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Casa de Bolsa Interacciones

CORPORACIÓN MOCTEZUMA S.A.B. de C.V.

CONSTRUCTION MATERIALS

CMOCTEZ* MM

Initiation of Coverage

June 28th, 2016

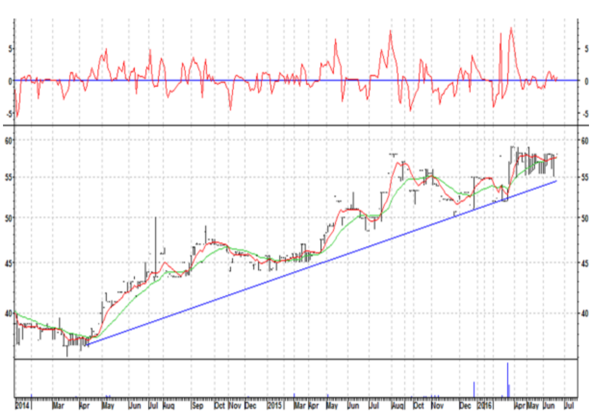
Last **MXN$57.99** | Mkt Cap **MXN$51,048 mn** | Shrs Outs 199.9mn | Free Float 22.7% | Beta (3 yr vs MEXBOL) **0.4** | Daily Value Traded (6m): **MXN$6.8 mn**

Source: Company & Interacciones Research

TP MXN$63.50 | **BUY**

CMOCTEZ: One of the most profitable companies in the BMV

- **We are initiating coverage of** Corporación Moctezuma, S.A.B de C.V. (CMOCTEZ*) with an end-Q217 target price of MXN$63.50 and a dividend of MXN$2.53 per share, implying an upside potential of 14.1%. Our rating is BUY.
- **Excellent growth prospects –** We expect high growth rates going forward, driven by greater operating capacity over the coming year, and efficiencies resulting from a high profitability focus, low energy costs, and high cash flow generation.
- **High profitability –** Our ROIC and ROE profitability analysis of the Mexican Stock Exchange (BMV) based on a sample of 90 companies, showed Corporación Moctezuma to be one of the most profitable companies (in ROIC terms), for five straight quarters since Q115. This can be attributed to the company's high capital turnover (1.27x as at Q116) and its EBITDA margin. It ranks second in terms of ROE.
- **Free cash flow generation –** This has given the company a solid financial structure with a net debt to EBITDA ratio of -0.7x. It also uses its own cash to fund growth. We expect that cash flows generated during the investment phase will finance the enlargement of the Veracruz facility.
- **Dividends –** The company has maintained an ongoing dividend policy. We estimate a dividend yield of 4.45% for the next 12 months.
- **Valuation multiples trail the industry –** CMOCTEZ is trading at a P/E multiple of 16.5x, -3% below industry multiples.
- **Main risks**: **i)** Dependency on sector and one economy; **ii)** low liquidity; **iii)** high sensitivity to energy costs; and **iv)** exchange rate exposure.



Multiples	2014	2015	U12M	2016E	2017E
P/E	19.9x	17.0x	17.1x	16.5x	16.1x
P/BV	4.8x	5.1x	5.0x	5.3x	4.9x
EV/EBITDA	11.7x	10.1x	10.3x	10.2x	9.7x

Estimates (MXN mill.)	2014	2015	U12M	2016E	2017E
Revenues	9,186	11,026	11,198	11,760	13,796
EBITDA	3,302	4,512	4,762	5,050	5,785
EBITDA Margin (%)	35.9%	40.9%	42.5%	42.9%	41.9%
Net Income	2,030	2,860	3,063	3,264	3,630
Net Margin (%)	22.1%	25.9%	27.4%	27.8%	26.3%
Net Debt	-1,759	-2,941	-3,349	-2,287	-2,562
Net Debt/EBITDA	-0.5x	-0.7x	-0.7x	-0.5x	-0.4x

Source: Interacciones Research and the company

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Table of Contents

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I. Executive Summary

i. CMOCTEZ: A brief overview

Corporación Moctezuma has 72 years of experience in the construction industry. It is engaged in the production, sale, and distribution of Portland cement and ready-mix concrete as well as the extraction and sale of aggregates. The company currently has three cement plants located in Tepetzingo Morelos, Cerritos San Luis Potosí, and Apazapan Veracruz, and an installed cement capacity of 6.4 million tons per annum.

Since Q414, Moctezuma has maintained double-digit year-on-year quarterly operating growth rates. In 2015, sales reached record levels (MXN$11.026.3 million, +20% YoY) and the company registered strong growth rates in operating profit (+42.9% YoY), EBITDA (+36.6% YoY), and consolidated net profit (+41.1% YoY). Q116 margins were historical highs; the LTM EBITDA margin reached 42.53% (vs 40.9% at end Q415) and the Net margin of 27.4%.

ii. Our investment thesis: Profitable company

Moctezuma has maintained double-digit year-on-year quarterly operating growth since Q414. In 2015, the EBITDA margin reached 40.92%, +497 basis points above 2014, and CMOCTEZ boasts a historical ROIC of above 30% (based on ROIC= EBITDA/Invested Capital). Furthermore, in Q116, the company achieved a record high LTM EBITDA margin of 42.53%.

For the last five quarters since Q115, Corporación Moctezuma has been one of the most profitable companies (in ROIC terms) thanks to its high capital turnover (1.27x as at Q116) and high EBITDA margin. In ROE terms, CMOCTEZ is the second most profitable company.

Our consolidated estimate implies a next 5-year Compound Annual Growth Rate (CAGR) of 6.77% in revenues, 10.71% in EBITDA, and 10.89% in controlling net profit, above the industry average (a CAGR of 5% in sales and 9.1% in EBITDA).

iii. Valuation

We valued the company using discounted cash flows and forward multiples. For our discounted cash flow analysis, we estimated the change in working capital, which is seasonal, and used a tax rate of 30%. As of 2022, we calculated the explicit value of the cash flows using perpetuity.

We found that CMOCTEZ is trading at a forward P/E multiple of 16.5x, -3% with the respective industry multiples. We assign Corporación Moctezuma an end-Q217 target price of MXN$63.50. Taking into account a dividend of MXN$2.53 per share, upside potential is 14.1%, so we rate the stock BUY.

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iv. Risks

Corporación Moctezuma shares are low liquidity. The last-six-month daily average trading volume was 170,094 shares, which means investors could have difficulty unloading or loading positions in the stock. The cement industry is energy-intensive (Petcoke and electricity), so increases in oil prices or peso depreciation can have an adverse impact on margins. The sector is strongly dependent on the economy. Economic recessions and booms can impact its sales volumes, prices, and operating margins.

II. Industry Characteristics

Mexico's Cement Industry

Mexico is a self-sufficient cement producer. Over the last decade the company has endeavored to strengthen external revenues by investing in cement plants in other countries. However, given the characteristics of its products (high transportation costs, volume, and oil prices) Mexican exports do not account for a large percentage of production. Therefore, if a cement company wants to make an inroad into a foreign market, it opts for an acquisition and/or builds Mexican plants there. The production, distribution, and sale of cement and concrete depends largely on the location of the market, quarries and production plants, so the transportation costs strongly influence production costs.

The cement industry is energy intensive (electricity and fuels). Energy costs are estimated to represent around 30% of production costs, which means the industry benefits from lower oil prices, as approximately 60% of costs are associated with Petcoke and 40% with electricity. In fact, cement company margins have moved higher since the end of 2014.

In the cement market, the producer that reaches the client first obtains a solid competitive advantage and differentiation becomes essential, either through price or brand recognition. As a result, most cement company investments focus on getting closer to the client (in addition to the fact that, as mentioned, transportation costs have a strong impact on the margin) and providing quality at the lowest cost and cheapest price.

In Mexico, federal government infrastructure and construction investment plans have fueled demand for cement and encouraged the industrialization process, but fallen short in terms of increasing cement plant capacity utilization.

The cement industry is an oligopoly that competes for quantity. The first mover is Cemex, which in Mexico has an installed capacity of 33%. As a result, the price of cement in Mexico is one of the highest in the world. In 2015 alone, the cement price index grew +9.67% YoY, and Q315 growth was especially strong. We think such growth can be attributed to two factors: **i)** robust demand growth driven by more credit, housing subsidies and self-building and infrastructure vs. a rigid industry offer; **ii)** peso depreciation against the dollar has made some raw materials more expensive (although this factor has less of an impact, as the dollar price has eased) and **iii)** a CEMEX price increase resulting from a change in its "value before volume" strategy focus. According to our estimates, cement prices substantially increase in the first half of the year and decrease in the second.

