Q3 2007 Earnings Call

Company Participants

- Graham Staley, CFO
- Joao Castro Neves, CEO
- Luiz Fernando Edmond, CEO
- Miguel Patricio, CEO

Other Participants

- Alex Roberts, Analyst
- Andrea Teixeira, Analyst
- Bob Ford, Analyst
- Celso Sanchez, Analyst
- Jose Yordan, Analyst
- Lauren Torres, Analyst
- Lore Serra, Analyst

Presentation

Operator

Good afternoon, and thank you for waiting. We would like to welcome everyone to AmBev Third Quarter 2007 earnings conference call. Today with us, we have Mr. Luiz Fernando Edmond, CEO for Latin America, Mr. Miguel Patricio, CEO for North America, Mr. Graham Staley, CFO Investor Relations Officer, and Mr. Joao Castro Neves, CEO for Quinsa. We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the company's presentation. After AmBev's remarks are complete, there will be a question and answer section. At that time, further instructions will be given.

(Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of Securities Litigation Reform Act of 1996. Forward looking statements are based on the belief and assumptions of AmBev's management, and on information currently available to the company. They involve risk, 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.

Now, I turn the conference over to Mr. Graham Staley. Mr. Staley, you may begin your conference.

Graham Staley {BIO 15381675 <GO>}

Thank you very much, Ray. Good morning everyone. Welcome to AmBev's Third Quarter results conference call. I'm Graham Staley, CFO of AmBev and, as Ray said, joining me today are Luiz Fernando Edmond, CEO for Latin America, Joao Castro Neves, CEO for Quinsa, and Miguel Patricio, CEO for North America. We also have Odalong Quares [ph], the Finance Director of Labatt with Miguel today.

I would like to start the call by sharing a brief overview of the quarter. As usual, Luiz Fernando, Joao and Miguel will then provide you with details about our operations in Brazil, HILA-ex, Quinsa and Canada. Then, before opening up for questions, I'll make a few comments and items between EBITDA and net income.

Before we start, I would like to comment on the changes we have made to the release for this quarter. In order to provide readers with more insight into the underlying trends, we've decided to segregate the organic performance from the impact of currency translation and scope; scope, for example, being the acquisition of Cintra in Brazil. I am sure that you will agree with us that this helps to explain and interpret trends far more easily.

So moving to the results. I am pleased to report that our consolidated EBITDA reached R$1.99 billion, which represents growth of 10.6%, and a margin expansion of 130 basis points on an organic basis compared to the same period in 2006. Our earnings per share growth, excluding goodwill amortization, was 26.3%.

The Brazilian business delivered a solid performance, with EBITDA up 12.7% and EBITDA margin up 90 basis points on the same period last year, both on an organic basis. Volumes grew organically 4.9% for beer, and 3.4% for CSD and NANC.

Quinsa also had a good quarter, despite pressures on costs, due to inflation, higher commodity prices and the energy crisis, growing EBITDA 13.7% and EBITDA margin 60 basis points on an organic basis.

In Canada, EBITDA grew 3.5%, and margins 210 basis points organically on the back of strong cost savings. The Lakeport acquisition helped drive reported volume growth of 7.6%, and a strength in the portfolio in a challenging, competitive environment.

HILA-ex delivered a positive result of R$3.5 million, with margin up 170 basis points organically. Although we're still showing a loss for the year in HILA-ex, the position is much improved compared to 2006, and each quarter leads us closer to break-even.

Our combined operations delivered net income of R$589.8 million, 21.3% higher than the Third Quarter last year. The main reasons for this year-over-year increase are, of course, higher EBITDA less the associated income taxes, the impact of currency translation on foreign investments as a result of the strengthening real, and the inclusion of a contingency provision in Q3 last year for a litigation settlement relating to warrants issued by the company.

With that brief introduction, I will now turn you over to Luiz Fernando, who will comment on Brazil and HILA-ex.

Luiz Fernando Edmond {BIO 5862219 <GO>}

Thank you, Graham and morning everyone. I will now provide you with details regarding the Brazilian and HILA-ex situations.

Starting with Brazil, we were able to grow our funds by 4.9%, and revenues throughout the year by 5.8%, both on an organic basis. Our focused campaigns to support and drive preference for our brands, coupled with disciplined execution, a healthiness to recover the market share lost at the beginning of the year, while maintaining our focus on profitability.

Although we were a few behind last year, we've been increasing share every month since April, and we're already 120 basis points ahead of the March figures.

Beer costs per hectoliter grew by 5% organically, impacted by higher labor costs, some raw material price increases and packaging mix, offset by the gains in commodities and FX hedging.

The packaging mix impact on COGS was compensated by higher can [ph] volumes, share in revenues per hectoliter.

SG&A for Beer Brazil, excluding depreciation and amortization presented 8.3% organic growth, driven by higher revenues, direct distribution expansion and impact of inflation on other costs. Putting these all together, we had a Third Quarter of 2007 with an organic result of 12.4% higher EBITDA for Beer Brazil, which was 70 basis points margin improvement.

