Q1 2017 Earnings Call

Company Participants

- Bernardo Pinto Paiva, Chief Executive Officer
- Ricardo Rittes, Chief Financial and Investor Relations Officer

Other Participants

- Alexander Robarts, Analyst
- Antonio Barreto, Analyst
- Isabella Simonato, Analyst
- Lauren Torres, Analyst
- Luca Cipiccia, Analyst
- Pedro Leduc, Analyst
- Robert Ottenstein, Analyst
- Thiago Duarte, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and thank you for waiting. We would like to welcome everyone to Ambev's First Quarter of 2017 Results Conference Call. Today with us, we have Mr. Bernardo Paiva, CEO for Ambev; and Mr. Ricardo Rittes, CFO & Investor Relations Officer.

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

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996 (sic) [1995]. 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 the comparisons with Q1 2016 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. Ricardo Rittes, CFO and Investor Relations Officer. Mr. Rittes, you may begin your conference.

Ricardo Rittes {BIO 15184017 <GO>}

Thank you. Hello, everyone. Thank you for joining our 2017 First Quarter Earnings Call. I will 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 you more details about our performance in Brazil.

Starting with the main highlight of our consolidated results, we started the year with solid results in CAC, LAS and Canada, impacted by an expected weaker performance in Brazil. On a consolidated basis, top line was up 8% in the quarter with volumes increasing by 2.4% led by growth in most of the regions we operate and a net revenue per hectoliter increased of 5.3%.

EBITDA was down 7.6% in the quarter, reaching BRL 4.4 billion with an EBITDA margin of 38.7%. Net profit was BRL 2.3 billion which is 20.1% lower than that of the first quarter of 2016, driven by EBITDA organic decline and currency translation negative impact due to depreciation of the Brazilian real. And cash generated from operations totaled BRL 3.1 billion versus BRL 2.3 billion in the first quarter of 2016, increasing by 37.7%.

In Brazil, our EBITDA declined 23.8% being explained by expected headwinds. First, the temporary increase of our cash COGS by 38.2% and on a per hectoliter basis by 34.8%, mainly due to FX impact, inflation, and a hard comparable in the first quarter of 2016 when our cash COGS per hectoliter increased by 2.3% despite of an inflation of around 10% and an FX impact of more than 20%.

Second, a tough comparable net revenue per hectoliter as the 2016 state tax increases only became effective towards the end of February 2016. And thus the first quarter of 2017 is still a year-over-year comparison on an orange-to-apple basis.

On the other hand, whilst the consumer market in Brazil remained challenging, leading to the beer industry decline of low-single digits based on Nielsen, we have been able to revert the negative trend and grow our beer volumes by 3.4%, outperforming the industry. Bernardo will expand on this topic.

Going into more detail of our operational results in Brazil, net revenue in Brazil was up 0.6% in the quarter and EBITDA down 23.8% to BRL 2.5 billion, with a margin of 39.0%. Net revenue per hectoliter in Brazil beer was down 2.2% in the quarter.

On top of a hard comparable basis, as part of our revenue management strategy, we continued to use our full portfolio of packs and brands to drive affordability to consumers, including the 1-liter returnable glass bottles in the on-trade channel and the 300 ml returnable glass bottles in the off-trade channel. Volumes of both packaging presentations grew double digits in the quarter.

Brazil CSD & NANC, top line was down 2.6% as flattish volumes were impacted by net revenue per hectoliter of minus 2.7%. According to Nielsen, the CSD & NANC industry declined high single digit, as consumers continue to be pressured by negative real disposable income growth.

Brazil cash COGS was up 38.2% while on a per hectoliter basis 34.8% mainly due to, first, FX impacts given our hedge policy, the devaluation of the Brazilian real in the first quarter of 2016 is fully impacting our COGS now at that time. The BRL suffered close to a 40% year-over-year devaluation, thus temporarily inflating the cost of our commodity price in U.S. dollars which represent around 50% of our COGS in Brazil. Second, inflation. And third, a hard comparable base in the first quarter of 2016 when our cash COGS per hectoliter increased by only 2.3% despite of an inflation of around 10% and an FX impact of more than 20%.

In this context, we reiterate our guidance that we expect cash COGS per hectoliter to grow double digits in the first half and to be flattish to low single digit up in the second half of 2017. Having said that, the year-over-year growth of the cash COGS per hectoliter in the second quarter of 2017 will be significantly lower than in the first quarter being a bridge for the second half of the year.

Brazil cash SG&A was up 1.5%, below inflation due to, one, a low single digit growth of distribution and administrative expenses. And second, a decline in sales and marketing expenses driven by efficiency gains in our non-working money.

Now, moving to our international operations, in Central America and the Caribbean, we continue to experience a good momentum in the region. In the first quarter 2017, EBITDA in CAC reached BRL 377 million, increasing organically by 7.8% while in U.S. dollars, reported EBITDA grew close to 25%. Net revenues increased by 5.5%; and on a per hectoliter basis, by 3.4%.

Organic volumes increased by 1.2% on a tough comparable of 10.4% growth in the first quarter of 2016. On a reported basis, volumes were up 27.3%, benefiting from the recent swap of assets carried out with ABI and our operations in Panama.

In Dominican Republic, we continued to connect with our customers through relevant platforms, such as Carnival Presidente, and The World Baseball Classic, supporting the equity of our brands. In Guatemala, we improved our execution with strong summer activation of Corona and Busch.

