PET and sugar, would put pressure on Coca-Cola Femsa's EBITDA margin by 40bps
- We establish a PT2021 of MXN 114.00, which implies a 7.7x FV/EBITDA 2021E multiple, higher than the current one but in line with the sector average (7.6x). We recommend BUY

Valuation reflects an excessive discount. After the impact of the pandemic on Coca-Cola Femsa's volumes, a more favorable scenario in 2021 would drive a recovery for said indicator. However, we estimate that KOF exposure to countries where recovery is expected to be more gradual would be reflected in slightly more modest relative growth (+4.0%e). Meanwhile, appreciation of the peso against other Latin American currencies would give an additional boost to revenues, which we estimate will rise 5.5% year-over-year to MXN 192.7 billion. Furthermore, we project that EBITDA margin could contract by 40bps y/y to 19.7%, due to the concentrate cost increase in Mexico agreed with *The Coca-Cola Company* this year, as well as the rise in raw material prices (such as PET and aluminum), which would counteract operating efficiencies, and strict cost and expense control. As a result, EBITDA would grow 3.4% y/y to MXN 37.9 billion. Through a DCF valuation model, we establish our PT2021 at MXN 114.00, which implies a 7.7x FV/EBITDA 2021E multiple, higher than the current valuation, in line with the sector average of the Coca-Cola system bottlers, but below AC.

Although we believe that the relative discount kept by the issuer seems excessive, and opens space for a rerating -even more so in light of the recovery outlook in volumes-, we believe that profitability pressure, for the time being, still justifies a discount similar to the one KOF has historically kept from AC. However, the relative valuation is attractive which is why we recommend BUY.

BUY	
Current Price	\$92.02
PT 2021	\$114.00
Dividend 2021	\$5.1
Dividend Yield (%)	5.5%
Upside Potential	29.4%
ADR Price	US\$46.40
PT2021 ADR	US\$57.60
Shares per ADR	10
Max – Min LTM (\$)	122.00 – 77.00
Market Cap (US\$m)	9,752.7
Shares Outstanding (m)	2,100.8
Float	22%
Daily Turnover US\$m	76.8
Valuation metrics TTM	
FV/EBITDA	6.7x
P/E	21.2x
MSCI ESG Rating*	A

Relative performance to Mexbol
LTM



Financial Statements

	2018	2019	2020E	2021E
Revenue	196,113	194,660	182,697	192,677
Operating Income	25,279	25,437	23,843	23,850
EBITDA	36,924	37,180	36,684	37,943
EBITDA Margin	18.8%	19.1%	20.1%	19.7%
Net Income	14,002	12,100	10,017	12,891
Net Margin	7.1%	6.2%	5.5%	6.7%
Total Assets	263,787	257,841	277,212	274,757
Cash	23,727	20,491	51,970	53,078
Total Liabilities	132,037	128,154	154,863	149,210
Debt	81,804	71,360	100,011	98,106
Common Equity	131,750	129,686	122,349	125,546

Source: Banorte

Valuation and Financial metrics

	2018	2019	2020E	2021E
FV/EBITDA	7.0x	6.7x	6.7x	6.5x
P/E	13.8x	16.0x	19.3x	15.0x
P/BV	1.5x	1.6x	1.7x	1.6x
ROE	10.3%	9.3%	7.9%	10.4%
ROA	5.3%	4.7%	3.6%	4.7%
EBITDA/ interest	4.9x	5.4x	4.6x	5.9x
Net Debt/EBITDA	1.6x	1.4x	1.3x	1.2x
Debt/Equity	0.6x	0.6x	0.8x	0.8x

