Q3 2018 Earnings Call

Company Participants

- Bernardo Pinto Paiva, Chief Executive Officer
- Fernando Tennenbaum, Chief Financial and Investor Relations Officer

Other Participants

- Antonio Barreto, Analyst
- Antonio González, Analyst
- Luca Cipiccia, Analyst
- Lucas Ferreira, Analyst
- Rafael Shin, Analyst
- Robert Ottenstein, Analyst
- Thiago Duarte, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. We would like to welcome everyone to Ambev's Third Quarter 2018 Results Conference Call.

Today with us, we have Mr. Bernardo Paiva, CEO for Ambev; and Mr. Fernando Tennenbaum, 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 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 the third quarter of 2017 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. Fernando Tennenbaum, CFO and Investor Relations Officer. Mr. Tennenbaum, you may begin your conference.

Fernando Tennenbaum {BIO 20615079 <GO>}

Thank you. Hello, everyone. Thank you for joining our 2018 third quarter earnings call. I'll guide you through our financial highlights of Brazil, CAC, LAS and Canada, including our below the line items and cash flow. After that, Bernardo will give more details about our operations in Brazil.

Beginning with the main highlights of your consolidated results, the third quarter was marked by different challenges across all regions, though we saw success from many of our initiatives, including innovation and continued premiumization.

On a consolidated basis, top line was up 5.8%, as the volume drop of 2.4% was more than offset by the growth in net revenue per hectoliter of 8.3%. EBITDA continued to accelerate, and grew organically by 9%, reaching BRL 4.5 billion with an EBITDA margin expansion of 120 basis points to 40.2%. Normalized net profit was BRL 2.9 billion, 10.2% lower than in Q3 2017, as EBITDA organic growth was impacted by the effects of Hyperinflation Accounting in Argentina.

Following the categorization of Argentina as a country for a three-year cumulative inflation rate greater than 100%, the country is considered highly inflationary in accordance with IFRS. As a consequence, starting this quarter, we are reporting the results of our operation in Argentina, applying Hyperinflation Accounting, which led to the following main impact, one, non-monetary assets and liabilities had to be restated using an inflation index, translating to higher cost of goods sold and depreciation of value; and second, the P&L accounts, which used to be converted to Brazil real is at the average exchange rate of (00:04:53) had to be adjusted for the cumulative inflation from January 1, 2018 on, and then converted using the end of the period exchange rate, which is the closing rate of September 30.

With that, we reported Hyperinflation Accounting negative impact of BRL 1.3 billion on net revenues and of BRL 574 million on normalized EBITDA, which contributed to an adverse impact on the normalized profit attributed to equity holders of BRL 275 million.

Having said that, I will now move to our divisional results and start with Brazil. Brazil EBITDA was just 11.1%, reaching BRL 2.6 billion with margin expansion of 350 basis points to 42.9%. In Beer Brazil, top line was up 1.3%, supported by net revenue per hectoliter growth of 4.6%, which was favorably impacted by the price adjustment implemented during the quarter. Volume declined by 3.1% is slightly underperforming the beer industry, which fell by approximately 2.5% according to our estimates, as the consumer environment in the country remained volatile. Bernardo will give further comments on this matter.

EBITDA for Beer Brazil was slightly up, with margin contraction of 50 basis points to 41.7%. Regarding costs and expenses, cash costs per hectoliter grew by 5% as favorable effects was offset by inflation and higher aluminum prices. Cash SG&A was down 1%, mostly driven by lower sales and marketing expenses, which had a higher concentration in Q2, due to the 2018 FIFA World Cup. Year-to-date, top line in Beer Brazil increased by 2.9%, and EBITDA was up 5.2% with margin expansion of 100 basis points to 42.4%.

In NAB Brazil, top line increased by 7% in the third quarter, supported by a strong net revenue per hectoliter growth of 11.3%, which benefited from the carryover of the revenue management initiatives implemented at the end of 2017. Volumes declined by 3.9%, affected by a too soft industry that was down approximately 6% according to our estimates. EBITDA grew by 136%, with some margin expansion of approximately 2,700 basis points to 49.6%.

In terms of costs and expenses, cash COGS per hectoliter was down 30.6%, benefiting from favorable FX and sugar prices. I'd like to take this opportunity to highlight that, despite such strong cost performance, we reiterated the guidance that we expect cash COGS per hectoliter for NAB Brazil to increase by mid-single-digits in the full year of 2018. Cash SG&A was down 4.5%, also driven by lower sales and marketing expenses. Year-to-date, top line in NAB Brazil grew by 3.1%, and EBITDA was up 66.7% with margin expansion of 1,350 basis points to 39.5%.

Moving now to Central America and the Caribbean, net revenues in CAC rose 16.5% as a result of strong volume that grew by 10.3%, coupled with net revenue per hectoliter increase of 5.7%. EBITDA reached at BRL 585 million, increasing organically by 5.8% with margin contraction of 380 basis points to 37.2%. EBITDA growth rate in CAC decelerated when comparing to the previous quarters, due to the increase of cash COGS per hectoliter of 15%, which is fully explained by Panama, where the strong volume evolution since 2017, has driven additional temporary costs in order to supply the market with no disruption.

Further, cash SG&A in the region was up 6% as higher administrative expenses were partially offset by lower sales and marketing expenses. Despite short term cost pressures, our commercial strategy in CAC remained on track supporting the healthy volume performance in virtually all countries in which we operate.

