Q4 2017 Earnings Call

Company Participants

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

Other Participants

- Antonio González, Analyst
- Isabella Simonato, Analyst
- Jose J. Yordan, Analyst
- Lauren Torres, 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 Fourth Quarter and Full Year 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 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 the comparisons with Q4 or full year 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. Ricardo Rittes, CFO and Investor Relations Officer. Mr. Rittes, you may begin your conference.

Ricardo Rittes {BIO 15184017 <GO>}

Thank you very much. Hello, everyone. Thank you for joining our 2017 fourth quarter and full year 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 more details about the evolution of our commercial platforms in Brazil.

Starting with the main highlight of our consolidated figures. Our results steadily evolved throughout 2017. After a challenging first half, we posted robust results in the second half of the year, especially in Q4, our strongest quarter. It is important to highlight that the Q4 is the most important quarter in the beer business, representing roughly 36% of EBITDA in the year. On a consolidated basis, top line was up 14.7% in the quarter. In the full year, top line rose by 9.6% with volumes growing by 0.9% and net revenue per hectoliter by 8.5%. EBITDA was up 22% in the quarter, that corresponds to organic growth of BRL 1.3 billion compared to the fourth quarter of 2016. In the full year, EBITDA grew by 7.9%, reaching BRL 20.1 billion with an EBITDA margin of 42.1%.

Net profit was down 31.7% in the quarter, while on a normalized basis, net profit was up 23.2%. The main difference between reported and normalized profit is a non-cash financial expense of BRL 836 million related to foreign exchange translation losses and intragroup loans that were historically reported in equity and were recycled to profit and loss account in the fourth quarter of 2017.

In the full year, net profit was down now 40%, while adjusted by exceptional items, net profit was up 2.1% along with the negative financial impact in the fourth quarter that I just mentioned. We have for the year first the swap of assets carried out with ABI at the end of 2016 pursuant to which we agreed to transfer our business in Colombia, Peru and Ecuador in exchange for the Panamanian business originally owned by SABMiller. Such transaction resulted in a BRL 1.2 billion non-cash gain in the fourth quarter of 2016 creating a hard comparable; and number two, the adherence to Brazilian Federal Tax Regularization Program that resulted in the recognition of a tax expense of BRL 2.8 billion in the third quarter of 2017. Cash flow from operating activities reached BRL 8.9 billion in the quarter and BRL 17.9 billion in the full year, which represents an increase of BRL 5.5 billion or 44.8% compared to 2016.

Now, moving to our divisional results. In Brazil, our EBITDA was up 24.3% in the quarter and 0.6% in the full year, while our results in the first half of 2017 were still impacted by expected negative drivers, we left most of such drivers in the second half of the year, returning to our pattern of growth.

Beer Brazil top line was up 15.2% in the quarter and 6.3% in the full year. Our beer volumes were up 5.1% in the quarter and 0.7% in the full year, outperforming the industry. Net revenues per hectoliter in beer increased by a robust 9.6% in Q4, mainly driven by our revenue management initiatives implemented during the third quarter. In the full year, net revenue per hectoliter was up 5.6%.

Now talking about Brazil CSD and NANC, the top line was up 6.7% in the quarter and up 1.6% in the full year. Volumes were down 3.7% in the quarter, in line with the industry. While in the full year, volumes declined by 4.3%, less than the industry, as the adverse consumer environment continued to drive consumers away from CSD to low-cost powder juices or even to tap water. Net revenue per hectoliter in the CSD and NANC business was up 10.8% in the quarter and 6.2% in the full year, driven by our price management initiatives implemented during the year.

Brazil cash COGS grew by 0.7% in the quarter while, on a per hectoliter basis, declined by 2.2%, benefited by a favorable FX. In the second half of 2017, Brazil cash COGS per hectoliter was up 1.0%, which is in line with our guidance of flattish to low single digit up. In the full year, Brazil cash COGS and cash COGS per hectoliter increased by 9.8% and 10.4% respectively.

Brazil cash SG&A was up 19.9% in the quarter as high administrative expense due to variable compensation accruals was partially offset by below inflation sales and marketing expenses. In the full year, cash SG&A was up 5.5%, as a result, Brazil EBITDA was up 24.3% in the quarter and 0.6% in the full year.

Moving now to Central America and the Caribbean region. In CAC, we delivered another solid year. Our performance was marked by great results in our new operations in Panama, now the second largest market in the region after the Dominican Republic. Going to more details. In the fourth quarter, top line in CAC increased by 15% and EBITDA by 25.2%, with another quarter of margin expansion. In the full year, top line grew by 8.8% leading to an EBITDA of BRL 1.8 billion, an increase of 23.3% when compared to the full year of 2016 with a robust margin expansion of 500 basis points to 38.9%. In U.S. dollars, reported EBITDA grew more than 40% in the quarter and 30% in the full year, reaching almost $600 million.

While we're still impacted by the severe hurricane season that affected the region in the third quarter, we were able to deliver a solid organic volume growth of 4.3% in Q4, driving a 1.9% volumes increase in the full year. Reported volumes increased by 30.1% in the quarter and by 26.9% in the full year, benefiting from the recent swap of assets carryout with ABI and our operations in Panama. The integration with Panama continued to be executed as planned and our portfolio of brands, that comprises Atlas Golden Light and Stella Artois, among others, achieved great results in the year, contributing to double digits organic volume growth and significant market share gain in the country. Further, we benefited from our financial discipline in the whole region, leveraging both costs and expenses, leading to an EBITDA margin expansion for the fifth year in a row.

