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New Rec: Coca Cola Femsa (KOF: $39.31) September 23, 2007

Position: Buy **Target: $55**

$ooo	Q107	Q207	Q307e	Q407e	2007E	2008E	2009E
Rev *	1,365	1,496	1,404	1,479	5,745	6,479	6,861
EPS$**	0.55	0.73	0.69	0.75	2.72	3.20	3.62
Y/Y	11%	31%	15%	4%	17%	18%	13%
PE	n/a	n/a	n/a	n/a	14.5	12.3	10.9
PSR	n/a	n/a	n/a	n/a	1.5	1.3	1.2
Cons.	n/a	n/a	0.67	0.70	2.74	3.23	3.51

* translated from Mexican Pesos ** net earnings per ADS (excludes FX/monetary items)

Shares Out: 184.6M ADS **Market Cap: $7.3B** **FYE: Dec**

Summary: Coca Cola Femsa (KOF) is the leading operator of Coca Cola (Coke) bottling franchises in Latin America. It is on track to ship 2.1 billion unit cases of

beverages in 2007 compared to just 620m cases in 2002. KOF has defensive and growth characteristics: defensive because it sells staple beverage products, and growth because it is a play on growing prosperity and a rising middle class in Central and South America. Barriers to entry are high, especially in Mexico and Brazil where KOF has a respective 70% and 55% share of the carbonated soft drink (CSD) market. The investment case for KOF is straightforward: the combination of organic revenue growth, accretive acquisitions, operating leverage and favorable raw material comparisons should result in continued solid growth in EBIT. Aggressive debt reduction should translate into faster growth on the bottom line. KOF's focus on profitable revenue growth is essential to our thesis. With a large percentage of costs fixed, the sale of incremental cases is highly profitable.

KOF shares seem inexpensive at 11.9x our estimated 2008 free cash flow, especially considering its strong balance sheet and increasing scale. Investors seem unconvinced that KOF's improved strategic relationship with Coke will result in accelerated earnings growth. We think that earnings should exceed consensus estimates in the latter half of 2008 and 2009. If we are correct, KOF shares should receive a higher level of interest and a multiple closer to the top of its historical range. That, combined with the earnings increase we expect (and the 2% dividend yield) should result in a very attractive investment return with low risk.

In October 2006, KOF and Coke embarked on a new collaborative framework that should benefit KOF in several ways. First, Coke has agreed to reinvest a relevant portion of any concentrate price increase in marketing and capital support for KOF's products. Second, the framework provides for accelerated development of the fast-growing non-carbonated beverage (NCB) category. Next, Coke has endorsed KOF's plan to expand its Latin American footprint and to explore opportunities in other markets. KOF appears to be in the leading position to acquire any Coke territories that come up for sale. Additional acquisitions should be highly accretive. Finally, the framework provides visibility on concentrate pricing. Considering that Latin America is Coke's most profitable region, KOF has become an indispensable partner and is positioned to maximize profitability by driving additional volume through its system.

Pursuant to this new accord, KOF and Coke agreed to a 50/50 acquisition of Jugos del Valle (JDV), a leading Latin American juice manufacturer, for $470M. JDV should provide meaningful production and distribution savings as well as considerable growth potential in an under-developed and rapidly-growing category. Most importantly, this is the first time Coke has agreed to share profits equally with a bottler, and we think this is the model by which KOF and Coke will expand the NCB business. KOF is also acquiring REMIL, a Coca Cola franchise in Brazil. It will purchase REMIL directly from Coke for about $380M, and the deal should close in Q108. The fact that Coke selected KOF (vs. a competitive auction)

to acquire this franchise is a testament to KOF's operational prowess and its improved relationship with Coke. KOF first entered Brazil in 2003 and has achieved double digit revenue growth in every quarter since 2004. Adding REMIL will increase KOF's sales in Brazil by 35% and should require little incremental capex. Moreover, REMIL's EBITDA margins are 13%, far below the 17.5% margin in KOF's existing Brazilian operations. We think KOF could close much of that gap by transferring its established practices and systems, raising prices and by achieving some apparent synergies. We have modeled in only a 200bp margin increase over the first 18 months. Thus, we have left room for meaningful upside to our estimates.

KOF generates strong and consistent FCF, driven by high margins and modest working capital needs. It has used its FCF to reduce debt by $1.1B over the past four years, resulting in an investment grade balance sheet with net debt approaching just 1x annual EBITDA. Despite its recent growth, KOF has not opened a new bottling plant since 2003. Instead, it has closed 22 under-utilized plants and shifted distribution to existing facilities. As a result, productivity (as measured in unit cases sold/plant) has increased by 80%. Management has an excellent reputation for reducing costs. Operating expenses as a % of revenue have declined by 110 bp over the past three years.

KOF should experience favorable y/y comparisons on raw material costs during the latter half of 2007 and into 2008. In recent years, it has withstood unusually large increases in prices of plastic (PET) bottles, sugar, high fructose corn syrup (HFCS), aluminum and fuel. It appears that some of these costs have begun to moderate. For example, KOF's sweetener costs increased 20% y/y during the first half of 2007. However, unfavorable Brazilian sugar contracts recently expired, and Mexican sugar prices have declined 9% from a multi-year peak. KOF's PET costs declined by 7% in the first half of 2007 and should decline by 5%-10% for the year, driven by lower prices and cost reductions.

KOF's share price has been hindered by slow growth in Mexico, its largest market. Mexico accounts for an estimated 58% of EBIT. Revenue growth in Mexico has slowed (+3.2% in Q207) due to high market penetration, increased competition and the growing demand for multi-serve offerings. However, Mexico is a large, young and growing market with warm weather and unsafe tap water. KOF has over 70% share of the Mexican CSD market vs. just 15% for Pepsi as Coke is a daily staple for many Mexicans. Pricing also appears to have stabilized; Q207 unit prices rose (in real terms) for the first time since Q405. Although we don't foresee high growth in Mexico, it should continue to generate ample free cash flow for KOF.

