

portion of the soft drink market.

Argentina. In Argentina, Coca-Cola FEMSA's main competitor is BAESA, a Pepsi bottler, which is owned by Argentina 's principal brewery, Quilmes Industrial S.A., and indirectly controlled by AmBev. In addition to BAESA, competition has intensified over the last several years with the entrance of a number of competitors offering generic, low priced soft drinks as well as many other generic products and private label proprietary supermarket brands.

Production and Distribution Facilities

Over the past several years, Coca-Cola FEMSA has made significant capital improvements to modernize its facilities and improve operating efficiency and productivity, including:

- increasing the annual capacity of its bottler plants;
- installing clarification facilities to process different types of sweeteners;
- installing plastic bottle-blowing equipment and can presentation capacity;
- modifying equipment to increase flexibility to produce different presentations, including swing lines that can bottle both non-returnable and returnable presentations; and
- closing obsolete production facilities.

As of December 31, 2003, Coca-Cola FEMSA owned 32 bottler plants. By country, Coca-Cola FEMSA has twelve bottler facilities in Mexico, four in Central America, six in Colombia, six in Venezuela, three in Brazil and one in Argentina.

Since the Panamco acquisition during 2003, Coca-Cola FEMSA consolidated 20 of its plants into existing facilities, including four plants in Mexico, one in Central America, eleven in Colombia, three in Venezuela and one in Brazil. At the same time, Coca-Cola FEMSA increased its productivity measured in unit cases sold by its remaining plants by more than 50% company wide.

As of December 31, 2003, Coca-Cola FEMSA operated 250 distribution centers, more than 40% of which were in its Mexican territories. Coca-Cola FEMSA owns approximately 80% of these distribution centers and leases the remainder. See “ -Product Distribution.” During 2003, as part of its consolidation process, Coca-Cola FEMSA closed 37 distribution centers across its territories.

The table below sets forth the location, principal use, installed capacity and percentage utilization of Coca-Cola FEMSA's production facilities by country:

Production Facility Summary As of December 31, 2003			
Country	Principal Use	Installed Capacity (thousands of unit cases)	% Utilization ⁽¹⁾
Mexico	Bottler Facility	1,417,345	59.5%
Guatemala	Bottler Facility	30,303	54.6%
Nicaragua	Bottler Facility	26,807	70.8%
Costa Rica	Bottler Facility	37,992	56.3%
Panama	Bottler Facility	28,830	36.1%
Colombia	Bottler Facility	264,036	37.5%
Venezuela	Bottler Facility	268,763	42.1%
Brazil	Bottler Facility	378,969	56.3%
Argentina	Bottler Facility	206,736	60.3%

(1) Annualized rate.

Taxation of Soft Drinks

All the countries in which Coca-Cola FEMSA operates, except for Panama, impose a value-added tax on the sale of soft drinks, with a rate of 15% in Mexico, 12% in Guatemala, 15% in Nicaragua, 13% in Costa Rica, 5% in Panama, 16% in Colombia, 16% in Venezuela, 18% in Brazil (only in the territories where Coca-Cola FEMSA operates) and 21% in Argentina. In addition, several of the countries in which Coca-Cola FEMSA operates impose the following excise or other taxes:

- Mexico imposes a 20% excise tax on soft drinks produced with high fructose corn syrup or HFCS in January 2002 that was suspended in September 2002. In January 2003, the Mexican government implemented a 20% excise tax on carbonated soft drinks produced with non-sugar sweeteners.
- Guatemala imposes an excise tax of 0.18 cents in local currency (Ps. 0.25 as of December 31, 2003) per liter of soft drink.
- Nicaragua imposes a 9% consumption tax.
- Costa Rica imposes a specific tax on non-alcoholic bottled beverages based on the combination of packaging and flavor, a 5% tax on local brands, a 10% tax on foreign brands and a 14% tax on mixers.
- Panama imposes a 5% tax based on the cost of goods produced.
- Brazil imposes an excise tax of 9% and a consumption tax of 6.9% in the territories where Coca-Cola FEMSA operates.
- Argentina imposes an excise tax on colas and on flavored soft drinks containing less than 5% lemon juice or less than 10% fruit juice of 8.7%, and an excise tax on flavored soft drinks with 10% or more fruit juice, and on mineral water of 4.2%.

Price Controls on Soft Drinks

At present, there are no price controls on soft drinks in any of our territories. In Mexico, prior to 1992, prices of carbonated soft drinks were regulated by the Mexican government. From 1992 to 1995, the industry was subject to voluntary price restraints. In response to the devaluation of the Mexican peso relative to the U.S. dollar in 1994 and 1995, however, the Mexican government adopted an economic recovery plan to control inflationary pressures in 1995. As part of this plan, the Mexican government encouraged the *Asociación Nacional de Productores de Refrescos y Aguas Carbonatadas, A.C.* (the National Association of Bottlers) to engage in voluntary consultations with the Mexican government with respect to price increases for returnable presentations. These voluntary consultations were terminated in 1996. In the last ten years, the governments in Colombia, Brazil and Venezuela have also imposed formal price controls on soft drinks. The imposition of price controls in the future may limit Coca-Cola FEMSA's ability to set prices and adversely affect its results of operations.

Seasonality

Sales of Coca-Cola FEMSA's products are seasonal, as its sales levels generally increase during the summer months of each country and during the Christmas holiday season. In Mexico, Central America, Colombia and Venezuela, Coca-Cola FEMSA

typically achieves its highest sales during the summer months of April through September as well as during the Christmas holidays in December. In Argentina and Brazil, its highest sales levels occur during the summer months of October through March and the Christmas holidays in December.

Raw Materials

Pursuant to the bottler agreements with The Coca-Cola Company, Coca-Cola FEMSA is required to purchase concentrate, including aspartame, an artificial sweetener used in diet sodas, for all *Coca-Cola* trademark beverages from companies designated by The Coca-Cola Company. The price of concentrate for all *Coca-Cola* trademark beverages is a percentage of the average price Coca-Cola FEMSA charges to its retailers net of applicable taxes. Although The Coca-Cola Company has the right to unilaterally set the price of concentrates, in practice this percentage is set pursuant to periodic negotiations with The Coca-Cola Company. In connection with the Panamco acquisition, The Coca-Cola Company agreed that concentrate prices would not be raised through May 2004. See "Item 10. Additional Information-Material Contracts-Coca-Cola FEMSA-The Coca-Cola Memorandum." In most cases, concentrate is purchased in the local currency of the territory.

In addition to concentrates, Coca-Cola FEMSA purchases sweeteners, carbon dioxide, glass and plastic bottles, cans, closures and fountain containers, as well as other packaging materials. Its bottler agreements provide that, with respect to *Coca-Cola* trademark beverages, all containers, closures, cases, cartons and other packages and labels may be purchased only from suppliers approved by The Coca-Cola Company, which includes manufacturing subsidiaries of FEMSA Empaques. Prices for packaging materials historically are determined with reference to the U.S. dollar, although the local currency equivalent in a particular country is subject to price volatility in accordance with changes in exchange rates. Under the agreements with The Coca-Cola Company, Coca-Cola FEMSA may also use raw or refined sugar or HFCS as sweeteners in its products, although it currently use sugar in all of its operations except for Argentina. Sugar prices in all of the countries in which Coca-Cola FEMSA operates, other than Brazil, are subject to local regulations and other barriers to market entry that cause it to pay in excess of international market prices for sugar. Coca-Cola FEMSA has experienced sugar price volatility in these territories as a result of changes in local conditions and regulations.

None of the materials or supplies that Coca-Cola FEMSA uses are presently in short supply, although the supply of specific materials could be adversely affected by strikes, weather conditions, governmental controls or national emergency situations.

Mexico. Coca-Cola FEMSA purchases some glass bottles, closures, plastic cases, commercial refrigerators, cans and certain lubricants and detergents for bottling lines from subsidiaries of FEMSA Empaques. It purchases returnable its plastic bottles from Continental PET Technologies de México, S.A. de C.V., a subsidiary of Continental Can, Inc., which has been the exclusive supplier of returnable plastic bottles to The Coca-Cola Company and its bottlers in Mexico. Coca-Cola FEMSA purchases some of its non-returnable plastic bottles, as well as pre-formed plastic ingots for the production of non-returnable plastic bottles, from ALPLA Fábrica de Plásticos, S.A. de C.V., which we refer to as ALPLA, an authorized provider of PET for The Coca-Cola Company.

Coca-Cola FEMSA purchases some can presentations from Industria Envasadora de Querétaro, S.A. de C.V., known as IEQSA, a bottler cooperative in which it holds 33.68% interest. Both Coca-Cola FEMSA and IEQSA purchase a portion of empty can supply requirements from Famosa. Coca-Cola FEMSA's supply agreements provide for market based pricing.

Sweeteners are combined with water to produce basic syrup, which is added to the concentrate as the sweetener for the soft drink. Coca-Cola FEMSA regularly purchases sugar from Promotora Mexicana de Embotelladoras, S.A. de C.V., known as PROMESA, a cooperative of *Coca-Cola* bottlers. These purchases are regularly made under one-year agreements between PROMESA and each bottler subsidiary for the sale of sugar at a price that is determined monthly based on the cost of sugar to PROMESA. Coca-Cola FEMSA also purchases sugar from Beta San Miguel, another sugar-cane producer in which it holds a 2.54% equity interest.

In December 2001, the Mexican government expropriated the sugar industry in Mexico. To administer this industry, the Mexican government entered into a trust agreement with Nacional Financiera, S.N.C., which we refer to as Nafin, a Mexican government-owned development bank, pursuant to which Nafin acts as trustee. In addition, the Mexican government imposed a 20% excise tax, effective January 1, 2002, on carbonated soft drinks sweetened with HFCS. As a result Coca-Cola FEMSA converted its Mexican bottler facilities to sugar-cane-based production in early 2002. On January 1, 2003, the Mexican government broadened the reach of this tax by imposing a 20% excise tax on carbonated soft drinks produced with non-sugar sweetener, including HFCS. The effect of these excise taxes is to limit Coca-Cola FEMSA's ability to substitute other sweeteners for sugar.

Imported sugar is also presently subject to import duties, the amount of which is set by the Mexican government. As a result, sugar prices in Mexico are in excess of international market prices for sugar and increased by approximately 8% in 2003.

Central America. The majority of Coca-Cola FEMSA's raw materials such as glass and plastic bottles and cans are purchased from several local suppliers. Sugar is available from one supplier in each country. Local sugar prices are significantly higher than international market prices, and Coca-Cola FEMSA's ability to import sugar or HFCS is limited.

Colombia. Coca-Cola FEMSA uses sugar as a sweetener in its products, which it buys from several domestic sources. It purchases pre-formed ingots from a local supplier and Tapón Corona, in which it has a 40% equity interest. Coca-Cola FEMSA purchases all its glass bottles and cans from suppliers, in which its competitor Postobón owns a 40% equity interest. Other suppliers exist for glass bottles, however, cans are available only from this one source.

