Q4 2015 Earnings Call

Company Participants

- Bernardo Pinto Paiva
- Ricardo Rittes de Oliveira Silva

Other Participants

- Alex Robarts
- Antonio González
- Gabriel Vaz de Lima
- Jeronimo De Guzman
- Jose J. Yordan
- Lauren Torres
- Luca Cipiccia

MANAGEMENT DISCUSSION SECTION

Operator

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

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

Before proceeding, let me mention that the forward-looking statements are being made under the Safe Harbor of Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ambev's management 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 Q4, 2014 or full year 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. Bernardo Paiva, CEO for Ambev. Mr. Paiva, you may begin your conference, sir.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Dan. Hello, everyone. Thank you for joining our 2015 fourth quarter and full year earnings call. As you know, we have Ricardo Rittes here, our new CFO since January 1, 2016.

Ricardo has been with the company for more than 11 years, a great partner. We've already been working as a team as he was the CIO of Ambev from 2012 until the end of last year, and I'm now even more excited to have him as our new CFO. Welcome, Ricardo.

Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you very much, Bernardo. Hello, everyone. I'm very happy to be here. Within these 11 years in the group, I had the opportunity to be the Treasurer of Ambev since 2005 to the end of 2006, Global Treasury of ABI from January 2007 to December 2011. I was based in Belgium and New York and have been the CIO of Ambev in the last four years. It is a great challenge to replace Jamel, but I'm deeply committed to preserve and improve whatever possible the outstanding job done by him and his team and strongly motivated to make sure we continue to create sustainable value to our shareholders. Please count on me.

From this quick introduction, I will guide you through our operational highlights and Bernardo will give his remarks at the end before moving to Q&A. And let's start now with our consolidated results.

We had another quarter of double-digit top-line growth. Top line was 10.4% above that of last year, leading to a strong 12% growth in the full year. EBITDA was up 7% in fourth quarter and 12.4% in the full year, reaching R$22.2 billion with an EBITDA margin expansion of 20 basis points to 47.5%. Operational cash flow generation in 2016 was R$23.6 billion, nominally up 48% year-over-year. After CapEx of R$5.3 billion, we generated R$18.3 billion of free cash flow.

In Brazil, our team's ability to deliver was once again put to the test as along with a difficult comparable base of the 2014 FIFA World Cup, the macroeconomic environment continued to deteriorate throughout the whole year. Nonetheless, we managed to deliver 8% top-line growth, which was at the upper end of our guidance range and a 10.8% EBITDA growth, with a 140 basis points margin expansion to 53.6%. More specifically, in Beer, Brazil net revenues increased by 8.4% in the quarter and 9.6% in the full year. Volumes were down 2.5% in the fourth quarter of 2015, mainly driven by diverse macroeconomic environment and unfavorable weather due to more rain than that of last year, partially offset by Premium and Near Beer growth.

Premium now represents 10% of our beer volumes with Near Beer representing 1% of the total volume. In the full year, volumes declined 1.8% as the challenging consumer environment was amplified by the difficult comparable base of the 2014 FIFA World Cup during the second quarter 2015, partially offset by the successful implementation of our commercial initiatives along the year.

Net revenue per hectoliter was up 11.2% in the quarter and 11.7% in the full year, as we continue to implement a revenue management strategy in a solid way, leveraging on our pack price strategy and benefiting from the positive impact of the new mix and an increased weight of direct distribution. Net revenues increased by 8.4% in the quarter and 9.6% in the year.

Moving to CSD & NANC Brazil, top line was down 1% in the fourth quarter of 2015 and 0.8% the full year 2015 due to negative volumes and price mix throughout the year. Pressured by negative real disposable income growth, we saw consumers reduce their frequency of CSD consumption and trade down to water and powder juices in 2015. Volumes are down 6.4% in the quarter and 5.2% the full year with market share gains partially offsetting a high single digit industry decline.

Within the energy drinks segments, Fusion continued to grow ahead of the industry and became the third-largest brand nationally while already being second in some regions. CSD & NANC net revenue per hectoliter increased by 5.8% in the fourth quarter and 4.7% in the full year.

The Brazil cash COGS per hectoliter grew 6.2% in the quarter and 6.9% in the year, benefiting from procurement savings and productivity gains and FX hedges, while being negatively impacted by currency movements, a high inflation in Brazil and product mix, mainly driven by the increased weight of premium products in view. In the full year, cash COGS increased by 4%, in line with our guidance of middle single digit growth. Gross margins were up 40 basis points in the year to 68.3%. Brazil cash SG&A was up 9.3% in the quarter, with higher sales and marketing and distribution expenses, partially offset by lower administrative costs.