Along with top-line, our EBITDA performance also benefited from a solid financial discipline, leveraging on both costs and expense saving, expanding our EBITDA margins for another quarter. Going forward, we will keep pursuing top-line growth and EBITDA margin expansion, and we remain enthusiastic with our operations in the region.

Now, moving to Latin America South. Our top-line in the region was up 27.4%; and EBITDA, 20.5% above that of last year, reaching BRL 1.2 billion. Net revenue per hectoliter increased by 23.3%, explained by revenue management strategy linked to inflation and premium mix. Volume grew 3.1%, as the softness of the CSD & NANC industry in the region was more than offset by strong performance of beer in, number one, Argentina, where volumes reverted the recent negative trend and increased by high-single digits with great contribution from Brahma, Iguana and Corona. Second, Bolivia, mainly driven by Huari. Third, Paraguay, with an outperformance of Brahma, Bud Light and Ouro Fino. Fourth, Chile, with strong performance of our Global Brand. And fifth, Uruguay with a double-digit volume growth driven by both mainstream and premium portfolios.

Cash COGs in the region grew by 41.8%, while on a hectoliter basis by 35%, mainly driven by high inflation and negative currency impact. Further, cash SG&A increased by 27.7%, adversely impacted by inflationary pressures, mainly in Argentina, resulting in an EBITDA margin compression of 250 basis points to 43.5%.

Going forward, we're excited with the positive volumes trend and top-line growth opportunity in the region, especially for beer, while we're still cautious with the macro environment in Argentina.

Turning now to Canada. We delivered in the first quarter, BRL 321 million of EBITDA, 17.5% higher than in the first quarter of 2016. Top-line was up 2.3% as volume decline was more than offset by an increase of net revenue per hectoliter of 3.3%, driven by our revenue management initiative.

Volumes were down by 0.9%, mostly due to contraction of the Canadian beer industry, impacted by Easter holiday phasing, partially offset by performance ahead of trend of our lead brand Budweiser, double-digit growth of Bud Light, and continued strong support from the craft and near beer portfolio.

Cash COGS decreased by 8.4%; while on a per hectoliter basis by 7.6%, primarily driven by cost absorption with increased production and cost efficiencies with our import portfolio from ABI, while cash SG&A expenses increased by 2.5%.

Going forward, we remain committed to balance volume and price and confident that we have the right portfolio to deliver profitable growth.

Back to consolidated figures. Other operating income totaled BRL 291 million in the quarter, mainly explained by government grants related to State VAT long-term tax incentives that were down year over year due to, one, the expiration of VAT Government Grants Agreements in the fourth quarter of 2016; and two, revenue geographic mix.

Now, moving below EBITDA. In the first quarter, our net financial results totaled BRL 873 million, 25.5% less than in the first quarter of 2016. Going to more detail, main items in the financial expense in the quarter were, first, interest income of BRL 109 million, driven by our cash balance, mainly Brazilian reais, U.S. dollars and Canadian dollars; second, interest expenses of BRL 402 million that include a non-cash accrual of around BRL 140 million related to the put option associated with our investment in Dominican Republic as part of the CND deal in 2012. A put option exercisable until 2019 was issued, which may result in an acquisition by Ambev SA of the remaining shares of CND for a value based on an EBITDA multiple.

Third, BRL 247 million of losses on derivatives instruments, mainly driven by the carry cost of our FX hedges, primarily linked to our COGS exposure in Brazil and Argentina. Given the interest rate differential between Brazilian reais and Argentine pesos and the U.S. dollars, we have financial cost associated to these hedges which are called carry costs. Carry costs are going down as expected mainly due to the reversal of the Brazilian real and due to lower interest rates in Brazil.

Fourth, losses on non-derivative instruments of BRL 78 million, mainly related to FX translation, 68% lower than that in the first quarter of 2016. Fifth, BRL 216 million of other financial expenses, mainly driven by interest on contingencies.

The effective tax rate in the quarter was 12.9% versus 10.4% last year. From a cash flow perspective, cash flow from operating activities before changes in working capital was BRL 4.6 billion. Cash generated from our operations was BRL 3.1 billion, which is 37.7% higher than that in the first quarter of 2016, and CapEx totaled BRL 559 million which is 20.9% less than that in the first quarter of 2016.

Finally, during the first quarter, we returned approximately BRL 1.1 billion to equity holders in dividends.

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

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thank you, Ricardo. Hello, everyone. We started 2017 with a solid volume performance, boosted by beer in Brazil, where volumes grew 3.4%, while the total industry was down low-single digit. In Brazil, we left 2016 before our beer volumes going down 6.6%, performing slightly below the industry that declined low-single digit. In the first quarter, we had a turnaround, outperforming the industry and recovering growth in a still very weak macro environment.

As explained by Ricardo, our financial results in Brazil were still weak due to temporary headwinds that will generate throughout the year. First, the increase of our cash COGS mainly driven by FX impacts, inflation and a hard comparable in the first quarter of 2016. And second, a tough comparable net revenue per hectoliter as the 2016 state taxes increase only became effective towards end of February. And thus, we still have a year-over-year comparison on an orange to apple basis.