Venezuela. Coca-Cola FEMSA uses sugar as a sweetener in its products, of which it purchases the majority from the local market and the rest it imports mainly from Colombia. In the second half of 2003, there was a shortage of sugar due to the inability of the main sugar importers to access foreign currencies as a result of the exchange controls implemented at the beginning of 2003. Coca-Cola FEMSA only buys glass bottles from one supplier, Productos de Vidrio, S.A., a local supplier, but there are other alternative suppliers authorized by The Coca-Cola Company. Coca-Cola FEMSA has several supplier options for plastic non-returnable bottles but it acquires most of its requirements from ALPLA de Venezuela, S.A. One exclusive supplier handles all of its can requirements.

Brazil. Sugar is widely available in Brazil at internal market prices which are generally lower than international prices. Coca-Cola FEMSA purchases glass bottles, PET bottles and cans from several domestic and international suppliers.

Argentina. In Argentina, Coca-Cola FEMSA uses HFCS from several different local suppliers as sweetener in its products instead of sugar. It purchases glass bottles, plastic trays and other raw materials from several domestic sources. Coca-Cola FEMSA purchases pre-formed plastic ingots, as well as returnable plastic bottles, at competitive prices from Complejo Industrial PET, S.A., which we refer to as CIPET, a local subsidiary of Embotelladora Andina S.A., a Coca Cola bottler with operations in Argentina, Chile and Brazil, and other international suppliers. Coca-Cola FEMSA purchases crown caps from local and international suppliers. It purchases its can presentations for distribution to customers in Buenos Aires from Complejo Industrial CAN S.A., which we refer to as CICAN, in which Coca-Cola FEMSA de Buenos Aires has a 48.1% equity interest.

Purchases from FEMSA Affiliates

Coca-Cola FEMSA regularly engages in transactions with FEMSA and its subsidiaries. In 2003, Coca-Cola FEMSA purchased

crown caps, plastic bottle caps, cans, commercial refrigerators, lubricants, detergents, plastic cases and substantially all of its returnable glass bottle requirements for its Mexican operations from FEMSA Empaques under several supply agreements. A subsidiary of FEMSA Empaques also sells refrigerators to Coca-Cola FEMSA's non-Mexican operations. The aggregate amount of these purchases was approximately Ps. 1.513 billion in 2003. Coca-Cola FEMSA believes that its purchasing practices with FEMSA Empaques result in prices comparable to those that would be obtained in arm's length negotiations with unaffiliated parties. Coca-Cola FEMSA also sells its products to FEMSA Comercio's chain of convenience stores. These transactions are also conducted on an arm's length basis .

FEMSA Cerveza

Overview and Background

FEMSA Cerveza is one of our core subholding companies and one of the two leading beer producers in Mexico measured in terms of sales volume. In 2003, FEMSA Cerveza sold 24.564 million hectoliters of beer. In 2003, FEMSA Cerveza was ranked the fourteenth-largest brewer in the world in terms of sales volume based on third party estimates. FEMSA Cerveza exports its products to more than 70 countries worldwide, with North America being its most important export market, followed by certain markets in Asia, Europe and Latin America. FEMSA Cerveza's principal operating subsidiaries are Cervecería Cuauhtémoc Moctezuma, S.A. de C.V., which we refer to as CCM, and which operates six breweries, and Cervezas Cuauhtémoc Moctezuma, S.A. de C.V. which operates our company-owned distribution centers.

In September 1994, Labatt acquired 22% of FEMSA Cerveza for US\$510 million and was granted an option to acquire an additional 8%. On December 1, 1994, FEMSA Cerveza and Labatt entered into a joint venture agreement whereby both parties agreed to combine their United States beer businesses through their joint ownership of Labatt USA. FEMSA Cerveza owns 30% of Labatt USA. In July 1995, Interbrew N.V./S.A., which we refer to as Interbrew, a Belgian holding company with extensive brewing interests worldwide, acquired Labatt. On May 15, 1998, Labatt, through its subsidiary, Stellamerica Holdings Limited, which we refer to as Stellamerica, exercised the option to acquire an additional 8% interest in FEMSA Cerveza for a total amount of US\$221.6 million. Currently, Stellamerica holds 18.42% of FEMSA Cerveza, and Labatt holds 11.58%, therefore Interbrew indirectly owns 30% of FEMSA Cerveza.

On March 3, 2004, Interbrew and AmBev announced a transaction that would affect the ownership of the majority interest in the limited liability company that owns Labatt USA. Wisdom has commenced litigation in the United States District Court for the Southern District of New York alleging, among other things, that the transaction involves a transfer of membership or other ownership interests in the limited liability company that owns Labatt USA, and that such a transfer cannot occur without the approval of Wisdom or at least one of the Wisdom-appointed directors on the board of the limited liability company. See "Item 8. Financial Information--Legal Proceedings--FEMSA Cerveza." In the event the transaction announced by Interbrew and AmBev were to be consummated, we believe the transaction would also involve a change of control, as that term is defined in certain agreements governing our relationship with Labatt. See "Item 10. Additional Information--Material Contracts--FEMSA Cerveza." We are currently in conversations with these parties to determine the future of our relationship with Labatt.

Business Strategy

FEMSA Cerveza's objectives are to produce, market, distribute and sell quality beer products, expanding penetration in its core Mexican markets as well as in key export markets, particularly the southwestern or sun belt states of the United States. FEMSA Cerveza seeks to achieve profitable volume growth to ultimately generate economic value for its shareholders. In order to achieve these objectives in its core Mexican markets, FEMSA Cerveza is following a comprehensive strategy which seeks to:

1. differentiate brand portfolios through market segmentation and brand positioning. After thorough analysis, portfolios have been tailored for each different market, leveraging the distinct attributes of FEMSA Cerveza's various brands.
2. develop advanced capabilities to gather information at the point of sale, ensuring that appropriate products are being sold at the right price points, and allowing FEMSA Cerveza to fine-tune its portfolio offerings according to the market's characteristics, which we refer to as revenue management competencies.
3. establish profitable, long-term relationships with retailers, by helping them to sell more product to the end consumer. FEMSA Cerveza implements customized client differentiation strategies that involve different commercial terms, promotional strategies, levels of refrigeration equipment and point of sale marketing materials to suit the individual retailer.
4. achieve balanced and profitable market coverage, by selecting the appropriate mix of on- and off-premise accounts, and a balance of image (such as an upscale restaurant) versus volume coverage accounts (such as beer depots). FEMSA Cerveza is committed to optimizing retail coverage and engaging solely in selective expansion with a priority on growing volumes profitably.
5. pursue continuously the maximization of efficiencies and cost reductions along the entire value chain, from production to final distribution, by using information technology and adapting processes accordingly. The implementation of FEMSA Cerveza's comprehensive Enterprise Resource Planning solution is well advanced and it is allowing us to coordinate and optimize most of our processes, enabling the different components of our strategy to come together, with a goal of generating improved results. See "--Enterprise Resource Planning."

Product Overview

FEMSA Cerveza currently operates six breweries, all of which are located in Mexico, with an aggregate annual installed capacity of approximately 32.496 million hectoliters. In 2003, FEMSA Cerveza sold an aggregate volume of 24.564 million hectoliters, of which 22.582 million hectoliters were sold in the Mexican market and 1.982 million hectoliters were sold abroad. FEMSA Cerveza produces and distributes 15 brands of beer in up to ten different presentations, resulting in a portfolio of 61 different product offerings. The most important brands in FEMSA Cerveza's portfolio include: *Tecate*, *Carta Blanca*, *Sol* and *Superior*. These four brands, all of which are distributed throughout Mexico, accounted for approximately 88% of FEMSA Cerveza's domestic sales volume in 2003.

Per capita information, product segments, relative prices and packaging information with respect to FEMSA Cerveza have been computed and are based upon our statistics and assumptions.

The Mexican Beer Market

The Mexican beer market is the eighth largest beer market in the world in terms of industry sales volume in 2003 and is characterized by (i) a concentrated domestic beer production, (ii) regional market share differences, (iii) the prevalence of government licensing regulations, (iv) favorable demographics in the beer drinking population and (v) macroeconomic factors affecting the level of beer consumption.

Concentrated domestic beer production

Since 1985, Mexico has effectively had only two independent domestic beer producers, FEMSA Cerveza and Grupo Modelo. Grupo Modelo, a publicly traded company based in Mexico City, is the holding company of 76.8% of Diblo, S.A. de C.V., which operates the brewing and packaging subsidiaries of Grupo Modelo. Grupo Modelo's principal beer brands are Corona, Modelo, Victoria and Pacífico. Grupo Modelo's Corona brand is distributed nationally, while Victoria is distributed primarily in Mexico City and the surrounding areas and Pacífico is sold principally along the Pacific coastal regions. Modelo Especial, Modelo Light and Pacífico are Grupo Modelo's domestic can presentations. In addition, Grupo Modelo produces Corona in a can

presentation for sale in export markets.

Historically, beer imports have not been a significant factor in the Mexican beer market, because they were subject to tariffs of up to 20%. Under NAFTA, the tariff on imported beer from the United States and Canada was gradually reduced and eventually eliminated in January 2001. Notwithstanding the reduction in tariff levels, imported beers accounted for approximately 1.8% of the total Mexican beer market in terms of sales volume during 2003. FEMSA Cerveza believes that tariff elimination has had a limited effect on the Mexican beer market because imported beers are largely premium and super-premium products sold in aluminum cans, which are a more expensive means of packaging in Mexico than beer sold in returnable bottles. However, periods of strength of the Mexican peso with respect to the U.S. dollar may lower the price of imported beer to the consumer and may result in increased demand for imported beer in the Mexican market.

Regional market share differences

FEMSA Cerveza and Grupo Modelo each dominate the Mexican beer market in separate regions of the country. FEMSA Cerveza has a dominant sales position in the northern and southern areas of Mexico while Grupo Modelo has a dominant sales position in central Mexico. We believe that this regional domination can be traced in part to consumer loyalty to the brand of beer that has historically been associated with a particular region. For example, FEMSA Cerveza's *Carta Blanca* brand was first produced in Monterrey, Nuevo León in 1891. The strong regional identity in Monterrey and surrounding northeastern areas is reflected in the region's preference for *Carta Blanca* and other FEMSA Cerveza brands.

We also believe that regional market strength is a function of the proximity of the breweries to the markets they serve. Transportation costs restrict the most efficient distribution of beer to a geographic area of approximately 300 to 500 kilometers surrounding a brewery. Generally, FEMSA Cerveza commands a majority of the beer sales in regions that are nearest to its largest breweries. FEMSA Cerveza's largest breweries are in Orizaba, Veracruz and in Monterrey, Nuevo León. Grupo Modelo's largest breweries are located in Mexico City, Oaxaca and Zacatecas.

