Q2 2015 Earnings Call

Company Participants

- Bernardo Pinto Paiva
- Nelson José Jamel

Other Participants

- Alexander Robarts
- Andrea F. Teixeira
- Carlos Laboy
- Fernando F. Ferreira
- 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's Second Quarter 2015 Results Conference Call. Today, with us, we have Mr. Bernardo Paiva, CEO for Ambev; and Mr. Nelson Jamel, CFO and Investor Relations Officer.

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

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ambev's management and on information currently available to the company.

They involve risks, uncertainties and assumptions because they relate to future events, and, therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Ambev, and could cause results to differ materially from those expressed in such forward-looking statements.

I would also like to remind everyone that, as usual, the percentage changes that will be discussed during today's call are both organic and normalized in nature. And unless otherwise stated, percentage changes refer to comparisons with Q2 2014 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. Nelson Jamel, CFO and Investor Relations Officer. Mr. Jamel, you may begin your conference.

Nelson José Jamel {BIO 16334129 <GO>}

Thanks, Cassia. Hello, everyone, and thank you for joining our 2015 second quarter earnings call. Today, I'll walk you through our results and Bernardo will give his remarks at the end, before moving to Q&A.

Starting with our consolidated results, during the quarter, we delivered a 10.3% net revenue and a 13.8 % EBITDA growth, with an EBITDA margin expansion of 130 basis points. Year-to-date, our top line is up 12.5% and EBITDA up 17.8%, with the EBITDA margin expanding 200 basis points.

In Brazil, despite the headwinds, we delivered another quarter of solid EBITDA performance, growing 8.8% in the period and closing the first half with a 13.9% EBITDA growth. EBITDA margin was up 210 basis points to 46.6% in the quarter, and 280 basis points in the first half of the year, with an average margin of 49.7% year-to-date.

Volumes in Beer Brazil came under pressure in the second quarter and were down 8.6%, mainly driven by the difficult comparable base of the 2014 FIFA World Cup, coupled with an unfavorable macroeconomic environment. As a reference, last year, our beer volumes increased 7% in the second quarter with at least a 5.5% benefit from the World Cup.

On the other hand, premium and near beer continued to grow, helping to expand the beer category and driving a positive price mix. Indeed, our net revenue per hectoliter was up a strong 15%, more than offsetting our volume decline. Along with the benefit of premium near beer, the performance was also driven by our revenue management initiatives, a higher weight of direct distribution, and an easy comparable base given the promotional environment during the World Cup last year.

Moving to CSD & NANC; the segment continued to be more impacted by the macro backdrop than beer. We estimate the industry was down 7% in the quarter. However, we continue to expand our presence in soft drinks, reaching an all-time high average market share of 19.6% in the second quarter, driven by strong performance year-to-date of Pepsi, Guaraná Antarctica, and Guaraná Antarctica Black launched in January. With the industry decline partially offset by our market share gains, our volumes are down 6% in the quarter.

Net revenue per hectoliter in CSD & NANC was up 3.1%, as our price restructuring in line with inflation was offset by an active product and channel mix. With that, our top line in Brazil, consolidating beer and CSD & NANC, was up by 3.1% in the quarter, with a significant impact from the World Cup volume hard comps. Year-to-date, our net revenue is up 7.4%, within the range of mid-single-digit to high-single-digits we continued to expect for the full year.

Brazil COGS was up 2.9%, while cash COGS was down 0.8%. On a per hectoliter base, our cash COGS per hectoliter increased 7.7%, below average inflation, benefiting from procurement savings and better commodity hedges, mainly sugar and PET and soft drinks, while negatively impacted by higher FX hedge, lower dilution of fixed costs and product mix, along with the higher inflation in Brazil.

Gross margin was up 30 basis points. But when adjusted by depreciation, that increased 29% in the quarter, given our recent CapEx investments. Cash COGS, as a percentage of net revenues, was significantly down by 140 basis points. Year-to-date, cash COGS in Brazil was up 3.4%. We continue to expect our cash COGS in Brazil to grow mid-single-digits to high-single-digits in the full year.

Cash SG&A was flat in the second quarter, with a strong deceleration versus Q1, benefiting from cost savings, mainly in our fixed and non-working money base, and from a higher comparable base also associated with the 2014 FIFA World Cup sales and marketing expenses. Higher distribution expense driven by increased weight of direct distribution were also offset by the volume decline. Year-to-date, our cash SG&A is up 6.4%, below inflation, as expected for the full year.

Now moving to Central America and the Caribbean, we delivered another very strong quarter, with EBITDA up 35.4% to R$251 million. This performance was mainly driven by double-digit volume growth in all of our main operations, and solid EBITDA margin expansion of 550 basis points. Similar to our strategy in Brazil, we continue to grow top line in Dominican Republic by connecting with our consumers through relevant marketing platforms, such as Barbarella, the largest electronic dance music festival in the Caribbean. Innovation has also been an important driver. We have just launched Presidente Black, a premium extension of the beloved brand, Presidente.

In Guatemala, we had another quarter of market share gains with great contribution of Corona and other Modelo brands. Along with strong top line across our main operations, our EBITDA performance also benefited from our solid financial discipline, leverage on both costs and expense savings; mainly in the Dominican Republic, expand our EBITDA margin for another quarter. Year-to-date, our EBITDA margin is 770 basis points up, driving EBITDA growth of 53.4% in local currency. In reais, our EBITDA is up more than 90%. Our plan for the region remains on track. We keep working our top line opportunity in the region both organic and inorganic while improving our operational excellence in the region to drive EBITDA margin expansion.