When we announced our full year 2016 results, we've mentioned that 2016 was also a year we took as an opportunity to strengthen our foundations for the future and that we're self-confident on our ability to resume growth. And our beer volumes in the first quarter of 2017 confirmed that. Beer volumes were up in all the segments we operate such as core, core plus and premium. Finally, a consistent recovery supported by the initiatives we've been implementing in our business through our commercial platforms.

Starting with Elevate the Core. Elevate the Core is our top priority. This strong brand is here to create enduring bonds with our consumers. Several initiatives were created in the past 18 months under the Elevate the Core platform, and that, as mentioned in our last call, such as new visual brand identities, improvements on primary and secondary packaging, bolder 360 activations, among others. All of them have started to hit the market during this quarter, positively impacting our volumes performance.

On top of that, we've been expanding (18:10), Skol, our easy-to-drink lager, boosted its presence during Carnival, bringing excitement to more than 40 cities, and engaging with more than 35 million people while delivering amazing experience in one of the most important events of the year. Skol also launched a new campaign, conveying meaningful message related to inclusion and diversity.

Examples of the brand's concept are the launch of the limited edition of skin-colored cans to celebrate diversity, and the Reposter campaign when Skol has invited feminist artists to redesign old posters with the purpose of passing on women's power and strength.

For Brahma, our classic lager, we've continued to communicate Brahma's campaign that highlights our passion for brewing. On top of that, we've just launched a new visual brand identity to enhance the brand's attributes of flavor and beer expertise. Its gold and red colors are still there (19:21) square label and on top of a new design inspired in its old visual brand identity, evoking all the tradition Brahma has based on more than 120 years of heritage.

With the Skol and Brahma package and VBI improvements, Skol with its strong label and (19:41) young spirit; and Brahma, with its square label and heritage, combined with all the brand's initiatives and together with meaningful and distinct communication for each brand, we'll be able to differentiate our easy-to-drink lager and our classic lager even more.

Still talking about Brahma family, Brahma Extra continues to deliver amazing results in the core plus segment, growing triple digits year-over-year.

Finally, Antarctica. It continues to engage with its core target consumers through its innovative media format, with a web series presented in YouTube and in cinemas, creating even stronger bonds with Rio De Janeiro in December as a background, conveying the underlying message that good things attracts good things. And there is still more to come. We will continue to focus on the full rollout of our initiatives and we are looking forward to deliver a strong execution and a 360 activation during all the key selling moments such as the traditional (20:51) in the Northeast and the LGBT Parade in São Paulo.

Now, talk about Premium, we have a complete portfolio of premium brands with domestic and Global Brands such as Original, Serra Malte, Budweiser, Stella Artois, and Corona. Our premium portfolio delivered another quarter of solid performance, with volumes growing double-digits, supported by a continuous improvement of execution and strong marketing campaign.

Budweiser continues to lead the segment with volumes increasing more than 30% year-over-year. Stella Artois launched the global campaign, Buy a Lady a Drink, in partnership with Water.org to help raise awareness of the global water crisis, inviting its core target consumers to leave a legacy and enhance the brand's attribute of quality.

Moving to Near Beer, our strong activation during Carnival has been supported by Skol Beats with its three variants, Senses, Spirit and Secret. Going forward, there's still a big opportunity for Near Beer, capturing a bigger share of throat in non-traditional beer occasions.

Moving to occasions and starting with the In Home. We are putting great efforts to improve execution in the off-trade channel through the expansion of programs designed to improve the assortment of products and category space, enhancing shoppers experience.

In addition the 300 ml returnable glass bottles are still a big focus in this year. They continue to grow year-over-year ahead of the industry, driving affordability to consumers amid the depressed macro environment. This is an important initiative for the short and for the long term.

Moving to Out of Home, in the Out of Home occasion, improving execution and service level across this country is definitely one of our top priorities. Further, among other initiatives, we are investing in meaningful trade programs to support the point of sales in such a tough macro environment. The 1-liter returnable glass bottles are also playing an important role in this channel, growing volumes year-over-year and driving affordability in the Out of Home occasion.

In summary, we are confident that the initiatives taken under our commercial platforms has played a key role for the recovery of our volumes. On top of that, it's important to highlight that we've continued to improve the efficiency of our sales and marketing investments with more developed process, stronger consumer insights and more robust test models.

On the other hand, it's important to keep in mind that the macro environment remains very challenging with an all-time high unemployment rate and depressed disposable income that's leading to a continued decline of the beer industry.

In this context, we remain cautiously optimistic for the year as we continue to leverage our commercial platforms. We will also keep pursuing efficiencies in our investment as we made in the first quarter.

And despite the short-term negative impact for our COGS, as part of our culture, we will push ourselves further to improve our cost performance and deliver superior results. We remain excited with the opportunities we see going forward to resume top line EBITDA growth.

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

Q&A

Operator

And thank you. We will now begin the question-and-answer session. Today's first question comes from Isabella Simonato of Bank of America Merrill Lynch. Please go ahead.

Q - Isabella Simonato {BIO 16693071 <GO>}

Good afternoon, Bernardo and Ricardo. Thank you for the call. I have two questions related to beer in Brazil. First that on SG&A, despite all the investments you made on Carnival, you managed to deliver flat SG&A. So you mentioned you captured some efficiencies on non-working money. If you could outline to us specifically which were those? And also, how sustainable are those efficiencies going forward?