KOF – Financial Statements

MXN, million

Income Statement

Year	2018	2019	2020e	2021e	CAGR
Net Revenue	196,113	194,660	182,697	192,677	-0.6%
Costs of goods sold	107,992	107,070	100,109	106,884	-0.3%
Gross profit	88,121	87,590	82,589	85,793	-0.9%
General expenses	61,481	60,604	57,429	60,633	-0.5%
Operating Income	25,279	25,437	23,843	23,850	-1.9%
Operating Margin	12.9%	13.1%	13.1%	12.4%	-1.3%
Depreciation	11,645	11,743	12,841	14,094	6.6%
EBITDA	36,924	37,180	36,684	37,943	0.9%
EBITDA Margin	18.8%	19.1%	20.1%	19.7%	
Interest Income (Expense) net	(6,925)	(6,089)	(6,342)	(4,874)	-11.0%
Interest expense	7,591	6,912	7,997	6,407	-5.5%
Interest income	1,075	1,234	1,151	1,270	5.7%
Other income (expense)	(138)	(77)	297	306	230.4%
Foreign exchange gain (loss)	(271)	(333)	207	(42)	-46.3%
Unconsolidated subsidiaries	(226)	(131)	(171)	(57)	-36.7%
Income before taxes	17,589	18,292	17,427	18,919	2.5%
Income taxes	5,627	5,645	4,735	5,205	-2.6%
Discontinued operations	3,200				
Consolidated Net Income	8,761	12,629	10,061	13,714	16.1%
Non-controlling interest	1,159	529	44	823	-10.8%
Net Income	14,002	12,100	10,017	12,891	-2.7%
Net Margin	7.1%	6.2%	5.5%	6.7%	
EPS	6.665	5.759	4.768	6.136	-2.7%

Balance Sheet

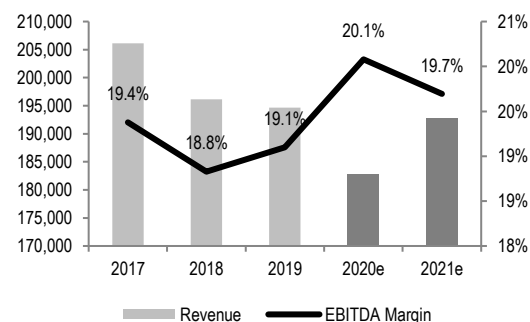
Total Current Assets	57,491	56,797	83,826	86,930	14.8%
Cash & Short Term Investments	23,727	20,491	51,970	53,078	30.8%
Long Term Assets	206,297	201,043	193,386	187,827	-3.1%
Property, Plant & Equipment (Net)	61,942	61,188	56,622	51,015	-6.3%
Intangible Assets (Net)	93,075	89,121	84,173	84,173	-3.3%
Total Assets	263,787	257,841	277,212	274,757	1.4%
Current Liabilities	45,523	51,010	56,682	52,843	5.1%
Short Term Debt	11,604	11,968	14,627	14,535	7.8%
Accounts Payable	25,832	30,645	32,762	28,467	3.3%
Long Term Liabilities	86,514	77,145	98,180	96,368	3.7%
Long Term Debt	70,201	59,392	85,384	83,571	6.0%
Total Liabilities	132,037	128,154	154,863	149,210	4.2%
Common Stock	131,750	129,686	122,349	125,546	-1.6%
Non-controlling interest	6,807	6,752	5,779	6,601	-1.0%
Total Equity	124,943	122,934	116,570	118,945	-1.6%
Liabilities & Equity	263,787	257,841	277,212	274,757	1.4%
Net Debt	58,078	50,869	48,041	45,028	-8.1%

Cash Flow

	2018	2019	2020e	2021e
CF from Operating Activities	29,543	31,292	28,886	18,003
CF from Investing Activities	(9,253)	(10,744)	(7,222)	(8,364)
CF from Financing Activities	(14,274)	(22,794)	8,111	(16,923)
FX difference in cash & equivalents	(1,056)	(989)	3,379	8,384
Change in Cash Balance	4,960	(3,236)	33,154	1,100

