

KOF

Quarterly Report

October 31, 2019

Tax benefit in Brazil drives operating results

- **Results came in above our expectations due to an extraordinary tax benefit in Brazil and IFRS16. On an adjusted basis, the report was in line at the operating level**
- **Revenues rose 10.3% yoy driven by robust volume growth in Brazil (+5.6%) and Central America (+2.8%) as well as price hikes above the rate of inflation in Mexico and Brazil**
- **EBITDA rose 18.6% yoy with a 20.7% margin. However, on an adjusted basis, EBITDA would have increased by only 3.6% yoy resulting in a 120bps decrease in the margin to 18.1%**

Mexico, Brazil and Central America drive revenues. KOF delivered annual revenue growth of 10.3% on the back of a 0.3% increase in the sales volume derived from robust volumes in Brazil (+5.6%) and Central America (+2.8%), which offset declines in Argentina (-20.2%) and Colombia (-0.8%). Price increases above the rate of inflation in Mexico and Brazil also underpinned sales growth. Furthermore, KOF obtained a MXN 1.139 billion tax benefit in Brazil. Thus, EBITDA rose 18.6% yoy and the margin increased 140bps to 20.7%. On an adjusted basis, EBITDA would have grown by only 3.6% yoy with a margin contraction of 120bps vs 3T18 to 18.1%, due to higher concentrate costs and the depreciation of most currencies with the consequent impact on dollar-denominated raw material costs. Net profit rose 23.3% yoy for the quarter driven by operating performance and a lower-than-expected tax provision. We will shortly be publishing our 2020 estimates, but for now reiterate our HOLD rating on the stock.

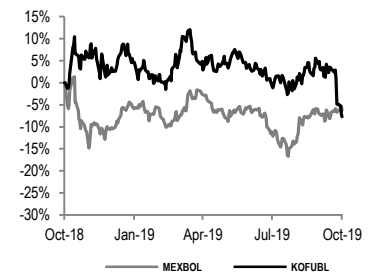
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HOLD

Current Price	\$107.14
PT 2019	\$137.00
Dividend 2019e	3.20
Dividend Yield (%)	3.0%
Upside Potential	30.9%
Max – Min LTM (P\$)	130.07 – 107.1
Market Cap (US\$m)	11,813.2
Shares Outstanding (m)	2,100
Float	25%
Daily Turnover (P\$ m)	158.2
Valuation metrics TTM	
FV/EBITDA	7.3x
P/E	14.4x

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	7.8x	8.2x	6.8x	6.6x
P/E	N.A.	16.2x	14.3x	15.9x
P/BV	1.6x	1.6x	1.4x	1.3x
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 3Q19

MXN million

Concept	3Q18	3Q19	Var %	3Q19e	Diff% vs Estim.
Revenue	44,148	48,699	10.3%	47,424	2.7%
Operating Income	5,778	7,012	21.4%	6,108	14.8%
Ebitda	8,492	10,069	18.6%	9,105	10.6%
Net Income	3,266	4,027	23.3%	3,338	20.6%
Margins					
Operating Margin	13.1%	14.4%	1.3pp	12.9%	1.5pp
Ebitda Margin	19.2%	20.7%	1.4pp	19.2%	1.5pp
Net Margin	7.4%	8.3%	0.9pp	7.0%	1.2pp
EPS	\$1.55	\$1.92	23.3%	\$1.59	20.6%

Income Statement (Million pesos)

Year	2018	2019	2019	Change	Change
Quarter	3	2	3	% yoy	% qoq
Net Revenue	44,148	47,978	48,699	10.3%	1.5%
Costs of goods sold	23,911	25,876	27,032	13.0%	4.5%
Gross profit	20,237	22,102	21,667	7.1%	-2.0%
General expenses	14,256	15,036	14,703	3.1%	-2.2%
Operating Income	5,778	6,338	7,012	21.4%	10.6%
Operating Margin	13.1%	13.2%	14.4%	1.3pp	1.2pp
Depreciation	2,714	2,842	3,057	12.6%	7.5%
EBITDA	8,492	9,180	10,069	18.6%	9.7%
EBITDA Margin	19.2%	19.1%	20.7%	1.4pp	1.5pp
Interest Income (Expense) net	(1,322)	(1,559)	(1,430)	8.1%	-8.3%
Interest expense	1,834	1,732	1,786	-2.6%	3.1%
Interest income	276	300	365	32.3%	21.9%
Other income (expense)	176	(35)	(47)	N.A.	33.6%
Foreign exchange gain (loss)	60	(91)	38	-36.7%	N.A.
Unconsolidated subsidiaries	(51)	(76)	(31)	-38.9%	-58.7%
Income before taxes	4,395	4,779	5,582	27.0%	16.8%
Income taxes	1,382	1,181	1,439	4.2%	21.8%
Discontinued operations	410				
Consolidated Net Income	2,602	3,598	4,125	58.5%	14.6%
Non-controlling interest	156	111	98	-37.0%	-11.7%
Net Income	3,266	3,487	4,027	23.3%	15.5%
Net Margin	7.4%	7.3%	8.3%	0.9pp	1.0pp
EPS	1.555	1.660	1.917	23.3%	15.5%

