# Q2 2007 Earnings Call

## Company Participants

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

## Other Participants

- Alex Robarts, Analyst
- Andrew Holland, Analyst
- Celso Sanchez, Analyst
- Lore Serra, Analyst
- Robert Ford, Analyst
- Trevor Sterling, Analyst

## Presentation

### Operator

Good morning, and thank you for waiting. We would like to welcome everyone to AmBev's Second Quarter 2007 earnings conference call. Today with us we have Mr. Luiz Fernando Edmond, CEO for Latin America, Mr. Miguel Patricio, CEO for North America, Mr. Graham Staley, CFO and Investor Relations Officer and Mr. Joao Castro Neves, CEO for Quinsa.

(Operator Instructions)

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.

Now I'll turn the conference over to Mr. Graham Staley.

Mr. Staley, you may begin your conference.

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## Graham Staley {BIO 15381675 <GO>}

Thank you, Nelson. Good morning, everyone. Welcome to AmBev's Second Quarter results conference call. I am Graham Staley, CFO of AmBev, and with me today on the call are Luiz Fernando Edmond, CEO for Latin America, Miguel Patricio, CEO for North America, and I've also invited Joao Castro Neves, CEO for Quinsa, to join us on this morning's call to share his perspectives on Quinsa's results.

As usual, I will start the call by sharing a brief overview of the quarter. Luiz Fernando, Joao and Miguel will then provide you with details about our operations in Brazil, Quinsa and Canada. Then, before opening up for questions, I'll deal with a few specifics regarding the Second Quarter financials.

So let's get started. During the Second Quarter, our consolidated EBITDA reached more than R$1.8 billion, which represents growth of 16.5% compared to the same period in 2006. If we exclude the effect of AmBev's stake increase in Quinsa from the Second Quarter 2007 results, EBITDA would have shown a growth of 11.7%. Our earnings per share growth, excluding goodwill amortization, was 13.1%.

The Brazilian business delivered a good performance, and despite pressure on comparable volumes, given last year's World Cup, delivered an EBITDA 13.2% higher than the same period last year. Volumes grew 4.6% for beer and 10.4% for CSD and Nanc. Quinsa had a good Second Quarter also, and as a standalone business saw EBITDA growth of 23.5% in U.S. dollars and under Brazilian GAAP

In Canada, Lakeport impacted positively on volumes, with a small dilution of net revenues per hectoliter. This effect, together with better package mix and gains on the cost side yielded a 12.9% EBITDA growth in Canadian dollars. As detailed in our press release, we made a small adjustment to the way we report bonus in Canada in this quarter. This had a positive impact on EBITDA in the quarter of C$7 million.

U.S. operations, although still showing a loss, posted a big improvement in comparison to last year, following the restructuring of the business, with EBITDA improving by R$16 million. Our combined operations delivered net income of R$449 million, 7.2% lower than the Second Quarter 2006.

As in the First Quarter of this year, this result was negatively impacted by higher goodwill amortization, attributable to the second part of the Quinsa transaction and to a step-up in the amortization curve for the Labatt goodwill.

The strengthening of the real also resulted in an incremental charge of R$84 million when compared to the Second Quarter of last year, relating to the translation of our investments in overseas subsidiaries.

Finally, I would like to highlight year-on-year improvements of over R$900 million in net cash provided by operating activities. This is due to our improved trading performance,

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but also our increased focus on working capital in all of our markets. With that brief introduction, I would now like to turn the call over to Luiz Fernando.

## Luiz Fernando Edmond {BIO 5862219 <GO>}

Thank you, Graham. Good morning, everyone. I will now provide you with details regarding the Brazilian and HILA-ex operations. Starting with Beer Brazil, we were able to grow our volumes 4.6%. Excluding Cintra, growth would have been 3.2%, despite the difficult comparables due to the work gap in the Second Quarter of last year.

Our revenues per hectoliter grew 4.7%, driven by the price increase in January 2007, premium brands development and direct distribution growth. Without Cintra, we would have grown 5.6%, despite a more aggressive competitive scenario.

Market share is improving over the last four months. As you should know, it was already announced that we gained share again in July, but we still haven't recovered what we lost in the first Q. So we would like to take this opportunity to say that we are not satisfied with the current market share level and we are working hard to keep delivering growth month after month.

At the same time, we will maintain our healthy balance between growing volume and net revenue per hectoliter. SG&A for Brazil Beer, excluding depreciation and amortization, grew 8.6%, driven by higher expenses on the expansion of direct distribution and higher freight expenses due to higher volume. We also have Cintra's SG&A in our results.

We are investing in our brands in line with our expectations. Putting this all together, we entered the Second Quarter of 2007 with an EBITDA for Beer Brazil 11% higher, with margins 70 basis points better than last year, which is a solid result, considering the tough comparables.

CSD and Nanc operations posted strong volumes, 10.4% higher than last year on the back of a very successful H2OH launching. Revenues per hectoliter grew 8%, attributable to our better package and product mix and some price adjustments done throughout the year.

The average market share for the quarter was flat with the same period last year, at 16.8%, and in July we achieved 17% market share. Due to the huge success of H2OH, we saw some price reactions from our competitor, especially in the Sao Paulo region. But even though we grew volumes more than 20% year-on-year in that marketplace.

We also saw that competitors opened the price gap to our major soft drink brand, Guarana Antarctica, and we have already reacted and are monitoring results to decide upon new actions.

The mix shift towards H2OH led to an increase in COGS per hectoliter of 11.4%. SG&A expenses, excluding depreciation and amortization, grew 0.6%. As anticipated, the SG&A line did not follow the growth trend of the first Q. The lower selling expenses in the

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Second Quarter, as a result of the World Cup last year, almost offset the high expenses from the volume increase in direct distribution.

The higher volumes and healthy operations yielded a great 28% increase in EBITDA with 230 basis points increase in EBITDA margin, reaching 33.7%.

