Q3 2017 Earnings Call

Company Participants

- Bernardo Pinto Paiva, Chief Executive Officer
- Ricardo Rittes, Chief Financial and Investor Relations Officer

Other Participants

- Alexander Robarts, Analyst
- Antonio González, Analyst
- Isabella Simonato, Analyst
- Lauren Torres, Analyst
- Luca Cipiccia, Analyst
- Pedro Leduc, Analyst
- Robert Ottenstein, Analyst
- Tristan van Strien, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. We would like to welcome everyone to Ambev's Third Quarter of 2017 Results Conference Call. Today with us, we have Mr. Bernardo Paiva, CEO for Ambev; and Mr. Ricardo Rittes, 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 session. 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 the comparisons with the Q3 2016 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. Ricardo Rittes, CFO and Investor Relations Officer. Mr. Rittes, you may begin your conference

Ricardo Rittes {BIO 15184017 <GO>}

Hello, everyone. Thank you for joining our 2017 third quarter earnings call. I will guide you through our operational highlights of Brazil, CAC, LAS, and Canada, including our below-the-line items and cash flow. After that, Bernardo will give you more details about our performance in Brazil.

Starting with the main highlights of our results, in the third quarter, this quarter, we reached an inflection point after four quarters of consolidated EBITDA decline, driven by a solid performance in most of our markets. On a consolidated basis, top line was up 9.6% as volumes decline of 2% was more than offset by a net revenue per hectoliter growth of 11.7%. EBITDA was up 15.8%, reaching BRL 4.6 billion with an EBITDA margin expansion of 220 basis points to 40.1%.

Excluding the impact of the Brazilian Federal Tax Regularization Program, net profit was up BRL 3.2 billion which is 1.2% higher than the third quarter of 2016 as EBITDA organic growth and the reduction of net financial expenses were partially impacted by, first, a negative effect of currency translation driven by the appreciation of the Brazilian real; and second, a higher tax rate.

Cash flow from operating activities was BRL 4.6 billion. Year-to-date, cash flow from operating activities totaled BRL 9 billion comparing to BRL 4.4 billion in the same period of 2016, which is an increase of 103.4%.

Also, during this quarter, Brazil, our most important market, resumed growth. Our results in the country benefited from a strong performance from our beer business that delivered an EBITDA increase of 25.7% with a margin expansion of 540 basis points. Such result was partially impacted by a decline in CSD&NANC EBITDA. Bernardo will expand on this topic.

Now, looking at our operational results into more detail and starting with Brazil. Net revenue in Brazil was up 9.7% in the quarter and EBITDA totaled BRL 2.4 billion, with an EBITDA margin expansion of 260 basis points, reaching 39.4%.

Beer Brazil top line was up 9.6% as volumes decline of 5.4% was more than offset by a robust net revenue per hectoliter growth of 15.8%, driven by revenue management initiatives implemented during the quarter. Beer EBITDA grew by 25.7%, with an margin expansion of 540 basis points.

Brazil CSD&NANC top line was up 10.2%, benefited from a slightly higher volume, coupled with a net revenue per hectoliter growth of 9.6% due to our revenue management initiatives implemented in the second quarter of 2017 and a positive mix. CSD&NANC EBITDA declined by 33.3%, with a margin contraction of 1,460 basis points to 22.5%.

Brazil cash COGS was up 0.9% and, on a per-hectoliter basis, up 5%. Cash COGS per hectoliter growth was heavily impacted by the CSD&NANC businesses in which cash COGS per hectoliter increased by 26.3% due to, one, sugar, which represents around 25% of CSD&NANC costs. Sugar price increase of around 60% in the second half of 2016 is fully impacting us now. For reference, sugar price in the third quarter of 2017 was of BRL 0.192 per bushel versus BRL 0.126 per bushel in the third quarter of 2016. Second, inflation and third, a negative mix due to high weight of cans during this quarter.

This year's sugar price impact on our profitability is temporary and will decelerate as of the fourth quarter before becoming a positive driver to our COGS. For reference, cane price for October 2018 is around BRL 0.15 per bushel. Finally, we confirm our previous guidance that we expect cash COGS per hectoliter in Brazil to be flattish to low-single digit up in the second half of 2017.

Brazil cash SG&A was up 1.9% below inflation as a result of higher administrative expenses, partially offset by lower distribution and sales and marketing expenses, which benefited from cost savings in our non-working money and phasing and efficiency gains in our working money.

Moving now to our international operations. Our international operations delivered once again solid results, with the exception of Canada, where our performance was heavily affected by weak summer season that led to an industry decline of low single digit.

In CAC, on the other hand, our EBITDA increased by more than 30%, with another quarter of robust margin expansion, also benefiting from synergy resulting from integration of operation in Panama. And in LAS, we continue to have a great volume momentum, especially in Argentina, as a result of an improved macro environment, leading to top line and EBITDA growth of more than 20%.

Going to more detail of our operational results in each region, starting with Central America and the Caribbean. In the third quarter, net revenue in CAC increased by 7.5% and by 6.1% on a per hectoliter basis. EBITDA reached BRL 474 million, increasing organically by 31.6%, with a margin expansion of 840 basis points to 40.8%. In U.S. dollars, reported EBITDA grew more than 35%. Year-to-date, top line in CAC was up 6.6% and EBITDA up 22.7%, with margin expansion of 550 basis points, 38.3%.

Organic volumes were flattish in the third quarter impacted by a sever hurricane season. On a reported basis, volumes grew by 23.8%, benefiting from the recent swap of assets carried out with ABI and our operations in Panama. The integration with Panama continue as planned, with synergies and cost savings of more than $10 million captured year-to-date. Our business in the country is also delivering a great performance, with our portfolio growing at a fast pace, translating into market share gain.

