Q2 2018 Earnings Call

Company Participants

- Bernardo Pinto Paiva, Chief Executive Officer
- Fernando Tennenbaum, Chief Financial Officer

Other Participants

- Antonio González, Analyst
- Isabella K. Simonato, Analyst
- Luca Cipiccia, Analyst
- Robert Ottenstein, Analyst
- Thiago Duarte, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. We would like to welcome everyone to Ambev's Second Quarter 2018 Results Conference Call.

Today with us, we have Mr. Bernardo Paiva, CEO for Ambev's; and Mr. Fernando Tennenbaum, CFO and Investor Relations Officer. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After Ambev's remarks are completed, there will be a question-and-answer section. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ambev's management and on information currently available to the company. They involve risks, uncertainties, and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of Ambev and could cause results to differ materially from those expressed in such forward-looking statements.

I would also like to remind everyone that, as usual, the percentage changes that will be discussed during today's call are both organic and normalized in nature. And, unless otherwise stated, percentage changes refer to comparisons with second quarter 2017 results. Normalized figures refer to performance measures before exceptional items which are either income or expenses that do not occur regularly as part of Ambev's normal activities. As normalized figures are non-GAAP measures, the company discloses the consolidated profit, EPS, EBIT and EBITDA on a fully reported basis in the earnings release.

Now, I'll turn the conference over to Mr. Bernardo Paiva, CEO. Mr. Paiva, you may begin your conference.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you. Hello, everyone. Thank you for joining our 2018 second quarter earnings call. Before starting, I would like to announce that we have here Fernando Tennenbaum, our new CFO, since July 1. Fernando joined Ambev in 2004, and while at Ambev, he served in many finance functions. Since January 2012, he has been the Global Treasurer of AB InBev.

I would like to thank Ricardo Rittes for all his support during his almost three years as our CFO, during which he delivered great results. I would also like to welcome Fernando and to wish him all the best in his new role.

I will now hand over to Fernando to go through our results in all the zones. And next, I will come back to take you through our commercial highlights in Brazil and to share with you our outlook for the country.

Fernando Tennenbaum {BIO 20615079 <GO>}

Thank you very much, Bernardo. I'm really happy to be here. Throughout these 14 years in the group, I had the opportunity to work as Investor Relations, Head of M&A, and Treasurer of Ambev. Rittes has set a very high bar as CFO and I am deeply committed to continuing his remarkable work and keep pursuing sustainable value creation for our shareholders.

After this quick introduction, I will start with the main highlights of our consolidated results. In the second quarter, we posted a strong growth in most of our markets.

On a consolidated basis, top line was up 11.4%, positively impacted by volume growth of 2.6%, coupled with a net revenue per hectoliter increase of 8.6%.

After 10.1% of EBITDA growth year-over-year in Q1, we further accelerated EBITDA growth to 16.7% in Q2 versus the same period last year, expanding margin by 180 basis points to 39.4% and reaching BRL 4.5 billion. Normalized net profit was BRL 2.3 billion, 9.7% higher than Q2 2017 as EBITDA organic growth and lower tax rate were partially offset by higher financial expenses.

Moving now to our divisional results, and starting with Brazil. Brazil EBITDA was up 14.8%, reaching BRL 2.4 billion with margin expansion of 190 basis points to 41.1%. Our Beer business in the country delivered good results. Net revenue increased by 9.2% and EBITDA grew by 11.1% with margin expansion of 70 basis points to 41.5%.

After an anticipated soft (00:05:27) start in 2018, Beer volume resumed growth to 1.7% despite the negative impact from the truck drivers' strike which was offset by the 2018 FIFA World Cup. The Beer industry according to estimates was flattish. Net revenue per hectoliter remained strong and grew by 7.4%, benefiting from the carryover of the price adjustment implemented in Q3 2017 as well as from our continued revenue management initiatives. Cash COGS per hectoliter for Brazil was up 2.7%, a combination of FX tailwinds and pressure from inflation, higher commodity prices and higher weight of cans.

Cash SG&A grew by 11.4% mostly driven by increased sales and marketing expenses associated with timing of investments related to the FIFA World Cup as anticipated. Year-to-date, top line in beer Brazil increased by 3.7% and EBITDA was at 7.9% with margin expansion of 170 basis points to 42.7%. Our NAB business in Brazil also posted healthy results in the second quarter. Top line was at 10.2% and EBITDA increased by 44.2% with for margin expansion of 920 basis points to 38.9%.

Volume grew by 1% (00:07:07) soft industry that declined by mid-single digits. Net revenue per hectoliter increased by 9.2% and benefited from the amortization of our revenue management initiatives implemented in the second half of 2017. In terms of cost and expenses, cash COGS per hectoliter in NAB was down 9.8% favorably impacted by FX and lower sugar prices.

Cash SG&A was up 13.5%, also driven by higher concentration of sales and marketing expenses encouraging connection with the FIFA World Cup. Year-to-date, top line in NAB Brazil grew by 1.2% and EBITDA was up 24.8% with margin expansion of 650 basis points to 34.2%.