The northern region of Mexico has traditionally enjoyed a higher per capita income level, attributable in part to its rapid industrialization within the last 50 years and to its commercial proximity to the United States. In addition, FEMSA Cerveza estimates that per capita beer consumption is also greater in this region due to its warmer climate and a more ingrained beer culture.

Mexican Regional Demographic Statistics

	Percent of 2003 Total Population ⁽¹⁾	Percent of Total 2003 GDP ⁽¹⁾	Per Capita GDP 2003 (Thousands of Pesos)
Region			
Northern	26.3%	31.0%	Ps. 68.0
Southern	22.6	15.6	39.9
Central	51.1	53.4	60.5
Country Total	100.0%	100.0%	Ps. 57.8

Sources: Mexican Institute of Statistics and FEMSA Cerveza's estimates.

(1) Estimated.

Government regulation

The Mexican federal government regulates beer consumption in Mexico primarily through taxation while local governments in Mexico regulate primarily through the issuance of licenses that authorize retailers to sell alcoholic beverages.

Federal taxes on beer currently represent 43.75% of the total retail price of beer to the consumer and include a 25% excise tax and a 15% value-added tax. The beer excise tax has remained constant at 25% since January 1998. The tax component of retail beer prices is significantly higher in Mexico than in the United States, where taxes on average represent approximately 19.2% of the retail price to the consumer.

The number of retail outlets authorized to sell beer is controlled by local jurisdictions, which issue licenses authorizing the sale of alcoholic beverages. Other regulations regarding beer consumption in Mexico vary according to local jurisdiction and include limitations on the hours during which restaurants, bars and other retail outlets are allowed to sell beer and other alcoholic beverages. FEMSA Cerveza has developed efforts that address these limitations at various levels, promoting better education of responsible consumption of beer with government and civil authorities. For instance, as part of its ongoing community activities, FEMSA Cerveza has been a very active sponsor of a nationwide designated driver program.

Since July 1984, Mexican federal regulation has required that all forms of beer packaging carry a warning advising that excessive consumption of beer is hazardous to one's health. In addition, the *Ley General de Salud* (the Mexican General Health Law), requires that all beers sold in Mexico maintain a sanitation registration with the *Secretaría de Salud* (the Ministry of Health).

Demographics of beer drinking population

We estimate that annual per capita beer consumption for the total Mexican population increased to approximately 52 liters in 2003. The legal drinking age in Mexico is 18. At least 38% of the Mexican population is under the age of 18 and, therefore, is not considered to be part of the beer drinking population. We consider the population segment of men between the ages of 18 and 45 to be FEMSA Cerveza's primary market.

Based on historical trends and what management perceives as the continued social acceptance of beer consumption, FEMSA Cerveza believes that general population growth will result in an increase in the number of beer consumers in Mexico. Based on historical trends as measured by the Mexican Institute of Statistics, we expect the Mexican population to grow at an average annual rate of approximately 1.2% per year over the period 2004 to 2009. We estimate that over the next ten years approximately one million additional people per year will become potential beer consumers due to the natural aging of the Mexican population.

In 2003, Mexico's annual per capita beer consumption was approximately 52 liters compared to approximately 80 liters in the United States. Generally speaking, countries with higher per capita beer consumption have relatively higher per capita income. Per capita income in Mexico in 2003 was equivalent to approximately US\$6,172 compared to a per capita income of approximately US\$37,770 in the United States. FEMSA Cerveza identifies approximately 61% of its consumers as blue collar, 28% as white collar and the remaining 11% as students, unemployed, retirees or other.

Macroeconomic influences affecting beer consumption

We believe that consumption activity in the Mexican beer market is heavily influenced by the general level of economic activity in Mexico, the country's gross wage base, changes in real disposable income and employment levels. As a result, the beer industry reacts sharply to economic change. The industry generally experiences high volume growth in periods of economic strength and slower volume growth or volume contraction in periods of economic weakness. Domestic beer sales declined in 1982, 1983 and 1995. These sales decreases correspond to periods in which the Mexican economy experienced severe disruptions. Similarly, the economic weakness observed in 2001 and 2002 corresponds to a reduction in domestic beer sales in 2002. In 2003, given the effect of a continued economic slowdown on consumers, FEMSA Cerveza decided not to increase prices. This reduction in prices in real terms (after giving effect to inflation) was the main driver for increasing sales volumes during 2003.

Annual Price Increases

FEMSA Cerveza did not implement a general price increase during 2003, reflecting the difficult economic environment. For the Mexican beer industry as a whole, the real average retail price of beer decreased 3.8 percentage points as shown below:

**Mexican Beer Industry
Cumulative Real Retail Beer Price Index: 1999-2003
(1999 = 100%)**

Year Ended December 31,

2003	2002	2001	2000	1999
101.5	105.3	105.0	104.9	100.0

Source: Banco de México

In February 2004, FEMSA Cerveza started a price increase representing an average 5% nominal price increase as compared to December 2003.

FEMSA Cerveza's Beer Sales Volume

FEMSA Cerveza volume figures contained in this annual report refer to invoiced sales volume. Invoiced sales volume represents the quantity of hectoliters of beer sold by FEMSA Cerveza's breweries to unaffiliated distributors and by affiliated distributors to retailers. The term hectoliter means 100 liters or approximately 26.4 U.S. gallons.

FEMSA Cerveza's aggregate beer sales volume totaled 24.564 million hectoliters in 2003, an increase of 3.2% from total sales volume of 23.811 million hectoliters in 2002. In 2003, FEMSA Cerveza's domestic sales volume increased by 3.3% to 22.582 million hectoliters and export sales volume increased by 1.4% to 1.982 million hectoliters.

**FEMSA Cerveza Beer Sales Volumes
(Thousands of Hectoliters)**

	2003	2002	2001	2000	1999
Domestic Sales Volume	22,582	21,856	22,018	21,868	22,197
Export Sales Volume	1,982	1,955	1,843	1,728	1,511
Total Sales Volume	24,564	23,811	23,861	23,596	23,708

FEMSA Cerveza's domestic sales volume recorded a five-year compounded average growth rate of 0.4% for the period 1999-2003. This compares with the 2.1% five-year compounded average growth rate of the Mexican GDP. Domestic net sales for the same period recorded a 2.1% compounded average growth rate. Currently, FEMSA Cerveza's strategy continues to focus on increasing consumption of its products while improving the real price of beer through revenue management strategies.

FEMSA Cerveza's Beer Presentations

FEMSA Cerveza produces beer in returnable glass bottles and kegs and in non-returnable metal cans and glass bottles. The following table shows the percent of total sales volume by presentation for the year ended December 31, 2003:

**FEMSA Cerveza's Total Beer Volume by Presentation
As of December 31, 2003**

Presentation	
Returnable Bottle-325 ml	23.4%
Returnable Bottle-1 liter	38.4
Returnable Bottle-190 ml	5.2
Subtotal Returnable Bottles	67.0
Non-returnable Bottle-325 ml and 190 ml	8.1
Cans	23.1
Kegs	1.8

Returnable presentations The most popular form of packaging in the Mexican beer market is the returnable bottle. FEMSA Cerveza believes that the popularity of the returnable bottle is attributable to its lower price to the consumer. While returnable bottles generally cost approximately twice as much to produce as non-returnable bottles, returnable bottles may be reused as many as 30 times before being recycled. As a result, beer producers are able to charge lower prices for beer in returnable bottles. Because non-returnable presentations are the most expensive, we believe that demand for these presentations is highly sensitive to economic factors. During periods when the Mexican economy is weak, returnable volumes generally increase at the expense of non-returnable volumes.

Non-returnable presentations FEMSA Cerveza's domestic presentation mix has been growing in non-returnable presentations in the last few years, as we tailor our offering to consumer preferences and provide different convenient alternatives.

Relative Pricing in the Mexican Market

Returnable bottles and kegs are the least expensive beer presentation on a per-milliliter basis. Cans have historically been priced approximately 40% higher than returnable bottles, and non-returnable bottles are generally priced approximately 30% higher than returnable bottles. The consumer preference for presentations in cans has varied considerably over the past 20 years, rising in periods of economic prosperity and declining in periods of economic austerity, reflecting the price differential between these forms of packaging.

In 2003, FEMSA Cerveza increased slightly the relative price of its non-returnable presentations as compared to the 325 milliliters returnable glass presentation. The relative price of the can presentation and the non-returnable glass presentation as compared to the 325 milliliters returnable glass presentation was 1.38 and 1.28, respectively, as of December 31, 2003. In February 2004 FEMSA Cerveza started a price increase differentiated by region, brand and presentation that was fully implemented by the first week of March. This represents an average 5% nominal price increase as compared to December 2003.

Domestic Beer Relative Pricing by Presentation As of December 31, 2003

<u>Presentation</u>	<u>Relative Prices (1)</u>
Returnable Bottle-325 ml	1.00
Returnable Bottle-1 liter	0.90
Returnable Bottle-190 ml	1.14
Non-Returnable Bottle-325 ml and 190 ml	1.28
Cans	1.38
Kegs	0.99

(1) Relative prices are based on information provided by FEMSA Cerveza with respect to its products and reflect wholesale prices excluding taxes. The 325 ml. returnable bottle was used as the reference price for calculating relative prices.

Exports

FEMSA Cerveza's export strategy focuses on the United States market, concentrating efforts on the markets in the sun belt states bordering Mexico. We believe that the sun belt states are FEMSA Cerveza's greatest potential market outside of Mexico.

Total export sales volume of 1.982 million hectoliters represented 8.1% of FEMSA Cerveza's total beer sales volume in 2003 and accounted for 6.7% of FEMSA Cerveza's total revenues. The following table highlights FEMSA Cerveza's export volumes and total revenues:

FEMSA Cerveza Export Summary

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Export Sales Volume ⁽¹⁾	1,982	1,955	1,843	1,728	1,511
Volume Growth	1.4%	6.1%	6.6%	14.4%	14.3%
Percent of Total Sales Volume	8.1%	8.2%	7.7%	7.3%	6.4%
Export Revenues					
Millions of Pesos ⁽²⁾	1,467	1,327	1,279	1,293	1,246
Millions of U.S. dollars ⁽³⁾	133	127	123	115	101
Revenue Growth (US\$)	4.6%	3.7%	7.3%	13.8%	14.3%
Percent of Total Sales	6.7%	6.2%	5.9%	6.4%	6.4%

Source: FEMSA Cerveza.

(1) Thousands of hectoliters.

(2) Constant Pesos as of December 31, 2003.

(3) Export revenues are invoiced and collected in U.S. dollars.

FEMSA Cerveza currently exports its products to more than 70 countries. The principal export markets for FEMSA Cerveza are North America, Europe, Asia and Latin America. In 2003, export sales volume to these areas accounted for 91.9%, 2.9%, 2.3% and 2.9%, respectively, of FEMSA Cerveza's total export sales volume.