Going forward, we continue to be enthusiastic with top line and EBITDA growth potential from our current operations as well as with nonorganic opportunities, being confident that we are in the right track to keep delivering solid results in the region and to reach our $1 billion EBITDA dream for that region.

Turning to Latin America South. Top line in that region was up 22.6% and EBITDA grew by 23.6% in the quarter. In the full year, top line increased by 26.1% and EBITDA by 24%, reaching BRL 4.9 billion, with margin contraction of 80 basis points to 45.2%, mainly due to negative impact of FX on our costs in Argentina.

Volumes were up 5.8% in Q4, driven by growth in both beer, CSD & NANC. Specifically regarding beer, we had a remarkable performance in: number one, Argentina, as a double digit volume growth was supported by our complete portfolio in the country from the mainstream segment with Brahma, that grew more than 20%, with preference trending up (11:37), coupled with Quilmes, with the launch of Quilmes Clásica which was a great success, and also premium with Stella Artois and Patagonia leading the way. Second, Paraguay led by the successful implementation of 340ml returnable glass bottle strategy. And third, Uruguay, driven by execution improvement and a strong industry. In the full year, volumes were up 5.9%, supported by double digit increase of beer volumes in Argentina and better performance of all global brands in the region that presented growth versus last year enabling us to achieve our all-time high volume mark for beer in LAS.

As we move forward, we're encouraged by the rebound of volumes in Argentina, where we have a particularly positive outlook for 2018, being confident that we are well-positioned to keep posting strong results in the region.

Moving now to Canada. EBITDA in Canada declined by 2.3% in the quarter, and an organic top line growth of 1.3% was impacted by higher cost and expense. In the full year, top line was flattish and EBITDA grew by 0.9%, reaching BRL 2 billion with margin expansion of 20 basis points to 33.9%.

Volumes were down 0.7% in Q4, driven by a poor weather that led to another quarter of industry contraction. In the full year, volumes declined by 1.3% in line with the industry. Despite the tougher industry, our main brands performed particularly well with Bud Light being the fastest-growing brand in the country, and Stella Artois, and our portfolio of local craft beers that include Archibald, Stanley Park and Mill Street, among others, outperforming the industry. Going forward, we remain committed to pursue improved results in Canada, supported by our strong brands and by our leading market position.

Now moving to below EBITDA. Net finance results totaled an expense of BRL 1.2 billion in the quarter. In the full year, net finance results reached an expense of BRL 3.5 billion, which includes two exceptional financial expenses that total BRL 977 million. Those two items are, number one: BRL 836 million, with no cash impact, related to foreign exchange translation losses or intragroup loans that were historically reported in equity and were recycled in the fourth quarter to profit and loss account, upon reimbursement of these loans; and BRL 141 million paid in connection with the Brazilian Federal Tax Regularization Program. Excluding such exceptional expenses, net finance results totaled expense of BRL 412 million in the quarter and BRL 2.5 billion in the full year, which represents a decline of 32% compared to 2016.

Going to more details, many items in the financial expenses in the year were: first, interest income of BRL 459 million, driven by our cash balance, essentially in Brazilian reals, U.S. dollars, and Canadian dollars. Second, interest expense of BRL 1.6 billion, that includes the accrual of around BRL 600 million related to the put option associated with our investment in the Dominican Republic. As announced on January 18, 2018, we increased our participation in the CND business from 55% to 85%. With that, we continue our partnership with E. León Jimenes company but with a larger stake. Third, BRL 543 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. Important to mention, the losses on derivative instruments declined by almost 65%, when compared to the full year of 2016, as low interest rates in Brazil contributed for the reduction of carry costs. Fourth, losses on non-derivative instruments of BRL 112 million mainly related to FX translation. Fifth, tax on financial transactions in the amount of BRL 180 million. And sixth, BRL 572 million of other financial expenses, mainly driven by interest and contingencies.

The effective tax rate was up in the quarter from 9.9% to 34.3% mainly due to an exceptional non-cash tax adjustment of approximately BRL 510 million related to the tax effects of the foreign exchange variation linked to the intergroup loans that, as I just mentioned, were historically reported in equity and were recycled to profit and loss account upon the reimbursement of those loans.

In the full year, effective tax rate was 39.3% versus 2.4% in 2016, as we not only face the tough comparable, but were also impacted by the exceptional tax adjustment of BRL 2.8 billion related to the Brazilian Federal Tax Regularization Program that we announced in the third quarter. Adjusted by those exceptional items, the effective tax rate was 23.9% in the quarter and 12.8% in the full year. Finally, CapEx totaled BRL 3.2 billion in 2017, declining 22.5%. On top of that, during the year we returned approximately BRL 8.5 billion to equity holders in dividends and interest on capital. This figure does not include the dividend payment of approximately BRL 1.1 billion announced on December 21, 2017 and made as of February 22, 2018.