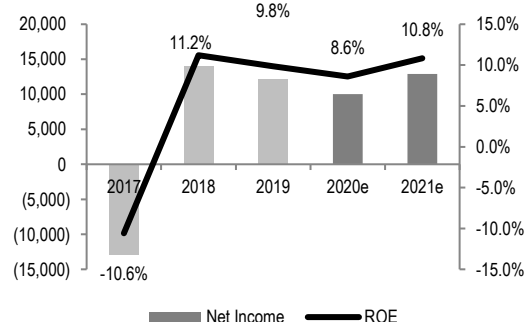
Revenue & EBITDA Margin

MXN, million



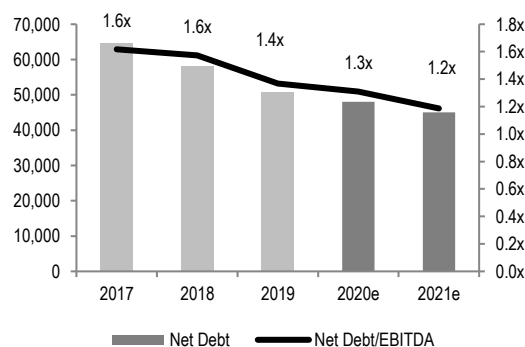
Net Income & ROE

MXN, million



Net Debt & Net Debt to EBITDA ratio

MXN, million



Source: Banorte, BMV.

2021 Estimates

After going through an extremely adverse economic environment in 2020, the outlook for 2021 is positive. We should recall that confinement represented a drop in volumes for KOF, due to store closures and a decline in demand for Food Service On-Premise (FSOP). Consequently, as economies get back on their feet –although with heterogeneous performance across countries– we should also see a recovery in the Bottler's sales volumes. However, we believe that KOF's geographic exposure would result in more moderate growth vis-à-vis AC, reflecting its operation in some countries where recovery is outlined to be more gradual. With this in mind, we estimate a 4.0% year-over-year growth for this indicator, reaching 3.4 billion unit cases at the consolidated level in 2021. This would be explained by an increase of 4.1% in Mexico and Central America (Mexico +4.3%e; CA +2.9%e), and 4.0% in South America (Colombia +5.8%e, Brazil +2.8%e, Argentina +7.7%e, and Uruguay +4.0%e). In addition, we anticipate that promotion of smaller and returnable presentations –derived from its affordability commercial strategy– would be reflected in price increases below inflation in most regions. However, the strengthening of the peso against other functional currencies would give an additional stimulus to sales from other latitudes, so that its total revenue would grow 5.5% to MXN 192.7 billion (Mexico and CA: +7.3%e; South America: +2.9%e).

For its part, we estimate a 70bps pressure on gross margin due to two factors: (1) Concentrate cost increase in Mexico (~28% of costs); and (2) raw materials price increase (mainly PET for bottles and aluminum), normalizing levels after the favorable environment seen in 2020, and offsetting the effect of hedges made for part of the needs in 2021. Meanwhile, consolidated EBITDA would reach MXN 37.9 billion (+3.4%e y/y), and EBITDA margin would drop 40bps y/y to 19.7%e, despite operating efficiencies, and the cost and expense control strategy implemented by the company. By region, we expect profitability in Mexico and CA to erode 90bps to 22% for the reasons already mentioned, while in South America we expect a slight expansion of 10bps in view of better operating leverage. Moving forward in the income statement, we estimate a 23.2% y/y decrease in CFC, reflecting lower interest payment (-19.9%e y/y) due to the company's debt reduction as a result of the peso's appreciation (ND -6.3%e y/y), and lower interest rates. With this in mind, the significant operating recovery would permeate to the net income level, which would increase 28.7% y/y to MXN 12.9 billion. Finally, we estimate that the company will exercise a CAPEX of MXN 9.6 billion (+17.8% y/y), as investment return to pre-pandemic levels.

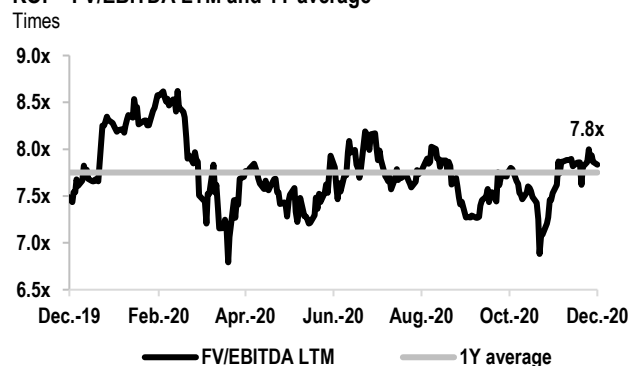
Valuation and PT2021 of MXN 114.00

Through a discounted cash flow (DCF) valuation model, based on the free cash flow to the firm (FCFF), we determined a PT2021 of MXN 114.00 per related unit. In our calculation, we assumed a weighted average cost of capital (WACC) of 9.1%, which in turn was calculated with a 0.8 beta, a risk-free rate of 6.75% ([closing 2021E of the 10-year M-bond](#) by our Fixed Income and FX analysis team), a 36% debt/equity ratio, and a market risk premium of 6.0%. In addition, for the terminal value we assume a 7.0x FV/EBITDA output multiple, below