Balance Sheet (Million pesos)

Total Current Assets	78,886	53,936	62,008	-21.4%	15.0%
Cash & Short Term Investments	18,475	23,486	30,230	63.6%	28.7%
Long Term Assets	199,917	205,792	200,690	0.4%	-2.5%
Property, Plant & Equipment (Net)	58,330	60,481	59,406	1.8%	-1.8%
Intangible Assets (Net)	90,116	90,454	85,378	-5.3%	-5.6%
Total Assets	278,804	259,728	262,698	-5.8%	1.1%
Current Liabilities	52,009	53,347	56,286	8.2%	5.5%
Short Term Debt	10,121	17,213	17,170	69.6%	-0.3%
Accounts Payable	26,508	28,356	31,581	19.1%	11.4%
Long Term Liabilities	95,676	77,191	76,712	-19.8%	-0.6%
Long Term Debt	79,832	59,926	60,734	-23.9%	1.3%
Total Liabilities	147,685	130,538	132,998	-9.9%	1.9%
Common Stock	131,119	129,190	129,700	-1.1%	0.4%
Non-controlling interest	15,929	6,942	6,659	-58.2%	-4.1%
Total Equity	115,190	122,248	123,041	6.8%	0.6%
Liabilities & Equity	278,804	259,728	262,698	-5.8%	1.1%
Net Debt	71,478	53,654	47,673	-33.3%	-11.1%

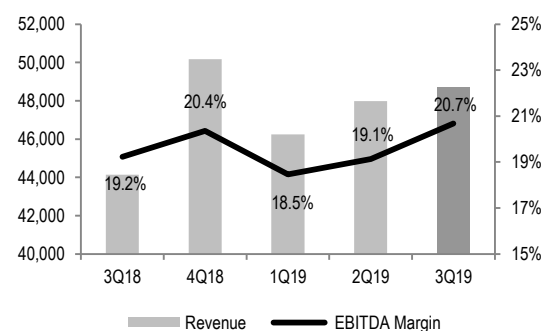
Cash Flow

CF from Operating Activities	383.1	8,783.1	9,265.8		
CF from Investing Activities	(2,337.2)	(2,314.7)	(2,392.2)		
CF from Financing Activities	(2,016.5)	(6,520.4)	(380.7)		
FX effect on cash	(1,023.9)	(77.9)	251.6		
Change in Cash Balance	(4,994.5)	(129.8)	6,744.5		

Source: Banorte, MSE.

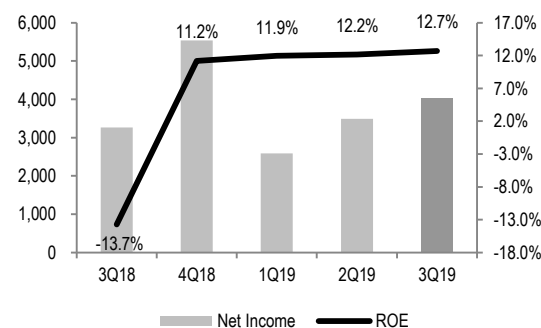
Revenue & EBITDA Margin

MXN, million



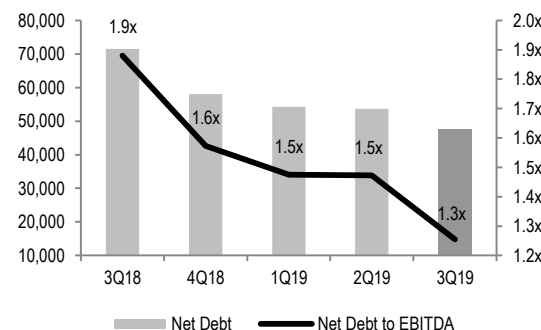
Net Income & ROE

MXN, million



Net Debt & Net Debt to EBITDA ratio

MXN, million



Revenues rose 10.3%. KOF reported revenues of MXN 48.699 billion, 2.7% above our forecast. The Mexico and Central American divisions reported revenues of MXN 28.166 billion (+8.0% yoy) and accounted for 58% of consolidated revenues. The South American division reported revenues of MXN 20.533 billion, an increase of 13.6% yoy. These results can be attributed to price hikes above the rate of inflation in Mexico and Brazil as well as solid volume growth in Brazil (+5.6%) and Central America (+2.8%).

The sales volume grew 0.3% yoy. KOF sold 842.1 million unit cases in the third quarter, equivalent to an annual growth of 0.3%. The Mexico and Central America division recorded sales volume growth of 0.3% yoy, as the Central American sales volume rose 2.8% on solid growth in Costa Rica and Guatemala, which offset declines in Nicaragua and Panama as well as flat growth in Mexico. The sales volume at the South American division rose 0.4% yoy driven by outstanding performance in Brazil (+5.6% yoy), which offset declines in Argentina (-20.2%), Colombia (-0.8%) and Uruguay (-0.8%).