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

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Ricardo. Hello, everyone. As mentioned Ricardo, we entered 2017 with a solid fourth quarter, delivering on a consolidated basis, an EBITDA growth of more than 20%. In Brazil, where I will concentrate my comments on, our beer business consistently evolved throughout the year, particularly in the last quarter, we posted strong top line, driven by a healthy net revenue per hectoliter increase and solid volumes, driving EBITDA growth of 27.5% and margin expansion of 500 basis points.

Beer volumes were up 5.1%, way above of the industry that was flattish, outperforming the market in all the segments, core, core plus and premium. In the full year, our beer volumes were up 0.7%, while the industry was slightly negative, due to a still weak consumer environment. In this context, even though the macro in Brazil continued very challenged, we were able to strengthen our market position and return to growth.

In addition, during the year, we also continued to broadly explore our beer expertise, offering to consumers a unique portfolio of high quality beers, meaning to fulfill different needs and taste on different occasions. We granted to consumers, the power of choice as beer is like happiness, everyone has its own recipe. Having said that, we are confident that all these achievements were fuelled by the initiatives taken under our growth platforms. Such as (19:38) Elevate the Core, our first and most relevant platform. In 2017, we implemented the most significant package improvements of Brahma's and Skol's history to reach our consumers in every occasion. Further, we kept progressing with our marketing strategy exploring the connection with the core consumer differentiating and innovating our brands.

As I mentioned in our third quarter earnings call, Skol, our easy-drinking lager launched in October a bold campaign extended to summer season and evoking once again the Desce Redondo signature, exploring the round versus square expression, stimulating people to be more open, connected and respectful to each other. This campaign comprised eight different TV ads, new trade materials and strong digital activation. The results were great, with the best consumer evaluation we've seen in Skol campaigns during the recent years, putting the brand in a positive momentum. Such momentum has been reinforced by the remarkable activations during Carnival. As this year, once again, Skol took a leading role in promoting the most important street parties in Brazil such as São Paulo, Salvador, Recife, Belo Horizonte, providing free entertainment for the population.

Now, talk about Brahma, our classic lager. Brahma had an amazing 2017, growing strongly quarter after quarter. As mentioned in our last call, Brahma's new VBI generated notable results with consumers' purchase intension growing quite significantly. This positive perception of the new Visual Brand Identity of Brahma was boosted by the (21:37) campaign, very successful one.

As we move to 2018, we are confident that Brahma is in a good position to maintain 2017 growth trend, supported by a strong (21:50) activation during the 2018 FIFA World Cup Russia. Still in Brahma's family, Brahma Extra was one of the main highlights of the year, providing consumers with access for – to a variety of beer styles, showing that food and beer can go along very well in making gastronomy something accessible to everyone. In the full year, Brahma Extra almost doubled its volume definitely consolidating the core plus segment in Brazil.

Finally Antarctica, Antarctica has a very relevant regional role, especially in Rio and Brasilia. In 2017, its major highlight was the result of the innovative web series format, blending fiction and reality. Being close to the consumers' life, in their everyday life, the series continue to deliver great numbers, reaching more than 50 million views. In 2018, Antarctica maintained its consistency promoting the Carnival in Rio and Brazil, and during the first quarter, bring another very important moment, the launch of its new Visual Brand Identity. Following the results and learnings we had with both Skol and Brahma, Antarctica's new VBI is expected to be a major success exploring brand tradition and quality.

Now moving to premium. Consumers have increased in premium and complete portfolio of premium brands has proven to be key to capture all the benefits arising from this trend. In the fourth quarter, our Premium portfolio of global and domestic brands experienced a great acceleration. All the brands grew substantially, driving positive mix and EBITDA margin expansion.

In the full year, our premium volumes also produced amazing results, growing double digits and accounting for more than 10% of our total beer volumes. We are proud that Budweiser was the leading brand of the premier segment for the third year in a row, growing more than 30%, while continuing to build its connection to consumers with meaningful and impactful message, such as the award All-Star at NBA (24:17) and the (24:20) campaigns. We are also proud to say that Colorado became, in 2017, the number one crafted brand in Brazil, inviting consumers to experience different tastes and a wide variety of ingredients. Showing to all of us that more than 10,000 years of their history was marked by diversity, and we will continue to convey this legacy. Looking ahead into 2018, we are confident that we have a very powerful portfolio to provide consumers with a wide diversity of premium brands while bringing memorable experiences.

Moving to different occasions and starting with the in home. RGBs continued to be a big focus for this year, carrying our core brands and having an affordable proposition. We have evolved with the penetration of returnable glass bottle in the off-trade channel, bringing affordability to consumers with a higher profitability. In 2017, returnable glass bottles accounted for 29% of our beer volumes in the retail, which includes supermarkets, mom and pops, pit stops, among others. With the 300 ml bottles, the main presentation in his channel growing double digits year-over-year. Still in home, we also implemented new trade programs during the year to boost the shop experience in more different size and formats of stores within the off-trade channel.

Turning now to out of home occasion. The on trade continues to be the most relevant channel in Brazil, representing the most of our volume. We've been segmenting even more in this channel, and with that designing any implementing trade programs to reach sub-segment of the on trade that's increased the effectiveness of our investments and the output of volumes.