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Throughout their history, cement companies have enjoyed pricing power. For example, in 2013, the production value of construction companies decreased -3.6% YoY and annual cement production -4.13%, but the consolidated sales of cement and material sector companies decreased by only -1.09% YoY[1].

The cement industry in Mexico and the rest of the world has few participants. The main local participants are: Cemex, Holcim, Cementos Cruz Azul, Cementos Chihuahua, Cementos Moctezuma, and Cementos Fortaleza (which recently acquired Lafarge). Of them, Cemex and Holcim have both a local and international presence; Cementos Cruz Azul and Cementos Moctezuma have a local presence, and Cementos Chihuahua and Cementos Fortaleza have a regional presence. (See map)

At the end of 2015, combined annual cement production amounted to 60.5 million tons, and we estimate that capacity utilization was 80%. Our estimated production is 48.4 million (+12.4% YoY). On the demand side, we estimate that around 97% of the cement produced was consumed (46.9 million tons) and that at the end of 2015, per capita cement consumption in Mexico was 383 kg. Due to expansions announced by Cemex, Cementos Cruz Azul, Cementos Fortaleza, and Corporación Moctezuma, Mexico's cement capacity is expected to increase by 7.6 million tons, 17.1% of which will correspond to Corporación Moctezuma.

Competition is strongest in the metropolitan area. In Q412, a new participant emerged, Cementos Fortaleza. Corporación Moctezuma's 2013 results were partially impacted by the newcomer sharing the same target market. However, the slowdown that year was mainly due to the housing crisis.

Installed Capacity

Million Mt	Number of plants	Installed capacity
Cemex	15	29.3
Holcim	7	12.2
Cruz Azul	4	8.4
Moctezuma	3	6.4
Chihuahua	3	2.2
Fortaleza	3	2
Total	35	60.5

Expansions

Plants	Company	Mill. Mt
14 Puebla	Cemex	4
2 Puebla	Cruz Azul	1
3 Veracruz	Moctezuma	1.3
1 Hidalgo	Fortaleza	1.3
	Total	7.6

CEMEX			Holcim				GCC	
1 Ensenada	6 Hidalgo	11 Guadalajara	1 Ramos Arizpe	6 Acapulco	1 Hidalgo	1 Tepetzingo	1 Juárez	1 El Palmar
2 Hermosillo	7 Valles	12 Zapotiltic	2 Hermosillo	7 Tecoman	2 Palmar	2 Cerritos	2 Samalayuca	2 Tula
3 Yaqui	8 Tamuín	13 Barrientos	3 Apaxco		3 Lagunas	3 Apazapan	3 Chihuahua	3 Vito
4 Torreón	9 Huichapan	14 Tepeaca	4 Orizaba		4 Tepezala			
5 Nuevo León	10 Atotonilco	15 Mérida	5 Macuspana					

Source: Interacciones and Canacem data

[1] Figure obtained by adding the operations of CEMEX, Corporación Moctezuma, Lamosa, and Grupo Cementos de Chihuahua

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III. Corporación Moctezuma

i. About Corporación Moctezuma

Corporación Moctezuma, S.A.B. de C.V. (CMOCTEZ) has 72 years of experience in the construction industry and is engaged in the production, sale, and distribution of portland cement and ready-mix concrete as well as the extraction and sale of aggregates. According to the company, most of its clients are in the self-building sector and the rest are institutional building companies and distributors.

The company currently has three cement plants located in Tepetzingo, Cerritos and Apazapan. It also has 27 distribution centers and 36 concrete plants. Its growth plan is based on greater penetration of Central, Western, and Southeastern Mexico

Chart 1. Cement Chart Description

Plant	Tepetzingo	Cerritos	Apazapan
Location	Morelos	San Luis Potosí	Veracruz
Operations beginning	1997	2004	2010
Annual Capacity (million tons)	2.5	2.6	1.3
Production Lines	2	2	1
Raw Materials Reserves	100 years aprox.	100 years aprox.	100 years aprox.
Ground extension (hectares)	300	900	600

Source: Corporación Moctezuma

In 2011, the company began exporting cement to Brazil, in 2013 to Colombia, and in 2014 to Nicaragua. Last year, it began exporting to Belize and also to Panama. CMOCTEZ has a local profile (99.4% of consolidated income), but if conditions are right, it will continue to export cement.

Vertical Integration
CMOCTEZ is a vertically integrated company, from the extraction of the raw material to distribution. As a result, the company has significant control over production chain costs. It also has a maintenance program that enables its cement plants to work 24 hours a day.

Cutting-edge Technology
Moctezuma has invested heavily in equipping both its cement and concrete plants with cutting-edge technology, which has enabled it to bring down costs and offer competitive prices.

The company has highly automated equipment. Management believes its plants are among the most modern in the country and abroad, due to their cutting-edge technology, ongoing modernization and manufacturing processes, and the incorporation of new production techniques.

This is mirrored in the company’s commitment to the environment. It uses an advanced mining system that includes the construction of vertical wells for transporting limestone to primary shredders at the heart of the mountain, thereby avoiding emissions and saving on transportation costs while at the same time eliminating any blight on the landscape (in contrast to open-pit mining processes).

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Another example of CMOCTEZ's state-of-the-art technology is the production area which uses horizontal roller mills (Horomills) to grind cement and make a 35% saving on electricity. *CMOCTEZ is the only cement company in Latin America to use this technology.* The company also uses a Gamma Metrics analyzer, which is a gamma ray sensor that controls quality by improving the homogeneity of each batch.

According to company information, the main source of pollution is incineration and quarrying, which includes dust, hot gases and CO2. Moctezuma reuses 88% of the pollutant gases for preheating. The dust is reused in mortar (ionization is used to separate it), which is then sent to the furnace and cooler.

ii. Stock Ownership and Management

The company is a 67.02% joint investment of Buzzi Unicem S.p.A. (an Italian company) and Cementos Molins, S.A. (a Spanish company). At December 22, 2015, this percentage belongs to the Dutch companies Fresit BV (51.78%) and Presa Internacional BV (Presa) (7.62%), all of which belong to Buzzi Unicem SpA and Cementos Molins, S.A., which also had a 7.62% stake in Cemolins Internacional.
In December 2015, Cemolins Internacional S.L.U. (an affiliate of Cementos Molins) gave a Presa Internacional a capital injection by contributing all of the shares it owned in CMOCTEZ (7.62% of total outstanding shares). This effectively made Presa owner of 15.24% of CMOCTEZ's capital, and Cemolins ceased to have a direct stake. Furthermore, both Buzzi and Molins wound up with 50% stakes in the Dutch companies.

Chart 2. Shareholders with more than 5%

Shareholder	Shareholding Structure (%)	Current Number of Shares
Fresit, B.V.	51.8	455,794,944
Antonio Cosío Ariño	10.3	90,450,200
Presa Internacional, B.V.	15.2	134,129,920
Suma	**77.3**	
Float	**22.7**	
Total	**100**	

Source: Corporación Moctezuma, Annual Report 2015

The capital stock is made up of 884,887,296 shares, 4,575,500 are treasury shares and 880,311,796 are outstanding shares. 77.29% of the latter correspond to shareholders with a more than 5% interest, and so the float is 22.71%.

iii. Dividends

Since 1998, the Board of Directors has maintained a cash dividend policy based on Capex and operating cash flow. In the last 3 years, the company has paid dividends in the second and fourth quarter of the year amounting to MXN$1 per share, or a dividend yield of 3.51% (at the June 1st price).

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On March 18, 2016, the company announced a dividend of MXN$1.5 per share; therefore, considering that the company usually pays the same amount twice a year, we estimate a dividend yield of 5.27% in 2016 (at the June 1st price). On March 22nd, the announcement sent the stock soaring to an historical high of MXN$59.04 per share, as the company had not paid a dividend of more than MXN$1 per share since December 2012.

iv. Corporate Governance

At the April 7, 2016 Ordinary Shareholders Meeting, the members of the Board of Directors, which consists of eight full members, four of which are independent, were elected and ratified.

Table 3. Board of Directors

Equity Directors		Independent Directors	
Owners	Alternates	Owners	Alternates
Juan Molins Amat (presidente)	Carlos Martínez Ferrer	Roberto Cannizzo Consiglio	Adrián Enrique García Huerta
Enrico Buzzi	Luigi Buzzi	Antonio Cosío Ariño	Antonio Cosío Pando
Pietro Buzzi	Benedetta Buzzi	Carlo Cannizzo Reniú	Stefano Amato Cannizzo
Julio Rodríguez Izquierdo	Salvador Fernández Capo	Guillermo Simón Miguel	

Source: Corporación Moctezuma, 2015 Annual Report

The Board of Directors is supported by: i) the Best Corporate Practices and Audit Committee, which consists only of independent members, and ii) the Executive Committee consisting of members and the Managing Director (Pedro Carranza Andresen). Both committees convene at least four times a year before the Board meeting.

