Q2 2016 Earnings Call

Company Participants

- Bernardo Pinto Paiva
- Ricardo Rittes de Oliveira Silva

Other Participants

- Alexander Robarts
- Andrea F. Teixeira
- Carlos Laboy
- Jeronimo De Guzman
- Lauren Torres
- Luca Cipiccia
- Robert E. Ottenstein
- Thiago Duarte

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and thank you for waiting. We would like to welcome everyone to Ambev Second Quarter 2016 Results Conference Call. Today with us, we have Mr. Bernardo Paiva, CEO for Ambev, and Mr. Ricardo Rittes, CFO and Investors Relations Officer.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After Ambev's remarks are completed, there will be a question-and-answer section. At that time, further instructions will be given.

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

I would also like to remind everyone that, as usual, the percentage changes that will be discussed during today's call are both organic and normalized in nature, and unless otherwise stated, percentage changes refer to comparisons with Q2, 2015 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 de Oliveira Silva {BIO 15184017 <GO>}

Thank you, Gary. Hello, everyone. Thank you for joining our 2016 second quarter earnings call. I will now guide you through operational highlights of Brazil, Central America and the Caribbean, LAS and Canada, including our below-the-line items and cash flow. And after that, Bernardo will give you additional color on our operations in Brazil.

Starting with our consolidated results. Second quarter presented high economic and political volatility in Brazil and Argentina, partially offsetting a solid growth in Central America and Canada. Consolidated top line was up 3.2% in the quarter with a volume decline of 6.7% and the net revenue per hectoliter growth of 10.6%.

EBITDA was up 1.8% to R$4.2 billion with an EBITDA margin of 40.5%. Year-to-date, top line is up 2.9% and EBITDA up 1.4% to R$9.5 billion. In Brazil, our performance improved over the first quarter, but we are not pleased with the rate of that improvement. Top line was up 1.7% and EBITDA down 2.7% in the quarter. Year-to-date, top line is down 1.4%, while EBITDA down 4.3%.

Brazil Beer top line increased by 2% in the second quarter of 2016 with volumes decline being more than offset by net revenue per hectoliter growth. Volumes were down 4.5% with great volatility during the quarter. Economic conditions continue to be adverse, with rising unemployment pressuring disposable income.

Our market share improved versus last quarter, and going forward, we continue to expect to fully recover our market share in a sustainable way. Bernardo will give you more details about our outlook for the rest of the year.

Net revenue per hectoliter was up 6.9%, driven by our revenue management strategy, including the benefits from Premium, but partially offset by the high weight of 1 liter and 300 milliliter returnable glass bottles. As discussed in previous calls, RGBs, while EBITDA margin accretive when compared with one weight, with one weight packaging, due to a significant lower cash COGS, carry a relatively lower net revenue per hectoliter. Cash COGS was up 4.1%, while on a per hectoliter base, was up 9%, mainly driven by over-inflation and Brazilian real devaluation, partially offset by procurement initiatives, RGBs, and FX and commodity hedges.

Cash SG&A was up 5.8% mainly due to higher sales and marketing expenses as we started to activate the Rio 2016 Olympics Games, higher logistics and administrative expenses due to inflation, but once again benefiting from efficiency gains in our non-working money base.

Brazil EBITDA was down 2.4%, year-to-date, Brazil Beer EBITDA is down 5.6%. In Brazil CSD & NANC, volumes were down 5.2%. The carbonated soft drink industry continues to be pressured by a negative real disposable income growth and its substitution to water and cheap powder juices. Within NANC, volumes were up double-digits with a strong performance of Gatorade, Lipton and Fusion. Fusion continued to gain market share in the second quarter, strengthening its market position and aiming for the leadership of this category.

CSD & NANC net revenue per hectoliter was up 5.7%, driving a 0.2% top line growth in the segment. Cash COGS increased 0.9% while on a per hectoliter base was up 6.4% as inflation and currency devaluation was partially offset by our FX commodity hedges and procurement savings. Cash SG&A was up 24.5%, driven by inflation and timing of sales and marketing and administrative expenses. As a result, CSD & NANC EBITDA was down 4.7%. Year-to-date, CSD & NANC EBITDA is up 4.7%.

Moving now to CAC, the Central America and the Caribbean region. There, we continue to deliver very strong performance. Following the trend of double-digit EBITDA growth in the first quarter, we managed to increase our top line by 19.9% and our EBITDA by 25.1% in local currency, with 150 basis points of EBITDA margin expansion. In Brazilian reais, our EBITDA was at 41.1%.

In Dominican Republic, we continue to expand the Beer category by connecting our consumers to relevant platform, such as Barbarella, which is the largest electronic dance music festival in the Caribbean. During the quarter, we also supported more than 1,000 micro events in the country activating demand in new out-of-home occasions. In Guatemala, we have been improving our execution with Modelo and Corona, allowing us to increase volumes in the country in a more profitable way.