I would also like to comment on the Cintra acquisition. Since Mr. Cintra did not sell the brand to other parties, we are in the process of acquiring it under the terms disclosed at the time of the transaction. It's too early to comment on the strategies at this stage.

CSD and NANC operations post organic volumes 3.4% higher than last year, presenting 30 basis points of market share increase. Revenues per hectoliter grew 5% organically, attributable to a better product mix and some price adjustments done throughout the year.

CSD and NANC COGS per hectoliter fell 7.7% organically, due to anticipated gains on commodities and foreign exchange ads, partially offset by product mix due to significant increase in H2OH! volumes year-on-year.

SG&A expenses excluding depreciation and amortization were 24.8% higher organically. This higher than average growth as result of two facing [ph] effects. In 2006, we moved some selling and marketing expenses from Q2 -- Q3 into Q4, where this year we did the opposite, as we anticipated some initiatives to be better prepared for the summer season. This will leave us a better position to concentrate on execution in Q4.

The CSD and NANC business delivered 20.6% EBITDA growth, with 340 basis points increase in margins.

Beer volumes in Hila-Ex were down by 4.9%, impacted by volume losses in Venezuela, where the whole market declined. However, Dominican Republic and Peru delivered double-digit growth in the quarter. Year-to-date we've improved beer EBITDA by R$34 million. Year-to-date, CSD EBITDA performance is a lot better than last year, despite the poor volume performance in Peru in Q3.

Wrapping up, I'd like to say that I'm pretty satisfied with the quarterly results and we're in good shape entering the summer. But as I always say, nothing would have been achieved without the commitment of our team and the focus on constantly delivering results.

I will now turn the call to Joao.

Joao Castro Neves {BIO 17456730 <GO>}

Thank you, Luiz Fernando. Good morning everyone.

The region continued to grow, laying the base for another good quarter for the company. Consolidated volumes increased 7.6% organically, based on the outstanding performance of the soft drink business, which grew 13.3% on an organic basis and a 3.6% organic growth in beer, in spite of the negative impact of the distributors and truck drivers strike in Argentina and poor weather conditions in both Argentina and Paraguay.

Bolivia and Uruguay kept strong growth rates, while our business in Chile showed important recovery reflected both in higher sales and market share.

Net revenues for hectoliter grew organically, both in beer and soft drinks. In the beer business, growth in revenues per hectoliter was motivated by strong performance of premium brands and some price increases implemented throughout the region.

In the case of CSD, we benefited from price increases introduced in Argentina, as well as the carry-over of increases introduced by the end of 2006.

The company performed particularly well in the premium segment in Argentina, where premium beer sales doubled its participation in the whole beer business. And also in

Chile, with increasing proportion of sales by Stella Artois and our two recently launched dark Brahma beers.

In terms of the individual beer markets, Argentina continued to perform very well, despite the distribution strike that precluded us from selling in Buenos Aires for about a week, and poor weather conditions in July and August. Net of the three brands sold to comply with the FX authorities [ph] our volume grew while we were able to increase our market share.

The Bolivian business continued to post very strong growth rates, despite an uncertain operating environment, with volumes increasing, the market share remaining stable. In fact, we are doubling capacity at our Santa Cruz plant this year to meet the increasing demand for the past two years.

In Chile, we have benefited from a growing beer market, while gaining market share. Our recently launched Stella Artois brand and outstanding performance by the two dark Brahma beers have strongly contributed to this increase in volumes and revenues.

This performance in premiums segment of the beer business is particularly important in Chile where it accounts for an estimated 10% of the total market.

The beer market in Paraguay was the exception in the region, since it contracted compared to 2006, basically due to the very poor weather that I just mentioned in July and August. This is the main reason for the decline of our volumes. We are already implementing some actions to boost market volume, such as the recent launch of Labatt, that's maybe the main one.

Price increases implemented last year resulted in an average sales price increase, also helped by higher mix of Brahma which is the leader with the highest price in this marketplace.

Even though (inaudible) declined in the quarter, it's important to highlight that the month September, reflected an important recovery, both for the industry and Quinsa's volumes as well.

Our beer business in Uruguay is also performing very well, reflecting volume growth with stable market share and a strong performance by our premium brand, Patricia.

In soft drinks, we had an excellent quarter in terms of volume, despite a very tough comparison with last year as a result of strong performance in both Argentina and Uruguay. Strong execution at point of sale has helped to increase market share in Argentina.

In Uruguay volumes were fueled by market growth, by the introduction of H2OH! flavored water brand at the end of last year, which already accounts for more than 30% of its segment, and by strong actions, aimed at recovering the market share lost during the month long strike during October last year. We have already recovered a large part of that loss.

Keeping our sustained growth in Argentina, Bolivia and Uruguay, together with the improving performance of Chile is the focus of sending our business Paraguay back in the growth pack [ph] have resulted in EBITDA organic growth of 13.7% in the quarter, despite the distribution costs in Argentina and the increasing costs for energy and labor.

EBITDA reached R$212 million, representing an EBITDA margin of 39.8%, and 6 basis points better than last year as Graham mentioned.