Regarding excellence in client service. As a service-oriented company, enhance our route to market in our service level is at the core of our priorities. For instance, we are steadily expanding the number of box serviced with by the company. We are also strengthening our relationships with all our clients through the improvement of our teller sales capabilities, what has resulted in increasing clients' satisfaction. On top of that, we also continue to further develop our B2B platforms, particularly for the off-trade channel and VIP clients and to invest behind new technologies striving towards the best-in-class level service.

Finally, moving to CSD & NANC, in the fourth quarter, in spite of the volumes going down 3.7%, in line with the industry. We were able to deliver top line growth in CSD & NANC, contributing to a EBITDA (27:24) margin expansion. In the full year, our volumes were down 4.2%, outperforming the industry. Irregardless of the pressure in the traditional CSD industry, our premium portfolio within the CSD & NANC which comprise Fusion, H2OH!, Lipton, Gatorade and Do Bem, delivered strong results in 2017. H2OH! and Lipton grew by double digits, while Fusion by high single digits. On top of that, Do Bem volumes increased by more than 100%, supported by the launch of the new line, Do Bem Todo Dia. Such premium brands reached together almost 10% of our CSD & NANC volumes in the full year.

Before closing, I would also like to highlight that 2017 was marked by the evolution of our Better World platform. We want to be here for the next 100 years and our commitment to sustainability is at the core of our priorities as well. For instance, in the beginning of 2017, we launched AMA, a mineral water from which 100% of the profit goes to projects for access to potable water in the semi-arid region of Brazil. AMA already benefited more than 7,000 people and has demonstrated great potential to continue to grow.

We're also involved in our road safety projects such as the (28:55) that saved more than 420 lives in 6 to 7 counties in the state of São Paulo. And Brasília Vida Segura that, in one year, saved more than 130 lives in the Federal District. These are only a few examples, and going forward we will keep investing behind our Better World platform, supporting others to continue to enhance not only our business, but the whole society.

In summary, 2017 was an important year in which we reached an inflection point resuming growth and strengthening the fundamentals of our business. As we move to 2018, we will continue to be consistent with our strategy, but expect a challenged first quarter for Brazil Beer, especially in terms of volume due to: first, a hard comp in the first quarter of 2017 when we outperformed the industry by 5.5% and; second, a soft industry that's expected to be impacted by the earlier Carnival (30:01) in a very poor weather. Nonetheless, we have a positive outlook for the rest of the year, even though the consuming environment remains volatile. More inflation, a declining unemployment rate, and a gradual increase in disposable income as the year progress as well as the FIFA World Cup should be supported for the industry.

On top of that, we are very confident that we have a powerful portfolio and a solid plan to further accelerate EBITDA growth. We believe Brazil continues to be a unique market that we have experienced and we will keep pursuing growth and profitability. In this context, a consistent execution of our growth platforms as well as our passion for bringing the best quality beers in the world will continue to be of a paramount importance.

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

Q&A

Operator

We will now begin the question-and-answer session. The first question comes from Luca Cipiccia with Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Good morning, Bernardo, Rittes. Thanks for taking my question. Congratulations on the strong finish and I guess on carrying the torch of optimism for Brazil consumers and I would actually want to ask about the 2018 outlook. Arguably, there is a lot of optimism in your speeches, it seems to be the case. It also seems that a lot of the investments some of them more sort of painful than others in the last couple of years are starting to bear fruit – you talk about premium, you talk about returnable, and I think that's great for the set up for this year. But surprisingly, your guidance is somewhat light on details this time around. And well, my question is first, very simply, why that is the case as compared to the past?

And then, assuming that you're not going to give us that many more details now in the call, maybe if you can help us understand how the volume, price mix balance should play out, particularly for Beer Brazil in 2018? Are you seeing elements that make you more comfortable that realistically with consumers trending up, with inflation in food still being very favorable, we could see an even stronger, let's say, revenue per hectoliter growth, at least a bigger delta between revenue and COGS per hectoliter as we progress through the year maybe after a more difficult first quarter? So that would be my question. If you can maybe give us some context for the balance between volume and price in 2018.

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

Hi, Luca. Thanks for the question. I will start here and Ricardo Rittes, maybe you comment later a little bit. So, I think that first, I mean, talking about Brazil and the prospects for 2018, in that important to all remind that we have been consistent in executing the growth platforms, and the strategy that we have as we're starting to reap the benefits of the investments that we've done in the last two years, and I think the fundamentals of our business are evolving in a much, much better place. And I think that the country will be in a better place as well in 2018 when compared to 2017, so the prospects are good. So I think the team is really, I mean, solid in terms of focus in executing the plan that we have. And we also have the FIFA World Cup that will activate strongly two brands, one core brand that's Brahma, and the premier is Budweiser. So the plans are really, really strong.

So having said that, the first quarter, I mean, volume maybe will be a little bit tough, as I said and basically because of the tough comps because there are – I mean, the last quarter – I mean, the first quarter of 2017, we outperformed the industry in 5.5 percentage points, so it was a tough comp. And secondly, weather seems – basically in December, I mean December is not helping at all and affects the industry. But the good news is the plants are strong. So the weather will be better for sure. We have World Cup, strong brand, and again, have been consistent with the strategy that we have, but I mentioned that not only looking for the short-term but for the medium-, long-term as well. So that's my view for 2018. That's why it's a positive view. So, Ricardo, want to comment anything more?

