Q1 2015 Earnings Call

Company Participants

- Bernardo Pinto Paiva
- Nelson José Jamel

Other Participants

- Alexander Robarts
- Andrea F. Teixeira
- Fernando F. Ferreira
- Jeronimo De Guzman
- Jose J. Yordan
- Jose de la Luz Lopez
- Lauren Torres
- Luca Cipiccia
- Robert E. Ottenstein
- Thiago Duarte

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. We would like to welcome everyone to Ambev's First Quarter 2015 Results Conference Call. Today with us we have Mr. Bernardo Paiva, CEO for Ambev; and Mr. Nelson Jamel, CFO and Investor Relations Officer.

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

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

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

I would also like to remind everyone that, as usual, the percentage changes that will be discussed during today's call are both organic and normalized in nature. And unless otherwise stated, percentage changes refer to comparisons with Q1 2014 results. Normalized figures refer to performance measures before exceptional items, which are either income or expenses that do not occur regularly as part of Ambev's normal activities. As normalized figures are non-GAAP measures, the company discloses the consolidated profit, EPS, EBIT and EBITDA on a fully reported basis in the earnings release.

Now, I'll turn the conference over to Mr. Nelson Jamel, CFO and Investor Relations Officer. Mr. Jamel, you may begin your conference.

Nelson José Jamel {BIO 16334129 <GO>}

Thanks, Kate. Hello, everyone, and thank you for joining our 2015 first quarter earnings conference call. I will start guiding through our consolidated and Brazilian results. Then Bernardo will talk in more details about our commercial initiatives in the country. And I'll come back in the end to talk in more details about our international operations and below EBITDA highlights.

Starting with our consolidated results, we had a strong start of the year in all of our geographies, leading to a 14.5% consolidated net revenue growth. Our EBITDA was up 21.1% with a margin expansion of 206 basis points showing the EBITDA margin of 47.1%.

In Brazil, despite a challenging macroeconomic environment experienced during the quarter, we delivered a quarter of robust top line and EBITDA growth. Our net revenue was up 10.7% while EBITDA grew 18.1% with an EBITDA margin of 52.3%, 330 basis points above last year. Brazil Beer volumes were up 0.4%, slightly ahead of the industry, driven by our growth platforms that Bernardo will detail in a few minutes.

These initiatives helped us navigate through the soft consumer environment and to mitigate the hard comparable base of last year, as our volumes were up 10.9% in the first quarter of 2014. Our net revenue per hectoliter was up 11%, due to our revenue management initiatives, growth of premium volumes and the increased weight of direct distribution that rated 7.5% (00:03:50) in the quarter. With that, our Brazil Beer top line was up by a strong 11.5%.

In Brazil CSD & NANC, our volumes were down 2.2% as the CSD industry declined 4.5%. But we increased our market share to 18.8% with a strong contribution of Guaraná Antarctica Black, launched in January, and the expansion of our 1-liter returnable glass bottles of Pepsi and Guaraná Antarctica. Our net revenue per hectoliter increased 8.6% due to our revenue management strategy and included weight of direct distribution as well, leading to a top line growth of 6.2%.

Brazil COGS per hectoliter was up 10.4%, while our cash COGS per hectoliter was up 7.8%, driven by overall inflation, unfavorable FX hedges, and the impact from product mix, including weights of premium. All that partially offset by lower commodity hedges, mainly in CSD, and procurement sales. As a reminder, our guidance for the year is related to total cash COGS. In the quarter it was up 7.5%.

Brazil cash SG&A grew to 12.8%, mostly explained by distribution expense that grew in the high teens due to higher inflation and increased weight of direct distribution. Regarding sales and marketing expense, we continued to invest behind our brands, but started to benefit from a higher comparable base related to the investment associated with the 2014 FIFA World Cup, as well as focus on cost management opportunities, mainly in our fixed and non-working money base.

Consolidated other operating income was up R$223 million net of expenses, mainly due to the growth of government grants in Brazil related to state VAT long-term tax incentives associated with investments done in the course of 2014.

Before moving to our international operations and below EBITDA highlights, Bernardo, up to you.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Jamel. Hello, everyone. It's once again a pleasure to be here with you. As Jamel just mentioned, we had a strong start of the year in all of our areas, including Brazil.

Now let's go and talk about the structural drivers of Brazil, the significant volumes opportunity we see on top of that and based on these consumer sites the growth strategies that we build on and identified for the future. Finally, we'll comment about the benefits we've put in place, a strong (6:30) commercial execution to boost our great portfolio of brands, while going big in our key actions.

We also comment that while we see these as long-term opportunities, these actions were already translated in concrete initiatives that could help us to navigate through external headwinds in the short-term. That links to the idea that we discussed with the team here that despite of the short-term challenge that we see out there, we are not the part of this crisis. And we will work hard and we'll focus on the things that we control.

Indeed that was the case of the first quarter, with a solid performance despite of the soft macro environment. Going forward, the challenge will be no different, but to remain focused on the things under our control, as I said before, and confident of our initiatives for this year.

First, it always starts with our core brands. We had a strong execution during summer and Carnival. As we enhance the equity of our brands, we're able to drive superior top line performance, balancing volume and price mix in a sustainable way. Skol expanded the summer experience to the top with the Skol Summer On music festival in six major cities during January, followed by the Lollapalooza in São Paulo at the end of March. All of those events were fully activated for digital media and in the trade as well.