Most importantly, investor concerns about slow growth in Mexico should be offset by the fact that 80% of KOF's revenue growth has been occurring outside of Mexico, where annual operating profits are increasing by 40%. We think KOF is well positioned to capitalize on the emerging middle class in these regions.

KOF is increasing its participation in the rapidly growing NCB category, which includes iced teas, fruit juices, isotonics, and flavored and enhanced waters. Since NCBs are still a very small percentage of overall sales, we think KOF could achieve strong growth for many years, especially given its new accord with Coke and the acquisition of JDV. KOF has already become a leader in bottled water under Coke's brands (Ciel, Dasani) as well as its own private label offerings. KOF is also benefiting from product extensions, such as the highly successful 2007 introduction of Coca Cola Zero, which is already 2% of the product mix in Mexico. Coke Zero has been attracting new customers to the CSD category.

Organic revenue growth plus the addition of JDV and REMIL should enable KOF to further leverage its dominant platform and increase free cash flow. We estimate FCF/ADS to be $3.29 and $3.70 in 2008 and 2009 respectively. Thus, KOF is inexpensive at 12x our estimated 2008 FCF. We think investors have taken a wait and see approach to KOF's stronger relationship with Coke. However, we think investors will buy KOF shares as they see tangible evidence of the accretion potential from REMIL and JDV. Better comparisons on raw material costs should also improve investor sentiment as could the probable abolition of inflation accounting for Mexican companies in 2008.

Based solely on our earnings forecasts, KOF shares would be an attractive investment. However, with increased investor interest, we think KOF will be awarded a slightly higher multiple due to its consistent free cash flow, improved strategic stance with Coke, and its rapidly increasing scale. KOF is no longer an emerging bottling company. Revenue should approach $6.5B in 2008 compared to just $1.6B in 2002. Moreover, KOF is well positioned to consolidate the Coke system in Latin America. Investors should also note that there are several potential wildcards that could cause earnings to exceed our estimates: KOF could acquire additional territories; raw materials costs could decline; and REMIL margins could exceed our forecasts.

We set a year end 2008 price target of $55 by applying a 15 multiple to our 2009 estimated FCF (which exceeds consensus estimates). This multiple is simply at the top end of the 12-15 range within which KOF shares have traded over the past four years. Moreover, our target price translates into an EV/EBITDA multiple of 7.2, which is below the current average 7.4 multiple of a comparable group of Latin American and U.S. bottlers. If we include expected dividends, our price

target would result in a total return of 43% over the next 15 months. We think the downside risk is about 15%, resulting in a risk/reward ratio of 1:3.

Background:

Coca Cola Femsa (KOF) is the leading operator of Coca Cola (Coke) bottling franchises in Latin America and the second largest in the world. Pro forma for acquisitions, roughly 48% of KOF revenue is derived from Mexico; 17.5% comes from Brazil; other territories include Colombia, Argentina, Venezuela and various parts of Central America. KOF products include carbonated soft drinks (CSDs), teas, juices, bottled water, enhanced water, Powerade and beer (in Brazil).

Coke owns 31.7% of KOF. FEMSA, a large Mexican conglomerate, owns 53.7%. KOF shares trade in ADS form on the NYSE. KOF is recognized by Coke as one of a few select "anchor" bottlers. Its relationship with Coke is critical for its success, as nearly 90% of its volume is derived from sales of Coke trademark beverages. Coke has considerable influence over KOF's business. For instance, Coke makes substantial contributions to KOF marketing expenses. It contributed $106M in 2006 in addition to the $160M spent on marketing by KOF. KOF relies on national advertising, sales promotions and non-price retailer incentive programs designed by Coke to target its consumers. These programs include providing commercial coolers to increase the visibility and consumption of KOF product and to ensure that they are sold at the proper temperature. Primary end channels include small mom & pop retailers, restaurants & bars, street vendors, convenience stores, supermarkets and third party distributors.

KOF's relationship with Coke is dictated by standard bottler agreements for each territory. These provide that KOF will purchase its entire requirement of concentrate (which is shipped as liquid in large barrels) of Coke trademark beverages from Coke and its authorized suppliers at prices and terms that are set by Coke at its sole discretion (KOF adds water, sweetener and carbonation to the concentrate to produce the end product). In return, KOF has the exclusive right to distribute all Coke beverages throughout its territories. It also has the right of first refusal on new Coke products subject to its existing terms. The price of concentrate is set by Coke as a percentage of KOF's revenue for each market and product. For Coke-branded bottled water (Dasani and Ciel), KOF pays Coke a brand fee, which also is a % of revenue. KOF, however, controls the price of all end products.

Discussion:

1. A central part of our investment thesis is KOF's improved relationship with Coca Cola. On October 19, 2006, KOF and Coke announced that they had entered into a comprehensive framework for a new stage of collaboration. This provides

KOF with an improved platform for growth on several fronts. First, Coke has agreed to provide a "relevant" portion of the funds derived from any concentrate increases for marketing and other support. Thus, it is in effect compensating KOF for a meaningful portion of previously announced price increases (In 2005, Coke announced that it would be increasing concentrate prices over a three-year period on certain products in Mexico and Brazil). The new framework also provides for accelerated development of the NCB (non-carbonated beverage) segment through acquisitions and organic growth. This is significant in that the rapidly-growing NCB segment is under developed and has been given little priority in the Coke system. Next, KOF will have the opportunity to expand its footprint in Latin America (and possibly into new markets) through horizontal acquisitions, and we have already seen evidence of this with the REMIL acquisition. KOF will also have Coke's consent to analyze the possibility of integrating beer and soft drinks in certain markets. Finally, the agreement sets the tone for a shared long-term vision of the economics of the KOF/Coke relationship, including long-term visibility on concentrate pricing. Thus, KOF will no longer be "surprised" by impulsive price hikes. We think investors should closely examine this new collaboration which we see as an important catalyst in the future growth of KOF. Coke management apparently thinks that it is better served by having KOF as a profitable, well-capitalized partner rather than a captive bottler.