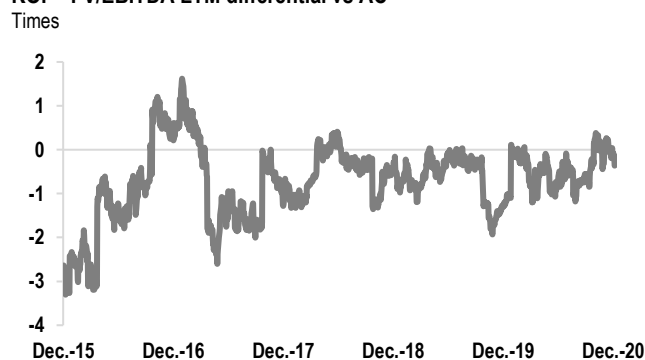
the one used in AC and of comparable companies. In our view, this discount (although in line with the one it has kept against its peer in Mexico) is justified given KOF's geographic exposure, which as we have already mentioned presents greater challenges, as well as the outlook of margin deterioration, and higher leverage.

Our PT represents a FV/EBITDA 2021E multiple of 7.7x, higher than the current valuation, in line with the 2021 Coca-Cola system bottlers average of 7.6x, but below AC. We believe that current valuation at 6.5x FV/EBITDA 2021E reflects an excessive discount, representing an attractive entry point, and therefore our recommendation is BUY.

KOF - FV/EBITDA LTM and 1Y average



KOF - FV/EBITDA LTM differential vs AC



Source: Bloomberg, Banorte

Discounted cash flow valuation (DCF)

MXN, million

	2021e	2022e	2023e	2024e	2025e	2026e	Perp.
(+) EBITDA	37,943	41,666	43,749	45,937	48,234	50,645	
(-) Working Capital	(3,070)	(3,174)	(3,500)	(3,675)	(3,859)	(4,052)	
(-) Fixed Capital Investment	(9,634)	(10,351)	(10,868)	(11,412)	(11,982)	(12,581)	
(-) Taxes	(8,575)	(8,822)	(9,625)	(10,106)	(10,611)	(11,142)	
(=) Cash Flow	16,665	19,319	19,756	20,744	21,781	22,870	
(+) Perpetuity	0	0	0	0	0	0	354,518
(=) FCFF	16,665	19,319	19,756	20,744	21,781	22,870	354,518
Risk-free Rate	6.8%						
Market Risk	6.0%						
Beta	0.8						
CAPM	11.4%						
Cost of Debt	7.0%						
Tax Rate	30.0%						
Net Cost of Debt	4.9%						
Debt/Capital	36%						
WACC	9.1%						
EBITDA Multiple	7.0x						
					(+)FCFs Present Value		80,437
					(+) Perpetuity Present Value		210,156
					= Enterprise Value		290,593
					(-) Net Debt		(45,028)
					(-) Minority Interest		(6,601)
					(=) Equity Value		238,964
					Shares Outstanding		2,101
					Target Price \$		113.75
					Current Price		92.02
					Upside Potential		23.6%

