Q1 2020 Earnings Call

Company Participants

- Jean Jereissati Neto, Chief Executive Officer
- Lucas Machado Lira, Chief Financial and Investor Relations Officer

Other Participants

- Ben Theurer, Analyst
- Isabella Simonato, Analyst
- Joao Soares, Analyst
- Luca Cipiccia, Analyst
- Robert Ottenstein, Analyst
- Thiago Duarte, Analyst

Presentation

Operator

Good morning and thank you for waiting. We would like to welcome everyone to Ambev's First Quarter 2020 Results Conference Call. Today with us, we have Mr. Jean Jereissati, CEO for Ambev; and Mr. Lucas Lira, CFO and Investor Relations Officer. As a reminder, a slide presentation is available for downloading on our website ri.ambev.com.br as well as through the webcast link of this call. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After Ambev's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions)

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 the 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 first quarter 2019 results. Normalized figures refer to the 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. Jean Jereissati, CEO for Ambev. Mr. Jereissati, you may begin your conference.

Jean Jereissati Neto {BIO 20161989 <GO>}

Thank you. Good morning, good afternoon to everyone. Thanks for joining our Q1 call. Today I will share the overall view on our business, and Lucas will cover the highlights of our financial performance. We will be as brief as possible, so we can dedicate more time to Q&A.

Since COVID-19 has been so life changing, I want to share what we have seen so far on the ground, what we are doing about it and how we plan to come out of this stronger. During Q&A, I will happily take any questions you may have regarding our Q1 performance.

I would like to start by thanking my team. They have risen to the challenge and have made a big difference in how we are managing the crisis so far. Above all, I want to thank our people at the breweries, at the distribution centers and everyone who has been servicing the market despite all the risks they are facing.

As you know, we already knew Q1 would be challenging. We expected COGS pressure, front-load of sales and marketing investments as part of our commercial plan and a tough comp, as we had the peak of our market share in Q1 '19. But then COVID-19 came. It was an unprecedented event that really negatively affected our performance on top of everything.

I would like to explain how each region was affected in terms of volume impact. Panama, Dominican Republic, and Bolivia were hit the hardest. Those countries had more severe restrictions on people circulation, adopting on and off trade opening hours in alcohol sales ban. Brazil suffered quite a bit, given the relevance of the on-trade channel, which was significantly impacted by state and local government measures to contain the spread of the virus.

Argentina, Paraguay and Chile suffered less because our volumes are heavily weighted towards the off-trade channel.

Canada volumes benefited in the short term, given the pantry loading. It has been challenging to manage through COVID. People are scared and there is a lot of uncertainty. But as far as Ambev is concerned, our dream of bringing people together for a better world is more relevant than ever. I believe we have been able to move very fast because we entered this crisis very well positioned.

What I believe is making the difference for us is the following. First of all, we are taking care of our people. Our top priority has been the safety and health of our team. We have focused on providing a safe working environment. Thankfully, we have had a limited number of cases and we have provided full support to our people and their family. Our team has shown great resilience, agility and sense of ownership. In fact, I think it is fair to say, this crisis has brought the team closer together.

Second, our size and scale are making the difference. Being present in 18 markets across the Americas and being part of AB-InBeva gives us a unique position to learn from each other. We can share best practice, anticipate issues and be prepared for what's about to come. We entered this crisis with ample liquidity. Our financial discipline also helped. We quickly revisited our cost, expenses and investments to focus on what matters most in the current environment. But we did not lose sight of product quality, the long-term health of our brands and our desire to continue to innovate.

Third, our strategy. COVID-19 is becoming a catalyst to accelerate the changes we have been implementing in the company so far. I would like to recall that our strategy is based on three pillars: Ambev as an ecosystem; innovation as a mindset; business transformation enabled by technology.

Let me share with you what we are doing in each of these three pillars. Starting with Ambev as an ecosystem. We know our businesses are local. We understand it is our role to help the countries and communities where we operate. We knew we had to collaborate, repurpose the company's competencies and capabilities to really solve real problems.