Carnival. During Carnival, our core brands took a leading role in regional events around the country. In Rio, for instance, Antarctica sponsored the street Carnival for the sixth year in a row promoting the 450th anniversary of the city and engaging more than six million people in the world's biggest street party.

For the rest of the year, we have a strong agenda with relevant platforms to keep connecting with the people. Already in May, Skol hosted Tomorrowland Brasil, the first South American edition of the world's most iconic electronic dance music festival.

Second, accelerate premium. The segment is growing fast and we expect it to continue to grow well ahead of the industry. Our premium volumes were up double-digits in the first quarter driving alongside the direct distribution increase. The net revenue per hectoliter grew above inflation. Budweiser led the way, boosting its premium leadership captured during the World Cup, coupled with a solid performance of Original and Stella Artois.

As we move up with the brands that we are launching, we're excited the Corona opportunity giving the super trendy premiumness and position of this brand. We started placing this brand along the first quarter on selected on and off-trade premium box with great reception from people in general. With our complete brands, including our craft beers and the tailor-made execution, we commit firmly to lead and to drive a superior growth in the premium side.

Third, the near beer strategy, focused on volumes in occasions where our share of growth has historically been low. Brahma 0.0% in less than two years after its launch became one of the Ambev main brands, rather representing around 1% of our volumes. Skol Beats Senses launched at the end of last year is growing even faster with great incrementality and great margins. We estimate that around 70% of Skol Beats Senses volume growth is incremental, mainly coming from other categories. With the rollout of the current brands and our strong innovation pipeline, we expect to win a bigger share of total alcohol beverage space.

Fourth, the in home opportunity. By leveraging on the restraint of the consumer habits, we see a significant opportunity to also increase the share of growth in the in home location. In the off-trade channel, we have been expanding our programs designed to improve the assortment, carrier space and optimum revenue managed strategy, enhancing the shop experience and increasing volumes in a profitable way.

And fifth, the out of home. Going out to bars with friends is a tradition and part of the Brazilian culture. Our brands make an increasing part of this with great liquids, a winning package and initiatives aiming to improve the consumer experience. Through the introduction of the innovative coolers like the Skol Cube, through a micro events structure and also by franchise and Skol Draft, we have a complete action plan to strengthen our brands, to have bar owners to generate incremental volumes and, finally, to perfect the out of home experience.

In CSD & NANC, also based on deep consumer sites, you have to decide the strategy to go after significant top line opportunities, while benefiting from a 360 commercial execution. One, connecting with the people through relevant platforms. In 2015, Pepsi will be the official sponsor of Rock in Rio, the biggest music festival in Brazil, celebrating 30 years of the first Rock in Rio in Rio de Janeiro, for sure, in the past. Guaraná (00:11:47) is for another year the official sponsor of Gabriel Medina, World Surfers champion in 2014.

Two, innovations such as new Guaraná (00:11:56) Black, the line extension of Guaraná (00:11:58) flavored water both launched in January. Three, the opportunity away from CSD industry is also significant. The energy drink segment continues to grow in a strong way and Fusion already became the top two brands in some regions. And fourth, addressing (00:12:15) in a profitable way for our packaging strategies like mainly the 1-liter returnable glass bottle. The 1-liter returnable glass bottle already accounts for 80% of our volumes.

In CSD, we just won a JV with Whirlpool focused on the development of an all-in-one beverage solution in home which we are very excited about. This is our plan and we remain committed to continue to deliver on it regardless the external headings. Therefore, we have no change in our guidance. We continue to expect for 2015 our top line to grow mid to high single-digits in the full year, our cash COGS in Brazil to grow mid to high single-digits in the full year, Brazil SG&A to grow below inflation in the full year, and CapEx is foreseen to be up to 2014 levels.

Before we go to the Q&A, Jamel will talk about the international business and below EBITDA items. Jamel, over to you.

Nelson José Jamel {BIO 16334129 <GO>}

Thanks, Bernardo. Before starting for international operations, a small announcement. From now on, the HILA-Ex region will be called Central America and the Caribbean or CAC. No change in the geography, just a change in the name, which better represents our presence in the region.

And starting with Central America and the Caribbean, we had a very strong quarter with an EBITDA up 77.5% to R$218 million. This performance was mainly driven by double-digit volume growth in the Dominican Republic and EBITDA margin expansion. Following a similar strategy we have been executing in Brazil for years, we expanded the Carnival experience to other regions with a big part of it taken over the country during February.

The weather was also strong during all summer. Given the double-digit volume expansion, coupled with net revenue per hectoliter of mid single-digits growth, we expect a significant operational leverage in the country, leading to more than 10 percentage points of EBITDA margin expansion in the country.

In Guatemala, our volumes increased by more than 50% in the quarter as the industry grew strongly and we gained significant market share with an important contribution of Modelo brands. Going forward, we remain excited with the top line opportunity in the region, organic and inorganic, while committed to continuing to looking for more expansion opportunities.

Latin America South, our top line was up 28% and EBITDA 27% above last year. Our volumes were down 1.4% in the region, mainly driven by Argentina and partially offset by Bolivia, Chile and Paraguay. In Chile, along with the strong industry growth, the addition of Corona and other Modelo brands to our portfolio drove another quarter of market share expansion with great profitability.

Mixxtail Mojito, our near beer innovation launched in the last quarter in Argentina, also continued its incremental volumes and margins. Net revenue per hectoliter increased 29.6% in the region, explained by our solid revenue management strategy and premium mix.