In Latin America South, our EBITDA grew a robust 61.6%, with an EBITDA margin expansion of 340 basis points. Our volumes were up 7.1% in the region, mainly driven by

Argentina where we experienced a very favorable weather during the quarter, while also benefiting from an easy comparable base as our volumes in the country declined high-single digits in the second quarter last year. But moreover, after the success of MixxTail Mojito, we launched MixxTail Caipiroska in Argentina, driving great increment wallet. We estimate that more than 70% (08:49) of the volumes we get from MixxTail come from other categories and that represent a growth of 2% of our total volumes in the country, another great example of a successful initiative in the near beer opportunity.

Elsewhere, the distribution of Corona in Chile and the roll out of the 340-milliliter returnable bottle in Paraguay were important drivers for volume growth in the region as well. Top line was also helped by solid net revenue per hectoliter performance, mainly driven by; one, our revenue management initiatives, mainly in Argentina as we continue to face a high inflationary pressure and; two, a higher mix of premium with strong performance of Corona and Stella Artois in our main markets.

Regarding cost and expenses, we remain pressured by high inflation and unfavorable currency hedges, mainly in Argentina, but we were able to offset an impact to top line growth and procurement savings initiatives, expanding our margins and driving a robust EBITDA growth. Year-to-date, our EBITDA is up 37.4% in local currency, was 63% in reais with an EBITDA margin expansion of 90 basis points. Going forward, we remain confident in our ability to deliver solid top line growth in Latin America South, while protecting our profitability, despite adverse macroeconomic environment.

Turning now to Canada, volumes increased 1.6%, driven by industry growth, and the sixth quarter in a row of market share gains, with solid performance of Corona, Bud Light and our innovations. During the quarter, we maintained the strong momentum on our commitment on improving the balance between price and volume with our revenue management initiatives and partly the mix driving net revenue per hectoliter growth ahead of inflation. Top line was up 3.5% in the second quarter, and in the first half 4.5% above last year.

EBITDA performance was impacted by higher COGS, primarily explained by unfavorable FX hedges, while cash SG&A expense rose above inflation, mainly driven by phasing of our sales and marketing expense. EBITDA declined 2.9% in the quarter, while in the first half, it was up 0.9%. Going forward, we remain excited with the volume opportunities of premium near beer and committed to balance net revenue per hectoliter and market share to deliver profitable growth in Canada.

Before moving to the main items below EBITDA, I'd like to explain the one-time R$230 million expense reported under special items in the quarter. This related to the agreement reached between Ambev and CADE, the Brazilian Antitrust Authority, to definitely settle the lawsuit associated with the Tô Contigo market program. The program was ended years ago, so there is no impact in our commercial practice or basis operations. With the settlement, there is no other pending CADE investigation or lawsuit that we are aware of.

Now, moving below EBITDA, our net finance results were a negative R$363 million, with our performance mainly impacted by higher non-cash accretion expenses in connection with the put associated with our investment in Dominican Republic, and losses on derivatives related to the implementation of our hedging policy. Our effective tax rate for the quarter benefited mainly from higher interest on capital, closing at 6.1% in the quarter and 16.8% year-to-date. As a result, our normalized profit increased 27.3% in the quarter to R$2.830 billion. Year-to-date, our normalized profit is up 20.2% to R$5.8 billion.

We generated a total of R$4.3 billion of cash from operations, a 46% increase versus last year as a result of strong operational performance, favorable FX translation from our non-Brazilian operations, and better working capital management. Year-to-date, we have originated R$8.2 billion of cash from operations, a 45% increase year-over-year. As for CapEx, we invested a total of R$1.9 billion year-to-date, of which R$1.4 billion in Brazil, both broadly in line with last year figures. During the quarter, we paid R$1.6 billion in interest on capital, and repurchased R$400 million of Ambev shares, bringing the year-to-date total pay-out figure close to R$7 billion, a 17% increase versus same period last year.

I will move now to Bernardo before going to Q&A. Bernardo, please.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Jamel. Hello, everyone. It's been six months of different challenges across our regions, and it's great to see that our team was able to deliver solid results for another quarter, reaching strong double digit top line and EBITDA growth year-to-date. But we're not here for one or two quarters, and we know that the challenge going forward will be no different across the markets where we operate.

With that in mind, I want to concentrate my remarks in Brazil. We've just been through a semester of very difficult comps, coupled with an adverse macro environment. Even then, we focus on the things we control. Our plan, top-line plan that we have for the future that we'll comment later and a strict cost discipline continued to drive our top-line growth and margin expansion to deliver 13.9% increase in EBITDA in Brazil in the first half of the year.

Going forward, we expect that the external macroeconomic environment remain a challenging one, but our strategy will not change. We'll continue to focus on the platforms, the top-line ones with a big, big focus on operational excellence. On the later, I have been stressing this a lot with our team, there is significant opportunity to actually improve what we would do in a more efficient way. Technology, for instance, has been a clear driver for this; and we continue to move in this way. We want to be better and little more efficient than we are nowadays; and this is the time to push this hard.

Regarding the top line and the plans that we have for the future, these are the levers under our control to continue to drive a sustainable top line growth. First, it always starts by elevating our core brands. Our brands are not only the biggest by volume, but they are the beloved ones with an even bigger preference in volume share. By further enhancing the acreage of our brands, we elevate volume and price mix potential.

Affordability remains priority and key, especially in a market like this. We continue to focus on our PET price and returnable glass strategy. Returnables actually gained share versus one-way in this quarter, mainly driven by our 300 ml that's growing volumes year-over-year, boosting the presence in the off-trade channel. So we start to see returnable bottles in the off-trade channel after many, many years. So that's great news.