In the core segment, we continued to invest in the introduction of new coolers in the market to further enhance Presidente brand in the Dominican Republic. In Panama, we launched a new visual brand identity for Balboa, our classic lager, highlighting the attributes of quality and heritage.

We also continued to roll out our premiumization strategy in the region, developing our brands Corona and Stella Artois and Budweiser through customized execution board for the on-premise and the off-premise channels. Premium accounts for less than 5% of the lead industry volume in CAC representing a great opportunity for the future.

Year-to-date top-line in CAC was up 13.9% and EBITDA grew by 14.8% with margin expansions of 40 basis points to 38.5%. I'd like to take this occasion to say that we're very excited about our business development and strong volume for the farmers in CAC reinforcing our positive outlook for the region moving forward.

Switching now to Latin America South, net revenue in LAS grew organically by 13.9% in the quarter with net revenue per hectoliter increase of 19.4%. Volume was down 5%, mostly driven by Argentina where volume declined by high single-digit as a consequence of the challenging market environment.

EBITDA in LAS was up 14.5% with margin expansion of 20 basis points to 44.4%. Cash COGS per hectoliter went up 12.8% below inflation, mostly driven by favorable effects while cash SG&A increased by 23.4%. Despite the macroeconomic volatility throughout the region, we remained focused on what we can control in our business and had positive developments.

In Argentina, we kept elevating our core brands through the differentiation of Quilmes, our classic lager, and Brahma, our easy drinking lager, in addition to continuing investing in single-serve packaging presentations.

Regarding the core plus segment, we continued to promote Budweiser in Argentina and launched BUDx, a proprietary platform that celebrates electronic music culture, reinforcing the brand's attributes of energy and internationality. We also launched Andes Origen in the country, a beer brewed in the province of Mendoza which further enhances our core plus portfolio.

Our premiumization strategy has also shown promising results in LAS, with our premium portfolio outpacing the industry across all countries in which we operate.

Year-to-date, top-line in LAS rose 21.3%, and EBITDA increased by 24.6%, with margin expansions of 110 basis points to 42%.

Going forward, while cautious with Argentina in the short term, we have positive mid- and long-term perspectives in the country, and we remain confident in our ability to deliver solid top-line and EBITDA in the whole region, supported by strong brands.

Turning now to Canada. Top-line in Canada was up 0.4%, as the net revenue per hectoliter increase of 1% was impacted by our volume decline of 0.6%, which was mostly driven by a slowdown of the beer industry.

EBITDA reached BRL 662 million which is 7% lower than in the third quarter of 2017. Explained by; one, cash COGS per hectoliter growth of 5% mainly due to higher aluminum prices; and, second, cash SG&A there increased by 4.9% as a consequence of phasing of market expenses, which presented a higher concentration during this quarter coupled with a higher distribution costs related to inventory rebalancing activities across the country. Despite industry challenges, we had good achievements with our portfolio during the quarter.

In the core segment, Bud, Light and Michelob Ultra maintained their momentum ranking among the fastest growing brands in Canada. In the previous segment, Stella Artois and Corona volume ramped up, enabling us to sustain our leadership position in the company. Moreover, the Craft portfolio in Canada once again grew double digits already accounting for close to 5% of our beer volume. Year-to-date, top line in Canada fell by 0.5%, and EBITDA was down 9.6% with margin contraction of 310 basis points to 30.4%.

Now back to consolidated figures below EBITDA. In the third quarter, our net financial results totaled an expense of BRL 611 million, BRL 9.5 million lower than in Q3 2017. Main items in the financial expense in the quarter were, first, interest income of BRL 105 million driven by our cash balance. Second, interest expense of BRL 293 million that also interest incurred in connection with the Brazilian Tax Regularization Program as well as a non-cash accrual of approximately BRL 60 million related to the put option associated with our investment in the Dominican Republic business. Third, with BRL 181 million of losses on derivative instruments, which were up year-over-year, explained by a hard comparable in 3Q 2017, when we incurred gains related to the equity swaps, and by the increase of carry costs of FX hedges linked to our COGS exposure in Argentina.

Fourth, losses on non-derivative instruments in the amount of BRL 215 million, mainly related to non-cash expenses due to foreign exchange variation on intercompany loans, as a result of the Brazilian reais and the Argentinean peso depreciation.

Fifth, taxes on financial transactions on the amount of BRL 39 million. Six, a BRL 103 million of other financial expenses, mainly driven by interest in contingencies. And finally, seventh, BRL 116 million of financial incomes, related to non-cash incomes resulting from the adoption of Hyperinflation Accounting in Argentina.

The normalized effective tax rate was minus 5% in the quarter, in line with Q3 2017. Year-to-date, the normalized effective tax rate was 7.7% versus 4.8% in the same period of 2017, mainly driven by a different phasing, the recognition of the IoC benefits.

Cash generated from operation activity in Q3 2018 was BRL 5.3 billion, which is 16.2% higher than last year. Year-to-date cash generated from operating activities is growing by 1.7%, reaching BRL 9.1 billion. CapEx reached BRL 914 million in the quarter and BRL 2.2 billion year-to-date, increasing 8.8% versus the first nine months of 2017.

Finally during this year, we announced approximately BRL 3.6 billion to equity holders in dividend.