FEMSA Cerveza's affiliate, Labatt USA, is the importer of FEMSA Cerveza's brands in the United States. Labatt USA manufactures and distributes Rolling Rock and is also the U.S. importer of Labatt's Canadian brands and of European brands such as Lowenbrau, Stella Artois, Boddingtons, Leffe and Carlsberg. Sales of FEMSA Cerveza's brands contributed 35% of Labatt USA's volume in 2003, representing 1% volume growth from 2002 levels.

On April 9, 2003, FEMSA and Interbrew jointly announced that Labatt USA would introduce Bass Ale into its portfolio of brands for a twelve to eighteen month trial period beginning July 1, 2003. On December 19, 2003 the trial period was extended for an additional 6-month period. This temporary arrangement gives Labatt USA distribution and marketing responsibility for

Bass Ale in the United States, and also gives Labatt USA an eighteen to twenty-four month period to establish the best development plan for the brand in the United States. During the period of the agreement, Labatt USA and its shareholders, Interbrew and FEMSA Cerveza, will continue to assess the desirability of a longer-term arrangement for Labatt USA to serve as the United States distributor of Bass Ale. This agreement also allows the existing core brands of the Labatt USA portfolio to benefit from incremental marketing support and sales resources.

In August 2002, FEMSA Cerveza began licensing the production and distribution of its *Sol* brand to Holsten-Brauerei AG, which we refer to as Holsten, a Hamburg-based brewer. This venture enables FEMSA Cerveza to leverage Holsten's extensive knowledge of the German beer market and offer a fresher product to a wider audience, while still complying with the exact quality specifications of the Mexican brew. In 2002, Holsten distributed the existing inventory of *Sol* in Germany and began brewing and distributing the brand in 2003.

FEMSA Cerveza's principal export brands are *Tecate*, *XX Lager*, *Dos Equis (Amber)* and *Sol*. These brands collectively accounted for 94% of FEMSA Cerveza's export sales volume for the year ended December 31, 2003.

**FEMSA Cerveza's Principal Export Brands
Year Ended December 31, 2003**

<u>Brand</u>	<u>Percent of Total Export Volume</u>
<i>Tecate</i>	58.4%
<i>XX Lager and Dos Equis (Amber)</i>	23.7
<i>Sol</i>	11.6
<i>Bohemia</i>	2.2
<i>Carta Blanca</i>	4.1
Total	100.0%

Primary Distribution

FEMSA Cerveza's primary distribution is from its production facilities to its distribution centers' warehouses. FEMSA Cerveza delivers to a combination of company-owned and third-party distributors. In 2003, approximately 75% of FEMSA Cerveza's domestic sales passed through 273 company-owned distribution centers. The remaining 25% was sold through 90 independent distributors operating under agreements with FEMSA Cerveza. In an effort to improve the efficiency and alignment of the distribution network, FEMSA Cerveza is adjusting its relationship with independent distributors by implementing franchise agreements and as a result, achieving economies of scale through alignment with FEMSA Cerveza's operating systems. FEMSA Cerveza has also increased the number of company-owned distributors by acquiring third party distributors in recent years. A franchise agreement is offered only to those distributors that meet certain standards of operating capabilities, performance and alignment. FEMSA Cerveza has already and will eventually acquire those distributors that do not meet these requirements. Through this initiative FEMSA Cerveza will continue to seek to increase its volume through company-owned distribution centers.

Retail Distribution

The main sales outlets for beer in Mexico are small, independently-owned "mom and pop" grocery stores, dedicated beer stores or "*depósitos*," liquor stores and bars. Supermarkets account for only a small percentage of beer sales in Mexico. In addition, FEMSA Comercio operates a chain of more than 2,798 convenience stores under the trade name Oxxo that exclusively sell FEMSA Cerveza's brands.

**Distribution of FEMSA Cerveza Domestic Sales Volume By Outlet
Year Ended December 31, 2003**

<i>Points of Sale</i>	
Small Grocery Stores	21.3
Beer and Liquor Stores	31.9
Mini-markets and Convenience Stores	16.0
Other Points of Sale	9.8
Subtotal	79.0
<i>Consumption Centers</i>	
Bars	9.7
Restaurants	4.9
Nightclubs	2.1
Other Consumption Centers	4.3
Subtotal	21.0
Total	100.0%

In 2001, FEMSA Cerveza began implementing pre-sale processes. For 2003, approximately 80% of our sales volume was sold through pre-sale, which consists of systematic on-site visits to collect advance orders. One of the primary objectives of pre-sale is to separate sales from distribution to ensure more reliable market access and to enhance efficiency by reducing the number of secondary distribution routes in otherwise highly fragmented markets. Overall, in markets where pre-sale has been implemented, we have experienced a significant reduction in unsold product and a net reduction in distribution personnel. Furthermore, pre-sale has enabled FEMSA Cerveza to collect customer and consumer information directly from the marketplace, which then becomes valuable in defining brand portfolios by channel. See "Marketing Strategy."

The Mexican retail market is fragmented and characterized by a preponderance of small outlets that are unable and unwilling to maintain meaningful inventory levels. Consequently, FEMSA Cerveza must make frequent product deliveries to its retailers. The existence of pre-sale systems facilitates systematic product delivery and helps discipline product inventory at the point of sale. As of December 31, 2003, FEMSA Cerveza serves more than 265,000 retailers and its distribution network operates approximately 1,926 retail distribution routes. This is slightly lower than the number of routes in operation in 2002 (without considering 176 routes acquired from third parties distributors during 2003), and reflects the reconfiguration in distribution logistics as a result of the implementation of pre-sale in many of our key markets.

Since 2001, FEMSA Cerveza has embarked on the implementation of an Enterprise Resource Planning or ERP system at various levels of the organization, with the ultimate objective of possessing an information and control platform that supports all commercial activities nationwide and correlates them with the administrative and business development decision-making process occurring in our central office. The ERP system has gone through a development phase in which the design, organization and configuration of various components of the system have been evaluated. In this phase, special care has been given to defining functions and procedures, which in some cases have spanned departmental divisions, in order to produce a cohesive set of operating processes. Some basic modules have been implemented successfully and according to schedule both at our central office and throughout the company. These modules assist finance, shared services, maintenance and equipment functions, among others. These ERP modules operate under the SAP® software platform.

In 2003, we started the rollout of the ERP commercial module in our company-owned distribution centers. By the end of 2003, approximately 36% of the company-owned distribution centers' volume were operating through ERP. As we advance in the implementation process, we are also working in increasing our personnel capabilities in order to take advantage of the new tools and improve our decision-making processes. FEMSA Cerveza expects that this percentage will continue to increase and that implementation will be completed during 2005.

Marketing Strategy

The principal marketing objectives of FEMSA Cerveza are:

- ensuring coherence between point of sale marketing and sales activities by linking the promotional programs of each brand with their respective communication and advertising campaigns;
- exploiting channel marketing and market research functions;
- defining and implementing differentiated strategies to promote the image of each brand; and
- capturing new sales or consumption opportunities through innovative solutions in product and package offering, refrigeration, visibility and sponsorships.

Focus on Consumer: Brand Positioning and Market Segmentation

FEMSA Cerveza's marketing strategy relies on a diverse brand and presentation portfolio to effectively serve all consumer and geographic segments of the Mexican beer market. FEMSA Cerveza's product portfolio consists of brands at different stages of market development. The strategy for each brand is dictated by its potential to either capture additional consumers or increase frequency of consumption in each market. The objective of FEMSA Cerveza's marketing is to position each of its four major brands as the principal brand in the respective region of relative strength. Our leading brands in their targeted domestic markets are *Tecate* in the northwest, *Carta Blanca* in the northeast, *Sol* in the central region and *Superior* in the south. FEMSA Cerveza believes that this strategy allows it to leverage the brand equity and market position of its products in their respective territories. In addition, FEMSA Cerveza plans to use other brands in its portfolio to complement, and thereby strengthen, its regional offering and to assist in creating a richer pricing scheme.

By defining brand positioning and the relevant promotional strategies to be executed by the sales team, FEMSA Cerveza's marketing efforts seek to establish connections between the consumer and FEMSA Cerveza's brands. The brand architecture and concept derived from brand positioning are founded on rigorous market research that evaluates, among other things, the brand's attributes from the consumer's perspective. Furthermore, periodic market research is conducted in several markets to monitor brand health attributes—such as brand awareness, recent trial, purchase intent and first favorite—to help FEMSA Cerveza keep accurate track of the status of the image of each brand. The branding specialists also rely on this market-obtained data to better target products and promotions.

Focus on Retailer: Channel Marketing

FEMSA Cerveza believes that defining channel strategies is just as important as defining brand positioning. Therefore, FEMSA Cerveza has established a channel marketing function within the marketing division with the objective of understanding the strategic relevance of the different channels across markets in order to define brand portfolios per channel. A channel refers to a category or sub-category of point of sale, such as supermarkets, beer depots, restaurants, etc. Channel marketing is responsible for:

- establishing the optimal promotional programs for each channel;
- identifying the most effective combination and position for merchandising material; and
- providing refrigeration equipment at the point of sale.

Channel marketing is also responsible for new channel development that could foster additional consumption opportunities for FEMSA Cerveza's brands.

Channel marketing and coverage will be strengthened considerably with the use of electronic maps of certain cities. These maps superimpose crucial information—socioeconomic strata, micro market share, outlet location and channel characteristics—allowing sales managers and marketing strategists to implement differentiated tactics such as revenue management and portfolio segmentation. FEMSA Cerveza is in the initial development stages of this sales tool.

Integrated Marketing

With the objective of further aligning the brand and channel strategies with the sales teams, FEMSA Cerveza began implementing integrated marketing programs that combine the functions of the sales and marketing divisions. An integrated marketing program promotes a brand through simultaneous deployment of media communications, intense marketing efforts and sponsorship of events, increasing the effectiveness of the sales force by bridging the gap between the brand and the channel.

Jointly, our brand and channel experts define an integrated brand strategy, which will be implemented in each type of market and in each designated channel by a specialized team responsible for designing the communication and marketing materials, including promotional programs that reflect the brand's strategy. FEMSA Cerveza utilizes the following forms of sales promotion: television, radio, billboards and point of sale material, as well as channel specific promotions, promotional material, refrigeration equipment and branded merchandise such as plastic furniture and neon signs to dress the point of sale. The implementation team is responsible for the delivery of the specific brand programs to the sales force, which is ultimately responsible for their market execution.

Product and Package Innovation

FEMSA Cerveza has established a working system that identifies, develops and ultimately launches product/package innovation alternatives to create incremental volume and value for its business. This system has a structured set of

components –functions and criteria– to help innovative ideas materialize into feasible rollouts in an optimal way. Currently, the product development initiatives at FEMSA Cerveza do not contemplate the introduction of new brands or the retirement of existing ones.