We also have been growing our business in other islands of the Caribbean through local presence and imports. Along with this strong top line, our EBITDA performance also benefited from our solid financial discipline, leveraging on both costs and expense savings, expanding our EBITDA margins for another quarter. Going forward, we continue to see significant opportunities to grow in organic and non-organic way in the region.

Now, moving to Latin America South. In LAS, our top line was up 2.6% and EBITDA 8.7% above that of last year. Our volumes were down 19.8%, impacted by the Peru CSD exit in the third quarter of 2015, and double-digits volume decline in Argentina, as adjustment and structural reforms undergoing in the country continue to pressure disposable income and consumption in the short term. Adjusted for Peru CSD, our volumes would be down low teens.

Volume weakness in Argentina was partially offset by a solid revenue management in the country and strong top-line performance from Paraguay and Chile. In Paraguay, we had double-digit top-line growth mainly driven by Pilsen and Brahma in the mainstream, and Budweiser and Corona in the Premium segments. In Chile, along with another quarter of solid performance of Stella Artois and Corona, we continue to benefit from the addition of Budweiser to our portfolio in that country.

Net revenue per hectoliter increased by 27.9% in the region, explained by our solid revenue management strategy linked to inflation and Premium mix. Regarding costs and expenses, we remain pressured by high inflation and unfavorable currency movements, mainly in Argentina. But we are able to offset these impacts through top-line growth and procurement savings initiatives, expanding our margins and driving EBITDA growth. Our EBITDA margin was up 210 basis points in the quarter to 36.7%. As we move forward, we remain confident in our ability to deliver a solid top-line growth in LAS while protecting our profitability, despite the economic volatility in Argentina.

Turning now to Canada. Reported volumes grew 8.7%, mainly driven by the benefit of our strategic acquisitions in the fast-growing craft, ready-to-drink and cider categories, leading to the 10th quarter in a row of market share gain. Organic volumes were down 1% with the industry negatively impacted by unfavorable weather, which was partially offset by solid performance of Bud Light, Stella Artois and Busch.

Net revenues increased by 1.6% with net revenue per hectoliter growing 2.4%, mainly driven by our revenue management initiatives and the benefit of a Premium mix. EBITDA was up 9.4% in local currency, benefiting from our recent acquisitions, increasing by 2.5% on an organic basis, driven by top-line growth and EBITDA margin expansion of 40 basis points. Going forward, we remain excited about our top-line momentum in Canada in the whole portfolio, including our recent acquisitions in the Near Beer, while also committed to balance net revenue per hectoliter and market share to deliver profitable growth.

Now moving below EBITDA. Our net financial results totaled a net expense of R$900 million compared to R$360 million last year. As discussed in previous quarters, we have seen higher net financial expenses, mainly due to FX and interest rates moves. Some of these expenses are cash. Some of these are non-cash and have no economic impact. Main non-cash items totaled around one-third of our net financial expense in the quarter.

Main items of our finance results in the second quarter were: first, interest income of R$104 million driven by our cash balance, mainly in Brazilian real, U.S. dollars and Canadian dollars. This is cash.

Second, an expense of R$358 million due to interest expenses. Of these expenses, around R$150 million is a non-cash accrual related to the put option associated with our investment in the Dominican Republic.

As part of the CND deal in 2012, a put option exercisable until 2019 was issued, which may result in an acquisition by Ambev S.A. of the remaining shares of CND for a value that's based on an EBITDA multiple. This non-cash accrual expense increases over time as we approach 2019, as EBITDA grows, currency devaluates, among other factors.

Third, R$465 million losses on derivative instruments, mainly driven by the carry cost of our FX hedges, primarily linked to our COGS exposure in Brazil and Argentina and mark-to-market losses of CapEx hedges. We have a disciplined hedge policy pursuant to which we're always hedging FX and commodity risks in our businesses. Given the interest rate differential between Brazilian reals or Argentine pesos and U.S. dollars, we have financial costs associated to these hedges which are called carry costs. Carry costs have increased significantly compared to recent years due to a U.S. dollar appreciation and higher interest rate differentials.

One important thing to highlight is that depending on the hedge instrument, the cash impact might differ in time from the expense accrual. Another important point is that also depending on the instrument, interest rates moves generate non-cash monthly gains or losses which can explain the core volatility of this line.

Fourth, R$39 million losses in non-derivatives which include around R$90 million non-cash impact from foreign exchange translation losses on intercompany loans, which are offset by foreign exchange translation gains on equities. Both have no economic impacts.

Moving to our effective tax rate. Effective tax rate was 9.4%, up from 6.1% last year. Year-to-date, our effective tax rate is 10% compared to 16.8% of that of last year. Due to higher financial expenses, slightly higher effective tax rate, our normalized net income was down 22.4% in the quarter to R$2.2 billion. Year-to-date, normalized net income is down 12.2% to R$5.1 billion.

From a cash flow perspective, despite the net income decline, cash flow from operating activities, before changes in working capital was flat year over at R$4.1 billion. That said, we have a negative cash impact on working capital due to higher receivables mainly driven by channel mix and lower payables as we have sequentially reduced our spending.