Table 4. Company Best Practices and Audit Committee

Antonio Cosío Ariño	President
Roberto Cannizzo Consiglio	Member
Carlo Cannizzo Reniú	Member

Source: Corporación Moctezuma, 2015 Annual Report

In 2014, the Best Corporate Practices and Audit Committee and the Board of Directors, authorized a change of External Auditor. Mancera, S.C. “EY México” was made external auditor responsible for auditing the company’s financial statements for a five-year period beginning in 2015. This change was triggered by best practices, as Galaz, Yamazaki, Ruíz Urquiza, S.C. (Deloitte) had been the company’s external auditor for the previous 10 years, from 2005 to 2014.

v. Company History

1943-2014

In 1943, Cementos Moctezuma built its first plant in Jiutepec, Morelos. The company that currently trades on the MSE was incorporated under the name Grupo Lacosa on June 28th, 1982, by the Italian Group Fratelli Buzzi (currently Buzzi Unicem SpA), the Mexican company Coconal, and Mr. Oscar Alvarado. That year, the company acquired Cementos Portland Moctezuma, S.A. de C.V.

In 1988, Corporación Moctezuma made a capital placement on the MSE and two other companies were formed: the Catalan company Cementos Molins, S.A. and Ciments Francais de Francia to provide the company with technology and funding.

In 1993, Fratelli Buzzi and Cementos Molins, S.A. became the only shareholders with a controlling stake in Corporación Moctezuma along with stock market investors.

In 1994, Grupo Carso made a large capital investment in the company sealing plans to build a cutting-edge cement plant in Tepetzingo, Morelos.

In 1997, the Tepetzingo, Morelos plant came on line with an annual installed capacity of 1.2 million tons.

In 2000, the plant's second production line started up, taking annual production to 2.5 million tons and consolidating the company's presence in central Mexico.

In May 2004, the first production line of the Cerritos plant in San Luis Potosí built to make incursions into states in northern Mexico came on stream at a cost of USD$150 million and an annual capacity of 1.3 million tons. Growth opportunities in this market resulted in the inauguration of a second production line in 2006 and an increase in annual production capacity to 2.3 million tons.

In 2010, the Apazapan plant in the state of Veracruz was inaugurated with an initial investment of around USD$265 million, and an annual cement capacity of 1.3 million tons. The plant boasts vanguard technology and supplies southeastern Mexico. At the end of 2010, Corporación Moctezuma's annual installed capacity was 6.4 million tons.

In 2012, the company CYM Infraestructura, S.A.P.I. de C.V. was created. This is a joint venture that marked the beginning of the company's active participation in the infrastructure sector with the placement of hydraulic concrete paving on the Guadalajara southern beltway.

In May 2014, the Board approved the construction of a second production line at its Apazapan plant with an annual production capacity of 1.3 million tons of cement. It will cost around USD$200 million, and operations are expected to begin in the first half of 2017.

2015

The company closed 2015 with its cement division present in 29 states and its concrete division in 12 states. Although the year was characterized by adverse macroeconomic factors, CMOCTEZ achieved record numbers: annual sales totaled MXN$11.026.3 billion (+20.0% YoY); cement sales were up 20.1% and concrete +19.6%, underpinned by higher prices and sales volumes. Margins were driven by lower electricity rates and oil costs.

To meet strong demand for cement, plants worked at almost full capacity thanks to strict planning and maintenance, and adequate logistics for transporting the cement to all clients. Furthermore, CMOCTEZ made an announcement regarding the success of the Central Plant's concrete recycler, an innovative machine that transforms leftover concrete into aggregates that are subsequently reused. They hope to install this system at other plants as well.

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Chart 5. Company's main assets

	2015	2014	2013	2012
Main Assets				
Cement Plants	3	3	3	3
Distribution Centers	27	26	24	26
Cement Hopper	87	77	72	66
Concrete Plants	36	45	49	57
Pumping Equipment	60	63	64	65
Revolving Units	363	385	380	366
Human Resources				
Total Staff	1121	1105	1148	1187
Market Share				
Cement	15.20%	15.00%	13.80%	14.30%
Concrete	9.40%	8.60%	8.30%	7.50%

Source: Corporación Moctezuma, Annual Report 2015

vi. Business Lines

Cement

At the end of Q116, this division represented around 79.48% of LTM consolidated revenues. Cement is a construction material obtained from the calcination of a mixture of limestone (75%), clay (22%), and iron ore (3%) at 1450°. Iron ore is used as an adhesive for its ability to set and harden when reacting with water.

Some Corporación Moctezuma subsidiaries sell different types of cement in different presentations: bulk, in 50kg sacks, and Big Bag, or 2 ton sacks. The company also distributes white cement in 25kg presentations.

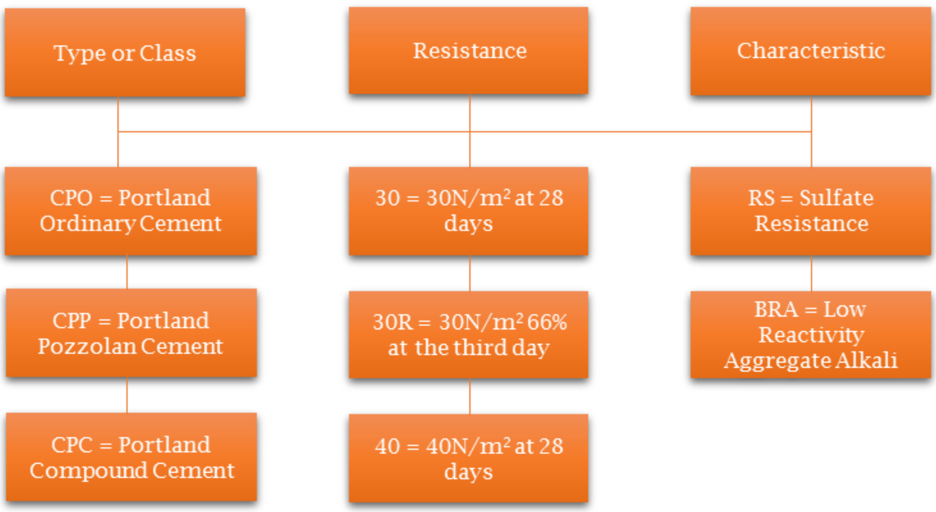
Chart 6. Cement Types

Cement Type	Characteristics	Uses
Ordinary Portland Cement (OPC)	Resistance class level 40 and special characteristic RS	Required for high mechanic resistance: prestressed, blocks, etc.
Puz Portland Cement (PPC)	Resistance Class level 30 R and two special characteristics: RS y BRA	Resistant to chemical attacks like sulfates from black waters, sea and salty soils. The concrete made with this product is manegeable, durable and waterproof and is used for dams, slabs, floors, etc.
Compound Portland Cement (CPC)	Two classes of resistance: 30R and 40 and special characteristic RS	Has CPP characteristics and aplications
Mortar	Elaborated with clinker portland, high resistance and plasticity, substitutes lime mortars, sand and cement.	Used in masonry, walls, finishes and flattenings

Source: Interacciones with Corporación Moctezuma Information

CMOCTEZ is the only cement company with a triple health certification. Moctezuma's cement is characterized by a slower setting compared to most other brands: a faster setting can produce cracks in the concrete.

Cement types and classifications



Source: Corporación Moctezuma, Annual Report 2015

Table 7. Cement Standards and Types

	Products of the Cement Division		
NORM	Tepetzingo	Cerritos	Apazapan
NMX-C-414-ONNCCE Valid	CPC 30 R RS	CPC 30 R	CPC 30 R
	CPC 40 RS	CPC 40	CPC 40
	CPO 40 RS	CPO 40	
NMX-C-021-ONNCCE Valid	Mortar	Mortar	Mortar
For Packaging : Packaging Lines	3	3	2
Bags per hour and line (average)	3200	3300	4000

Source: Corporación Moctezuma and 2015 Annual Report

Concrete

At the end of Q116, this division represented 20.51% of total LTM revenues. The production and sale of concrete takes place at 36 concrete plants located in different Mexican cities. Ready-mix units and equipment are used to pump concrete and offer clients an integral service. Investments in the concrete division have made distribution more efficient and improved concrete quality. Some of the company's concrete plants are mobile, which strengthens customer service, as the concrete is produced on site. This enables Corporación Moctezuma, through its concrete subsidiaries, to participate in large projects in the 12 states where as at December 2105, it is present.

