

# KOF

Quarterly Report

July 31, 2019

## South America pressures on profitability

- KOF's results were in line with our estimates and those of the consensus, due to price increases that resulted above or in line with inflation and consolidation of recently acquired territory
- Volume rose 2.2% yoy given an outstanding performance in Brazil (+7.2%) and a slight growth in Colombia (+0.6%), which offset declines in Mexico (-0.8%) and Argentina (-17%)
- Higher concentrate costs in Brazil and an unfavorable FX effect in South America pressured the company's profitability, which offset the margin expansion in Mexico and Central America

**Mexico and CA improve profitability, complex environment in South America.** In 2Q19, the company generated MXN\$47.9 billion in revenue, a 7.6% increase vs. 2Q18 on a comparable basis (excluding the effect from the Philippines). Unit case volume surged 2.2% yoy resulting from a 0.5% increase in Mexico and CA, coupled with a 5.7% expansion in South America. Meanwhile, the price strategy implemented by the company translated into a 9.4% surge in Mexico and CA, offsetting a 4.3% decrease in South America from the adverse FX effect in such region. Although consolidated EBITDA grew 5.2% yoy to MXN\$9.1 billion, the corresponding margin reported a 50bp contraction to stand at 19.1%, as a consequence of higher concentrate costs and depreciation of the majority of the currencies which affected U.S. dollar-denominated raw material costs. As for net profit, it grew 25.4% yoy, given a lower than expected tax provision. After incorporating 2Q19 figures, the FV/EBITDA multiple fell to 8.3x from 8.5x. Local uncertainty and a lower investors' confidence would limit a company re-rating for the time being.

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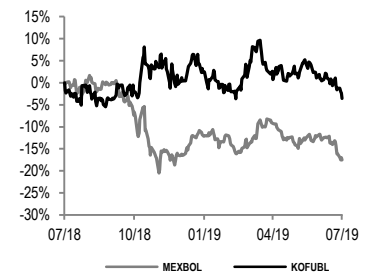
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**HOLD**

Current Price	\$115.07
<b>PT 2019</b>	<b>\$137.00</b>
Dividend 2019e	\$3.20
Dividend Yield (%)	2.8%
Upside Potential	18.9%
Max – Min LTM (P\$)	130.07 – 112.2
Market Cap (US\$m)	12,609
Shares Outstanding (m)	2,100
Float	25%
Daily Turnover (P\$ m)	79.4
<b>Valuation metrics TTM</b>	
FV/EBITDA	8.3x
P/E	16.2x

**Relative performance to Mexbol**

LTM


**Financial Statements**

	2017	2018	2019E	2020E
Revenue	206,103	182,342	199,431	206,801
Operating Income	25,652	24,673	28,967	28,187
EBITDA	39,938	35,456	40,898	41,273
EBITDA Margin	19.4%	19.4%	20.5%	20.0%
Net Income	-12,977	13,910	15,783	14,122
Net Margin	-6.3%	7.6%	7.9%	6.8%
Total Assets	285,678	263,787	270,250	273,288
Cash	18,767	23,727	26,365	30,518
Total Liabilities	144,968	132,037	137,826	137,778
Debt	88,935	83,418	73,905	70,734
Common Equity	140,710	131,750	132,424	135,510

Source: Banorte

**Valuation and Financial metrics**

	2017	2018	2019E	2020E
FV/EBITDA	8.4x	8.8x	7.2x	7.0x
P/E	N.A.	17.8x	15.3x	17.1x
P/BV	2.1x	2.0x	1.9x	1.9x
ROE	-9.2%	10.6%	11.9%	10.4%
ROA	-4.5%	5.3%	5.8%	5.2%
EBITDA/ Interest	5.0x	5.4x	7.9x	10.9x
Net Debt/EBITDA	1.7x	1.6x	1.1x	0.9x
Debt/Equity	0.6x	0.6x	0.5x	0.5x

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Document for distribution among public

## KOF –Results 2Q19

MXN million

Concept	2Q18*	2Q19	Var %	2Q19e	Diff% vs Estim.
Revenue	52,086	47,978	-7.9%	48,140	-0.3%
Operating Income	6,277	6,338	1.0%	6,299	0.6%
Ebitda	9,512	9,180	-3.5%	9,315	-1.5%
Net Income	2,781	3,487	25.4%	3,141	11.0%
<b>Margins</b>					
Operating Margin	12.1%	13.2%	1.2pp	13.1%	0.1pp
Ebitda Margin	18.3%	19.1%	0.9pp	19.4%	-0.2pp
Net Margin	5.3%	7.3%	1.9pp	6.5%	0.7pp
EPS	\$1.32	\$1.66	25.4%	\$1.50	11.0%