With cost and expense pressure by strong inflation, mainly in Argentina, we continue to focus in non-working money saving opportunities and better product mix to protect our profitability. Our EBITDA margin was flattish at 45.4%. As we move forward, we remain focused on driving a solid top line growth in LAS, while protecting our profitability, despite the inflationary pressures, mainly in Argentina.

Turning now to Canada, net revenue grew 6% and EBITDA 9.6% with EBITDA margin up 90 basis points. The good performance was mainly driven by a robust top line performance and some operational leverage. After a very cold start of the year in January and February, the weather improved in March. And the industry was slightly up in the quarter, 0.2% above last year.

Our reported volumes increased 2.1% as we maintained the good momentum seen last year in the second half, mainly driven by Bud Light, Shock Top and Stella Artois. Our innovations with (00:16:20) is still growing from a small base, but more than doubling its volumes and mainly Corona, as we only started distributing the brand in March last year.

Net revenue per hectoliter was a strong 4.6% due to our revenue management strategy including premium mix and benefited from an easier comparable base, as our net revenue per hectoliter was flattish in the first quarter of 2014, given the time of our price strategy. Going forward, we will not have the same net revenue per hectoliter easier comp, but we remain excited with the volume opportunities of premium near beer and committed to balance net revenue per hectoliter and market share to deliver profitable growth.

Now let me walk through the main items between the normalized EBIT of R$4.4 billion and normalized profit of R$3 billion for the quarter. Our net financial results were a negative R$482 million in the quarter with performance mainly impacted by higher non-cash accretion expenses in connection with the put associated with foreign investment in the Dominican Republic, loss on derivatives related to the implementation of our hedging policy, and foreign exchange translation loss on intercompany payables and loans as a consequence of the BRL depreciation in the quarter.

Given the nature of these intercompany transactions, the non-cash currency translation impact is reported in our income statement. However, such impact is economically offset by the foreign exchange translation gains from offshore companies that are registered directly in equity. Our effective tax rate for the quarter ended up being 24.3%, as we benefited from a high interest on capital, but faced a one-time negative impact of approximately R$360 million related to intercompany transactions.

We generated R$3.7 billion of cash from operations, a 40% increase versus last year, mainly as a result of a stronger operational performance. Our CapEx was R$720 million in the period. Finally, during the quarter, we paid almost R$5 billion in interest on capital to shareholders, a 25% increase in payout versus the same period of last year, including dividends paid.

Thank you. And I believe we can now move to our Q&A session. Kate, can you please remind everyone the procedure for Q&A?

Q&A

Operator

Yes. We will now begin the question-and-answer session. The first question comes from Luca Cipiccia of Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning, Bernardo. Good morning, Nelson. Congratulations on the results and thanks for taking my question. I was hoping you could speak a bit more on market share both for beer and soft drinks and maybe if you can qualify some of the trends. We have seen in beer quite a lot of divergence in the quarter between the different players. So I was curious if you can maybe see how the market or comment how the market is evolving given the pressure the consumer is facing and also differences that may be relevant across different regions and segments.

And then a similar question for soft drinks. You've mentioned your comment on market share advances. The Coke bottlers, the published numbers, made a similar statement. So I was hoping to reconcile maybe the two again, if there's any notable differences across region, price segment and how do you see the market share structure to evolve as we go through a year that is for the industry on both, not particularly, even specifically it just started quite well? That would be my question. Many thanks.

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

Okay. Luca, thank you for your questions. Just to confirm. I mean I think there are a couple of points you touched upon. So we are going to talk about first beer and Bernardo is going to walk you through our reviews on industry, data and trends, as you said. And then I'll take the question on CSD. Okay.

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

Yeah. Thanks, Luca. Thanks for the question. First of all, we don't comment a lot on how other companies perform in the quarter. We can comment about the industry. And I think that we have been getting all the information, see the information, using information. Let's try to understand a little bit better there.

As you know, (00:21:16), for instance, to talk about the first source, the lines and the bottom that goes through the line and given the inventories that will vary over the time, it's not necessarily the best proxy for the sales volume in the short-term like a single quarter or worse a month. On the other hand, (00:21:37) that is very helpful and useful to indicate industry trends in the long-term if you use kind of the rolling 12-month basis. Moreover it has the good thing that almost reached 100% of the coverage of the industry, including innovations like Skol Beat Senses, for instance, right away, and beyond beer and occasions and activation of occasions like Carnival, for instance. So this is (00:22:09), is one source.

Looking at Nielsen data on the other hand, we have a better view of the short-term sales, volumes. That's good. And also many relevant breakdowns like channels, regions, brands and so on. But Nielsen has its limitations as well. I mean some areas the quarter is not big like innovations, as I mentioned before, and important out of home occasions that we can activate.

All in all, bottom line, all data are very, very important for us, (00:22:46) or Nielsen or other internal sources. They are important to understand the trends in the marketplace and support the decision-making to maximize the top line and the profitability. In the end, that's what matters. So this is basically what I could say about the industry – the numbers that really the industry share.

Related to the macro environment, I mean there is no question we're facing a challenging market there. On the other hand, it's important to remember that our industry tends to be more resilient than others. And, for instance, it's not dependent at directional credit and I mean link is not direct to the overall GDP. And while also supported by strong underlying fundamentals that hold even in tough moments like that such as the demographics. In fact, we have seen much worse scenarios before. It's not the first time that Brazil took a hard time in the short-term, but we continue to focus on things that we control.