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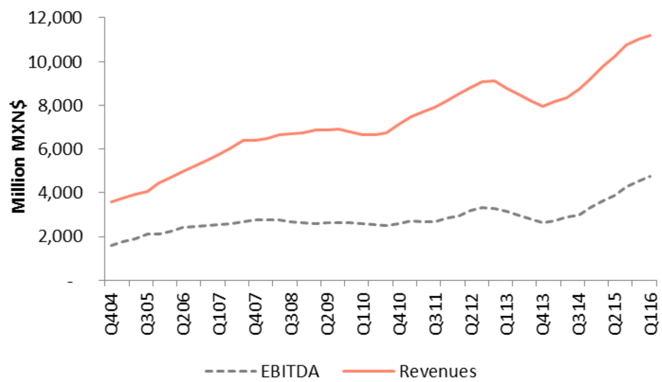
IV. Investment Thesis

i. Excellent record in value creation

Attractive growth rates. Moctezuma has achieved double-digit year-on-year operating growth in every quarter since Q414. At the end of Q116, revenues registered a Compound Annual Growth (CAGR) of 7.80%, gross profit +13.04%, EBITDA +12.30% and net profit +13.84%.

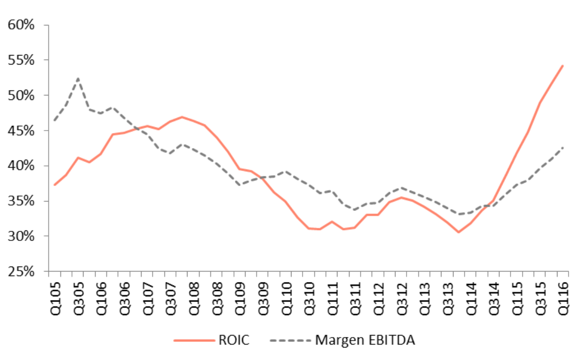
According to an aggregate analysis of the cement industry, which includes the MSE-listed cement companies, sales display a last-five-year CAGR of 5%, gross profit +8%, and EBITDA +9.1%. These numbers surpass industry growth, and we expect this to continue in coming quarters due to a capacity increase next year and efficiencies generated by management's focus on high profitability, low energy costs, and high cash flow generation, all of which give CMOCTEZ a solid financial position.

Chart 1. LTM sales and EBITDA



Source: Interacciones and company data

Chart 2. LTM ROIC and EBITDA margin



Source: Interacciones and company data

High profitability. The 2015 EBITDA margin was 40.92%, an increase of 497 basis points vs. 2014. Historically, CMOCTEZ has maintained a ROIC of above 30%[1]. Due to strong margin expansion, in Q116, the company achieved its highest historical LTM EBITDA margin of 42.53%. It has also consistently reported positive net profit for more than ten years.

CMOCTEZ has managed to reduce operating cycle efficiencies from 108 days in Q313 to 66 days in Q116 due to less client and inventory days, or greater inventory and client turnover as a result of growing demand. Supplier days have remained stable at 20 days.

[1] We used our ROIC= EBITDA/Invested Capital methodology, not the original methodology that includes the net operating profit after tax (NOPLAT) concept; we used LTM EBITDA to eliminate tax obligation distortion of value creation.

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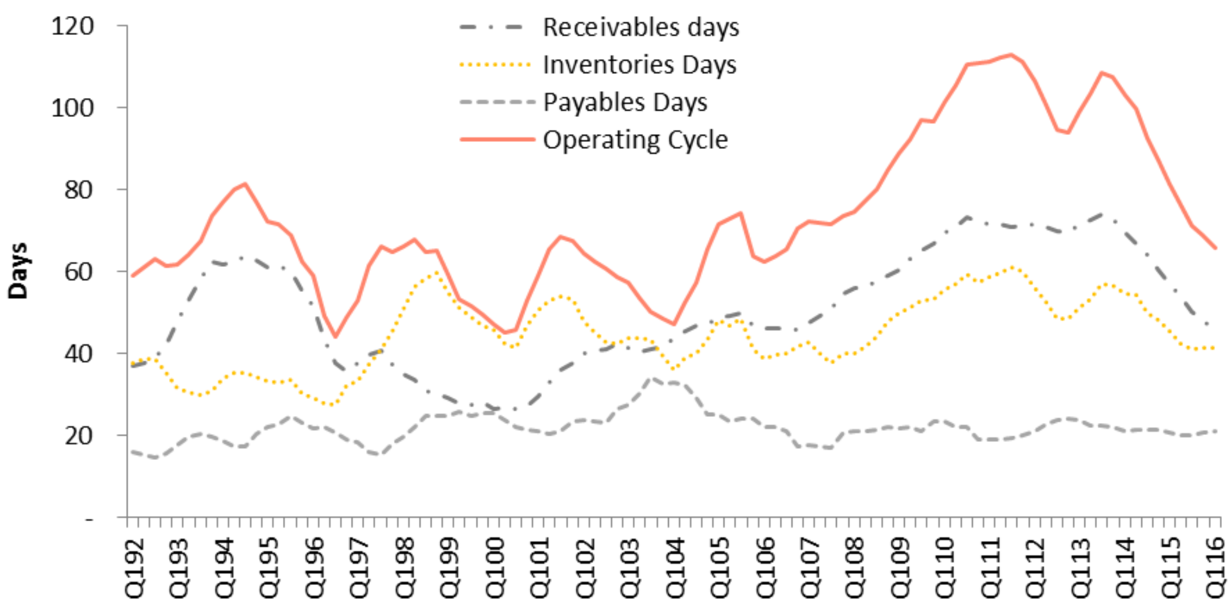
Chart 3. Main working capital indicators, LTM figures



Source: Interacciones and company data

ii. Excellent growth prospects. Projections

Although we expect 2016 and part of 2017 to be a complicated period for the construction industry due to less public investment and lower global growth expectations, as reflected in lower growth in cement prices, we think CMOCTEZ could maintain a next five-year CAGR similar to Q116's for the reasons mentioned in the previous section. However, our estimates are more conservative so as not to overestimate the target price.

Our consolidated estimate implies a CAGR in revenues of 6.77%, EBITDA 10.71% and controlling net profit 10.89%.

Cement (79% of LTM revenues and approximate 95% of EBITDA)

This segment represented 79.5% of LTM revenues as at Q116. According to the company, the segment contributes around 95% of EBITDA.

We estimated the division's revenues using our volume and price estimates for a ton of cement. We should mention that in this segment, cement is sold in two ways: in bags and in bulk. Bagged cement carries a better margin than bulk cement (our price estimate is 8% higher than for bulk cement), so the company tries to boost bagged cement sales, an assumption we also considered in our cash flow model.

Our price estimates are based on our cement price sample and the cement price index published by INEGI. Volume was estimated based on installed capacity and the percentage the company is expected to operate at in the coming years.

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On the costs side, we considered oil price estimates to reflect the impact on the price of petcoke and the average electricity rate. We found a six-month lag in the price of petcoke and a four month lag in the electricity rate.

Another key assumption was that we estimated a gross margin of 6% for this segment, which is above the consolidated gross margin. This is because the cement margin is higher than the concrete margin, but given its low participation in consolidated margins, we think the cement margin is very close to the consolidated margin.

Capex was estimated based on expected investment in the second production line of the Apazapan plant over the coming years, plus a percentage corresponding to maintenance and replacement expenses.