I would like to end my comments by saying that I am very excited with the outstanding performance that we will delivery [ph] -- we reached that in '07, and about our prospects for continued growth. Despite the unstable environments and some cost pressures, I expect that the Fourth Quarter gets back to the same growth trends as of the first half of the year.

Thank you. And I will now invite Miguel to take over.

Miguel Patricio {BIO 4264830 <GO>}

Okay. Thanks Joao. Good morning everybody. Now let me start by sharing with you my excitement about our Third Quarter results. Of course, it could have been better if the industry had not been negative versus last year.

The acquisition of Lakeport starts to bear fruit. This quarter, Lakeport and Labatt's combined market share was stable in Canada for the first time in many, many years. More than that, we actually achieved a slight share growth in the profitable market of Ontario after many quarters of decline. And very important, we achieved this at no cost to profitability. I have to say that I feel good to acknowledge that Labatt is progressing in our challenge to get back on track for top line growth.

Meanwhile, we have kept a relentless drive on cost control. The tight grip on our cost structure has played a key role in ensuring continued profit growth and effective support for brand building, and that is not likely to change any soon.

You surely notice that the 7.9% decreasing in SG&A, excluding depreciation was fundamental to the leverage of 3.5% organic growth in EBITDA, but we did that with market increase versus last year.

Despite the fact that we already captured the obvious upsides in cost reduction, such as the role of our VBD [ph] and the centralization of back office process in shared service centers, I'm confident we have a pipeline loaded with initiatives to further improve our business.

To give you just an example, we can mention the implementation in '07 of a specialized service organization jointly with BAT, dedicated to procure non strategic resources ranging from tickets to office supplies, to printing services. This was a key driver for savings in operating expenses achieved this year.

I have to say that I remain confident on the prospect of our business, and also fully conscious about the challenges of our environment. In Canada, we are never on calm water.

But before I conclude, I would like to comment on the management changes at Labatt. As you probably know, I'm taking new role in the AmBev world, and I should leave Canada by the end of '07. I wanted to take a chance here to welcome Bernardo Paiva, which I considered 100% prepared to replace me. With Bernardo experiences on sales, he will be very, very important to take Labatt to next level of market execution.

During these three years I spent in North America, I focus my energies on changing the culture at Labatt to solve a very long time share decline, and to be obsessed about cost controls. I can assure you that at Labatt today, we have a company totally aligned with AmBev culture, which was a quite big challenge.

In terms of top line, the Lakeport acquisition solved the share gap we had, and this quarter, we basically had the same share as last year when combined Labatt and Lakewood.

In costs, we have been able to reduce costs significantly quarter-after-quarter. Even now with Bernardo in Canada, Labatt will go to a next level. His experience on finance and supply, but specially on logistics and sales will certainly transform Labatt into a sales machine. That is the piece that is still missing in the puzzle that Bernardo is bringing to Canada.

Well thank you all, and I will now pass it to Graham.

Graham Staley {BIO 15381675 <GO>}

Thank you, Miguel. I would now like to briefly address the main lines between the reported EBIT of R$1.6 billion, and a net income of R$590 million, as shown on page 16 of our release.

As I've already mentioned, the year-on-year comparison benefited from the inclusion of a contingency provision in Q3 last year for a litigation settlement relating to warrants issued by the company.

Other operational expenses amounted to R$335 million in the quarter, compared to R$269 million last year, which is mainly explained by the impact of currency translation on foreign investments as the result of the strengthening real.

We recognize the foreign exchange translation loss on overseas investments, which amounts to R$69 million in the quarter compared to a R$15 million gain in Q3 2006. This is a non cash, non tax deductible expense.

Our net financial result amounts to an expense of R$313 million, slightly ahead of Q3 last year, mainly impacted by higher interest expenses associated with the Quinsa bonds issued in the second half of 2006.

At this stage, I should point out that at the end of the quarter, our net debt stood at R$7.4 billion, and was impacted by higher cash and cash equivalents. This higher than normal level of cash on hand is purely the result of timing, as we were prepared to make a dividend payment with almost R$1 billion on October 10.

The provision for income tax and social contribution was an expensive R$374 million, versus R$258 billion last year. This increase is mainly the result of higher income before taxes, and slightly higher non deductible goodwill amortization.

Earnings per share in the quarter amounted to R$0.95, an increase of 26% compared to Third Quarter 2006. Excluding goodwill amortization, earnings per share increased 26.3%.

With respect to our payout situation, so far in 2007, we have distributed R$4.1 billion in dividends and buybacks, excluding the dividends, declared in September -- sorry, including the dividend declared in September and paid in October. This is completely aligned with our strong cash generation resulting from a healthy and growing business combined with a clear and consistent payout strategy.

Finally, I would like to comment on the impact of commodity costs in 2008. Given the competitive environment, we are not providing guidance on next year's commodities costs at this time, other than to say that recent pressure on prices, especially barley and malt, will impact cost of sales in all business units next year. However, this is likely to be offset by favorable results from sugar and US dollar hedge contracts that we already have in place, plus a continuing program of productivity and efficiency initiatives throughout the company. Overall, we expect to keep increases in total cost of sales per hectoliter, below the level of inflation in 2008.