I have been discussing here with the team and with you guys a lot about, I mean, the long-term strategy that has continued to keep track on that in a consistent way, talking about our core brands, accelerate premium, that help a lot in moments like that to really drive net revenue above inflation in a good way. Talk about the near beer opportunity is big, in home and out of home. So we continue to do that. Looking ahead, yeah, the main headwind that you have is in the second quarter because of the FIFA World Cup last year. We know that. On the other hand, when we think about marketing expense, I mean, it would be an easy comp for us. But, again, finally, the guidance maintained – the same. We maintained the same guidance and we work hard to continue to deliver the solid top line EBITDA growth.

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

Yeah. Luca, just to complement on your question about CSD, we are, of course, also impacted in this segment by the tough economic environment, right. I mean it's a challenging one. Actually the impact is even more than beer mainly because of a higher, let's say, volume-price elasticity in this segment. But on the other hand, I mean, that said, we remain very confident with our strategy. I mean we have been consistently, quarter-over-quarter and over time, driving market share gains, market share growth, profitable way. So it's not at the expense of our margins.

And this is basically, first, connect with consumer through relevant platforms. I mean Bernardo just mentioned. I mean they are going to be, let's say, the new news, right. I mean they would be the official sponsor for Rock in Rio, for instance, the biggest music festival in Brazil, so for the years of – the first Rock in Rio. So it has to do with relevant connection with consumers. Driving innovation is key, right. I mean when you look at our strength, we have been consistently bringing innovation through (00:25:57). Right now the highlight of the quarter, of course, is the new Guaraná (00:26:01) Black which is a huge success, is a line extension of Guaraná (00:26:05) and also have lower flavored water both launched already in January.

And three, addressing further is also create (00:26:16). And they were leader within water. Also soft drinks is a major step. So with that, we feel confident again but we also see competitors did public numbers and we use that as a reference, of course. But we have a clear view on where we should go and very confident on the plan. I think that's the message.

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

Luca, in the two business, based on the external information that you have and internal, our best estimate is that we grew volumes ahead of the industry in beer and in soft drinks.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thank you. Thank you both.

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

Thank you.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Just a very quick one for Budweiser, again market share. How much of what you gained through the workout were you able to retain in the premium segment? One would have thought that was a bump but arguably you seem to have carried over into this area as well.

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

I think that, I mean, last year, Luca, there was a step up in the FIFA World Cup and then from there to continue to grow big time leading the premium segment in Brazil in the first quarter, so.

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

That's not a bump, right?

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

That's not a bump. I mean we used the World Cup to really step up and then from there never look back.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Okay. Perfect. Thank you.

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

Thank you.

Operator

The next question comes from Fernando Ferreira, Merrill Lynch. Please go ahead.

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

Thank you. Good morning, everyone. Good morning, Bernardo and Jamel. Just had a quick one. I mean why didn't you feel the need to change your guidance despite the solid performance in Q1, especially on the top line? And if I may, I mean the same topic, what's your biggest concern for the quarters ahead? Thank you.

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

Hi, Fernando. Nelson here. Well, thanks for your question. Well, when we think about our guidance for the year, our top line guidance in 2015, of course, we take into consideration different scenarios, right. I mean we talked a little bit of these elements in previous Bernardo's answer. Of course, from one side, we have a tough and challenging market environment with volatility, as we all know.

We had the tough comps of the FIFA World Cup. And that's particularly relevant for next quarter. So on the other hand, we see, I mean, premium growth as very important positive news, the near beer roll out, the entire innovation pipeline we have ahead of us. So different, let's say, trends or impacts and we are kind of early in the year. But in the end, all the scenarios we run for those, let's say, key drivers, they fit within the current top line range, which was provided at the beginning of the year.

Of course, if at some point in time, it wouldn't be the case anymore, I mean, we would have actually to change our guidance or adjust the range for the better or for the worse, as we have always done in the past, which was even the case last year. But at this point, we feel very confident with our growth strategy. Of course, we think the first quarter was a great step into the direction for the full year guidance but we think for the time being we should keep it the way it is. And your second question was about, sorry?

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

It was about the same. I mean, what's your biggest concern for the quarters ahead?

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

Sorry. Regarding the concern, I mean, those are the points we are looking at. They could drive – I think they are, just set aside. I think Bernardo already said it. But the major challenge we see for the inter goal actually is the tough comp of the second quarter, let's say, top line wise giving volumes. But at the same time, as we said, we're going to face easy comps on SG&A and we should see, for instance, SG&A converge into the full year guidance below inflation, which was not the case in the first quarter. As such, we face easy comps. So in the end, I mean, both top line guidance and also profitability guidance in a way we feel very comfortable about them.

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

And just to add here. I think that in moments like that, I mean that's, let's say, a tough out there for the short-term is opportunity to really go bold and big in some initiatives that we tested, that we know and we are doing that. And really expand faster our business through the beer landscape to the really alcohol beverage landscape. So it's an opportunity as well. So we are understanding what's going out there in terms of the short-term, I would say, crisis. We decide not to be part of that and we will boost our key initiatives to even exit this short-term environment tough moments in a much stronger way.

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

Great. Thank you.

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

Fernando, okay. Thanks for the question.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yes. Hi, everyone. Not to belabor a lot of the points that you've already made or the questions that have already been asked, but I was just curious to get a bit more clarity on the breakdown for mid to high single-digit sales growth for the year. It seems like you were cycling tough comps also in the first quarter but you gave us modest growth, which was great. Just curious if you think that is still sustainable in light of how the consumer environment is turning now.

And also on InBev's call this morning, they do keep talking about this healthy balance between volume and revenue per hectoliter. So with that said, I'm curious how you're thinking about benefits from pricing and mix over volume. And I don't know if it's beer and soft drinks with that said if that's where the balance is coming from. Thank you.