Moving now to Central American and Caribbean region. We continue to experience the positive trends seen the last quarter. EBITDA in CAC reached BRL 548 million, increasing organically by 21.2% with margin expansion of 170 basis points to 39.8%. Net revenue increased by 16.2% and on a per hectoliter basis by 4.9%. Volume was strong growing by 10.8% with the Dominican Republic and Panama, the two largest countries in the region, delivering a healthy performance. In the Dominican Republic in particular, we continued to activate the Presidente brand through a remarkable execution that comprises, among other initiatives, the sponsorship of micro events and the introduction of new coolers in the market. And in Panama, we embraced Panama's first World Cup with a memorable activation of Balboa, which contributed to a strong volume increase in the country.

Cash COGS per hectoliter in CAC was slightly positive growing by 1.5% benefiting from a tight cost management. Further, cash SG&A was up 20.9% mostly driven by phasing sales and marketing expenses related to 2018 FIFA World Cup. Year-to-date, top line in CAC was up 12.5% and EBITDA grew by 20% with robust margin expansion of 250 basis points to 39.3%. I would like to highlight that we are pleased with the evolution of our business in CAC and we remain enthusiastic about the opportunities we've seen in the region in both the short as well as the long-term.

Moving now to Latin America South. Our LAS region had a strong quarter. EBITDA was 37.4% above that of last year, reaching BRL 941 million with a margin expansion of 360 basis points to 39.4%.

Net revenue grew by 25.6%. As a result of volume growth of 4.9% coupled with net revenue per hectoliter increase of 19.5%, which was a consequence of high inflation and revenue management initiatives. In Argentina in particular, beer volumes grew by mid-single digits on a hard comparable of more than 20% growth in the second quarter of 2017. This performance was mainly fueled by Brahma and Quilmes Clásica that continued to deliver strong results in the country. Cash COGS per hectoliter in LAS went up 7.3% benefited by FX; while cash SG&A increased by 20.9%, as below inflation market expenses were impacted by higher distribution costs associated to volume increase.

Year-to-date top line in LAS rose by 25% and EBITDA increased by 30% with margin expansion of 170 basis points to 41.5%. In LAS, while cautious about the Argentinian macroeconomic environment, we have a track record of delivering solid results in the region and we remain confident in our ability to maintain this pattern (00:11:23) supported by the strength of our brands and by our financial disciplines.

Turning now to Canada. We delivered in the second quarter BRL 650 million of EBITDA in Canada, which is 6.6% lower than in the second quarter of 2017. Top line was down 2.0% as net revenue per hectoliter increase of 0.8% was impacted by volume decline of 2.7%, driven by a soft industry as well as a discrete (00:11:54) comparable in second Q 2017 when we outperformed the market.

Despite volume decline, our core brands Bud Light and Michelob Ultra continue to deliver strong results being among the fastest growing brands in Canada. On top of that our high end brands Stella Artois and Corona outpaced the industry and our local craft brands portfolio comprised of Mill Street, Archibald and Stanley Park, grew by double digits. Cash COGS per hectoliter in Canada was up (00:12:30) 11.8%, mostly due to a hard comparable in Q2 2017 when cash COGS per hectoliter was low single digits down (00:12:39). On the other hand, cash SG&A declined by 7.4%, benefiting from cost savings in our non-working money, as well as from phasing and efficiency gains in our working money.

Year-to-date, top line in Canada decreased by 1% and EBITDA was down 11.3% with margin contraction of 340 basis points to 29.5%. Finally, whilst not satisfied with our recent results, we will cycle COGS hard comparable as of 3Q 2018 and supported by our strong portfolio, we are committed to continue to pursue an improved performance in the country to resume EBITDA growth.

Now back to consolidated figures. Other operating expenses totaled BRL 242 million in Q2, mainly explained by government grants related to State VAT long-term tax incentives that were up 4.1% year-over-year mainly due to higher revenues.

Finally, moving below EBITDA. In the second quarter, our net financial results totaled an expense of BRL 1 billion increasing by 50% when compared to the second quarter of 2017. This increase is mainly driven by higher non-cash losses related to equity swaps and foreign exchange variations on intercompany loans.

Going to more details, (00:14:11) financial expenses in the quarter were: first, interest income of BRL 94 million driven by our cash balance, mainly Brazilian reais, U.S. dollars and Canadian dollars. Second, interest expenses of BRL 295 million that include, among other items, interest incurred in connection with the Brazilian Tax Regularization Program, as well as non-cash accrual of approximately BRL 50 million related to the put option associated to our investment in the Dominican Republic business.

As expected, this non-cash accrual declined by approximately 65% (00:14:48) year-over-year as a result of the partial exercise of the put option in January 2018, which result in the decrease from 45% to 15% (00:14:57) of ELJ ownership in the business. Third, BRL 232 million of losses in derivative instruments, mainly driven by non-cash expenses related to negative results of equity swaps. Fourth, losses on non-derivative instruments in the amount of BRL 389 million, impacted by non-cash negative results incurred in connection with foreign exchange variation on intercompany loans.

Fifth, taxes on financial transactions on the amount of BRL 104.7 million. And sixth, BRL 123 million of financial expenses mainly driven by interest on contingencies.

The effective tax rate decreased from 9.4% to 6.9%, mainly explained by an easy comparable in Q2 2017, when the tax rate was adversely impacted by a one-time tax adjustment. Year-to-date, the effective tax rate was of 13.7% versus 11.2% in the half year of 2017, mostly driven by an increase in taxable income. Cash generated from operations in Q2 2018 was BRL 3.5 billion, which is 45.6% higher than in Q2 2017. Year-to-date cash generated for operating activity is growing by 9.7% reaching BRL 6.1 billion.