In HILA-ex, as you might have seen in the results, we improved R$16.4 million in the bottom line. The initiatives on our organizational structure, our revenue management and innovation are leading us in the right direction. For example, we've recently launched Brava Beats in Guatemala and Brahma Light in Dominican Republic. We are getting close to breakeven, but we are still not satisfied. We will keep up the efforts in the region in order to have positive results in the very near future.

We have our team motivated and committed to it. In summary, I would like to remark that these results were not achieved by chance. We have very structured internal targets and (inaudible; background noise) performance of our people, to whom I would like to congratulate for another great quarter.

I'll now turn the call to Joao Castro Neves. Thank you.

## Joao Castro Neves {BIO 17456730 <GO>}

Thank you, Luiz. Good morning, everyone. The region continued to grow at strong rates, laying the base for another very good quarter for the Company. Consolidated volumes grew 6.7%, with very strong performance in Argentina and Bolivia. Organic growth was actually higher, around 10.1%, given that we had to dispose of three brands in Argentina at the end of the last year, given the antitrust decision.

Sales price grew in average 16% throughout the region, strongly helped by local currency appreciation, contributing to a net revenue increase of 23.8%. The Company performed particularly well in the Beer Premium segment on a consolidated basis. Important for this performance was the Stella Artois brand, which is doing very well throughout. It was recently launched in Chile to strengthen our business there.

In terms of the individual beer markets, Argentina continues to perform very well, despite the loss of the three brands that we just mentioned. In fact, we sold more volume during the first half of 2007, without the three brands, than we did last year with them.

Price increases were also introduced, which allowed the Company to partially keep up with inflation and to keep profitability virtually unchanged, despite higher labor and energy cost. Premium brands such as Stella Artois and the dark beers that we've launched in the last 12 months, had excellent performance, growing 82% compared to last year.

The Bolivian business continued to perform outstandingly, despite an uncertain operating environment, with volumes increasing more than 18% in the quarter. We are in the process of doubling capacity at our Santa Cruz plant to meet the increase in demand of the past

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two years. This will increase our total capacity in the country by approximately 25% and should be completed towards the end of the year, before the season.

In Chile, we are receiving a very good market response in the launching of Stella Artois, which is already being sold in cans, longneck and the liter bottle. This introduction is aimed at top image on-premise points of sale in selective supermarket outlets. With this introduction, we're focusing on the premium segment of the Chilean market, which is one of the largest in Latin America in relative terms, accounting for slightly above 10% of the total market. We have also introduced two new dark beers to the Brahma brand, aiming at the fast-growing segment of the market.

The beer market in Paraguay was the exception in our region, in that it declined compared to 2006. This was the main reason for a 4% decline in our volumes in a more competitive environment. In spite of that, net revenues have grown based on a 6% price increase, which was in line with the inflation, a strong appreciation of the local currency and a better sales mix. Brahma brand continued to increase its preference and share of the total portfolio.

In Uruguay, industry volumes and Quinsa's market share have remained stable in the quarter, with higher sales price given that among other things our premium brands (patrician) is growing at a faster pace than the rest of the portfolio.

Talking now about soft drinks, the recovery of the economy in Argentina has helped both the industry volumes and also the mix of premium brands at the expense of B brands. Basically, people are upgrading. Our brands have gained market, especially in the Pepsi brand, due to strong execution on our sales, new product development and also important investments behind the brand.

At the same time, in Uruguay, CSD volumes were fueled by market growth, by the introduction of H2OH flavored water brand, in November, which already accounted for 25% of its segment in the quarter.

In summary, we have been able to deliver excellent results based on this good execution at point of sales, strong brand positions but also discipline regarding our pricing strategy. We have kept and will keep our focus in cost efficiencies, despite the increasing of labor, energy and transportation costs, which in a way is inherent to the Argentina business model at this point.

We achieved an EBITDA growth of 23%, 22.5% in dollars in the quarter, reaching RUS$95.1 million, with a margin of 45.7. I am very excited with the results that we have been delivering so far. I am enthused about our prospect for continued growth, but nevertheless we know we have challenging goals to meet in a more difficult environment. It will get tougher in the future as comparisons will become more difficult and challenges (inaudible).. But we will continue to work hard to deliver our targets.

I will now invite Miguel to take over.

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## Miguel Patricio {BIO 4264830 <GO>}

Thank you, Joao. Good morning, everyone. I will now talk about the Canadian operation. Before I start, I would like to highlight that all results will be quoted in Canadian dollars to exclude any effect of currency. First of all, we are proud to mention that this is the 11th consecutive quarter of profit growth in Canada in both local currency and organic terms since the closing of AmBev into Brazil.

Despite the challenges we face in tough Canadian markets, Labatt remains committed to continue the improvement of the bottom line. On a like-for-like basis, Labatt delivered EBITDA organic growth of 6.2%. That is excluding the EBITDA contribution from the Lakeport brands, which was C$7.5 million and the reclassification of bonus expenses from SG&A to the profit-sharing provision of C$7 million.

The earnings improvement in the quarter was driven by, first, a revenue increase of roughly 2% in domestic net revenues per hectoliter, and that is excluding the performance of Lakeport portfolio, second, continuing reduction in COGS per hectoliter, driven by a strong ZBB discipline in our fixed industrial costs and, third, savings on our overhead, mainly driven by the business aggregation allowed by the shared service center we implemented in Canada last year.

On the negative side, volume growth remains a tough challenge. The industry was flat in the quarter and the combined portfolio of Labatt and Lakeport delivered a volume decline of 0.9%. The Lakeport deal represents a great addition to the Labatt portfolio of brands, giving us our fair share of the discount segment in the province of Ontario, the largest market in Canada and the one in which discount is the largest segment. At this time, Lakeport is fully integrated into our operation.

On top of discount, we have also made strides in the light segment. After more than five years of share losses in light, we have now stabilized our portfolio and we are confident that we can grow share in this, that is the fastest-growing segment in Canada.