2. Our confidence in the improved KOF/Coke relationship has been augmented by two acquisitions. In December 2006, KOF and Coke agreed to acquire Jugos del Valle (JDV), a leading player in the Latin American juice and juice-based beverage categories, for $470M. JDV trailing revenue is $445M (about 120M unit cases), 70% of which were derived from Mexico (the remainder from Brazil and the U.S.). The ultimate objective is for KOF to reduce its 50% stake by inviting other Coke bottlers in Mexico and Brazil to buy into JDV on equal terms according to their franchise territories. Thus, JDV will get complete market coverage and KOF will participate both as an owner of the brand and as a distributor in its own territories. The most intriguing part of this 50/50 JV is that KOF and Coke will share equally in revenue and costs. This is a dramatic shift from the historical CSD model and could signify a new model for growth in the NCB segment. By acquiring JDV, KOF should capture administrative, production and distribution synergies by leveraging its existing assets in Mexico and Brazil. It should also improve JDV's total distribution coverage. For example, an estimated 80% of JDV's volume is sold through the modern channel (supermarkets, convenience stores and third-party wholesalers). Only 20% reaches the core mom & pop stores that blanket Mexico. In contrast, KOF sells most of its volume through these mom & pops. Thus KOF should be able to boost JDV sales immediately. Moreover, JDV has had poor service and suboptimal pricing in various markets, and we think KOF could remedy that within a short time.

To satisfy antitrust concerns about the JDV deal, KOF agreed to certain conditions. First, it agreed to relinquish its exclusive right to distribute Coca Cola to Oxxo stores over a 5 year period (20% per year). Coca Cola sales at Oxxo stores account for only 2% of KOF's Mexican sales. KOF also agreed to use a separate sales force when selling juices to certain "large" clients. We note that the same truck will distribute both Coke and JDV products, but that a separate "pre-seller" will sell and maintain the JDV products while the existing sales force will continue to sell Coke products to those specific customers. Regulators apparently wanted to ensure that a Coke salesperson would not use the Coke brand to force the sale of JDV juices on the retailer. The final condition of approval is that for small mom & pop stores that have only a single cooler (that is owned by KOF), the cooler must be opened to potential competitors. However, this is far less dire than it appears since KOF will be allowed to replace those coolers. The new coolers will have an upper and lower door. The upper compartment will have 75% of the space (this is the premium space) and will carry only KOF products. A separate lower door will be available at the discretion of the store owner who could use it to carry vegetables, dairy products, competing beverages, or even KOF beverages. KOF estimates that of its 400,000 retail coolers in Mexico, only 15,000 will need to be replaced at a cost of $600 per cooler or about $9M.

3. More recently, KOF announced that it will acquire REMIL, the Coca Cola franchise in the state of Minas Gerais, Brazil, home to 15M people. REMIL is owned by Coke, which acquired the territory in 2000 from a group of Brazilian investors. KOF will pay a total of $370M, or about 7.5x 2008 EBITDA for REMIL, with an expected closing date in Q108. Importantly, this deal was a negotiated sale rather than a competitive auction which signals that Coke views KOF as a partner as well as the best potential operator of the franchise. (We note that Embotelladora Andina was interested in REMIL since it owns the Coke territory contiguous to REMIL). We think KOF could have the first option on future consolidation opportunities. The addition of REMIL will increase KOF's Brazil revenue by 35% and will require very little new capex. We expect KOF to selectively raise prices and to apply its systems and best practices to REMIL. It should also capture some cost efficiencies (closing DCs, back office, etc.). Thus, we think KOF could increase REMIL's modest EBITDA margin (12.9%) by at least 200bp over the first 18 months and by 350 bp within three years. Management thinks it can get margins close to the 17.5% margin in its existing Brazilian business. It also estimates it could drive existing margins to 19-20% over time. We note that Andina has a current EBITDA margin of 19.7% in Brazil. We also point out that KOF acquired its current Brazilian territory in 2003, and that it has more than doubled the EBITDA margin from 8% in 2003 to 17.5% today. Thus, we think there is upside to both our estimated REMIL margins and KOF's margins in its existing Brazilian operations.

Considering the fixed-cost nature of KOF's business, we view acquisitions as an essential part of future earnings growth. KOF has a proven track record of acquiring, integrating and improving Coke franchises. We expect it to acquire additional properties over time and to continue its practice of using free cash flow to maintain debt at a conservative level. We also see an opportunity for KOF to use its stock as acquisition currency, provided the shares can obtain a multiple closer to its larger peers. We think KOF's best profit potential would be in further consolidating Brazil and Mexico. KOF might also have the opportunity to acquire the Coke franchise for Uruguay. KOF will also consider acquiring properties outside of Latin America. It is important to note that our forecasts do not include any acquisitions beyond REMIL. Thus, there could be potential upside should any additional deals transpire.

4. KOF has strong and consistent free cash flow, driven by high profit margins, moderate working capital requirements and strict cost control. KOF generated $2.17 per ADS in FCF in 2006, and we estimate FCF of $2.76 and $3.29 for 2007 and 2008 respectively. Moreover, based on our estimate for maintenance capex (about 70% of total capex), we think normalized FCF/ADS could surpass $4.00 in 2009. We expect KOF to use its considerable excess cash flow to fund the acquisitions of JDV and REMIL, to invest further in technology and infrastructure, and to maintain a moderate dividend, all without straining its balance sheet. KOF also maintains an investment-grade balance sheet, and management has made it a priority to reduce the debt related to its $3.6B acquisition of Panamco in 2003. Despite investing in organic growth and paying a dividend, KOF has reduced debt by $1.1B over the past 3.5 years using internally generated cash flow. As a result, its ratio of net debt to EBITDA is approaching 1x. This compares to 4x and 2.8x for CCE and Pepsi Bottling Group respectively. Following the REMIL and JDV acquisitions, we expect KOF to continue reducing debt unless there is an opportunity to acquire an additional Coke territory.