I would also like to highlight that our results in CAC include non-forecasted expenses and write-offs made in connection with the hurricanes that affected the region and that they were fully recognized during this third quarter. As you know, in September, the region was heavily hit by hurricane. In Dominica, the hurricanes severely damaged most of the buildings of the island, which included our brewery. The island was also left without electricity and communication.

The Dominican Republic, our most important market in CAC, also suffered significant impact. While none of our employees has suffered serious injuries, we work together with authorities to support the local communities with an emergency relief using our distribution network and donating bottled water, juices, milk and construction materials.

Going forward, we are resolved (11:02) to initiate the reconstruction of our facility in Dominica to restart our business in the island as soon as possible. Along with that, we will keep pursuing significant top line and EBITDA margin opportunity in CAC and remain very enthusiastic with the development of our business in the region, especially in Panama.

In Latin America South, top line was up 21.3% in the quarter with net revenue per hectoliter growth of 16.1%. EBITDA was up 22.8% in the quarter, reaching BRL 1.1 billion with an EBITDA margin expansion of 60 basis point to 45.3%. Volumes grew 4.5% in the quarter as the softness of the CSD&NANC in the region was more than offset by a strong performance from, one, beer volumes in Argentina, that grew double digits, supported by the overall improvement in macroeconomic environment and favorable weather; second, Paraguay, due to the continued success of our 340 ml returnable glass bottle strategy; and third, our high end portfolio, that is delivering strong performance led by our global brands, they are growing double digits year to date.

I would like also to emphasize that we are very pleased that our volume performance this quarter enabled us to achieve our all-time high volume mark for beer in the third quarter in LAS. Year-to-date, top line in LAS grew by 27.7% and EBITDA was up 24.2% with a margin contraction of 120 basis points to 42.7%. Going forward, we're confident in our ability to continue to deliver solid results in the region being particularly excited with the recovery of beer volumes in Argentina.

Turning now to Canada, we delivered in the third quarter BRL 599 million of EBITDA, 8.3% lower than in the third quarter of 2016 with an EBITDA margin compression of 180 basis points to 34.6%. Top line declined by 3.6% with net revenue per hectoliter declining by 0.7%, primarily impacted by negative mix. Volumes were down 2.9% in the quarter, driven by the industry contraction that was heavily impacted by a weak summer season.

In spite of the challenging environment, we maintained our great market share momentum as our main brands performed particularly well led by: one, Bud Light, that remained as the fastest growing brand in Canada, coupled with Bud Light Radler, a strong brand extension meant for a non-traditional beer occasion; and second, Stella Artois, that is steadily growing.

Year-to-date, top line in Canada was flattish, while EBITDA increased by 1.8% with margin expansion of 70 basis points to 33.5%. Going forward, we remain committed to strive towards an improved performance in the country, supported by our great market share momentum and by our portfolio of brands.

Now, back to consolidated figures; other operating income totaled BRL 254 million in the third quarter, compared to BRL 342 million in the same period of 2016, mainly explained by government grants related to State VAT long-term tax incentives that were down year-over-year due to VAT Government Grants Agreements that have expired by the end of 2016.

And now moving below, EBITDA. In the third quarter, net financial results totaled an expense of BRL 675 million, including exceptional finance expense of BRL 141 million paid in connection with the Brazilian Federal Tax Regularization Program. Excluding such exceptional expense net financial results totaled an expense of BRL 534 million versus an expense of BRL 723 million in the same period of last year, which is a decline of 26%.

Going to more details, main items in the financial expense in the quarter were: first, interest income of BRL 107 million, driven by our cash balance, essentially in Brazilian reais, U.S. dollars and Canadian dollars; second, interest expenses of BRL 362 million, that includes a non-cash accrual of BRL 145 million related to the put option associated with our investment in the Dominican Republic; third, BRL 33 million of losses on derivative instruments, mainly driven by the carry cost of our FX hedges, primarily linked to our COGS exposure in Brazil and Argentina. Losses on derivative instruments declined by almost 90%, when compared with the same period of 2016, as low interest rates (16:19) in Brazil and positive results from equity swaps are contributing for the reduction of carry costs.

Fourth, losses on non-derivative instrument of BRL 51 million, mainly related to FX translation; fifth, taxes on financial transactions in the amount of BRL 43 million; sixth, BRL 152 million of other financial expenses, mainly driven by interest on contingency.

The weighted nominal tax rate in the quarter was 27.1%, while reported effective tax rate was 95.3%. Such increase results from the fact that as announced on September 29, we joined the Brazilian Federal Tax Regularization Program, committing to pay some tax contingencies that were under dispute, including contingencies related to corporate income tax and social contribution on profit. The amount of BRL 958 million will be paid in 2017 and the remaining amount 145 monthly installment starting January 2018, plus the interest.

Adjusted by the impact of the regularization program, the effective tax rate was minus 6%, driven by higher interest on shareholders' equity benefit.

CapEx total BRL 728 million, 19.3% lower than that in the same period of 2016. While year-to-date, CapEx declined by 26.2%, reaching BRL 2 billion. Finally, during this year, we announced approximately BRL 3.6 billion for equityholders and dividend.

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

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Ricardo. Hello, everyone. The third quarter marked an important turn with great results in most of the countries we operate. I will concentrate my comments in Brazil. Our largest market is back on track and will be able to return to a pattern of growth. Especially for Beer Brazil, as mentioned by Ricardo, our revenue management initiatives implemented in the quarter contributed to a healthy increase in top line that coupled with improved quarter performance, resulted in EBITDA growth of 25.7% and a significant margin expansion.