In the full year, cash SG&A was up 8.3% in line with our guidance of below inflation due to, number one, high single digit logistics costs mainly driven by inflation and increased weight of direct distribution; two, administrative costs in line with inflation; and three, middle single digit sales and marketing expenses, as we continued to invest behind our brands but benefited from efficiency gains an easy comparable base given the investment made during the 2014 FIFA World Cup.

Now moving forwards to Central America and the Caribbean, which we will call CAC, we delivered another quarter of double digit volume growth with a strong performance in the region. EBITDA declined in the quarter due to the time of sales and marketing and administrative expenses, but in the full year EBITDA was up 25.2% in local currency with a margin expansion of 220 basis points to 35.3%. In Brazilian reais, our EBITDA increased by more than 65%.

Presidente, our leading brand, continued to grow volumes in the Dominican Republic and expand its presence in other islands of the Caribbean region. Margins continued to expand as we moved a step forward in terms of operational excellence in this country. In Guatemala, we gained significant market share with an important contribution of the Modelo brands, driving volume growth in a profitable way.

Now, to put our CAC business in perspective, since 2012 when we acquired CND, our EBITDA in CAC moved from roughly R$200 million to almost R$1.2 billion in 2015. Building on that success, we are excited with the top-line possibilities organic and non-organic, while committed to improve our operational excellence to fully capture the margin expansion opportunities.

Moving to Latin America South, our top-line was up 24.7%, while EBITDA grew 12.3% in the quarter. In the full year, top-line increased by 29.7% and EBITDA by 24.7%. Within Beer, we had another quarter of volume increase, leading to a 4.8% volume growth in the full year, driven by mainstream, premium, and near beer initiatives.

In Argentina, Mixxtail family continued to drive incremental volumes that coupled with a solid performance from our mainstream portfolio and our premium brands, mainly Corona and Patagonia, drove a low-single-digit volume growth. In Chile, while mainly benefiting from the first year of Corona distribution, all of our main brands grew volumes. In Paraguay, the 340ml returnable glass bottle of Brahma launched this last year continued to grow, leading to double-digits volume increase in country. And in Uruguay, premium volumes experienced a strong growth in the year.

In LAS, CSD & NANC, volumes were down 22.1% in the quarter and 13.4% in the full year, mainly driven by the divesture of our soft drinks business in Peru. As a result, we are no longer reporting CSD volumes in Peru with no material impact at EBITDA level. Adjusted for Peru CSD, our volumes would have been down low-single-digits in the year, reflecting the challenging trading conditions in the region.

While the industry is still pressured by the macroeconomic environment in Argentina, we are particularly excited with opportunities coming from the recent launch of Guaraná Antarctica in the country. Top-line benefited from a solid net revenue productivity performance due to higher weight of premium and near bear in our Beer volumes and inflationary pressure, particularly in Argentina.

Our COGS per hectoliter was pressured by inflation, unfavorable currency movements, and product mix. While benefiting from our FX hedges, SG&A was also negatively impact by inflation coupled with high investment in sales and marketing. As we move forward, we remain confident in our ability to deliver a solid performance in the region in the short-term and better position ourselves for the future.

Turning now to Canada, volumes increased by 2.9% in the quarter and 1.7% in the full year due to beer industry expansion and market share gain, with solid performance from Bud Light, Corona and Goose Island in the year. Throughout the year, we remain focused on pursuing an optimal balance between volume and price with our revenue management initiatives and the benefit of increased premium mix driving 2.2% net revenue per hectoliter growth in 2015.

Net revenue was 4% above last year leading to the best top-line performance of the last five years. EBITDA on the other hand, declined 9% in the quarter and 2.4% in the year, negatively impact by the currency devaluation, higher administrative expenses, and higher sales and marketing expenses. Going forward, we remain excited with our top-line momentum in Canada in the whole portfolio, while also committed to balance net revenue per hectoliter and market share to deliver profitable growth.

Now moving below EBITDA, our net financial results totaled an expense of R$2.2 billion in the year. And today, I will spend a little bit more time than usually here, not only because this result was significantly worse than that of last year, but also because I'd like to better explain the nature of these expenses, some of them non-cash. So the full year result is mainly explained by, first, interest income of R$575 million driven by our cash balance mainly in Brazilian reais, U.S. dollars, and Canadian dollars.