Cash generated from operations was R$2.5 billion while CapEx reached R$1.2 billion. Year-to-date, we have generated R$4.7 billion in cash from operations. In the quarter, we announced the R$2 billion dividends to be paid. As from today, July 29 year-to-date, we have paid or announced R$4.2 billion in interest on capital and dividends.

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. As Ricardo said, we ceased the quarter with high economic volatility in Brazil and in Argentina almost fully offsetting strong results in Central America, Canada and other countries in LAS.

In Argentina, structural reforms undergoing in the country present a great potential for the future, further putting pressure on consumption in the short-term. That said, we're still able to grow our EBITDA in LAS from the solid revenue management, disciplined cost control and strong performance from other countries in the regions.

In Brazil, our numbers improved month-by-month, but not at the speed that we anticipated especially in the mainstream segment. So I'd like to concentrate my comments today on three topics. One, what's working. Two, what's not working. And three, how we expect to build a stronger momentum going forward.

So I'll start with topic number one, what's working. In a challenging environment, having focus on the levers we can control, as we always did in the past. Through our strategy, the five pillars that I always comment with you, we have been strengthening our competitive position in Brazil. In Elevate the Core, we have been expanding our prices and boosting major music and sporting events, the key selling moments.

In the second quarter, we had the strongest average execution of St. John's Festival in the Northeast, where these parties can be bigger than Carnival, and we started to promote St. John's Festival in other regions of Brazil. Along with that, we delivered great experience to people in general, and we see an opportunity to build brand even more and activate demand in new occasions with huge volume uplift.

As another example, for the first time ever, a beer brand, Skol, partnered with the LGBT Pride Parade in São Paulo, the biggest LGBT parade in the whole world, bringing more than 2 million people to the streets, a long-term partnership that makes this an even bigger party going forward.

Let's go to Premium. Premium volumes continues to grow in a strong way, with Budweiser leading the segment in Brazil. In the second quarter, we launched the new one-way 600 milliliter bottle for Budweiser, highlighting its premium appeal through a unique and cool design. Premium preference is high, and it's going up in Brazil. At the same time, there is still significant opportunity to improve the performance. As a consequence, even in this environment, we see Premium growing ahead of mainstream, providing positive price and EBITDA mix.

Within Near Beer, Brahma 0.0% continues to gain weight more than three years after its launch. Coupled with that, we have the Beats family. Near Beer is driving double-digit volume growth in 2016. By further improving the execution of Skol Beats family and Brahma 0.0% and leveraging a strong and solid pipeline of new liquids, we continue to target occasions on where we have a low share of growth, capture incremental volumes in a profitable way.

In the In Home occasion, the big focus this year is definitely on the RGBs. 300 milliliter returnable glass bottles or the Minis, as they are now called, accelerated this year-over-year growth in the second quarter, more than doubling volumes once again in supermarkets. And we have a plan to activate it in the right way, making it sustainable. It's good for everyone that drinks our great brands. It's good for the environment, and it's good for the margins. This is a huge shift in consumption behavior with important implications for the short-term and long-term.

In the Out of Home, affordability plays an important role as well with the 1 liter returnable glass bottles showing volume and mix growth – and mix year-over-year. We have been also strengthening our market position in the on trade channel with our complete portfolio of brands and packs boosted by our improved point of sale execution.

Along with our top line focus, we are also taking advantage of our cost management capabilities which helped us in the past to improve our profitability in different sites. Significant cost savings and efficiency gains were already achieved in the first half, and will continue to positively impact our profitability in the quarters to come in a material way.

Despite of the evolution that we have in our top line plans, we are not pleased with the speed of recovery, nor our results. This leads us to the topic I'd like to discuss, what's not working, the second one. We've been evolving in our top line plans especially in Beer and Near Beer – in Premium and Near Beer. But the mainstream industry remains very rich. We've seen some very good signs of stabilization in the macro front with inflation is going down and the consumer confidence improving, but rising unemployment continues to put pressure in disposable income in the short-term; affordability remains a big issue.

To reflect this reality, we're updating our top line guidance for 2016, also included a new scenario for RGBs in the full year and its impact in the net revenue per hectoliter. We are also updating our COGS guidance to reflect the benefit of RGBs along with an important and strong evolution of our cost initiatives. Now, we expect top line in Brazil to be flat in the full year instead of the mid to high-single digits as previously expected. Cash COGS in Brazil to grow mid to high-single digit in the full year instead of the low to mid-teens as previously expected. We have no change to our SG&A and CapEx guidance. In this context, we need to balance our initiatives to navigate through the short-term, but also to build our long-term, especially when we start to see early signs of stabilization in the macro front.

With that in mind, we see an opportunity to take advantage of an anticipated soft semester to build a stronger momentum for our core brands. This leads me to the third topic, how we expect to build a stronger momentum going forward. Within our top line platforms, we increased the focus on affordability, leveraged the power of our core brands, mainly through our RGBs and complete pack price strategy. As we speak, we are boosting our RGB strategy in the off-trade, launched a national campaign for the Minis, the 300 milliliter bottles, and expanded our initiatives in the new areas in Brazil.