CapEx reached BRL 805 million in the quarter and BRL 1.3 billion in half year, declining 2.5% versus the first half of 2017.

Finally, during this year, we announced approximately BRL 3.6 billion to active holders () in dividends.

Thank you very much. I will now hand back to Bernardo before going to Q&A.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Fernando. Let's start talking about beer. Our Beer Brazil results in the second quarter were strong and demonstrate that we are on track with our commercial strategy, what is a result of consistency and excellence in the implementation of our growth platforms. These results also confirm what I said in our first (00:17:16) quarter earnings call when I focused and explained the main drivers that led to beer volume decline in Brazil in Q1 and on the reasons that our volume performance in that quarter was no indicative of any structural change in our business. I would like to highlight that we stated (00:17:36) several times during this quarter as a result of the truck drivers' strike that took place in May (00:17:41); however, our relentless focus on excellence in route to market and service level were decided to (00:17:48): one, keeping our products on shelves during this period; and second, react fast after the strike, restoring inventory levels in the market quickly.

Along with that, we also had a successful execution during the 2018 FIFA World Cup. All the factors that I just mentioned contributed to a beer volume growth of 1.7% outperforming the industry. In this context, as said by Fernando, we've managed to deliver solid top line and EBITDA growth.

Our Non-Alcoholic business also posted great results. Volume grew by 1%. Meanwhile the soft drink industry was down mid-single digits. Solid top line in cost performance also allowed us to increase our EBITDA by more than 40% with significant margin expansion.

Having said that, our commercial strategy in Brazil remained consistent during the quarter, and we continue to focus on our growth platforms, which have the following highlights: Start with (00:18:57) Elevate the Core, our first and most relevant platform. As I mentioned in the previous calls, Brahma, our classic lager, has been experiencing memorable momentum in growing strongly quarter after quarter. Brahma connects with consumers through relevant platforms including soccer, Brazilian's greatest passion.

As such, Brahma's momentum was reinforced by the 2018 FIFA World Cup. The brand sponsored the Brahma Arenas set up in traditional venues in seven Brazilian capitals; São Paulo, Rio de Janeiro, Belo Horizonte, Recife e Salvador (00:19:33), Curitiba and Florianópolis, where consumers watched the games while enjoying free entertainment. Brahma also promoted several other smaller events across the whole country following (00:19:49) with its core target consumers and leveraging this opportunity to drive volume growth while enhancing its brand equity.

The brand's activation during the World Cup was also marked by a meaningful campaign that (00:20:04) all its tradition and its connection to the Brazilian national team coupled with a (00:20:10) that boosted the brand visibility, always reinforcing its heritage and recognized quality.

Now talk about Skol, our easy-drinking (00:20:22) lager. Innovation is very important for Skol, our brand (00:20:27) has always been setting the trends and inviting consumers to enjoy new experience. During the quarter, we launched Skol Hops, an innovative pure malt beer brewed with aromatic hops that provide a unique combination of lightness, freshness and flavor. Positioned within the core plus segment, Skol Hops was launched in the northeast of Brazil and is expected to be rolled out across the country during the second half of 2018, reinforcing Skol's innovative DNA.

Still talk about the core plus segment, our brands within (00:21:08) this segment also continue to deliver great results. Brahma Extra and Bohemia grew more than 50% during the second quarter providing to consumers the best trade-up alternative. In the second half of the year, our mainstream brands will continue to leverage key brand moment (00:21:28) like the World Cup. We'll continue to invest in relevant equity campaigns, and we'll continue to connect with their target consumers to support top line and EBITDA evolution.

Now talk about premium. The 2018 FIFA World Cup was also marked by a full integrated position (00:21:49) for Budweiser as a global feature (00:21:52) sponsor of the event. The brand's activation in Brazil was based on the Light Up The World (sic) [Light Up The FIFA World] (00:21:58) campaign and the creation of Bud Basements in 10 cities, which are [indiscernible] (00:22:06) events that reinforced Budweiser's values such as authenticity and freedom.

Besides broadcasting the most important matches, we took the Bud Basements (00:22:16) good music, tattoo studios, barbershops as well as cool and trendy parties. The World Cup initiatives was also highlighted by a consistent execution in the off-trade, and by extensive distribution of the Red Light Cup across the country, which lights were activated through the sound of the fans watching the games.

(00:22:41) on premium, I would like to reinforce that our strength in the premium segment is a great portfolio of brands. Each of our premium brands maintained its own territory, brand position and price point reaching different consumers in different locations (00:22:57).

With that in mind, both Stella Artois and Corona also had a great quarter allowing our premium portfolio of global brands to grow by more than 30%. Corona's performance was supported by a great activation during the world surfing league event in Saquarema, Rio de Janeiro. Corona encourage consumers to spend more time outside, disconnecting from the daily grind. As such the Balboa CL activation (00:23:27) was highlighted by the Corona house (00:23:30), where consumers could engage in several outdoor activities and have access to cool attractions.

Stella, on its turn, (00:23:41) heritage dating back to 1366, continue to explore new occasions via its space (00:23:47) elevating the food experience supported by Stella draft and by its unique package such as the 550 mL bottle and the 300 tonnage lid can (00:23:59).