Revenue management also plays an important role to drive affordability. Beer inflation is running below overall inflation year-to-date helped by a renewal and big pressure obsession for price point optimization in every part that it is. And I could not talk about our core brands without mentioning the launch of Skol Ultra, a totally new liquid targeting the active lifestyle needstate. Skol is an official sponsor of the Rio 2016 Olympic Games; and Skol Ultra perfectly fits this opportunity, further enhancing the brand equity of their mother brand, that's Skol.

Second, another important platform is to accelerate premium. The Premium segment has been an important driver to price mix and higher margins growing volumes ahead of overall industry, but the opportunity is still big. That's why a realistic rate implement portfolio and dedicated execution, activation, demand and expanding our domestic, international, and high end workforce.

Third, we are very pleased with performance of the Skol Beats Senses in the near-beer fight, driving not only incremental volumes, but better margins; much better. In less than nine months since its launch, Senses already got a sizeable preference among its core target and relevant volume, with an opportunity to be even bigger. We just saw the mixed effect and the volumes that we saw in last. This will help us to get a higher share of the total collate beverage space already in second half, more to come in our near-beer fight.

Fourth, in-home, we continue to step up how we execute the stores in the off-trade channel, increasing the space of beer category in the stores improving the assortment of our products, while also focusing on affordability by expanding, as I said before, returnables in this channel. Returnables already account for more than 15% of volumes in supermarkets, driving affordability in a profitable way.

And fifth, in the out of home, we have a great opportunity to improve even further the bar and overall on-trade experience through innovations like Skol Cube, Skol Draft and market programs like Curtisom, that's our micro events platform. This is our plan and we remain committed big time to continue to deliver on it. Therefore, there is no change in our guidance for Brazil.

So now let's move to the Q&A.

Q&A

Operator

The first question comes from Luca Cipiccia of Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Bernardo, Jamel, good morning – good afternoon, and thanks for taking my question. I was able to – you could elaborate a bit more on the volumes in Brazil. Clearly, the World Cup impact was very sizable and easy to identify. Still, if we take that out, volume was still down I think 2% or 3% on our calculation. My question is more – which again, is very entirely surprising, but – the question is, are you seeing sequential deceleration, if you've seen that throughout the quarter? I don't know if there is anything you can share about July not to be too sure to have focus but just to understand how things have developed throughout and how should we think about volumes going forward?

And on the comments on the second half from the new initiatives, maybe if you can discuss as well – you hinted to more initiatives in the near-beer segment. Would this require – is this more – refers to more declination of the Skol Beats concept? Should we think about that type of innovation more broadly whether these are the categories, are the brands? And similarly you made no mention of the smaller acquisition that you've done in craft beer, but I don't know if in this call maybe you can share a little bit as well what type of boost you expect to give to that space. It is very small as it is. But what do you think could fit in the portfolio maybe more in the medium term if right now or in the immediate future it's not going to be particularly large? Thank you.

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

Okay, Luca. Thanks for the three questions. I'll start with the first one, the volume of beer. It's no question that we're facing a tough environment of beer, macro environment, but it's not the first time. So I mean I've been here operating moments like that for the last 25 years; and 25 years in this company and someone ends like that in the past; and we have a great team here that knows how to really deal with macro environments and not help us. Having said that, I mean you continue to focus in the short-term – in the long-term things that can really control and make a difference. So the top line focus that I said to you before starting off elevate the core brand. We're doing well, Skol's performing much better and even better is here affordability as I said in the comment.

Very important move for the off-trade that could be a legacy for the future in the sense that we're bringing back returnable bottles to the off-trade channel. That's very, very important. Premium growing a lot and helping us, international premium, Budweiser, Stella, Corona helping, starting to really have a very good volume with very good price. And near-beer, as I comment later, I can answer now for you I think that it's important not only to launch a product, but to launch a product and really go end-to-end. So launch is not the first one that gathers, but really assure that you have a sustainable volume for the future.

Yes, we have a pipeline of innovation ready to go in the future, but we don't like to go (22:34) end-to-end and really get the full volume of each of this area of Skol Beats Senses or more things to come in the future. So the pipeline of near-beer, it's very strong, very robust and very positive about that, I cannot comment more than that.

And then the other one, as I said, in home, I mean really making the experience for the shoppers much better than it was before; and then helping the channels as well – the chain, sorry, to sell more and sell more beer; and we sell more as a consequence. And returnables bring you back in. Out of home, the bars, it's our strength, big, big strength in year in terms of volume, in terms of bringing experience.

Going forward in the sense of our guidance, I mean we still remain 100% sure that we'll get our top line guidance. And then we will navigate in the macro environment and adjust the levers to get to the guidance that we deliver to you guys in the beginning of the year; and then you are reinforced that.

Linked to the small – I mean brewers, the craft brewers that we bought here; I think the most important thing is the portfolio of brands. I think that understanding the needstate and the occasions that people I mean drink beer, and not only beer, we're able to address with different brands those occasions.

So, yes, some craft brands, I mean like we bought (24:16), but I mean the main growth will come from the international premium, the domestic premium, original and more things to come in this site. And I think those craft brands will be an important part of the approach in terms of the portfolio of brands that we'll put in the market and then fulfill the needstate that we understand very well and the occasions where those needstates are applied. So I think the portfolio gain is the gain, not specifically one brand.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Thank you.

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

Thank you, Luca.

Operator

The next question comes from Fernando Ferreira of Bank of America. Please go ahead.

Q - Fernando F. Ferreira {BIO 2389113 <GO>}

Thank you. Good afternoon, Jamel and Bernardo. I have also a question on Brazil beer. My question is related to the balance of volumes and pricing, right. Given how unbalanced this accretion was in the second quarter, do you feel that this is the time to refocus a little bit on volumes and maybe give back a little bit of your strong revenue per hectoliter? Just wanted to get a sense on that given that your market share is back to the low of your historical range, right. And in that same topic, if you could also break down how much of your 15% of revenue per hectoliter growth came from price to consumer mix and the easy outlook comps relative to last year? Thank you.