Plants and Facilities

FEMSA Cerveza currently operates six breweries with an aggregate monthly production capacity of 2,708 thousand hectoliters, equivalent to approximately 32.5 million hectoliters of annual capacity. Each of FEMSA Cerveza’s breweries has received ISO 9002 certification and a Clean Industry Certification (*Industria Limpia*) given by Mexican environmental authorities. A key consideration in the selection of a site for a brewery is its proximity to potential markets, as the cost of transportation is a critical component of the overall cost of beer to the consumer. FEMSA Cerveza’s breweries are strategically located across the country to better serve FEMSA Cerveza’s distribution system.



FEMSA Cerveza Facility Capacity Summary
(Thousands of Hectoliters)
Year Ended December 31, 2003

	Average Annualized
Brewery	
Orizaba	7,200
Monterrey	7,800
Toluca	5,400
Navojoa	4,200
Tecate	4,680
Guadalajara	3,216
Total	32,496
Average capacity utilization	73.8%

Between 1999 and 2003, FEMSA Cerveza increased its average monthly production capacity by approximately 210,000 hectoliters through additional investments in existing facilities. During 2003, FEMSA Cerveza expanded average monthly capacity in the Monterrey brewery to achieve a production of 650,000 hectoliters. FEMSA Cerveza’s management believes that it will be able to continue to adequately expand its production capacity by investing in existing facilities.

FEMSA Cerveza operates seven effluent water treatment systems to treat the water used by the breweries, all of which are wholly owned by FEMSA Cerveza except for the effluent treatment system at the Orizaba brewery, which is a joint venture among FEMSA Cerveza, several other local companies and the government of the state of Veracruz.

Seasonality

Demand for FEMSA Cerveza’s beer is highest in the Mexican summer season, and consequently, brewery utilization rates are at their highest during this period. Demand for FEMSA Cerveza’s products decreases during the months of November, January and February primarily as a result of colder weather in the northern regions of Mexico. Demand for FEMSA Cerveza’s products tends to increase in the month of December reflecting consumption during the holiday season.

Raw Materials

Malted barley, hops, certain grains, yeast and water represent the principal ingredients used in manufacturing FEMSA Cerveza’s beer products. These inputs are generally available in the open market. FEMSA Cerveza satisfies its commodity requirements through purchases from various sources, including purchases pursuant to contractual arrangements and purchases in the open market. The prices and supply sources of raw materials are determined by, among other factors, the level of crop production, weather conditions, export demand and government regulations and legislation affecting agriculture. Hops is the only ingredient that is not available domestically. FEMSA Cerveza imports hops primarily from the United States and Europe.

The principal source of barley for the Mexican beer industry is the domestic harvest. If domestic production is insufficient to meet the industry's requirements, barley (or its equivalent in malt), can be sourced from the international markets. Before 2003, pursuant to NAFTA, an annual duty-free import quota for barley (or its equivalent in malt) was set. Beginning in 2003, under NAFTA, barley imports from the U.S. and Canada are tax free and there are no import quota restrictions. Domestic barley production increased significantly in 2003, and as a consequence we believe that imports have experienced an important reduction. Prior to NAFTA, domestic barley prices were significantly higher than international barley prices. Since the implementation of NAFTA, domestic barley prices have declined, and local producers now generally price their crop so that, after accounting for transportation and other import-related expenses, imported barley and barley purchased from the domestic market result in the same cost to the domestic purchaser.

Purchases from FEMSA Empaques

FEMSA Cerveza obtains its packaging materials primarily from its affiliate, FEMSA Empaques. In 1994, FEMSA Cerveza's principal operating subsidiaries entered into a packaging supply agreement with FEMSA Empaques. See "—FEMSA Empaques" and "Item 10. Additional Information—Material Contracts—FEMSA Cerveza—Packaging Supply Agreement." As of December 31, 2003, FEMSA Empaques supplied 100% of FEMSA Cerveza's bottle, aluminum can, bottle cap and label requirements.

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FEMSA Comercio

Overview and Background

FEMSA Comercio operates the largest chain of convenience stores in Mexico, measured in terms of number of stores, under the trade name Oxxo. As of December 31, 2003, FEMSA Comercio operated 2,798 Oxxo stores located in 25 states of the country, with a particularly strong presence in the northern part of Mexico.

FEMSA Comercio, the largest single customer of FEMSA Cerveza and of the Coca-Cola system in Mexico, was established by FEMSA in 1978 when two Oxxo stores were opened in Monterrey, one store in Mexico City and another in Guadalajara. The motivating factor behind FEMSA's entrance into the retail industry was to enhance beer sales through company-owned retail outlets as well as to gather information on customer preferences. In 2003, sales of beer through Oxxo represented 5.4% of FEMSA Cerveza's domestic sales volume as well as approximately 12.8% of FEMSA Comercio's revenues. A typical Oxxo store carries 2,723 different SKUs in 37 main product categories, representing a significant increase in the product offering historically distributed in Oxxo stores.

In recent years, FEMSA Comercio has gained importance as an effective distribution channel for our beverage products, as well as a rapidly growing point of contact with our end consumers. Based on our belief that location plays a major role in the long-term success of a retail operation such as a convenience store, as well as a role in our continually improving ability to accelerate and streamline the new-store development process, we have focused on a strategy of rapid, profitable growth. We continue to add selling space across the northern border of Mexico, even as macroeconomic variables have weakened in some parts of the country, particularly along the Mexican northern border with the United States, in furtherance of our long-term view of our businesses. FEMSA Comercio opened 297, 437 and 582 net new Oxxo stores in 2001, 2002 and 2003, respectively. The accelerated expansion yielded total revenue growth of 25.3% to reach Ps. 16.601 billion in 2003, while same store sales increased 8.2%, which was considerably above the retail industry average. FEMSA Comercio served approximately 628 million customers in 2003 compared to 505 million in 2002.

Business Strategy

A fundamental element of FEMSA Comercio's business strategy is to utilize its position in the convenience store market to grow in a cost-effective and profitable manner. As a market leader in convenience store retailing, based on internal company surveys, management believes that FEMSA Comercio has an in-depth understanding of its markets and significant expertise in operating a national store chain. FEMSA Comercio intends to continue increasing its store base while capitalizing on the market knowledge gained at existing stores.

FEMSA Comercio has developed proprietary models to assist in identifying appropriate store locations, store formats and product categories. Its model utilizes location-specific demographic data and FEMSA Comercio's experience in similar locations to fine tune the store format and product offerings to the target market. Market segmentation is becoming an important strategic tool, and it should increasingly allow FEMSA Comercio to improve the operating efficiency of each location and the overall profitability of the chain.

FEMSA Comercio has made and will continue to make significant investments in ERP technology to improve its ability to capture customer information from its existing stores and to improve its overall operating performance. Approximately 97% of the products carried through Oxxo stores are bar-coded, and 100% of the Oxxo stores are equipped with point of sale systems that are integrated into a company-wide computer network.

FEMSA Comercio has adopted innovative promotional strategies in order to increase store traffic and sales. In particular, FEMSA Comercio prices high-frequency items such as beverages, snacks and cigarettes at competitive prices. FEMSA Comercio's ability to implement this strategy profitably is partly attributable to the size of the Oxxo chain, as FEMSA Comercio is able to work together with its suppliers to implement their revenue-management strategies through differentiated promotions. Oxxo's national and local marketing and promotional strategies are an effective revenue driver and a means of reaching new segments of the population while strengthening the Oxxo brand. For example, the organization refined its expertise in executing cross promotions (discounts on multi-packs or sales of complementary products at a special price) and targeted promotions to attract new customer segments, such as housewives, by expanding the offerings in the grocery product category in certain stores.

To implement revenue management strategies, FEMSA Comercio created a division in charge of product category management, such as beverages, fast food and perishables, to enhance and better utilize its consumer information base and market intelligence capabilities. FEMSA Comercio is implementing an ERP system, which will allow FEMSA Comercio to redesign its key operating processes and enhance the usefulness of its market information going forward.

Store Locations

With 2,798 Oxxo stores in Mexico as of December 31, 2003, FEMSA Comercio operates the largest convenience store chain in Latin America measured by number of stores. Oxxo stores are concentrated in the northern part of Mexico, but also have a growing presence in central Mexico and the Gulf coast.

FEMSA Comercio
Regional Allocation of Oxxo Stores
as of December 31, 2003



FEMSA Comercio has aggressively expanded its number of stores over the past several years. The average investment required to open a new store varies, depending on location and format and whether the store is opened in an existing retail location or requires construction of a new store. FEMSA Comercio is generally able to use supplier credit to fund the initial inventory of new stores.

Growth in Oxxo Stores

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Total Oxxo Stores	2,798	2,216	1,779	1,482	1,225
Store Growth (%)	26.3%	24.6%	20.0%	21.0%	19.3%

FEMSA Comercio expects to continue the growth trend established over the past several years by emphasizing growth in areas of high economic potential in existing markets and by expanding in underserved and unexploited markets. Management believes that the southeast part of Mexico is particularly underserved by the convenience store industry.

The identification of locations and pre-opening planning in order to optimize the results of new stores are important elements in FEMSA Comercio's growth plan. FEMSA Comercio continuously reviews store performance against certain operating and financial benchmarks to optimize the overall performance of the chain. Stores unable to maintain benchmark standards are generally closed. Between December 1999 and December 31, 2003, a period during which the total number of stores increased by 1,573, 1,647 new stores were opened and 74 stores were closed.

Competition

Oxxo competes in the convenience store segment of the retail market with 7-Eleven, Super Extra and Circle-K, AM/PM, as well as other local brands of convenience stores. The format of these stores is similar to the format of the Oxxo stores. Based on an internal market survey conducted by FEMSA Comercio, management believes that, as of December 31, 2003, there were approximately 4,610 stores in Mexico that could be considered part of a convenience store segment of the retail market or network. Oxxo is the largest chain in Mexico, operating more than half of these stores. Furthermore, FEMSA Comercio operates in 25 states and has much broader geographical coverage than any of its competitors.

Market and Store Characteristics

Market Characteristics

FEMSA Comercio is placing increased emphasis on market segmentation and differentiation of store formats to more appropriately serve the needs of customers on a location-by-location basis. The principal segments include residential neighborhoods, commercial and office locations, stores near schools and universities, along with other types of specialized locations.

Approximately 71% of Oxxo's clientele is between the ages of 15 and 35. FEMSA Comercio also segments the market according to demographic criteria, including income level.

Store Characteristics

The average size of an Oxxo store is approximately 114 square meters of selling space, excluding space dedicated to refrigeration, storage or parking. The average constructed area of a store is approximately 183 square meters and, when parking areas are included, the average store size increases to approximately 415 square meters.