Moving on, our premium portfolio for the (00:24:04) Non-Alcoholic business, which comprise Fusion, H2OH!, Lipton, Gatorade, and Do Bem also delivered great results in the quarter growing double digits and outpacing the traditional CSD industry. Going forward, we reinforce that our premium portfolio is well positioned to keep driving the beer category upward and supporting a positive mix.

Now moving to Drive Smart Affordability. As I mentioned in our last call, fostering (00:24:38) beer consumption in Brazil is crucial, and we have incorporated affordability initiative into our growth platforms. Our most important initiative to address the affordability issue in Brazil is the expansion of the returnable glass bottles in the off-trade channel. This year we are focusing on growing this package penetration in pit stops and small store formats – those with less than 4 checkouts – which are closer to consumer house, with the purpose of continuously enhancing consumers shopping experience while delivering affordability.

Finally closing with different locations (00:25:17) in home and out of home. We've been stepping up our route to market across the country via several different initiatives including the use of new technology. As such, as I mentioned before, our strong route to market was to key to (00:25:32) support our operations during that truck drivers' strike.

On top of that, during the World Cup, along with meaningful campaigns for Budweiser, Brahma and Guaraná Antarctica. We also delivered remarkable execution in the on-trade and off-trade, particularly in the on-trade, which implemented special activations for the 2018 FIFA World Cup in 1,000 parks (00:25:55), using this opportunity to deliver memorable experience to consumers.

With that, we managed to execute a truly integrated (00:26:07) sales and marketing approach across the whole country allowing us to build momentum not only for the second quarter, but also for the future.

Before moving to the Q&A, I'll just spend a few minutes sharing with you our outlook for Brazil. First for beer, I would like to highlight that we are implementing our annual price adjustment during the third quarter as we did in 2017. Having said that, our expectations for Brazil for the balance of the year remain mostly unchanged. We are optimist about our business. Although the environment is still challenged and volatile, we are confident in our strategy and remain committed to maintaining a disciplined execution of our growth platforms to accelerate EBITDA growth versus 2017.

Our long-term perspective didn't change either. We believe that Brazil is a unique market, which provides combination of growth opportunities and profitability, as favorable demographics, the closing of regional gaps in per capita income and consumer demand for innovative and premium products should support and will support long-term growth.

We can move now to the Q&A. Thank you.

Q&A

Operator

And our first question comes from Robert Ottenstein with Evercore ISI. Please go ahead.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much and congratulations, Fernando. Two questions, one just a simple one on the Skol Hops. I was just wondering if you could talk a little bit more about that brand extension and sort of what are the opportunities you're going after or the occasions, what you're trying to solve for. That's question one.

And the second question is, ABI announced today a fairly meaningful reorganization, some new roles within the top tier of the management. And I was just wondering to get your perspective on how some of those changes may or may not impact Ambev and specifically on the opportunity in terms of retail, and it looks like, at least on the corporate level at ABI looking to perhaps put more emphasis on the retail channel and ownership of that? Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Robert. Great question. So just first about Skol Hops. I think we have been (00:29:03) evolving the portfolio in Brazil as I have been talking in every call. So it's key to have a full portfolio of brands to offer to people, in general, great beers in different flavors, different tastes and occasions as well. So in 2016 we launched, just to remind us, Brahma Arenas, and we launched three Brahma Arenas, creating – and do created at that time to call (00:29:29) the core plus segment in Brazil offering the first opportunity to trade up (00:29:34), so it's very important for us, not only the premium, but to create this core plus; was the first step-up in terms of the profitability and then a more experience – a better – not a better, but I'd say (00:29:47) a different experience that people would have with beer.

Since we launched Brahma Extra, this brand has grown quarter by quarter (00:29:57) strongly and it's already 1% of the beer volume – our beer volume in the country. And on top of that, what we saw Brahma Extra had a positive impact in the mother brand (00:30:09) because it's, I mean, it's the family and helped Brahma profit (00:30:14) to grow as well. And Skol, that's the most innovative brand in the Brazilian market should be part of this as well. So Skol could not be left behind in the core plus segment.

So that's why we launched the Skol Hops (00:30:31) so I like to do this in a different way. So it's a very light beer, but it's a refreshing beer with its aromatic hops that we study a lot, our brew masters (00:30:42) have been working on this for a long period. There (00:30:46) just like Brahma Extra, we expect a major success to reinforce the core plus segment. And bringing just in the perspective of the core plus, three years ago we didn't have the core plus segment in Brazil. We shaped the industry and we created a portfolio that's already counts for 2% (00:31:03) of our beer volume with a higher profitability. So Skol Hops will be part of that, and for sure we will grow big time and will help us to even enhance and grow the core plus segment, helping the mother brand of Skol (00:31:19), as well Light Brahma Extra did with (00:31:22) (00:31:23).

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Hi, Robert. Fernando here. On the question about the ABI announcement, in Ambev (00:31:32) level all operations remain exactly the same. So there will be no change from an Ambev (00:31:37) perspective.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. And just, is there any increased emphasis on owning retail that was something that (00:31:49) on the ABI level seems like just going to get more attention, are there any plans for that in any part of your region?

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

(00:31:59) the first focus that we have is work for – with the retail network that we have here in Brazil. So I mean – now the point of sales, the change that we're working (00:32:09) very, very, very well and we commit to work with them. If you have, I mean, we have here some own stores, some franchise business. It's becoming relevant, having talked about the pit stops. So this retail focus not new for Ambev, something that we have been doing for a long time, and then continue to do when makes sense, in the occasions that make sense. But again, the first focus is work with the retail natural gas (00:32:38) we have here in Brazil that have been supporting our brands that we've been working hard in terms of (00:32:44) route to market (00:32:46) level to serve our point of sales in an even better way year over year.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Thank you very much.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Robert, for the question.