And my second question is regarding volumes, in my calculations here you were able to get a market share that is close to the top of the range historically. I understand that Carnival probably represents a big part on that. But if you could give more details on what else helped to drive this performance, any change in terms of consumers or competitive dynamics this quarter. Thank you.

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

Thanks, Isabella, very good question. I think the first question is regarding the SG&A and the marketing and sales investments. As I've said in my speech, we've continued to improve the efficiency in the sales and marketing investment. And first, it's much better when you (26:19) not only in the way that you build the brands but really finding the meaningful message. So with that, we can concentrate investment in the meaningful message behind the brands. And in the trade as well so all the shopping sites that we have had been helping us to be more efficient in the investment.

The second point is better process really bring excellence even more to the next level not only for the sales organization but the marketing organization. Investing more everything that we do and we had a much more robust testing model and we are making choices as well. (27:02) the right insights you can not only be more efficient but bring the money, put the money behind the things that really matter to grow.

For the second question was linked to the share. I think that as we always said, Brazilian market share is, it's tough but we are pleased with our volumes, our volumes are 3.4%. And as you saw, I mean the industry, I mean low-single digit below last year, so I think that we are pleased with the kind of performance in the market that we have in the first quarter since we significantly outperformed things.

Q - Isabella Simonato {BIO 16693071 <GO>}

Thank you.

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

Thank you.

Operator

And our next question comes from Mariana Hernandes (27:56) of Credit Suisse. Please go ahead.

Good afternoon, Bernardo and Rittes. Thanks for taking my question. My question is also regarding Brazil SG&A. I was wondering if maybe you could be more specific. I mean, there was a reallocation of a portion of the expenses between beer and soft drinks SG&A. What was this about exactly? And I mean, what did you mean by efficient gains with non-working money for the beer SG&A in particular?

And still on SG&A but now looking longer term, how do you see this line evolving going forward? I mean given the strategy of boosting top-line growth nominal EBITDA growth but also considering you are going to start reaching point of sales that you are not yet present or you are not operating as long as you think are. And I think it's also fair to say, also considering in the new outlook, now there's a different or bigger competitor in the market. So how do you see this line evolving going forward? Thanks a lot.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Mariana (29:05). This is Ricardo. Thank you for your question. I mean first of all in terms of SG&A, we just want to highlight that it's not like a program or anything, it's part of our strategy, long-term strategy for us to find non-working money and take this out of the system and then invest the necessary resource into the marketplace for us to be able to win in the marketplace.

As a result of that, it's nothing different from what we have been doing in a while (29:35). If you go back a couple of years, you'll see that we step up some of our solid investments over the course of the last year. But in a way, I think the company has been able to outperform through (29:50) inflation in the SG&A line over the course of its existence. So that's pretty much, I think, the strategy.

We don't give guidance for SG&A for the longer term. And as Bernardo said, the Brazil market is very competitive. We don't like to comment specifically about any of our competitors. It has been very competitive for a long time already. And as a matter of fact, like – I think even (30:18) said in their call today, we like good competition.

Q - Operator

Okay. Thanks a lot.

And our next question comes from Luca Cipiccia of Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Good afternoon. Thanks for taking my question. I wanted to ask two things. One, maybe a clarification on some comments that were made in the earlier call from ABI. Just when you look at the margin contraction, the gross margin contraction in the quarter in Brazil, we've seen the drivers, revenue per hectoliter, cost per hectoliter and some of the things that you highlighted.

But I think there was a comment that suggested that 75% or so of the margin contraction was FX-related as compared to mix, and I just wanted to clarify maybe or if you could expand a little bit or help us separate a bit better what is packaging mix, what is in fact more of the sort of temporary FX headwind that we discussed in the past? But I think there was that reference in the ABI call if I'm correct. And I was hoping that you could clarify that. That's my first question and then I have a more general follow up.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Luca. This is Ricardo. Thank you for your question. And in a nutshell, I think essentially what we had impact margins are this temporary headwinds. This is like the number one reason and represent, like ABI said, 75% of the impact or even more. And this, as also discussed in the ABI call, these are headwinds that are expected to dissipate over the course of the year. That was even the word that we sort of used.

How can we say that? Because of course, we have a hedging policy in which the transactional impacts we know some time in advance. And we discussed that even when we announced the third quarter of last year results and again in the fourth quarter, that we made a decision to – took like a short-term hit into our P&L in order to build, if you will, a better future for the whole Brazilian industry.

And so in summary, I mean giving as much clarity as we could give, essentially what you see the number one impacting factor in the margin contraction and the 75% is correct as well is the FX impact.

Q - Luca Cipiccia {BIO 6914452 <GO>}

And thanks, that's clear. Just as a follow-up to that, without necessarily putting a timeline, but if I look at your gross margin for Brazil beer on a say 10 or 12 years' average I think it's been around 70% or so, last year it was around 64%. So that's about a 500, 600-basis-point gap between the type of profitability we've seen in 2016 and even lower in fact in this quarter.

And my question would be, as we seem to be moving to a more normalized environment in Brazil, lower inflation, consumer – arguably, possibly picking up later on, is there an element of doubting that you can go back to that level of normalized profitability again on a gross margin basis around 70% that we've seen historically you were able to achieve, or some of the structural mix and evolution that we're seeing should suggest there's more caution? Again, not necessarily putting a timeframe, but more under a normalized Brazilian market from a consumer standpoint and FX backdrop as well.