Second, interest expense of roughly R$1 billion, of which around R$600 million non-cash expense related to the put option associated with our investment in the Dominican Republic. As part of the Cervecería Nacional Dominicana, CND, deal that we had in 2012, a put option exercisable until 2019 was issued, which may result in an acquisition by Ambev of the remaining shares of CND, for a value that is based on EBITDA from operations. The remaining portion or close to R$400 million was driven by usual interest expense from our total debt outstanding, mainly linked to interest rates in Brazil.

Third, R$838.7 million losses on the derivatives instruments, these losses reflect the carry cost of our hedges. We have a disciplined hedge policy, first onto which we are always hedging the U.S. dollar-denominated portion of our COGS in all countries we operate, along with any other cash risk that could arise from FX and commodity moves, both in payables and receivables. This result is primarily linked to our COGS exposure in Brazil and Argentina, partially offset by carry gains from our foreign cash position hedged to BRL.

One important thing to highlight is that depending on the hedge instrument, the cash impact might differ in time from the expense accrual. Another important point is that also depending on the instrument, interest rate moves can generate non-cash monthly gain or losses, which explains the quarterly volatility this year. That said, the consolidated figure in 2015 of R$800 million is a good proxy of the carry cost we incurred this year. In short, while the spot to spot results flows into the COGS results, the interest rate deltas go into this line. Now fourth, the R$460.4 million losses in non-derivatives are mainly due to non-hedgeable foreign exchange translation losses on payables, primarily in Brazil and Argentina.

Let's move to our effective tax rate. The effective tax rate was up in the quarter from 14.9% to 28.3% as we do not only accrued lower benefits from interest on shareholders' equity in the fourth quarter 2015. But this benefit was also partially offset by negative Other tax adjustments, mainly driven by higher withholding tax provisions in the quarter. In the full year, while our net cash tax expense were close to that of last year, we reported a 22% effective tax rate, significantly above that, the last year's 14% tax rate, mainly due to, one, higher non-taxable net financial and other income mainly due to BRL devaluation.

Two, a non-deductible expense reported in the second quarter of 2015 related to the R$230 million agreement reached between Ambev and CADE, the Brazilian Antitrust Authority. Three, higher foreign taxable income in Brazil due to BRL devaluation and, mainly, the new Brazilian legislation for foreign profits. Four, slightly lower positive impact from interest on capital accrual. As discussed in the past, we always maximize the cash benefit from IOC, and 2015 was no different, but the accrual that differs in time from the cash benefit was actually lower than that of last year.

Fifth, a negative Other tax adjustment mainly driven by close to R$350 million one-time impact from intercompany loans reported in the first quarter of 2015. This came as a result of taxable profits generated through these transactions in certain affiliates, which were not offset by equivalent deductible losses due to the lack of sufficient taxable profits in the corresponding affiliates. Once profits are generated in the tax loss carrying affiliates, this negative impact is expected to be reverted.

Also, included in the Other tax adjustments, there are higher withholding tax provisions due to FX variation associated with unremitted earnings from international subsidiaries. Given the significant devaluation of Brazilian real, unremitted earnings are worth more in reais, generating a positive impact in shareholders' equity, and consequently a higher provision for withholding taxes. This provision is only converted into cash when we remit these earnings as dividends. As a result, our normalized profit decreased in the quarter by 7.9% and closed the year 6.3% above that of last year.

Important to mention that while net profit increased only by 6.3%, operating cash flow was up 48% to R$23.6 billion in 2015. This figure eliminates the non-cash nature of some financial expenses, reflects the cash spent on taxes, and includes a significant improvement in working capital achieved this year. With this cash generation of R$23.6 billion, we invested R$5.3 billion in CapEx; R$1.2 billion in acquisitions, mainly in Canada and the Bahamas; paid R$700 million of debt; returned to shareholders more than R$12 billion; and we still increased our cash position by R$4 billion. Half of this will be used for the IOC payment announced on January 25 to be paid starting on February 29.

As my final message, I would like to emphasize that in order to create sustainable shareholder value, we will be always maximizing cash flow generation, allowing us to, number one, invest for additional growth; and two, return a significant portion of this cash to shareholders. Thank you very much. I will now move to Bernardo before going to the Q&A.