Operator

And our next question comes from Antonio González with Credit Suisse. Please go ahead.

Q - Antonio González

Good morning, Bernardo and hello, Fernando. Good luck on this new role. I also wanted to ask a couple of questions on your relationship with ABI. First, I wanted to come back to the previous question on the announcements that ABI did this morning, and I understand your comment, Fernando, that there are no organizational changes at Ambev, but I want to get some, I guess, perspective from you guys to understand if you can better leverage on your access to ABI, specifically as it relates to two areas. First, you're sending some – part of your talent as part of this reorganization from ABI Carlos Lisboa and Bernardo Nobic (00:33:57), and so on. I want to ask if you are in this occasion importing some talent as well.

Second, I wanted to ask if, specifically in the Soft Drinks business, volumes have been soft for a number of quarters now and on – in the second quarter we saw a rebound of what I guess – if we see the last 18 months or so, there has been some weakness. So I wanted to ask if there's something that you think you should be doing structurally different in that business, and perhaps this reorganization from ABI helps.

And sorry to make it a long question, but the last point I wanted to ask is, I wanted to see if you can add some perspective on also, I guess, corporate governance, and your relation – your broader (00:34:55) relationship with ABI not only because of these changes that ABI announced today, but also there's shareholders' agreement between several shareholders at Ambev, the control (00:35:09) shareholders at Ambev that is expiring next year; and obviously, since the creation of this agreement, a lot has changed. You've formalized several committees at the board, the merger of the two-share (00:35:23) classes, et cetera. So I just want to ask, Bernardo, if your – from your conversations with Brito, has a strategic view of the relationship changed at all and how have these formal bodies such as the compliance committees and so on improved the relationship between yourselves and ABI? Sorry for the very long question, but I wanted to address those three points.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Antonio, thanks for the questions. So I'll touch first one, people will think (00:35:53) that we are exporting people as we said and I think that's, you said, it's very important for our culture to people continue to see they have opportunities of growth. So, this attracts great people. And part of the development of great people is really to give them different challenges, and so they'll be – you become better partners in the future, (00:36:14) always import for (00:36:15) people. So that's a flow and then outflow and then inflow (00:36:17). So we have here Fernando, so he was the Global Treasurer of (00:36:22) ABI. He wasn't in Ambev at that time in five years, six years ago. (00:36:29), become much more experienced, I mean, knowledgeable and so on, then back to Brazil now to help us here.

And you will see this flow now, so in our efforts (00:36:38), I mean, seeing the exports flow and then I mean, I think that we could see the next month some inflow as well, people coming, so that's good, and because it's good for that doing export (00:36:52) people because when they come back, they come back with a different view. Happened (00:36:57) with all of us, happened with me in that state, I mean, eight, nine years outside of Brazil when it happened helped the way and Paula (00:37:04) and the other people with the team – how we can shape the strategy here, the experience that we have outside. So I think that's a good thing. It's good thing for the culture because people grow, they can attract great people because they see that a place that they can grow opportunities and so on and it's good to have a better partners (00:37:23) have a broader experience. So (00:37:26) for sure in the future and more news to come.

Linked to the second point, I think for the Soft Drink business. So I think that our approach and we know that we have been talking (00:37:40) we really like to work in the fundamentals of the business. We have good fundamentals always in Ambev. But I mean, given the challenge that we have or had, we had been working hard to really assure that the fundamentals would be there. And one example, in terms of service level, in terms of elevating the core, in terms of our core brands, in terms of the (00:38:04) portfolio of premium. And we have been doing the same in the Soft Drink business. We're focusing (00:38:13) a little bit more focused on those basic things, the fundamental things doing well, excellence in the beer business and have been doing this in the Non-Alcoholic business as well. That creates maybe in a period of time a disruption because we are – I mean, changing some structural things. But in a point of time, if you are a true owner (00:38:36) like we are, doing the right things, this will start to come to appear (00:38:42).

And I think that soft drinks fits (00:38:43) in the Non-Alcoholic business in a moment that some of things that you put the seed in the past, you would think that it started to come, the portfolio is much more broader, the execution of our Non-Alcoholic business is better, still lots of room to increase. So I think, that the way that we promote in the market, as well, becoming more – I mean, more clever in terms of intelligence, in terms of technology, algorithms (00:39:14), and so on that have been using for beer for more time. So I think that Brazil is becoming better as well, I mean, better as the country is evolving, now that we can see that could be even more in the future for sure. And structurally, I think our business is in better shape and a good thing that to see lots of opportunities to further increase the way that we operate in the non-alcoholic business, that's a great opportunity and we'll continue to focus on that. So good momentum for soft drinks ahead and we continue to work in the fundamentals. So we'll now move to Bernardo for your last question if you allow me.