A - Ricardo Rittes {BIO 15184017 <GO>}

Luca, thanks for the question. I think, may I remind all of you, we don't give a guidance with margins. But I think it's fair to say that we see opportunities now to really enhance the margins. In the last 5, 10 years, we're able to keep consistently increasing margins. And in the long run, I mean, we have done that and despite of the short-term issues like we have last year so – and still this quarter that are temporary and will be dissipating towards end of the year.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. I understand. Thank you. Thanks.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi. Good afternoon. Bernardo, I was hoping you could expand a little bit more on your commercial platform of accelerating premium. I think it's been quite impressive in light of a softer consumer that we've seen this double-digit growth in the premium category. So just looking for your broader perspective on the potential of the premium category in Brazil. I think it does under index versus the world average of premium brands.

So how quickly do you think this could develop, not just the volume, but I guess the profit or the margin potential of these premium brands to your mix. I think we ask a lot about pricing, but forget about mix. So can you talk about that mix impact to your numbers and how quickly we could see more of that being impactful to your numbers going forward? Thank you.

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

Thanks, Lauren. I think that – I mean as I've said the premium brands are growing in a solid way and we are very confident that the segment will continue to grow ahead of the index for the next years. So I mean one important information, there is strong preference for premium brands in Brazil, close to 30%. And the segment is underpenetrated including in regions of the country. On top of that, we have a complete portfolio of brands that today represents 10% of our beer volumes. It could be even more. We have Global Brands, we have domestic premium brands, we have the craft beers that we acquired and more important than that, we have a deep knowledge of the consumer insights and need states (36:26) to assure that each brand will play in the right space.

So that's why you think that there is no other else in the market positioned as good as we are to benefit from this opportunity. And taking one example, Budweiser for instance, was up 30% year over year and is the leading brand in the segment. And every quarter we see that, I mean this brand is growing and growing in a very healthy way, because all the brand attributes are up as well.

And all the go-to-market and sales execution initiatives that are put in place to support specific execution that is needed for the premium, things that have been evolving a lot. So with that, and in a market that we need to build brands with the right content, the right brands but in the trade as well. I think that we are really in the right path to really get all the opportunity that the premium segment growth will have in Brazil for the future. We are doing this and continue to do even more.

Q - Lauren Torres {BIO 7323680 <GO>}

And I guess just as a quick follow-up, I know you don't directly comment on competition, but Heineken is obviously doing the same initiative with their premium brand. So just to add on to that, if there is any differentiating factor that you can talk about with respect to your portfolio and how you feel that relative to the competition, you're doing something a bit different or to capture more attention longer term.

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

I mean, we already said we don't talk about other companies and I think that we like to compete in the market. It's good for the industry, and it's good for us as well because (38:20). But I think that one of the biggest strengths that we have is the portfolio, the complete portfolio of brands that we have.

So we have in the global (38:30) we have not only Budweiser but we have Stella and Corona as well. If we go to domestic premium, Original, Serra Malte (38:40). And if you go the crafts, we have important brands as well like Wäls, one example. That's important. It's important really to fulfill the needs state that we can see in the marketplace.

So the portfolio then is really, really strong. And again, together with that, our strong execution that we are evolving big time to support the execution of those brands in the right places.

Q - Lauren Torres {BIO 7323680 <GO>}

Very good. Thank you.

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

I think that's it. Okay. Thank you.

Operator

And our next question comes from Pedro Leduc of JPMorgan. Please go ahead.

Q - Pedro Leduc {BIO 16665775 <GO>}

Hello, everyone. Thank you for taking my question, two quick ones. First on the Brazil beer volumes up 3.4%, if you have an estimate of what it looked like, excluding the more advantageous Carnival weeks, so just for us to gauge what the underlying trends maybe for the next one. And still then on Brazil beer average prices down 2% year-over-year. I understand you're right here it's related to a tough base, tax effect. But also I'm looking to perhaps the mix between channel and as well as packaging.

And first of all I understand that you did not discount prices down 2% year-over-year just to make sure and if you've noticed any sort of improvement in the consumer health maybe looking for up-trading, maybe a little more on trade activities which I haven't seen any of that or is it still to come in your view. Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Pedro, this is Ricardo. Let me start by commenting on the net revenue per hectoliter. So net revenue per hectoliter one way of looking at it is also to look sequentially, because we had information on the third and fourth quarter of last year, so when you look sequentially usually from the fourth quarter to the first quarter, there is a reduction on net revenue per hectoliter. Why? Because there's a catch-up in terms of taxes as we have discussed many times. And as a result of that, the important period to look and compare the first quarter to the third quarter which is like immediately before price increases for you to have a sense on the evolution of net revenue per hectoliter on a more linear basis.

So from the third quarter of 2016 to the first quarter of 2017 after pricing and state taxes update, net revenue per hectoliter was still was up increasing by 7.8%. So in any case, we should keep in mind that the longer the period, the better or more precise is the visibility of net revenue per hectoliter. So for instance, if you go back five years, net revenue per hectoliter had increased in line with inflation despite of some short term volatility. And again, what we said in the release that the minus 2.2% is related to (41:32) oranges-to-apples basis because also we have now the tax increase towards the end of February of last year.

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

And Pedro, I mean we don't comment about performance in Carnival and so on. But just a point (41:44) to understand what we have been doing in terms of understanding occasions, it's always important to be present and to gain share to pick the demand in occasions that maybe beer is not so relevant. But it's also, and even more important, to boost the occasions that beer is relevant.