A - Nelson José Jamel {BIO 16334129 <GO>}

Thanks. Very good question, Fernando. First of all, I mean in terms of (25:55) it has been our mantra for many, many years to raise price in line with inflation. So we have been doing that. And then you have to bear in mind that in the beginning of the year inflation was around 6%, I mean, the forecast; and it's now 9%, a little bit plus on that. So this is the first time. So we continue to remain and we stick to our mantra that price will go in line with inflation.

Secondly, the obsession of mix management for the company that I personally have it's very important and this strong lever to drive net revenue. Net revenue not only per hectoliter but net revenue in general; and then have some parts of that. First one, brands, in terms of managing the mix to drive the right brands and we are doing that. Not only the premium brands that when you see the volume growth, but as well the most profitable mainstream brands. So mix of brands are key.

Mix of packs, very important. So our mix, internal mix of IGB, and one way IGB has started to grow again. That's very important because in terms of top line net revenue, you don't see too much difference, but in terms of the market line and EBITDA line, it is important help for us in terms of EBITDA in cash because they are not profitable packs.

And the third one that I mean get down and study is the mix of regions. There are many regions, the portfolio that we have sold more profitable products there with better net revenue, product total and better market as well; and then we're doing this. And we know that all the research that we have in the market that attract market share take over a part of the market, but we didn't go to 100% of the market. And then we are going to some places in Brazil and selling our brands there and selling very, very well because they have very good price. (27:51) for the research that we have. So to give an information for you guys, for instance, our (27:59) number market share for the first half of the year, it's a fair number in the sense that we can, I mean, mitigate the inventory effect. This is likely above next year. So part of this likely is risen by the current research that had in the market as part of that they are not able to read, so in the sense of this balance in terms of market share, you could say based on the external research and the external numbers, internal numbers that we have first half of the year we are at least in line with last year and slightly above last year; and at the same time mix is helping a lot in net revenue.

So I'd say to you that what's above net revenue per hecto, half is the World Cup effect, the promotion that we have last year; and half is mix management. So that's why you can close the gap from the inflation to the total net revenue per hectoliter that you saw before. And again doing that driving RGB, that's good for the short-term and for the long-term with market share that according our internal numbers and (29:14) is lightly above last year and including the, to use the number in the range that we always had at 67, 69 (29:20).

Q - Fernando F. Ferreira {BIO 2389113 <GO>}

Perfect. Thank you.

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

Thank you.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi, everyone. In the quarter, you mentioned that you were impacted by unfavorable currency hedges, but it was partially offset by better commodity hedges. So I was just curious to get your perspective as we think about the rest of the year. And I don't know if you want to touch upon next year, seeing the weaker currency and knowing that as a percentage of your cost per dollar denominated, how do you manage the currency risk and any visibility on your commodity exposure would be helpful too? Thank you.

A - Nelson José Jamel {BIO 16334129 <GO>}

Sure, Lauren. Thanks for your question. As you know, I mean, for our hedging policy, what we had for this year is already locked and was even when we made the announcement right at the beginning of the year of the results we talked about, for instance, FX being a net effect on our COGS this year with an average FX implied in our COGS of R$2.3 per $1, knowing that's roughly 40% of our COGS is dollar denominated. So, again, we have full visibility and it's embedded in the guidance we gave for 2015. So you shouldn't expect any surprise there. Again, with the hedging policy which we hedge not only our FX, but also our commodity exposure around for an average 12 months in advance.

I think it's important to emphasize, I mean, briefly 2016, because we are not providing any specific guidance at this moment. But when you think of 2016, actually one of the results of the hedging policy is really to give the appropriate time to work on mitigating actions to deal with changes in FX or changes in commodity effectively. The policy is working and helping us right now, because they have this predictability, visibility for 2015. And then as we plan for 2016, we're going to deal with it regardless the scenario we have going forward.

As I said, we're not providing specific guidance. Of course, there'll be a massive FX effect from next year, but important to emphasize it's going to be partially offset by lower commodity price. I mean, we know the market price for both. And I think bottom line, I mean, with the advantage of the policies of having this time to react, be it through our policy of putting price in line with inflation, for instance, we're talking about top line now, which at this stage means a 9% increase as opposed to a 6% increase that we had recently.

And naturally, part of this inflation hike is linked to this very same depreciated BRL, right, or be it through cost efficiency, as adjusted footprint, as related to engineering products, and a list of things we normally do. Year-to-date, our goal is to protect our profitability despite this currency devaluation, more importantly in a sustainable way as we did many times in the past I mean including in moments with tougher market conditions than the ones we have right now. So it's part of the policies, it's part of the strategies, and in due time we're going to provide a more specific guidance.

Q - Lauren Torres {BIO 7323680 <GO>}

That's very helpful. And if I could just ask on a follow-up to that response. The beer category has been somewhat resilient despite the downturn. So I was just curious to get your perspective as you talk about protecting profitability, and I know pricing isn't the only component. But you feel that there is room for more pricing. As I said, it's been resilient, but at the same time the consumer seems to be just weakening even more. So is there more upside on that front, do you see that?

A - Nelson José Jamel {BIO 16334129 <GO>}

Yes. I think in the end a lot of breaks on that when we talked about the portfolio. So at the same time, we are of course sticking to our policy of price in line with inflation, this is on average. So what we do at the same time is, while we leverage for instance on premium brands, I think we have touched a lot on that and is also an upside to our margin; we are also investing on affordable packs. So the whole point about we kind of returnable glass bottles is critical and we see them grow even faster. I think that's an important message as well this quarter.