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

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Fernando. Hello everyone. As mentioned by Fernando during this quarter, we saw success from many of our initiatives echoing the innovation and continued premiumization. Ambev Brazil, volumes declined by 3.1% after the scheduled price increase, slightly below the total beer industry.

After showing early signs of recovery from May up to July, the beer industry faced volume shortfall in August, and specially in September. This is a consequence of a volatile macroeconomic environment, which is affecting consumption mainly due to high unemployment rate, disposable income recovering at a slow pace, and is still at low levels, and consumer confidence that's in the very negative territory. However, despite of the short-term challenge, the shape of our volume shows very positive sign and premium brands are increasing, delivering a good performance.

Having said that, we remain confident that Brazil presents a great potential for the future and that's why I would like to take this opportunity to walk you through the different segments of the Brazilian beer market. In the main initiatives that we're implementing other our growth platforms to compete in each of these segments. So, the Brazilian beer market can be divided to three segments. One, premium, that accounts for approximately 10% of the total industry. Second, core, which represent roughly 65% and third, value, that accounts for the remaining one-fourth of the market. So, I would like to start with premium, premiumization is a trend that can be expected to continue to drive the beer category (00:19:52). As I just mentioned, premium currently represents approximately 10% of the industry. As I've been highlighting in our recent calls, we have a portfolio approach to compete in this segment, which is comprised of global brands and domestic brands with different and complementary positioning, addressing multiple consumer need stakes and minimizing overlaps. I will explain more about them.

Starting with the global brands, Budweiser, Stella Artois and Corona. Budweiser is our largest global brand, and the main (00:20:31) alternative for consumers entering the premium segment. Budweiser is an easy drink lager, which stands for authenticity and aspiration of a true pop culture exploring the nightlife, music concerts in great moments of consumers' life, combined with the quality from its brewing, brewing tradition. We are proud that during this quarter, Brazil became the first country to launch the new Budweiser's proprietary roadmap in sharing size bottles. With a more than a visual brand identity, exclusive shape, the (00:21:10) special metalizer labels, the new packs highlight the brand's signature that is of modernity, quality and authenticity supporting Budweiser's remarkable growth.

Stella Artois on its turn is a classic lager, priced right in the middle of Budweiser and Corona. The brand is there (00:21:34) moment in consumer's life, especially occasions where food is present. This quarter, Stella Artois grew more than 55%, supported by a strong expansion in the on-trade channel with its new sharing size bottle. The brand also boosted visibility with the sponsorship of the Rio Gastronomia, the largest food event in the country, taking this opportunity to definitely embrace gastronomy as its proprietary platform.

And finally, Corona. Corona explores the outdoor lifestyle. It's the coolest premium beer brand in Brazil. This quarter, Corona's volume was up more than 75%, being one of the fastest growing brands in the country. We are confident that Corona will continue to ramp up at the fast pace, being far from reaching its full potential.

Now, I would like to spend a few words about the domestic portfolio, Original and Serramalte in particular. These brands were first developed in their on-trade channel, delivery amazing experience to consumers. Original and Serramalte will continue to play an essential role in our portfolio going forward. Their combined net volumes increased by more than 10% during the third quarter, supported by the launch of Serramalte cans.

Domestic brands along with global brands volume performance translating to double digits premium volume growth and significant market share gains in the premium segment. The solid growth of premium is a positive strength for our business as all brands are margin accretive. With that in mind, we are proud of the evolution of our premium strategy in recent years and we will continue to further enhance the portfolio to drive us towards sustainable long-term growth.

Now talking about the core segment. Core is the largest segment represents approximately 65% of the industry, and it's a segment in which we have the highest market share. Core brands deliver high volume and solid profitability. Over the last couple of years we've implemented several initiatives in order to elevate and differentiate our core brands and then reach consumers' experience, such as improving primary and secondary packaging, introducing new visual brand identities, activating key brand in (00:24:25). So I would like to take a few minutes to talk a little bit more about our two main core brands, Brahma and Skol.

Let me begin with Brahma, our classic lager. Brahma has been outperforming the industry quarter-after-quarter, mainly explained by; one, the implementation of very successful commercial initiatives such as its new visual brand identity, the World Cup campaign that connect Brazilian consumers to the soccer passion point, the (00:24:58) that bring the consumer schools (00:25:00) music to name a few. Second, the wide and strong portfolio of seven different liquids, with recognized quality and tradition that goes from Brahma Chopp, the largest bestselling classic lager to Brahma Extra Lager, a pure malt alternative to (00:25:25) Brahma, the best experience with being draft beer. And third, the growth of the attribute of flavor among Brazilian consumers. Surveys conducted with consumers have indicated that the beer market is becoming more balanced and the driver of lightness which historically has been by far the most important on defining consumers' preference is sharing space with flavor. This change in consumers' preference is causing a shift from easy drinking lagers, such as Skol to classic lagers such as Brahma and that's why we have (00:26:01) so that it can address a different consumer need states and absorb structural change in consumer preference.