For the first time in many years, we're activating returnables on TV and social media, along with C-stores, pit stops, and supermarkets. We launched a national campaign to highlight the affordable proposition of returnables. Already in July, we had the strongest volume of RGB in the off-trade at least for the last 20 years.

We are also boosting our top line initiatives in the underperforming regions, ensuring that we have a complete portfolio and strong service level in the on-trade, in the off-trade, in all those areas. This will help us to close share gaps and improve efficiency of our revenue management initiatives through our complete pack price strategy.

In the environment that we have nowadays, we are also seeing opportunities to expand Skol, Brahma and Antarctica sponsorship in major music and sporting events that we were not present until today, such as the important Salvador Carnival with Skol, and the Villa Mix Country Festival with Brahma, big events that with direct and interact with millions of people with real experience and contact, enhancing the equity of our brands in key regions for us.

As a final example, we will take advantage of the Rio 2016 Olympic Games to deliver a once-in-a-lifetime experience to consumers, strengthening the equity of Skol brand. We'll deliver a national 360-approach campaign in the Olympic Games, ranging from activation in the off-trade and in the on-trade in the main urban centers in Brazil to unique experience in Rio, such as micro events and Vila Skol, where thousands of people will be able to watch the games, watch the games, eat at food trucks, drink great beers and dance with the DJ, and dance. Upbeat party going on in Rio de Janeiro during the Olympic Games fully organized by Skol.

To close, I would like to highlight that despite the short-term adversity, we are even more excited of the growth opportunities we are seeing. There is a strong, strong sense of urgency in our team to once again accelerate our results, but we need to do it in a way that's right for the business in the short term and the long term. Most of the initiatives we are taking carry structural components linked to brand equity enhancing (26:32) consumer behavior to different packs and to improve our execution-specific areas. That's why we expect our volume momentum to reaccelerate towards the end of the year.

With that, we can now move to the Q&A.

Q&A

Operator

We will now begin the question-and-answer session. The first question comes Andrea Teixeira with JPMorgan. Please go ahead.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

[Foreign Language] (27:24). Thanks for the question. I wanted to just pretty much explore a little bit more on what Bernardo and also – I'm sorry, Ricardo also commented on the call, on the prepared remarks pretty much on the guidance. When you're thinking about the total of the top line being flattish and given that the average pricing is relatively in the mid-single digit growth, should we assume that, as you normally do with RGBs more long term that the volume environment is still going to be difficult and you were tactically building it for the long run as usual and you're not going to go in any price war?

Because I was surprised, usually the second quarter, market share dynamics, as you called in the first quarter call, were improving. So I wanted to just reconcile it a bit of the top line. Thank you.

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

Thanks, Andrea, for the question. We know that the first quarter was tough, but some headwinds in terms of taxes that we had to put price. And, yes, we lost some market share on that. But again, in the second quarter we improved it, not at the speed that we expected, but we improved it. And we have opened many, many fronts in our top-line brand, Premium, Near Beer, execution in the point of sale, the market programs with Modelo. But, again, the mainstream industry remains very (28:55), Andrea.

We have seen early signs, as I said in my speech, that 2017 could be better, inflation is going down, consumer confidence improving. But at the end of the day, the rising unemployment in the short term is putting pressure in the industry in the short term. And that's why to reflect this and to reflect the new RGB reality and the impact in net revenue, we revised the top-line guidance as we speak.

Let me get to the specific to your question of market share. I think that for the second half of the year, we're improving a lot and boosting those structural initiatives that I mentioned before. So first, again, RGB is going very, very well. July was very good, national campaigns, everything that we're doing in many, many regions. Market programs to underperforming regions, we expanded that, Olympic Games, expanding Skol and Brahma activation in many major sporting events and musical events and doing these (30:00) to reactivating all the channels, digital as well, and above the line campaign.

So with that, we have been seeing that our market share trending in the right path. And the early sign that we have for our July numbers shows that we are back to our range and in line with last year's numbers in terms of market share for July. So things are turning in the right path and we think in the right way.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

All right. Thank you.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi, everyone. I guess somewhat as a follow-up to your comments on the last question. I've heard from yourselves, and ABI made a number of comments this morning, about very competitive behavior going out in the industry right now in Brazil. I know you don't like to talk too specifically about your competitors, but I'm just trying to get a better sense of the magnitude of this competitive behavior, I guess, that we're seeing.

Looking into the second half of this year, your defense, I don't know if it's more on the mixed RGB side or there are pricing opportunities or there's more on Premium brands? But like I said, I'm just trying to get a better sense relative to what you're seeing from a competitive standpoint. Your reaction if things continue to remain as tough as they've been. Thank you.

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

Lauren, thanks for the question. I think the Brazilian industry has been always tough. Today is not different, and we know that (31:35) in the first half of the year, putting price, plus tax, federal tax, and state tax, was a tough call, but was needed. And then, again, we lost some market share.