Prices above the rate of inflation. Average prices per unit case rose 7.7% at the Mexico and Central American divisions, above the rate of inflation. In South America, prices in MXN rose 4.2%, also driven by price hikes above the rate of inflation in Brazil and a favorable product mix effect.

Despite more stable sweetener and packaging costs, the gross margin decreased 135bps. Gross profit rose 7.1% yoy for the quarter, below revenues growth, totaling MXN 21.667 billion, while gross margin decreased 135bps to 44.5%. The main reasons were: (1) higher concentrate costs in Mexico and Brazil, the latter due to a lower tax credit on concentrate bought in the free trade zone of Manaus, and (2) average exchange rate depreciation in most currencies applied to dollar-denominated raw material costs.

The EBITDA margin declined 120bps on an adjusted basis. Consolidated EBITDA was MXN 10.069 billion (+18.6% yoy). However, excluding the MXN 1.139 billion tax benefit in Brazil, EBITDA would have amounted to MXN 8.930 billion (-1.9% vs. our MXN 9.105 billion estimate). It is important to mention that KOF's numbers were modified at the beginning of this year ahead of the introduction of **IFRS 16**. Thus, the application of those accounting standards represents 30bps over sales. We therefore estimate that on an adjusted basis, EBITDA would have risen 3.6% yoy with a profitability adjustment of 120bps vs. 3Q18 to 18.1%. Regarding the breakdown by division, operating expense efficiencies in Mexico and Central America drove the EBITDA margin by around 30bps to 21.0%. As a result, EBITDA grew 9.6% to MXN 5.922 billion. Furthermore, in South American, lower sweetener and PET prices along with the extraordinary tax benefit in Brazil, drove EBITDA, which totaled MXN 4.147 billion (+34.2% yoy), equivalent to margin expansion of 310bps to 20.2%. However, excluding the positive impact on operating results of the tax benefit in Brazil, South American EBITDA would have amounted to

MXN 3.008 billion (-2.6% yoy) with a margin contraction of 240bps to 14.7%.

Performance charts by region

Mexico & Central America					
	3Q18	Margin	3Q19	Margin	% yoy
Volume	534.1		535.7		0.3%
Price*	\$ 48.78		\$ 52.53		7.7%
Revenue	\$ 26,056	100%	\$ 28,144	100%	8.0%
EBITDA	\$ 5,402	20.7%	\$ 5,922	21.0%	9.6%

South America					
	3Q18	Margin	3Q19	Margin	% yoy
Volume	305.1		306.4		0.4%
Price*	\$ 49.25		\$ 51.31		4.2%
Revenue	\$ 18,079	100%	\$ 20,533	100%	13.6%
EBITDA	\$ 3,090	17.1%	\$ 4,147	20.2%	34.2%

Consolidated					
	3Q18	Margin	3Q19	Margin	% yoy
Volume	839.2		842.1		0.3%
Price*	\$ 48.95		\$ 52.09		6.4%
Revenue	\$ 44,148	100%	\$ 48,699	100%	10.3%
EBITDA	\$ 8,492	19.2%	\$ 10,069	20.7%	18.6%

*Average Price per unit case

Higher operating results and lower tax provisions positively impacted net profit. KOF reported net profit growth of 23.3% yoy driven by operating results and a lower-than-expected tax provision. It should be mentioned that the effective tax rate was 25.8% vs. 31.4% in 3Q18. Nevertheless, net interest expenses rose 8.1% yoy derived from an increase in other net financial expenses due to losses on derivative instruments and a lower FX gain compared to the prior year.

Reduced leverage. The ND/EBITDA ratio decreased to 1.3x vs. 1.5x in 2Q19. Net debt decreased 11.1% qoq as the cash position rose MXN 6.744 billion qoq (+28.7%) to MXN 30.230 billion, due to good operating performance. Furthermore, debt with cost stood at MXN 77.903 billion (+1.0% qoq), MXN 1.384 billion of which corresponded to leasing liabilities.

Second dividend payment. On November 1, 2019, KOF will pay a second installment amounting to MXN 0.4425 per share (equivalent to MXN 3.54 per unit), representing a 3.3% yield at current prices, very attractive in our view.

Reiterate HOLD. After incorporating 3Q19 results, the LTM FV/EBITDA multiple decreases from 7.8x to 7.3x derived from solid operating results driven by the Brazil tax benefit, higher cash generation and stable debt. We believe that in the case of the company's more major operations, average price hikes above the rate of inflation will continue going forward, driving revenue

growth. Likewise, we expect ongoing solid volumes in Brazil. However, news on the business relationship between KOF and Heineken in Brazil and the impact on volumes of recent developments with the tax on sweetened beverages in Mexico are things to watch. We will shortly be publishing our 2020 estimates, but for now reiterate our HOLD rating on the stock.

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

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PT and recommendation history

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

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