With that, I will now hand back to Ray and open up for questions.

Thank you, Ray.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Bob Ford of Merrill Lynch. Please go ahead.

Q - Bob Ford {BIO 1499021 <GO>}

Hi. Good morning everybody. And congratulations, guys. I think relative to the challenges in the industry, this might be one of the best, the best comps in the world. But as -- you touched, Graham, on the raw materials pressure. Can you discuss where you feel you have the best pricing power across the different geographies, if you were to resort to that, to try to offset the raw materials pressure?

And to the extent that you feel comfortable, can you touch on the warrant litigation that's ongoing and that's been making some headlines in the local press? Thank you.

A - Graham Staley {BIO 15381675 <GO>}

When you talk about pricing power, I presume you're talking about our ability to influence those costs of commodities?

Q - Bob Ford {BIO 1499021 <GO>}

Exactly, and in some cases, the competitive dynamics may not allow you to, right?

A - Graham Staley {BIO 15381675 <GO>}

Yes. It's because of the competitive dynamics, it's exactly the reason we're not disclosing the details that we have provided in the past. I will say that, obviously, we have more exposure to the dollar here in Brazil as you know from previous disclosures, so that clearly brings us a benefit in 2008. Last year, we locked our dollar exposure in at something like 2.3. The spot rate today is about 1.75, so clearly, here in Brazil, we have an opportunity which will obviously compensate for exposures in other parts of the (inaudible). But I'm not prepared to go any further on it because clearly, it's information we'd like to keep to ourselves.

In terms of the warrant litigation, that's an ongoing legal matter. Clearly, I can't comment on that. It would be inappropriate for me to do so.

Q - Bob Ford {BIO 1499021 <GO>}

Is there any precedent from any earlier rulings that might allow us to feel a little bit more comfortable in terms of the implications for dilution?

A - Graham Staley {BIO 15381675 <GO>}

I think it would be unwise of me to comment at all. Whatever I say could be taken out of context so I'm sorry, I'm going to have to pass.

Operator

Thank you. Our next question comes from Andrea Teixeira of JP Morgan. Please go ahead.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi. Good morning, everyone. I just -- again, congratulations on the results. In general, just one quick comment regarding the pricing. I see here (inaudible) per liter going up in Brazil, but not as much as used to be in the past. So I just wanted to see what is, organically, was 5.8. It was distant increase here. Can you guide us for 2008? I understand how competitive it is in the mix. It's slightly tougher in Brazil now. Should we see a deceleration? This has been above inflation for most of the year in the past years because of this direct sales distribution and a lot of different factors, but as you get into the 60% level of direct distribution, which I believe is the case now, should we see that decelerating?

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

Well first, let's see if we agree with the numbers, because as we are reporting this breakdown between organic and scope, it's important to highlight, when you look at the organic numbers, you are not including the Cintra variations. So when I, we did the report, I see a 5.8% net revenues [ph] rapid increase in the year which is then higher than the average for the year-to-date, for the nine months of the year. So in the balance of the year, the Third Quarter was even better than in the previous quarters. And compared to a lower inflation, so compared to other years in the past, so the previous years, inflation is going down.

The average in previous years was to grow net revenues in line with inflation, plus another 100 basis points, another 120 basis points, coming from direct distribution, premium, and (inaudible) management. So the results I see today, they are even better than previous quarters and previous years, and these results come exactly in line with what we did in the past. We continue to expand our distribution, we continue to exploit [ph] premium in our portfolio, and that's why we are increasing 180 basis points more than inflation. So I see the results in line or even better than in the past.

Q - Andrea Teixeira {BIO 1941397 <GO>}

No, Luiz, definitely, but that's why I'm asking. It definitely was a very good result, given all the reasons why you explained. And that's why it bolts into my question. Should we see, because of this tough comparison next year, as you go for next year, you are not going to see probably close to inflation, as your costs also going to go with inflation, you're probably not going to see that improvement any more, right? Is that a fair assumption? Do you see more to extract from this?

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

Honestly, I would like to emphasize what we've been doing for a long time, and you follow us for a long time. We continue to see room for the expansion of our distribution. We continue to see Brazil as a great opportunity to expand premium beers, and we will remain committed with our discipline to pass inflation to prices, so I don't see why that will change. When Graham mentioned the COGS in line -- a lower than inflation for next year, of course, Brazil will benefit by bad [ph] currency, so I see that the competitive environment for next year wouldn't be significantly different from this year. Before, I believe, you should expect similar results. I don't see why results would be different than the ones we are delivering in the next many, many quarters.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay, perfect. Thank you very much Luiz, and best of luck, Miguel. Thank you very much for all your contributions to AmBev. Best of luck in getting there [ph].

A - Miguel Patricio {BIO 4264830 <GO>}

Thank you, Andrea.

Operator

Thank you. Our next question comes from Lore Serra of Morgan Stanley. Please go ahead.