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Luca. Thank you very much for your question. I would like to just to start to say that, Ambev, out of the three main players in Brazil, is – was the only one who used to give guidance, driving to an asymmetric competitive dynamic. Last year, we decided to provide a cash COGS per hectoliter. I think we have – because of the volatility that we had in that specific line. But if you look at – to our guidance since 2010, you see that we varied a lot in the level of quantitative guidance provided to the market. What we are trying to do is to compensate somehow with a qualitative view, as you pointed out, with a more detailed – you called optimistic, about Brazil core realistic, about operations that even provide you more color about the first quarter like Bernardo just said.

Q - Luca Cipiccia {BIO 6914452 <GO>}

And this is, maybe, just on the receptiveness of the consumer to price increases, and maybe your comments about premium, is that sort of – maybe, can you comment about the speed of that improvement? Is that sort of surprising you, is that encouraging you maybe to be more assertive on pricing as we move towards the year? Is there any additional, maybe, qualification on that?

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

I think that every time we do a price increase, like we do in the third quarter of last year, I mean, in the first quarter, in the quarter that we do that. If one (36:50) suffer, we lose share. I think that the way that's implemented, the price increase, looking for the full mix, the portfolio and so on. (36:59) can help us, the returnable bottles industry can do that, assuring that you – we would maintain the most important price points per channel. Our outside (37:09) intelligence, or our tax sales intelligence, all that technology that have been put into understanding the sub-segments per channel understanding exactly the first point that should be here and there. It's helping us to mitigate the impact of a price increase.

And I think that's why the fourth quarter was, was I mean one of the reasons was that as well, together with the portfolio or the strategy, I mean, that's the way that's implemented I think it was, I mean, very, very good so, good learnings for the years to come. And I think that people are stacking up Brazil will be out of this and disposable income will come back, and why I think that the fundamentals will help us, because when disposable come – income back on track, and we're back on track in Brazil, our portfolio will be much stronger, The premium much, much stronger. It's very, very important to say that the last quarter not only Budweiser grow up, all our brands did the same. So, Stella, Corona, Original, so the domestic premium as well. So I think that's very – I would excited about the opportunities of the premium segment. But our first, I would say, big focus continues to be the core, because the core brands represent the bulk of our business and have great brands, historical brands, brands that people like a lot and we will continue to invest in every touch point of those brands of people that taste and drink Brahma (38:39) in our everyday basis here in Brazil.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Very clear. Thank you. Thank you both.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

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

Thanks, Luca.

Operator

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

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you. Good afternoon. Bernardo, Ricardo. Two quick questions. First of all, in Brazil on the price mix for the quarter, which was very strong, can you exclude the positive impact on the price mix growth from the tax effect and, and should that continue towards 2018? And the second, on Latin America South, with SG&A well below inflation, can you elaborate a little bit more on between the (39:22) and G&A lines and looking for the good prospect for volume growth this year, if you could give us an indication how that line should perform this year? Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Isabella. Thank you for questions. So, just sort of to give you in terms of order of magnitude, the impact of the tax change, if you will, is one-fifteenth of the total growth that we had in net revenue per hectoliter. So, it's not the main impact, it's not even 10%, so that was not the biggest change. And when you look at SG&A, I would ask Bernardo to go through very quickly.

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

Hi, Isabella. Morning. (40:11) I think that, as you know, we have been steadily improving the market effectiveness and doing the way that we can optimize the campaigns. The media vehicles are testing more the media mix (40:23). So, and then we will – we also know that the World Cup is an important investment, but what we are doing is really channeling or prioritizing as well the investment, doing the World Cup, because it's a very important key selling moment and to build brands as well. So, we don't expect kind of a significant SG&A increase due to the marketing investment doing the World Cup. Again, we're investing in better media mix, be more effective on depth. Yes, we do – we will do a strong activation during the World Cup, but we don't expect – I mean, not giving any guidance, but we don't expect, I mean, a big swing in terms of the marketing and sales investments during this year.

Q - Isabella Simonato {BIO 16693071 <GO>}

Great. Thank you very much.

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

Thanks a lot.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

Operator

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

Q - Antonio González

Good morning, Bernardo and Rittes. Thank you for taking my question and congrats on the results. I wanted to ask on the category expansion framework in ABIb's (41:34) a lot of emphasis on their conference call this morning. And I wanted to see if you can elaborate on how Ambev is supplying these, obviously to some extent you've been working in Brazil already over the last few years in RGB, when it comes to affordability and premium, with (41:54) and the rest of the brand, et cetera. But I wanted to ask how those – these category expansion frame work accelerate the deployment of these initiatives in Brazil? If you've seen [Technical Difficulty] (42:04)

Do you see do you see upside between implementing easy drinking and classic lager occasions in – or any other initiatives in particular in Brazil? And then secondly, there were some comments on Argentina in this framework in particular on the ABI call. I want to see how quickly can you deploy this framework across your countries. Do you think this can be implemented all throughout this year or start only in 2019 and how relevant do you think it can be for them express yield markets for Ambev? Thank you.