I think that we took the right path to really to implement our top-line plan, to do structural moves in this market in a sustainable way and bring the share back in a sustainable way. We could recover the share right away the next month. Maybe pulling price down, we can do that. We started to implement, I mean, again, structural initiatives like the RGBs. So, again, the plan for the second half of the year is very confident on that. I think that the portfolio of the brands – we have a great portfolio of brands. Our preference is way above our market share. Premium continues to grow, Budweiser is leading this segment. You see the Near Beer growing as well.

On top of that, execution in the point of sale, and there is some reason that we are not 100% like we expected. It wasn't big, big. And those major events that we are sponsoring will help us to build a 360-campaign not only in the event, to really build that momentum through the second half of the year and even start next year in a much more strong way.

Q - Lauren Torres {BIO 7323680 <GO>}

And can I just ask then as a follow-up. You mentioned boosting some specific initiatives. I'm assuming this is not at any incremental cost, kind of rebalancing cost. How are you thinking about spend behind these initiatives?

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

No, it's no incremental cost. But think that when you do structural things, like the returnable bottles in the off-trade, it's a learning curve how to operate it better. And there we are relearning that very, very fast. So don't expect no cost increase or the opposites, our costs are completely under control, using all the technology that we have to do things in a more efficient and cheaper way.

Q - Lauren Torres {BIO 7323680 <GO>}

Thank you.

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

Thank you.

Operator

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

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you. Good afternoon, everyone. Well, my question is regarding free cash flow generation and dividends. If you look at your free cash flow statement, you've been hit this year by lower trade payables, which I understand is because your production volumes is going down and so you're suffering on that. And therefore, your cash flow generation this year is a little bit lower than what we thought.

And if you look at your dividends payment, and dividends announced so far, they're also lower than what we saw last year. So just wondering how much you think you're going to be able to generate of cash this year, considering that your outlook seems like considering further deceleration of volumes or at least a flattish sales kind of imply that and how you think of dividend payout considering that historically you have guided for 100% dividend payout in terms of free cash flow? So it would be nice to hear your thoughts on that. Thank you.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Hi, Duarte. Thank you for your question. So I will guide you through the main drivers. So we start from a very similar cash flow generation before working capital and provisions of debt of last year. And then we had a negative cash impact from working capital. So we do have a negative working capital position which means that every time we grow, and over the long-term we expect to grow, so as I just quote a little bit of what (35:23) said in his call, we continue to expect Brazil across the cycles to grow, maybe not grow in a straight line, but growing over time. So it's a great position for you to be in, having a negative working capital position.

But every time you grow a business, there's of course a working capital back, but the opposite is also true. So, as a consequence of the deceleration of Brazilian economy, I can go through the drivers in there, we did have an impact when you compare it to 2015 of both receivables and payables. And as a result of that, I mean, when you look at the cash flow generated from our operations after that was R$2.5 billion in the quarter and R$4.7 billion in the year.

When you look at what we gave back to shareholders, and that's what we said even in the speech, we already paid, or announced R$4.2 billion in interest on capital and dividend, which talks to the R$4.7 billion. And also, I would like just to highlight that, of course, every time we have excess cash, we return it to our shareholders. That's what we have been doing. That's part of our financial discipline. And as a result of that, also one thing for you to have in mind is that the seasonality helps going forward in the second part of the year. So, we have like a concentration in terms of cash flow generation. And as soon as the growth resumes, we can get this working capital delta back.

Q - Thiago Duarte {BIO 16541921 <GO>}

Great. Thank you, Rittes. And if I could have a follow-up question, looking for more granularity on the volume performance. You mentioned in the first quarter that April was looking much better. And, of course, we ended up having this negative performance. So it will be interesting to see how the volume is performing throughout the quarter in a more – with a little bit more granularity? That would be great. And if you could also mention or comment if there were any big discrepancies in terms of performance per region in Brazil, any specific region that you saw different competitive pressures or demand hit or something like that? Thank you.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

First of all, I'm going to start with the second part of your question. It's the easy one. We don't comment on any specific regions, and I apologize for that. But our performance in the first quarter versus the fourth – in the second quarter versus the first quarter, improved, like Bernardo said, not in the speed that we had anticipated. And we have been involved in many commercial fronts, especially Premium and Near Beer. Market share trends improved. Like Bernardo said, we are pretty much in July already in the range that we have been before, and in line with that of last year, but the mainstream industry remains very weak.

So the current trends and what we expect for the second half is linked to our guidance, which also includes the updated scenario for RGBs, both on the top line and in the cost side. And if you go back to what we said, the strong April, and also as we already discussed, we have seen very high economic volatility. So (38:45) in April compared to the first quarter, and our results in the second quarter improved versus the first quarter. But, again, just to highlight, not to the speed that we anticipated.

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

And, Duarte, the fact that the high unemployment rate, that's – I mean it's going up month-by-month. As I said in my speech, will put pressure in the mainstream industry in the second half. But we'll play offense in the sense, I mean implementing our top line plan, and really build this momentum through the end of the year and to start in an even more stronger position in 2017.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you so much.