Q - Lore Serra {BIO 1506730 <GO>}

Yes. Good morning, or good afternoon. I wonder if you could talk a little bit more about the soft drink business? As you mentioned in the opening comments, the numbers looked strong in terms of growth year-on-year, but I guess it was interesting to see the deceleration in volume growth. And you mentioned that your market share was stable, which isn't the conclusion I would have guessed from seeing some of the publicly traded Coke [ph] bottlers. We also saw your pricing slip a bit sequentially, so could you just give us an update on the conditions in the soft drink market as you see them? Thank you.

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

Hi, Lore. I think -- you were right. There are mixed (inaudible) in the CSD results this quarter, but let me try to separate things and to explain in more details. First, volumes were low compared -- the volume growth was low compared to the previous quarters. It's basically a consequence of very poor July sales. We tried to understand that as much as we could. We are getting all the numbers we have internally, comparing to the Nielsen numbers, and indeed we increased share during the quarter according to Nielsen numbers, but the very poor performance in July basically offset the good performance we had in August and September.

So was a one month situation that we had problems in explaining why that happened, but the good news is August/September and in middle October, we recovered, and in the performances of these three last months, they're more in line with the rest of the year than specifically July was. So I think volume was not good for the quarter, but unfortunately, it's difficult for us to explain exactly why, and we know when we compare with the -- the main competitors here. They did very well, but we did not lose share. So we even gained share during this period, so we expect that we can continue to have good performance for the rest of the year.

In terms of SG&A, we are doing something different than we did in previous years, trying to have a better organized calendar between beer and soft drinks, so we've anticipated some of the investments we usually make at the end of the year into the Third Quarter, so we will be in better shape to compete in the summer season in both beer and soft drinks. So last year we had postponed some of these investments, and to be in line with our strategy in terms of competitors launching new beers, new brands, and be more aggressive in the last quarter, so we organized the calendar together in beer and soft drinks in the market. With the programs this year we did exactly the opposite. We anticipated the investments that we usually do in the last quarter, so we have a double counting effect in the Third Quarter. So for the total of the year, we see that the SG&A for soft drinks, it should be in line with what we've been in the first half of the year. So the total of the year, the figures should be more similar to the ones we got in the first half.

Q - Lore Serra {BIO 1506730 <GO>}

Okay, that's very helpful, thanks very much. And just a couple of quick follow-ups on the costs in beer. We see the costs in beer on a COGS basis go up a little bit more during 2007 than we've seen in the case of the soft drink business, where we've seen it tighter. Should we just assume there that it's the raw material pressure that's causing the COGS increase? Because your hedge gains as you reported them should be helping you, I would have suspected, a bit more than what we see in this quarter.

A - Graham Staley {BIO 15381675 <GO>}

Yes, do you want to comment on Q1, Luiz, or shall I take the whole thing? Yes, Q3 was a little more challenging on the costs. We did get the benefits of the currency and the commodity gains as we'd previously anticipated, but that packaging mix was adverse. There's a little more can mix in there which was helping us to recover share, but obviously was driving up our cost of sales, but overall giving us better results, better margin. We're seeing labor cost inflation, and we've still got price increases on some raw materials, particularly corn, where we don't necessarily have hedge-able contracts. So if you recall, we'll still have a benefit coming from currency and hedging in the Fourth Quarter, and so we're expecting slightly better results in that Fourth Quarter.

Q - Lore Serra {BIO 1506730 <GO>}

Great, thank you.

A - Graham Staley {BIO 15381675 <GO>}

On beer; that's not on beer.

Q - Lore Serra {BIO 1506730 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Jose Yordan of UBS. Please go ahead.

Q - Jose Yordan {BIO 1496398 <GO>}

Good morning, everyone. I guess just to stay on the same general subject, can you comment at all what your -- I understand you don't want to talk about your hedges, your dollar hedges, but what's your outlook for the dollar price of barley for next year against this year? And especially if you can talk about aluminum as well. What's been going on and what do you expect to happen there?

A - Graham Staley {BIO 15381675 <GO>}

We've been watching barley and -- barley prices and wheat prices very closely the last few weeks. It's been yo-yoing up and down, and obviously we -- as we say, in many cases, we take out hedge transactions against that price. So it's very difficult to know what's happening. The crop has been very poor worldwide, as you know. There are signs that in South America the crop will be less disappointing, and so that should be good for supplies as we move into the harvest season, and certainly in northern hemisphere is not the same positive situation.

In terms of currency, clearly there's a significant movement in currency. A year ago we were communicating, as I said earlier to Bob, a price that we'd locked into for 2007 of R$2.3 to the dollar. Now we're talking the spot rate of R$1.75. So in terms of your financial models, you can clearly expect that we've, here in Brazil, locked into something in between those two numbers. I think that's about as far as I'm prepared to go on this call. I hope that covers most of your questions.

Q - Jose Yordan {BIO 1496398 <GO>}

Comment on aluminum?

A - Graham Staley {BIO 15381675 <GO>}

Aluminum still increasing. Again there's evidence that demand is outstripping supply. As we look at the markets around the world, China is putting a lot of pressure on demand, but at the same time, we're getting more supply coming on. As demand increases, obviously, businesses open new smelting plants, which should help to level it out.