FEMSA Comercio—Operating Indicators

Year Ended December 31,
(percentage change against previous year)

2003	2002	2001	2000	1999
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Total Store Sales	25.3%	18.7%	19.8%	28.4%	19.2%
Same-Store Sales ⁽¹⁾	8.2%	6.0%	6.4%	13.4%	9.9%
<i>Beer-related data:</i>		(percentage of total)			
Beer sales as % of total store sales	12.8%	13.3%	13.6%	14.0%	14.7%
Oxxo store sales as a % of FEMSA Cerveza's volume	5.4%	4.5%	3.9%	3.7%	3.0%

(1) Same-store sales growth is calculated by comparing the sales of stores for each year that have been in operation for at least thirteen months with the sales of those same stores during the previous year.

Beer, telephone cards, soft drinks and cigarettes represent the main product categories for Oxxo stores. FEMSA Comercio has a distribution agreement with FEMSA Cerveza. As a result of this agreement, Oxxo stores only carry beer brands produced by FEMSA Cerveza. See "Item 10. Additional Information—Material Contracts—FEMSA Cerveza." Prior to 2001, Oxxo stores had informal agreements with Coca-Cola bottlers, including Coca-Cola FEMSA's territories in central Mexico, to sell only their products. In 2001, a limited number of Oxxo stores commenced the sale of Pepsi products in certain cities in northern Mexico, as part of a defensive competitive strategy.

Approximately 90% of the Oxxo stores are operated by independent managers responsible for all aspects of store operations. The managers are commission agents and are not employees of FEMSA Comercio. Each store manager is the legal employer of the store's staff, which typically numbers six people. FEMSA Comercio continually invests in on-site operating personnel, with the objective of promoting loyalty, customer-service and low personnel turnover in the stores.

Advertising and Promotion

FEMSA Comercio's marketing efforts include both specific product promotions and image advertising campaigns. These strategies seek to increase store traffic and sales, and to reinforce the Oxxo name and market position.

FEMSA Comercio manages its advertising on three levels depending on the nature and scope of the specific campaign: local or store-specific, regional and national. Store-specific and regional campaigns are closely monitored to ensure consistency with the overall corporate image of Oxxo stores and to avoid conflicts with national campaigns. FEMSA Comercio primarily uses point of purchase materials, flyers, handbills and print and radio media for promotional campaigns, although television is used occasionally for the introduction of new products and services. The Oxxo chain's image and brand name are presented consistently across all stores, irrespective of location.

Inventory and Purchasing

FEMSA Comercio has placed considerable emphasis on improving operating performance. As part of these efforts, FEMSA Comercio continues to invest in extensive information management systems to improve inventory management. Electronic data collection has enabled FEMSA Comercio to reduce average inventory levels. Inventory replenishment decisions are carried out on a store-by-store basis.

Management believes that the Oxxo chain's scale of operations provides FEMSA Comercio with a competitive advantage in its ability to realize strategic alliances with suppliers. General category offerings are determined on a national level, although purchasing decisions are implemented on a local, regional or national level, depending on the nature of the product category. Given the fragmented nature of the retail industry in Mexico in general, Mexican producers of beer, soft drinks, bread, dairy products, snacks, cigarettes and other high-frequency products have established proprietary distribution systems with extensive direct distribution routes. As a result, almost 78.7% of the products carried by the Oxxo chain are delivered directly to the stores by suppliers. Other products with longer shelf lives are distributed to stores by FEMSA Comercio's distribution system, which includes six regional warehouses located in Monterrey, Mexico City, Guadalajara, Mexicali, Mérida and León. The distribution centers operate a fleet of 120 trucks that make deliveries to each store approximately every week.

Seasonality

Oxxo stores experience periods of high demand in December, as a result of the holidays, and in July and August as a result of increased consumption of beer and soft drinks during the hot summer months. The months of November and February are generally the weakest sales months for Oxxo stores. In general, colder weather during these months reduces store traffic and consumption of cold beverages.

Other Stores

FEMSA Comercio also operates a small number of stores under the names Bara, Six and Matador.

FEMSA Empaques

Business Overview

Our packaging operations are handled through, FEMSA Empaques, the operating subsidiaries of which manufacture and distribute a wide variety of packaging solutions to the beverage industry primarily in Mexico. FEMSA Empaques has 12 production facilities and 29 service centers throughout Mexico and conducts operations primarily through two main subsidiaries: Famosa, which manufactures aluminum beverage cans and ends, and crown caps and closures; and Silices de Veracruz, S.A., which we refer to as Sivesa, which manufactures glass beverage bottles. We also manufacture commercial refrigeration equipment through Vendo de Mexico, S.A. de C.V., which we refer to as Vendo, flexible packaging materials through Grafo Regia S.A. de C.V., which we refer to as Grafo Regia, and other items such as plastics and chemical products. We announced on October 23, 2003 that FEMSA Empaques would become part of FEMSA Strategic Procurement, which we refer to as Strategic Procurement and which will coordinate procurement efforts across FEMSA.

Business Strategy

Within the FEMSA business portfolio, FEMSA Empaques performs a relevant role as it supplies essential packaging materials, particularly for our beverage operations. We have determined that certain operations within FEMSA Empaques, namely glass, cans, crown caps and closures and commercial refrigerators, are essential for our core beverage operations. Furthermore, the structure of the industry for some of these products warrants our ownership of these businesses to balance pricing and supply conditions in order to adequately support our beverage operations. For example, our main competitor in the Mexican beer market is also one of the largest packaging producers in Mexico. Therefore, we are committed to keeping those operations as part of our business going forward.

Certain other operations, such as labels and flexible packaging, plastics and chemical products, face more competitive conditions in their respective industries and are relatively less relevant to our core operations, and therefore, we have indicated our intention to divest those operations as opportunities present themselves. The price, terms and timing of these divestitures have not been established.

The primary objective of FEMSA Empaques is to provide our beer and soft drink subsidiaries with high-quality packaging materials at competitive prices. To maximize our operations, FEMSA Empaques also provides packaging materials to unaffiliated third parties. FEMSA Empaques places particular emphasis on reducing costs through productivity gains and resource conservation initiatives, providing customers with technical service as a means of ensuring production quality and competitive differentiation and investing in human and capital resources to facilitate cost reduction and competitiveness.

Customers

In 2003, sales to affiliates represented 57.5% of FEMSA Empaques' total revenues of Ps. 7.352 billion. While sales to affiliates are still the most significant portion of FEMSA Empaques' business, it has increased its penetration with unaffiliated third parties in recent years to improve capacity utilization and to continue to reduce the cost of packaging products for its beverage affiliates.

Currently, FEMSA Empaques' main third-party customers include unaffiliated Coca-Cola bottlers, Casa Pedro Domecq, S.A. de C.V., Compañía Nestlé, S.A. de C.V., Labatt, Miller Brewing Co. and Coors Brewing Company. In 2003, more than 70.8% of FEMSA Empaques' sales of crown caps were sold to unaffiliated third parties. In addition, FEMSA Empaques believes that it has developed a significant presence in the export market. In 2003, approximately 12.0% of FEMSA Empaques' total revenues were generated through export sales.

The following table sets forth an allocation of FEMSA Empaques' revenues by product and client category:

FEMSA Empaques—Revenue Allocation by Product and Client

	Year Ended December 31,				
	2003	2002	2001	2000	1999
<i>Product Categories:</i>					
Beverage Cans	33.4%	32.7%	32.4%	36.6%	35.8%
Crown Caps	10.0	10.5	10.8	10.3	9.0
Glass Bottles	20.2	22.0	20.5	19.0	19.9
Commercial Refrigerators	11.1	9.3	12.4	10.7	8.2
Labels and Flexible Packaging	8.0	9.8	9.1	8.6	7.0
Other ⁽¹⁾	17.3	15.7	14.8	14.8	20.1 ⁽²⁾
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
<i>Client Categories:</i>					
Coca-Cola FEMSA	17.8%	17.4%	12.9%	14.6%	11.6%
FEMSA Cerveza	39.7	40.9	43.5	38.8	40.2
Third Parties	42.5	41.7	43.6	46.6	48.2
Domestic	30.4	30.6	33.8	36.1	40.2
Export	12.0	11.1	9.8	10.5	8.0
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%

(1) Other includes food cans, chemical products and plastic products.

(2) Includes paper and cardboard, which was produced until 1999.

Capital Investments

Over the past five years, we have invested approximately Ps. 1.2 billion in capital improvements and expansion projects at FEMSA Empaques. These projects have included the expansion of can and can-lid capacity, and most recently, a major refurbishment of a furnace to produce glass bottles. We believe that these investments, coupled with ongoing efforts to

reduce costs and streamline operating processes, have resulted in significant productivity gains by FEMSA Empaques. However, we maintain that current and future capital investments in FEMSA Empaques will be primarily determined by the packaging requirements of our beverage subsidiaries.

Principal Products

Beverage Cans

FEMSA Empaques' activities in the beverage can segment are oriented towards the beer, soft drink and juice industries. FEMSA Empaques' oldest operating subsidiary, Famosa, was established in 1936 to supply crown caps to the Cuauhtémoc brewery. Famosa operates six production lines, four that produce aluminum beverage can bodies at our production facilities in Ensenada and Toluca, and two that produce can ends at our production facility in Monterrey. Aggregate annual production capacity for beverage cans at our production facilities in Ensenada and Toluca is approximately 3.2 billion cans and capacity utilization was approximately 97.4% in 2003. Aggregate annual production capacity for can ends at our production facility in Monterrey was approximately 4.2 billion can ends, and average capacity utilization was 82.1% in 2003.

We believe that Famosa's production facilities utilize state of the art technology. Famosa has a technology exchange agreement with Ball Corporation, which we refer to as Ball, for the licensing and cross-licensing of beer and soft drink can technology. Ball has recognized FEMSA Empaques' Monterrey and Ensenada can production facilities as the benchmark for Ball's licensees worldwide. See "Item 10. Additional Information—Material Contracts—FEMSA Empaques—Ball Licensing Agreement."

FEMSA Empaques is the largest Mexican beverage can manufacturer based on sales volume in 2003. The following table sets forth an allocation of FEMSA Empaques' sales volume by client category:

FEMSA Empaques—Beverage Can Volume

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Beverage can sales volume (in Millions of units)	3,231	3,000	2,808	3,001	3,216
<u>Client Categories:</u>					
FEMSA Cerveza	46.3%	45.7%	50.5%	44.9%	43.5%
Coca-Cola FEMSA	12.0	11.0	6.7	12.6	9.7
Third parties	41.7	43.3	42.8	42.5	46.8
Domestic	23.7	28.9	35.1	33.7	40.6
Export	18.0	14.4	7.7	8.8	6.2
Total Sales Volume	100.0%	100.0%	100.0%	100.0%	100.0%

Crown Caps and Closures

In addition to can ends, in 2003 Famosa operates 10 crown cap production lines in Monterrey with an annual production capacity of approximately 16.4 billion crown caps. In 2003, capacity utilization was approximately 87.3%.