Now switch to Skol, even though the added attribute of lightness is declining among consumer preference, Skol is the most powerful beer brand in the market, and we will continue to invest behind the brand with marketing, quality, and more importantly, innovation. So with the summer approaching the brand is launching its new campaign. The campaign conveys the underlying message that for Skol they will never stop turning and that the brand will continue to bring great innovations to the market such as Skol Hops, which was considered the best Brazilian (00:26:49) business at the World Beer Awards. After its introduction in the northeast of Brazil during the second quarter of this year, Skol Hops has been rolling out across the country during the third quarter. Preliminary results are encouraging, making us confident that Skol Hops has a meaningful role to play in our portfolio. The launch of this Skol Hops also opens the door for Skol to launch new products in the beer segment with a view towards our exciting innovations under the brand. It also comes to reinforce our position in the so-called core plus segment, which began to shape in 2016 with the launch of Brahma Extra. The core plus segment represents the first (00:27:43) alternative for consumers, and with Brahma Extra, Bohemia and Skol Hops, already make up almost 3% of our total beer volume in Brazil.

Finally, I would like to take this occasion to highlight that the core segment has been thoroughly impacted during the last few years not only because of the premium growth, but also because of the growth of the value segment, which with consumer disposable income under a big pressure grew from 19% to nearly one-fourth of the market. However, the core segment is the one that tends to benefit the most with the rebound of the economy, representing a great opportunity going forward.

I'll now spend a few minutes talking about that. The (00:28:36) segment is characterized by an importance, I repeat, an importance of brand equity. Moreover, even though it's quite relevant in terms of volume, its share in (00:28:49), it's very, very low. Our participation in volume has historically been very small. However, considering its relevance in terms of volume, we've been challenging ourselves to track affordability with relevant brands and as well disruption in profitability. As a consequence, we've developed initiatives related to packaging such as a 300 ml with thermal glass bottles, and more recently related to (00:29:17) such as Nossa. Nossa is a beer that we have launched in the state of Pernambuco during this quarter, which is probably brewed with cassava produced by local farmers.

Nossa is being commercializing the 600 ml returnable glass bottle in the on-trade, and in the 300 ml returnable glass bottle in the off-trade, our most profitable pegs.

And while driving affordability to consumers with healthy margins, the brand fosters social engagement, promotes local economy development, and enhanced the culture of the State of Pernambuco. Nossa, it's a great example of how we can compete in this value segment, driving affordability to consumers and capture incremental volume with good margins, and brands that have a significant meaning to consumers.

In summary, in the last few years, we've made structure investments in our business, which are putting us in a strong position to compete in each of the segments of the Brazilian beer market and to fully benefit from expected rebound of the economy. We see plenty of opportunities ahead of us and we're confident that we have a strong portfolio to capitalize on such opportunity.

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

Q&A

Operator

We will now begin the question-and-answer session. The first question comes from Antonio González with Credit Suisse. Please go ahead.

Q - Antonio González

Hi. Good morning, Bernardo, and Fernando, thank you for taking my question. I just have two quick ones. First, Bernardo, thank you so much for the incremental color on how you see the different price segments in Brazil at the moment. I wanted to ask now that especially you are innovating in the lower end of the market with profitable proposition of Nossa, what is your view about the value segment or the economy segment more recently and going forward, can you share if you've seen any signs at all of these roughly 6% touch points, higher participation that value now has in the beer market in Brazil, has that stabilized at all? Do you see any evidence of that reverting to more normalized levels that we saw pre-crisis or you have no evidence of that at the moment? And then secondly, maybe for Fernando, I wanted to ask very quickly, obviously, ABI today announced there'll be 50% cut on their dividend. And I wanted to ask if you can remind those and how you are thinking about the dividend policy at the Ambev level. There were a number of extraordinary events last year that I would assume impacted your dividend, the acquisition of the Dominican Republic and the Tax Regularization Program in Brazil et cetera. But if you can just share any perspective on what to expect in terms of dividend payout at the Ambev level going forward that would be super helpful.

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

Antonio, thanks for the question. I think first let's talk about the developed segment. We all know that in the last four years, I mean, all the crisis – the economic crisis that Brazil faced, put lots of, tons of pressure in disposable income, and as the value segment grew from almost 19% to up to 25%. So what I think that will happen in the future depends on what we think, what will be the rebound of the economy. If the hypothesis that I think, that the Brazilian economy will be in a better place next year. In my opinion, being based on the numbers that I had been seeing this year in the first two quarters, I think that we are in a stable wave of the value segment and this is the economies – the economy become better could even shrink. Don't know if it shrinks for the 19% that was in the past, but in every market that we saw after a crisis with the rebound of the economy, we see again a trade up from value to core, because you have to bear in mind that beer is not only exactly the liquid, but is the brand, is the emotional link that a consumer has with the brand, with that. And we know that the value segment, it's basically no branded segment. No brand equity there. So, better economy, trade up will happen from the value to core. So, again my perspective for the country for next year that the economy will be better. I don't know if it'd be much better, it should be slightly better. But I think that would be better. Let's see if it this happen, I think that the value segment tends to reduce the wave in the – in the full market.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Hi, Antonio. Fernando here. Thanks for your question. So from an investment point there is no meaningful changes in our dividend policy. We will continue to pay out the available free cash flow. The only thing and I think this is not news we are not so prescriptive on the timing of the dividend, because it depends on various factors. But the idea is that we keep paying out every year the free cash flow available.

Q - Antonio González

That's very clear. Thank you.

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

Thank you, Antonio.

Operator

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

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. A couple of small questions. One, I've had some discussions with some convenience store owners in Brazil, and they'd mentioned to me that they love the returnable glass bottles. They love the pit stops, but they're having some supply issues. And I've heard that from a few, so I don't know if that's kind of one-offs or whether there is something else going on there. And then second, wondered if you could give us any kind of sense at all, we're hearing that Heineken has followed the price increases in September/October, are you seeing any kind of improvements in market share in October? Thank you.