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

Sure, Lauren. Well, regarding the guidance for the year and also consistent with our long-term strategy. I mean, our idea is really to pursue this optimum balance, right, I mean protecting profitability, for instance, putting prices in line with the inflation and then I'd say allowing volumes to grow and the per capita to grow and opportunities to be captured. I think that's the optimum balance as opposed to having, let's say, a short-term boost in net revenue by putting prices above inflation but then compromising, let's say, even the interest rate in terms of how healthy it could be.

And also we have to look at this in the context of the current macroeconomic scenario. So actually we are very happy with the fact that our net revenue per hectoliter in the first quarter – it grew, I mean, double-digits, right. But the fewer pricing element was in line with inflation. All of the growth or the real growth came primarily from the premium mix or product mix, if you will, and some also positive impact from direct distribution. But that is the mindset we have, I mean, to drive top line growth without having to use the pure pricing lever as the way. Of course, the upside you get from premium, that distribution has to pay some bills, if you will, at the cost level, also at the SG&A level. But, again, we have no doubt it is accretive EBITDA-wise, margin-wise. So that's how we see it.

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

That's why – I mean the beauty of the five points that I mentioned before, I mean starting from the core, show the basis there. Our brands – I mean brands Skol, Antarctica, Guaraná Antarctica will be very strong, even in a moment like that. And then the second one – and that's why there is always accelerate premium growth. So really go big on that thing because it can protect the industry, price and line inflation and really, I mean, drive net revenue per hectoliter growth through premium mix. So that's what happened in the first quarter and give us reasons to believe that's a good formula in a virtual cycle.

Q - Lauren Torres {BIO 7323680 <GO>}

That's very helpful and clear. Thank you. And can I ask one other question? This morning, too, InBev's did ask and addressed the fact that you have an acquisition as far as Bogota Beer in the quarter in Colombia. Is there anything you could provide us on details behind that business?

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

Yeah. We just announced that InBev has rightly called agreement with BBC, Bogota Beer Company, a leading craft brewery in Colombia. The deal, of course, is including all of the brewery, but also 27 point of sales, including pubs. We are going to, of course, continue to emphasize and support, let's say, the craft feature, creativity, the great job the guys have done so far. So we don't expect any change to the business and the idea is to continue to benefit from this growing segment. Colombia is a very important market. It's a major beer market. They are the leaders in Latin America. We are totally committed to take this opportunity and take it to the next level in terms of profitability and focusing on this craft segment there and on top of that to put a strong team there to run this business. So, very excited about the Colombia opportunity.

Q - Lauren Torres {BIO 7323680 <GO>}

Great. Thank you.

Operator

The next question is from Andrea Teixeira [JPMorgan]. Please go ahead.

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

Thanks, everyone, and congrats on the results. I have like two questions. One on the cost side, I'm sure obviously you had slightly above – I mean I know you talk about the total cost, not the cost per hectoliter as a guidance. But just to reconcile how you've been evolving there obviously for a good reason because of the mix. But if you can, explain to us, what you're seeing in terms of percentage-wise and if percentage of premium – as a percent of total volumes and that impacting – what was the impact since you grew double-digits on the COGS side? Of that, what is the mix inducted? And that would be my first question. The second question is more related to the fiscal fees on the financial revenues. If that 4.65% increase may impact you, given that you are cash rich and if you can explain to us that? Thank you.

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

Sure, Andrea. Hi. Thanks for your question. Maybe we'll start with the COGS. As we said, I mean our guidance is on total cash COGS growth in Brazil from mid to high single in the full year. Actually, the quarter – we were there, right? We were at 7.5%. (00:37:24), slightly different in terms of the drivers behind the number, but, again, the range was provided with this objective, I mean, to give a good indication of where we should land. Maybe the specifics of the quarter, right, but also that's for the year. The main drivers there were the negative impact from the FX hedges. That was the most important.

One in particular in Q1 is we will face the toughest impact on the currency devaluation in Brazil, given the way we put our hedges in place on every 12 months in advance, as the currency was devaluing over the year. That was the toughest comp FX-wise for COGS. There was also a negative impact, if you will, from a product mix perspective, the same way it adds on net revenue and what did reason for the growth in net revenue above inflation. It has an impact on COGS per hectoliter, also on total COGS, but, again, offset there at the margin level. And there were some savings coming from COGS, mainly in CSD, more to come in beer, given the inventory level of barley and also some procurement savings.

So also feel very confident if we go with the guidance for the year and, as we said before, I think it could mix impact in this mid to high single-digits total cash COGS growth. Regarding the fiscal fees on financial income, of course, it was not added this quarter. We had no impact and actually not going to have an impact in the second quarter neither. The risk tables of the full fiscal fin tax rate, it's going to be valid as of July 1. It will have an impact, of course, in our financial results, but any potential impact actually depends on a couple different factors. And, at this stage, we are not providing specific guidance since again it will kick in as of the second half only.

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

Thank you very much.

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

Thank you, Andrea.

Operator

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

Q - Alexander Robarts {BIO 1499637 <GO>}

Thanks. Hi, everybody. Two questions from my side would be around the cash SG&A in Brazil and also these other operating income items. In looking at the cash SG&A, you had 14% growth in the fourth quarter year-on-year. We're seeing now 12% or so in this first quarter. So it looks like you had a summer with double-digit cash SG&A growth in Brazil. And the one kind of descriptor you've got is about distribution related expenses. If you could kind of give us perhaps a little bit more color on what was driving this double-digit cash SG&A growth in the first quarter. And if we think about the guidance, right, below inflation, I guess, it's going to imply an important pull back on this. What gives you the confidence that you can kind of reduce the pace of this cash SG&A growth? So that would be the first question if you could help us with that one.