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

Thanks, Antonio. Hi. Thanks for the question. So I think it's first, regarding the expansion framework, I mean, it's really good, I have been learning a lot. And one of the good things that confirmed as well some initiatives in terms of the growth platforms that you know already, the core, (42:55) premium, so on, that we have been doing here. So I think that what gives us a frame at least to the extent (43:04) the portfolio that we – that we have, the opportunities is in terms of the needs and positioning each brands that we have in the right spot. And really differentiate the brands for each consumer target has been helping a lot in that portfolio design. But also, we know that what we have been learning was good, of course, the learnings with the SAB, the maturity to market model, because Brazil is not only one country, we have different countries here. So help you understand what regions of the countries included have more learnings from U.S. market or this from the African experience that our partners have had there as well.

So both things have been very, very important for us from a source of learning, but confirms as well the past that we have been talking – I mean the last three or four years in terms of the platforms that we have conveyed to you. And think that the strategy in the growth platforms, I mean tax reform portfolio again that the cash expansion framework help us to define better. And that's been in the regions that we have in Brazil, the mature market framework help us as well. But adding that, the occasions, that is very, very important because we understand how we can execute a brand – positioning of a brand in different occasion, in different touch points is very key that's helping doing that so in terms of the shape in home, boosting out of home. So just, I would say complements all the category model expansion of the maturity to market things that we have been doing confirm that past that we have implement in the last three or four years.

And on top of that, I think that – we think that it also is very, very important to have a view of the cost of the point of sale. Because at the end of the day to provide those experience and brining this portfolio to life that defines who we are in the category expansion model, we need to I mean to bring this to life and the channel is very, very important. The point of sale is very, very important not only for selling more but was fully experienced, we reflect the position for each brand.

So I think that, again, in summary, I think that the category expansion model, I mean helped us a lot. Helped us to assure that we are in the right path in terms of learnings as well. And we guess we can cascade this for other countries as we said and ABI Co. (45:35) Argentina is another example. The same beer that had been differentiating Brahma and (45:43) the three years in terms of Skol, more young, (45:46) easy drinking, so not only the easy drinking part in terms of the functionality of the liquid, but the emotional parts as well I mean – the, it's a young brand (45:56), it's youth it's edgy. So, Skol easy drinking, Brahma, classic lager, same thing we are doing there. So, (46:03) Brahma there.

So, think that we are doing this as we speak, our partners are doing that and I am confident that the category model expansion, the framework expansion, the maturity model together with the things that we have been implementing in terms of the overall for the growth strategy here, it's very powerful.

And I think that we'll reap the benefits in the future as well and we have the mindset to be consistent to do that, not only think about one year, six months, but being consistent, one – another example here, all that packaging improvements and investment that we've done in Brahma and Skol, is – was done to assure that you have a clear role for the package for Skol and for Brahma, and a clear differentiation. Dennis (46:53) started to do that two years ago and its started having the benefits now. So, I think that's a model that can help us build on in the things that have been working in the last years in Brazil.

Q - Antonio González

Would you be, would you be able to comment – thanks for that color, Bernardo – would you be able to comment whether this new framework has been formally incorporated into the business plans of the different countries and regions, KPI's compensation metrics and so on or that's still, I guess, work in progress?

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

I think I'd not comment in details, Antonio. But I would say that it's formally included in our business cycle, in our lives. So, it's further in our plans. So, we adopted very, very fast. And again, in Brazil it was very, I mean the adoption was, I mean, almost instantaneous.

One, because we have been working, in the – I mean, in this path even before. So, I think that we adopted very, very fast, not only Brazil but in other countries as well.

Q - Antonio González

Fantastic, thanks and congratulations again.

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

Thanks, Antonio. Bye, bye.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Hi, everyone. My question relates to channel trend. Bernardo, you did talk about on- and off-premised behavior. But I was curious in light of the consumer getting a bit better, and I know it's a gradual process. But are you seeing better on-premise trends? I understand, I guess, the first quarter with Carnival, that could be skewed. But are you seeing, just generally, better restaurant/bar consumption. And how does that make you think differently about your investment spent this year? I know you spent a fair amount on RGB use. It is a large percent of your beer volume in retail. So, in order to maintain that, does the investment still stay behind that particular format or based on how consumers or where they consume, will you redirect that spend this year?

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

Thanks, Lauren. I think that the – talk about the channels – I mean, yes, the off-trade channel in Brazil is gaining weight over time. But even though the on-trade is still the most important relevant channel here in Brazil not only in terms of volume, but in terms of brand building as well. In any case, and you should keep in mind that the plans for both (49:16) and more than ever, I mean, think about being a more service-oriented company, consumer-centric company even more.

So, just an example, so we're understanding a lot about the in home and the consumption at home, so – and knowing how the product could arrive there and what kind of experience you have or must do in the off-trade channel to assure that the product will arrive in the right way and provide a nice experience there. So, having said that, understanding these sub-channels of the trade is very, very important and we continue to work very, very hard with the big accounts that do continue to do that, capital management, increasing the shopper's experience, but understanding how those more format works as well and translating to them some of this knowledge is very, very important. And then I think that we have been doing this. So, understanding how significant that is (50:16) off trade, can assure that in the off-trade we could have an equally better margins in the future, because you know the segments more, you know how to execute more better, the brands will be – the assortment would be the right ones very specific sub-channel.