So what are we doing? First, we need to be there for our community. Let me give you three examples of what we have been doing so far to impact people's lives in a relevant way. In most of our markets, we converted some of our production lines to produce and donate hand sanitizers to most of our markets. In Brazil, for example, we put out a team into a project to build a 100-bed hospital in 36 days just being delivered before the peak of the virus. We will also produce and donate 3 million PET protection masks for health professionals in Brazil.

In Argentina, we are donating beer barley to produce bread. We are also helping to distribute the bread through our route to market in collaboration with NGOs.

We need to be there for our customers to particularly the on-trade. Stella Artois has had a campaign to support restaurants and bars in most of our markets where consumers can support their favorite bars and restaurants by buying vouchers for future consumption. Finally, we need to be there for our wholesalers, suppliers and commercial partners and we need to work together with government. We are being as flexible as possible to work with the stakeholders while protecting our business. Lucas will speak more about this later.

The second pillar of our strategy is innovation as a mindset. On Carnival, we have had a successful nationwide launch of Beats GT. It was consumed by four out of every 10 people who attended the street celebration. And among younger people above the legal drinking age, the number increases to six out of ten. In the first quarter, we were also piloting Brahma Duplo Malte as a innovation on the core plus pure malt segment, with a different concept of liquid to play. And because every crisis brings opportunities, we quickly identify a social need that people need to have access to entertainment while staying at home, the livestream concerts and we were able to ramp Brahma Duplo Malte up, achieving in two months what was supposed to be done in two years.

We expanded the livestreams platform into a full calendar of concerts with different musical genres, and included our broader portfolio such as on top of Brahma Duplo Malte, Bohemia, Budweiser and Original. We had 375 million views so far breaking all viewing records possible. We had 24 times more earned media impressions than FIFA World Cup in 2018. On our first livestream with Bohemia, we had 272,000 mentions on social media, which means about 8% of the total number of mentions that we had from all of our brands in 2019.

The third pillar of our strategy is business transformation enabled by technology. Here I would like to highlight the acceleration of our B2B and B2C across our market. We boosted our capability and reach, solving clients pain points and bringing convenience to consumers. For example, our B2C platform in Brazil, Ze Delivery more than doubled the coverage of POCs since mid-March. Only in April, it made more than 1 million deliveries, compared to 1.5 million during all of the year 2019.

To wrap up, I would like to say, we are not only focused on surviving the storm, but we really want to come out of this stronger. Thanks to the transformation that we already had begun. Q2 will be tougher than Q1 as all our markets cope with volume decline that results from COVID-19 and the operational deleverage that comes with it. But we are here for the long term and are confident in our ability to bounce back and we will do that by focusing on our people, being there for our consumers and clients, continue to invest towards a winning portfolio, and serving our communities and collaborating with wholesalers, suppliers, commercial partners and government.

So thank you very much. See you in the Q&A. And Lucas, over to you.

Lucas Machado Lira {BIO 21526003 <GO>}

Thank you, Jean. Good morning, good afternoon, everyone. Great to be back at Ambev after 6.5 years at AB-InBev. I'd like to thank Tennenbaum for his support during the transition and for leaving behind a great team, which has made a huge difference as I arrived.

I've already had the opportunity to reconnect with some of you on the sell-side and the buy-side in the last couple of months. And I look forward to working with the investment community going forward.

Our Q1 financial performance was mainly impacted by the EBITDA decline and a significant increase in our financial expenses, due to the settlement of equity swaps and higher carry costs related to the hedging of our FX and commodity exposure in Argentina.

In terms of our financial performance since the COVID-19 outbreak, we've been focusing on two things: one, manage our liquidity in a disciplined way; and two, revisit our cost structure and expenses to minimize the impact on our profitability.

Regarding liquidity, although we entered the COVID-19 crisis with a very solid cash position, we haven't lowered our guidance. We've increased the level of tracking of receivable, being flexible where we can to support our wholesalers and POCs. We are sitting down with governments to see where we can work together to support trade, we're working with our suppliers as everyone adapts to the tougher outlook, we're revisiting our CapEx and re-prioritizing our investments, and we've access to credits in select markets as an additional safeguard.