Beer top line was up, supported by a solid net revenue per hecto (sic) [hectoliter] (19:01) that grew 15.8%, while volumes presented expected deceleration declining by 5.4%, pressured by, one, the beer industry that in spite of gradual recovery is still falling around 1% versus last year, according to Nielsen; second, pricing, as you are aware, this year, we carried out our annual price adjustment earlier, increasing prices in the third quarter when compared to the fourth quarter of last year, resulting in a different comparable base.

And third, there was a lag between our implementation of price initiatives and those of the industry. Year-to-date, volumes declined 1.1%, outperforming the industry that declined around 2% according to Nielsen. In this context, during this quarter, we continue to leverage our commercial platform to capture all the opportunities that may arise going forward.

Start with elevate the core, we concluded an important step of the implementation for our packaging innovation and that I've been emphasizing in our calls (20:15). New Visual Brand Identity for both Skol and Brahma and improved secondary package can now be seen in all regions of Brazil.

Focus specifically about Brahma, our classic lager, we are very proud that the whole Brahma family is revamped and is standing out on the shelves. Surveys conducted with consumers demonstrated that Brahma's new VBI increased consumers purchase intention by double digits and helped on maintaining the brand's health in a positive trend.

Brahma also launched two relevant campaigns in the quarter. The first one is (21:00) to celebrate and create awareness to its renewed Visual Brand Identity. The second is (21:08), as there is an increasing interest in beer, we've invited our consumers to ask any question about beer such as ingredients, production process, expires and so on.

During four weeks, members of our team, including 30 brew masters, recorded more than 1,000 live videos and answered the consumers' doubts through the social media. The campaign generated amazing social listing (21:36) results with a high ratio of positive comments and great engagement from consumers. (21:44) Brahma family, Brahma Extra launched a special edition of Märzen Lager for the Oktoberfest, contributing to another quarter of double digit growth of our core plus portfolio.

Talking now about Skol, our easy-drinking lager, summer, the most important season for beer, will start soon. During summer, people are more open to connect with for others (22:09) and to boost this behavior, Skol launched the BEER (22:13) campaign. The slogan, Desce Redondo that has been followed the brand for 20 years is back, supporting the underlying message that round comments (22:24) brings people together while square comments (22:27) separate them. The campaign will be on air for October until Carnival, extending to the summer season with (22:36) activation that includes many different TV ads, new trade materials and innovative digital business.

Now, talking about Antarctica, the brand kept engaging with its target consumers with innovative formats that transcend regular advertising. Season 2016 (22:56), through a consistent web series that blends fiction and reality, Antarctica reached its highest ad recall level and won three best (23:09) Brazil.

Finally, I would like to highlight that Skol, Brahma and Antarctica campaigns, that I just mentioned, are good examples that we're evolving in our marketing strategy, exploring new frontiers of brand building, with external (23:25) use of non-traditional media to interact with our consumers.

Now, turning to premium. Premiumization is a trend that can be expected to continue to foster the beer category. Once again, our high-end brands delivered strong results. Following the implementation of the premium portfolio price adjustment in the beginning of the quarter, the volume growth of our premium portfolio presented the expected deceleration when compared with the previous quarters, but is still performing particularly well.

Our three global brands, Budweiser, Stella, and Corona, continue to ramp up and, combined, increased by double digits in the quarter. Budweiser kept on reinforcing its values of freedom and authenticity. After the successful campaign with (24:19), Budweiser aired another meaningful campaign featuring Rodrigo Santoro, a well-known actor; and Rincon Sapiência, a female singer.

Stella Artois continued to further consolidate its position as the most sophisticated lager beer connecting (24:37) platform, while Corona kept on growing volumes and exploring [Technical Difficulty] (24:42) that define it as the coolest premium beer brand.

Turning to near beer, Skol Beats Senses continue to enhance the equity of its mother brand and to bond with its core target consumers delivering breakthrough experience, such as its Skol Beats Tower, an unique festival that took place in a building with four floors and eight different parties.

Moving to occasion, and starting with in home, an important initiative to shape in home consumption has been the steady evolution of our market programs designed to all sizes of stores in the off-trade channel. Such initiative has the purpose to elevate the beer category in the off-trade, improving consumers shop experience.

Further, we continued the implementation of our 300 ml returnable glass bottle strategy. Our minis are growing year-to-date with an increasing popularity. This is an important step to bring affordability to consumers with a higher profitability.

Out of home, going out with friends to enjoy beer is part of the Brazilian culture. So we continue to step up our service level across the country through different initiatives. The use of new technology is playing an important role. We've been developing sales algorithms in our B2B platform to improve our sales process, strengthen our relationship with the customers and, as a consequence, enhance consumer experience at the bar.

Now I'd like to move to CSD&NANC; as you know, the CSD industry is even more challenged than the beer industry when hit by pressure on disposable income and discretionary spending, as consumers tend to trade down to powder juices or tap water. In this environment, we delivered slightly positive volumes, while the industry declined mid-single digits. Nonetheless, our results were temporarily affected by increased costs and investments ahead of the curve. We are not pleased with our CSD operational results this quarter, but we are confident that we are taking the right measures to deliver a stronger performance and we will push ourselves even further to resume growth.

Finally, this quarter was also marked by an important event. We are very, very proud that for the first time, Ambev was the brewery that received the highest number of medals in the World Beer Awards, a competition with the participation of the best breweries in the world. We received in total 27 medals and is an important recognition that we have the greatest beers in the worldwide. As we continue to brew with passion and expertise from seed-to-seed taking care of all the stages to deliver high quality beers to our consumers. (27:50) beer is part of our DNA.

