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Second Party Opinion

Arca Continental S.A.B de C.V.'s Sustainability-Linked Financing Framework

March 26, 2024

Editor's note: This SPO report is based on S&P Global Ratings' "[Analytical Approach: Second Party Opinions and Transaction Evaluations](#)" dated Dec. 7, 2022, which was partly superseded by S&P Global Ratings' "[Analytical Approach: Second Party Opinions: Use of Proceeds](#)," dated Jul. 27, 2023, following the launch of our integrated use-of-proceeds SPOs.

Headquartered in Monterrey, Mexico, Arca Continental S.A.B. produces, distributes, and sells nonalcoholic beverages and snacks from several brands. It serves 128 million customers across Mexico (representing 47.0% of total revenues), the U.S. (35.7%), Peru (8.4%), Ecuador (6.1%), and Argentina (2.7%). The company was formed in 2011 after the merger of Embotelladora Arca and Grupo Continental, and it has been publicly listed on the Mexican Stock Exchange since 2021. The company is the second largest Coca-Cola bottler in Latin America.

In our view, Arca Continental's sustainability-linked financing framework, published in March 2024, is aligned with:

- ✓ Sustainability-Linked Bond Principles, ICMA, 2023
- ✓ Sustainability-Linked Loan Principles, LMA/LSTA/APLMA, 2023

Issuer's Sustainability Objectives

Arca Continental has further developed its sustainability strategy since it first established targets in 2019. The company's strategy is to reduce its environmental footprint aligned with key partner companies, such as The Coca Cola Co. In 2022, the company established local sustainability committees in each country where it operates. Furthermore, Arca Continental updated its materiality assessment in 2022, integrating a double materiality (meaning assessing both its financial and nonfinancial impact) approach and redefining its sustainability objectives. It defined three main pillars of action (social positive impact, environmental leadership, and transformational partnership), as well as nine priorities, including climate action and a circular economy.

Arca Continental has also set corporate targets for 2030 in line with its strategy related to carbon footprint and waste and packaging. In this context, the company developed its sustainability-linked financing framework to link its financing activities with reducing greenhouse gas emissions and use of recycled PET plastic, which is in line with its circular economy and climate action agenda. The sustainability-linked financing framework is applicable to Arca Continental S.A.B. and its subsidiary AC Bebidas, S. de R.L. de C.V.

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Selected Key Performance Indicators (KPIs) And Sustainability Performance Targets (SPTs)

KPI	SPT	Baseline	2023 performance
Absolute scope 1 & 2 greenhouse gas emissions	Reduction of absolute scope 1 and 2 greenhouse gas emissions measured as tons of carbon dioxide equivalent (tCO ₂ e) by 33.9% by 2030, from a 2019 baseline.	643,998 tCO ₂ e (2019)	444,691 tCO ₂ e (2022)
Absolute scope 3 greenhouse gas emissions	Reduction of absolute scope 3 greenhouse gas emissions measured as tCO ₂ e by 15% by 2030, from a 2019 baseline.	4,550,939 tCO ₂ e (2019)	3,980,693 tCO ₂ e (2022)
Percentage of recycled food-grade PET and Bio-PET containers over total tons of PET used	Increase recycled food-grade PET and Bio-PET containers over total tons of PET used to 39% by 2026 and 50% by 2030.	24.7% (2019)	24.9%
Percentage of renewable energy consumption over total energy consumption	Increase renewable energy consumption to 65% by 2026.	26.5% (2019)	44.1% (2022)

Second Party Opinion Summary

Selection of key performance indicators (KPIs)

Alignment	 Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.				
KPI 1	Absolute scope 1 and 2 greenhouse gas emissions (tCO2e)	Not aligned	Aligned	Strong	Advanced
KPI 2	Absolute scope 3 greenhouse gas emissions (tCO2e)	Not aligned	Aligned	Strong	Advanced
KPI 3	Recycled food-grade PET and Bio-PET containers (%)	Not aligned	Aligned	Strong	Advanced
KPI 4	Renewable energy consumption (%)	Not aligned	Aligned	Strong	Advanced