As far cost and expenses, we conducted a bottom-up exercise with each line item owner to tighten the belt, revising the budget and reprioritizing, particularly what we call non-working money. As an example, we have significantly reduced our travel spend and internal event. we've internalized certain services and revisited our entire people spend towards avoiding furloughs or layoffs, while taking advantage of government relief initiatives.

We're also looking into working money. We reviewed our trade spend on the on-premise channel, we've leveraged more our draft lines content creation team as well as revisited our marketing investments. For instance, we've suspended investments that are tied to large scale events that have been suspended or postponed. In content creation, that does not speak to what consumers are currently going through have been either suspended or shifted towards our prioritized marketing initiatives, like the one Jean mentioned. All of this while maintaining or even boosting service levels to clients, sticking to our main investments behind key innovation and without compromising the quality of our product.

Finally, our hedging policy for FX and commodities remains in place. Given the increased level of volatility, we see even more value in the predictability that hedging our exposure on average 12 months ahead gives us.

To wrap up, given all the uncertainty that lies ahead, we will continue with dual focus on protecting liquidity on the one hand and minimizing the impact of volume decline on our profitability on the other hand, while trying to seize opportunities that come up. It is fair say however that protecting profitability will be our biggest challenge on the financial side, particularly in Q2.

With that, let's go to Q&A. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Isabella Simonato with Bank of America. Please go ahead.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you. Good afternoon, everyone. Jean, Lucas, congratulations on your new role, and welcome back. I have two questions. First of all, we are seeing China finally opening up again right after almost four months of lockdown. Which lessons can we learn or can you can you actually learn from the opening of the country and from the early recovery of the consumption, right, in terms of channels and in terms of the size of the recovery. How can we -- how can you anticipate some of that to what Brazil may face in Q3?

And second of all, looking at the volumes in March specifically and what we are seeing in April, can you provide some color on the performance per channel specifically discussing what's going on in the retail, right, and also for category of beer between the mainstream and the premium, if you could quantify a little bit the performance. Thank you.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

Okay, thank you very much, Isabella. You know, I have been in China for -- I worked in China for four years. I left China in the end of 2018. So, the team over there is pretty much the team I have worked for a while and we are in a very close moments. So I have been working on the crisis in China. Since the beginning of February, I was invited to participate to understand what's going on at first to help China and then at some point in time to understand and learn and use the learnings here in Brazil and we have seen a lot of things over there.

So what we see it is that this crisis has some phases, that you really have to take care on the operational side. So first is about, people first, then we saw that you have to be very accurate on predictability and volumes for not stop hardly the production or lose the timing on the come backs of S&OP is something that has to be very well run with all the company looking at it.

What we saw too is that this come back -- it come back in stages, so we see different types of return in different types of channels. Of course the off-trade, it was more resilient on this crisis. And then we saw - and then the e-commerce has really accelerated and then we see restaurants coming back slowly in the nightlife taking a little bit more time. So we have to have this type of proxy to the come back here in Brazil. When you look at this in Brazil, these trends that we see is really in moms and pops and small off-trade is the channel that has more resilience during this crisis and for sure e-commerce and convenience is just on fire.

Another thing that we are looking too is that everybody has to think like an ecosystem on this come back. So we have to have ability to find a way to guarantee that the ecosystem is healthy and you don't lose wholesalers and then you don't lose POCs, the most you can stabilize the system this fast is the recovery moving forward. So in -- lots of learnings with China, doing this proxy to what's going on in Brazil, it's pretty much what we are seeing, in-home consumption going up, local purchase mainly from small off-trades and moms and pop, core brands showing resilience on this crisis more than before. Everything is going digital, orders, entertainment, conversation, media. So everything is really going digital is not -- if you are not prepared, it's very hard for you to move fast and we have to have a base for us to really serve what's going on. And we are seeing convenient packs, cans, long necks really moving much ahead on the returnable packs. There is the best that are more related with their on-trade channels.

Operator

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

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi, Jean, Lucas, good morning. Thanks for the question and I hope you all are well. My question is the following. If I think about the discussions over the last maybe couple of years, I think a lot of sense is around the health of the brand portfolio, the consumer preferences shifting or evolving as well as the right balance between premium, main stream, affordability. So my question would be, do you see opportunities in this environment to, let's say, recognize maybe initiatives or certain sort of brand initiatives that you may have not been able to pursue in the past? Or if so, how could you find maybe some competitive advantages in taking this time and taking this sort of pause in the operating environment to reinforce some of the connection with consumer with certain brands? And secondly -- I'm talking beer in particular here.