We have also been successful in improving the profitability of our brand portfolio, delivering continued margin expansion. Note that our gross margin grew 300 bps in the last two years, from Q2 '05 to Q2 '07. We acknowledge though that it is imperative to effectively grow the top line, which we will continue to pursue in a disciplined manner.

In Western Canada, the region where we have a leading share positioning, we continued to gain ground in the market while creating value for the beer category. Unfortunately, that is not the environment we experienced in the central and eastern region.

In Ontario, Quebec and Atlantic Canada, we continued to face tough price competition. These challenges represent a true chessboard. We have fought hard to maintain our market share in this market, but at the same time we have kept a rigid eye on our bottom line, since uncontrolled strides down the path of discounting might compromise long-term prospects.

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Going forward, I expect to see continued price competition, especially in the regions I just mention. That obviously translates into more pressures on both the top and bottom lines, but I am confident that Labatt still has reasonable opportunities for cost reductions to ensure sustainable, profitable growth.

I will now ask Graham to proceed with the highlights below EBIT now.

## Graham Staley {BIO 15381675 <GO>}

Thanks, Miguel. I would now like to guide you through the main lines between the reported EBIT of R$1.5 billion and the net income of R$449 million, as shown on page 19 of our release.

Other operational expenses amounted to R$444 million in the quarter, compared to R$243 million last year, and there were three main items driving this increase. Firstly, we recognized amortization of the Labatt goodwill based on the future earnings curve. As a result, the charge for the quarter increased from R$242 million last year to R$282 million this year.

Secondly, the Second Quarter contained two months of amortization of Quinsa goodwill, amounting to R$39 million, and relating to the second part of the acquisition transaction in August 2006. I would like to point out that there will be a change to the way we account for this amortization in the future, given the recent incorporation of BAH. Following incorporation, Brazilian GAAP requires us to report the goodwill amortization in SG&A depreciation and amortization expense in Brazil. This charge will amount to approximately R$58 million per quarter going forward.

And finally, we recognized a foreign exchange translation loss on overseas investments which amounted to R$121 million in the quarter. This is a non-cash, non-tax deductible expense, dependent of course on movements in the real.

Our net financial result amounted to an expense of R$337 million, mainly impacted by higher interest expenses associated with the Quinsa debentures, which were issued in the second half of 2006. Our net debt stood at R$8.7 billion at the end of the quarter.

The provision for income tax and social contributions was an expense of R$295 million. The year-on-year increase is the consequence of higher income before taxes and the including of the InBev Brazil-AmBev merger fiscal benefit in Q2 2006, which lowered last year's income tax charge. On a comparable basis, and as shown on page 21 of our release, inclusion of the InBev Brazil-AmBev merger fiscal benefit would have adjusted the income tax charge to R$207 million in the Second Quarter.

Earnings per 1,000 shares in the quarter amounted to R$7.2, a decrease of 3.2% compared to Second Quarter 2006 figures. Excluding goodwill amortization, earnings per 1,000 shares increased 13.1%. Cash flow remains a top priority for AmBev, and we are delivering good results.

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As I mentioned earlier, net cash provided by operating activities in the quarter increased by over R$900 million year-over-year, and we remain committed to distributing all excess cash if we cannot identify value-enhancing alternative uses within the business. Our payout strategy remains unchanged, interest on capital to the limit and the rest divided into dividends and buybacks.

I'd like to make a few comments on the recently issued bond, denominated in reals. We had an opportunity in the market for this issue with a 10-year maturity in order to refinance part of our short-term debt. Since we already generate strong cash flows, we chose to give priority to the interest rate rather than the amount of issue in order to optimize the creation of shareholder value. The result was that R$300 million was raised, with an all-time lowest rate for a corporate issue, namely less than 70 basis points above the comparable Brazilian government security.

Finally, regarding Sarbanes-Oxley compliance, I am very happy to communicate that we recently received confirmation from our independent auditors, stating that, in their opinion, AmBev maintained in all material respects effective internal controls over financial reporting as of December the 31, 2006. This represents two years of hard work by many people across the whole company, and we are very pleased to have full SOX compliance, which clearly demonstrates our commitment to financial discipline and good corporate governance.

With those comments, I will now hand back to Nelson and open up for questions.

## Questions And Answers

### Operator

(Operator Instructions)

Our first question is coming from Robert Ford of Merrill Lynch.

### Q - Robert Ford {BIO 1499021 <GO>}

Good day, everybody. Thank you for taking my call, congratulations on another solid quarter. I had a question with respect to Canada, and, Miguel Patricio, I was just looking at some quick numbers, forgive me if I made a mistake, but I'm curious. You've been in Canada for a long time, now, and as you take a look at the cost structure, if you look at cost of goods sold and SG&A per hectoliter in Canada, it's about 45% higher than the price you get per hectoliter for beer in Brazil.

They dwarf the cost structure in Brazil, and with respect to cost of goods sold, I'm just curious, it's almost R$100 per hectoliter, and I was wondering if you could dimension the differences and where you think you can bring the cost structure in Canada, given the dramatic disparity in costs.

### A - Miguel Patricio {BIO 4264830 <GO>}

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Robert, basically, the biggest contributors for what you just mentioned are, first, royalties, but we have the AB brands in our portfolio and Budweiser is the number one brand in Canada, so royalties is a big part of that.

The second, only secondary packaging, so in Brazil you're basically selling crates, where 65% of the volume is in crates, and that does affect the COGS side, so secondary packaging is definitely another reason. The third one is this high share of cost (in ports).

I think these are the basic three reasons, but I wouldn't like to comment the amount, but I think that these are basically the three reasons why it's more expensive than when you compare with Brazil.