The wave of RGB grew over one way, when you compared to a year ago. And I think that's linked also to sort of scenario. So having returnable glass bottle, especially 300 milliliter rollout in the (34:00) of 15% of our volumes sold to supermarket. So you total that and put that all together, you can benefit from this positive trends and positive mix impacting premium, while protecting volumes in a profitable way with returnable glass bottles, which is also good for consumers, right.

They can specially in tough times, they're going to have this advantage of paying less for their preferred brand; and that's what we see clearly going on there. It will help consumers to bridge this stuff of macro moments. So that's how we play with the portfolio to protect volume growth stability.

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

And then one more on this, just as I mentioned before, the mix of regions are very, very important. So having a portfolio, a strong portfolio like we have, we can apply this portfolio in the different countries that we've within here. So Brazil is very big. So you go to – you know that, São Paulo is more of a developed market. But you go to northeast, complete different. So we had impact in the portfolio that we apply in each region and the volume opportunities have to have in each region. So mix of regions are very important as well. So mixed management overall helped us a lot in this quarter in terms of net revenue and will continue to help in the future.

Q - Lauren Torres {BIO 7323680 <GO>}

Very clear. Thank you.

A - Nelson José Jamel {BIO 16334129 <GO>}

Yeah.

Operator

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

Q - Thiago Duarte {BIO 16541921 <GO>}

Hello, everyone. Thanks for taking the question. I have two questions actually. First one, going back to the Brazil beer pricing discussion, I understand that you have three impacts there in terms of net revenue per hectoliter growth, right? You have the price increase, you have the mix that is improving, and you have the easy comps from last year promotions. So I'm worried about this last aspect of your revenue per hectoliter. I mean, you provided us this plan for us in order to understand how volume performed during the quarter. Considering the World Cup, is it possible to understand how much pricing performance considering the World Cup? How much the promotions from last year and the different mix from last year's World Cup impacted, so that we understand how much is your ongoing and underlying mix performing going forward? So this would be the first question.

And the second question is regarding working capital. I know this question was asked several times before, but you keep performing really well in terms of cash conversion cycle. You keep unlocking a lot of cash from working capital. So I would love to hear from you guys what kind of initiatives are taking place? Is that sustainable? Can you improve it even more going forward? It would be interesting to hear. Thank you.

A - Nelson José Jamel {BIO 16334129 <GO>}

So, Thiago, let me try to first break down the net revenue per hectoliter growth that we saw in the quarter, right? I mean, as we said, an important part of it is our policy of putting price in line of inflation. So bear in mind that inflation was running around 6% – was running around 9%. So in normal terms it's high, right? So that's an important part, actually the number one. And then, for the real growth, I mean, above inflation, this quarter – actually in the first quarter, we already had that. Maybe you might remember that we said, I think we grew around 11% and we said that the real growth was only driven by premium mix and ix again but – mainly premium as well as higher rate of direct distribution.

I would say that this quarter the contribution from premium and near beer mix was pretty much the same. So half of – roughly half of the real growth was driven by this positive mix management impact, and the half of it was pretty much basically because of the World Cup mirror. Another way to talk – think about it, you might remember, last year our revenue per hectoliter grew below 4%. So actually when you look the CAGR of the two years, it is 9% when compared to 2013, CAGR two years is 9%, each year on average, which again inflation plus positive mix. So that's a way to understand the impact of the – I'd say basic concept of the promotion activities linked to the World Cup.

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

And I think that, Thiago, there is one more thing and that's what Jamel said, but doing this – I mean, doing a price increase in line with inflation we managed many many years, understanding better the regions, the brands and the relationship between returnables. I think that we have been doing a very good job in terms of adjusting the price in the moments like that to assure that we will have good profits and profitability and a better marketplace for the industry and for us in the long-term boosting in the RGBs; so have been doing that, and have been doing very granular on that per channel, per region and per brand. So I think that's a good point, because it's not only good for the short-term, but good for the long-term, because it start to really have a better industry for everyone, including us.

A - Nelson José Jamel {BIO 16334129 <GO>}

And then continuing with the second question, working capital; I would say we are very pleased with the results. I mean, we have a very strong free cash flow with the resulting operational performance, but also boosted by this working capital management, and again higher cash flows, higher returns at the end of the day.

We continue to focus there the same way we have just mentioned about this granular approach on price and mix and regions. We started to do the same thing for some time on our working capital. We're retouching the drivers, the behaviors with owners, targets, incentives. I mean, the full package and it's given us some opportunities. I mean, when we benchmark ourselves against versus other zones within ABI, we see gaps. So we work to close them all. But we're evolving, no doubt, in the right direction. One thing that's actually helping is at – on the payable side for instance.

As we continue to maintain an important level of CapEx investments, this helped by the mix, as you can imagine – I mean, you don't have to pay, let's say services which are labor related. We pay as everybody, in 30 days, people buy equipment expecting that decelerating, let's say market, we are able to get better deals, not only in price, but also in terms. Again, this CapEx mix helps the longer payables, the same with investing. I mean, really big diving, see what you can do better in terms of optimizing the supply chain after many years of increasing SKUs, increasing number of sites, actually lost a little bit (41:11) because of this growth. Now, we continue to improve year-over-year, actually quarter-to-quarter, the same on accounts receivable management. So it's really – there is no silver ballet, it's really one by one. But we continue to see opportunities as we benchmark and stretch the targets here.

Q - Thiago Duarte {BIO 16541921 <GO>}

Very helpful. Thank you very much.

A - Nelson José Jamel {BIO 16334129 <GO>}

You're welcome.

Operator

The next question comes from Andrea Teixeira of JPMorgan. Please go ahead.

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

Thanks. Good afternoon, everyone. So thanks for taking the question. I just want to – basically three questions, please. One is on the trade down. I mean – I think we haven't seen probably the worse yet and how can people trade down the liquor how can you protect that?