And secondly, how do you see the market coming out of this with regards to affordability that as we discussed in Q4 in the last call, was already an ongoing effort or an initiative in normal market conditions. So how should we think about that balance between premium, affordability, maybe some of the value initiatives that you've done over the last few months. Can you discuss a little bit brands, portfolio, health and maybe opportunities as well as the price/mix balance as we hopefully come out of this in the next few months?

A - Jean Jereissati Neto {BIO 20161989 <GO>}

Okay, thank you. Somehow I don't see a major change on consumer trends in preference because of the crisis. What I really see is really an acceleration what's -- about what's going on. With the caveat that everybody looks like it's a little bit more pressured in terms of money, in terms of disposable income, so this is an important piece, that there is a little bit of a push for a trade down, but that I cannot confirm that yet. Okay. So this is one thing that we are seeing. But I think it's too early to tell.

But having said that, Brazilian consumer is very -- the category of beer is very healthy in terms of share of sold. So the consumers are very open to understand then to go deep and to have more occasions and to understand the heritage and the meaning of the products or the concepts of innovations. We see this being very accelerated during the crisis because digital media is the most important media and then you can go deep, you can have more storytelling.

So in the end, what I see, it is an acceleration of trends that are there, and the good part it is that really things that we were doing, things that would have two years, three years to mature, they are maturing much faster, for example. So we are really -- the innovation of 2019 was really Skol Puro Malte that is doing well. It continues to grow. Brahma Duplo Malte will come a little bit further. It will take time. We're really seeing it picking up much faster because of the platforms, because of the moment, because it really had hit a home run like batting on the lives. So we're really seeing things that would take three years taking two months or three months to be in terms of awareness at least. Okay.

So I'm seeing a lot of acceleration. And what I can add on top of that it is that -- so to be what we have seen is the competitive landscape really do not moving as fast and as consistent as we are, so that's how I feel. Somehow since January, I've been talking about Ambev as an ecosystem, innovation as a mindset in technology, and it looks like this mantra is really something that is really been accelerating during the crisis, while other competitors are really fighting for survival or really very alienated, or following what's going on. So I really think that we will get out of this crisis stronger in terms of consumer connections, in terms of brand connections, just to give you an information.

Ambev is the number one brand, remember, in terms of doing good during this crisis, so mainly in recessions [ph], we are seeing that Ambev about the mother brand. Brahma Duplo Malte is the beer brand of the quarantines of this moment, because it's really trying to solve a problem of consumers that we cannot go well. So I really think that we're going to have a deeper connection and I really think that the strategy that we put in place, in January, it was really the right one to go over this crisis.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Jean, as a quick follow up, as you -- are you seeing some of that coming through in the off-trade market share or portfolio mix performance given that that traditional channel, the market, the competitive balance, the competitive structure has been more balanced than the on-trade? So are you seeing some signals in that channel that's continuing to operate on some of the variables that you mentioned?

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So, what I'm seeing is really the -- so in terms of channel, what I'm really seeing it is a small format, small off-trade format, and moms and pops stronger and is much more granular. I think people is not traveling that much to go to a far away supermarket, hypermarket to really get a view, I think people is really buying more closer to home, so moms and pops, small supermarkets, very granular. Much more granular than we expected is really -- the most important is really these -- the channels that are more resilient. The fastest growing channels are really the e-commerce platforms, are really the convenient one, but the resilience is really on moms and pops and small off-trade, and then capillarity, ability to operate, ability to have a footprint nation-wide is really making a difference. It's not just about have some tiers, deliver some products on cash and carry and get it right in this crisis. It's incredible, I didn't anticipate that.

But the granular is more volumes of moms and pops and supermarkets is really making a difference, and who are able to really deliver that even during the crisis is making a difference.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Very good. Thank you. Thank you very much. Best of Luck.

Operator

The next question is from Ben Theurer with Barclays. Please go ahead.