## Q - Robert Ford {BIO 1499021 <GO>}

But if you look at it on a price per hectoliter, I mean, you've got more than twice the price of beer in Canada versus Brazil. It should compensate for some of those things, no? And given the pricing differential, one would hope that the down margins could be similar or greater than those of Brazil. Am I exaggerating, or is it the royalties, packaging and the distances that you have to ship (Coke NE) and Alexander Keith's so big that it offsets the price advantage?

## A - Miguel Patricio {BIO 4264830 <GO>}

I wouldn't disagree with you. The realities of the two countries are very different, but I think that's one of the reasons why we continue to be optimistic about reducing costs in Canada going forward. I think there are still opportunities. We are looking at them all the time and we have some left, but, yes, there is room to continue extracting costs from the operation, Robert.

## Q - Robert Ford {BIO 1499021 <GO>}

Thank you very much, and if I might, just one other question. How do you see the role of Lakeport now, as the competitive dynamics continue to remain fairly intense? You mentioned that you don't want to see price discounting run amok, but simultaneously you seem to have acquired a very powerful asset.

## A - Miguel Patricio {BIO 4264830 <GO>}

It's definitely a very powerful asset. The brand is growing, but I wouldn't like, Rob, to comment the actions on pricing and other things from the future, because of course I would be disclosing information about what we are going to do. But it is definitely a very powerful brand that we have in our portfolio, and the brand is performing very well. We are very happy with the results.

We are, as I said before, we are now fully integrated with Lakeport, so Lakeport today is another brewery that we have in our portfolio, so now we have seven breweries and one of the brands that we have in our portfolio. And we believe that also on the Lakeport side we have a lot to extract on costs as well, a lot of efficiencies to bring from the brewery that we have with Lakeport as well.

So we are mapping these things and, of course, focusing on the continued growth of Lakeport on one side and maximizing the profitability on the cost side on the brewery we have that today produces exclusively Lakeport.

## Q - Robert Ford {BIO 1499021 <GO>}

Maybe I can ask the same question in a much more innocuous way, and that is, is the way you deployed Lakeport tactically in the Second Quarter predictive of the way it will function in your portfolio going forward?

## A - Miguel Patricio {BIO 4264830 <GO>}

I apologize, but I cannot talk about it. I cannot say. I apologize about that.

## Q - Robert Ford {BIO 1499021 <GO>}

No. I understand. Thank you very much.

## A - Miguel Patricio {BIO 4264830 <GO>}

Thank you.

## Operator

Thank you. Our next question is coming from Lore Serra of Morgan Stanley.

## Q - Lore Serra {BIO 1506730 <GO>}

Good morning, or I guess good afternoon. I wanted to ask a bit about the Brazilian beer business. You mentioned in the opening comments that you had gained some share back in July. I wonder if you could share those figures with us, and I guess in the First Quarter conference call, when you talked about the market share performance, you sounded pretty confident that, with tactical, sort of small changes, you could gain back market share. I'm wondering if three months later you think that you might have to take more aggressive marketing actions to achieve your share goals?

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

This is Luiz. First of all, I think we continue to be very confident that we can recover share. We are working very hard, but in the same way we always did, not giving up profitability, not giving up prices and not dramatically increasing our SG&A or our sales expenses to recover the share, although the market, the competitive environment, has deteriorated a little bit since the end of last year, but especially in the beginning of this year.

Of course, as the market is growing, competitors seem to have more resources to invest in the market, especially not increasing prices in the same pace they did in the past. So our expectations are of course based on historical data and historical behaviors on our competitors.



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Again, we are not happy with the share we have today. We are, on average, when you compare the actual share, which is 67.5% in July, compare it to the average of last year, which was 68.8%, we're still 1.3% below the average. So we will continue to work hard, using our tools, using our market knowledge, using our brands, and introducing some new initiatives that have been developed for some time now, but of course takes some time to mature, takes some time to roll out.

And of course, when we look ahead, we believe we can continue to recover. We are not happy with the pace we are recovering, but we continue to believe that the right way to do it is guaranteeing our profitability and to implement surgical, tactical and long-term structural initiatives.

So I don't see why we should give up the level of profitability we have today in order to recover share faster than we are doing, since we believe we have the right tools and the right market programs and the portfolio. Sometimes it takes longer than you expect for competitors to react, but we know that they have their own pressures. So they have to deliver good results, too, so as they start to do that, we see our performance improving.

And we have to deal with the specific situations that we have in some markets. For example, in Rio, which is let's say the worst performance we have today and recover some specific markets that are not doing well at this point.

I'm pretty comfortable that we can continue to grow at the level of profitability we have today.

## Q - Lore Serra {BIO 1506730 <GO>}

Okay. Thanks for that. And I guess I wanted to understand a little bit more your comment about SG&A spending. I know that it's been a bit uneven and it's obviously difficult to forecast quarterly numbers, but we did see a pretty large rise in your SG&A in the quarter, given that you were comping the World Cup spending which was, as you said a year ago, pretty elevated. So if we look year-to-date, if I'm doing the math right, your cash SG&A is up, I don't know, something like 12%, 13%.

And I'm wondering if this is a timing issue and it's just sort of front-end loaded, or whether this is the year where we are going to see SG&A expenses grow at revenue or above it.

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

Year-on-year, if you look at beer, only beer, it's around 80% growth and there are several facts into this SG&A. So you have first of all, if you consider Cintra, which SG&A numbers are included this year and not included last year, that would represent around 2% additional expense. You have the volume effect, so although last year the Second Quarter was very positive with the World Cup included, this year, even with the tough comp, we had a 3%, 3-something percent increase only in brands we have last year. So it would represent around 1% or 2%.

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You have the direct distribution that continues to expand, so maybe another 1% out of this 8%. And you have some inflation. So the especially the media, to acquire the TV spots, to announce on TV they became exactly more expensive, since Brazil overall is expanding. It's growing. So not only in the beer industry, but in many industries, more brands being advertised are giving the TV networks more chances to increase prices.