Q - Jose Yordan {BIO 1496398 <GO>}

And just to clarify on your earlier comment on barley, you are hedging the dollar price of barley as well?

A - Graham Staley {BIO 15381675 <GO>}

Yes. We hedge -- here in Brazil in particular where we have the contracts that allow that, we always hedge our currency exposure, and we are obviously looking at the hedge position carefully on barley as well as a commodity.

Q - Jose Yordan {BIO 1496398 <GO>}

Okay. Thanks a lot.

Operator

Thank you. Our next question comes from Alex Roberts of Santander. Please go ahead.

Q - Alex Roberts {BIO 16281499 <GO>}

Hi everybody. I guess I would like to continue on this barley theme as well. I wanted to get a better understanding, and I appreciate you can't comment necessarily on '08, but as we look into the Fourth Quarter, you had talked about just, if we could start in Brazil, this year having about R$100 million in raw material savings from the hedging. And is it, if I'm reading the press release and understanding your comments now, is it safe to assume that perhaps the physical prices of the commodities have gone up a lot in the second half and you might not get that R$100 million?

And I guess secondly, where is your physical barley price today versus a year ago? And I guess the third part of this goes to Canada. If, understanding that you're doing less hedging there and if you think about your prices for barley in Canada, can we assume that actually they're having more pressure, relatively speaking, on your cost structure? And if we think about '08, and I know the only guidance you're giving us is COGS in line with inflation per hectoliter, but could we assume next year in Canada in '08, that in fact Canada will be higher in barley prices '08 versus '07?

Sorry a lot of related questions but it really is, I think, an important issue in the industry when wanting to get some more understanding there.

A - Graham Staley {BIO 15381675 <GO>}

Thanks Alex. A lot there obviously, and we could spend a lot of time talking about it. I would like to reiterate for everyone's benefit, the press release, we're not talking about our cost of sales for AmBev being in line with inflation, we're talking about them being below inflation. We still feel, yes, we have pressures on commodity prices. Commodity pressures are going to be there for some considerable time. Currencies are moving all over the place. It's very difficult to predict what's going to happen there. So that's a fact of life, we have to live with that.

But also I'd like to stress, we have a big organization when it comes to production and supply organizations. We're leveraging every opportunity there, so there are still more efficiencies that we can draw out of the business. That's why we feel in a positive position about the cost of sales overall for next year, and why we feel we will be below the level of inflation, taking the company as a whole.

You had specific comments and questions regarding Brazil. We are still delivering the anticipated hedge gains on sugar, aluminum and currency. Those are still embedded into our forward thinking and our forward forecasts. It's just that in Brazil, as Luiz alluded to, in the beer side, we have a different packaging mix, which obviously is offsetting some of those gains. And on the soft drinks side, we had a movement more towards H2OH!, which is obviously impacting cost of sales as well. It's a higher product, a higher cost product to produce.

Physical barley prices today versus a year ago. All I know is they're a lot higher. I can't give you the precise number, but it's a lot higher. Movements in barley, or should I say wheat, which is the benchmark, have been moving tremendously in the last month. Very difficult to pin it down and on some occasions, very difficult to identify what's driving the movement. So that's where a solid risk management strategy comes into play.

In Canada, yes, just different hedging opportunities. I'm not going to get into the regional differences. I just want to re-emphasize that AmBev overall is working as a coordinated business, and we will deliver cost of sales increases below the level of inflation.

Q - Alex Roberts {BIO 16281499 <GO>}

Can we assume, sorry Graham, that we have perhaps then into '08 more relative pressure from the barley in Canada versus Brazil?

A - Graham Staley {BIO 15381675 <GO>}

Yes. That's obvious. You know we have verticalized operations in South America. We don't have those operations in North America so there obviously is more exposure.

Q - Alex Roberts {BIO 16281499 <GO>}

Okay. And sorry, just a final thing in Argentina, if I may. Excuse me. And it's perhaps more of a clarification. If I'm reading the press release correctly, the reported revenue per hectoliter in Quinsa beer down to 96, I guess about 10% down year-on-year. And I guess, in my numbers, also about 11% down versus the Second Quarter. Am I reading this right? And why have we had on Quinsa beers, price per hectoliter, this drop versus Q2?

A - Joao Castro Neves {BIO 17456730 <GO>}

Hi Alex, this is Joao. I think the nice thing about the new format that we're releasing, when you look at the column as reported, you're right, you're seeing 9.6%, and when you look at the organic column, you'll see for the quarter, are 1% up. But as you read down the explanation, we're saying that beer net revenues grew organically 9.1%. Okay. So most of the effect that you see on the as reported, is twofold. One is the currency and that's why we -- that's one of the advantages of having this format. So the real organic growth on, let's say, if you want the whole concurrency, of all the five countries together, is a 9.1%. And there was also adjustment in the way the malt and things [ph] were treated. The combination of both currency and the adjustment in the malt business showed us 1%, but the correct figure on organically in loss of currency is 9.1%.

Q - Alex Roberts {BIO 16281499 <GO>}

Okay. Thank you.