The principal clients for crown caps and closures are the domestic and international beverage industries. Demand for crown caps in Mexico has decreased due to shifts in packaging options in both the beer and soft drink industries. In response to this trend, in 1998 FEMSA Empaques added a plastic cap production unit to its existing facilities. The current installed capacity of this unit is 1.1 billion caps per year. FEMSA Empaques has been able to minimize the impact of reduced demand by its beverage affiliates through sales to an increasing number of domestic third party clients and through exports. In 2003, export demand accounted for 58.5% of FEMSA Empaques' crown cap production.

The following table sets forth an allocation of FEMSA Empaques' sales volume of crown caps and closures by client category:

FEMSA Empaques—Crown Caps and Closures

	Year Ended December 31,				
	2003	2002	2001	2000	1999
Crown caps and closures sales volume (in Millions of units)	14,347	14,287	14,028	13,404	12,765
<u>Client Categories:</u>					
FEMSA Cerveza	27.2%	27.4%	27.9%	29.0%	30.9%
Coca-Cola FEMSA	4.3	5.6	5.4	5.9	6.0
Third parties	68.5	67.0	66.7	65.1	63.1
Domestic	10.0	11.9	15.7	18.9	20.8
Export	58.5	55.1	51.0	46.2	42.3
Total Sales Volume	100.0%	100.0%	100.0%	100.0%	100.0%

Glass Bottles

FEMSA Empaques manufactures glass bottles through Sivesa, which was founded in 1948. Sivesa conducts operations through its glass production facility in Orizaba, Veracruz and its bottle decorating plant in Nogales, Veracruz. In 1979, the bottling department acquired "press blow" technology through Hermann Heye, Kommanditgesellschaft, which we refer to as Heye Glass of Germany, to produce narrow-neck beer bottles. The glass production facility in Orizaba includes three glass furnaces with an aggregate glass production capacity of 260,000 tons per year (the equivalent of approximately 1,300 million bottles). As of December 31, 2003, Sivesa's capacity utilization was approximately 80.4%.

In the past, all of Sivesa's output was sold to FEMSA Cerveza and Coca-Cola FEMSA. However, in the late 1990s Sivesa began selling bottles to domestic third party clients because of a reduction in the purchase of glass bottles by Coca-Cola FEMSA resulting from rapid changes in the presentation mix to non-returnable PET presentations in the Mexican market. The reduction in glass bottle sales volume during 1999 and 2000 reflects this change in presentation mix. In 2001 and 2002, this

trend reverted as Coca-Cola FEMSA increased its demand for glass bottles with the introduction of a new eight-ounce Coca-Cola non-returnable presentation. In 2003, the sales volume to FEMSA Cerveza increased, but was not enough to compensate for the decrease in sales volume to domestic third parties and Coca-Cola FEMSA. During 2003, Sivesa sold 74.5% of its output to FEMSA Cerveza and 19.5% to Coca-Cola FEMSA. This represented 100% of FEMSA Cerveza’s bottle requirements and approximately 95% of Coca-Cola FEMSA’s bottle requirements. The following table sets forth an allocation of FEMSA Empaques’ sales volume of glass bottles by client category:

FEMSA Empaques–Glass Bottles					
Year Ended December 31,					
	2003	2002	2001	2000	1999
Glass bottles sales volume (in Millions of Bottles)	1,034	1,053	972	790	856
Client Categories:					
FEMSA Cerveza	74.5%	68.2%	59.8%	69.6%	73.4%
Coca-Cola FEMSA	19.5	21.0	8.6	3.5	2.2
Third parties	6.0	10.8	31.6	26.9	24.4
Domestic	3.9	9.8	26.6	21.2	21.5
Export	2.1	1.0	5.0	5.7	2.9
Total Sales Volume	100.0%	100.0%	100.0%	100.0%	100.0%

Other

FEMSA Empaques manufactures commercial refrigerators through Vendo and labels and flexible packaging through Grafo Regia. Vendo, which began operations in Mexico City in 1941, produces vertical and horizontal commercial refrigerators for the soft drink, beer and food industries. In 2003, Vendo sold approximately 101,415 refrigeration units, 74.9% of which were sold to affiliates. In 2003, Grafo Regia, which began operations in 1954, has its facilities in Monterrey with an annual production capacity of 13,500 tons of flexible packaging. In 2003, Grafo Regia operated at approximately 88.5% of capacity. During 2003, Grafo Regia sold 60.0% of its label production to FEMSA Cerveza and 25.8% to Coca-Cola FEMSA. Third-party customers accounted for the remaining 14.2% of production in 2003.

Management believes that growth at Vendo and Grafo Regia will continue to reflect the marketing strategies of Coca-Cola FEMSA and FEMSA Cerveza.

Plant Locations

The following map shows the locations of FEMSA Empaques’ principal production facilities:



Raw Materials

The principal raw materials used by FEMSA Empaques include aluminum, steel, paper, aluminum foil, silica sand, soda ash and polyethylene. FEMSA Empaques is vertically integrated in silica sand mining, and FEMSA Empaques’ silica sand mine has been able to satisfy all of FEMSA Empaques’ silica sand requirements. With the exception of aluminum, all of these products are available from a variety of domestic and international sources. FEMSA Empaques purchases aluminum and steel directly from qualified suppliers on a contractual basis. These contracts generally have terms of six months or one year and specify prices free-on-board at FEMSA Empaques’ plants. Companies such as Alcoa, Nittetsu-Shoji, Alcan, CSN and Rasselstein have been selected as qualified suppliers. FEMSA Empaques purchases polyethylene from Petróleos Mexicanos, which we refer to as PEMEX, and several other suppliers.

Seasonality

Demand for FEMSA Empaques’ products is closely correlated to demand in the beverage industry. However, as a supplier to the beverage industry, FEMSA Empaques’ peak demand periods generally precede the peak beverage seasons.

Other Business Segment

FEMSA Logística, S.A. de C.V., which we refer to as Logística, provides logistics services to Coca-Cola FEMSA, FEMSA Empaques and third-party clients that either supply or participate directly in the Mexican beverage industry or in other industries. Logística provides integrated logistics support for its clients' supply chain, including the management of carriers and other supply chain services. Prior to January 1, 2003, we reported Logística as part of a separate business segment that included Logística CCM, S.A. de C.V., which we referred to as Logística CCM and which provided logistics services to FEMSA Cerveza. As of January 1, 2003, Logística CCM was merged into FEMSA Cerveza, and we began reporting Logística as part of our other business segment.

Perfil Corporativo, S.A. de C.V., which we refer to as Perfil Corporativo, is the owner of the Mundet brands of soft drinks and certain concentrate production equipment.

FEMSA Servicios employs all of our corporate staff, including the personnel managing the areas of finance, corporate accounting, taxation, legal, planning, human resources and internal audit. FEMSA Servicios directs, controls, supervises and reviews the operations of our subholding companies. FEMSA Cerveza, FEMSA Empaques and FEMSA Comercio pay Emprex management fees for the services provided to them by FEMSA Servicios. In addition, FEMSA Cerveza and Coca-Cola FEMSA have each entered into a services agreement with FEMSA Servicios pursuant to which they pay for specific services.

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Description of Property, Plant and Equipment

As of December 31, 2003, we owned all of our manufacturing facilities and substantially all of our warehouses and distribution centers. Our properties primarily consisted of production and distribution facilities for our beer, soft drink and packaging operations and office space. In addition, FEMSA Comercio owns approximately 10% of the Oxxo store locations, while the other stores are located in properties that are rented under long-term lease arrangements with third parties.

The table below sets forth the location, principal use and production area of our production facilities, and the subholding company that owns such facilities:

Production Facilities of FEMSA On December 31, 2003

<u>Subholding Company</u>	<u>Location</u>	<u>Principal Use</u>	<u>Production Area</u> (thousand sq. meters)
FEMSA Cerveza	Tecate, Baja California Norte	Brewery	90
	Toluca, Estado de Mexico	Brewery	374
	Guadalajara, Jalisco	Brewery	97
	Monterrey, Nuevo León	Brewery	209
	Navojoa, Sonora	Brewery	463
	Orizaba, Veracruz	Brewery	246
Coca-Cola FEMSA México	San Cristobal de las Casas, Chiapas	Soft Drink Bottling Plant	24
	Cedro, Distrito Federal	Soft Drink Bottling Plant	18
	Cuautitlán, Estado de Mexico	Soft Drink Bottling Plant	35
	Los Reyes la Paz, Estado de Mexico	Soft Drink Bottling Plant	28
	Toluca, Estado de Mexico	Soft Drink Bottling Plant	280
	Celaya, Guanajuato	Soft Drink Bottling Plant	87
	León, Guanajuato	Soft Drink Bottling Plant	38
	Morelia, Michoacan	Soft Drink Bottling Plant	50
	Juchitán, Oaxaca	Soft Drink Bottling Plant	27
	Ixtacomitán, Tabasco	Soft Drink Bottling Plant	90
	Apizaco, Tlaxcala	Soft Drink Bottling Plant	80
	Coatepec, Veracruz	Soft Drink Bottling Plant	96
Guatemala	Guatemala City	Soft Drink Bottling Plant	46
Nicaragua	Managua	Soft Drink Bottling Plant	59
Costa Rica	San José	Soft Drink Bottling Plant	52
Panama	Panama City	Soft Drink Bottling Plant	29
Colombia	Barranquilla	Soft Drink Bottling Plant	27
	Bogotá Norte	Soft Drink Bottling Plant	89
	Bucaramanga	Soft Drink Bottling Plant	27
	Cali	Soft Drink Bottling Plant	88
	Manantial	Soft Drink Bottling Plant	33
	Medellín	Soft Drink Bottling Plant	44
Venezuela	Antimano	Soft Drink Bottling Plant	14
	Barcelona	Soft Drink Bottling Plant	141
	Calabozo	Soft Drink Bottling Plant	70
	Maracaibo	Soft Drink Bottling Plant	34
	Maracay	Soft Drink Bottling Plant	31
	Valencia	Soft Drink Bottling Plant	91
Brazil	Campo Grande	Soft Drink Bottling Plant	36
	Jundiaí	Soft Drink Bottling Plant	191
	Mogi das Cruzes	Soft Drink Bottling Plant	95
Argentina	Alcorta	Soft Drink Bottling Plant	73
FEMSA Empaques	Ensenada, Baja California Norte	Beverage Cans	33
	Toluca, Estado de Mexico	Beverage Cans	22
	Monterrey, Nuevo León	Crown Caps and Can Lids	51
	San Juan del Río, Querétaro	Refrigeration Equipment	25
	Acayucan, Veracruz	Silica Sand Mine	7

Insurance

We maintain an "all risk" insurance policy covering our properties (owned and leased), machinery and equipment and inventories as well as losses due to business interruptions. The policy covers damages caused by natural disaster, including hurricane, hail, earthquake and damages caused by human acts, including, explosion, fire, vandalism, riot and losses incurred in connection with goods in transit. In addition, we maintain an "all risk" liability insurance policy that covers product liability. We purchase our insurance coverage through an insurance broker. The policies are issued by Allianz, and the coverage is partially reinsured in the international reinsurance market.