The results are shown below:

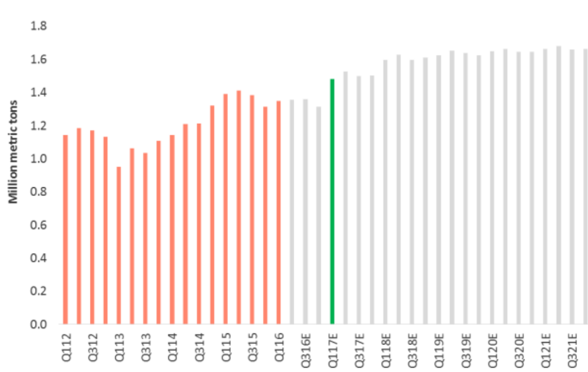
Chart 8. Income Statemente Cement Forecast

Cement	2015*	2016e	2017e	2018e	2019e	2020e	2021e
Packaged Volume / bulk (Thousands t.m.	5,496	5,380	6,008	6,427	6,537	6,598	6,660
Average Price (Thousand P$/ton)	1.57	1.72	1.77	1.81	1.84	1.87	1.91
% y/y volume	*12.50%*	*-2.10%*	*11.70%*	*7.00%*	*1.70%*	*0.90%*	*0.90%*
% y/y price	*6.90%*	*9.70%*	*2.70%*	*2.10%*	*1.60%*	*2.10%*	*1.80%*
Income (P$/millions)	**8,704**	**9,362**	**10,740**	**11,737**	**12,139**	**12,515**	**12,860**
Costs (P$/millions)	4,472	4,606	5,341	5,765	6,020	6,218	6,553
Gross Income (P$/millions)	4,232	4,756	5,398	5,972	6,119	6,297	6,307
Gross Margin (%)	***48.60%***	***50.80%***	***50.30%***	***50.90%***	***50.40%***	***50.30%***	***49.00%***
Expenditures (P$/millions)	270	329	415	589	602	615	627
Operating Income (P$/millions)	3,962	4,427	4,983	5,383	5,517	5,682	5,681
Operating Margin (%)	*45.50%*	*47.30%*	*46.40%*	*45.90%*	*45.40%*	*45.40%*	*44.20%*
EBITDA (P$/millions)	4,392	4,875	5,546	6,133	6,285	6,469	6,484
EBITDA Margin (%)	***50.50%***	***52.10%***	***51.60%***	***52.30%***	***51.80%***	***51.70%***	***50.40%***
CAPEX (P$/millions)	599	1,539	1,159	469	486	501	514

Source: Interacciones

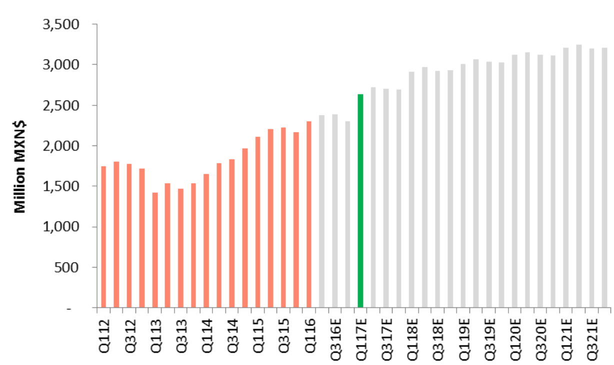
*For year 2015, the only observed data are Income and Capex, everything else are our estimations

Chart 4. Quarterly volume of bagged and bulk cement



Source: Interacciones
*Historical volume is also estimated

Chart 5. Quarterly revenues from bagged and bulk cement



Source: Interacciones

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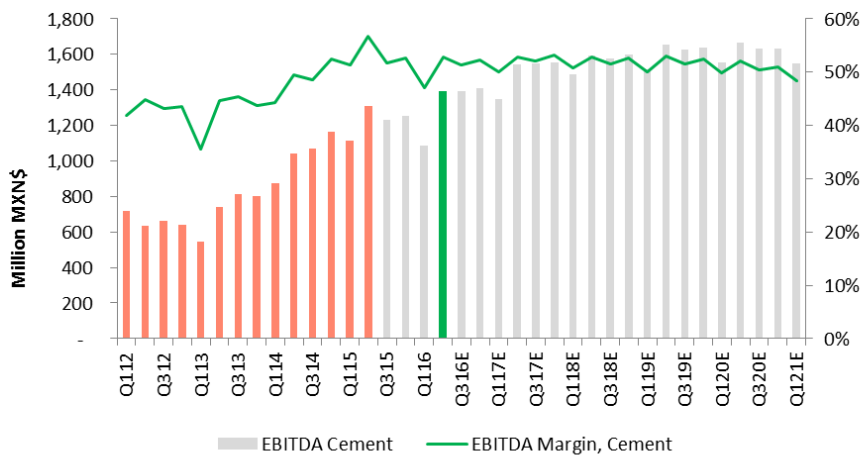
Chart 6. Cement EBITDA and EBITDA margin, quarterly data



Source: Interacciones
*Historical EBITDA is also estimated

Concrete (21% of LTM revenues and approximate 4.5% of EBITDA)

This segment represented 21.5% of LTM revenues as at Q116. According to the company, this segment contributes around 5% of EBITDA.

For this segment, we also estimated the volume of tons of concrete transported and the concrete price index. A percentage of cement is required to produce concrete which is considered a sale in the bulk cement heading.

Furthermore, concrete has a lower margin, partly due to stronger competition and less differentiation by clients.

An important assumption we made for both cement and concrete is that CAPEX is distributed among both segments in accordance with the percentage of revenues each represent.

The table below shows the segment's income statement.

Chart 9. Income Statement Concrete Forecast

Concrete	2015*	2016e	2017e	2018e	2019e	2020e	2021e
Concrete Volume (thousand t.m.)	1,817	1,746	2,151	2,179	2,189	2,201	3,477
Average Price (thousand P$/ton)	1.28	1.37	1.42	1.45	1.5	1.54	1.57
Income (P$/millions)	**2,322**	**2,397**	**3,056**	**3,161**	**3,284**	**3,387**	**3,477**
Expenditures and Costs (P$/millions)	2,202	2,272	2,902	3,030	3,145	3,242	3,326
Operating Income (P$/millions)	120	124	154	132	139	145	151
Operating Margin (%)	***5.20%***	***5.20%***	***5.00%***	***4.20%***	***4.20%***	***4.30%***	***4.30%***
EBITDA (P$/millions)	183	195	250	260	271	280	288
EBITDA Margin (%)	***7.90%***	***8.20%***	***8.20%***	***8.20%***	***8.20%***	***8.30%***	***8.30%***
CAPEX (P$/millions)	162	143	250	109	113	115	118

Source: Interacciones
*For year 2015, the only observed data are Income and Capex, everything else are our estimations

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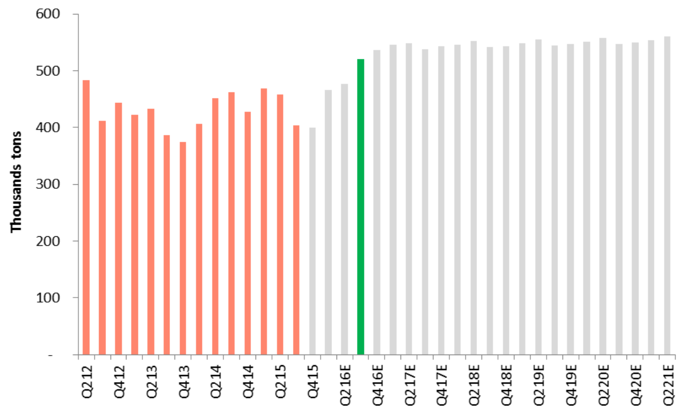
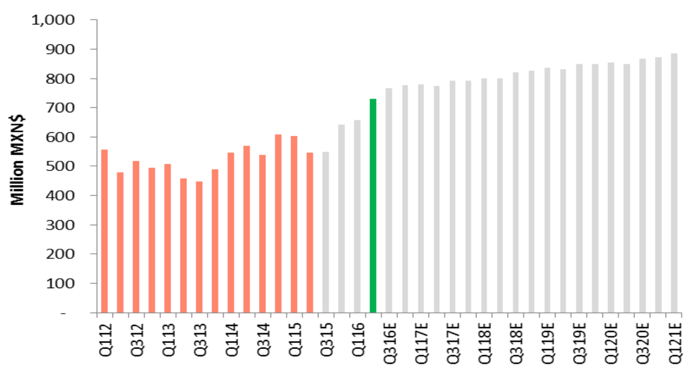
Below we include graphs with our volume, revenues, and EBITDA estimates. According to the company, it is relatively difficult to increase the concrete margin, so we assume relative margin stability in this segment, as shown in chart 9.

Chart 7. Quarterly concrete sales volume



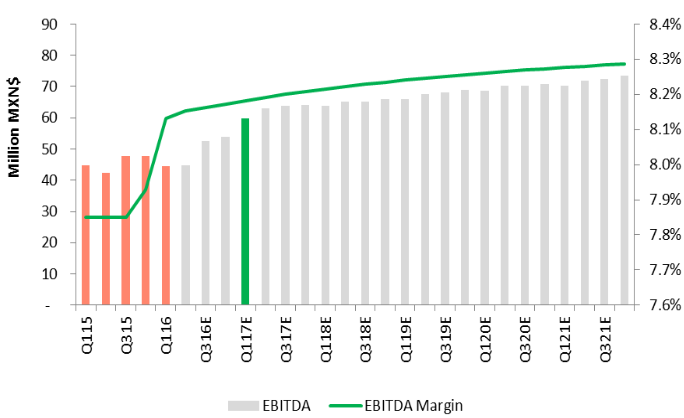
Source: Interacciones
*Historical volume is also estimated.