Hello, Antonio. Thanks for the question. So a little bit on the corporate governance. The current Shareholders' Agreement was executed in 1999 in the context of the merger between Antarctica and Brahma for a 20-year term. So that meant that if nothing happens there would be no shareholder agreement after 2019. In 2013, at the time where we merged the (00:40:27) at the end to have one single class of share which we think was a very positive outcome for our shareholders. Another agreement was negotiated to be in force at the time that the original shareholders' agreement would expire. So from 2019 and onwards, so it's fair to say the scope is different for this agreement than the first one, but I think the more important corporate governance point they're still valid and nothing changed. So the foundation is who is going to be on the shareholder agreement. Under the new shareholder agreement, any matter (00:41:08) shall be best efforts aligned between the shareholders, if consent is not reach, M&A transaction shall be approved by the majority of the board members. And of course, we see

that controlling the majority of the board members. They will be able to approve it. But having said that, if there is a M&A transaction carried out with related body then we're not talking about shareholders' agreement, we are talking about Brazilian Corporate Law which is over and above the Shareholders' Agreement. So under the local regulation and the company bylaws, shareholders and board members must abstain from voting matters when they have conflicting interests with the company. We ended being a little bit even more restrictive here. So whenever we perceive there is a conflict, the shareholders even abstain from the discussion, not only the voting but from the discussion. So just to follow up a little bit more on the transactions with the related party, we have the compliance in related party committee. We first analyze each one of the transactions including its arm's length aspect before it's submitted to the board. So I think we have all the controls and tools in place to make sure that the relationship is the right one.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

And I think that on top of that, Antonio, and all of you guys, on top of all of these controls and so on, we are partners of Ambev. We have a reputation here (00:42:39) myself. I'm 27 years in this company. We will do always what's the best for the shareholders of Ambev. So this for sure. So I think this is not a technical question – answer, but it's the real one. I think that's the final part despite of the laws and so on that I mean protects everything, is the most important thing. Shareholders of Ambev, we are partners of Ambev and we will protect the shareholders of Ambev always.

Q - Antonio González

Fantastic. Thanks for the color on the three themes.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Thank you, Antonio.

Operator

Your next question comes from Isabella Simonato with Bank of America Merrill Lynch. Please go ahead.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Thank you. Good afternoon, Bernardo, Fernando. I have two questions. First of all, (00:43:31) the ABI's call he mentioned that the impact of the truck drivers' strike in beer in Brazil was 3 percentage points. I was wondering if you could share with us what sort of impact you saw from the World Cup which has a set of – pretty much offsets the impact from the strike. That would be the first one. And the second one on soft drinks in Brazil. You have been having good tailwinds regarding costs, but your guidance for the year overall still shows an increase versus 2017. So I was wondering if you could share the drivers of that cost inflation for soft drinks specifically. Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Isabella, thanks for the questions. So first, I'll touch the volume part and Bernardo will talk about the cost of soft drinks. So (00:44:28) we all should take a look in two things, the effects of the strikes and the World Cup as (00:44:36). Let's start with the strikes. As you know, (00:44:38) for a long time we have been stepping up the go to market across the country via several different initiatives. I've been talking personally with you in the last three years about that and that was a long-term initiative. But we knew that in a point of time – we start to reap the benefits on that. And then I think (00:45:01) was done. And this year, we continue to do. So the strong distribution that we have, (00:45:09) service level were key to keeping our products on shelves during the truck drivers' strike. It also enable us to (00:45:16) quickly after the strike. So just to give one example, we knew – I mean that strike could end, was in a holiday, we worked every day during the holiday. So, I mean all the sales force, all the brewers, all the trucks, so I mean to react even faster to reassure that we will mitigate the volume loss. And the volume loss, yes, we had, because we saw at that moment a change in the consumer behavior during that specific period which led to a volume loss.

So we estimate that was – (00:45:53) that during this quarter, we lost approximately 3 percentage points of volume as a consequence of this strike. We mitigated that, this could be even higher. So given all the excellence in terms of service levels (00:46:06) could be – I mean we will mitigate that at the end of the day, given that demand deceleration was around 3% for the quarter. So I think the World Cup, I mean I've been working hard and then in terms – four years, we're sure that the World Cup would be a strong one, Brahma was amazing, strong, Budweiser as well. And, yes, the World Cup, – with the World Cup was able to fully offset this 3% of volume that we had lost with the strike. So the volume grew 1.7%.

So all in all, two things, so first message, we're able to mitigate the effect of strike, given the excellence in operations. Certainly, the World Cup was very positive not only for the volume, but we're able to mitigate that loss of strike, but for the brand building as well of those two brands that are very strong. And just to finish, we see that the consumer environment is recovering, it is at its lowest pace, but the trend is positive. So (00:47:13), Fernando, you can comment on the...

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Hi, Isabella. It's Fernando here. So to – your question was on CFG. So our cost performance for NAV was very strong this quarter. However, in the second half of the year, there are tailwinds and headwinds that impact our performance, among them lower sugar prices and the reductions of the minority trades on benefits (00:47:40). So when we consider there would be a lot of moving parts that make many of the cost projection difficult, we decided to give this guidance to make sure that people don't get it wrong. This is not the case for beer, that's why we're only looking at soft drinks and providing this kind of a range, so people don't get surprised by the preparations quarter-on-quarter.

Q - Isabella K. Simonato {BIO 16693071 <GO>}

Perfect. Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Isabella.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Thank you.

Operator

Your next question comes from Thiago Duarte with BTG. Please go ahead.