I understand all the – 300 ml withdrawal (42:02) but we have yet to see it. And then the content of alcohol per liquid is still probably one good alternative for someone who wants that content for the lowest possible price? That's the first question.

The second question is about competitive environment. We are seeing higher costs, but yet it doesn't seem that your competitors are probably following. So I want to see like from your...

A - Nelson José Jamel {BIO 16334129 <GO>}

Yeah, right.

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

...7.5%, for your half and half, which you described being the composition of the pricing vis-à-vis mix; where you expect to be in 2016 when potentially this mix will change? So how your strategy will be given the cost pressures that will shift next year? And the other thing is, in the EBA call, they mentioned about innovation pipeline. So can you elaborate a little bit more on that? If there is anything big? Is it channel? Is it product? Is it something that you want to comment? If there is also any time left I want to talk about the Brazilian government talking about taxes with you and if you're collectively reaching out for that given the newer targets? Thank you.

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

Hi, Andrea. Thanks for the question. I think the first one was very good, I mean the question that the trade down. Actually, I see these as opportunities – not big opportunities for us in order to really expand RGB, returnable bottles. Yes, you're right. I mean, saying that we have been doing that, have been doing that great in the last year, but not in the off trade channel. And we're boosting the RGB in the off trade. I remember, 1996, 1995 probably about 90%, 80% of the volume that was sold in the off trade bottles were returnable off trade. We're not seeing that this will go to this level. But I mean, one year-and-a-half ago it was almost zero. So we're now at 50% of the full volume.

So we can't bring affordability. I mean, we can get this trend of trade down, that's – I mean, because of the external environment, yes, the macroeconomic environment we have there through our main brands. So that's a good deal for everyone, because you can enjoy Skol, that's your – the beloved brand here. The brand that you prefer or Brahma, Antarctica, depends on the specific region at a very good price point in the on trade – in the off trade. And that's why returnable bottles are growing – our mix of returnable bottles are growing as well. I think that, I saw in the past, value brands in Brazil was – I mean this is a country that people like brands. They like to connect with brands. So only price will not sell here.

We have beloved brands at a very very good pricing plus best price strategy, with the biggest focus even more in terms of the price point discipline POS by POS (45:16). So I see as a opportunity – that only moments like crisis like that, you can really push and the returnables will grown and it'll grow even more driven by the most important brands that we have. So I think it's a opportunity for us. The competitive environment, I mean we cannot talk. Sorry, sorry about that. And for the future in terms of – I think the last question was linked to the...

A - Nelson José Jamel {BIO 16334129 <GO>}

Innovation pipeline,

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

Innovation, very well there was one about the net revenue for 2016. I can repeat the same answer that I made before. So pricing minus inflation as usual and then expect mix to continue to help us. And then innovation pipeline, we have a strong one and we prefer to do bigger things – I mean, many, many new use – sometimes we put a new use just to reinforce some other brands, but we have a pipeline of bigger things going forward and really want to – really want to assure that those bigger things will work end to end not just launch for six months innovation go to another one. So that's why we are really (46:28) for instance. Full year of (46:33) and then we have more to come.

So the mindset of innovation is not only in terms of liquids or products, it's in the full company, in terms of trade programs, like how to bring (46:43) to the POS, to the point of sales because we know that people enjoy more, they stay more in the bars, so we have our micro events, we have more things to come in this sense. We have a Skol Draft. So we're bringing draft beer experience in larger scale in Brazil for the first time. So that's very interesting not only people like that – I mean, they like experience of drinking draft beer. So we always said in terms of that operational excellence be even more is marked and even more operating – even more excellent a little bit nowadays.

Will be a big competitive plus for us in the years to come, because not only can operate the things that you do nowadays on our main brands, but you can add complexity, and do this in a perfect way so – in every area, and again including the cost side as well. I mean, it's not exactly your question, but we will continue to drive non-working money, to find the non-working money and eliminate that and to invest behind our brand. So operational excellence such every part of the company, co-working capital, to the costs, to the ZBB and to assure that you go lean and to invest those money to support our topline growth and EBITDA growth, okay?

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

Okay. Thank you.

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

Thank you. Andrea.

Operator

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

Q - Alexander Robarts {BIO 1499637 <GO>}

Yes, hi. And thanks for taking the question. Actually for me as well, I guess, I had two, thinking first of all about Brazil beer and then secondly LAS. One of the five pillars that you layout here for the outlook in the press release is the accelerate premium. And it kind of sounds counterintuitive as we think about the back half of the year and what's going on just generally with the Brazilian consumer. But if you could kind of comment on specifically where you see impact coming from initiatives to accelerate these premium beers? In other words, is it fair to assume that this segment will continue to outperform? What you're seeing in your mainstream growth? We were recently in Brazil and noted that Corona was both an on-and-off premise. How has that been going this year? And touching on Craft, I know it's very small. You've made some initiatives in the first part of the year with acquisitions. If you could kind of comment and touch on the Craft part? So again what specifically can we think about as far as what you might be able to do to accelerate the premium in the second part of the year?

A - Nelson José Jamel {BIO 16334129 <GO>}

Hi, Alex. Thanks for the question. I think related to the trend of premium, it's a mega trend. It's everywhere. I've been working in the last eight years outside of Brazil very closely U.S. market, China market, European market. And you'll see that premium rates are growing. And they're growing, because this is the stage in the trend that people ask for that. And this is happening here, continues to happen including this quarter, even with the tough comps premium goes way ahead of the industry, the premium brands.