Bernardo Pinto Paiva {BIO 7186008 <GO>}

Thanks, Ricardo. It has been a very challenging year, but we are able to once again deliver a solid result. It was not easy. The macroeconomic environment in Brazil deteriorated in a material way along the year, but we know that our team's ability to quickly adapt to a new reality has been key in our passion to drive strong performance; and this year, it was no different. But it has passed. We had the opportunity to celebrate 2014, but the focus now is on 2016 and the years to come.

We all know that 2016 will be another challenging year. And as part of our DNA, our values, we will go to deliver big again. And our strength and our attitude has not changed at all. We acknowledge the adverse reality we have in Brazil, our most important country, but first, we have been through crises before in Brazil and in other countries we operate. We have a strong culture, an experienced team. We know how to operate in scenarios like this one.

Second, we are strongly, very strongly excited with some initiatives that are already helping us in the short-term, but the biggest payoff will come in the future, like the returnables, back to the

(25:33) premium booze and near beer, just to name three of them. So we have decided to once again using this challenge period as an opportunity to strengthen our platforms and improve our operational excellence.

And third, we know that to build our future in a sustainable way, we have to deliver in the short-term, and we will do it. To do that we have to focus on what we can control and be even more connected with the changing consumer needs in a volatile environment. This is what we did in 2015 and what we continue to do going forward.

With that in mind, we enter 2016 ready for a tough year and very confident in our plan. In Brazil Beer we will continue to focus on the five commercial platforms. The first one, elevate the core, because it always starts with our core brands: Skol, Brahma and Antarctica, our beloved brands in Brazil. Part of the consumer's day-to-day lives and have the ability to deliver great experience through relevant initiatives such as summer festivals, Carnival, São João, music and sport events, including the 2016 Rio de Janeiro Olympic games. These key branding and selling moments will be even more important in 2016. By leveraging on these initiatives, further improving our sales and marketing – way that you go to the market and boosting the consumption occasions, we create the base to drive superior top line performance in a sustainable way while enhancing equity of our brands.

Premium, our second big bet platform, is already a reality in Brazil with the segments growing from 8% to 10% of our beer volumes, and Budweiser leading the segment with more than 30% volume growth in 2015, but the opportunity is bigger. Our premium brands continue to grow as expected. Along with that, there are execution gaps to be closed and specific opportunities to enhance the portfolio, mainly with international brands and domestic specialties. With that we see significant room to grow the premium segment in Brazil even further, driving a positive price and margin mix.

Our third platform is near beer. When we started talking about near beer one year ago, we had to explain what was this, what it meant, the share of total opportunity, et cetera. We always believed that could be transformational. Right now Skol Beats Senses and Spirit already represent 1% of our beer volumes, with more than 70% of this volume coming from other liquors than beer, and it keeps growing. We are actually creating a whole new industry in the alcoholic beverage base in Brazil, targeting occasions that were not roused (28:54) before. Not only that, we have created one of the coolest brands we've seen in the portfolio, with a strong preference among young adults and also helping Skol as a mother brand.

After launch success with this iconic blue bottle, and now to Spirit, the green one, consumers are trying to anticipate what will come next, the new color, the new taste, and so on. It's an amazing success.

With slightly more than 1% of volumes, non-alcoholic beer also fits perfectly in our strategy of targeting new occasions, namely with Brahma 0,0%, the leader in the segment. In the whole near beer segment, as we further improve our distribution and carefully expand the portfolio of brands with a solid pipeline of new liquids, we see an exciting opportunity to grow our share of growth, capturing incremental volumes in a highly profitable way.

In our home occasion, the fourth big bet platform, we see a significant room to improve the way people buy beer and consume it at home. The leverage on strong shopping sites research and taking advantage of the current environment, it has been enhancing the beer category execution in the small and big off-trades performance with initiatives as boosting product shelves and cooler placements.

We've been also accelerating returnable glass bottles in supermarkets. In the fourth quarter returnable volumes grew 100% in the off trades, driving affordability when people most need it with better margins than the one-way cans. What we are experiencing is a material shift in the shopping behavior of Brazilians, one that's good for consumers, good for the environment, good for the retailers and good for us.

And fifth, the out of home platform. The on-trade is the place to build brands and activate demands. Along the time, we have been perfect in the occasion for new liquids, new packages, and new trade marketing initiatives. In 2015 we launched a Skol Draft now present in more than 10,000 bars, promoted 35,000 music events in all regions of Brazil with Curtisom, our microevents platform, increased by 50% the introduction of new coolers in the market, and continued to expand the one-liter returnable glass bottle, driving affordability again when people most need it.