So altogether, I would say this 8% is in line with our expectations and going forward I believe the second half of the year will be in line with this kind of growth we had in the Second Quarter.

## Q - Lore Serra {BIO 1506730 <GO>}

Thanks very much.

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

You're welcome.

## Operator

Thank you. Our next question is coming from Alex Robarts of Santander.

## Q - Alex Robarts {BIO 1499637 <GO>}

Hi, everybody. I guess I wanted to start off with Quinsa, and the question relates really to the lack of, I guess, operating leverage in the beer assets, EBITDA growing slower than the sales in beer. And I guess it seems to be really focused on the labor cost in Argentina, and is that really going to be kind of an issue that we should be following more intently in the second half of the year?

And I guess, Joao, you seemed to mention earlier in the call that you see some kind of challenges up ahead and I'm wondering if you could give us some more color about that?

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

Okay, Alex. Well first, to start with the challenges, I think that the business model that we have in Argentina, it's a country-wide government business model. It's a business model where the government will work to increase salaries on real terms, okay. So they will sponsor "the labor unions." You are in a country where 50% of the formal jobs are unionized jobs.

So given that the government for last year and this year was fostering, was pushing for, salaries going up let's say between 18% and 26%, depending on the industry, on inflation that is between 10% and 15%, salaries should really go up on real terms.

The good upside of that is that we are having very, very strong volume growth, so it is a model where you're going to have, we're having, higher volumes, given these higher real salaries, but this will in a way impact our cost. So I do not expect that we will decline our

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beer EBITDA margin on the year, but I don't expect a strong growth, neither, given this sort of situation.

Because when you talk about salaries, you're not talking just about unionized employees that work for the Company, but you're also talking about truck drivers that will impact our distribution cost, that will potentially impact the margin of our distributors. So this is a big issue. What we're trying to do is benefit at the same time from the higher volumes and we're trying to contains as much as possible on the cost side.

To give you an idea, you probably know or have heard or have read, we have had already two strikes, two important strikes this year in Argentina. Given that we are trying not for the costs to have all this impact that I just mentioned. I think also other companies in the region are having this problem. I don't think they're fighting as hard.

I think if other listed companies were fighting in the same way that we're fighting, I think that we would have a net-net better benefit, but we're taking care of ours. So I think at the end this is one of the main challenges. It will impact. It will not allow us to expand it a lot, but I don't expect a contraction. We're working not to have a contraction on the year, so that's I think the risk number one.

We have a second risk, which is maybe not -- it's impacting as much as this one, but has an important impact, which is the energy crisis. I mean, given that the country has been growing 7%, 8%, 9% for the past four years, it doesn't have enough energy, mostly gas, to meet all of the demand.

This is impacting our cost structure also. The government is spending good signals regarding the second semester. They are optimistic that we will have enough energy. To guarantee that we're not going to lose any sales, we have been buying or renting generators, so slight impact on CapEx and OpEx, so that's the second one. And I would say in Argentina, those are probably the two biggest ones, given that the first one also impacts our distributors.

But again, I would summarize saying that the impact will not have the same impact on the year that it had probably in the quarter. The other thing is when you look at Argentina as a whole and not just the beer business, of course, soft drink has been expanding its margin. We think that it can continue to expand. But when you put both of the businesses together, the business mix of the soft drinks is growing faster than beer, it ended up impacting your total EBITDA margin.

So that's why I was talking about them in separate terms.

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## Q - Alex Robarts {BIO 1499637 <GO>}

Okay, that's helpful. And I guess we talked a little bit about this last quarter, but the market share in soft drinks in Argentina, clearly it seems that you're gaining the share and I think you said last quarter that it looked like the B brands were a source of that gain. Is that still the case, or have you seen some gains versus the Coke bottlers?

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

If you look on the last three, four years, we have gained on average between 0.6% and 0.9%, or close to 1%, and that's where we are this year against last year, but this year in particular both us and Coke, we've been gaining share. B brands have reached close to 25 or 26, so it's very close to let's say a "not all-time low," but a low given, compared to the last four or five years. So they've been a source of growth for both of us.

You have to remember here that with price controls, people are being able to upgrade. I mean, both in beer and soft drinks, our premium brands are growing a lot, because people have enough money to organic either from B brands to A brands, or from a brand that he liked to a more premium brand.

So this will probably continue to -- this has happened in the First Quarter, Second Quarter. And I would say that until the end of the year we should expect that trend to continue. When I look at the published volumes from the industry, and I look at ours, this will confirm that we're growing faster than the industry, even when we include the A brands.

## Q - Alex Robarts {BIO 1499637 <GO>}

Okay. And I guess the last that was more of a clarification back in Canada, and I think -- what I just wanted, I think what I heard is that, excluding Lakeport, the growth was 6.2%. And I just wanted to make sure, what did that 6.2% refer to? And I think you also said that the Lakeport portfolio was down 1% in volume, and if that's true if you could give us an explanation about that.

## A - Miguel Patricio {BIO 4264830 <GO>}

Alex, so reconfirming what I said. I said that Labatt EBITDA organic growth was 6.2% and that excludes the reclassification of the bonus that Graham mentioned before that accounts for C$7 million and that excludes the Lakeport brand that accounts for C$7.5 million. And in terms of volume, what I said before is that in the quarter the industry was flat and the Labatt portfolio and Lakeport portfolio combined delivered a volume of 0.9% decline.

## Q - Alex Robarts {BIO 1499637 <GO>}

And did Lakeport -- was that faster or slower than your overall kind of --

## A - Miguel Patricio {BIO 4264830 <GO>}

Yes. It was faster. It was faster.

## Q - Alex Robarts {BIO 1499637 <GO>}

Okay. Thank you.

## A - Miguel Patricio {BIO 4264830 <GO>}

Thank you.

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## Operator

(Operator Instructions)

Our next question is coming from Andrew Holland of Dresdner Kleinwort.