Q - Ben Theurer

Yes. Hey, good afternoon and thanks for taking my question. So clearly challenging times. One question, actually for Lucas on the financial side. So you've mentioned you're accelerating some of the reviews, strategic cost savings et cetera. Can you give us a little bit of a sense of -- to the magnitude where you think you can work through SG&A savings and other cost savings that will allow you to be stronger ones the challenges are over. Just like what is the recurring cost you might have been identifying during the recent review, that you can save further on? And then I have one quick follow-up. Thanks.

A - Lucas Machado Lira {BIO 21526003 <GO>}

Okay. Thank you, Ben. I think with respect to how we're approaching the tightening the belt exercise, I think a few things that are important to us is, I think number one, is the bar is higher when it comes to reprioritizing, right and allocating resources. So we really try to focus on what are the must-have investments, what are the must-have expenses, not only to survive in the short-term, but also to protect the key initiatives that we don't want to compromise precisely because they're very connected to our long-term strategy, right.

And so for example, Brahma Duplo Malte, that Jean mentioned, right, this is a big bet for us as we look to roll it out across Brazil. So the investment that goes behind that is one that we want to preserve, okay. There are other areas where there is less flexibility when it comes to fixed versus variable, right. So for example, when it comes to logistics, right, there is less flexibility there. But that's where the good old ZBB [ph] cost discipline having the visibility, having the routines to work with each package owner right across the country, really helps us look for opportunities on a more frequent basis. Okay.

There are other things that we don't want to compromise as well when it comes to quality of our products, for instance, service level that we want to keep improving. Okay. So there is no silver bullet, there is no magic here. It's really doing the day-to-day work on the cost and expense side. Thanks to all the kind of the DNA. It's in the DNA of the company. Okay. And then just to give you some reference here, how to think about SG&A, I think historically, our SG&A 50% has been fixed and 50% of it has been variable. Obviously this varies across SG&A line, right, so sales and marketing there is a higher level of discretionary spend and investment, so we have more flexibility there, and that's where really prioritizing to be in tune with our commercial priorities and strategy makes a -- is first and foremost.

Then on the distribution side, again, we have less flexibility there given our direct distribution in Brazil, which is heavily weighted. And then finally, when it comes to overhead, here you really have to go package by package. On the people side, we're reviewing our structures to see where there may be adjustments required. I mentioned in my opening remarks, the need to look at travel spend, internal events. We have internalized maintenance -- certain maintenance activities, we have internalized consulting fees. So there are many, many examples of things that we're doing and we will continue to do. Okay.

Q - Ben Theurer

Perfect. That was very clear. And then just your positioning within competition and you've mentioned in the press release that you feel you lost some share against competition. Now how do you think of pricing in the different core premium segments to even maintain share or maybe you're willing to give up some share to keep profitability in check? So what's the strategy on pricing in an environment where volumes, as you said, in April are down, consolidated almost 30% on a year-over-year basis. Hello?

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So I can pick this one Lucas?

A - Lucas Machado Lira {BIO 21526003 <GO>}

Yes, go ahead.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So volumes declined 11%, okay. Brazil, let's talk about Brazil Beer, okay. While the industry declined by mid-single digits, according to Nielsen. So let me break down this number here. Okay. So we had a soft start in terms of industry in Brazil, declining so what Nielsen told us Jan plus Feb industry was declining low-single digits through February, while our volumes traded slightly at around minus 4. So that's where we were January plus Feb, Nielsen industry low-single digits, with minus 4, a little bit underperforming it, pretty much because of the channel mix and then came COVID and then the things completely changed, and then Nielsen will take a time to get from March on all these -- those impact. And then we have to see a little bit more time moving forward.

Having said that, I think the big issue is not about -- I think moving forward, it's not about giving discounts, it's not about fighting for market share with discounts. I think the ability of distribution and granularity will be key, will make a difference. The concern that we have, it is really the channel mix, because the question is when the on-trade channel will come back after the reopening if it will come back fast, if it will take time, because the channel mix has an impact on the net revenue per hectoliter since it's a important -- it's a channel with important profitability for us.

Q - Ben Theurer

Okay, perfect. Thank you very much, Jean.