So the Carnival volume is not a given. The Carnival volume if you understand really how to operate, how do a 360 occasion basis activation, the right brand with the right message going to the (42:19) street vendors, activating Carnival, even 30 days before Carnival, you can really build demand. And if you build demand for our brands, you will be able to gain share and activate the industry.

I think that the demand activation mindset has a steady build occasions in connecting with the brands. (42:38) company it's very powerful because it can lead the industry, make this industry better and leading that, we will gain share as well. I think that is what I can comment. That's why the key selling moments are so important following those in the industry. And for us, I mean as the leader of this industry, we'll do it even more to elevate beer and to drive volumes to our company.

Q - Pedro Leduc {BIO 16665775 <GO>}

Bernardo, thank you. And just last, the last piece, if you have noticed any sort of improvement under the same consumer health, any up-trading, any more on-trade activity, any signs of that or is it yet to come in your view?

A - Ricardo Rittes {BIO 15184017 <GO>}

Pedro, just to highlight on that. So as you – as we mentioned in the speech, when you look at the overall industry, the beer industry in Brazil still had a decline in spite of a Carnival that was later in the year compared to the previous year. So we have no doubt the macroeconomic environment in Brazil is still very tough with high unemployment and disposable income still at very low levels. But what we are confident is with that, we can see that there is improvement in site (43:54). So we're very confident with Brazil, with the country resuming growth going forward.

Q - Pedro Leduc {BIO 16665775 <GO>}

Very well. Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you, Pedro.

Operator

And our next question today comes from Thiago Duarte of BTG. Please go ahead.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you very much. Good afternoon, everybody. A couple of questions here. First, I wanted to follow-up on the discussion about gross margin and the COGS in Brazil. If you look at the 29% growth year-over-year of COGS per hectoliter, ABI mentioned in the release that there is a 40% impact from the currency hedge and that represents roughly 50% or half of your COGS. So that leaves us about a 20% impact coming from the rest of your COGS that are not FX-related.

So, just wanted to get a little bit more granularity there in the sense that you mentioned that you have pretty hard comps in terms of COGS from last year's first quarter and that's probably true. So just wanted to understand what you think in terms of what your normalized costs should look like. Should we think more in terms of the first quarter of this year or the first quarter of last year, and why would be the difference?

And the second question is related to market share. You mentioned a few times that you made a pretty good progress in terms of outperforming the industry and gaining market share this year, so – in the first quarter. So just wanted to understand a little bit more if you could give us a little bit more in terms of granularity for – in terms of channel, in particular, if you made a better progress in the on-trade versus the off-trade for some reason or vice versa, or even in terms of segments in the mainstream or the premium? That would be interesting. Thank you very much.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thiago, this is Ricardo. Just starting with the COGS, and we mentioned even the hard comparison of the first quarter. It's very important for you to bear in mind that within the quarters, it's easy for you to have volatility even into the hedging and the comparison, et cetera. So again, the longer the period, the easier it is for you to see.

We're going to stick to the guidance. So we expect a double-digit increase in terms of the COGS structure really for the first semester of the year, and of course, a flattish to low single-digit evolution in the second semester of 2017.

What we added in this review was that the second quarter of 2017 is expected to be a bridge in which the year-on-year variation is expected to be significantly lower than that of the first quarter. So the first quarter, being it should be like a bit of a concentration in terms of this variation and then migrating towards the second semester. This is as far as we went.

And again, we just used the comparison of the first quarter of 2016, for you to see that in spite of being very systematic in the way we hedge. So even on a year-per-year basis, I think the hedging of 2016 on the second was at it (47:11) was like $0.09 (47:12) lower than the average of the spot rate of 2016. And the hedging of 2017 I think it was exactly $0.09 (47:21) ahead of the average of the spot rate for the FX in 2016. So again, (47:30) then we decided to give you even more color on the COGS exactly for the people to be able to make a description (47:38) of how the year is going to look like on the COGS side.

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

And Thiago, thanks for the question, maybe (47:45) to the market share, I mean, as I said before for the industry there about probably low-single digit. Our volume was 3.4% above last year. Very, very pleased with that. And what I can say, I mean, to get a volume like that (48:00-48:07) good results in the In-Home location but in our Out of Home location as well. That is a proxy for the channels but I think that's what I can say to you. (48:20) right path in both locations in terms of market share and in terms of volume performance.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thanks, Bernardo. Just a follow up on this, you also mentioned a good brand preference development throughout the quarter given your commercial initiatives and activations and so on and so forth. Can you give us a sense of if that happened across the board in terms of your brand portfolio? If there was a good recovery for the mainstream brands or how that stacks up versus the brand preference that you had a few years ago just for us to get a sense whether you're truly in terms – especially in terms of the mainstream brands. That would be interesting.

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

Thiago, again, what I can say this is because of the volumes and this is because we understand why this volume happened. I mean, the initiatives that are put in place in the marketplace, and one of that is all of the things that we have been doing in terms of Elevate the Core. There are things that you don't plan and implement overnight. I mean, I've been working hard in the last two years to – I mean, some of the things that I've said in terms of new ABI packaging, better understanding of the key selling moments, meaningful message behind those brands, Brahma, Skol, Antarctica, our core.