## Q - Andrew Holland {BIO 17383424 <GO>}

Yes, hi. Two questions. Just in answer to an earlier question on Canada, you highlighted the fact that you've now got seven breweries in Canada, following the acquisition of Lakeport. I just wondered whether you were sort of hitting there that there may be scope for further capacity reductions to boost margins in that market? And secondly, could you give an idea of when you plan to introduce zero-based budgeting in Quinsa. I believe I'm right in thinking you haven't already done so and what you might think the sort of cost-saving potential from doing that could be and when you would get the benefit.

## A - Miguel Patricio {BIO 4264830 <GO>}

Okay, regarding the breweries, or regarding Canada, Lakeport Brewery is in Hamilton. It's pretty close to our brewery in London. However, we are running almost at full capacity today in Hamilton and we closed last year a plant here in Toronto. So at the time this is the footprint that we believe we have to run with.

We don't have any intention to close any of our breweries, but of course we'll always be looking for opportunities for the future, but at this moment we don't foresee any brewery closures.

Okay, Joao, go ahead on the Argentinean part?

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

Could you just repeat the second part, meaning if we are bringing the same sort of programs to Quinsa, is that what you referred to?

## Q - Andrew Holland {BIO 17383424 <GO>}

Yes. And just on a sort of wider InBev platform, obviously you've been rolling out ZBB first in Canada and at the InBev level in Europe. I'm just wondering when that program is likely to be introduced into Quinsa?

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

Sure, well, first of all, I think we briefly have mentioned this in some of the previous quarter. We are in the process of implementing both the shared service concept as well as the ZBB concept here at Quinsa. Also, we have to take in consideration that we've been here at Quinsa not on a full controlled basis since 2003.

So a lot of the programs that we see at the InBev level, as you mentioned, to use your same words, they are not so new here as they were maybe to Canada, or they are maybe

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to some of the zones of InBev. But we definitely see the benefits of fully implementing these programs.

We are in the process of doing that, but I think just as a comment when I compared to Miguel's situation or to Canada, we are right now in the process of when we look at capacity or plants, we are I would say more expanding, growing, either new plants or further expanding existing plants in terms of CapEx or in terms of production, total production.

But the concept and the culture of being as lean as possible is something that we're working on and that I'm sure will yield further benefits to our results.

## Q - Andrew Holland {BIO 17383424 <GO>}

And can you give an idea of when you think those benefits might come through? Is that a 2008 or even 2009 prospect?

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

Yes, most of those programs, they will be implemented by the end of this year. I think some of the culture part, of course, I think some of that already will help our results in 2007, from the future side. But I think the more hard-figure benefits, we're looking more into 2008.

## Q - Andrew Holland {BIO 17383424 <GO>}

Okay. Thank you.

## Operator

Our next question is a follow-up coming from Lore Serra of Morgan Stanley.

## Q - Lore Serra {BIO 1506730 <GO>}

Hi. I have two follow-ups, one in Canada, one in Brazil, so let me ask Canada first. My question in Canada is to understand whether you see the competitive environment worsening. I know that part of the reason you -- or one of the benefits, rather, of having bought Lakeport was to see some share of the growth in the value segment in Ontario, which has been, as you've pointed out many times, the fastest-growing part of the beer market in Eastern Canada. And so to see a 0.9% decline in the combined portfolio, obviously I think implies weakness in the ex-Labatt portfolio -- I mean, ex-light portfolio.

At the same time, you acknowledge on the call that you're doing very well with light beers, and a year go you had pretty good volume growth. So I know there's a lot of stuff there and there's things that are hard to sort of fully disclose, but can you just give a sense of whether this was just a tough comp in the Second Quarter or whether you see the competitive environment really worsening in Canada?

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## A - Miguel Patricio {BIO 4264830 <GO>}

Hi, Lore. I don't see reasons for believing that the second half of the year is going to be better or even equal to what we have the first half. I see every day more -- especially price competition in place. And definitely we have different models ourselves and our competitors. The results are very different year-to-date and I receive news every day of markets being more competitive in pricing and especially this year Quebec has been the ground on this count.

Our competitors are being very, very aggressive on that region. And well, since you mentioned competition and if you look at our model, year-to-date, so the first half of the year, if we compare numbers, the EBITDA growth, the EBIT growth of Labatt, and that is excluding Lakeport and excluding the bonus that I mentioned before, are -- we are about 13.7% above last year in EBIT. And our competitors are 1.5% below last year.

So it's definitely a different model. We definitely have different models of operating in Canada. I wish we had a more stable marketplace in terms of pricing, but to tell you the truth, I don't see any reason to believe that that's going to happen. So my expectation is that the second half is going to be harder than the First Quarter.

## Q - Lore Serra {BIO 1506730 <GO>}

Thanks, that's very helpful. And I guess a similar question in the soft drink market in Brazil. You mentioned in the opening comments about sort of stepped-up activities from the successful launch you've had in H2OH and some more sort of market activities. And I'd love to understand how much of that you think is just sort of normal kind of competitive dynamics versus a more -- or signal of let's say more price-based market into the second half of '07.

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

Lore, to be honest, it's difficult to predict what's going to happen in the second half of the year. Since the H2OH launch was very, very, very successful, that really transformed the market in Brazil, so creating a new segment. We achieved market share in the Rio market and Sao Paulo market, if you take the diet segment, we took a third of the segment only with one brand, which was very significant.

And of course, our competitors, they were very concerned about that and they started to react with not only their flagship brand but with lemon brands and flavor brands. I believe they didn't know how far we could go with the launch of H2OH and of course it took them some time to react, launching their own brand to compete against H2OH.

I think part of the price activity was related to these market share pressures in the short term, not to lose market share. And I think they did it. They were successful in keeping and even growing their share while we launched H2OH.

So from now on, I would expect a more rational behavior. Of course, we are implementing new initiatives with the packaged portfolio, with the price points, with more packs and specifically in some markets, not across the country. But we have to wait and see.