Calibration of sustainability performance targets (SPTs)

Alignment	 Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.				
SPT 1	Reduction of absolute scope 1 and 2 greenhouse gas emissions measured as tCO2e by 33.9% by 2030, from a 2019 baseline.	Not aligned	Aligned	Strong	Advanced
SPT 2	Reduction of absolute scope 3 greenhouse gas emissions measured as tCO2e by 15% by 2030, from a 2019 baseline.	Not aligned	Aligned	Strong	Advanced
SPT 3	Recycled food-grade PET and Bio-PET containers representing 39.0% of total containers by 2026 and 50% by 2030, from a 2019 baseline	Not aligned	Aligned	Strong	Advanced
SPT 4	Renewable energy consumption of 65% by 2026 from a 2019 baseline	Not aligned	Aligned	Strong	Advanced

Arca Continental's sustainability-linked financing framework commits to include annual targets for SPTs considered on each respective documentation of loans, derivatives, and deposits issued under the framework.

Instrument characteristics

Alignment  Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

Depending on the performance of the SPTs by target observation date, the instruments issued under Arca Continental's framework will be exposed to variations in their financial characteristics in the form of either a benefit (step down) and/or penalty (step up). Specific observation dates and financial impacts will be specified in each transaction documentation. Furthermore, the framework defines a fallback mechanism if the performance of the SPT against KPI can't be calculated or observed in a satisfactory manner.

Reporting

Alignment  Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

Score Not aligned Aligned **Strong** Advanced

Arca Continental commits to disclose, on an annual basis, an update on KPIs and any information relevant to monitoring the SPT progress in its ESG Report or on its website. The company will also publish information on the impacts of the SPT performance on the instrument's economic characteristics on an annual basis. In addition, the company commits to disclose additional information on the use of proceeds.

Post-issuance review

Alignment  Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

Arca Continental commits to having an independent external verification of its performance against the selected SPTs at least annually.

Framework Assessment

Selection of key performance indicators (KPIs)

The Principles make optional recommendations for stronger structuring practices, which inform our relevancy opinion as aligned, strong, or advanced. For each KPI, we consider how relevant the KPI is for sustainability by exploring the clarity and characteristics of the defined KPI; its significance for the issuer’s sustainability disclosures; and how material it is to the issuer’s industry and strategy.

 Arca Continental’s sustainability-linked financing framework is aligned with this component of the Principles.

KPI 1	Absolute scope 1 and 2 greenhouse gas emissions (tCO2e)	Not aligned	Aligned	Strong	Advanced
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We assess this KPI as aligned given that the framework clearly articulates the scope, objective, and calculation methodology. The KPI aims to reduce scope 1 and 2 emissions, which contributes to the global and company efforts to combat climate change, in line with the company’s sustainability strategy, and the strategy of its partner company The Coca Cola Co.

Arca Continental incorporates climate action as part of the priority topics of its sustainability strategy. This strategy aims to manage and mitigate risks associated with climate change, looking to incorporate new policies and strategies that contribute to a transition to a low-carbon economy. Arca Continental’s plan to reduce its carbon footprint incorporates new technologies and efficiency in manufacturing processes.

The KPI will incorporate all assets under the company’s operational control, which covers more than 95.3% of its total business by revenues. Arca Continental operates with full control over its core businesses such as beverages and snacks. Noncontrolling participation or joint ventures are only applied to noncore businesses, which we deem as less relevant for the scope of this KPI.

However, scope 1 and 2 emissions only accounted for 10% of the company's total greenhouse gas emissions in 2022, which limits our view on the relevance of the KPI both for the company and the sector’s most material risks. The scope 2 emissions account for the sum of electrical energy emissions from the national grid (location based) and those that come from renewable sources (market based) from all relevant business lines. We view this a best practice because it allows for the creation of incentives to invest in renewable energy, by accounting for emissions from local energy grids as well as those from contract agreements with energy suppliers.