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

Thank you.

Operator

The next question comes from Alex Robarts with Citi. Please go ahead.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thank you. I guess my main interest is understanding the cost inflation outlook here in the context of your lower guidance, specifically how we were now at mid to high single-digit growth from the low to mid-teen growth in Brazil cost. And so, you've got the hedges in place for the rest of the year that are both on the commodity cost side as well as FX. And is it safe to assume then that the fact that costs in Brazil are now expected to increase less, is it just solely a function of your expectation to sell less volume?

And I'm trying to relate this also to the fact that as you ramp up more the RGB, I guess that's an incremental cost component. So – and definitely appreciate you giving us the range. It is a wide range. And so kind of the motivation of the question is just to kind of get a sense of really where do you think you could be in that range on the cost growth? Again, is it solely just a function of you're going to have less volume?

And the second part of the cost inflation question is, any color or any thoughts about kind of the shorter term outlook on some of your input costs? Specifically, I'm thinking of the soft drink input, the PET, and the sugar that seem to be trending up. So that's my question. Thanks very much.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Alex, thank you very much for your question. Let me just go first with, among other things, cash COGS benefited from, number one, a positive mix of RGB, procurement saves and productivity gains, and FX and commodity hedges. So when you look at the amended guidance that we provided, both for top line and COGS, they talk to each other. When you see like the opportunities that we have on the COGS side, they also talk somehow to the environment in which we are living in Brazil specifically.

And that's one aspect of our culture in which quiet as (42:19) such as this one, we have our procurement, but all the whole organization, supply organization trying to get the same, and partnering with our suppliers to try to get the same, and get productivity into the system.

So while we're being negatively impacted by currency movements, operational deleveraging and increased weight of Premium products, we are able to somehow improve what we expected for the year in terms of COGS. And going specific to the RGB, so driving affordability, because we can get the benefit on the COGS side is a top priority for 2016, because we believe that's a win-win situation. So again, significant procurement savings were already achieved in the first quarter, now in the second quarter accelerating. So we feel very confident in providing the guidance in the range that we gave.

Q - Alexander Robarts {BIO 1499637 <GO>}

Right. So, I'm sorry, but lower volume is probably, I guess, and would be my follow-up, so lower expected volume in Brazil is probably the main driver of having low cost, is that a fair assumption, and – yeah, sorry.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

No, Alex. Actually not, I mean, what's the main factors that whenever you have demand in the whole country, not only demand for beer, but demand for the supplies that we need to produce beer as well going down. It presents opportunity for our procurement, for our supply organization to work a little bit more efficient. And as a result of that, you see an improvement. Overall, when you look at the overall COGS, well, you'll also see an improvement in terms of our expectation on a COGS basis as well.

On top of...

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

That's into our guidance.

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

On top of that, Alex, I mean, our culture are cultures of operation excellence. So I think that our team is stepping up in terms of operation excellence that will bring the cost down as well. So to do the same and better with less money. So it's part of our culture. It's what we have been doing.

Q - Alexander Robarts {BIO 1499637 <GO>}

Sure. Now, thanks for that. Fair enough. And any thoughts still on kind of cost inflation outlook on the commodities in the near-term, or...?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Actually, the only breakdown that we provide is within the guidance. So it's essentially – it's no – there's no breakdown that we could provide at this moment.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. All right. Thank you.

Operator

The next question comes from Jeronimo De Guzman with Morgan Stanley. Please go ahead.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Hi. Good morning. I wanted to ask this COGS question, maybe from another angle, I mean, I'm just trying to reconcile the guidance with the fact that the year-to-date has been much lower. You're down 1.7% for the six months. And considering that you still have kind of the expectations of lower top line growth and higher returnable mix, I'm just wondering why your guidance implies such a big change in the trend, why you would expect such a big, I guess acceleration on the COGS side that you're not having on the top line? That would be my first question.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you for your questions, Jeronimo. So, we are amending the guidance downwards, and that's the guidance that we have for the full year. So, our expectations are included in the guidance, and of course, you can follow-up exactly what the math that we're doing, what are the questions that you have specifically. But our full year expectations is embedded into the guidance. There's seasonality in the business. There is an impact of our hedges which takes into consideration a little bit as we are very disciplined and methodical in the way we do it. We don't take a view on anything. And as a result of that, what you see is a little bit of a mirror of what has been the effects the year before, roughly speaking. So all that needs to be taken into consideration when you look at the full year COGS performance.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Yeah. I mean, I guess I'm just thinking that if you brought the top line down, that in itself causes the COGS to be down, but then on top of that, you've got the savings from RGB. So, I guess that's why I was thinking that it could be even kind of a lower increase in COGS for the year. But anyway, I can leave it at that. And then on the SG&A side, I guess a little bit different, I mean, how confident are you that you can maintain that guidance just given that, yeah, year-to-date, it seems like it's on track, but the second quarter, you did have a bigger increase in the first quarter. So, any thoughts on that?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

So, just like to be very clear, the guidance that we have amended for COGS reflects more opportunities in terms of overall COGS per hectoliter in comparison to what we have anticipated, including the RGB acceleration, in which, like Bernardo said, we had the best month ever in terms of our RGBs volumes in the last month.