### Income Statement (Million pesos)

Year	2018	2019	2019	Change	Change
Quarter	2	1	2	% yoy	% qoq
<b>Net Revenue</b>	<b>52,086</b>	<b>46,248</b>	<b>47,978</b>	<b>-7.9%</b>	<b>3.7%</b>
Costs of goods sold	29,135	25,355	25,876	-11.2%	2.1%
Gross profit	22,951	20,892	22,102	-3.7%	5.8%
General expenses	16,126	14,847	15,036	-6.8%	1.3%
<b>Operating Income</b>	<b>6,277</b>	<b>5,714</b>	<b>6,338</b>	<b>1.0%</b>	<b>10.9%</b>
<b>Operating Margin</b>	<b>12.1%</b>	<b>12.4%</b>	<b>13.2%</b>	<b>1.2pp</b>	<b>0.9pp</b>
Depreciation	3,235	2,826	2,842	-12.1%	0.6%
<b>EBITDA</b>	<b>9,512</b>	<b>8,540</b>	<b>9,180</b>	<b>-3.5%</b>	<b>7.5%</b>
<b>EBITDA Margin</b>	<b>18.3%</b>	<b>18.5%</b>	<b>19.1%</b>	<b>0.9pp</b>	<b>0.7pp</b>
<b>Interest Income (Expense) net</b>	<b>(1,381)</b>	<b>(1,593)</b>	<b>(1,559)</b>	<b>12.9%</b>	<b>-2.2%</b>
Interest expense	1,682	1,735	1,732	3.0%	-0.1%
Interest income	93	249	300	223.6%	20.4%
Other income (expense)	(59)	5	(35)	-40.5%	N.A.
Foreign exchange gain (loss)	268	(112)	(91)	N.A.	-19.3%
Unconsolidated subsidiaries	(50)	12	(76)	52.7%	N.A.
<b>Income before taxes</b>	<b>4,855</b>	<b>4,079</b>	<b>4,779</b>	<b>-1.6%</b>	<b>17.2%</b>
Income taxes	1,664	1,331	1,181	-29.0%	-11.2%
Discontinued operations					
<b>Consolidated Net Income</b>	<b>3,191</b>	<b>2,749</b>	<b>3,598</b>	<b>12.8%</b>	<b>30.9%</b>
Non-controlling interest	410	158	111	-72.9%	-29.7%
<b>Net Income</b>	<b>2,781</b>	<b>2,590</b>	<b>3,487</b>	<b>25.4%</b>	<b>34.6%</b>
<b>Net Margin</b>	<b>5.3%</b>	<b>5.6%</b>	<b>7.3%</b>	<b>1.9pp</b>	<b>1.7pp</b>
<b>EPS</b>	<b>1.324</b>	<b>1.233</b>	<b>1.660</b>	<b>25.4%</b>	<b>34.6%</b>

### Balance Sheet (Million pesos)

<b>Total Current Assets</b>	<b>56,951</b>	<b>53,789</b>	<b>53,936</b>	<b>-5.3%</b>	<b>0.3%</b>
Cash & Short Term Investments	23,469	23,615	23,486	0.1%	-0.5%
<b>Long Term Assets</b>	<b>224,515</b>	<b>205,307</b>	<b>205,792</b>	<b>-8.3%</b>	<b>0.2%</b>
Property, Plant & Equipment (Net)	72,523	60,411	60,481	-16.6%	0.1%
Intangible Assets (Net)	91,632	92,016	90,454	-1.3%	-1.7%
<b>Total Assets</b>	<b>281,466</b>	<b>259,096</b>	<b>259,728</b>	<b>-7.7%</b>	<b>0.2%</b>
<b>Current Liabilities</b>	<b>49,542</b>	<b>56,494</b>	<b>53,347</b>	<b>7.7%</b>	<b>-5.6%</b>
Short Term Debt	12,003	17,360	17,213	43.4%	-0.8%
Accounts Payable	31,086	31,481	28,356	-8.8%	-9.9%
<b>Long Term Liabilities</b>	<b>99,096</b>	<b>77,120</b>	<b>77,191</b>	<b>-22.1%</b>	<b>0.1%</b>
Long Term Debt	81,258	60,461	59,926	-26.3%	-0.9%
<b>Total Liabilities</b>	<b>148,637</b>	<b>133,613</b>	<b>130,538</b>	<b>-12.2%</b>	<b>-2.3%</b>
Common Stock	132,829	125,483	129,190	-2.7%	3.0%
Non-controlling interest	17,049	6,808	6,942	-59.3%	2.0%
<b>Total Equity</b>	<b>115,779</b>	<b>118,674</b>	<b>122,248</b>	<b>5.6%</b>	<b>3.0%</b>
<b>Liabilities &amp; Equity</b>	<b>281,466</b>	<b>259,096</b>	<b>259,728</b>	<b>-7.7%</b>	<b>0.2%</b>
<b>Net Debt</b>	<b>69,792</b>	<b>54,206</b>	<b>53,654</b>	<b>-23.1%</b>	<b>-1.0%</b>