Q - Thiago Duarte {BIO 16541921 <GO>}

Hi. Hello, everyone. Hello, Bernardo. Hello, Fernando. I have two questions actually. The first one is trying to understand a little bit more the net revenue per hectoliter performance. I mean, the performance was very strong, I think, across the board, across all the divisions. And of course, unfortunately, you don't provide a breakdown by how net revenues and gross revenues perform for each of the division. But even if you look on a consolidated basis, we've been seeing the last few quarters the total deductions on gross revenues going down. So the net revenue per hectoliter has been growing more than gross revenues per hectoliter. This has been true in the last few quarters, and it was particularly true in this quarter. So understand there were some changes in the excise tax calculations, with the changes in PIS, COFINS and ICMS in Brazil. But when we look at the breakdown, the discounts are also going down. So I wanted to get a sense from you why is that happening, does it have something to do with what you've just said, Bernardo, which is related to the economic environment improving slowly, so you're not having to give more discount, has something to do with the World Cup. So it would be interesting to hear whether you think this trend where net revenue outperforms gross revenues could continue to be the case going forward will be interesting to hear.

And the second question is more on a longer term question and has also to do with the portfolio of the company. If you look at this quarter and several quarters behind us, when you talk a little bit about the performance of the brands, you got the core plus segment doing great, you got the premium segment doing great, everything growing double digits. But it has clearly been outperformed in the mainstream market. And even if you try to run the math, it looks like the mainstream market is not still picking up, your mainstream brands are not still picking up, which is not necessarily a problem as you've been saying, Bernardo, because it's more about building the portfolio.

But my question would be you have historically talked to us about a balanced growth between volumes and prices trying to find the right balance between volumes and prices for top line growth. When we look at the core plus, premium outperforming mainstream for so long, it looks like consumers are replacing one for another. So my question to you would be, should we start thinking more about a top line growth more driven by pricing rather than volumes? So that would be the second question. Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thiago, thanks for the question. Start from the – it's a very good one. Let's start from the net revenue price and just to always remind ourselves and you guys that our – I mean price strategy is to increase price in line with inflation, plus taxes over time because that affects the industry and then this is a strategy that we have been doing in a – I mean in longer period of time. But it's very important. We always like to highlight that our net revenue per hectoliter performance is the combination of price increase and revenue management initiatives. And operating with excellence positively affects the net revenue in two fronts. So again, everything that we are talking about of serving more point of sales, serving better, understanding better and if it is getting better, the leverage will activate demand in each point of sale, in each channel helps the volume, help other things, but helps the net revenue as well in two fronts. First, better managing of discounts in a win-win view or that we do with the trade. In a way, that's good for us and it's good for the trade as well. We only do that if you have better relationship with the point of sales, you can serve better and (00:52:22) their business. And then with that, yes, it's possible to manage better discounts.

That's a good way to grow net revenue per hectoliter because you're not affecting the consumer in the (00:52:35). So it's the first one. Second, make sure that the products, given the way that you serve the market, the way that we deal and serve the point of sales, we arrive in the market with the right consumer price, good for everyone. And why this is important not only for the industry, not only for the shares (00:53:03), it affects the net revenue as well because discounts (00:53:08). But most taxes are calculated on full price and not discounted price to consumers. So, a more efficient taxation is a positive consequence of excellence in revenue management. So then this affects net revenue per hectoliter as you have seen as well.

So, we believe that we still want to evolve in the initiatives linked to the revenue management discounts. This can be done through the use of algorithms, for instance, having talked about technology, tax sales, with you guys. All those things can be supportive for the grant of more effective discounts in a win-win proposition to the trade. So that's basically the first question.

Linked to the mainstream brands, we think that we have all the (00:54:09) segment. In the core segment, our mainstream brands are strong and our share is stable including the last year of information that we had (00:54:18). So, yes, it's a segment that's under pressure, the full mainstream. First, because of the premiums growing, that's not bad news, because when premium grows, better margins. And then you have boost in premium in the first step up of the – that's the core plus that – it's a very good segment to shape because it's a good segment that you offer. Great brands, I mean (00:54:46) offer for all of our brands and at the same time talks to the business model that we have in our brewers and so on. So, boosting the core plus and boosting premium, yes, the trade-up will happen that's a good driver of mix that helps net revenue per hectoliter, not price increase, net revenue per hectoliter given to the mix.

And because we know – so this is good. So what we think that happen and there are other factor that affect the mainstream segment recovery is that the disposable income in Brazil that really mix the sales segment that you don't have margins in other segment (00:55:28) volume. So if you get the profitability of the better segment in Brazil kind of be not meaningful, have a pressure of increase of the fair segment because of all disposable income and crisis that we have been having in Brazil in the last years. But the good news is that in all of countries that we know that we operate when the country starts to recover, the disposable income will start to, I mean, to be back at the value segments always shrink again. And the core segment grows again. And then if the brand in the core segments, I think in good shape and they are building a core plus based on those brands, so we'll talk about Brahma Extra (00:56:18) Brahma is growing, Brahma is strong. Skol Hops, the same thing. So this could be a positive effect for the core segment and for our brand in the future when disposable income comes.

So if you think and I think that Brazil will recover for that, I mean, long period of crisis, it's positive news for the core segment, for our brands. Positive news that premium is growing, good for us because better margins. It's positive news that we're shaping – successfully shaping the core plus segment. That's good for the margins, that's good for our brand as well. So that's why I think in terms of the portfolio approach, we have been doing that and working hard to give this full portfolio strong brands. I think that it's our assets that has and not only for the current year but for the future when Brazil becomes a better macroeconomic environment (00:57:14).