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

In the supermarkets.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

In the supermarkets.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Okay. And on SG&A, sorry?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

SG&A, we are very comfortable with the guidance that we have provided. Very confident, and there's no amendment needed there.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Thank you.

Operator

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

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good afternoon. Thanks for taking my questions. It's a very general one, Bernardo. I think we've had a relatively consistent picture from a number of consumer companies over the second quarter that was even tougher than Q1. At the end of Q1, there was maybe some optimism for sequential improvement, and then things got worse, very - a lot of comments understandably about trading down, mix, impact. And I think that's pretty consistent, I think very much in line with the situation in Brazil.

My question is, from where you stand, from where you see and how you plan into the second half, where do you stand with the view of the second quarter may have marked the draft for consumer weakness, and/or this type of trends, and then from now on, we might see some better support? Or rather, your changing guidance, your changing strategy reflects more the view that this is how things are, probably they're going to stay like this for a while, and therefore we are stepping up even more certain initiatives, returnable, affordability, and so on and so forth.

Maybe just your sense on, in this there's a lot of wishful thinking I guess when it comes to the improvement in Brazil. So maybe what do you think about that? And if we may hit the bottom and even slowly from now there's more of a recovery ahead?

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

Thanks, Luca, for the question. I think, Luca, first of all, I have been operating in Brazil for more than 25 years in the country. The direction is growth. The country will grow, and then we have some bumps here and there. We always know that and know how to deal with an environment like that. Specific for the second half of the year, as I said in my speech, we expect a more soft industry because this industry is under pressure given the higher unemployment, lower disposable income that we're seeing in the short term. So this is a fact the second half of the year.

And together with our RGB expansion that I explained before, this explains the guidance, the top line guidance that we changed. So, after that, 2017, I think that we know that we have early signs that the country will be back on track. And that's why due to strong plan for the second - we are - we double up our plan for the second half of the year to build a strong momentum towards the end of the year that will reaccelerate our volumes. That's what we expect and will help us to start 2017 in an even more stronger way.

First signs of that, as I said before, was our July 1 views on our market share. That is in line with our range and in line with what we had last year. So we are confident that Brazil will be back to the game, and even more confident that when it happens, we will be ready to fully profit of this growth that will be back.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Perfect. Thank you. Thanks, guys. Thank you.

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

Thank you.

Operator

The next question comes from Carlos Laboy with HSBC. Please go ahead.

Q - Carlos Laboy {BIO 1506984 <GO>}

Yes. Good afternoon, everyone. I have questions on three areas of your RGB strategy. The first one is, if you could please comment on what type of change in the industry is your refillable glass strategy maybe provoking? Is anyone following you with it, are there similar package shifts happening among other brewers, or are you seeing response in the form of maybe discounting in cans? What change are you provoking with this strategy?

The second one is, can you speak about the next phases of the Mini bottle roll-out beyond supermarkets? Is there a role for these smaller packages in some on-premise occasions or channels? And, third, maybe you can speak on broader terms about any other markets around the world that informed you on the potential of this mix shift strategy in beer?

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

Yes. Carlos, thanks for the questions. I think that the RGB, in the off-trade, it's really change in the consumption, a big change of consumption behavior. That's why it's not helped overnight, but help is happening in a faster pace. So basically the last time that we shown important volume in Brazil with RGB, this was in 1996, probably 1997. And then after that, the one-way packs get there. Seeing the environment like that, people are understanding that should have every day same price and lower price, affordable price proposal. We need strong brands like Skol, Brahma and Antarctica. It's a great deal.

On top of that, I think that society changed a lot in 20 years. People are much more concerned in terms of the environment impact of the effects. And I think that RGBs could be not only in their off-trade a proposition to the In Home occasion, not only because of their affordable price, but because it's cool. It really shows that people are connected to what's happening outside in the world. So based on our research that we have is not only because it's affordable, but, again, because it's good for the environment and even some people say that taste's better. So when you have the buzz in the market.

So that's why I think that we have room to improve, increase. Based on the other markets that I have been visiting my previous life, (54:14) I visit many, many markets, we can see markets that RGBs in Australia, kind of 90% of weight. I think that Brazil not yet there. But certain markets, important markets, and big markets, like South Africa for instance, Colombia for instance, that is important. Mexico as well, important (54:42) RGB. Argentina as well, Uruguay as well, Paraguay as well. So I that's it's a trend that's started to operate. It's more complex. Does not mean that is more costly. It's more complex. But with our culture, our team, we have excellence, operating, doing things with excellence. I think that we can do this in the right way, in a sustainable way and helping as well to build our brands.

Q - Carlos Laboy {BIO 1506984 <GO>}

Can you speak about the next phases of the Mini roll-out beyond supermarkets, as the role for this on-premise?