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As I said, we are more entering specifically the activities against Guarana Antarctica, which is our biggest and most profitable brand. We are not giving up any share on Guarana Antarctica. And so we will fight to get back the share we lost. That was compensated by the other brands, but we'll fight to get it back, as it's the most important brand we have.

And we specifically are not letting them open the price gap. So of course, as followers, as we are in the soft drinks, we will try to set our price in the right reference to guarantee the share level we always had with Guarana Antarctica.

So it's difficult to predict. There are some sugar pressures, but in the other hand, maybe the currency is favorable, so at this point we are very profitable. The business is performing very well. The volume is growing, the market is growing, but market share wise, specifically in Guarana Antarctica, we are not happy.

So we have already implemented the initiatives and if they work it's enough for us. Let's see how the reaction is in the next two or three months. Maybe during the Third Quarter results announcement I can get into more details for you.

## Q - Lore Serra {BIO 1506730 <GO>}

Terrific. Thanks very much.

## Operator

Thank you. Our next question is coming from Celso Sanchez of Citigroup.

## Q - Celso Sanchez {BIO 1803012 <GO>}

Hi. Good morning, or good afternoon. I just wanted to ask a couple of questions about Cintra, actually. I think I understand correctly that the volumes that you have with Cintra could go away if a buyer is found later this year. For some reason, October stands in my mind. Can you please confirm if that's true and what your expectation is of the impact that that might have on your operational cots, if those volumes go away?

It seems to me as an ancillary comment that the COGS per hectoliter, certainly in beer, also reflected some costs with Cintra even though that wasn't specifically cited in the press release. Can you give us some --?

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

Yes. I'll explain to you the Cintra situation and then Graham can expand on the COGS results. So we -- (Mrs.) Cintra, she has until October 28th the right to sell Cintra to anyone she wants to, so during the negotiation period, we decided that we would have this alternative with period that is finished until end of October.

At this point, if he is not able to sell the brand, we have the rights to acquire the brand at a $10 million cost, meaning that we would then incorporate the brand into our portfolio, of

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course, still having to discuss with the antitrust authorities what the outcome of this discussion will be.

But in the meantime, what happened is we have Cintra as many of our brands, with revenues, costs, shares and everything else. So at the end of October, if we sell the brand, it won't belong to us anymore. If we keep the brand, then going forward the Cintra brand will be definitely incorporated into our portfolio. So I know sometimes it's difficult to explain that, because we don't have the rights of the brand, but we have the results of the brand until October 28th.

If we keep the brand, that's the scenario going forward in terms of revenues, volumes and everything else. If we sell the brand, then it would be you can consider that as a negative impact in our results, since Cintra volume is a positive contributor to our EBITDA.

Is that okay for you? Do you have any questions on that, or can we move to the COGS?

## Q - Celso Sanchez {BIO 1803012 <GO>}

Actually, if you don't mind, before we do, so obviously it's a positive contributor to the revenues, but also obviously it also has cost components. And presumably the operation was run at a margin lower than yours. So the point is it's dilutive to margins as long as it's incorporated in your results, not just at the SG&A but also at the COGS level, correct?

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

It's 100% included in our results, so consider as we had Cintra, 100% of the Quinsa operations now incorporated into the AmBev operations. That's all you have to do, so 100% of every single number, volumes, revenues, COGS, SG&A, are now incorporated to our results.

## Q - Celso Sanchez {BIO 1803012 <GO>}

Right, and presumably, again, when I say dilutive, meaning at a lower margin, because presumably the operations that you acquired in Cintra was less profitable.

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

Yes. Absolutely. Absolutely right.

## Q - Celso Sanchez {BIO 1803012 <GO>}

And actually, Graham, if you could maybe quantify the extent which -- was the COGS disproportionately affected by that, because I guess it was a little higher than I thought it was. Or, conversely, the gross margin didn't expand quite as much as I thought it might this quarter.

## A - Graham Staley {BIO 15381675 <GO>}

Yes. Good morning, Celso, or good afternoon. There's not a huge impact of Cintra in the COGS story here. COGS per hectoliter in the quarter I think were up 2.8%. When you look



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at Q2 versus Q1, you'll see that the growth over the quarters was closer to 5%, 4.7% or 4.8%, I seem to remember.

The story there on beer is there's a number of factors. One of the factors is not commodities. There's no significant change on commodities. But we do have new 18-packs on beer and obviously there's freight costs and packaging costs associated with that.

There were some pressures on some of the adjuncts we use in the production of beer. Again, these are small items, but when you add them together they have an impact. Cintra, of course, added some fixed costs, as we took on two breweries, and those fixed costs find their way into the COGS.

I suppose as you look at the quarter, thinking about this a little bit more, we are building up, ready for the summer, and so we are incurring costs, some fixed costs, that reflect in cost of good sold.

In preparation for the summer, we have to carry those costs during the Second Quarter. And there's some general increase and pressure on costs, as Luiz was saying. As the economy grows and prospers and as resources become a little bit more scarce, even people resources, that puts a little bit of pressure on costs. Against that, working in favor of Q1 was it was a bigger month in terms of volume. I think it was more than 10% higher than Q2 in terms of volume. So because of some of these COGS are fixed in nature, there was some extra absorption fixed costs on a per-hectoliter basis in Q1 compared to Q2.

So when you add all those together, probably six or seven items, that gives you that increased cost of goods versus Q1. But nothing in isolation is of any concern for us, and we look forward to just continuing to work on that as we go through the year.

## Q - Celso Sanchez {BIO 1803012 <GO>}

And to just talking about COGS, if we could a little bit more, going into the second half of the year, obviously you've disclosed in the past you have a hedge in place and we had an idea of the terms in that. The incremental volume for Cintra, have you accounted for that, at least through October 28th? In other words, have you hedged incremental volume or not? And I guess if you could offer any perspective, presumably you've already worked your way into 2008, I imagine.