5. In our view, one of the main reasons for the recent lackluster performance of KOF shares has been the sluggish growth in its largest market, Mexico. As detailed in Table 1, Mexico has accounted for more than 50% of KOF revenue and nearly two thirds of its EBIT in recent years. KOF operates an extensive network in Mexico, including 12 bottling plants, 92 distribution centers, and a fleet of trucks that reach an estimated 500,000 retail locations. However, over the past several years, its sales growth has declined to the 2-4% range due to a number of factors. First, annual per-capita consumption of CSDs in Mexico is already high at 410 eight-oz servings, second only to the U.S. Mexico has also become increasingly competitive with price pressure coming from Pepsi and from discount brands such as Red Cola (introduced in Mexico City in Q206) and Big Cola. At the same time, KOF has been hit with unusually high increases in the prices of key raw materials and has begun to absorb higher concentrate costs from Coke. As a result, EBIT

margins in Mexico have declined from 21.5% in 2005 to 19.3% in the first half of 2007.

Table 1: KOF Mexico

($mil)	2004	2005	2006	2007E	2008E	6 MO '07
Unit case volume (mil)	990	1,025	1,071	1,106	1,145	552
% change	-1.2%	3.5%	4.5%	3.3%	3.5%	3.1%
Revenue	2,600	2,697	2,760	2,891	3,086	1,420
% change	6.8%	3.7%	2.4%	4.7%	6.8%	2.5%
% of total KOF rev	55.8%	54.9%	52.6%	50.3%	47.6%	49.6%
EBIT	549	579	581	564	617	275
% margin	21.1%	21.5%	21.0%	19.5%	20.0%	19.3%
% of total KOF EBIT	71.4%	69.1%	67.6%	61.0%	58.2%	57.9%

However, we think margins in Mexico have bottomed. The increased marketing spending from Coke should boost profits by adding to volume growth. There is a strong historical correlation between Coke's national ad spend and unit-case volume growth. We also estimate that the y/y raw material cost comparisons should improve markedly in the latter half of 2007, particularly with respect to sweetener costs. Moreover, there is evidence that profits in Mexico are stabilizing. EBIT declined just 1.5% y/y in Q207 compared to an 11% decline in Q107. Furthermore, Q207 was the first quarter since the end of 2005 in which there was an inflation-adjusted price increase in the CSD portfolio, and several competitors have followed KOF's recent price increases. In addition to these improving trends, the acquisition of JDV will put KOF into the fast growing packaged juice segment, and should also result in material synergies within the first year.

Investors should note that KOF still has very high margins in Mexico, and should continue to generate substantial free cash flow which could be reinvested to improve operational efficiency and to fund growth opportunities. Mexico, with an estimated population of 109M, is a large, growing, and young marketplace and it is more stable politically than in the past. Coke is also considered to be a daily staple in Mexico and maintains a dominant share of the market. KOF's market share of CSD volume exceeds 70% compared to just 15% for Pepsi and 13% for the three leading B-brands combined. KOF's extensive distribution network also gives it a significant competitive advantage over smaller bottlers that depend on third-party wholesalers. Most importantly, investors concerned about slow Mexican growth should consider that KOF's Mexican profits should decrease as a percentage of overall profits due to the addition of REMIL as well as the rapid growth of business outside of Mexico.

6. Brazil is KOF's second largest market and offers substantial growth potential for KOF, especially considering that per capita consumption is less than half of the level in Mexico. Coca Cola has been selling beverages in Brazil since 1943 and has a dominant share of the market. KOF entered Brazil in 2003 as part of its acquisition of Panamco. It currently has an estimated 55% share of CSD volume, triple the share of its largest competitor Ambev (18%). The rest of the market is highly fragmented among 17 smaller local bottlers. KOF is already the leading seller of bottled water in the important Sao Paulo region with its proprietary Crystal brand, and it distributes Kaiser Beer for FEMSA. KOF has become a one-stop shop for retailers by offering a complete portfolio of beverages. Its success in Brazil is visible in its financial results. KOF has increased revenues in Brazil by at least 10% in each quarter since the end of 2003, and has increased EBITDA margins from 8% at the time of acquisition to 17.5% today. During the first half of 2007, KOF's case volume in Brazil increased by 8.9% while EBIT increased 19%.

REMIL should increase KOF's Brazilian sales by 35% and should be highly accretive. KOF also has numerous other growth opportunities in Brazil. It should continue to increase juice sales following the successful introduction of Minute Maid Mais in 2006 as well as the pending JDV acquisition. KOF's overall NCB volume in Brazil grew by more than 80% in the latest quarter. KOF also introduced Coke Zero, Coke Light and Dasani flavored waters in Brazil during 2006. All three are growing at rates of 30-40%. Finally, we note that Coke has agreed to buy Matte Leao, which controls half of the bottled tea market in Brazil.