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

Sure. Thanks for the question, Alex. This quarter, different from COGS, we were above the inflated guidance for the full year, right, because we were above inflation. And actually the main reason for that was really the distribution expenses and in particular the increase of the weight of direct distributions. So what happened last year – and again it explains pretty much what you put in a question – is that we were increasing distribution along the year. And we closed Q4 at a level close to 72%.

So it was, as you mentioned, had an important increase in Q4. Last year that was not the only reason but it was there, in the 14% you just mentioned. It is now in the first quarter kind of still – well, not likely yet, the increase we did last year. So by the second half, for instance, we're going to have much more of an easy comp in terms of weight of direct distribution. And that's why in the beginning of the year there is an increase.

And also, when we're looking to sales and marketing, we're also going to face an easier comp, especially in Q2 and then in Q3. So we feel very comfortable with the guidance of the year. And that's why we said distribution was the key element in Q1. We're going to have easier comps in the second half and also easier comps in sales and marketing in the following quarters. And regarding the other operating income, I think, that was also one of your questions, right?

Q - Alexander Robarts {BIO 1499637 <GO>}

Yeah. Yeah. Let me specifically frame the question. Sorry. So I mean it almost doubled, right, in Brazil Beer. And in Brazil, there was 70%, 80% increase. And you still got normalized margin expansion in Brazil, excluding that. But it is a distorting factor. And I guess you associated it with some investments last year that gave you extra – this incremental VAT tax incentive payment. How can we think about this going forward? Because I remember in 2013 that was a very lumpy item throughout the year, normalized last year. Are we in for another lumpy year in this line item? Or if you can give us a sense of how we can think about this other operating expense line for the rest of the year? Thanks very much.

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

Okay. Thank you for the question, Alex. I think that's also a very good point. And when you look into this line, as you said, I mean we had actually in 2013 a very high increase. But since then, and not by coincidence, we also maintain very high CapEx levels to start with. So last year was another year of record CapEx. And given the nature of these investments, I mean we are entitled to apply to this government grant.

And if you look on a quarterly basis what happened last year, for instance. The easier way to think about this line going forward is to look at it as a percentage of sales because that's the main driver, right. So last quarter or last year in the first quarter, as I said, they were running between 4% and 5%. And with the investments we did in the course of the year, we managed to take it close to 7% in the fourth quarter of last year.

And this quarter actually was pretty much more or less the same 7% because, again, the incentives were also captured in the course of the year. So, the way to think about it at this stage – bear in mind that those incentives are long-term incentives, totally recur. As I say, cash is really cash and is a quality result. We should think of them – we should take Q1 as a base, the number we just published. We should see them evolve on a quarterly base, in line with our net revenue growth. That is the main driver, as was also the case in the last quarter last year.

Q - Alexander Robarts {BIO 1499637 <GO>}

Okay. Got it. Thank you.

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

Thank you, Alex.

Operator

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

Q - Thiago Duarte {BIO 16541921 <GO>}

Hi, guys. Good afternoon, everybody. One final question actually going out of Brazil for a second looking at Central America. I mean 23% volume growth was pretty strong. And so I just wanted to get more color from you guys on what drove the volume and if possible some sense of – I know you're talking about different markets, different countries, but some sense of market share or how you're growing relative to the industry. I mean, at the end of the day, I'm trying to understand how to think about volume in Central America throughout the rest of the year. I mean the division is becoming quite relevant meaning in terms of EBITDA contribution similar to Canada. So it would be nice to get a little bit more color on growth going forward. Thank you.

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

Well, thanks for the question. I think that it's a very good one. If you go to DR, that's the main country there. I think that's a real example of what could happen in other countries here in Ambev, in Argentina, even in Canada and in Brazil, when you expand the industry from beer to alcohol. And then basically the strategy that we have implemented there is the same that I detail here, the five points, elevate the core, accelerate premium, near beer, in home, out of home. And basically I mean it's working very, very well. Because you not only see that we have opportunities to gain share, but to understand much better the revenue management initiatives that you can do your pack price. You not only see beer but you see other alcohol as well. It's really different.

And the thing that you see the results – I mean we are gaining share of throat, gaining share of beer and it continues to gain. And I think that – I mean, months ago, I have been talking with you a lot about this mindset, different consumer insights, alcohol beverage landscape, the fight, big things that you do to get there. I think that Brazil first quarter was a good example that the reason to believe that you continue to grow that. And if you go to Central America, you see that's a reality. So very excited for our business there and it will continue to go and push the borders and push big time to grow this business there.

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

Just to build on Bernardo's comment, I think, the great news in this quarter is that – what he just described, particularly in DR. Let's say, this total alcohol beverage space is already a reality there since the day one when we did a deal with the C&D, so important source for volumes and driver on top of the full execution of the so-called Carnival would rather have a thing. And then with the same set of results, the real results are very strong volume growth, but in a completely different scenario, which is another important country for us.

A key market for us in the view was Guatemala. We grew volumes above 50% in the quarter, so very relevant as well volume-wise, but in a different scenario, because we were gaining market share in beer with not only the portfolio that we have there, right, for a while but also leveraging the important Mexican brands, which are really making a difference for us there.