Chart 8. Quarterly Concrete Revenues, millions of pesos



Source: Interacciones

Chart 9. Concrete EBITDA and EBITDA margin, quarterly data



Source: Interacciones
EBITDA and EBITDA margin are also estimated

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Corporate Division

This segment's revenues correspond to leases from properties the company owns. Given that corporate revenues account for a minimal share of total revenues, we estimated growth rates in a very simple way.

Table 10. Corporate Division Projected Results

Corporative	2015	2016e	2017e	2018e	2019e	2020e	2021e
Income (MXN$/millions)	**0.516**	**0.516**	**0.526**	**0.537**	**0.548**	**0.559**	**0.57**
CAPEX (P$/millions)	20.195	0.608	6.458	4.261	5.369	3.806	3.412

Source: Interacciones

iii. Strong cash flow generation

Strong cash generation has enabled the company to grow organically and maintain a sound financial situation, which in turn has translated into ongoing cash dividends for shareholders.

According to our estimates, the investment in the second production line of the Apazapan plant is approximately USD$200 million and will be financed entirely by the company without any material impact on cash levels.

At the end of 2015, cash surpluses represented 74% of consolidated operating profit (100% of that year's cash). Once the investment at the Apazapan plant is complete, we estimate cash flow to considerably increase, possibly to as much as 37% of total assets by the end of 2021, not considering any additional investments during those years.

In view of this, and as we expect the company to be operating at around 94% capacity in 2021, we do not rule out new acquisitions or capacity expansions to invest accumulated and future cash, although the company has made no mention of any such plans to date.

iv. High profitability

According to our ROIC and ROE profitability analysis of the Mexican Stock Exchange (MSE), Corporación Moctezuma is one of the relatively more profitable companies in terms of ROIC, and ranks second in terms of ROE based on a sample of 90 companies and five straight quarters. Below we include the charts corresponding to our MSE profitability analysis as at Q116.

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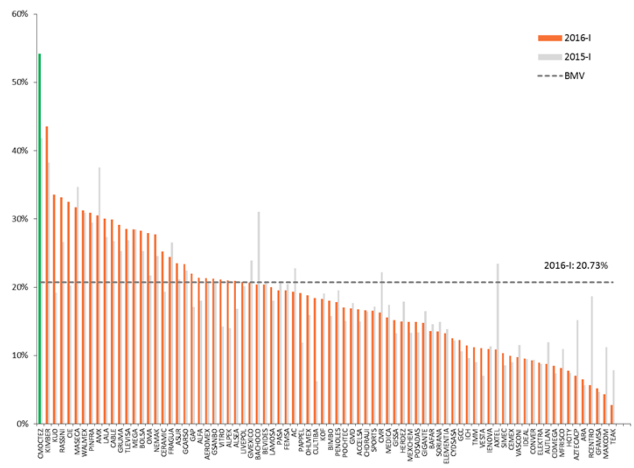
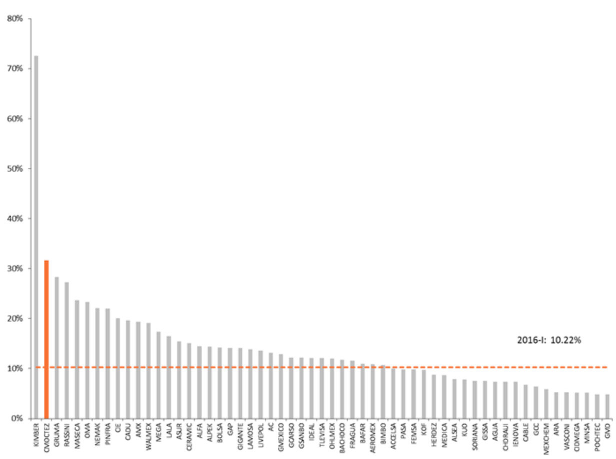
Chart 10. Analysis of MSE's ROIC, Q116 and Q115



Source: Interacciones

Chart 11. Analysis of MSE's ROE, Q116



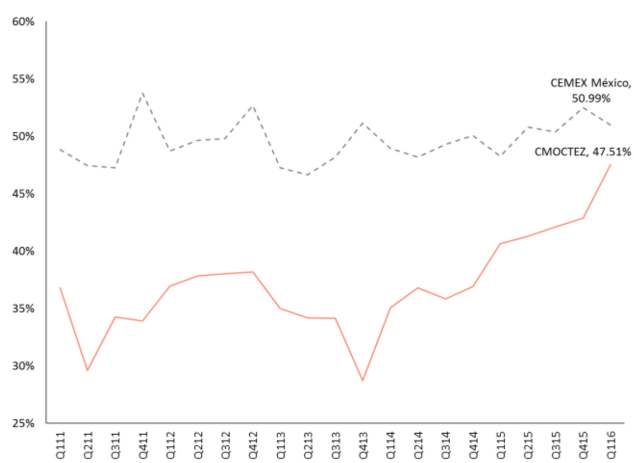
Source: Interacciones

As mentioned previously, Corporación Moctezuma invests heavily in technology. At the end of Q116, capital turnover was 1.27x, which along with a high EBITDA margin, enabled the company to substantially increase its profitability ratio and claim the number one position in 2015 and Q116.

The main reason why the company's ROIC has shot up over the last 12 months, is excess cash, in our invested capital methodology, surplus cash is subtracted from the heading, decreasing the size of the ROIC ratio denominator and increasing its value. The increase in ROIC due to high cash generation, is based on the assumption that the cash will be used to add value in the future; in other words, that the company will invest in profitable operations. We reiterate our view that the company will not sustain these cash levels, and do no therefore rule out new capital investments or acquisitions.

Above-industry margins. In terms of margins, and compared with CEMEX México, we found that Moctezuma's gross margins have historically trailed the competition, although the spread has narrowed in recent quarters. However, we compared operating and EBITDA margins, and found that since Q114, Moctezuma's have surpassed those of Cemex México, the highest spread occurring in Q116.

Chart 12. Quarterly Gross Margin



Source: Interacciones

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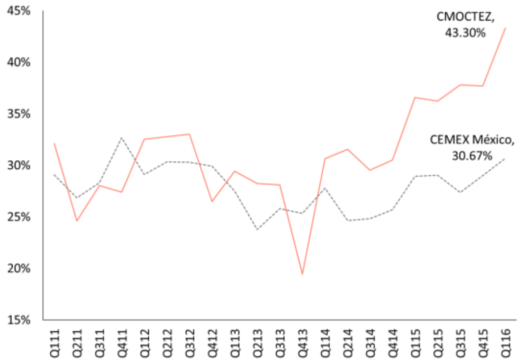
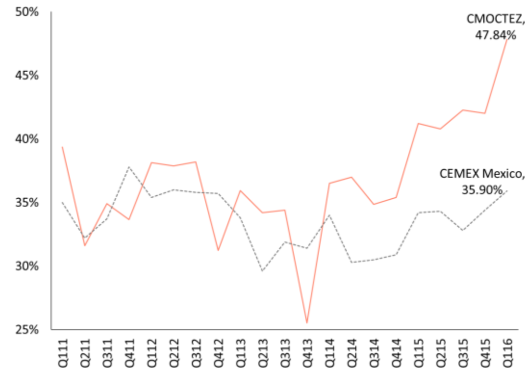
Chart 13. Quarterly Operating Margin



Source: Interacciones, not considered expense/income for corporate purposes

Chart 14. Quarterly EBITDA margin



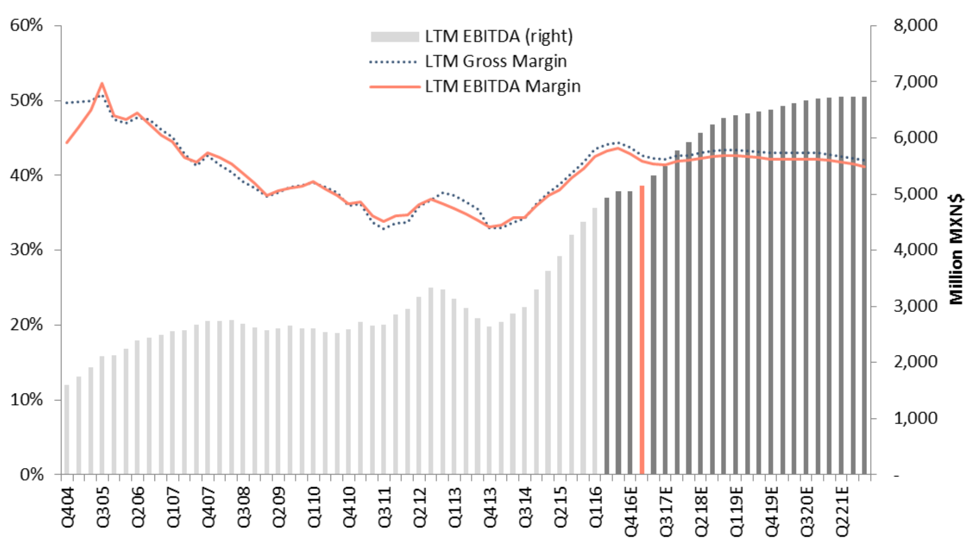
Source: Interacciones, not considered expense/income for corporate purposes

Energy cost efficiencies. In 2004, CMOCTEZ began investing in its plants to convert fuel oil to Petcoke. Petcoke is now used relatively more (99.5%) and fuel oil much less (0.5%) to fire furnaces, which has lowered fuel oil costs by 60%. Most of the Petcoke the company uses is imported from the United States.