So this will continue to happen. And we are right here in Brazil even more. So instead of being reactive for the strength, we will, I mean, boost, and because it's good for the business, it's good for us, but to do that portfolio is key, so that's why, I mean, you have the international global brands, I would say, Corona, Budweiser, Stella is doing great, have the domestic premium that you call, I mean original is our flagship on this. And you have some craft brewers that we will add to our mix. That's important for some specific parts, for some specific need states.

So portfolio is key. And then a lot of that innovation will be important as well. So in near beer it's a one front, but not only that. So I see for the future that premium can work, can help us even more, because, again, everything that I said you before this megatrend, the portfolio that we have, we are stretching ourselves in terms of how to execute in the market to really assure the money for some areas of the company and invest in a better structure to reassure that have a customized execution for those brands in the field. And even in outlooks of the industries that are not doing well, (51:44) in a simple way.

Okay, premium beer, it's expensive, how much? R$4, R$5, R$3 a bottle. We are not talking about the BMW or a car that you would trade now for a BMW to whatever company. So it's for the people that really have the money to pay for premium brands, they still have. So it's somewhat inelastic industry, this premium, because in the end of the day, we're not talking about a huge out of pocket on this. So basically, and again, we have lots of opportunities in regions that premium are not well placed in the moment, so will be in the future. So I'm bullish about that our premium portfolio and the premium growth in the second half and in the future.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Very helpful. Thanks. LAS, almost 20% of your group EBITDA in this quarter. And a good chunk of that, I guess, half is Argentina. And we've been seeing other beverage companies post very good numbers in that particular market. Europe 40% currency-neutral in LAS EBITDA in this first half of the year, 61% in this quarter. Just talk to us about, I mean, fair enough weather, you talk about easy comps in the quarter helping LAS. But it seems to me that there's been kind of a resurgence in demand, I guess, construction projects pre-election related to public works. I mean, can you talk a little bit about the Argentine beer industry, the prospects for the second half? Can we see LAS grow in these rates that we've seen in the first year on a currency neutral basis? That's the second question. Thanks very much.

A - Nelson José Jamel {BIO 16334129 <GO>}

Okay, Alex. Nelson here. Thanks for the question. I think you already touched on some key points in your question, right. I mean, of course, we've seen the volume is back to positive term after seeing a big dive. There was a little bit of an easier comp; volumes actually were down high-single-digits last year this quarter. But it has also had some, let's say, weather help, but we also had and that's important the way we talk a lot about Brazil here. I mean, we had the same, I mean, our commercial platform in our team is very similar to be honest. So, for instance, incremental volumes for near beer initiatives, actually, they're performing even better in addition at this stage.

I mean, the MixxTail launch was a success, but we've now had launch of MixxTail Caipiroska as a flavor, along with lemon and also strawberry. And they already represent 2% of our volumes in the country, less than six months. It's amazing. We're making great results and it continues to grow, again, with great incrementality.

So the combination of overall environment, getting better as well. I mean, regarding macroeconomic environment, we have lots of improvement on important indicators, right. I mean, the seasonal inflation of those two combined with declining consumer comps, that's an important one, getting back to better levels, and moreover, I would say as well, that we are used to operate in such an environment, right.

I mean, I discussed in the past. I mean, we have strong brands, strong team, we continue to use our full toolkit to implement on our brand initiatives, but also to manage costs as efficiently as possible. So we really believe that after this tough – very tough environment we lived then and by the way, we took the opportunity to become even more efficient, leaner, but while going through this also invest in (55:49) brands, invest in the commercial platform.

So I think we are right now in the moment of positive trends, in a way, I think, it's important to emphasize that Q2 result. There was a component (56:05) for the rest of the year, because that will be too optimistic. But for sure, we are in a positive trend, great team, great brands, great execution, and overall environment getting better, although still bad high inflation in order rates, right.

Q - Alexander Robarts {BIO 1499637 <GO>}

Got it. Okay. Thanks very much.

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

Thanks, Alex.

Operator

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

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

Great. Thank you very much. Couple of quick questions. In the introduction, you mentioned that you had or will be making technology investments to drive greater productivity. Can you just give us a sense, have those investments been made now, what's the timing on them and the rough order of magnitude please?

A - Nelson José Jamel {BIO 16334129 <GO>}

Rob, hi. Thanks for the question. It's not exactly – in terms of the investments, in terms of the CapEx that will be the relevant here, but how we use those investments that we have nowadays and be smart in using apps, in using not only the big hardware, but great people working us and with – in the marketplace, in our brewers to really assure that our team in the field will have that solution automated solution, algorithms and things like that to reassure that they are more efficient in their work day-by-day. So it's used – the hardware that you have nowadays, we think that's a little bit more in terms of CapEx here and there, but the guidance for the CapEx remains the same.

But it's much more length, the process that we have and how we can use in a more smarter way, better software, better – I mean, even better people working, understanding the process, bringing a solution to be more efficient. Less hardware and more software, more thinking in terms of integrating process to technology. So I mean, have been doing this for many, many years, I'm really bullish about that and it leads to operational excellence as well.

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

Okay. So should I take this – that there is – we shouldn't see some noticeable pickup in investments on this front?

A - Nelson José Jamel {BIO 16334129 <GO>}

No. I mean, CapEx guidance remains the same.

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

Great. And then, I think, last year, you started talking about building out your premium – a premium-focused sales force, having a separate sales force in Brazil, focused on the premium brands, focused on premise, has that – is that build-out largely done now? And can you give us a rough idea of either – how many people is that involved and/or kind of what percentage of your overall sales force?

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

So I think I mean, yes, have been building execution dedicated team in some parts of our business in many of the urban centers and then we continue to grow, but more – when we think about the steps of sales, a lot of sales, not only, I mean, there is the order taking part, how to prospect across, how to execute, how to activate, how to bring experience. So you can use the backbone that you have nowadays, and in specific classes of folks who bring a special team that sometimes would take the orders, sometimes not. So sometimes people always think about the sales of the order taking, it's much more than that. And again, is that how to prospect, how to close deals, how to take the order, how to activate that part and create experience through that and build brands and raise volume.