Because looking at the end game and the strategy, we are building share, becoming even more relevant in the market in an even more profitable way, because those brands, as you know, Corona, Negro Modelo and the others, they command a better price than the mainstream brands that we have there. So two different strategies, each country for, let's say, specific role and fit right now, both delivering strong volume and results.

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

Again, just one data to give you reasons to believe of the growth there, not only in the other countries, but in the DR. Our share of throat there is below 60%. Likely our share of throat in Brazil is below 50%. So while pushing this agenda, we are pushing this agenda big time, because we are cracking the code here. And in doing that, I mean we will unleash bigger opportunities in the market out there, not only DR, in Brazil, in Argentina. That's why we see in other country a launch of Mixxtail in big time in last. So it's a big opportunity, the share of throat agenda for us.

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

And talking about the relevance of the BU, as you said, we continue to see a significant growth opportunity in CAC, right, in Central America and Caribbean, not HILA-Ex anymore, both organic and non-organic. So currently we estimate that we have around 40% of the 50 million hectoliters markets rightsized in Central America and Caribbean. But with current EBITDA, let's say, rolling 12 months, about $300 million, but we think we could both, again, organic and inorganic. We should be able to more than triple that. And our dream there is to have $1 billion BU in due time.

Q - Thiago Duarte {BIO 16541921 <GO>}

Thank you. Very helpful.

Operator

The next question comes from Jose Yordan of Deutsche Bank. Please go ahead.

Q - Jose J. Yordan {BIO 1496398 <GO>}

Hi. Good morning, guys. I just have one simple question, which is if you can remind us what your CapEx budget is for this year? And then the second question is about Chile. When you took over the distribution of Corona in Chile, did you take over the entire country and all channels or only part of it? I understand that the previous distributor may have kept a certain channel or geography but I was unclear on that. And if that's the case, how do you manage the differences in retailer margin that I believe they were giving to retailers when under the old contract and the kind of retail margins the mainstream – you and the other mainstream brewer give to retailers in Chile?

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

Hi, Jose. Thanks for your question. I think let me start with the CapEx one. The guidance for the year is to have pretty much CapEx up to the levels of last year in Brazil, which were slightly above R$3 billion. And regarding Chile, I'll let Bernardo comment.

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

Hi, Jose. How are you? I think that Chile is a great success case done by the LAS guys and the opportunity to push this agenda. They are starting from a good business in our core – of our core brands. So Becker is a great brand and it's growing a lot. I mean, it's not only volumes but in terms of equity as well. And on top of that now, I mean we make this deal. Corona will help us big, big time to push the boundaries there.

The guy that operated there is a great guy. So I mean what I can say to is that we are aligned for their own trade business here. We still manage this brand and some super premium brands because I think that he added a lot for Corona in the past and can add value in the future, not only for this brand, Corona, but for some specific super premium brands that he operate there and do take care of the brand mostly off straight channel in the rest of the country.

So I think that's a win-win. And I think that Chile – I mean that we had kind of in 2008/2009 5% of share. We're talking about 25% plus. It's a great, great, great success history. And I think the guys from LAS have been doing a great job there and he continue to do.

Q - Jose J. Yordan {BIO 1496398 <GO>}

All right. Great. Thank you.

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

Thank you.

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

Thank you.

Operator

The next question comes from Jeronimo De Guzman of Morgan Stanley. Please go ahead.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Hi. Good morning. I had a question on Brazil Beer pricing. Just wanted to know how you're thinking about pricing as you go into the – or as you have gone into the higher taxation at the beginning of May because as I was thinking as you have the extra tailwind going right now from the premiumization and the direct distribution, but as you said the underlying pricing has been in line with inflation. So the question is, is the goal still to pass through the increase through incremental pricing? Or is it to use some of this extra pricing gains or extra revenue per hectoliter gains you've gotten to help offset the taxation?

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

Hi, Jeronimo. Thanks for your question. I mean yes, we had the new model which actually was announced earlier this year with the implementation date as of May 1. So, of course, have kicked in, not really new news. Of course, we don't comment on specific pricing activities, right, in the short-term, because of sensitive information. But to your question, I mean our guidance, yes it – our strategy about is that continue to be – to put price below inflation plus any tax offset. And that was already included in our guidance for the full year, in terms of top line growth from mid to high single-digits.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Okay. So no changes there. And then just to follow-up on the direct distribution, which has helped, as you mentioned, your revenue per hectoliter. You mentioned that you're going to have kind of a slowdown in these increases or the SG&A pressure from it in the second half. Does that imply that you're kind of getting to the point where you have smaller incremental gains in direct distribution or not really? You'll continue having these gains.

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

There is no specific goal or target of increasing direct distribution. At the end of the day, what I did describe is more what had happened and the carryover impact for this year. But we continue to do what we have said, is that we had the optimal relative market – this strategy has been announced and described. So, again, it might go up or not, but the ultimate goal is not about distributing directly, but making sure the relative marketing and distribution platform is optimized. So no specific guidance on that.

Q - Jeronimo De Guzman {BIO 15888043 <GO>}

Okay. Thank you.

Operator

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

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

Great. Terrific. And first off, congratulations on a terrific quarter. In terms of Colombia and Bogota, do you plan to aggressively expand the number of beer pubs in Bogota and in Colombia? And should we expect that you'll be introducing Corona, Bud and Stella? That's question number one. And question number two on beer in Brazil, can you talk a little bit about what the price to consumer look like in the quarter? Thank you.