## A - Graham Staley {BIO 15381675 <GO>}

To be honest, Cintra volumes is not a significant enough factor to influence our hedging strategy. You always have ups and downs on hedging strategies and there's no really significant difference there. In terms of '08, yes, we're well into considering our strategy for '08. We will certainly at Q3 give the same sort of disclosure we gave last year in Q3 so that you can build that into your financial models.

But the environment still remains positive for us in terms of currency and sugar. Aluminum's the one that we're looking at carefully, because that's bobbing around a little

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bit. But we'll give you full disclosure in Q3 so that you can build that into your models for '08.

There's no change to the forecast for '07. What we disclosed in Q3 last year still remains and we're still expecting a good upside in cost of goods for both beer and soft drinks in the second half of the year.

## Q - Celso Sanchez {BIO 1803012 <GO>}

That's very helpful. Thank you.

## A - Graham Staley {BIO 15381675 <GO>}

Thank you.

## Operator

Thank you. Our next question is coming from Trevor Sterling of Sanford Bernstein.

## Q - Trevor Sterling

Most of the questions answered, but one very quick one. You mentioned that the Cintra volumes and revenues are included in this quarter's numbers. Are the Cintra volumes included in the Nielsen quoted share of 67.3?

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

No. They are not.

## Q - Trevor Sterling

So could you tell me what the underlying market growth was for the quarter?

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

Yes. We don't disclose that, because the market growth, you have to take the Nielsen reports. They are in line with the share reports, but not necessarily the real market growth. So it's research that they give the numbers. So we prefer not to disclose that, because you can take it as a 100% certain number and not necessarily it is. So we don't like the comparisons.

To be honest, you tell everyone that has ever looked at these numbers, they would compare the figures that we have, that they are in fact absolutely real, because they are in our reports, in our accountings. And when you compare they not necessarily will match. They can match over the year and they can match over the months, but not necessarily in a quarter basis. And sometimes they are positive. Sometimes they are negative.

We respect Nielsen, we use them a lot. Sometimes we don't like their results. Sometimes they match 100%, sometimes they don't. So we prefer not to disclose this market growth,

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as we don't have an industry market growth, as in other countries. Unfortunately, in Brazil, the industry has never gotten into an agreement to share their real numbers. And of course, AmBev is the only one that is a public and listed company, so of course we have to.

But that's all we can say.

## Operator

Thank you. Our next question is coming from Celso Sanchez with Citigroup.

## Q - Celso Sanchez {BIO 1803012 <GO>}

Sorry, just a follow-up. I didn't get a chance. After all, on Quinsa and on Quilmes actually, in Argentina, one of the things that struck me, not so much the cost-savings potential, but rather the revenue side in terms of some of the more focused mechanisms that have been used for a while in Brazil, the marginal contribution of the (macro base). Can you give us a bit of a feel for where you are in that process? Do you feel that the sales incentive structure is where it needs to be now? Are you still working your way toward one that's more aligned with sort of the AmBev profitability goals, rather than just volume goals?

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

Okay, well, Celso, I think two comments there. We're definitely moving. I mean, we're doing things in this second half, for example, in terms of promotional, in terms of incentive to the sales force, incentives to distributors, things that we have done in the past in Brazil that we have never done here, so definitely there are new things, new tools that we have been using. Last call, I think we mentioned some of the revenue management techniques and going through the details on price lists and things like that.

Now we're going onto the variable remuneration of the salespeople and going onto the sorts of promotions that will incentivize them. So this is still going on and I think the second half will demonstrate further advantages from that, as for sure next year.

But I also think in this second half, and affected by what we did in the first half, has been, and the same time that we've been working together with the government, of course, to fight inflation and to try to do our part to help that, we have at the same time been working with them to find some flexibility to recover for the cost pressure that we are not just facing but which is actually impacting our results. So the government does understand that and so besides all the revenue management techniques and promotions and incentives to these sales force, we have been also finding some room to discuss and sometimes implement price increases that at the end beginning of the year we didn't think it would be possible.

So we're benefiting from both things. In most cases, we continue to have the same policy that we've talked in the past about in Brazil, which is to have prices to grow in line with inflation. We have prepared ourselves to have prices below inflation in Argentina this year, but we continue to work to have a net impact to be in line with inflation.



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## Q - Celso Sanchez {BIO 1803012 <GO>}

In other words, mix benefits or whatever.

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

Yes. Whether it's from a new price increase that the government has allowed or will allow us to do, whether it's from the growth (dynamic) of the 82% coming from Stella and from the dark beers -- the dark beers that we have launched last year and that are really doing well in this semester that composes 82%. They have a price that is well above our Quilmes Cristal brand, which is a mainstream liter that if we would be comparing with Brazil, it's kind of scope price position.

So you have Quilmes at the 100 and you have both Quilmes , both Quilmes Boch and Quilmes Stout at above 110%, sometimes 115%, and you have Stella at let's say 135%. So when you have this volume growing at 82% against last year, you also benefit from that. So it is a combination of this growth and the up-trading to premium brands, also the other initiatives that we mentioned, but also working with the government to find some price increase to recover also for some or all of the cost pressures.

So those three things together will help us to probably have better pricing results on a net price per hectoliter than if we had thought about in the beginning of the year.

## Operator

Thank you. This does conclude the Q&A session. I will now turn the floor back to Mr. Graham Staley for any closing remarks.

## A - Graham Staley {BIO 15381675 <GO>}

Thank you, Nelson. I just want to thank everyone for attending this morning and for your insight and your questions, and look forward to speaking to you all again during the Q3 release and conference call, which I think will be on November the 8th. So thank you very much and have a great day. Bye-bye.

## Operator

Thank you. This does conclude today's AmBev Second Quarter 2007 earnings conference call. You may disconnect your lines at this time and have a wonderful day.

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