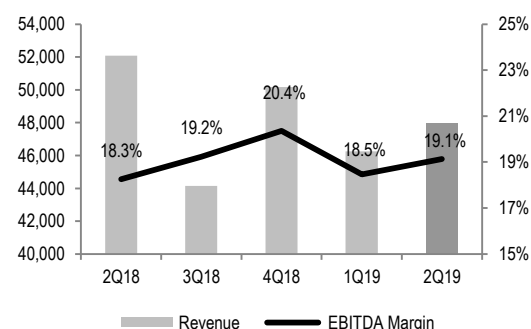
### Cash Flow

CF from Operating Activities	8,405.1	7,322.4	8,783.1		
CF from Investing Activities	(8,668.2)	(1,295.6)	(2,314.7)		
CF from Financing Activities	3,571.7	(5,584.4)	(6,520.4)		
FX effect on cash	611.7	(553.8)	(77.9)		
<b>Change in Cash Balance</b>	<b>3,920.2</b>	<b>(111.4)</b>	<b>(129.8)</b>		

Source: Banorte, MSE. \*2Q18 figures include operations of Philippines

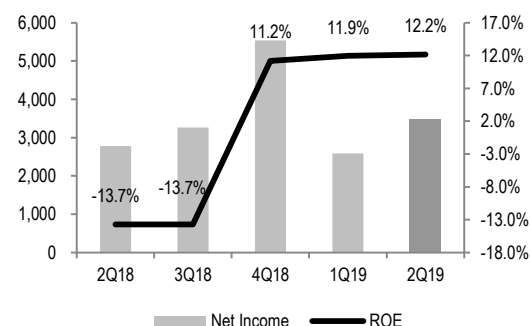
## Revenue & EBITDA Margin

MXN, million



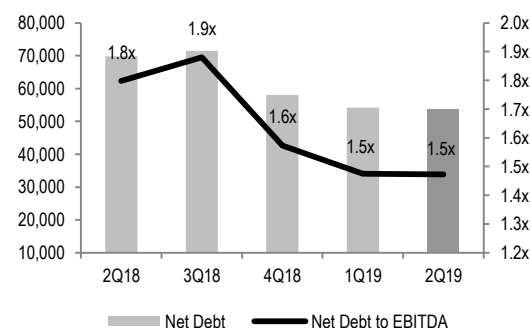
## Net Income & ROE

MXN, million



## Net Debt & Net Debt to EBITDA ratio

MXN, million



**On a comparable basis volume rose 2.2% yoy.** In 2Q19, KOF registered 840.9 million-unit cases, equaling a 2.2% annual increase. Mexico and Central America division reported a 0.5% yoy expansion in sales volume, as such indicator in Central America rose 12.6%, which is explained by the integration of new territories in Guatemala and a significant increase in Costa Rica, Panamá and Guatemala (organic), which made up for a 0.8% volume drop in Mexico. As for the South American division, it presented a 5.7% year-on-year growth in sales volumes, resulting from an outstanding performance in Brazil (+7.2% yoy) and a modest increase in Colombia (+0.6%), in addition to the incorporation of new territories in Uruguay. These were able to offset the declining effect in Argentina (-17%), which stood in line with our expectations. It is important to highlight that volumes in Argentina suffered a smaller drop in comparison to those reported in previous quarters. Moreover, volume in Colombia managed to grow despite the recent enforcement of the new tax.

**Prices rose above inflation in Mexico and Central America.** As for average price per unit case, the business division in Mexico and Central America underwent a 9.4% increment, above inflation. On the other hand, in South America, prices in Mexican pesos fell 4.3% hit by a negative FX effect, as the company increased average prices that resulted above or in line with inflation levels in the territories of this division.

**On a comparable basis, revenue increased by 7.6%.** KOF reported MXN\$47.9 billion in revenue, 0.3% below our estimate. As for revenue in Mexico and Central America, it stood at MXN\$29.0 billion (+9.9%) contributing with 60% of the company's consolidated revenue. On the other hand, the South American division generated MXN\$18.9 billion in revenue, posting an annual 4.4% increase.