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

Robert, thanks for the question. I think that all the strides that we have been put in place to shape the in-home occasion I think that pit stops are very, very important, because they've been growing a lot. Its returnable, good margins, close to the homes of the people, who sell cold beer and really growing big, big time. We don't see any problems in supply for specific stores overall in the marketplace, but I'll check maybe here and there one or another store is selling a lot and maybe we could have a problem, but it's not something is structured, and it's not in (00:37:02) so good message here, but I would check that, but the good message that it's a very good franchise model, very profitable and aligned with a sharper mission of people that go to a gas station and can buy cold beer, nice price, and great brands.

This – the second question basically, we talked about, we don't talk a lot about price, behavior of other companies. But what I could say this year that overall the price adjustment took longer to happen. That's what I can say.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Are you seeing any signs that you'll be able to recover market share from your primary competitor in the fourth quarter? Just kind of based on what you're seeing in October now?

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

It's a good question. Maybe we can talk a little bit and take the opportunity to talk about the volume and in this channel. So when you think about the share, not sure that's your question, so let's go step by step. So first the industry in the quarter was negative. No matter which source you use to cut the industry to us between minus 2 and minus 3, so we have all the sources, all different sources and this basically is the number minus 2 and minus 3. Keep in mind that sellout data, that the end of the inventory levels can have some difference to selling that for the players. So taking in account of our third quarter results, our market share is slightly below last year, (00:38:52) but is under control. So second, about the share again. We gained significant share increment, the most problem shared segment. So all global brands are performing strong and momentum is great. And even in a quarter that increased price, and the price behavior of the other players were not exactly the same in the beginning we gained share in the premium segment that's something very, very good and supports for gain as I said. Third, in the quarter price increase, the core segment tends to be more effective and value tends to outperform. So, for instance one information, in this quarter that we had this price adjustment are more on our core, more affordable brand that (00:39:42) grew more than – double digits, was a strong growth. So, in the quarter of price increase given the dynamics of the market of the price behavior of the market (00:39:59) a lot.

And fourth, what we see in the market is a strong shift of volume among value brands from different players. It's an important thing and then you can see, we have all the value segment that grew, and then a big shift on the pyramid for our non-profitable segment. Having said that, we remain committed to our price discipline investing in the profitable segments of the Brazilian market, core, which would be the segment to benefit the most with the rebound of the economy, and premium, that is growing despite the economic crisis or whatever and that we are gaining share. So basically that's what I could say and I hope that's good answer to the question, Robert.

Q - Robert Ottenstein {BIO 1498660 <GO>}

No. Very clear and very helpful. Thank you.

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

Thank you.

Operator

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

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi good morning, Bernardo, Fernando. Thanks for taking my question. I also wanted to follow-up on the portfolio and Brazil. I think any of – nobody can say that you are not proactive in the last four years during the crisis with the various initiative in beer, in soft drinks, in channel, in package, and so on and so forth. Yet, there was always this message around the value segment that was not an area where you wanted or you thought it was economical to – to be attracted to participating, and now you have this new initiative with the Nossa brand coming quite late, one could say in the decline or in the change in the structure of industry, changes in the industry, so my question is on the one end what is it that surprised you like the duration of the pressure on the consumer relative to your original plan, did you think that maybe whether it was returnable, whether it was sort of the core initiative that had helped you, it would have helped you more than what they really did or was there something else that changed maybe in the way consumers are relating to the kind of category, in the way some of your competitors are operating in that segment that made you enter arguably in the later part of the, of this negative cycle as compared to other initiatives that you did very quickly early on compared to most others?

And then secondly related to this when you say that you are now in the value segment but in a profitable way, if you can maybe expand a little bit more on what the, what does that mean given that you are also trying to build equity and I would assume that required some investment, so maybe if you can clarify what does it mean to do it profitably and maybe what does it mean in terms of potential dilution to margins overall? Thank you.

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

Thanks, Luca for the question here. First was not a surprise that the value segment would grow, not at all. So basically, we built in the last years two avenues. One, the portfolio gain in the premium that we're much better in gaining share that's very important to say and the portfolio gain with the core brands that we knew that the segment would suffer during that crisis. But in the moment that Brazil would rebound, we would have to get trade up again. (00:43:35) lager, classic lager a portfolio approach in packaging (00:43:42) new liquids, bring – bringing the brewed – all of the brewing knowledge that we have for the core brands. So the momentum is good not for the segment, but for those brands, so this is the avenue and we really think that if Brazil rebounds that's my opinion that could happen. We will – the core segment you'll take the benefit of that and our core brands are in good shape. This is the first avenue.