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

In the on-premise, it's not our power pack in the on-premise, because I think we have a great pack in the on-premise, the one-liter bottle, the 600 milliliter and the one-liter bottle, because the on-premise is on Out of Home occasion, is more sharing occasion. So it's good for people to share. So in this case, the 600 milliliter and the one-liter are the packs, the power packs there.

But I think that the returnables, the Minis, could expand even more, not only for the retail, big retail, but for the small formats as well. And off-trade is growing in Brazil. So I think that, yes, I think that we have room to grow more. That means that, again, it's good for everyone, it's good for the great people that drink our beers, because it's affordable, it's good for the environment, it's good for the margins, and lots of people say that it tastes even better. So, I think that's a good proposition for the future.

Q - Carlos Laboy {BIO 1506984 <GO>}

Thank you.

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

Thank you, Carlos.

Operator

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

Q - Robert E. Ottenstein {BIO 1498660 <GO>}

Hey, guys. I know you've addressed this throughout the call a little bit, but I'm still a little bit confused on the change in the top line guidance. Just trying to get a sense of, I know things aren't improving as fast as expected. Is that due to economic factors in the consumer, the elasticity of demand, given changes in disposable income, execution issues on your side, and/or the impact of returnable glass bottles, and to what extent is the impact of the returnable glass bottles a factor in the change of guidance? And what percentage of that change of guidance would be attributable to a faster than expected acceleration in the impact of returnable glass bottles?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Hi, Robert. Thank you very much for your question. Ricardo here. As Bernardo said, again, our performance in Brazil improved over the first quarter, but not at the rate that we had anticipated. And as we have been involved in many commercial fronts, especially Premium and Near Beer, we see that the mainstream industry remains weak. And then we have seen some early signs of stabilization on the macroeconomic front with the inflation slowing down and consumer confidence sequentially improving. But still, rising unemployment should continue to pressure disposable income in the short-term. That's all taken into consideration.

And then to reflect this reality, we decided to update our top line guidance for 2016, which also included a new scenario for RGBs for the full year and its impacting net revenue per hectoliter. As a consequence of that, we are also updating our COGS guidance to reflect the benefit of RGBs, along with an important evolution of procurement initiatives, which also talk to that macroeconomic scenario that we discussed before.

Q - Robert E. Ottenstein {BIO 1498660 <GO>}

So is the answer, the economy is a little bit worse than expected and RGBs are a little better than expected?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Again, it is the way (59:01) that we have seen early signs of stabilization. But again, inflation is lowering, but unemployment continue to pressure disposable income in the short-term. We are very happy to follow-up that with you with more detail offline. But I think that's the summary of it, and of course, the top line connects also with the COGS, even the COGS per hectoliter, because the same macroeconomic front that presents a more challenging top line scenario also presents more opportunities for us to go there and put efficiencies into the system that we believe are going to stay for the medium-term and long-term.

Q - Robert E. Ottenstein {BIO 1498660 <GO>}

Got it. Got it. And then just given the economic situation, can you give us an update in terms of the outlook for any changes in taxation at either the national or state level, please?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

In terms of taxation, we had a new model approved in 2015 with federal tax increases scheduled for 2016, 2017, and 2018. So we already have the change. We believe this new system is an enhancement over the old one, because it brings greater simplicity and predictability, and very important to emphasize, will ensure government tax collection continues to grow, but with no material impact on volumes.

In terms of on the state level, what we have seen is that we believe that in each state, it still has its own model on tax rate. There's always discussions going forward. And I think that in a similar way to the discussions that we have at federal government level, the cold beverage industry as a whole, holds a permanent and constructive dialogue with each state government, with intent of showing that a lower tax burden on the industry enables a greater potential for volume growth and further investments.

And as a result, allows tax collections to continue to grow with no pressure on inflation, job creation, and investment. And we also, the industry as a whole, communicated that on the other hand, in the case of tax increases, the industry as a whole will always pass through this tax increase to consumers. So, we believe that it's no news, and we continue to have a seat on the table.

Q - Robert E. Ottenstein {BIO 1498660 <GO>}

Terrific. Thank you very much.

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

Thanks, Rob.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you.

Operator

This concludes the 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, Gary. So as I think of the final messages, I mean, first, I mean, Brazil will be back on track. We know that the short-term second half, I mean, the industry continues to be pressured. As Ricardo said, and as I said before, unemployment, still high, but mid and long-term, back on track, as it always did in the past.

Second, our market share, based on our top line plans, that plans are being well implemented, and we are in a good track to back our share – to get our share back, and July is a good sign of that. So very positive on this and confident on that.

And third, I mean, the strong push and a strong plan that we have for the second half will build the momentum for the second half, reaccelerate volumes and start 2017 in a much stronger shape that we started this year or even the previous year.

So in a moment like that, of crisis, these people, this company, our culture, our team really works harder to be more creative. And we assure that we'll ramp this turbulent moment in Brazil in a much better shape in terms of brands, execution, costs that we entered. So that's the final message, a positive one we'll keep here with the sense of urgent and fighting every day to improve. Thank you.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you.

FINAL

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Operator

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