A - Graham Staley {BIO 15381675 <GO>}

If I could, Alex, I'll just come back on one point there. Many of you have heard me talk before about the tea [ph] policy we have regarding risk management on commodities and currency. This is a classic example where our tea policy comes into play. When there are these shocks in the market place around something like barley, and the price of malt, then the tea policy and the way we hedge our contracts, allows us to buy time to re-engineer our business, re-think our strategies or whatever, as required, in order to deal with those shocks which means, therefore, we can take out any significant impact on our business over a longer period of time. This is a good example. That's why we feel comfortable talking about cost to sales next year being lower than the level of inflation.

Q - Alex Roberts {BIO 16281499 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Lauren Torres, HSBC. Please go ahead.

Q - Lauren Torres {BIO 7323680 <GO>}

Yes, hi. I was hoping you could talk a little bit more about the competitive environment in Canada, and I guess obviously more specifically about the pricing environment? You talk about building brand equity and now looking at Lakeport and Labatt, and your plans going forward, but just hoping you could talk a little more about what your plans are to withhold or build your brand equity in light of what's going on today in the pricing environment, and if you're going to keep going with this over the near term really to achieve your goals in that market.

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

Sure definitely. I think that the price environment in Canada changed dramatically versus previous years because 'til last year, pricing activities were basically concentrated in Ontario and mainly because of the discount segment that was growing a lot, and among the brands in this current segment, Lakeport was the brand that was really growing. Well Lakeport continues growing, it's in our hands. But the price environment is not healthy and is not now concentrated in Ontario any more.

Then, there's a lot of discount activity happening, especially in Quebec, near (inaudible) because Quebec is the region where Labatt and (inaudible) together have about 85% share so we should have been able to have a more discipline on price. But that definitely is not happening. There is a lot of discount going on, a lot of activity on pricing, and in the Atlantic, which is a smaller region but in the Atlantic as well.

In terms of brand health, so in terms of plans for the future, Lakeport, our idea is to continue supporting the brand. The brand is -- in Ontario, the discount segment, the TDS [ph] represents more than 40% of the total volume. And we cannot ignore it and it continues growing. And among all the brands, Lakeport is the brand that grows more, and also with brand equity. So the brand health of the brand is pretty strong among brands in this segment. So we believe that there is room for more growth for the upcoming years and we will continue supporting the brand Lakeport in that specific segment that has been so -- such a big problem for us, or had been 'til last year.

Of course, that expectations for next year, especially with the pressure on the cost of raw materials, etc., is that we have more discipline on pricing among competitors and ourselves, and that we can have a healthier environment in terms of pricing so we can have better margins next year.

Q - Lauren Torres {BIO 7323680 <GO>}

But as of the last couple of months --?

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

Does that answer your question?

Q - Lauren Torres {BIO 7323680 <GO>}

It does but just over the last couple of months, or even last month, if I could ask, with respect to the pricing environment, has it gotten tougher or it's basically been the same throughout the year?

A - Luiz Fernando Edmond {BIO 5862219 <GO>}

I think has been, since April, so since the beginning of the summer season, has been pretty tough, and with price activity not -- in all segments of the market, right? So imports, a lot of imports on discount, from competitors. We didn't reduce prices on imports. But a lot of this company imports, especially on imports, but also on core premium brands. So I don't see any reduction in terms of pricing activity at the moment. I'm cheering for pricing reduction.

Again, this last quarter what was different from the last -- from the previous quarters was the industry, and, unfortunately, the industry was very bad, was negative versus last year. I think that was, basically, the big difference. Everything else, in terms of pricing activities, I don't see a slowdown at the moment.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. That's it. Thank you.

A - Miguel Patricio {BIO 4264830 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Celso Sanchez of Citi. Please go ahead.

Q - Celso Sanchez {BIO 1803012 <GO>}

Hi. Good afternoon. Can you give us a little bit more color on the packaging mix shift in Brazil that you're talking about? You mentioned cans and I wonder, as I understand, although I didn't see this myself when I was there a few weeks ago, the idea of multi packs, offering a bulk discount on cans might have started to be part of the commercialization strategy. So can you confirm, first of all, if that's true and, if it is true, can you help us understand a little bit of the thinking behind it and what you think the bigger picture impact might be on the industry of getting people accustomed to what the rest of us, I think, in the other markets are accustomed to which is a discount for multiple can packs? That's my first question, please.

A - Miguel Patricio {BIO 4264830 <GO>}

Yes. First, the packaging mix shift towards cans, is first an effect of we are recovering share in the segment, that we had lost a lot of share in cans. This is a segment where our share is more volatile when we increase prices so we have to suffer a lot, especially because we had gone above the one held [ph] reference. We use it to advertise a lot at the R$0.99 and, after the price increase, we cannot do that, and, of course, maintain the profitability level. So we lost some share in cans.

We reacted not only implemented by rolling out the stretch [ph] of the 18 pack. There's more to come in that direction, but then we can play better with the price points that we can have. We continue to improve in returnables, but in cans, we recover more than returnables in the short term. That means that, not necessarily the channel mix is changing, or the weight of the cans in the market are increasingly significantly, but that means more that we are recovering share in cans where, to be honest, is where we have the lowest share compared to the other segments in the other presentations.