In summary, we had an important turn this quarter and the worst is behind us. For the rest of the year, we expect to continue benefiting from a healthy top line and reduced cost in Brazil, posting EBITDA growth and margin recovery. Further, beer volumes, will also benefit to the early timing of implementation of our annual price adjustment. But (28:21) along with the consolidation for our commercial platforms and an improved industry perspective should also support us to deliver strong operational results.

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

Q&A

Operator

We will now begin the question-and-answer session. The first question comes from Isabella Simonato with Bank of America Merrill Lynch. Please go ahead.

Q - Isabella Simonato {BIO 16693071 <GO>}

Good afternoon, Bernardo (29:12). My question is on beer volumes and the decline that we saw was a little bit stronger than what we thought. If you could give us more details on per channel or segment or even packaging, how did you see volume declining accordingly?

And also talking about industry volumes, did you see any gradual evolution throughout the quarter? When we look on a monthly – run a monthly performance, is there any sign that – or any month that we already saw positive volume for the industry or this is still not happening? Thank you.

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

Thanks, Isabella. Thanks for the question. I think the beer industry has not reached its inflection point. Just a quick recall for the year, in the first half of the year, the industry fell around 2.4% according to Nielsen. In the third quarter, the industry continued to fall less than in the first half of the year. That's good news. So it's evolving, but still negative.

However, with the softer industry would explain what explained the minus 5.4%. Basically, you have two things; our price policies, not much (30:23) increase price in the second half of the year, normally in the third quarter, but last year, we did it in the fourth quarter. This year, price was taken again, as we always do, in the third quarter. You have a hard comp in this quarter.

The second, there is a lag between our implementation of price initiatives and those of the industry, impacting volumes in the short term. So volumes decline in the third quarter is strongly, strongly related to the early timing of the implementation of the price initiatives. On the other hand, such early time will actually benefit in the next quarter, the current one, the fourth one. This resulted in a shift in volumes from September through October.

All-in-all that we are very confident about our future and our top line initiatives. Even after the price increase in the third quarter, year-to-date volumes are declining 1.1% while the industry is declining around 2%, according to Nielsen. So we are outperforming beer (31:25) industry.

Basically, Isabella, I would say, we have to think that the recovery of the industry, given that the disposable income is in the right path, we have cost (31:41) quarter by quarter but the most important things that we are working in the platforms that you know that we really have been investing in a consistent way, executing these platforms on a consistent way to assure that we will continue to outperform the industry to the remaining of the year – remaining part of the year.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you.

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

Thank you.

Operator

The next question comes from Luca Cipiccia with Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Good morning. Thanks for taking my question. I have two quick ones. One, again on Beer Brazil and on the discussion about pricing. How early – if you can share, how early in the quarter was the price increase? In a sense that, we understand it was different last year, but if you were to compare it to what you would have normally done before 2016, did it come towards the end of the quarter or is it more fully represented even (32:40) entire quarter?

And that's still contextualized a little bit the gap between your pricing and competitors. It seems that from the volume divergence, the third quarter may have incorporated fully that price difference and also just to understand how much of an incremental impact we will see in the fourth quarter. So that will the first question.

And then secondly, quickly on the soft drinks side of things, Bernardo, you mentioned, you are not happy with the performance and I think if we look at the numbers, especially at the EBITDA, I think it's an understandable statement. But then if I was to look at volumes only and even pricing, it seems that you've done better than the industry. Even Coca-Cola, yesterday, I think, commented on high single digit volume decline. So I'm just trying to maybe understand a little better your comment. I mean, is it anything to do with your execution or it's rather a comment more about the industry overall and the headwinds that you're seeing on the COGS front, in particular? That would be the two questions.

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

So, Luca, thanks for the question again. Related to the price adjustment that is done in the third quarter, we've done that during the third quarter, so yes, I would expect some additional benefit in the fourth quarter that you take the full price increase for the three months.

Specifically, the CSD part, I think (34:10) that this quarter, yes, there, our volumes are slightly up, while the industry declined 5.5% (34:16). In the year-to-date, our volumes are declining 4.5% while the industry is around 8%. So, yes, we are gaining share and we are very pleased about that. But as you saw, specifically in this quarter, our EBITDA was not good. We know that there are reasons; one, first – and it's basically the most important one is that the cash COGS that increased 26.3%. I mean almost fully – that almost fully explains the EBITDA that we had a decline. Such increase is driven by the negative mix – slight negative mix due to the higher rate of cans and mainly to the sugar prices that grew around 60% year-over-year.

I think in the second, SG&A expense (35:03) sales and marketing expenditures; and third, the reduction of the net operating – net other operating income (35:12) in the fourth quarter 2016. So I think that our – I mean our job of what we are doing in the market, we are happy it's evolving (35:23) even more. I think that Pepsi brands are performing well, but we like – I mean, you know us. We know the gaps and we would like to outperform the industry and grow EBITDA.

So that's why going forward, we are confident that we will be able to resume growth in the CSD&NANC business. And among other factors, we have visibility that the COGS impact is temporary and will decelerate. So we're going to continue to gain share and deliver the profitability that's why (35:57) we are working for every day.

Q - Luca Cipiccia {BIO 6914452 <GO>}

And just a quick one. On the SG&A front, on the marketing investment, it was been an element of you having anticipated something, some of the – what you had budgeted for the year, meaning that in the fourth quarter that variable will be less of a drag or is that the right way to think about it?