Operator

The next question is from Joao Soares with Citigroup. Please go ahead.

Q - Joao Soares {BIO 17386703 <GO>}

Hi, thank you everybody. Hi, Jean, Lucas. Congratulations on your efforts to help out the community in this very complicated environment. So I have two questions. The first one regarding working capital. I just wanted to understand how -- I mean, you're operating in a very high cash position for some time. So imagine that you will be allocating in relation -- being more flexible, probably extending the payment deadline. So can you just talk a little bit more about how that is playing out? How could that reflect also on your internal cash generation? And also talk about the other -- the underlying suppliers and inventory as well. So that's my first question.

The second question is on CapEx. You noticed there was a big jump in the CapEx this year versus last year. So I just wanted to know what's behind this increase? In which review that CapEx was allocated? And how should we think about CapEx going forward? Thanks.

A - Lucas Machado Lira {BIO 21526003 <GO>}

Okay. Juan, this is Lucas. Let me start with the second question because it's quicker on CapEx. So our BRL1.3 billion of CapEx in the quarter was mostly concentrated in Brazil. Okay. And within the CapEx in Brazil, we had two large commitments. One was the can plant that we built -- we were building. And also, we've been adapting the production of many of our lines to enable them to brew our pure malt brands, right. So pure malt brands and having a strong pure malt portfolio is a commercial priority for us, and so we have to invest behind that, and so that's what the invest we did. Okay. So it's mainly Brazil, and within Brazil can plant and enabling our plants to brew our pure malt portfolio. Okay.

When it comes to working capital, in the same way, we're approaching cost and expenses. We've been very, very disciplined around protecting the liquidity of the company. Okay. Despite our strong cash position, we've been very, very cautious and very prudent in managing this. But again, we don't exist in a vacuum, so we're also very mindful, and we've been working together with points of sale, with our wholesalers, with our suppliers to make sure that our liquidity is protected, but where we can be flexible, we are flexible. We're trying to be flexible. Okay.

So, but again this is day to day work. This is having a lot of visibility, having the routines in place. So we have just to give you some color, we have weekly meetings, me together with my team and members of our procurement organization, our sales organization, we have weekly meetings to track our performance in terms of receivables, bad debt, which had an initial spike towards the end of March and the beginning of April, but have now started to trend back towards the historical levels. So that's good news. Again, very fluid still. So we have to stay very vigilant and manage very closely. But the initial spike has started to trend down in a good way.

When it comes to payables, the same thing, have lots of granularity, see where the pain points are, we have a very concentrated payment cycle, right, and so that put some strain in our interim month, cash position, but we've been able to manage that so far. And there what we've been doing is identifying the key suppliers sitting down with them. We're not taking any unilateral action. This is all working together with them to see what needs to be adjusted and how we can adjust that. So no major disruption in terms of our payables.

And then in terms of inventory, again, this is going to fluctuate according to our reduction in production given the volume decline in March and in April. But as we ramp up production going forward depending on the pace of recovery, we're going to try to smoothen the inventories curve as much as possible without compromising service level. So I think that's key for us. We want to have the right SKUs at the right place at the right time, and so you do need a certain level of inventory to be able to accomplish that.

Q - Joao Soares {BIO 17386703 <GO>}

Okay. Thanks, Lucas. Very clear.

Operator

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

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you. Hello, Jean. Hello, Lucas. Hello, everybody. three questions on my side, if I may. First, ABI, in their call, they shared some color on the breakdown for COGS per hectoliter increase, mentioning the percentage of it coming roughly from operational deleverage, commodity effects and mix changes. I was wondering if you could do that, the same thing for Ambev as well that would be very helpful.

My second question is related to a little bit to pricing, right. In your opening remarks, you mentioned the challenge to protect profitability during these difficult times, which is right at time when we are seeing much less inflationary beer market in Brazil, which I think has a lot to do with what you have been saying in the recent past about balancing volumes and pricing a little bit more in this market. But Jean also mentioned a sort of alienated competition. So just wondering whether we should expect a different behavior from Ambev on the pricing side in Beer Brazil in terms of protecting profitability and ignoring a little bit more irrational competition, that would be nice to discuss as well.