So, we actually divide those steps of the sales and then we allocate that resource accordingly. So we can have one guy visiting to take the order, and the other guy visiting at night to activate that specific brand for this specific target customers that are important for that brand. And how we do that, sometimes people ask, okay, you add people in answer to you I mean how many people, yes we can add in one part of this type of sales and you can take on the other one. At the end of the day, you can have the win-win, it's a – I mean, building – be more efficient in terms of cost and even though providing a better solution in terms of service and then activation, if you know your customers, if you know your brands, and you know how to activate those brands in specific clusters, and we know those points that I just talked to you.

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

So should I take this initiative as largely done now in terms of building out the separate capability?

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

It's evolving – it's evolving, I mean we start from the urban centers, but still have opportunity and then we continued to do as a portfolio growth and remind that not only the structure, but how the brands evolved as well and remind that we've many Brazils inside one. So we approach the country as some countries inside one and we went over the portfolio and the structure and everything according to that that's why I'm focusing in other top line initiatives that I mentioned to you before.

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

Thank you very much.

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

Thank you, Rob. Very good.

Operator

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

Q - Carlos Laboy {BIO 1506984 <GO>}

Good afternoon everyone. To keep within your market share guardrails, it seems like you have to almost shrink your mainstream volume, because some of your competitors are either effectively collapsing as we speak or because others are too weak to invest and to grow mainstream. So the two questions I have for that are one, how do you keep your mainstream brands fit and strong in a weird environment? Were you have to shrink mainstream and debilitate volumes because weaker volumes can – some of your weaker players out there can grow volumes? The other question is would you be leaning on the price lever this hard if you were free to chase all the profitable volumes and all the higher scale that this market can offer, in other words if your competitors could keep pace with you?

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

So, Carlos, I mean, thanks for the question. Again first question, I mean, we don't speak about the other guys what they're doing there. In terms of our core brands, I mean having doing as we've always did in the past and continue to do. So as I say about core brands when I talk about premium, we know how to – we're learning and doing much better how to execute our premium brands. And we're getting those learnings for their core brands. So if you have an advance for a super premium brand who have – I mean, for Skol, these summer only events, so we will bring experience and we will bring nice campaigns. We touched the fashion points that we know that we leverage the brand equity, and we continue to invest. I think that's the moment that those – a lot of brands to be closer to the people in a moment like that, that I mean the country and that macro is not helping, Skol, Brahma and Antarctica will be close to them.

And investing in Carnival, in St. John, (01:03:27) in 360-degree approach, the much more efficient way linking that top line activation, above the line activation, below the line activation in integrated ways. So, we're seeing that, it's a great opportunity to reinforce the equity of the core brands in moments like that, because we are close to the people in moments that they are struggling out there. So, for me, a great opportunity.

The other question, Carlos, could you...

Q - Carlos Laboy {BIO 1506984 <GO>}

Yeah. Would you be leaning on the price lever this hard if you were free to chase all the profitable volume and higher scale that this market can offer, and if your competitors could really keep pace with you and refill old bottle investments and then chasing affordability. There's so much volume to grab in Brazil.

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

Exactly. I mean we are not going high in terms of price. We are going in line with inflation and all the difference above the inflation is exactly what Jamel and I said before. And there's some part of mix, half of mix and half of the, I mean, promotional second quarter of last year, that have more activations during the World Cup. And the thing that we've always had for 25 years are much of the pricing line with inflation.

If the other guys will follow us or not, we will keep that and force ourselves to do even better in terms of execution, in terms of brand building, to really assure that you will be in our range of market share, that we are and growing having opportunities out there. So I don't see, I mean I have the numbers that don't show this hard, I mean both in terms of price as I said, but in terms of volume out there, yeah, I think that Brazil is a great country. And then, despite of the performance that have been nowadays this will come back, I mean many, many times come back it was in 1992, 1993 and it is in the company 1998 and 2002 and 2003 and 2009 and 2008. So that's – and this will come back, and I think that you can exit this tough moment in even better shape of this strong core brands of celebrating premium, fighting, near beer, returnables, being even stronger, that's why, I mean we are here, here for the short-term, but for the long-term as well and I'm completely confident that delivering what we need.

Q - Carlos Laboy {BIO 1506984 <GO>}

Thank you.

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

Thank you, Carlos.

Operator

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

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

So, thanks everyone for the questions, great ones. I think that the final message is, I mean we know that the macroeconomic environment is not helping us. And again, just to remind ourselves on the first time, is that just had before that this happened, have a great end year, team that's used to operate in tough environments like these many times in the past. And a team that's open to learn as well, to understand what the gaps that we have and how we can evolve, and learn from, I mean, all the experience of that we have outside Brazil, other companies as well, and for the best that we're doing here.

So I think that this both things, I mean the will to perform in moments like that, the knowledge to perform in moments like that, and understand that's a opportunity to really do things that only the crisis allow us to do like bring returnables for a better place like elevating our core brands to a better place to even more closer, accelerate dreams, shaping the channels and the occasions in there, right way with trade programs like we said, like craft. So it's a great opportunity to not only to navigate in the short-term, but really exit this macroeconomic environment that's not so good one, that we will come back and it will be good for sure like Brazil always had in the past in a much, much, much better place. So I think that I'm very confident here with the team, and I'm confident that we can deliver. So this year, and the years to come, this strategy that we just showed to you before in the speech. And overall the guidance is unchanged. So that's the final words.

Thanks for your time, and see you next quarter.

Operator

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