Q - Thiago Duarte {BIO 16541921 <GO>}

That was very helpful, Bernardo. Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Thiago.

Operator

And our last question today will come from Luca Cipiccia with Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good afternoon, Bernardo, Fernando. Thanks for the question. I have a couple of other ones on the price mix discussion that we're just having. First maybe on the short term while looking at the third quarter it seems to me you're going to get into that with a positive momentum across brands, some positive tailwinds in market share as well at least related to the comments you made about the industry growth in the second quarter. So I was hoping you could share maybe some more comments on how do you think pricing will play out? Is this going to be a fairly smooth process this time around, how do you see both the competitive environment from that perspective as well as consumer receptiveness in the tail end of the positive quarter that you had as you move into the third quarter?

And then secondly, still on pricing expanding maybe on your last answer. As you keep elevating the core – expanding the core plus, growing faster in premium, would you expect the rest of the market to follow or rather given the differences in portfolio breadth and reach, maybe further polarization or a drive for competitors to polarize more and pressure more at the lower end of the market where you don't necessarily participated since you're moving if not away from (00:58:53) still driving – trying to drive the mix and the brand portfolio higher. Maybe if you can comment additionally on these two points both short term and more in the medium term on price mix, that would be great.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Luca. Thanks for the question. So Luca, to the price, I mean, the short-term, so we normally increase pricing in Brazil during the third quarter, and this year will not be different. And again, we will do it and we implement in our annual price adjustment for our portfolio of brands throughout the third quarter, exactly as we did last year. That I think that's including good to compare volumes because it would be apple to – apples-to-apples, I mean, comp. That was not exactly what happened at 2017 against 2016. But this year 2017-2018 is apples-to-apples a quarter, including for you guys to have a better view in terms of the volume, and so on. So we will increase our – adjust the price because as we did last year. And then we adjust prices in line with inflation plus any tax offset over time. So these are the changes what we have been doing.

In terms of the long-term, I think that it's very important as leaders here in the market, in terms of the volume, in terms of the profitability, I mean even more. We have a responsibility to drive the industry in the right track. So there is a possibility of our business here in Brazil is not only, I mean, together have a better share (01:00:33) we're going in the right track. So that's why we like to work and to build brands in the core segment , in the core plus segment, in the premium segment not only because it could have a good side effect in terms of (01:00:51) better disposable income of our core brands, if they're strong and so on we'll grow because of the trade up we will capture margins. But because what differentiate our

category to some maybe others that basically people buy price because we have brands because we have an emotional link, because we have a really a clear that we have for quality of our products, the liquids and so on. And then you build something different that a consumer give values and pay – value and pay for that. So for us, I mean, we don't comment for the other companies would do, I mean, it's their job. What we will do, we are committed to build a much better beer capital. And we think that to sell value brands with no brands with no (01:01:35), I would say, paper, not against paper, but again something that's unbranded is not something good for the industry.

So we will always be committed for a healthy industry which means strong brands, which means core, core plus and we like to look up, not look down. And we have alternatives of this market affordability to tackle the affordability issue in a profitable way, the returnable, it's one, the service level is very important because if you are serving better parts, we will be able to assure that the consumer price would be fair and the impact of affordability as well.

When you have a focus in the pit stops, our franchise we're talking about RGBs, great brands, close to people because on gas stations and so on. So there are ways and there are more things to come in terms of smart affordability – to tackle the affordability issue in a smart way without compromising our commitment to build a better category of – beer category in Brazil.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Perfect. Thank you. But if I can squeeze just a very last one, just a small question on the Skol Hops initiative that you mentioned. I think you mentioned that you've rolled it out first in the north and I was curious if this type of approach is in any form unusual. I remember in the past, you commented on some of the benefits of the practices that we were incorporating from SABMiller on how you segment the market, are you further tuned the go-to market? So I was just curious if this type of stage rollout – is there anything to read there or there's any additional comments you can make?

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Yeah. I mean, the launch of Skol Hops in one area saying that we have been putting out a lot of our innovation pipeline for the many stage of the pipeline and the one that we have the idea as you (01:03:39) and so on. You have to think that the pilot is very, very important to learn, to learn how to launch better and so on. So that's why we've done the act in the northeast because I think that is a region that would be as fast because I mean our market chain in the northeast is below average of the (01:04:00). And then I said look, let's pilot Skol Hops there. It's doing well there. For sure it will be, I mean, even better in other places.

And you learn with that process. So when you saw all the initial information I have for the launch of Skol Hops, have been in a successful way getting people to understand the core plus segment and so on. And I think that with those learnings and so on, the pilot where we'll go national. I do not explain and for competitive reasons when, but we think that the second half would be a good moment to really roll out of the learnings of the pilot. That's the – it's not limited to any region, not just innovation process that we think that's the best for sure that the national launch would be even more successful with the learnings of the pilots in the initial tests.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Understood. Very clear. Thank you.

A - Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks. So, before we finish our call, I would like to close saying that we'll continue to put great efforts in our commercial initiatives in a consistent way, in a relentless way and really assure that we'll have a better business in the future that will help us to deliver healthy results across all the regions in which we operate. We are confident that we are well-positioned to drive long-term sustainable growth and shareholder value creation. Thank you. Have a great day and enjoy the rest of your day. Bye-bye.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.