We have been working a lot in the last, I mean, one year-and-a-half, two years to really go to the next level, those brands, and we're happy to say that – what drove, I mean, our preference in the first quarter was the core brands.

So I will not comment in one brand or another, for competitive reasons. But I think that the core, premium continue to grow, was good, you knew that, it will continue grow in the future. But I'd say that happy to see that the core brands had a very good quarter, and we have very good plans for the future in our Elevate the Core platform.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you.

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

Okay. Thank you.

Operator

And our next question comes from Antonio Barreto of Itaú. Please go ahead.

Q - Antonio Barreto {BIO 17449798 <GO>}

Hi. Good afternoon. Thanks for the question. My question, my first question is about Argentina. You mentioned a high-single-digit growth in the country. I was wondering if you can give us a little bit more color if you can compare to how the market performed.

And also you commented on the FX hedging impact. So I was wondering if we can expect that the FX hedges would have about the same shape of impact that you're having in Brazil and they will dial down over the next quarters.

A - Ricardo Rittes {BIO 15184017 <GO>}

Hi, Antonio. This is Ricardo. So, Argentina, I think we are seeing important improvement in Argentina when you look in terms of the volume trends and when you look at the overall market dynamic, if you will. Again – but the overall environment in the country continues to be challenging with the negative real disposable income growth, structural reforms are undergoing in the country. And we believe that presents a great potential for the future. But like we've said before, they're putting pressure in the short term.

One way that we put it like in the past is that the harder it is the short term in Argentina, the more excited we get about the future. Why? Because that means the structural reforms which present the challenge for the short term, they are being implemented. And as a result, we are more excited about the future. We have been in the country for a long time. Our brand has been in the house of the consumers for a very long time. And we are – again, the same way that we are in Brazil, we are (52:03) excited with Argentina.

We believe we have a strong brand and strong team. We continue to use our full toolkit to implement our revenue management initiatives to operate in a high inflationary environment in the country. And so the bottom-line is that our team knows how to work in this environment, and we remain fully committed to our business in Argentina. And the good news is that when things improve, we believe we will be even better positioned to capture it.

In regards to the COGS and the specific impact of the FX in the COGS in Argentina, we didn't disclose any of that for the market (52:48). So we didn't disclose that. But what you could expect also is similar – again, we're very systematic in the way we do hedges. So a similar pattern that we described for Brazil is what you should expect for Argentina as well.

Q - Antonio Barreto {BIO 17449798 <GO>}

(53:09) if you can comment. It would helpful if you would – could at least comment on how was your volume performance, the high-single digit performance that you reported. How was it compared to the market in Argentina?

A - Ricardo Rittes {BIO 15184017 <GO>}

I mean, we don't disclose market share information on a quarterly basis. If you look at the difference between Brazil and Argentina, why, we're able to comment on that, is number one, one of our competitor disclosure how the market performed and provided even the source in the first quarter. And on top of that, again I think we were giving some guidance, if you will, or some directions in terms of how we perform, but we don't do that in Argentina. Traditionally, we don't do that.

Q - Antonio Barreto {BIO 17449798 <GO>}

Okay. And if I could ask just one last question about the working capital. I saw the working capital cycle going a bit down in this quarter, especially in the long-term accounts payable. If you could go over a little bit to explain us or give us a little bit more color on what happened there would be helpful.

A - Ricardo Rittes {BIO 15184017 <GO>}

Well, I mean, when you look at the overall cash flow generated from our operations, which was BRL 3.1 billion, it was almost like 40% higher than that in the first quarter of 2016. I think to be precise it was 37.7%. CapEx was also down. Again, we can – if you look at the overall working capital cycle specifically on the payables, when you come from the last quarter of the year which you have like a higher stock of payables in comparison to the first quarter, you tend to see payables going down a little bit, as an (54:55) evolution as you see over the course of the year level.

Q - Antonio Barreto {BIO 17449798 <GO>}

Okay. Thank you.

Operator

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

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. Two questions of a little bit different path than we've been on. In Brazil the Coca-Cola Company now has been talking about the need to restructure its price pack architecture in the light of the kind of new realities for the consumer and disposable income. I wanted to get a sense of where you thought you were on the soft drink side. And whether you feel that you need to make those same sorts of moves or are you well ahead of the curve? That's question number one.

And then question number two, I was wondering if you could give a little bit more insight into what's going on in Canada. Volumes were down but very strong revenue per hectoliter, up 3.3%. So just trying to understand a little bit what's going on there and then also what's going on, on the COGS, which was down substantially? Thank you.

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

Hi, Rob. How are you? Thanks for the question. I think I'll just get the question of the soft drinks. We've been doing a very good job in terms of the revenue management with soft drinks. And really trying to understand per region, per channel because we know that the, I mean, the huge crisis that we have is to face tax (56:32) disposable income and this affects the soft drink business even more in fact, compared to beer. Both (56:42) but the CSD business even more. Having said that, I think that we have a good plan in terms of revenue management and the disposable income per region, per channel.

And (56:54) the capacity that we have in each area and, I mean doing this kind of match capacity, elasticity models that you have per pack, per region, per channel, to maximize the capacity that we have to drive affordability in a moment like that with good margins. So that's what I could say. But, I mean, we are working on this. I mean, not now. I mean, since we knew two years ago, three years ago that the crisis in Brazil would be tough and (57:34) business even more than other kind of business.