7. Investors may not fully appreciate the rapid growth occurring outside of Mexico. In addition to Brazil, KOF is also achieving rapid growth in Colombia and Central America, and to a lesser extent in Venezuela and Argentina. We view KOF as a play on the emerging middle class in Latin America, where millions of people have become the beneficiaries of the region's economic stability and growth. As evidence of this, in Brazil between 2000-2005, the number of households with annual incomes between $6,000 and $22,000 grew by 50% to 22.3M, while those earning less than $3,000 per year declined sharply to just 1.3M. Similar trends are occurring in Colombia, Argentina and Costa Rica. Although still relatively poor, the budding prosperity of this new "lower" middle class is driving the rapid growth of the mass consumer market. KOF appears to be well positioned to benefit from these trends given the affordable and convenient nature of its consumable beverages and the predominantly warm climates in its territories. In Table 2, we highlight KOF's rapid growth outside of Mexico. During the first half of 2007, revenue increased by 15.6% on a 10.6% rise in unit volume. More importantly, EBIT grew by 47.8% and was driven by operating leverage, a decline in raw material costs, increased operating efficiency and some currency benefit. We

estimate that EBIT outside of Mexico will increase by 28% in 2007 and another 25% in 2008 (including the addition of REMIL).
Table 2: KOF ex – Mexico

($mil)	2004	2005	2006	2007E	2008E	6 MO '07
Unit case volume (mil)	822	865	928	1,009	1,161	483
% change	6.1%	5.2%	7.3%	8.7%	15.1%	10.6%
Revenue	2,062	2,212	2,489	2,854	3,393	1,441
% change	8.2%	7.3%	12.5%	14.7%	18.9%	15.6%
EBIT	220	259	279	360	443	185
% change	N.A.	17.8%	7.6%	29.2%	22.9%	47.8%

In Colombia, annual per capita consumption of CSDs is only 87 8-oz servings, or a fifth the level of Mexico. However, favorable economic conditions should continue to drive increased consumption from that low base. KOF has made significant progress in Colombia over the past several years with average volume and revenue growth of 6-8% and 10-12% respectively. The resulting operating leverage has driven impressive profit growth: EBIT increased by 26% in 2006 and is up 86% y/y in the first half of 2007. KOF has established its proprietary brand, Manantial, as the leading bottled water in Colombia. It has also enjoyed success in the important flavored CSD category with the Crush brand, introduced in 2005. Although we do not expect these growth rates to continue, we estimate 18% revenue growth and 45% EBIT growth in Colombia in 2007. For 2008, we forecast revenue and EBIT to increase by just 6.5% and 9% respectively.

KOF is also experiencing rapid growth in Central America where its case volumes increased by 10% in 2006 and another 9.5% in the first half of 2007. The introduction of Hi-C juices enabled KOF to more than double its juice volumes in 2006. Sales of PowerAde are growing at 50%. Positive pricing and operating leverage drove EBIT higher by 23% in 2006 and 30% in the first half of 2007. We expect further margin increases in 2008. KOF is also achieving solid growth in Venezuela (volume +16% in Q207), albeit from a very small base (Venezuela accounts for just 4% of total profits). Sales of flavored sodas and Nestea have been strong in 2007. Consumer spending in Venezuela has been aided by increased government spending of oil revenues. However, inflation remains rampant, the political environment is tenuous and reliable sugar supplies have become scarce. Finally, in Argentina, which accounts for 5% of KOF's profits, rising costs and government imposed price controls contributed to a 10% decline in EBIT in 2006. However, EBIT increased by 23% in the first half of 2007. We remain cautious on the sustainability of growth in Argentina and Venezuela.

8. We think KOF's principal asset value and barrier to entry resides in its extensive production and distribution platform. It has a network of 31 bottling facilities, 206

distribution centers, and a fleet of trucks that reach 1.6M retail points of presence throughout Latin America. It has also developed key relationships with its retail customers. For example, in Mexico, a KOF salesperson typically visits most stores an average of three times per week to take orders (on a handheld PC) and to ensure that products are displayed properly. Ordered products are then delivered the following day by a separate person. Thus, a KOF employee is at the store as many as six times per week. KOF's size, dominant market share, and in-depth market knowledge have enabled it to achieve efficiencies that its smaller competitors are not capable of realizing. Backed by the powerful Coca Cola brand and marketing machine, KOF has implemented sophisticated multi-segmentation strategies (suited to specific local market conditions) to drive top line growth and market share gains. For example, in Mexico, KOF has developed a large base of returnable presentations, mostly with its 2.5 Liter plastic bottle (returnable bottles account for 26% of KOF's volume in Mexico). Management estimates a plastic returnable bottle is used an average of 16 times. Since KOF's net production costs are much lower with a returnable bottle, it can set the price close to the discount brand, thus enabling a lower-income customer to buy Coca Cola.

KOF has also made significant capital improvements to drive efficiencies by increasing annual capacity, installing clarification facilities to process different types of sweeteners, and modifying equipment to produce different presentations (e.g. returnable & non-returnable). KOF also continues to innovate. It developed a rapid cold-cleansing process that has reduced line changeover times by 50% at its mega plant in Toluca, Mexico. KOF has closed 22 obsolete facilities since the Panamco acquisition in 2003. As a result, it has increased its productivity (unit cases sold/plant) by more than 80% over the past 4 years. Finally, KOF has invested in its distribution routes and in hand held and point-of-sale technologies which have enabled it to more effectively price and distribute its products.

9. We think the y/y comparisons of raw materials costs should improve in the latter half of 2007. Most notably, sweetener costs should begin to moderate after increasing by 20% in the first half of this year. The biggest change should occur in Brazil where in 2006, KOF entered into unfavorable futures contracts when sugar prices were near their peak (sugar is used to produce ethanol in Brazil). Prices have since declined by more than 40% and should create a very favorable y/y comparison following the contract expiration in July. KOF appears to have locked in its sugar requirements for the rest of 2007 at a cost of $0.09/lb. In addition, the price of sugar in Mexico has declined by about 8% from its 2006 peak and should result in better y/y comps as well. It is important to note that in Mexico, KOF pays nearly 3 times the international price of sugar due to strict government protection of the domestic sugar industry. KOF uses sugar as its primary sweetener except in Mexico and Argentina where it uses a 60/40 mix of sugar and HFCS-55. We

expect HFCS prices to remain at their current elevated levels for the foreseeable future.