And lastly, if I could, can you explain a little bit more the impact on the financial expenses, particularly coming from the derivatives. You booked BRL945 million impact in the quarter. I was just wondering if this is particularly related to the mark-to-market of the FX volatility in the quarter or it was just the increase in hedging costs that you put in there. So just if you could guide us through a little bit your expectations for that in the coming quarters, that would be nice as well. Thank you so much.

A - Lucas Machado Lira {BIO 21526003 <GO>}

Okay. Thiago, this is Lucas. Let me kick off by talking about your last question, financial expenses and then I can speak to the COGS per hectoliter question. And then maybe Jean can speak to the pricing going forward. Okay.

So with respect to the financial expenses, that's exactly right, Thiago, the main impact that we saw in Q1 was really the losses on derivative instruments. And if you break that down, we had primarily two main impacts. One was the mark-to-market accrual of our position on the equity swaps, so as the stock price declined, as it did in Q1, we obviously have to adjust for that, but again this is for the most part, it's a non-cash impact.

And then the second big effect within the losses on derivative instruments is -- was really around the carry cost during Q1 in connection with our hedging of our exposure in Argentina. So that carry cost evolved during the course of 2019 and is at a higher level nowadays, and so this ended up impacting our financial expenses in a relevant way as well.

Then when it comes to our losses on non-derivative instruments, that's mostly FX related, and then -- but also mostly non-cash.

Then moving to COGS per hectoliter. I think it's hard to give you a precise breakdown at this time. What I can say and what I would emphasize is, number one, we had already flagged -- and we had already flagged this in our Q4 full year call, given the hedging curve that was implemented last year, we already anticipated that we would have a very tough impact on the product of the FX commodity, hedging equation. So this was the quarter where we already anticipated the largest impact. And so that explains most of the impact, I would say.

The second impact on the COGS per hectoliter that I would flag, Thiago, is the deleveraging effect of the volume decline, granted the volume decline related to COVID was mostly during March. But given that part of our COGS is fixed, historically, our COGS has been roughly 20% fixed, 80% variable. As volumes decline, there is a deleveraging effect there as well. So I think those are, I would say, the two main elements there that are in play.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So about pricing, so I've been saying that what I believe is that over the long run, price really should grow in line with disposable income, inflation, these are two metrics that we like to compare. What we've learned over the last few years that depending on the economic environment, we've preferred to adopt a more balanced pricing strategy in order to bring more consumers in the category. What I was saying here is based on our historical, always trying to use this lever and what I'm saying is that we have to find the balance. This -- I don't see any context even though with the COVID crisis that we could bounce to the other side and go for price wars and big discounts I don't see that. What we are really trying to see is really to find the balance.

The issue that we have when I look at net revenue per hectoliter is really the mix trends, is really about the channels, restaurants and bars, supermarkets, and so this is going to -- it's what's going to -- that we're going to have to answer, how is going to be the recovery because this mix, it impacts our net revenue per hectoliter. And besides that, I really think that is the moment to use the distribution level, really to find volumes to capillarity to our service level, the reliability of the supplier is very important. So I'm really betting for volumes on that.

Q - Thiago Duarte {BIO 16541921 <GO>}

That's helpful. Thank you so much.

Operator

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

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. A couple of questions and my apologies if you covered this earlier on, as I had to jump on a little bit later. But number one, can you talk, particularly about the Beck's brand that rolled out, I think, late last year, very promising. Is that something that you're in the current environment able to continue to put time and investment behind or do you maybe perhaps back off on that? So that's number one on Beck's, and how it was doing.

Number two, maybe give us an update on the smart affordability initiatives, what percentage of sales are under that classification now and how is that business doing?

And then third, based on your comments about how well the smaller mom and pop channel is doing, presumably you have an advantage distribution to that channel. Therefore in terms of on-premise by itself, taking out the on-premise, but if you just look at off-premise by itself, would you expect to gain share this year, all things equal? Thank you.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

Hi, Robert. Let me see what I can answer of your questions. So Lucas help me on here. So first of all, talking about Beck's, so Beck's is, we are so excited about it because it was really something that came with a much more -- with the pull ahead of the push even in a moment -- even in the past that we were just in the beginning of the launch. So it was really a concept that resonated big time with A class. And so we are so excited about it. It's our priority. We want to invest ahead of the curve. This is a piece of the business that I would not think to decelerate or really to cut investments as really part of the business that I wanted.