In addition, the KPI incorporates stronger features such as following international methodology defined by the GHG Protocol Corporate Accounting and Reporting Standard and defining the KPI in absolute figures. In our opinion, absolute KPIs generally express more clearly the direct impact of the issuer's sustainability efforts than those expressed in relative terms (see "Navigating The Strengths, Challenges, And Best Practices In Sustainable Finance Frameworks And Transaction Documentation," published Jan. 18, 2022).

KPI 2	Absolute scope 3 greenhouse gas emissions (tCO2e)	Not aligned	Aligned	Strong	Advanced
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We consider this KPI to be aligned with the Principles because its scope, objective, and calculation are clearly articulated in the framework.

In our view, the scope 3 greenhouse gas emission reduction KPI contributes to the global effort to combat climate change. Moreover, the KPI addresses a relevant sustainability issue (climate transition risk) faced by the consumer products beverage sector and is integrated into the group’s sustainability strategy.

Scope 3 emissions represent 90% of the group’s total emissions. Therefore, we consider this KPI and engaging with stakeholders’ emission reduction efforts as key enablers for Arca Continental's decarbonization efforts.

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The KPI calculation is based on the GHG Protocol Corporate Accounting and Reporting Standard. This includes the most relevant categories for the sector such as category one: purchased goods and services. Nevertheless, an independent third-party hasn't verified the historical metrics.

The KPI's calculation consists of absolute greenhouse gas emissions. In our opinion, absolute KPIs generally express more clearly the direct impact of the issuer's sustainability efforts than those expressed in relative terms.

KPI 3 Recycled food-grade PET and Bio-PET containers (%)

Not aligned

Aligned

Strong

Advanced

We assess Arca Continental's KPI on percentage of food-grade PET and Bio-PET (plastic made from renewable resources that are biodegradable) containers to be aligned with the principles, given its disclosure on the scope, objective, and calculation. The KPI aims to reduce the use of raw plastic material and contribute to a circular economy, in line with both the company's sustainability strategy and that of the Coca Cola Co., Arca Continental's most important business partner.

The KPI directly relates to plastic pollution from the bioaccumulation of plastics within ecosystems, one of the main environmental risks for the sector and in line with the company's "World Without Waste Goals," which incorporate several actions to reducing plastic waste such as bottle design, recollection, and using recycled materials. The calculation of the KPI covers all beverage production centers under the company's control and is in line with the International Capital Market Association "KPI Registry" (reusable, recyclable, or compostable plastic packaging) and the Ellen McArthur Foundation definition, which supports its comparability.

In our opinion, the percentage metric clearly expresses the impact of the issuer's efforts towards reducing its overall use of raw materials considering potential growth of its production and number of bottles needed. However, limiting our view are the environmental constraints that come from using noncompostable plastics, such as the molecular degradation that limits its recyclability and usability over time, as well as lack of consideration for the sustainable sourcing of raw materials for plant-based paraxylene of Bio-PETs.

KPI 4 Renewable energy consumption (%)

Not aligned

Aligned

Strong

Advanced

We consider this KPI to be aligned with the Principles because its scope, objective, and calculation are clearly articulated in the framework.

Specifically, the issuer aims to increase the share of renewable electricity consumed in beverage production centers under its operational control (as of 2023, all beverage centers are under operational control and represent 93.6% of total revenue). We view as positive that Arca Continental has screened renewable energy sources with less than 100g CO₂e/kilowatt hours (KWh) direct emissions and only accounts for on-site self-generated energy and virtual and physical power purchase agreements (PPAs).

On the other hand, although we consider the use of PPAs as a relatively strong supply-side emissions-reduction tool appropriate to reduce scope 2 emissions, PPAs can correspond poorly to reductions in local grid emissions when generated in a market that differs from the purchaser's location or from old renewable assets (see "Purchased Energy Emissions In Second Party Opinions And ESG Evaluations," published March 23, 2023).