**Despite more stable costs in sweetener and packaging, gross margin contracted 70 bps.** During this quarter, the company reported a 6.0% yoy growth in gross profit, standing at MXN \$22.1 billion, presenting a 70bp gross margin contraction to 46.1%. The main elements that influenced such reduction were: (1) higher costs of concentrate in Mexico and Brazil, the latter related to the reduction of tax credits on concentrate purchased from the Manaus Free Trade Zone; (2) an unfavorable currency hedging position in most of the operations; and (3) the depreciation in the average exchange rate for most of the operating currencies applied to U.S. dollar-denominated raw material costs.

**EBITDA margin reported a 50bp contraction.** Consolidated EBITDA stood at MXN\$9.1 billion (+5.2% yoy), in line with our MXN\$9.3 billion estimate. Consequently, EBITDA margin reported a 50bps contraction to stand at 19.1% vs 19.6% in 2Q18. It is important to highlight that KOF's figures were modified during the year-start given the implementation of **IFRS 16**. Therefore, the adoption of these accounting standards represents 20bp over sales. As for the division breakdown, lower costs in sweeteners and PET resin, coupled with more efficiencies in operating expenses in Mexico and Central America boosted the region's EBITDA margin by 40bp

to 21.7%. Accordingly, EBITDA grew 12.0% to stand at MXN\$6.2 billion. On the other hand, in South America, lower sweetener and PET prices failed to offset the unfavorable effects related to the free trade zone in Brazil and FX fluctuations, resulting in a 7.0% drop in EBITDA to stand at MXN\$2.8 billion, equaling a 180bp margin contraction to 15.3%.

**Lower tax provisions improved the company's net profit.** KOF reported a 29.0% year-on-year drop in paid interests, representing a 24.7% effective rate vs. 34.3% in 2Q18. This effective tax rate reduction was driven by the increase in the relative weight of Mexico's profits in the consolidated results, which have a lower tax rate. This coupled with certain tax efficiencies and efforts to reduce non-deductible items across its operations. Therefore, net profit grew 25.4% yoy to stand at MXN\$3.4 billion. We will monitor any development to assess whether this effective rate is sustainable in the future.

**Stable leverage levels.** The ND/EBITDA ratio stood stable at 1.5x vs 1Q19. At quarter-end, the company reported cash and equivalents of MXN\$23.4 billion. On the other hand, interest-bearing debt stood at MXN\$77.1 billion, of which MXN\$1.5 billion corresponds to leasing liabilities.

**Estimates 2019.** In our coverage initiation report, we assumed that the distribution of Heineken beer would end during 2Q19. However, seeing that there is no resolution yet, we incorporated the beer distribution revenue in Brazil. Therefore, we raised our 2019 projections in sales and EBITDA to 4.3% and 8.2%, respectively. However, this change in estimates does not modify our target valuation. We consider that local uncertainty and the lower risk assets appetite prevailing in the Mexican market would limit a rerating for the company.

## Performance charts by region

Mexico & Central America					
	2Q18	Margin	2Q19	Margin	% yoy
Volume	552.2		554.7		0.5%
Price*	\$ 47.78		\$ 52.28		9.4%
Revenue	\$ 26,392	100%	\$ 29,008	100%	9.9%
EBITDA	\$ 5,614	21.3%	\$ 6,285	21.7%	12.0%

South America					
	2Q18	Margin	2Q19	Margin	% yoy
Volume	270.8		286.2		5.7%
Price*	\$ 56.29		\$ 53.88		-4.3%
Revenue	\$ 18,177	100%	\$ 18,970	100%	4.4%
EBITDA	\$ 3,112	17.1%	\$ 2,895	15.3%	-7.0%

Consolidated (2Q18 includes Philippines)					
	2Q18	Margin	2Q19	Margin	% yoy
Volume	977.1		840.9		-13.9%
Price*	\$ 50.29		\$ 52.82		5.0%
Revenue	\$ 52,086	100%	\$ 47,978	100%	-7.9%
EBITDA	\$ 9,511	18.3%	\$ 9,180	19.1%	-3.5%

Consolidated (2Q18 excludes Philippines)					
	2Q18	Margin	2Q19	Margin	% yoy
Volume	823.0		840.9		2.2%
Price*	\$ 50.58		\$ 52.82		4.4%
Revenue	\$ 44,569	100%	\$ 47,978	100%	7.6%
EBITDA	\$ 8,726	19.6%	\$ 9,180	19.1%	5.2%

\*Average Price per unit case

## 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 Thalía Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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

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## PT and recommendation history

Stock	Date	Rating	PT
KOFL	18/01/2019	Hold	\$137.00

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