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi. Luca, this is Ricardo. Thank you for your question. Yes, you're right. I mean, there's some phasing also in the SG&A on the soft drinks business, yes. But when you look at the comparable base for the fourth quarter, last year, it was very small number. So again, there is some phasing. We brought some expenses from the fourth quarter to the third quarter in the soft drinks business specifically, yeah.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Thank you. Thank you.

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

Thank you, Luca.

Operator

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

Q - Antonio González

Hi. Good morning, Bernardo and Ricardo. Thank you for taking my question. I wanted to ask about margins in beer in Brazil. You mentioned, Ricardo, in your prepared remarks that you still expect cash COGS per hectoliter to comply with the guidance that you've originally shared for the second semester. Yet obviously, in this quarter, COGS per hectoliter was up 5%. So I was just wondering if you can help us understand what are the elements that help lower that figure in the fourth quarter so that you get to the guidance. (37:36) hedges or is there any other element that it helps sequentially from the third to fourth quarter?

And then, just secondly, when I see your SG&A expenses in Beer Brazil or in Brazil overall, obviously, you guys are doing a great job in Brazil overall with that 2% growth or so, year-on-year. I wanted to ask have you seen (38:02) some sequential improvement in market share given the anticipated pricing that you just discussed. And can you maintain these low levels of SG&A growth going forward? I know there's no specific guidance for this number but I just wanted to understand qualitatively, how do you think about operating leverage on the way of – as you recover your margins – volumes? Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Antonio, thank you very much for your questions. So let me start with the margins one. The Brazil cash COGS per hectoliter was impacted by the CSD&NANC business as Bernardo was just explaining. And as we have a hedging policy, we also have visibility over this number going forward.

Given the volatility of this specific line over the quarters of this year that's the reason why we decided to provide a guidance on the cash COGS per hectoliter for the year. But the main fact, bringing a little bit higher to 5%, the cash COGS per hectoliter was the CSD&NANC cash COGS per hectoliter that increased 26.3%, as Bernardo just mentioned. As we have like a decline on that and on top of that, as we have already visibility over the FX evolution given the hedging policy, like we said in the beginning of the year, we separated the year in two semester. But we saw the first semester much tougher than the second – the first quarter much tougher than the second quarter and now the third quarter, an improvement and we can continue to see that so that we remain very confident and committed to the guidance that we provided in the beginning of the year.

Now, going to the SG&A, qualitatively, I think what we can say is that essentially the business model of the company is translating non-working money into working money and being more efficient every day into making sure that the money that we spend is money that the consumers can see that they'll be willing to pay for any (40:12).

So, overall, we are happy with the performance of the sales and marketing and we cannot forget that the investment that we're making on package renovation that impacted our COGS. They also represent an investment behind our brands. So liquids and package are the main touch points with consumers.

Q - Antonio González

All right. Thank you so much for Ricardo (40:42).

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

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

Thanks, Antonio.

Operator

The next question comes from Pedro Leduc with JPMorgan. Please go ahead.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you. Good morning, everybody. A further question on Brazil beer still. Could you, Bernardo, elaborate a little more what you meant behind the phasing of the price increases of this industry and also the earlier comments that you had about dislocation of volumes? Correct me if I'm wrong, would it be meaning that you're already growing more or less with the industry so far in October and the fourth quarter? That will be the first one.

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

Thanks, Pedro, for the question. I think that in terms of the phasing of the volumes that I said, I mean, every time that we increase prices, there's a natural load (41:25). So if you increase price like last year in the beginning of October and had (41:26). And basically not having this exactly in the fourth quarter but in the third quarter, this is kind of the shift of the volume that always happen.

And then linking to the question in terms of the price increase, we always know and it's always like that that every quarter that we increase price, our volumes tends to be below the industry because, I mean, the other companies, they tend to lag the implementation of this price increase in the market. So it's expected, but the good news is that for the full year, we are above the industry. So our share is doing well. And we are very confident in (42:24) and all the platforms that we have been implementing in the market (42:31) packaging to Antonio question – before Antonio's question before is an important touch point. I mean, these people – I mean, having the (42:40) brands, so we are confident to end the year in the right path in terms of volume, brand and margin expansion and EBITDA.

Q - Pedro Leduc {BIO 16665775 <GO>}

And if you can comment, has the catch-up already happened towards the end of the quarter, meaning 4Q, maybe more in line with industry?

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

I could not comment about that. But I would say that we – again, we are confident that the fourth quarter, you will be – we end the year in the right path, I would say.

Q - Pedro Leduc {BIO 16665775 <GO>}

Thank you. And one quick one for Ricardo, the tax settlement regularization program, there, BRL 1 billion will be paid in 2017. Will that by any chance be removed from what you had planned as a dividend or you're seeing good enough cash flow to keep the dividend plan despite this disbursement?

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you for your question, Pedro. Just as a recap, we distributed dividends and interest of our own capital pretty much in the amount of the cash flow of the year. As we announced and as I just said in my speech, cash flow year-to-date for the year is more than a 100% higher than that of the previous year. So what's then implicit in there is that there is no constraints in terms of the dividend that the company would be able to pay by the tax regularization program.

Q - Pedro Leduc {BIO 16665775 <GO>}

Great. Thank you very much. Talk to you next year.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

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

Thank you.

Operator

The next question comes from Lauren Torres with UBS. Please go ahead.

Q - Lauren Torres {BIO 7323680 <GO>}

Hi and good afternoon. Totally understand that the industry trends are still negative but the rate of decline is lessening. But curious to get your perspective if you're seeing any changes with respect to the packages or channels to show you that directionally the confidence is coming back, the spending levels are improving. Just to get a better sense going into 2018 that directionally, there are beginning of, I guess, movements of better consumption trends.