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

Hi, Rob. Thanks for your question. I mean starting with Colombia, we just announced the partnership there. Of course, it's a relevant market, very dynamic, a good place for the time being actually to just make sure that we have a smooth integration, which in the end should be the case, because we don't intend to make any change to the business model. I think it's a winning business model. Of course, the area of focused on the high end segment, so premium brands, craft. And their history proved their experience even further to consumers. So there's nothing relevant in addition to what has been already announced.

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

I think the only thing to add here to what Jamel said is that we have a strong team there and a portfolio of brands, the high end brands, that will have interworked. And they are strong. So I think that we see a good opportunity there in Colombia. For the second point, I mean how we manage the price point in the bars and off-trade, I think, that operational excellence is key for us.

So this is a key issue that you always look and you always assure that if you have the right price point, it's good for everyone, good for the industry, good for the bar owner because they'll sell more. So it's a daily KPI that we follow to assure that everyone will win, the bars, people that drink our beers and others as well, in terms of charging the right price in our view. So it's part of the operational excellence delivered here and we're working hard on that and we'll continue to work.

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

Okay. Did the price to the consumer go up in line with inflation in the quarter or less, please?

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

Yeah. It was in line the inflation, slightly above, but didn't have the mix premium impacting also, this impact to consumers, but in the right way, as you have a selective distribution. So we feel, as Bernardo said, the strategy is actually working very well also from this perspective.

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

Okay. And then just one last question. Can you make any comments on the rest of the Modelo portfolio, the other brands, where you see potential for Modelo Especial, Victoria, any of the other brands in that portfolio in any of the countries and if there's any particular restrictions on any of those brands due to previous agreements?

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

I think that in Central America, as you see, a huge opportunity there. We can bring other brands and, by the way, we're doing in some countries there. Guatemala is one example. Modelo Especial is doing very, very well. But here, in Brazil, the focus is not to bring additional brands. Corona's the biggest one. It's an amazing brand. It's a lifestyle. And people really like the brand here and you do a great job with this brand here in Brazil. So basically there's that.

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

Okay. I understood. Are there any restrictions on the other brands in particular countries or over time will you be able to theoretically tell so all of the brands of the same countries that you can sell Corona in?

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

You can but the big issue here is to how to manage the brands, the portfolio that you have in the right way, not dilute a lot and go big in the ones that make sense. So that's part of our mantra and then you continue to surge from there.

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

Perfect. Thank you very much.

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

Yeah. Thanks, Rob.

Operator

The next question is a follow-up from Fernando Ferreira of Merrill Lynch. Please go ahead.

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

Thank you. Thanks for taking my follow-up. Just wanted to have a bit more color on the higher effective tax rate in the quarter, specifically on this intercompany transaction that had this negative impact of R$360 million. Was that a one-off? And should we expect the effective tax rate to go back to more normalized levels in the next quarters? Thank you.

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

Hi, Fernando. Well, regarding the effective tax rate, I mean, as we reported, it was a one-off this quarter. This was basically the result of taxable foreign profits generated through these intercompany transactions. So we said, an affiliate – there was a taxable foreign profit, which were not offset by the equivalent. That was lost due to lack of sufficient taxable profits in the corresponding affiliate. So a little bit technical but at the end of the day not only it was a one-off but once profits generated in the tax loss carrying affiliate, this negative impact is expected to be reverted. So from quarter-to-quarter low that our ETR may vary but expect that should be, of course, a wash over quarters.

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

Got it. Thank you.

Operator

And the next question comes from Jose de la Luz of Barclays. Please go ahead.

Q - Jose de la Luz Lopez {BIO 18706903 <GO>}

Hello, everyone. You've seen here how premium beer is gaining relevance, especially on Brazil market. I'd like to know if you could give us some color on what percentage of volume is coming from premium right now and how is it that you look the potential for the future?

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

Thanks for the question. I mean for last quarter, it was more than eight, so that's why it helped but (01:03:08) as I said. And I think that – we think that could go beyond that for sure based on the portfolio of brands that we have, the focus we are putting in place and the go-to-market, I mean all the business model that are put in place here to go even bigger in our premium business. So we are very excited about the opportunity here in Brazil but the premium continue to lead the way.

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

Okay. And then, well, I'd just like to thanks for all the questions. I see there are other questions in the list, which we can follow-up later on the call, myself, Marino. We're just out of time, so I would like just to ask Bernardo to come with final words. And from my side, again, thanks for your questions, for attendance and looking forward to talk to you again, guys.

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

Thanks, Jamel. So I mean, final message, I mean I have been sharing with you – we have been sharing with you all our long-term plan here. I think that – I mean the five things that, I mean, we will continue to hammer, I mean the core business, elevate the core, accelerate the premium, the near beer, in home, out of home. We're working hard on that, not only in Brazil, but in all other countries as well. So we really think that could make the difference for the future and started to make big time in the first quarter.

Top line (01:04:32) I mean in the mind of all the team to go to the top line and top line means go to the volume and activate demand in every occasion, 24/7. So it's a big opportunity. And then if you expand that for the alcohol industry even more and in the end will help us in our mix management to drive net revenue above inflation given to our mix of premium growing.

So – and base off that, I mean, the operational excellence, I mean, continue to manage the costs and operating revenue very well in the point of sale level, will help us support this new thing, maintain the thing that you have to support the new thing. And, again, final message, we know that the short-term crisis is out there, but Brazil will continue to grow in the future, for sure, as it happened in the past. And we decide not to be part of this crisis, and so far, so good. So thanks for your time and see you next quarter.

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

Thank you.

Operator

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