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Capital Expenditures and Divestitures

Our consolidated capital expenditures for the years ended December 31, 2003, 2002 and 2001 were Ps. 6.789 billion, Ps. 5.780 billion and Ps. 5.531 billion, respectively, and were for the most part financed from cash from operations generated by our subsidiaries. These amounts were invested in the following manner:

Capital Expenditures

	Year Ended December 31,		
	2003	2002	2001
<i>In Millions of Mexican pesos</i>			
Coca-Cola FEMSA	Ps. 1,910	Ps. 1,410	Ps. 1,000
FEMSA Cerveza	3,246	3,292	3,674
FEMSA Comercio	1,210	857	638
FEMSA Empaques	376	255	95
Others	47	(34)	124
Total	Ps. 6,789	Ps. 5,780	Ps. 5,531

Coca-Cola FEMSA

During 2003, Coca-Cola FEMSA's capital expenditures focused on integration of its new territories, placing refrigeration equipment with retailers and investments in returnable bottles and cases, increasing plant operating efficiencies, improving the efficiency of its distribution infrastructure and advancing information technology. Capital expenditures in Mexico were approximately Ps. 1,431 million and accounted for most of its capital expenditures.

FEMSA Cerveza

Production

During 2003, FEMSA Cerveza invested approximately Ps. 783 million in its production facilities, of which Ps. 627 million was spent on equipment substitution and upgrades and approximately Ps. 145 million on expansion projects in existing production facilities. The capacity expansion projects occurred mainly in the Navojoa brewery. FEMSA Cerveza's monthly installed capacity as of December 31, 2003 was 2.7 million hectoliters, equivalent to an annualized installed capacity of 32.5 million hectoliters.

Distribution

In 2003, FEMSA Cerveza invested Ps. 258 million in its distribution network. Approximately Ps. 163 million of this amount was invested in the replacement of the distribution fleet, Ps. 20 million in land and buildings and improvements to leased properties dedicated to various distribution functions, Ps. 32 million in office equipment for the distribution units and the remaining Ps. 43 million in other distribution-related investments.

Market-related Investments

During 2003, FEMSA Cerveza invested approximately Ps. 2.2 billion in market-related activities and brand support in the domestic market. A significant amount of these investments were directed to tied-account agreements with retailers and commercial support to owned and third-party distributors. Investments in retail agreements with tied customers that exceed a one-year term are capitalized and amortized over the life of the agreement. In general, FEMSA Cerveza's retail agreements are for a period of three to four years. Other market-related investments include the purchase of refrigeration equipment, coolers, plastic furniture and other promotional items. These items are placed with retailers as a means of facilitating the retailers' ability to service consumers and to promote the image and profile of FEMSA Cerveza's brands.

FEMSA Comercio

FEMSA Comercio's principal investment activity is the construction and opening of new stores. During 2003, FEMSA Comercio opened 582 net new Oxxo stores. The amount invested in 2003 dedicated to the opening of new stores and improvements to leased properties was Ps. 1.1 billion. In addition, FEMSA Comercio invested Ps. 76 million in ERP system software.

FEMSA Empaques

In 2003, FEMSA Empaques invested a total of Ps. 376 million, of which Ps. 225 million was for the refurbishment of a glass bottle furnace. In addition, investments in the metal products production facilities, which include aluminum cans and crown caps, amounted to Ps. 76 million, primarily for plant improvement and equipment substitution.

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Regulatory Matters

Competition Legislation

The *Ley Federal de Competencia Económica* (the Federal Economic Competition Law or the Mexican Competition Law) became effective on June 22, 1993. The Mexican Competition Law and the *Reglamento de la Ley Federal de Competencia Económica* (the regulations under the Mexican Competition Law), effective as of March 9, 1998, regulate monopolies and monopolistic practices

and require Mexican government approval of certain mergers and acquisitions. The Mexican Competition Law subjects the activities of certain Mexican companies, including us, to regulatory scrutiny. In addition, the regulations of Mexican Competition Law prohibit members of any trade association from reaching any agreement relating to the price of their products. Management believes that we are currently in compliance in all material respects with Mexican competition legislation.

In Mexico and in some of the other countries in which we operate, we are involved in ongoing competition related procedures. We believe that the outcome of these procedures will not have a material adverse effect on our financial condition. See "Item 8. Financial Information--Legal Proceedings--FEMSA Cerveza--Antitrust Matters" and "Item 8. Financial Information--Legal Proceedings--Coca-Cola FEMSA--Antitrust Matters."

Environmental Matters

In all of the countries where we operate, our businesses are subject to federal and state laws and regulations relating to the protection of the environment. We have expended, and may be required to expend in the future, funds for compliance with and remediation under local environmental laws and regulations. Currently, we do not believe that such costs will have a material adverse effect on our results of operations or financial condition. However, since environmental laws and regulations and their enforcement are becoming increasingly more stringent in our territories, and there is increased awareness of local authorities for higher environmental standards in the countries where we operate, changes in current regulations may result in an increase in costs, which may have an adverse effect on our future results of operations or financial condition. Management is not aware of any pending regulatory changes that would require additional remedial capital expenditures in a significant amount.

Mexico. Our Mexican operations are subject to Mexican federal and state laws and regulations relating to the protection of the environment. The principal legislation is the *Ley General de Equilibrio Ecológico y la Protección al Ambiente* (the Federal General Law of Ecological Equilibrium and Environmental Protection) or the Mexican Environmental Law, the *Ley General para la Prevención y Gestión Integral de los Residuos* (the General Law for the Prevention and Integral Management of Waste), which are enforced by the *Secretaría de Medio Ambiente, Recursos Naturales y Pesca* (the Ministry of the Environment, Natural Resources and Fisheries) or SEMARNAP. SEMARNAP can bring administrative and criminal proceedings against companies that violate environmental laws, and it also has the power to close non-complying facilities. Under the Mexican Environmental Law, rules have been promulgated concerning water, air and noise pollution and hazardous substances. In particular, Mexican environmental laws and regulations require that Mexican companies file periodic reports with respect to air and water emissions and hazardous wastes and set forth standards for waste water discharge that apply to their operations. We are also subject to certain minimal restrictions on the operation of delivery trucks in Mexico City. We have implemented several programs designed to facilitate compliance with air, waste, noise and energy standards established by current Mexican federal and state environmental laws, including a program to install catalytic converters and liquid petroleum gas in delivery trucks for our operations in Mexico City.

In addition, we are subject to the *Ley Federal de Derechos* (the Federal Law of Governmental Fees), also enforced by SEMARNAP. Adopted in January 1993, the law provides that plants located in Mexico City that use deep water wells to supply their water requirements must pay a fee to the city for the discharge of residual waste water to drainage. In 1995, municipal authorities began to test the quality of the waste water discharge and charge plants an additional fee for measurements that exceed certain standards published by SEMARNAP.

Central America. Coca-Cola FEMSA's Central American operations are subject to several federal and state laws and regulations relating to the protection of the environment, which have been enacted in the last ten years, as awareness has increased in this region about the protection of the environment and the disposal of dangerous and toxic materials. In some countries in Central America, Coca-Cola FEMSA is in the process of bringing its operations into compliance with new environmental laws. For example, in Nicaragua Coca-Cola FEMSA is in the final phase of the construction of a water treatment plant located at its bottler plant in Managua. Also, Coca-Cola FEMSA's Costa Rica operations have participated in a joint effort along with the local division of The Coca-Cola Company called *Proyecto Planeta* (Project Planet) for the collection and recycling of non-returnable plastic bottles.

Colombia. Coca-Cola FEMSA's Colombian operations are subject to several Colombian federal, state and municipal laws and regulations related to the protection of the environment and the disposal of toxic and dangerous materials. These laws include the control of atmospheric emissions and strict limitations on the use of chlorofluorocarbons. Coca-Cola FEMSA is also engaged in nationwide campaigns for the collection and recycling of glass and plastic bottles.

Venezuela. Coca-Cola FEMSA's Venezuelan operations are subject to several Venezuelan federal, state, and municipal laws and regulations related to the protection of the environment. The most relevant of these laws are the *Ley Orgánica del Ambiente* (the Organic Environmental Law), the *Ley Sobre Sustancias, Materiales y Desechos Peligrosos* (the Substance, Material and Dangerous Waste Law) and the *Ley Penal del Ambiente* (the Criminal Environment Law). Since the enactment of the Organic Environmental Law in 1995, Coca-Cola FEMSA's Venezuelan subsidiary has presented to the proper authorities plans to bring certain of its production facilities and distribution centers into compliance with the law. While the laws provide certain grace periods for compliance with the new environmental standards, Coca-Cola FEMSA has had to adjust some of the originally proposed timelines presented to the authorities, because of delays in the completion of some of these projects.

Brazil. Coca-Cola FEMSA's Brazilian operations are subject to several federal, state and municipal laws and regulations related to the protection of the environment. Among the most relevant laws and regulations are those dealing with the emission of toxic and dangerous gases, which impose penalties, such as fines, facility closures or criminal charges depending upon the level of non-compliance. Coca-Cola FEMSA's production plant located in Jundiaí has been recognized by from the Brazilian authorities for its compliance with environmental regulations and for having standards well above those imposed by the law. The plant has been certified for the ISO 9000 since March 1995 and for the ISO 14001 since March 1997.

Argentina. Coca-Cola FEMSA's Argentine operations are subject to federal and provincial laws and regulations relating to the protection of the environment. The most significant of these are regulations concerning waste water discharge, which are enforced by the *Secretaría de Recursos Naturales y Ambiente Humano* (the Ministry of Natural Resources and Human Environment) and the *Secretaría de Política Ambiental* (the Ministry of Environmental Policy) for the province of Buenos Aires. Coca-Cola FEMSA's Alcora plant meets and is in compliance with waste water discharge standards.

Water Supply Law

FEMSA Cerveza and Coca-Cola FEMSA purchase water directly from municipal water companies and pump water from wells pursuant to concessions obtained from the Mexican government through the National Water Commission on a plant-by-plant basis. Water use in Mexico is regulated primarily by the *Ley de Aguas Nacionales de 1992* (including regulations issued thereunder, the Mexican 1992 Water Law), which created the National Water Commission, charged with overseeing the national system of water use. Under the Water Law of 1992, concessions for the use of a specific volume of ground or surface water generally run for five, ten or fifteen year terms depending on the supply of groundwater in each region as projected by the National Water Commission. Concessionaires may request concession terms to be extended upon termination. The Mexican government is authorized to reduce the volume of ground or surface water granted for use by a concession by whatever volume of water that is not used by the concessionaire for three consecutive years. Our management believes that we are in general compliance with the terms of our existing concessions and that such concessions satisfy our current water requirements in Mexico. We cannot assure you, however, that groundwater will be available in sufficient quantities to meet future production needs.