Operator

Pardon me, this is the conference operator. We appear to have lost, Mr. Jereissati's line. Lucas, can you jump in here?

A - Lucas Machado Lira {BIO 21526003 <GO>}

Yes. Can you still hear me?

Operator

Yes, sir. Please go ahead.

A - Lucas Machado Lira {BIO 21526003 <GO>}

Okay, great. So I think as Jean was mentioning, Robert, Beck's is one of our best to really strengthen our pre -- high-end portfolio. We want to have the winning portfolio not only with international import brands, our imported brands, but also a strong domestic high-end portfolio, be it in premium, be it in craft as well. So I think the performance in Beck's has been good. That's growing in a very strong way, the brand power -- off of a low base, but still, it's very strong growth. And also I would mention, Robert, that the brand power is in good shape. I think the brand power, which is another KPI we look at, I think we're very happy so far. Still have a lot to do, but so far we're very happy with the brand power indicators that we're seeing. Okay. I'm not sure if Jean has reconnected.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

Yes, I'm back. Okay. Smart affordability is still a play, it is a play that we are doing. So we are seeing that during this crisis, we have to understand that where it's going to land in terms of -- if that's going to have any trade down of consumers, how it's going to be is a consistent strategy that we have been for a while. We launched Nossa, Magnifica and Legtima. Magnifica is the one that's really inspiring us and the other ones really doing well, performing very strong, gaining market share in states like Maranhao. Hence, we're going to continue, it is an important piece of our strategy.

Talking about market share, Robert, it's very early to say. The market -- it's tough for me to give you a guidance on that. The market is changing so fast. What I can say is that, who is going to be prepared and fight the right way for the recovery and understand and help the ecosystem on the recovery, on the bars, can they reach with the moms and pops, it's really who is going to manage better during this crisis. I really believe that the situation that we are for distribution, capillarity, service level with consumers, we really make a difference during this crisis. This is the most I can say.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Can you give us a sense on the smart affordability either kind of what percentage of your overall volume in the first quarter was in that group of brands? Or maybe in the particular states where they are in, how big they are? I'm just trying to get a sense of the general relevance on that initiative.

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So, we have a basket. I think I can say that. So, like 20% of our mix, it is on this basket of what we call affordability -- smart affordability.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Perfect. And can you give us a sense of how that mix did in the quarter?

A - Jean Jereissati Neto {BIO 20161989 <GO>}

So what I can say now, Robert, it is that, so the things that surprised us most was really the resilience of the core. So that's what we saw in the early stages of the crisis. We don't know moving forward, if the people will run out of money and the value will go up or people will go back to their only luxury moment at home that would be a premium business. What -- so what we saw in the very short term of the crisis, the core more resilient. So that's what I can say.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Terrific. Thank you very much guys.

Operator

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

A - Jean Jereissati Neto {BIO 20161989 <GO>}

Okay. Thank you very much to be here with us today. May be it is a cliche to say to never waste a crisis. But this -- what we are living is unprecedented moments in our history -- early history. It is something that is impacting us big time. But to be the company, to be the leaner and most efficient player in the market in this moment really has its value, to have the highest reach in terms of distribution with less intermediate has its value going into this crisis, to come into this crisis with a very solid cash position, not lowering the guard, but with the ability to find that shifting channels granular growth consumers is making a difference too, to be the most remembered brands in terms of doing good during this COVID-19 by the Croma institutes and many other institute is Ambev, the mother brand is the most remembered, so it has its value too. And to hit this home run with the live platform in Brazil supporting our innovation of the year, that's going to be Brahma Duplo Malte is really something that will make a difference. And to you have been investing in new technology for a while, B2B, B2C to really get this moment and really grow exponentially over an important base that was already created is really something that make us very confident about really using this crisis to come out of it stronger.

Thank you very much. I hope you all stay safe, and thank you very much for being with us during this call. Bye-bye.

Operator

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