This KPI is widely used in the market, allowing for external benchmarking. It has been calculated from the company's internal data by measuring in kWh how much renewable electricity the company purchases from external sources, as a share of the total electricity consumed by beverage production centers under operational control. Nevertheless, we note that the metric has not been verified by an independent third-party. Furthermore, although we consider the use of renewable energy as an effective strategy to decarbonize operations and relevant to the entity's sustainability strategy, reduction of scope 2 emissions has limited effect on the company's overall emissions, which constrains our assessment.

Calibration of sustainability performance targets (SPTs)

The Principles make optional recommendations for stronger structuring practices, which inform our ambition opinion as aligned, strong, or advanced. We consider the level of ambition for each target by assessing its clarity and characteristics, how the issuer defines the target with reference either to its past performance, or to external or competitor benchmarks, and how it explains what factors could influence future performance.

 Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

SPT 1 Reduction of absolute scope 1 and 2 greenhouse gas emissions measured as tCO₂e by 33.9% by 2030, from a 2019 baseline.

Not aligned

Aligned

Strong

Advanced

We believe the ambition, clarity, and characteristic of Arca Continental's scope 1 and 2 greenhouse emission targets to be aligned with the principles, given that the issuer outlines a time to achieve the target, trigger events, and strategy to reach the target. Specifically, the company targets to reduce absolute scope 1 and 2 emissions by 33.9% by Dec. 31, 2030, from a 2019 baseline.

The company's decarbonization pathway aligns with a below-2.0 Celsius global scenario by 2030. SBTi validated Arca Continental's targets in 2023, taking into consideration its timeframe, emission coverage, and ambition. This helps benchmark the SPT against market practices, which we view as an adequate form of benchmarking in line with global standards.

However, the company has already achieved most of the reduction target in recent years, which limits the SPT's ambitiousness. As of 2022, Arca Continental had already reduced 30% of scope 1 and 2 emissions compared to 2019's baseline, leaving little room for improvement in the following eight years (the company needs to reduce 37 basis points annually until 2030). Nevertheless, we expect the company to keep growing its business in the next several years, which will demand continuing investments in renewable energy, optimization of refrigeration systems, and use of energy-efficient equipment to keep absolute emissions decreasing over time.

The framework includes some insights on how Arca Continental plans to achieve the target, such as investments in renewable energy, electric vehicle and truck fleets, and system and process optimization. In addition, Arca Continental identifies external factors beyond its control that may affect achievement of the SPT. Such events could materialize if there is lack of availability and feasibility of renewable energy sourcing or low-carbon technologies or electric vehicles expansion, as well as it continues to need fuels and refrigerants due to processing and packing, which the company considers beyond its control.

Baseline	Reduction of absolute scope 1 and 2 greenhouse gas emissions measured as tCO ₂ e by 33.9% by 2030, from a 2019 baseline.
2019	2030
643,998 tCO ₂ e	425,682 tCO ₂ e
	Equivalent to a 33.9% reduction

SPT 2 Absolute scope 3 greenhouse gas emissions reduction of 15% by 2030, from a 2019 baseline.

Not aligned

Aligned

Strong

Advanced

We consider the ambition, clarity, and characteristics of SPT 2 as aligned with the Principles' requirements. The framework clearly mentions the expected observation date, baseline, and trigger events. Specifically, the company targets a 15% reduction of absolute scope 3 greenhouse gas emissions by Dec. 31, 2030, from a 2019 baseline.

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We assess this SPT as relevant and ambitious for the timeframe stipulated. SBTi scientifically validated the target in 2023, which we view as an adequate form of benchmarking in line with global standards. For further clarification on the SPT's ambition, the company provides its performance over the past three years.

However, the company already achieved most of the reduction in recent years, which limits the SPT's ambitiousness. As of 2022, Arca Continental had already reduced 12.5% of scope 3 emissions compared to 2019's baseline, leaving little room for improvement in the following eight years (the company needs to reduce 31 basis points annually until 2030). Still, we view as positive that the entity commits to achieving the reduction of absolute emissions amid expected volume growth and therefore consider the SPT ambitious. Business growth will lead to higher production rates, which could pose challenges to manage absolute greenhouse gas emissions.