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

Lauren, thanks for the question. (44:55) I mean, our plans are linked (44:58) to grow in both channels and more than ever to a consumer-centric and service-oriented approach. Actually, the focus is on the consumer. And we see the channel as a way to (45:14). So the in-home occasion, specifically, so we understand that the in-home is the new frontier for us, while really making important steps and bringing better shopper experience in the off-trade channel. In the off-trade channel, in many types, it's not only the big ones that are considered important, but the smaller formats that links to the sales excellence (45:39) that you are – I mean, we're working in a daily basis to step up our service level in all chains.

So, I think that the focus on the off-trade will continue to be a big change but with a really, really strong push as well to serve better every customer in Brazil and knowing that people are buying more in the smaller accounts or in the small point-of-sales. So we are improving out there experience into many, many types of off-trade.

And in the out-of-home, that's a big, I mean fortress for us. We still think that we have opportunity to increase, to reach more point-of-sales in a better way so we can continue to expand our volume in this channel. So, sometimes (46:38) of the off-trade, the prices are lower but you have to always bear in mind that the logistics cost (46:47) are lower as well. We have a higher weight of premium brands, a smaller CapEx and in the end, both channels are very, very profitable.

Q - Lauren Torres {BIO 7323680 <GO>}

And (46:58) are you seeing RGB penetration in supermarkets changing? I guess I'm just thinking on a quarter-over-quarter basis, more relevant or less or the same on a quarter-over-quarter basis?

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

The RGB and it's not new for you (47:14) for you, Lauren, and you know that's kind of been implementing in the off-trade channel in not only the big chains, but smaller chains as well. And those still, I mean, continue to evolve. So basically, the year-to-date, the 300 ml returnable glass bottles, volumes are growing double-digits, so ahead of the industry. And specifically, the third quarter, it had presented an expected deceleration due to the early time of the price increase that we've done.

So – but it's growing. And people love (47:49) because, I mean, it's a great brand, it's a fresher liquid including. It's good for the environment, it's good for their pockets as well with very good margins for us. So, we'll continue to be bullish in our RGB strategy.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Great. Thank you.

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

Thank you.

Operator

The next question comes from Robert Ottenstein with Evercore ISI. Please go ahead.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. Two questions. When you talk about confidence and sustainable growth now going forward in Brazil, is that volume growth or top line growth, please? And what gives you – if it is volume growth, what – talk about a little bit more in terms of what gives you that confidence.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Robert. Thank you very much for your question. This is Ricardo. So, I mean, it's a combination of both. If you look at the Brazilian industry, I mean, the Brazilian industry hasn't grown since 2014. That was the last time the Brazilian beer industry has grown. Then, in 2015, it went down by roughly 1.8%; 2016, on average, according to Nielsen, 5.5%.

And what we have seen in the last couple of quarters, that's five quarters more or less, is an improvement. And that's the explanation also of the expression we are cautiously optimistic, because in spite of being (49:14) decline, it's a lower decline quarter after quarter after quarter and that's the story of this year as well.

So in the long term, we're super bullish and confident and excited with the Brazilian beer industry. And what we've seen is that, in the short term, we're somehow getting back to the historical growth that we have seen in the last 10, 15 years.

That's essentially a function of, one, the demographics; number two, of the per capita or the things that we can do in the disposable re-income (49:50) and et cetera; and innovation of the overall industry as a whole. So, for example, the returnable glass bottles that Bernardo just mentioned is an affordable and an innovation in terms of package that allows more people into the category.

And in terms of profitability, we see some of the headwinds that we have had in the last couple of quarters dissipating so that we're excited both in terms of volume and also in terms of bottom line.

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

And I think that the plans that have been put in place, I mean, in the last years in a consistent way, I mean, the platforms that Ricardo explained to you, they have an impact in the industry as a whole. So if you think about (50:29), I mean, talk about stronger brands and we have stronger, better campaigns, better packaging. That makes a huge difference in the tables of the bars in Brazil, stronger key selling moments.

Just remember, this year, we've done 42 carnivals, huge carnivals in Brazil. Last year, it was five, previous year, one or two. So we can activate demand as well in the plans that we're doing. So core, they are very important on that despite the obsession of this elevated core is the first and most important platform that we have.

(51:05) are changing. Consumers are understanding them even better (51:10). The kind of insight that we have from our marketing team and sales team, they're able to really ensure that the portfolio of premium brands are even stronger to get on the (51:21) and the arising (51:23) getting there.

And in the end, all the long-term initiatives that we have put in place to really boost our service level in every part – in every place in Brazil from the state of Acre to the state of Rio Grande do Sul, even going – I mean, (51:40) but going there and activating the demand in every bar, in every off-trade store in the country. Again, it impacts the volume and impacts the industry as well. So for both, I would say, (51:59), the one that Ricardo said, the macro one and the internal one that we're doing, we are confident that Brazil and the industry will be back on track.

Q - Robert Ottenstein {BIO 1498660 <GO>}

And if I can ask a follow-up question. You now have a competitor that is very different than anything you've had before and the good news is they pay their taxes. The other side of it though is that they are good, patient, brand builders. They know how to build international premium. They – apparently, from what I hear from our contacts, they did a terrific job with Rock in Rio and gained a lot of share from that not just on the delay on the price increase but they did get a great job of Rock in Rio, gaining a significant share at least in September in Rio, while at the same time, you're – it looks like you're backing off a little bit on some of the SG&A. So perhaps you could kind of frame how maybe you're shifting your strategic plans to deal with very different type of competitor and give us some insurance that you're able to deal with somebody who has a very different strategy than the kind of competitors that you've worked with in the past.