The second avenue is basically how you could play in the value segment in a profitable way. So the 200 ml returnable bottle, it's one that had been complementing, and there are other ways of how we can launch regional brands that based in an ecosystem of that specific state who could build a business case together with the states that can provide jobs for local farmers, who have good wealthy, improve the wealth for those farmers And together with the – with each government you can have a win-win. So create jobs in the countryside. That's very, very important. So very, very important for a brand like – like Nossa. Again it helps to create wealth in the countryside, poor people that live there with the farmers moving from the subsistence agriculture towards the commercial agriculture, promoting better life for their families. So with that, with the state together with us, we'll be able to have a great brand connected to local people, creating jobs there with a nice price point, and (00:45:42). So we have been working this project for two years. I would say it's not so simple to put all the, I would say, all the pieces of this puzzle to get Nossa there because we have to have the local farmers, the government and us. I think that in Pernambuco we are able to do that, and very proud of that, and it's like an example for other states in Brazil. So Nossa you'll be the brand only be sold in Pernambuco is the brand of this state the flag there. But, yeah, as you have other exciting projects in other states on the pipeline, which are not public.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Right. So just (00:46:24) so it's not that Nossa is going to be rolled out more broadly across Brazil is rather that the model of this initiative could be applied to other region, other states is that the right way to think about it?

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

(00:46:40) Nossa will be only sold there in Pernambuco, because it's not only price point with good margins, because margin is good, is margin at least neutral when I compare to core. It's I would say it's a partnership between local farmers, government, and us to provide jobs in the country side as I said and at the same time bringing a nice brand with a nice hook for the local culture with a nice price point that could drive volume and that would be good for everyone, good for the farmers that to have the job, good for the government that we increase tax revenue, because we increased the penetration of beer, and good for us because we have a great brand with a good price point and no – with no dilution of much. So having said that, Nossa, it's only one state. But again, we have other siting projects, not Nossa, but could be others. Other states on the pipeline that I would say with this, I mean in a more stable environment in each state after the elections you'd be I would say are easier as to roll out the concept.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Understood. Thank you. Thanks.

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

Thank you.

Operator

The next question comes from Lucas Ferreira with JPMorgan. Please go ahead.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi there gentlemen, good afternoon. If you can comment a little bit on Argentina on the volume decline there and the conditions of the market, if you see that this specific quarter, the drop was greater than you expected? And what you expect to see for the quarters to come and if you have already some reading on the conditions of that market, specifically moving to October?

And my second question is regarding your leverage as to keep your margins stable going forward on the cost side and also SG&A, if you can comment on how you're seeing those leverages to avoid any potential compression coming from the raw material pressure that I imagine that we could see in 2019? Thank you.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

Hi, Lucas. Fernando here. Thanks for your question. It's fair to see that global external factors coupled with Argentina and doing that led to FX depreciation. So far, year-to-date until September, it's something so far, year-to-date until September, it's something like 130% in inflation acceleration. Consumer confidence reaching September the lowest level in the last three years, so that further impacted consumption. But having said all that, we are used to operate in Argentina. It's not something new for us and we have a very strong track record of delivering solid results in the country, despite all the ups and downs.

We acknowledge that inflation is very high, and that the consumer environment will be challenged in the short term, but we will continue using our revenue management initiatives and our two (00:49:50) driver for the ability to consumers, such as the 340 ml returnable glass bottles for both Quilmes and Brahma.

We also continue to believe in the commercial strategy, which has strong volume growth year-to-date in both for our core brands, Quilmes and Brahma, as well as a continued growth in the premium segment, especially through Stella Artois, Corona, and the local brand Patagonia.

The core plus segment, which is something that we're aware of developing in Argentina, is very promising, so we are enhancing Budweiser, and we just launched the new brand Andes Origen, the one I mentioned on my opening remarks. So in summary, short-term volatility in Argentina, but when you see where we think the country could go, where the market could go, we continued to be optimistic about Argentina.

In terms of the levers to margin, I'll let Bernardo go over.

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

So, basically, it's true that FX will be a headwind for next year. But first, I would like to highlight that 2019 would be very different from 2016, when we had a major FX movement and a pressure in our margins. Back then, there were a lot of other things even more relevant than FX, such as state tax increase, reduction of government grants, and operational de-levers due to volume decline. In addition, we'll continue to evolve in excellence, better process, technology, operating in a lean way (00:51:32) in order to mitigate the habits. We are constantly searching for opportunities to reduce and optimize costs, saving the non-working money.

Having said that, even though we cannot provide any margin guidance for 2019, we continue to believe that over the long term, we can further expand our minds supported by healthy top line increase and tight cost management, that I would say for you.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you very much.

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

Thank you.

Operator

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

Q - Thiago Duarte {BIO 16541921 <GO>}

Hi. Hello, Bernardo. Hello, Tennenbaum. Hello, everyone. I have two questions. The first one is, I wonder if you could draw an analogy between the price increase process that you're implementing this year in Brazil Beer compared to what happened last year. Last year, you implemented price increases a little bit earlier than normal, just like you did this year. Last year, we saw the company losing a good amount of market share in the third quarter versus the second quarter. It looks like the same happened this year once again. But when you look at what happened in the fourth quarter of last year, we not only saw the full capturing of the price increase, but we also saw a good recovery of volume growth and market share. So, I just wonder whether you think we could be seeing more or less the same film, if you look both in terms of capturing the price increases in terms of net revenue per hectoliter and the volume and market share performance. So, that would be the first question?

And the second question, it's a quick one, just wondering when you look at the other operating results or the tax subsidies, we saw a decline in the Beer segment in Brazil as a percentage of revenues to 2.1%, but we saw a big jump in NAB to I think almost 10% of revenue. So, just if you could clarify towards why that volatility took place and how we should think of those tax incentives in both divisions going forward, it would be very helpful. Thank you very much.