The framework includes some information regarding the issuer's strategy for achieving the target. The company is committed to engaging with suppliers to reduce emissions and is seeking to implement cold drink energy-efficient technologies and increasing efficiency in transportation and distribution operations. Additionally, Arca Continental outlines factors beyond its direct control that may affect its target achievement, which we think are in line with constraints other companies face while decarbonizing value-chain operations.

Baseline	Absolute scope 3 greenhouse gas emissions reduction of 15% by 2030 from a 2019 baseline.
2019	2030
4,550,939 tCO ₂ e (2019)	3,868,298 tCO ₂ e
	Equivalent to 15% reduction

SPT 3 Recycled food-grade PET and Bio-PET containers representing 39% by 2026 and 50% by 2030, from a 2019 baseline.

Not aligned

Aligned

Strong

Advanced

We believe the ambition, clarity and characteristics of SPT 3 is aligned with the principles with strong characteristics. The framework provides information on the company's past performance and describes Arca Continental's strategy for achieving the target as well as external factors that may affect its performance. The company incorporates two target dates aligned with its corporate "World Without Waste Goals" for 2030.

The percent of recycled food-grade PET and Bio-PET decreased to 23.6% in 2022 due to Arca Continental's focus on restructuring and aligning its business strategy across Mexico and the U.S. While the company increased this to 24.9% in 2023, this still leaves an expected increase to reach the target of 1,410 basis points (bps) for 2026 (a 57.9% increase from baseline) and 2,510 basis points by 2030 (a 102.4% increase from baseline), which goes significantly beyond the historically slow growth pace.

The company expects to reach both targets in this SPT by integrating its waste management strategy into the company's operations, while adapting it to diverse regional contexts. Some of the actions the issuer foresees to implement is designing sustainable packaging, incorporating different value chain actors, and investing in collection and recycling facilities.

In 2018, the company signed the Ellen McArthur Foundation's New Plastic Economy Global Commitment to tackle plastic pollution, which includes reducing virgin plastic in packaging, further demonstrating Arca Continental's commitment to decreasing global plastic production and waste.

We consider the issuer targets as significantly ambitious compared to its historical performance. Moreover, we assess that the target selected by Arca Continental is within the range of peers' performance that operate in similar regions, even though some have different plastic need that limits comparability.

Baseline	Recycled food-grade PET and Bio-PET containers representing 39.0% by 2026 and 50.0% by 2030, from a 2019 baseline.
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2019	2026	2030
24.7% of food-grade PET and Bio-PET	39% of food-grade PET and Bio-PET	50% of food-grade PET and Bio-PET
	Equivalent to 1,430 bps increase	Equivalent to 2,530 bps increase

SPT 4 Increase renewable energy consumption to 65 % by 2026. Not aligned Aligned **Strong** Advanced

We consider the ambition, clarity, and characteristics of SPT 4 as aligned with the Principles' requirements, with strong characteristics. The framework clearly mentions the expected observation date, baseline, and trigger events. Specifically, the company plans to increase its renewable energy consumption to 65% by Dec. 31, 2026, from a 2019 baseline.

We consider the company's previous performance and local jurisdiction when assessing the calibrated 2026 target. We think the target demonstrates a material improvement against the baseline. Moreover, we believe the selected target is within range of peers' performance. Although historical performance shows a slightly higher annual average increase (annual average of 580 basis points) than what the company expects for the next two years (annual average of 550 basis points), we note the issuer faces external factors that limit the target's ambition. These mainly relate to the limited availability of renewable electricity and regulatory constraints in major markets of operation. For instance, progress on increasing the share of renewable energy sources in Mexico has been slow over the past few years, while its energy continues to be mainly composed by fossil fuels such as coal (5.4%), oil (44.3%), and natural gas (39%). The Mexican market accounted for 47% of Arca Continental's revenue in 2023. Given this context and the timeline of the target, we consider Arca's calibrated target as ambitious and aligned with local peers' performance for the target observation date.