A - Ricardo Rittes {BIO 15184017 <GO>}

Robert, I'm going to start the answer and then of course Bernardo will finish. Just started by saying that the Brazilian market is and has been an extremely competitive market and we expect a lot of competition but we are also very cognizant of the strength of our portfolio. And we have been building this portfolio over time, not over night.

And one thing just that I would disagree with when you said like a constriction in terms of SG&A. We never save any money in terms of working money. We just try to be more efficient and get more benefit out of the resource available. That's what is within the culture of the organization.

So again, when we look to the outside and compare ourselves to our competition in the last 15 years or 20 years, I think the Brazilian market has been extremely competitive. If you look back in the 1990s, we used to have a beer brand which I'm not going to say the name, which had more than 20% market share, just one brand was leading some of the capitals of Brazil. But again, but our portfolio approach has proved to be over time a winning one and getting close to our consumers I think is extremely important in this moment in which there's shift in the competition. Now, Bernardo.

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

I think, Robert, I mean, everyone that come here to play the marketplace, building brands and not using the leverage, I would say, of only price. And it's good for the industry because it elevate (55:13) beer. So everything that's good for in terms of the brands of beers is good for the category and it's good, I mean, for our business because it elevates beer.

I think that we've been working a lot in these platforms, I mean, that are consumer-centric big time and service-oriented to the parts (55:32) that we serve in a very consistent way. So the packages that are pouring in the market, the depreciation of our easy-drinking lager that's Skol and the classic lager that's Brahma, the evolution of our social media platform. I mean, we've different type of campaigns not only above-the-line campaign, but using the experiential moments that are creating through the events, through the (56:00) and boosting these via digital media.

All of those things you see that we've been working on these for a long time and we've started to reap the benefits. We know the Brazilian market, but we know other markets as well. I've been working eight years outside Brazil, I mean U.S., Canada, LAS, our head of marketing that's Paula. She was Head of Insights of ABI, so she knows all the markets. Our Head of Sales worked in the U.S., Canada as well.

So I think that – I would say that Ambev – I mean, lots of people move out from Ambev, great people, but people are coming back. When they come back, they come back of the knowledge of other markets. So we didn't wait any – the arrival of any other company here to do what should be done, and as such, we're reaping the benefits of this consistent implementation of the top line platforms that I mention in every call.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Thank you very much.

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

Thank you, Robert.

Operator

The next question comes from Tristan van Strien with Redburn Partners. Please go ahead.

Q - Tristan van Strien {BIO 20270393 <GO>}

Hi. Good afternoon, guys. I have two questions. I may have missed it on the first one. I just wanted to get a feeling of your 16% pricing that you have in Brazil. One level, there was mixed. Were you able, with your premium brand growth, be able to offset the higher margin, but I guess top line dilutive RGBs that you had. And how should we think about that going forward? And also may be related to that, have you been able to increase your own distribution in the quarter as well?

And then, the second question is about Panama. You're very excited about it. Obviously, you've lost the Miller portfolio there, I believe that has come back to Molson Coors, which was a very big driver of the premium side of that country. Have you been able to offset that? Have you been able to get – gain that premium volume back and which brands are driving the premium side in Panama?

A - Ricardo Rittes {BIO 15184017 <GO>}

Well, first of all, thank you for your question, Tristan. I'm going to start with the 15.8%, just as we do every time that we get a question about pricing. We are very disciplined and consistent in terms of pricing strategy which is the best of pricing (58:26). And together with that, when you look on our quarter-by-quarter basis, sometimes you have volatility to the downside or to the upside. This quarter, we have more towards the upside as opposed to the downside.

What impacts is volatility. For example, the timing of a price increase, immediately after a price increase, as we have disclosed in our 20-F, for example, for last year, we had out of the gross profit roughly 48% of that is taxes. When you do a price increase and have timing in terms of the changing of the basis for taxes for some of the states specifically. What you tend to have also is the benefit in the top line. I think people have seen that before so we have a little volatility beyond what is the true price increase.

On top of that specifically on soft drinks and I'm going to highlight, just for soft drinks, we had a mix impact that benefited, on one side, top line towards the upside and, on the other hand, also impacted COGS negatively. So specifically we mentioned that the mix of cans, specifically in soft drinks, was higher. Cans costs more, but it also costs more to produce and then you have a little bit of impact there.

But besides that, I think the price adjustment was in line with our strategy. And usually, (59:57) again, the price increase translates into higher increase in net revenue for the shorter term. So, I think that's the short term of that.

In terms of the competitor specifically that you mentioned, we don't comment on any specific competitor or strategy, or anything specific. I just – I'm going to repeat myself a little bit in terms of the answer that we just gave. The Brazil market is extremely competitive, but we believe we have the right portfolio and all the tools in order to compete in this market, specifically.

Q - Tristan van Strien {BIO 20270393 <GO>}

Well, the second was more about Panama. You took over that business, but the biggest premium brand that was driving the growth for the last three years was Miller Lite. Now, you've lost that but you're very excited about Panama. So, my question is more around what premium brands are you driving to replace that lost volume in Panama?

A - Ricardo Rittes {BIO 15184017 <GO>}

So, Panama, like we said in my speech, Panama is booming. And I think specifically a brand that is growing the fastest there is Atlas Golden Light and that brand is a brand that has been gaining market share. We, as a company, in spite of losing the Miller family in terms of brand, we are – we're gaining a lot of market share in that country in the last 12 months, partly because of the great job that our colleagues (01:01:24) have been doing, but also because of the implementation of the full portfolio (01:01:28) and some of our portfolio approach techniques that we do whenever we get to a specific account (01:01:34). So we are very pleased with the results in Panama so far.