Through the first half of 2007, KOF's PET costs declined by 7% and we are forecasting a 5-10% decline across the company for the entire year. Thus, the y/y comparisons should remain favorable. In addition to price declines, KOF has been reducing the weight of some of its plastic bottles and has been reducing the amount of resin used in the manufacturing process. As we discussed earlier, KOF will also face higher prices (roughly 3-5%/year) for concentrate over the 2007-2009 time frame. We estimate the gross reduction to EPS to be $0.14 and $0.22 in 2008 and 2009 respectively. However, we expect a significant portion of these increases to be offset by increased spending by Coke as well as selective price increases by KOF on the affected categories. We think Coke will reinvest 80% (and possibly 100%) of the funds it generates from concentrate increases into marketing, capex, and new product launches on the behalf of KOF. Based on our conservative estimates of a 1% price by KOF and a profit recapture equal to just 30% of Coke's increased spending, the respective net EPS reduction would be closer to $0.05 and $0.10 in 2008 and 2009. These levels of reductions should be more than offset by expected declines in sweetener costs alone.

10. There are a number of risks to holding an investment in KOF shares. The primary risk, in our view, is the currency risk. A U.S. based holder of KOF ADSs is subject to changes in the value of the US Dollar relative to the Mexican Peso. If the Peso were to depreciate against the Dollar, Dollar-based EPS would decline. In addition, since KOF purchases some of its key raw materials in US Dollars, it would face higher costs. Investors have the option of hedging the currency risk. KOF also operates in markets that have experienced volatile economic and political environments in the past, and similar events could transpire in the future. A deteriorating economy in the U.S. could indirectly affect economic growth in Latin America, especially Mexico which depends on its large export revenue. A substantial decline in the price of oil could also reduce export revenues in Mexico, Brazil and Venezuela. There is also weather risk – tropical storms and rainy weather typically reduce demand for cold beverages. Finally, the small share float, which is a function of the large ownership stakes of Coca Cola and FEMSA, could make it difficult for investors to establish large positions, and could result in higher share price volatility during unfavorable market environments.

11. In KOF's most recent quarter, Q207, consolidated revenue increased 8.2% on a 5.9% increase in unit case volume and a 2.2% increase in unit pricing. In Mexico revenue increased 4% on a 3.8% volume increase, while in Brazil revenue increased by 11%. Ex-Mexico, revenue increased by 13.2%. On a consolidated basis, gross margin was flat at 48.1% vs. 48.0% in Q206, while EBIT increased 10.5% to $253M, driven by an improvement in operating expenses. The EBIT

margin increased to 16.9% from 16.5%. EBIT declined by 1.5% in Mexico and increased by 44% outside of Mexico. In Brazil, KOF's second largest market, EBIT increased by 24%. Below the operating line, net interest expense increased 11%. Other expenses, monetary and currency related items combined (both cash and non-cash) improved by $44M. This was driven by a $37M improvement in FX which added an estimated $0.14 to EPS. Reported EPS was $0.94 vs. $0.67 last year. However, after normalizing the tax rate and eliminating the effects of FX and monetary changes, our adjusted earnings per ADS was $0.73 in Q207 compared with $0.66 in the prior year period, an increase of 11%. At June 30, 2007, KOF had net debt of $1.2B, or about 1x annualized EBITDA.

12. Financial assumptions

All of our financial estimates are translated from Mexican Pesos into US Dollars at the constant rate of 11MP per $US. Thus, they do not incorporate potential future changes in relative valuations between the $US/MP. There are also differences between Mexican Financial Reporting (MFR) and US GAAP. These mostly relate to deferred promotional expenses, inflationary adjustments of prior years statements, and various classification differences. We note that GAAP EPS was higher by $0.10 in 2004, lower by $0.06 in 2005 and higher by $0.02 in 2006 as compared to MFR standards. On a combined basis, GAAP EPS was higher by $0.06 or about 1% over the three-year period. We also exclude any FX and monetary gains from our earnings and cash flow estimates.

For the second half of 2007, we forecast consolidated revenue growth of 7.3% on a 5.2% case volume increase. We include one quarter of JDV in our estimates. A slight y/y increase in gross margin to 47.5% should be more than offset by higher operating expenses, resulting in a second half 2007 EBIT margin of 16.5% compared to 16.8% in the year earlier period. Next, we model in a 24% decline in net interest expense and a slightly higher tax rate (31%) to arrive at our adjusted earnings per ADS of $1.44, which is a 9.2% increase over the latter half of 2006. For comparison purposes, our EPS exclude FX and monetary items.

For 2008, we estimate consolidated revenue will increase 12.9% to $6.5B, driven by a 9.0% increase in unit case volume and a 3.5% price increase across all markets. Our 2008 estimates include the addition of JDV and REMIL (for 10 months). We also incorporate slower revenue growth in Colombia, Central America and Venezuela relative to their respective 2007 growth rates. Our 2008 gross margin declines slightly to 47.3% based on the addition of JDV and REMIL as well as the net impact from concentrate price increases. We think there could be upside to our gross margin estimate. Next, we estimate a slight decline in the operating expense ratio to 31.1% from 31.2%, as we forecast that increased efficiencies should more than offset the lower inherited EBIT margins at REMIL

especially during the latter half of 2008 (REMIL should add 5-6% to KOF's overall revenue base). The result is a 2008 EBIT margin of 16.3% flat with 2007. Next we estimate a 22% decline in net interest expense to $105M as we assume KOF uses most of its excess FCF to reduce debt, as it has been doing for several years. After subtracting other operating expenses and income taxes (at a 33.5% rate), we arrive at net income after minority interest of $590M, or $3.20 per ADS, a 17.5% increase over 2007. Our share count remains unchanged at 184.6M ADSs. Our FCF estimate for 2008 is $3.29 per ADS, assuming $273M for capex. At year end 2008, we have net debt at $960M, or about 0.7x trailing EBITDA. For 2009, we estimate revenue increases 6% to $6.86B. Our EBIT margin increases to 16.5% vs. 16.3% in 2008 as we expect KOF to increase margins at REMIL and to generate additional operating leverage from higher revenue. Again, we think there could be meaningful upside to our margin forecast. With lower interest expense and no change in the tax rate, our adjusted 2009 EPS is $3.62, a 13% increase. Our 2009 FCF estimate is $3.70.