The framework includes some information regarding the issuer's strategy for achieving the target. Specifically, the company will increase its current PPAs to meet the specified target by 2026. Arca Continental expects to meet its renewable energy requirements mainly through PPAs from solar power projects. The company will additionally certify the achieved reductions through Energy Certificates (CERs). The purpose of these is solely to certify the emission reduction, not to compensate for emission reductions. Currently, the issuer doesn't anticipate investing in self-generation renewable energy projects, which we consider a best practice.

Baseline	Increase renewable energy consumption to 65% by 2026.
2019	2026
26.5% renewable energy consumption	65.0% renewable energy consumption
	Equivalent to a 38.5% increase

Instrument characteristics

The Principles require disclosure of the type of financial and/or structural impact involving trigger event(s), as well as the potential variation of the instrument's financial and/or structural characteristics.

 Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

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Arca Continental discloses that any instrument issued under the framework will be subject to effects on its financial characteristics, linked to at least one of the SPTs defined by the issuer. These potential variations may include a benefit (step down) and/or penalty (step up). The entity also clarifies that a step up will take place if it fails to calculate, observe, or report information on the performance against the targets for each KPI by the observation dates. In addition, the framework commits to disclose and explain any fallback mechanisms in the applicable transaction documentation.

The issuer commits to include within the final terms and conditions of each sustainability-linked instrument a description of the trigger event that will take place if the company fails to meet one or more SPTs on the relevant observation dates, or it fails to publicly report information on the performance against the targets for each KPI.

Derivative- and deposit-linked instruments may use the framework as a reference for future transactions. However, we do not opine on the alignment of those products given they are out of scope from ICMA's, LSTA's, LMA's, and APLMA's principles.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 Arca Continental's sustainability-linked financing framework is aligned with this component of the Principles.

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider Arca Continental's overall reporting practices to be strong.

The company commits to publishing annual updates on KPIs and SPTs in its ESG Report or on its website, including sufficient information to allow investors to monitor the progress of the SPTs. Arca Continental will report annually the SPTs performance by the target observation date on the instrument's economic characteristics.

We view positively that Arca Continental commits to disclose illustration of the positive sustainability impacts deriving from the performance improvement. Moreover, the commitment to report on any reassessments and/or pro forma adjustments of KPIs, as well as any potential restatements of SPTs, represents a strong feature, in our opinion.

Post-issuance review

The Principles require post-issuance review commitments including the type of post-issuance third-party verification, periodicity, and how this will be made available to key stakeholders. Our opinion describes whether the documentation is aligned or not aligned with these requirements. Please note, our second party opinion is not itself a post-issuance review.

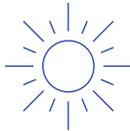
 Arca Continental's sustainability-linked financing framework is aligned with this component of the include applicable Principles.

Arca Continental commits to obtaining an independent qualified external post-issuance verification of its performance against SPTs at least annually, following the Principles' guidelines for external reviews. The company will publish the performance verification on its website.

Mapping To The U.N.'s Sustainable Development Goals

The Sustainable Development Goals (SDGs), which the United Nations (U.N.) set up in 2015, form an agenda for achieving sustainable development by 2030.

Arca Continental's sustainability-linked financing framework intends to contribute to the following SDGs:

KPI	SDGs
KPI 1 - Absolute scope 1 and 2 greenhouse gas emissions	  <p>13. Climate action 7. Affordable and clean energy*</p>
KPI 2 - Absolute scope 3 greenhouse gas emissions	  <p>13. Climate action 7. Affordable and clean energy*</p>
KPI 3 - Recycled food-grade PET and Bio-PET containers	  <p>13. Climate action 12. Responsible consumption and production*</p>
KPI 4 - Renewable energy consumption	  <p>13. Climate action 7. Affordable and clean energy*</p>

*The KPI is likely to contribute to the SDGs.

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