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

And for the premium brands there, Corona is growing a lot and its amazing brand. It's very cool as you know, everywhere it's (01:01:45) as well, and Stella Artois is in the same path. So not only our core brands are doing pretty well, the execution in the market that was there, I mean, kind of one month ago for – I mean, if you visit (01:01:54) the market everywhere, it's amazing how we are stepping up the execution and the portfolio is strong, so the momentum is really good there.

Q - Tristan van Strien {BIO 20270393 <GO>}

Brilliant (01:02:07). Thank you, guys.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

Operator

We have time for just one more question and that question will come from Alex Robarts of Citi. Please go ahead.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thanks for taking the question. I appreciate it. I was keen really just to go back to the cash COGS trend. It seemed to be cropping up in several areas, including Canada. So the first part of the COGS question is on Canada. We see on an organic basis that they were up, cash COGS per hectoliter, about 5%, but year-to-date trend, flat. So just the first question is, was there a step-up in one part or several parts of your – the COGS structure there in Canada that perhaps you can comment on in the seasonally strong quarter up there?

And then – and the second part of the COGS question is more generally at the Ambev level, group level, aluminum had hit a five-year high recently, kind of 25% I guess up year-to-date, year-on-year. What percentage of your aluminum costs today represent this uptick and how are you looking at this important input cost as you set your commodity hedge into next year? That would be the question with two parts. Thanks a lot.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you very much for your question, Alex. And starting specifically with Canada. Again, Canada, I think most of the COGS impact that you have is due to mix. When you look specifically, when you look like the full year, again, taking out the volatility of a weak summer season like we had recently, Canada was flattish in terms of top line year-to-date, while EBITDA increased by 1.8% with a margin expansion of 70 basis points, totaling 2.3% (01:04:27).

So, this year we had margin expansion in Canada and top line flattish, so we had operational leverage there. And, again, the Canadian market is a very sophisticated one. We just had a board meeting there like a couple of weeks ago. We visit not only things like (01:04:43) – we visit even the West Coast of Canada, very well-developed market. And what we do being a consumer-centric organization, we provide consumers what they want even if that represented more expensive products and products that provide us with a better margin that's somehow reflected in our EBITDA increase year-to-date.

When you look at the COGS more in general and I'll go into the main countries and let's potentially even talk about Brazil, specifically, I think Brazil is very important. You're absolutely right. I mean, when you look the aluminum prices today, they were – they are much higher than the aluminum prices that we had one year ago. And this will impact us sometime for now. Typically, (01:05:33) the time the react for the company is between 10 to 14 months.

The good news is that on the other side, and Brazil being an exporter of commodities, typically when commodities go up, the Brazilian real goes down – I mean, Brazil real appreciates sort of the number, the Brazilian real per dollar goes down, which is great news. So what you're comparing, aluminum being an extremely important commodity in terms of exposure for us, going up, Brazilian real going down. And the way we look at this specific input cost is aluminum in reais, so one somehow can compensate the other.

And also, when you have one specific commodity that's moving up, I think our hedging policy works really well, because that's exactly when you can get the benefit of, for example, shift in mix, so can incentivize people through like price differentiation. If you want an aluminum can, you're going to have to pay a little bit more because aluminum can is more expensive going forward and et cetera, incentivize the returnable glass bottles like we discussed. So there are more things that we can do in comparison to when we have an FX shock when FX moves too fast.

So, again, given the exposure that we have (01:06:55) commodities, some are going to go up like the aluminum, some are going to go down like the sugar, and most important, when you at the FX that we have had – the FX movement than we've had recently, I think that's a tailwind that's much bigger than the headwind that we have for one or from any specific commodity and aluminum specifically being a very important one but the tailwind coming from the currency is much bigger than the headwind coming from the aluminum.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. And just a clarification, the 6% increase that you shared was sugar in Brazil. Is that 6% increase based on what you're hedging is or is that you are talking about the price of sugar up 6%? Thanks a lot.

A - Ricardo Rittes {BIO 15184017 <GO>}

It's actually 60%. So the price of the sugar impacting this quarter is more than 60% higher than the price of sugar, specifically one year ago. Sugar is very important for the soft drinks. So there is a concentrated impact on the third quarter, also what I said in my speech is that we expect that to decelerate much faster than the impact that we had seen in the FX that lasted more quarters, if you will. So, yes, there is an impact this quarter specifically for the soft drinks profitability, with the sugar, which is 60% – so 6-0% impact on our costs.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. All right. Thanks a lot guys.

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

Thanks, Alex. So I mean...

A - Ricardo Rittes {BIO 15184017 <GO>}

Yeah. Thank you. Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Bernardo Paiva, for any closing remarks.

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

So thank you. And now, I can go. So before we finish our call, I would like to highlight that we're very pleased that this quarter as expected we'll return to growth especially in Beer Brazil. Our beer volumes were really impacted by phasing with the early implementation of our annual price adjustment, what will actually be a positive driver for volumes performance in the next quarter. Along with that, gradual recovery of the beer industry and the steady evolution of our commercial platforms will also see EBITDA growth and margin recovery.

And as I always say, we will continue to be extremely consistent about the implementation of our commercial platforms in this whole obsession of quality in our beers. Because at the end of the day, the love of beer – for beer is in our DNA. So have a great day and enjoy the rest of the day. Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

Operator

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