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

So, Thiago, thanks for the question. I mean I'll take the first one and Fernando takes the second one. I mean, first one, Thiago, I'll reinforce what I said. I mean, no matter the number we cut here for all the internal information that we had, the industry was between minus 2% and minus 3%, and our volume was kind of 3% plus, below the industry that we don't like, but the market (00:54:10) a range that makes sense for a price increase that we had.

Regarding specifically the price increase, what I can say again that this year, the overall price adjustment took longer to happen, but took longer to happen, but happened. That was the insight. That was a kind of little bit different than last year. And the other thing is that, what we see in the market in a moment that you have a kind of an adjustment of price like that is that the value segment go more, yes, put the pressure on the core, as I said, that we're able to I mean compensate in the overall share, good part of that gaining sharing premium. That we've done.

But we saw a huge shift among value brands from different players. So really, I mean an important shift in many, many regions. (00:55:17) don't play that. I mean, I say that you don't play with cans, selling cans, BRL 1.99 and BRL 1.75. (00:55:23) We don't do that. And then you see it in the market, players that want to do that, they get more volume. When they stop doing that, the volume goes to another place. That's basically the view of the third quarter.

Again, the share loss was – I mean for our industry of minus 2% to minus 3%, but our volume 3% plus. So, slightly ahead that. The price adjustment, the overall price took longer to happen, but happened. And the value segment shift among different players in terms of those brands could explain big time market share among different players in the market.

A - Fernando Tennenbaum {BIO 20615079 <GO>}

And hi, Thiago. This is Fernando here, also thanks for your question. Your question on the other operating, it's more quarter specific. It's not something we expect to see going forward. It is somewhat related to the inventories on soft drinks for the summer. I think this is somewhat related also to the impact that we had in the cost of goods sold. There's all types of the same (00:56:38) the inventories, but I don't expect the same effect to happen in this fourth quarter.

Q - Thiago Duarte {BIO 16541921 <GO>}

Okay. That's clear. So, you would keep the – let's say, the historical pattern as a percentage of revenues as the normalized level of tax subsidies going forward, right?

A - Fernando Tennenbaum {BIO 20615079 <GO>}

We don't like to give any guidance – or not (00:56:58) give any guidance, but this seems to be a more reasonable approach.

Q - Thiago Duarte {BIO 16541921 <GO>}

Okay. Perfect. Thank you, guys.

Operator

The next question comes from Rafael Shin with Morgan Stanley. Please go ahead.

Q - Rafael Shin {BIO 7420117 <GO>}

Yeah. Hi, everyone. And thanks for taking my question. I was wondering if you can provide a little bit more color specifically on Skol? I mean if I understand correctly, it seems that a lot of the volume is going into Brahma, a lot of it is also going into the value segment. I was wondering if there is any other competitor you see in the core segment?

And also, if you can share some information about what's happening in different channels? Do you see more competition on the on-premise or off-premise, and the where are you losing more market share? Thank you.

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

I think that – I mean talking about Skol, again, very important, Rafael, to – and thanks for the question – to talk about the core segment again, I mean. The core segment that has been suffering, the food (00:57:57) segment, in the last years, given the growth of the (00:58:01). So, having said that, inside the core segment and, as I mentioned in my speech, there was a change in the last years in the attribute of lightness (00:58:16) continues to be the most important one, but the attributes of flavor has become even more important. And this is the beauty of having the portfolio, because Brahma is our classic lager and had been capturing this trend big, big time. And yes, because of the attribute of likeness going , I mean, down, (00:58:40) the most important is going down. Skol, is a drink lager, is suffering more than Brahma that's a classic lager. That's negative due to the more flavor attribute that is growing. But the most important thing that that we have been doing of with those brands is to really separate those brands.

So, we're repositioning Brahma in 2016. And then, I mean, having working hard and the brand is doing pretty, pretty well, amazing with seven different liquids, whereas the soccer platform with the Sertaneja country music here in Brazil (00:59:16) growing big, big time, new packs.

In Skol, we are bringing more brewing knowledge for the brand. (00:59:30) I think that Skol Beats was very, very important, but was not exactly a liquid that that I mean taste specifically like beer. But it's important, it's there. And I think that that's why we launched our core plus, Skol Hops, because it's not only helped to brew to grow the core plus segment, but bring a new I would say speech or a new flavor to Skol, because Skol have the Skol (01:00:01) and have a Skol Hops with different Hops and so on, it brings definitely the brewing knowledge to Skol. That is needed, as it needed for Brahma, but we're doing for a Skol in a different way.

So, drink all beer, Skol Hops. (01:00:18) 4% alcohol but brings this flavor in a different way. It's good for the mother brand and is helping the mother brand. So that's a – at the end of the day, core segment, the beauty that you have, it's a portfolio there with a very strong (01:00:34) the Skol is the most powerful brand. (01:00:37) external research, Skol is the very strong (01:00:43) lightness is the most important one going down. and good thing that we repositioned Brahma and it taken all the I would say the tailwind of the flavor attribute going.

In terms of the channels, I mean Brazilian market is very I mean market is very – I mean you know that it's a very competitive market. And (01:01:06) don't trade in the off trade, I mean nothing strictly changed.

Q - Rafael Shin {BIO 7420117 <GO>}

Okay, thank you.

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

Thank you, Rafael.

Operator

The next question comes from Antonio Barreto with Itaú BBA. Please go ahead.