13. Organic revenue growth plus the addition of JDV and REMIL should enable KOF to further leverage its dominant platform and increase free cash flow. We estimate FCF/ADS to be $3.29 and $3.70 in 2008 and 2009, respectively. Thus, KOF appears to be inexpensive at 11.9x our estimated 2008 FCF. We think investors have taken a wait and see approach to KOF's stronger relationship with Coke. However, we think investors will buy KOF shares as they see tangible evidence of the accretion potential from REMIL and JDV. Better comparisons on raw material costs should also help investor sentiment as could a shift in investor preference toward defensive companies in a slowing economy. Furthermore, the probable elimination of inflation accounting for Mexican companies in 2008 should improve revenue and profit growth rate comparisons. It could also result in greater interest (and confidence) from a wide swath of foreign investors given the expected decline in reporting complexity. Based solely on our earnings forecasts, KOF shares would be an attractive investment. However, we think KOF could be awarded a slightly higher multiple given its consistent free cash flow, improved strategic stance with Coke, and its rapidly increasing scale. We point out that KOF is well positioned to further consolidate the Coke system in Latin America. Moreover, it is no longer an emerging bottling company: revenue should approach $6.5B in 2008 compared to just $1.6B in 2002. Investors should also note that there are several potential wildcards that could cause earnings to exceed our estimates: KOF could acquire additional territories; raw material costs could decline; and REMIL margins could exceed our conservative forecasts.

We are establishing a year end 2008 price target of $55 by applying a 15 multiple to our 2009 estimated FCF (which exceeds consensus estimates). We note that this multiple is only slightly higher than the 12-15x range in which KOF shares have traded over the past four years. Our price target also translates into an

EV/EBITDA multiple of 7.2, which is slightly below the average multiple of a comparable group of Latin American and U.S. bottlers, as detailed in Table 3 below. It is also within the historical average range of 5.7x to 8.5x forward EBITDA that KOF shares have traded at over the past four years. If we include expected dividends, our price target would result in a total return of 43% over the next 15 months. Investors should also have solid downside protection (we estimate downside risk at 15%) based on KOF's modest current valuation, its investment-grade balance sheet and sustainable free cash flow.

For 2008 there are 5 "street" estimates ranging from \$3.14 to \$3.42, and for 2009 there are two "street" estimates, one at \$3.38 and one at \$3.60.

Table 3: Global Bottler Valuations

Company	PE - 2007	PE - 2008e	EV/EBITDA - 07	EV/EBITDA - 08
KOF	14.4	12.3	7.1	6.3
Arca	12.7	11.6	6.9	6.1
Andina	13.1	11.1	8.2	7.4
Coca Cola Enterprises	18.4	17.1	8.5	8.0
Pepsi Americas	18.7	16.6	8.4	7.9
Pepsi Bottling Group	17.8	15.9	7.7	7.0
Coca Cola Hellenic Bottling	18.7	16.9	9.8	8.8
Average - ex KOF	16.3	14.5	8.1	7.4

14. Financial Models $000

a. annual projections	2005	2006	2007e	2008e	2009e
Mexico	2,696,545	2,760,000	2,890,578	3,085,873	3,271,025
Brazil	604,545	716,818	785,389	1,128,022	1,193,448
Central America	330,545	376,818	420,152	460,067	492,271
Columbia	462,182	500,818	597,626	638,863	670,806
Venezuela	534,091	594,818	700,101	784,113	831,160
Argentina	280,909	299,636	350,818	382,041	401,907
Total revenues	5,041,737	5,351,066	5,744,648	6,478,979	6,860,617
COGS	2,569,748	2,798,517	3,017,894	3,411,545	3,621,720
Gross profit	2,471,989	2,552,549	2,726,753	3,067,434	3,238,897
Operating expenses	1,611,298	1,676,182	1,792,360	2,013,019	2,103,602
EBIT	860,691	876,367	934,393	1,054,415	1,135,295
Interest expense, net	210,738	167,655	137,545	105,000	65,000
FX loss/(gain)	(18,581)	21,131	(3,545)	0	0
Net monetary loss (gain)	(79,645)	(94,161)	(23,545)	0	0
Other expenses, net	36,321	28,082	42,636	36,364	38,182
Pretax income	711,858	753,661	781,302	913,051	1,032,113
Income taxes	255,929	258,758	245,550	305,872	345,758
Net income - total	455,929	494,903	535,752	607,179	686,355
Minority income	11,578	15,755	16,000	17,000	18,636
Net income	444,351	479,147	519,752	590,179	667,719
Adjusted EPADS	$2.05	$2.33	$2.72	$3.20	$3.62
average ADS outstanding	184.6	184.6	184.6	184.6	184.6

% of Rev	2005	2006	2007e	2008e	2009e
Gross profit	49.0%	47.7%	47.5%	47.3%	47.2%
Operating expenses	32.0%	31.3%	31.2%	31.1%	30.7%
EBIT	17.1%	16.4%	16.3%	16.3%	16.5%
Interest expense/ FX	4.2%	3.1%	2.4%	1.6%	0.9%
Other expenses, net	0.7%	0.5%	0.7%	0.6%	0.6%
EBITDA	21.5%	20.8%	20.9%	20.8%	21.0%
Depreciation	2.6%	2.6%	2.5%	2.6%	2.6%
Pretax income	14.1%	14.1%	13.6%	14.1%	15.0%
Income taxes	36.0%	34.3%	31.4%	33.5%	33.5%
Net income	8.8%	9.0%	9.0%	9.1%	9.7%