In terms of the on-trade, I think that's not only important for building brands and you have trade programs understanding the sub-segments as well with all the tax sales initiatives that have been put in place. There is another thing linked to the route to market strategy that's helping the on-trade, because you are selling more box in more – smaller box in more counties in Brazil, more areas in Brazil in the suburbs and say even better. Most of those box are the on-trade. So when you go direct, you'll be able to activate demand in those places, and then we'll be able to assure that on-trade will continue to be a strong segment for the future.

So in summary, I think that we have strategies and plans for both channels. And the route-to-market plans that have been put in place actually are helping a lot, the very small box in most of them are in their own trade segments. And in the end, I mean the profitability of both channels are, today, are very, very similar, for many, many, many reasons. One of the reasons, they're often, in the case of the off-trade, is the implementation of the boost of their RGB that today represents 29% of our volume in the off-trade channel.

Q - Lauren Torres {BIO 7323680 <GO>}

Can I just ask then a quick follow-up on that and Brazil is quite different than other parts of the world, as far as people consuming out of the house versus in the house, and coming off a soft environment in Brazil, do you think that that could change over time, meaning a greater percentage of volume could go to at home consumption or just directionally Brazil is a market where more on-premise consumption will always be that much more relevant?

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

I mean, yes. I think that I know the strength, and I agree with you. I think there are two ways to do (52:30) like that, no – really has been just wait, that we're not doing. Understanding the trend of the in home and do it I mean – and I'll say taking advantage of this trade and trying to shape in a better way to understand the sub-channels of this off-trade of how the products arrives there. So we have a good example of the pit stops, so they have a – that's a franchise business that we have that's growing a lot. I'm just saying that we know that the in home will grow, but we have ways, I mean to assure that this trend will go in the right path for the industry.

In terms of the on-trade, yes, but have to bear in mind that in Brazil people like to go to a bar. I mean, because – and beer, it's like – it's unified people. I mean, people really bring beer with the friends in a bar. If you serve better and we're doing that in the bars, in the smaller ones, not only are we creating jobs for the country and so on, but activating demand and assuring that the on-trade will continue to have an importance in the long-term. Yeah, you can say, it's slightly against the trend, yes. This is why they're against the trend. But I think that it's the good route-to market, the good service level and so on. Yeah. We can assure that the number of box in Brazil will not go down and the on-trade will not be shrinked as you see in other countries.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Great. Thank you.

Operator

The next question comes from Jose Yordan with Deutsche Bank. Please go ahead.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi, good morning, everyone. My question is on the SG&A in Brazil. I mean, it grew almost 20%. And I think that was significantly above, I guess, not your guidance, but certainly my expectations. And I was just wondering how much of that 20% growth was due to perhaps catch up bonus accruals? And how much was due to increased marketing spend to support the price increase?

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Yordan. This is Ricardo. All of it is due to a variable compensation from management; a number that, the year before, variable compensation was initially zero. And this year as we had growth for the business, more accelerated and skewed towards the last quarter – the six months, but especially towards the last quarter that's where the accrual of the bonus happened.

Q - Jose J. Yordan {BIO 1496398 <GO>}

So in terms of marketing spend, there was no unusual growth year-on-year?

A - Ricardo Rittes {BIO 15184017 <GO>}

Actually, it was down.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Okay, thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

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

Thank you.

Operator

The next question is from Thiago Duarte with BTG. Please go ahead.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thanks. Good afternoon, Bernardo, Rittes. Well, I would like to have a follow-up question actually on Lauren's question and this discussion regarding the on-trade channel versus the off-trade channel. I guess to you, Bernardo, my question would be, do you think you can be as profitable in the off-trade as you are probably historically in the on-trade. I mean, because it seems that as you look at the most important revenue initiatives and growth channels that you guys have been exploring, they all seem to pursue this growth in the in home consumption and in the off-trade in particular.

And if you look at the EBITDA margins that you guys made in the fourth quarter, and you compare to what you eventually achieved a few years ago, even considering the adjustments for FX and hedges, just wondered so far if you were still below where you were in terms of Brazil Beer profitability, a few years ago. So I wonder whether this is related to this migration to the off-trade as opposed to the on-trade channel? I think it would be interesting to hear on that.

And second, back to the SG&A, just wondering – I know you guys are not providing a guidance anymore for the year, but you know when you look at the Brazil operations as a whole, you used to have SG&A over sales close to 28%, 29% of sales. Is – this figure is now as high as 32% or so, is it reasonable in your view to assume that this figure will eventually go back to 31%, 30%, eventually 29%, 28% again or do you think it's fair to us – for us, for modeling purposes, let's put it this way, to assume that this figure might stay higher for little bit longer? Thank you.

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

Hi, Duarte. Thanks for the question. I'll touch again in the on-trade and off-trade issue and then Ricardo will go for the other question. I think that your question is, do you think that the off-trade could be as profitable as on-trade? The answer is yes, we think. And reasons to believe is that not only are we increase of capabilities that we have to operate in the off-trade, understand the right assortment to stay in the revenue management initiatives, the logistics system to get there because including this dropside and hires, so the dropside and hire (57:52) lower.