Source: Banorte

Relative Valuation

Stock	Market Cap (US\$m)	FV (US\$m)	P/BV	P/E			FV/EBITDA			Dividend Yield
				LTM	2020E	2021E	LTM	2020E	2021E	
COCA-COLA FEMSA SAB DE CV	9,716	12,327	1.6x	21.2x	19.3x	15.0x	6.7x	6.7x	6.5x	5.3%
ARCA CONTINENTAL SAB DE CV	8,661	11,730	1.3x	17.1x	16.6x	14.3x	7.4x	7.2x	6.6x	1.0%
COCA-COLA CONSOLIDATED INC	2,518	3,644	5.6x	24.5x	16.1x	14.7x	7.9x			0.4%
EMBOTELLADORA ANDINA-PREF B	2,151	3,046	2.1x	10.2x	14.4x	13.3x	6.0x	6.7x	6.3x	4.6%
COCA-COLA EMBONOR SA-B	646	923	1.1x	12.6x	13.3x	9.5x	5.8x	6.3x	5.3x	3.1%
Average Bottling Companies America	4,738	6,334	2.3x	17.1x	15.9x	13.4x	6.8x	6.7x	6.2x	2.9%
Median Bottling Companies America	2,518	3,644	1.6x	17.1x	16.1x	14.3x	6.7x	6.7x	6.4x	3.1%
COCA-COLA EUROPEAN PARTNERS	21,464	23,738	3.0x	19.7x	22.8x	16.4x	13.6x	13.7x	11.0x	4.3%
COCA-COLA HBC AG-DI	11,629	15,401	3.9x	22.7x	22.9x	19.2x	11.3x	11.6x	10.3x	
COCA-COLA ICECEK AS	2,051	2,401	1.8x	11.3x	11.3x	10.3x	6.5x	6.4x	5.6x	
ANADOLU EFES BIRACILIK VE	1,784	3,929	1.1x	15.0x	13.7x	12.3x	5.8x	6.3x	5.4x	7.6%
Average Bottling Companies Europe	9,232	11,367	2.5x	17.2x	17.7x	14.6x	9.3x	9.5x	8.1x	5.9%
Median Bottling Companies Europe	6,840	9,665	2.4x	17.4x	18.3x	14.3x	8.9x	9.0x	7.9x	5.9%
COCA-COLA AMATIL LTD	7,100	8,698	7.0x	47.3x	30.1x	25.0x	17.2x	13.5x	12.1x	2.7%
COCA-COLA BOTTLERS JAPAN HOL	3,221	4,782	0.6x			46.8x	10.1x	8.8x	7.1x	1.5%
HOKKAIDO COCA-COLA BOTTLING	304	208	0.7x	36.5x			4.4x			1.5%
HAAD THIP PUBLIC CO LTD	232	238	2.3x	13.6x	12.6x	11.2x	7.9x	7.6x	7.0x	4.4%
Average Bottling Companies Asia/Oceania	2,714	3,481	2.7x	32.4x	21.4x	27.7x	9.9x	10.0x	8.7x	2.5%
Median Bottling Companies Asia/Oceania	1,762	2,510	1.5x	36.5x	21.4x	25.0x	9.0x	8.8x	7.1x	2.1%
Average Bottling Companies Global	5,498	7,005	2.5x	21.0x	17.6x	17.3x	8.5x	8.6x	7.6x	3.3%
Median Bottling Companies Global	2,518	3,929	1.8x	18.4x	16.1x	14.5x	7.4x	7.2x	6.6x	3.1%
ARCA CONTINENTAL SAB DE CV	8,661	11,730	1.3x	17.1x	16.6x	14.3x	7.4x	7.2x	6.6x	1.0%
Premium/Discount vs average			-47.5%	-18.4%	-5.5%	-17.5%	-13.1%	-16.5%	-12.7%	
COCA-COLA FEMSA SAB DE CV	9,716	12,327	1.6x	21.2x	19.3x	15.0x	6.7x	6.7x	6.5x	5.3%
Premium/Discount vs average			-35.4%	1.1%	9.9%	-13.5%	-21.3%	-22.3%	-14.1%	

Source: Banorte, Bloomberg

Certification of Analysts.

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

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Guide for investment recommendations.

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

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History of PT and ratings

Stock	Date	Rating	PT
AC	18/12/2020	Buy	\$126.00
AC	06/09/2019	Buy	\$129.00
KOF UBL	18/12/2020	Buy	\$114.00
KOF UBL	27/07/2020	Buy	\$116.00

MSCI ESG Rating Scale

CCC	B	BB	BBB	A	AA	AAA
LAGGARD			AVERAGE		LEADER	

*MSCI ESG Rating is an indicator that evaluates companies in Environment, Social and Governance (ESG) metrics

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