Q - Antonio Barreto {BIO 17449798 <GO>}

Hi, guys. Good morning. When you mentioned the direction of the company is to increase the differentiation of brands, I'm just trying to understand here when you launched Skol Hops, for example, doesn't Skol communicate lightness to the consumer and in a certain sense it confuses a little bit the message that you convey with Brahma, which at least in my point of view it communicates a little bit more flavor. So how do guys think of that? And why the decision to launch Skol Hops and not another new brand or even a different liquid on Brahma for example? You mentioned that you already have seven on Brahma, so I just wanted to understand a little bit why that move on Skol and not on all your brands.

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

It's a very good question. I think that for Brahma, the portfolio that we have it's just – it's a strong. We have seven different liquids. Brahma is doing pretty, pretty well. We do it in and out. So I think Brahma is in very shape there. I think what was important to Skol to bring in this core plus segment, in different liquids, in a I would say, drinkable way. So after I mean sometimes, I mean one year and a half, trying to get a very drinkable liquid, but with a different flavor, that's Skol Hops. It's a 4% alcohol. This aromatic hops brings the aroma, but of the hops but not the difference, so it's a very drinkable, it's not beer and it's a 4% liquid.

So, and just for the reference, in three months, Skol Hops already accounts for almost 50% of volume of Brahma, and it (01:03:19) last month only. So, full national launch is just one month and already doing really, really well. And we go to the market that people, in general, drinks more premium beer and so on, they really understand the idea of the brand is of the Hops, try to understand the impact of different Hops in the liquid, but we still the drinkability is there. I mean you should be able to taste the liquid we understand (01:03:49) what I'm saying.

The big challenge for our brew masters who want a beer that is Skol is drinking, it's drinkable I can't drink in the, I mean, in the beach summer with a different aroma, with some signature of flavor, but still very, very drinkable, because the Skol is drinkable, it's a 4% alcohol brand, Skol Hops. So I think that we are able to bring a beer liquid to Skol and expand the Skol family and bringing I would say brewing knowledge for the brand.

If you go to the social media, here in Brazil, even with Skol, I mean the Facebook, the page of Skol Hops, you could see the comments there, very drinkable, like, people will like a lot with the women, big, big time, but I mean with this different aroma, but very drinkable. I think that is very good for the mother brand, which is again bring to Skol this brewing knowledge that the brand has and should be more recognized by everyone.

Q - Antonio Barreto {BIO 17449798 <GO>}

Thank you, Bernardo. And if I can add just one question, you mentioned several times that you believe that, according to all the estimates that you look at, the beer market has shrunk between 2% and 3%. When you talk to industry stakeholders, we heard from more than one that they believe that the beer market is not actually decreasing that the estimates, the traditional estimates (01:05:27) over a big chunk of the market that may be growing more.

First of all, I would like to understand if you agree with that kind of statement. And if not, why do you think that the beer market is so weak right now? We understand that the consumer environment in Brazil is not the best, but it has been like this for some time. So, if you don't agree with that kind of statement, why do you think the beer market is so weak at this point?

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

It's a good question. I mean, first one, we have been working in the coverage of the research that we have and then to a contract. So, I would say that today, our coverage, our data from the industry, it's not the same. That's probably true two years ago. I have been worked with partners to assure that this coverage is huge. It's much better than we had in the past. I would say, I mean close to 100%, not exactly 100% of the market, but it's close.

And based on those data, that's a sellout data, I think again, no matter we cut could be between 2% and 3%. These are numbers that we have. As to how I think about the sellout and sell-in data, it has difference, it can vary according to inventory levels during specific quarter. So, basically I think that the industry , it was negative, for all the information that we have in that quarter. (01:06:59) think that yes, we had a better quarter in the second quarter, even if with the strike, the truck strikes (01:07:13) the World Cup.

Even July was very, very interesting month for the industry and for us. But we do have disposable income in a very low level and consumer confidence going down. And (01:07:33) safe player of the market do a pricing adjustment. And (01:07:38) that, I would say – this is my, it is not technical, it's my field, (01:07:43) go to the market. The environment of the country, I mean, is not the best one I would say. I mean and probably you know what I mean know, elections divide people talking to each other, I mean friends fighting, because of this and that, and I think that does not help those two things. I mean in terms of the biggest player, yes, putting price in the market that has an impact in the industry in the short-term.

And secondly, I think that this whole environment that we're living here in Brazil, that's in one point of time (01:08:22) because I mean the elections will be in one – few days. So that's my view. I think that to us industry continue under pressure. This quarter, a little bit more given those two reasons. And in terms of the industry, we are – I mean have all the numbers (01:08:43) here and there. And we are I mean pretty sure that the industry was negative and have always (01:08:51) sell-in and sell-out balance.

Operator

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

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

Thanks, Gary. Before finish our call, I'd like to close saying that we remain confident that we are evolving in a consistent way with our commercial strategy. In Brazil, we will continue to push premium further and we will continue to increase our participation in this segment. Portfolio is very, very strong. We are, I mean, doing a great job, the team with the brands from the brands to the trade and are very confident that we continue to bring share there. And we are also positive about the rebound of the economy in Brazil, what should be a tailwind for the core segment that has been suffering a lot in the last four years and could be appealing for us as well given the portfolio of brands, strong brands that we have in the core segment. So thank you. Have a great day. Enjoy the rest of your day.

Operator

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