As we expect oil prices to gradually recover, we believe the gross margin could approach 42%, and the EBITDA margin 41.3%.

In the first half of 2017, CMOCTEZ will start up the second production line at the Apazapan plant in Veracruz, which will increase production capacity by 20.3% to an annual 7.7 million tons. As a result, EBITDA should surpass MXN$6.7 billion by 2021.

Chart 15. Gross Margin, EBITDA Margin and EBITDA, LTM figures



Source: Interacciones

v. Solid financial structure

CMOCTEZ has an 83% equity structure and a Debt/Equity ratio of 0.28%. Therefore, it has no interest rate risk exposure in relation to liabilities in contrast with balance sheet assets where there is variable interest income received from the investment of surplus cash. Despite a debt with cost structure policy, the company has credit facilities with a number of institutions in case it requires financing.

This may not be an ideal situation, as it is a well-known fact that the cost of equity is higher than the cost of debt, and the tax benefit consisting of the deduction of interest is also lost. This has resulted in an effective tax rate of close to 30%, and a higher weighted average cost of capital.

V. Valuation

i. Target Price and Rating

Based our analysis and assumptions, we assign an end-Q217 target price of MXN$63.50 to Corporación Moctezuma, which is potential upside of 14.1%. Our rating is BUY.

ii. International Comparison and Multiples

The table below shows CMOCTEZ's prospects compared to its peers. Its EBITDA margin is higher as are ROE (return on equity) and ROA (return on assets) ratios. Even so, forward multiples trail the industry, implying that the stock is inexpensive. It is the only company with negative Net Debt in 2016.

Table 11. International multiple comparison

Cementeras	Country	Currency	MCap (Mill. USD)	Float (%)	Last Price	Target Price	Div. Yld.	YTD Return	Total Exp. Return
Cemex	Mexico	MXN	8,679	100.00	11.72	14.19	0.00	29.26	21.04
Cementos Argos	Colombia	COP	5,284	30.97	11,680.00	11,622.94	1.57	20.16	1.07
Union Andina de Cementos	Lima	PEN	1,288	31.98	2.59	3.18	2.01	52.35	25.25
Elementia	Mexico	MXN	1,001	24.79	21.67	25.09	0.00	-5.62	15.80
Cementos Pacasmayo	Lima	PEN	999	47.37	5.90	6.16	4.75	18.00	9.42
Grupo Cementos de Chihuahua	Mexico	MXN	861	24.82	48.99		0.00	9.33	
Cmoctez	Mexico	MXN	2,732	22.71	57.50	63.50	5.18	5.37	10.43
Meadian									
Weighted Average									

Source:: Interacciones

Cementeras	PE Ratio T12M	PE Ratio 2016E	PE Ratio 2017E	EV / EBITDA T12M	EV / EBITDA 2016E	EV / EBITDA 2017E	P / BL Current	NET DEBT/EBITDA	ROA	ROE
Cemex	51.58	33.01	17.21	11.33	9.17	8.21	1.16	6.81	0.75	3.02
Cementos Argos	30.97	28.27	23.08	13.62	11.69	10.28	2.01	3.27	3.20	7.32
Union Andina de Cementos	25.56	10.36	8.63	7.68	7.11	6.81	1.08	3.97	1.57	4.30
Elementia	917.21	18.71	16.86	8.19	7.52	7.04	1.20	1.76	0.03	0.07
Cementos Pacasmayo	15.53	15.05	14.18	11.12	9.93	9.29	1.65	2.19	6.48	10.95
Grupo Cementos de Chihuahua	17.46			7.76			1.09	1.99	3.63	6.56
Cmoctez	17.10	16.50	16.10	10.30	10.20	9.70	5.00	-0.70	24.00	29.00
Meadian	28.26	18.71	16.86	9.66	9.17	8.21	1.18	2.73	2.39	5.43
Weighted Average	37.26	28.00	18.17	11.38	9.73	8.73	1.43	4.81	1.94	4.81

Source: Interacciones

We calculated the Q416 target price and estimated the Q217 price using a weighted average cost of capital. Table 12 shows the Q416 target price estimate. Furthermore, based on our projected multiples (EV/EBITDA 10.2x and P/E 16.5x at Q217), we included the following sensitivity analysis for a possible share price range. The results show our target price to be conservative in light of our EBITDA and net profit growth estimates.

Table 12. EV/EBITDA and P/E multiple sensitivity

	EBITDA				
	-10%	-5%	Est.	5%	10%
Multiple	5,206	5,496	5,785	6,074	6,363
8.7	51.39	54.24	57.10	59.95	62.81
9.2	54.33	57.35	60.37	63.39	66.40
9.7	57.27	60.45	63.64	66.82	70.00
10.2	60.21	63.56	66.90	70.25	73.60
10.7	63.16	66.66	70.17	73.68	77.19
11.2	66.10	69.77	73.44	77.11	80.79

Source: Interacciones

	Net Income				
	-10%	-5%	Est.	5%	10%
Multiple	3,267	3,449	3,630	3,812	3,993
13.5	50.02	52.80	55.58	58.36	61.14
14.5	53.71	56.70	59.68	62.67	65.65
15.5	57.41	60.60	63.79	66.97	70.16
16.5	61.10	64.49	67.89	71.28	74.68
17.5	64.79	68.39	71.99	75.59	79.19
18.5	68.48	72.29	76.09	79.90	83.70

Source: Interacciones

iii. Discounted Cash Flow Valuation

Based on financial information as at Q116, sales strategies, company expansion plans, industry prospects and other announced considerations, revenues, costs, depreciation, other expenses, CAPEX, and EBITDA were estimated in detail per business segment through Q421. For 2022 and the out-years, the perpetuity value was calculated to determine enterprise value.

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Cash flows were discounted at Q416 prices to obtain the fair share price for the end of that year. The discount rate used was the Weighted Average Cost of Capital (WACC), calculated using the cost of equity and debt, which in the case CMOCTEZ is virtually zero. The table above shows the Q416 target price, which we subsequently adjusted to obtain the corresponding Q217 price.

Table 13. Discounted Cash Flow Valuation

Million MXN	2017E	2018E	2019E	2020E	2021E	Perp.
Operating Income	5,122	5,479	5,604	5,784	5,789	5,991
Tax Rate	30.00%	30.00%	30.00%	30.00%	30.00%	30.00%
Fiscal effect on operating income	- 1,537	- 1,644	- 1,681	- 1,735	- 1,737	- 1,797
NOPLAT	3,586	3,836	3,922	4,049	4,052	4,194
Depreciation	663	882	905	926	945	964
Changes in Working Capital	- 1,954	- 2,168	- 2,135	- 2,159	- 2,098	- 2,140
CAPEX	- 1,415	- 583	- 603	- 620	- 636	- 648
Free Cash Flow to the Firm	879	1,967	2,089	2,196	2,263	2,369
Perpetuity Growth Rate						4.7%
Explicit Period PV (2016 - 2020E)						7,228
Perpetuity Value						63,880
Perpetuity PV						39,384
Theoretical Present Value						46,612
Net Debt						- 7,394
Theoretical Market Value						54,006
Outstanding Shares						885
Theoretical Price per Share at 2T17						P$ 63.5
Current Market Price						P$ 57.50
Estimated Dividend Yield 2016						4.45%
Potential yield w/dividends						14.83%
Average Cost of Debt						9.30%
Long Term Tax Rate						30.00%
After Tax Cost of Debt						6.50%
Cost of Capital						8.40%
Market Risk Premium						6.00%
Risk Free Rate						6.00%
Beta						0.4
% Total Debt						0%
% Capital						100%
WACC						8.39%

Source: Interacciones

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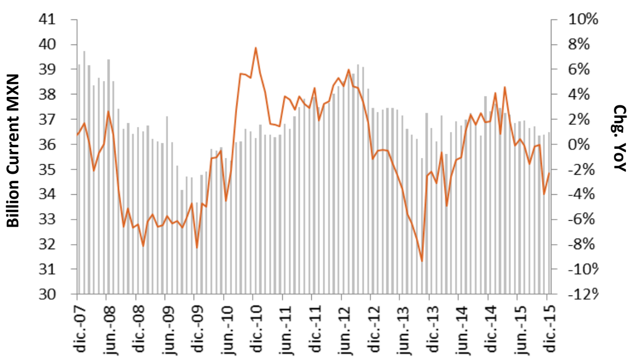
VI. Risks

i. Dependency on a single sector and economy

Corporación Moctezuma is engaged in the Mexican construction industry, whose performance is strongly linked to the country's economic performance and is the reason why upturns and downturns in the sector's economic cycle can have an impact on sales volumes, prices, and operating margins.