We believe we, going forward, to play against these price strategies, that most of the small competitors put a lot of pressure in the supermarkets and in cans. This more complex portfolio that we are offering will allow us to play better with the consumer request in terms of prices and volumes. Always trying to leverage volume per case or volume per ticket, but also try to have a better profitability, a better price in average. So I don't see as a trend today, the negative trend, though even if it was the case, today, the margins we deliver in cans, supermarkets, in average, they are not as high as returnables, but they are much more similar than the ones we used to have in the past. So profitability-wise is not a concern but, of course, in terms of guarantees that our distribution system continue to make a lot of difference in a very fragmented market, we are watching the moves very, very closely and, of course, trying to influence that trends if they come up.

So for, if you take the last five years, the channel and the package mix are pretty much stable. It looks like more as a short term result than a consumer shift towards a more modern trade than the tradition one. Even more because the inflation's going down in Brazil and, of course, the big supermarket chains, they have big stores, and consumers are looking more for convenience today. So particularly [ph] in small volumes in more times they are shopping.

Q - Celso Sanchez {BIO 1803012 <GO>}

Okay. Just to make sure I'm very clear, the notion of multi pack discounts, not just package size, 18 pack, 12 pack, or whatever else is coming down the pipe, but the idea of getting 18 for the price of maybe 16 or 17, or whatever it is, rather than 18 times the individual can, that's something to me, at least, that's relatively newer, and your perception is that that's not something longer term that you think undermines the commercialization strategy, not just for yourselves but for the industry?

A - Miguel Patricio {BIO 4264830 <GO>}

To be honest, what we're doing and what we'll continue to do is to have different presentations, but not take more and pay less as you take 14 cans for the price of 12. That's not what we're doing in Brazil. So it's the 12 pack has a price, the 18 pack has a different price, if you buy the unit there'll be a different price. But of course, not all presentations will be present all the time.

So we are playing with -- you could read that as promotions but it's, in average, if you look at the prices, they are in line with our policy to maintain prices in line with inflation. So that's bringing us more flexibility to play with discounts at certain moments, at weekends, at holidays, at special dates that we don't have to discount 100% of the volume, but only those volumes that will be relevant for consumers. For the consumers they are looking for great quantities and, therefore, comparing price in a more restricted way. Right?

Q - Celso Sanchez {BIO 1803012 <GO>}

Thank you very much.

Operator

Thank you. Our final question comes from Lore Serra, Morgan Stanley. Please go ahead.

Q - Lore Serra {BIO 1506730 <GO>}

Yes. Thank you. Just a couple of quick follow-ups in Canada. The strength of the Canadian dollar versus the US dollar will help you in terms of managing your cost outlook for 2008. That's correct, right?

A - Miguel Patricio {BIO 4264830 <GO>}

(inaudible) when I answered that question?

A - Graham Staley {BIO 15381675 <GO>}

Or I can take that. I think it's -- the situation is a little bit more complicated in North America because we do have exports to the US as well, so we have -- we obviously have some natural hedges in place as well. So it will help a little bit, but the impact is not that substantial.

Q - Lore Serra {BIO 1506730 <GO>}

Okay. Then, just second question, I guess, just -- it's a bit repetitive for what was asked earlier, but I think it was mentioned on the AmBev conference call that you weren't as aggressive about reacting to competitor promotions in the market in the Third Quarter as you might have been. So if you fast forward going into the Fourth Quarter, have you played out that sort of market behavior and is the industry moving to less promotions or are we -- or is the market still in a thicker, heightened promotional activities?

A - Miguel Patricio {BIO 4264830 <GO>}

Well I wouldn't -- cannot comment on that because I cannot tell my competitors how the Fourth Quarter is going to be. I apologize about that.

Q - Lore Serra {BIO 1506730 <GO>}

No, no. Just comment on how things have been in October. How are the pricing dynamics in the market nationwide in October compared to what we saw in the Third Quarter? Maybe that's something you could comment on.

A - Miguel Patricio {BIO 4264830 <GO>}

I don't think it changed. I don't have the details here with me about average price, etc. I still don't have it, but I can assure you that I don't see any reasons to believe that it changed.

Q - Lore Serra {BIO 1506730 <GO>}

Okay. Thanks very much.

A - Miguel Patricio {BIO 4264830 <GO>}

Or what can change in the Fourth Quarter is the industry, but I don't see reason to believe that the price is going to change.

Q - Lore Serra {BIO 1506730 <GO>}

Okay. Thanks, Miguel.

A - Miguel Patricio {BIO 4264830 <GO>}

Thank you.

Operator

Thank you. I would now like to turn the floor back to Mr. Staley for any closing remarks.

A - Graham Staley {BIO 15381675 <GO>}

Thank you very much, Ray, and thanks everyone for joining the call this morning, and my colleagues for the way they've handled the conference this morning. So look forward to meeting you all again in March when we talk about the full year 2007 results. Take care and goodbye.

Operator

Thank you. This concludes today's AmBev Third Quarter '07 earnings conference call. You may now disconnect, and have a great day.