Q - Robert Ottenstein {BIO 1498660 <GO>}

So it sounds like you're ahead of them in terms of rightsizing, so to speak, the price pack architecture.

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

We will not comment about, I mean, the – about what they are doing, other competitors are doing. Just saying that this is a top issue in our agenda. It has been a top issue in our agenda, and we are evolving the way that we think that's good for Ambev and for the people that like our brands.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Okay.

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

Thank you.

Q - Robert Ottenstein {BIO 1498660 <GO>}

And then...

A - Ricardo Rittes {BIO 15184017 <GO>}

And, Robert, the next question about Canada. We had very strong performance in Canada this quarter. And just to highlight, it's a little bit of the same but inverted situation that we have had in Brazil with the volatility on the COGS side here in terms of the input cost being translated into more Brazilian reais and as a result of that negatively impacting our business in Brazil.

In Canada, just for example, we also have an important brand there, Corona, that we import from Mexico and buy from ABI, it's imported and (58:42) produced in Mexico. And so also we had some FX among them, some of the Corona impacting the P&L, specifically the COGS line on a positive scenario, given the recently weakness of the Mexican peso.

Operator

And thank you, sir. Today's final question will come from Alex Robarts of Citi. Please go ahead.

Q - Alexander Robarts {BIO 1499637 <GO>}

Hi, everybody. Thanks. I wanted to go back to the Brazil COGS. And appreciate the guidance and the new information around 2Q. The reality is that there's still a 4 percentage points or 5 percentage points of delta in the second half when we think about how COGS per – how the growth of COGS per hectoliter decelerates. And at the gross level, that can be meaningful when we think about earnings.

So kind of in the spirit of that, I had two related questions on Brazil COGS. I understood from your prepared remarks that dollar COGS as a percent of total COGS in Brazil have – are now around 50%. And I guess I recall the messaging last year that that was – that number was around 40%. And I guess I wonder, is it fair to assume that there's been a step up in just the dollar piece of your Brazilian COGS?

And the second related question is, you made the case publicly that the dollar hedge cost pressure will dissipate as we kind of look out to the rest of the year. But I'm wondering about the dollar commodity cost curve which you also hedge. And is it fair to assume that perhaps it goes the other way? And the reason why I ask that is when we look at the aluminum price futures with the wheat which is how we get kind of a proxy for malt as well as PET (01:01:03), it seems like those three inputs seem to be or have been trending up. So I'm wondering if that sounds about right and would it be fair to think that the commodity hedge that you guys have this year might be above the one last year? Thank you.

A - Ricardo Rittes {BIO 15184017 <GO>}

Alex, thank you for your question. So let me start with the – first, the comment that you made is absolutely correct which is that 40% of our total COGS moving up to 50%. And of course, as FX moves, and that 40% increases more than the other 60% on a proportional basis increases the overall percentage of the pie. And as a result, that's was what happened. If you look at our COGS, total COGS with an FX before what we've seen, like let's say, at the level of 2.5 (01:02:00) or something was closer to 40%. At the current level (01:02:05) is closer to 50% just to explain the evolution why now I think it would've been easier for people to do their, let's say, mental calculations with the 50% of our COGS being FX related.

Regarding that COGS effect over the course of 2017, again, like we said, we expect it to dissipate second semester just to reiterate. We believe that COGS structure is expected to be flattish to low single digit in the semester, the second semester of this year. And we provided more information about the second quarter saying that from this very high level or this evolution that we have seen this quarter, we expect the second quarter to be a little bit of a bridge to that.

With regards to the other commodities, specifically the ones that you mentioned, aluminum is the most important one out of the three that you mentioned. So I'm going to use aluminum as an example. Aluminum has increased in price recently and that's true. But at the same time, aluminum is still very inexpensive when we look in real terms on a longer term deal, if you will.

So aluminum has been – has traded, let's say, 10 years ago, if you will, at like $3,300 per metric ton. And currently it's at much, let's say, lower levels. So in spite of the recent volatility we have had in aluminum, our hedging policy protects us to be able to react operationally. I just want to make the point and highlight that the size of magnitude and the size of export of the Brazilian real FX which is 50% of the COGS is much, much larger than any of the other commodities that we have individually, if you will. In spite of some of those commodities having a higher volatility than the FX historically, it is still a gain. The Brazilian FX impacts the Brazilian COGS much more than any of the commodity individually.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Got it. Thank you.

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

Thank you, Alex.

A - Ricardo Rittes {BIO 15184017 <GO>}

Thank you. Thanks for your questions.

Operator

And this concludes our question-and-answer session. I'd like to turn the conference back over to Mr. Bernardo Paiva for any closing remarks.

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

Thanks, Rocco. So (01:04:33) before we finish our call, I'd like to highlight once again that the headwinds that have impacted our results in this quarter will dissipate throughout the year. On top of that, we are very pleased with our beer performance in the first quarter, which was strongly supported by our commercial platforms.

However, we cannot deny that the economic activity in Brazil has still not, I mean, yet in the shape that we want. And the macro is still very tough out there. Having said that, we remain cautious optimists for the year, and we continue to put greater force on our planned, commercial platforms to strength the pillars for the future and for the short-term, and we are very confident that we are in the right path to resume top line and EBITDA growth.

Thank you. Enjoy the rest of your day.

Operator

And thank you, sir. This concludes today's conference. You may all disconnect your lines. And have a wonderful day.