The production value of construction companies has been volatile in recent years. The sector saw a strong boom between 2010 and 2012, which was followed by a strong downswing in 2013 and a recovery in 2014. However, 2015 growth rates were also negative.

Chart 16. Real value of construction company production, base 2003



Source: Interacciones and INEGI data

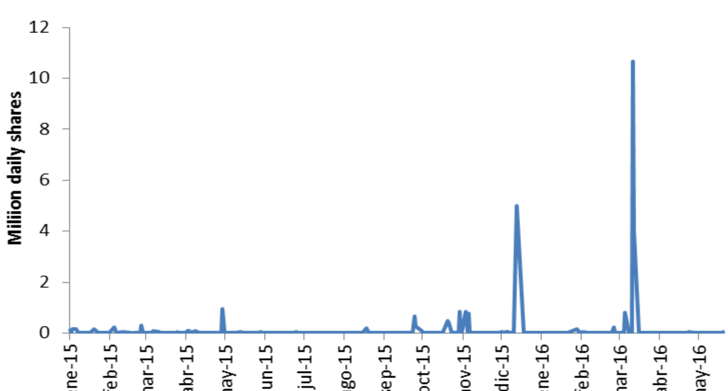
II. Low Liquidity

CMOCTEZ*'s daily average amount traded for the last six months is MXN$6.8 million, placing the stock at percentile 49 of a sample of 89 MSE-listed companies. The daily average trading volume for last six months was 170,094 shares[1], placing CMOCTEZ* at percentile 43 of our sample. Recent movements in turnover have resulted in a strong increase in the aforementioned averages and taken the stock to a higher percentile of our MSE sample.

Below we show the number of shares traded daily over the last year. The March 17, 2016 turnover was due to a brokerage house transaction. Norges Bank, which had held the largest position since 2014, with 4.44 million shares, unloaded them in Q116, while Compass Investment increased its position from 27,522 shares to its current one.

We view Moctezuma as an attractive investment option, although the stock is often bought for long-term wealth creation purposes, which has lowered liquidity.

Chart 17. Daily Turnover



Source: Bloomberg

[1] As at May 30, 2016

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III. High sensitivity to energy costs

As observed, throughout its history, energy costs have had a strong impact on the company's margins, so a rise in the price of the oil mix could lead to another adjustment. Although the LTM EBITDA margin currently stands at 2008 levels, history shows us that CMOCTEZ was capable of achieving an EBITDA margin of as much as 980 basis points above the current level when crude oil prices were around USD$40, but the exchange rate was MXN$10.5 /USD$.

IV. Exchange rate exposure

Exchange rate risk should have no impact on revenues, as 99% are in pesos while around 17% of costs are in USD$ due to the cost of Petcoke. Strong peso depreciation could lead to a strong rise in costs and a decrease in the gross margin and EBITDA.

According to the company's most recent report, only 6.72% of total assets are foreign-currency denominated (14.94% of current assets), 56.70% of which are in dollars and the rest in euros. Regarding debt, only 1.94% of total liabilities are foreign-currency denominated (4.29% of current liabilities), 92.56% of which are in dollars, and the rest in euros, so the company's balance sheet would not be affected by peso depreciation, rather, its financial position would benefit as asset exposure would be greater than liability exposure.

VII. Results and projections

Table 14. Free Cash Flow Projections

Financial Ratios	2014	2015	2016E	2017E	2018E	2019E	2020E	2021E
Leverage								
Net Debt / EBITDA (x)	(0.5x)	(0.7x)	(0.5x)	(0.4x)	(0.6x)	(0.7x)	(0.9x)	(1.1x)
Short Term Debt / Total Debt (x)	58%	36%	32%	33%	32%	47%	46%	47%
Yield								
ROE= Net Income/Equity	23.68%	30.53%	31.47%	31.27%	28.80%	25.75%	23.64%	21.21%
ROIC	38.50%	51.61%	52.23%	49.82%	49.13%	46.10%	45.44%	43.39%
ROA	18.89%	24.69%	26.20%	26.65%	25.67%	24.09%	22.72%	20.57%
Interest Hedge								
EBITDA / Paid Interests (x)	986.4x	1,527.9x	2,324.6x	2,453.3x	2,664.0x	3,377.3x	4,076.6x	4,031.7x
EBITDA - Capex /Paid Interests (x)	880.0x	1,263.6x	1,549.9x	1,853.2x	2,420.0x	3,064.2x	3,700.0x	3,651.0x
Operating Income / Paid Interests (x)	839.4x	1,359.9x	2,083.6x	2,172.3x	2,294.6x	2,907.8x	3,514.1x	3,465.9x
Inversions								
CAPEX / Sales	4%	7%	14%	10%	4%	4%	4%	4%
CAPEX / Depreciation	72%	157%	321%	214%	66%	67%	67%	67%

Source: Interacciones and company reports

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Table 15. Main multiples and operating indicators

MULTIPLES*	2014	2015	U12M	2016E	2017E	2018E	2019E	2020E
EV / EBITDA	15.0x	10.7x	10.1x	9.7x	8.4x	7.5x	7.2x	6.7x
P/E	25.2x	17.9x	16.7x	15.7x	14.1x	13.1x	12.8x	12.3x
P/BV	6.1x	5.4x	4.9x	5.0x	4.3x	3.7x	3.2x	2.8x
Dividend Yield	3.44%	3.44%	3.44%	5.18%	3.54%	3.72%	3.90%	4.10%
OPERATIVE INDICATORS	2014	2015	U12M	2016E	2017E	2018E	2019E	2020E
Sales	9,186	11,026	11,198	11,760	13,796	14,899	15,423	15,903
EBITDA	3,302	4,512	4,762	5,050	5,785	6,361	6,508	6,710
EBITDA margin	*35.95%*	*40.92%*	*42.53%*	*42.94%*	*41.93%*	*42.70%*	*42.20%*	*42.19%*
Control. Net Income	2,030	2,860	3,063	3,264	3,630	3,903	4,014	4,178
EPS	2.31	3.25	3.46	3.71	4.12	4.43	4.56	4.75
Net Debt	(1,759)	(2,941)	(3,349)	(2,287)	(2,562)	(3,526)	(4,517)	(6,092)
Net Debt / EBITDA	(0.5x)	(0.7x)	(0.7x)	(0.5x)	(0.4x)	(0.6x)	(0.7x)	(0.9x)
Δ% Sales	15.42%	20.03%	14.86%	6.65%	17.32%	7.99%	3.52%	3.11%
Δ% EBITDA	25.19%	36.63%	30.93%	11.93%	14.55%	9.97%	2.31%	3.09%
Δ% Control. Net Income	37.18%	41.06%	36.00%	14.03%	11.04%	7.47%	2.81%	4.04%
Δ% EPS	37.14%	40.89%	35.65%	14.13%	11.24%	7.51%	2.85%	4.08%
ROE	23.68%	30.53%	31.63%	31.47%	31.27%	28.80%	25.75%	23.64%
ROIC	38.50%	51.61%	54.17%	52.23%	49.82%	49.13%	46.10%	45.44%
ROA	18.89%	24.69%	25.70%	26.20%	26.65%	25.67%	24.09%	22.72%

Source: Interacciones and company reports.
*Both historical and estimated multiples were calculated using the June 22nd 2016 closing price.

Additional information available upon request.

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