Cash Flow	2005	2006	2007e	2008e	2009e
Net Income	455,929	494,903	535,752	607,179	686,355
Depreciation	132,493	139,388	145,470	169,101	180,434
Amortization & other	121,102	116,682	119,273	121,818	123,636
Net monetary items	(79,645)	(94,161)	(23,545)	0	0
Receivables	(30,719)	3,058	(8,182)	(14,091)	(21,364)
Inventories	(4,762)	(46,710)	(11,364)	(10,909)	(16,364)
Suppliers	14,099	19,184	18,182	9,091	14,091
AP/Other liab	(52,007)	36,608	9,091	4,545	4,091
Labor liabilities	(4,669)	(8,248)	(6,818)	(6,364)	(6,364)
Other	2,054	(16,033)	0	0	0
Operating cash flow	553,875	644,671	777,858	880,371	964,517
Capex	(207,190)	(242,354)	(268,182)	(272,727)	(281,818)
Free cash flow	346,685	402,317	509,677	607,644	682,699
FCF/ADS	$1.88	$2.18	$2.76	$3.29	$3.70
Cash	198,133	414,551	457,767	353,593	594,474
Total Debt	1,961,251	1,793,420	1,591,000	1,318,273	954,636
Net debt	1,763,119	1,378,869	1,133,233	964,679	360,163
Stockholders' Equity	3,327,358	3,732,159	4,107,116	4,621,841	5,211,378
BV per ADS	18.02	20.21	22.24	25.03	28.22
Net Debt / EBITDA	1.6	1.2	0.9	0.7	0.3
y/y % change					
Mexico	3.7%	2.4%	4.7%	6.8%	6.0%
Brazil	13.4%	18.6%	9.6%	43.6%	5.8%
Central America	-2.7%	14.0%	11.5%	9.5%	7.0%
Columbia	9.4%	8.4%	19.3%	6.9%	5.0%
Venezuela	5.6%	11.4%	17.7%	12.0%	6.0%
Argentina	7.6%	6.7%	17.1%	8.9%	5.2%
Total Revenue	5.3%	6.9%	9.4%	12.8%	5.9%
Unit cases sold	4.3%	5.8%	5.8%	9.0%	3.5%
Operating expenses	4.0%	4.8%	9.0%	12.3%	4.5%
EBIT	9.0%	2.6%	8.7%	12.8%	7.7%
Interest expense, net	-7.3%	-19.8%	-16.4%	-23.7%	-38.1%
EPADS	22.9%	13.7%	16.6%	17.7%	13.1%

b. quarterly projections	Q306	Q406	Q107	Q207	Q307e	Q407e
Total revenues	1,306,273	1,379,273	1,365,455	1,496,364	1,403,590	1,479,239
COGS	684,909	728,000	727,455	776,727	732,674	781,038
Gross profit	621,364	651,273	638,000	719,636	670,916	698,201
Operating expenses	408,000	413,273	431,273	467,000	438,482	455,606
EBIT	213,364	238,000	206,727	252,636	232,435	242,595
Interest expense, net	45,273	38,691	31,818	42,545	34,091	29,091
FX loss/(gain)	(27,273)	4,745	8,455	(12,000)	0	0
Net monetary loss (gain)	(43,909)	(35,200)	(17,636)	(5,909)	0	0
Other expenses, net	7,636	8,036	15,091	10,727	8,182	8,636
Pretax income	231,636	221,727	169,000	217,273	190,162	204,868
Income taxes	70,818	62,645	56,727	66,364	58,950	63,509
Net income - total	160,818	159,082	112,273	150,909	131,212	141,359
Minority income	1,727	6,027	5,455	4,182	3,182	3,182
Net income	159,091	153,055	106,818	146,727	128,030	138,177
Adjusted EPADS	$0.60	$0.72	$0.55	$0.73	$0.69	$0.75
Avg ADS	184.6	184.6	184.6	184.6	184.6	184.6
% of Rev						
Gross profit	47.6%	47.2%	46.7%	48.1%	47.8%	47.2%
Operating expenses	31.2%	30.0%	31.6%	31.2%	31.2%	30.8%
EBIT	16.3%	17.3%	15.1%	16.9%	16.6%	16.4%
Interest expense/ FX	3.5%	2.8%	2.3%	2.8%	2.4%	2.0%
Other expenses, net	0.6%	0.6%	1.1%	0.7%	0.6%	0.6%
EBITDA	21.7%	20.9%	19.9%	21.2%	21.4%	21.0%
Depreciation	2.8%	2.3%	2.5%	2.4%	2.7%	2.5%
Pretax income	17.7%	16.1%	12.4%	14.5%	13.5%	13.8%
Income taxes	30.6%	28.3%	33.6%	30.5%	31.0%	31.0%
Net income	12.2%	11.1%	7.8%	9.8%	9.1%	9.3%
y/y % change						
Unit cases sold		5.0%	7.1%	5.9%	5.0%	5.4%
Total Revenue		7.1%	9.2%	8.2%	7.5%	7.2%
Operating expenses		3.8%	5.1%	7.3%	7.5%	10.2%
EBIT		0.3%	10.8%	10.5%	8.9%	1.9%
Interest expense, net		-20.0%	-25.1%	11.4%	-24.7%	-24.8%
EPADS		10.5%	10.4%	11.0%	14.9%	4.2%

(Amounts in $000, except ratios)

Current debt	1,840,909
Current Equity	3,999,636
Current tangible BV	363,273
Current market value	7,254,760
Current cash	635,273
Current DSO	14
Current DIO	36

	2006	2007e	2008e
EBIT	876,367	934,393	1,054,415
EBITDA	1,110,818	1,199,136	1,345,334
Free cash flow	402,317	509,677	607,644
Surplus cash flow (net inc.+D&A - capex)	508,619	532,313	625,371
Capex	242,354	268,182	272,727
EV/EBITDA	7.6	7.1	6.3
EV/(EBITDA-capex)	9.7	9.1	7.9