And the last point, understanding the sub-segments within the off-trade, how we can serve better? Because off-trade is much bigger than a big chain or a big – I mean, store with 20-plus checkouts. Actually, the off-trade that's growing more for us are the small formats and it stops – that franchise business, that's off-trade alternative as well. So, understanding, again, these sub-segments of the off-trade, how faster they can be. And on top of that, revenue management, right assortment, premium growth has to bear in mind that in the off-trade, the premium weight is much higher than the on-trade as well. Because of all of this, yes, we think that the off-trade could be as part of the on-trade and actually in some areas (58:44) of Brazil, they already are in the same level.

A - Ricardo Rittes {BIO 15184017 <GO>}

And now, going specifically to the margin, the way we see it, we do have a high watermark, but if you look at the historical evolution of our margins in the last 15 years, you'll see that the directions – a clear direction towards higher margins. And of course, there are like short-term volatility, but we continue to believe that we can improve our business and improve the profitability of our business. And when you specifically talk about SG&A and – you are right on your numbers – I mean, for example, if you look at 2010 SG&A as a percentage of net turnover, it was like around 25.6% and they developed consistently over time around – 2013 was like over 26%, to a point in which in 2016 it reached 29.2% and in 2017, again, 29.2%.

So for some time, it has been like a – on a upwards trend, and then it has stabilized when you look on a year-over-year. Even though, in 2017, we had the bonus accrual and in 2016, we didn't. So, when you account for that difference, there's already a reduction on a year-over-year basis. And of course, but if you – if you project Brazil in the medium-term to grow again, in terms of volume and et cetera, so you will get a dilution of some of those costs and you should naturally see a positive evolution over time.

Q - Thiago Duarte {BIO 16541921 <GO>}

Very clear. I appreciate it. Thanks a lot.

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

Thank you.

Operator

Due to the constraints of time, this will be the final question. And it comes from Robert Ottenstein with Evercore. Please go ahead.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Thank you very much for fitting me in. Can you talk a little bit about the – it's been a number of years now, the impact of Heineken on the market, a world-class (01:00:48) marketer compared to the more local competitors that you faced and still face, but now, they seem to be doing very well, they're gaining share. So, how has that changed the market? How has that changed your strategy, and are you doing anything now in other markets to prepare for a possible entrance by Heineken? Thank you.

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

Hi, Robert, thanks for the question. I think, as you know, I know you have been following us for a long-time, the Brazilian industry has always been very competitive, so – and as you already know, again, we don't speak about competitors, and we will continue to focus on the business that we have and let nothing change for us in this sense. What I could say is that we have been focused a lot in building a strong portfolio of brands, and be consistent in our growth strategy that have been conveying to you in the last three, four years. And then ahead from (01:01:54) doing things on that, on the fundamentals of the business, our core brands for example, all the package that we've done, all the differentiation in terms of the – our easy drinking at Skol, like classic lager (01:02:09) Brahma (01:02:11) performing well.

And we are focused a lot in the core and in the premium segment. So we gain share, we gained share last year. We don't participate in the value segment. We participate in a smart way with the returnable bottles which from core brands. I think that we'll have a different mix than other companies in the market that most of their volume is value. So that's not our case. So our focus i's really core and premium and I think that you're right, we are, and are gaining share because of core and premium because we're losing in the value segment.

So and because of that, I'm bullish that the portfolio that we'll have, the plans that we'll have and the, I would say, competition that we'll have, that's always good, that push us to do even better, will put our business in a much more better place a year from now as it was today, or a better place than a year ago, because the fundamentals are better, because we've been consistent in our strategy that I have been talking to your in every call, in every meeting that we've had in the last three or four years. So, and again and to reference you back (01:03:23), I think that people that trade down a lot for the value segment, that's not the most of our volume, maybe it's the competitors volume. Most of that (01:03:33) is not our case. I think that we'll be more – have more benefit or have a stronger core and premium portfolio in the market.

Q - Robert Ottenstein {BIO 1498660 <GO>}

So, so on that point if you segment the market value, core, mainstream, and super premium or – and premium, obviously the premium has been growing, has over the last couple of years, how much share has the value segment gotten in the market in 2017 and 2016?

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

I think that in the last years, I mean, because of the crisis in Brazil, the value segment grew, because of the disposable income issue. But this will come back. We are taking a slightly benefit there in the right way because of the returnable bottles in the core brands have a very good margin. Having said that, I mean we don't disclose our market share per segment. And what I can say is that in the core segment and in the premium segment, market share for us, it's not an issue. And because of that, overall we gained market share last year, which means that overall, market share as well is not an issue, we'll continue to work hard to gain more market share and to fight every day, but it's not an issue.

I think that I'm very confident in the portfolio, in the approach, I think for the occasions, in the service level for box, that what this could bring and continue bringing for the future in terms of benefits for our core and premium portfolio.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Terrific. Well, thank you very much. That's very clear.

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

Thanks, Robert.

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>}

Okay. So, thanks Gavin. Before I finish our call, I would like to highlight that we are very pleased with our fourth quarter results and that the evolution of our business for 2017 is a consequence of being consistent in our growth platforms in the last years. Going forward, we remain optimist with the development of our growth platforms, as I said before, and we believe that we have a solid plan and fundamentals to drive further EBITDA growth. Have a great day and enjoy the rest of your day. Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

Operator

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