On top of that, technology is becoming the most powerful tool to improve the selling process, helping us to close gaps in terms of volume, assortment and price execution. It's also helping us to focus even more in the sell-out work with bars, restaurants and night clubs to further enhance the leverage that activate demand, also bringing great experience to consumers in the out of home occasion.

Moving from beer to CSD, we have been seeing a trade-down to part juice (32:35) and other business was low, due to the lower disposable income. And you see many (32:43) as well in this case. On the other hand, we had been gaining market share in a profitable way through innovations, and our pack price strategy. In the last 12 months, with the launch of the Guaraná Antarctica Black, Black Zero, Pepsi Zero, Mountain Dew, further expanded the returnable glass bottle and have just relaunched (33:09). On the higher end of the nonalcoholic business, energy drinks continue to grow in Brazil, and they continue to gain market share. Fusion is now the third largest energy drink brand in Brazil and already circling some important areas driving positive EBITDA margin mix.

Along with our top line focus, operational excellence is something we are obsessed about. Year-over-year we have been raising the bar for our cost performance and delivered superior profitability in the industry. That said, we have no doubt that it is the time to push our sales even and even and even further. On the other hand, we have some important cost headwinds to offset. And on the other, the current environment presents us a unique opportunity for us. Technology as well has also been a significant source of efficiency gains. From enhancing the hardware and software used by our sales reps to the introduction of real-time traffic optimization apps to truck drivers, improving not only safety, but also saving time and cost. Costs for sure will be the obsession in 2016.

Here is our plan for Brazil. When the environment gets tougher, we need to push ourselves even harder to continue to deliver. With that in mind, we expect in this 2016, top line in Brazil to grow mid to high-single-digits in the full year with an expected weak first quarter impacted by a tough comparable. We have an early Carnival and a hard comp due to the timing of seller tax increases which impacted our base zoning (35:05) in the second quarter of 2015. We expect cash COGS in Brazil to grow low to mid-teens in the full year, mainly explained by the impact of the devaluation of the Brazilian real during 2015, partially offset by cost initiatives; Brazil SG&A to grow low-single-digits in the full year with overall inflation being offset by efficiency gains; CapEx in Brazil to decline year-over-year.

Having significant operations outside of Brazil has proven to be a great asset some of the time. We continue to see significant top line growth and EBITDA margin opportunities in all countries we operate in CAC. Not to mention, some of nonorganic opportunities we also see. And last, we remain confident in our ability to deliver solid top line and EBITDA growth in the region, supported by strong brands in all countries we operate. And in Canada, we continue to pursue healthy top line growth with superior profitability and a great cash flow leveraged by an improved portfolio of brands.

We can now move to the Q&A.

Q&A

Operator

Thank you. We will now begin the question and answer session. And our first question comes from Luca Cipiccia of Goldman Sachs. Please go ahead.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Hi. Good morning Bernardo. Good morning Ricardo. Thanks for taking my questions. I wanted to ask about the beer mix in Brazil. You commented about Premium now becoming 10% of the mix and the performance of Budweiser within that. I was hoping you qualify a little bit more this growth in terms of, has the Premium accelerated? Is it more of a function of mainstream being slower and Premium being more resilient, which I assume is probably the case. And if that is correct, where do you see that going given that this type of divergence is probably going to continue in 2016?

And then in parallel to this, on the mix front, if you could give us an update as well on the returnable mix for the off-trade, and on the on-trade how are you managing and do you see a risk with inflation accelerating with prices going ahead where you would want them to be? It was the case a while ago, but it doesn't seem to have been a reason for a rise, but how are you managing that? How are you seeing that going? That would be great if you could give us some more details on this point.

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

Luca, thanks for the questions. I think that the first one, the Premium, I think that first the Premium industry is growing ahead of the overall industry and we know that this will continue to happen years to come. Premium industry is growing not only in Brazil, but in many, many countries; we know that as well. So I think that our Premium volumes grow, first, because of the industry, and second because the brands that we have – and not only Budweiser, but Stella Artois, Corona, Original, San Miguel (38:52), their launches are coming, including here the Near Beer as well. I think that the portfolio of brands that we have are just the niche space that we see in the market that we researched that. I think that again, we continue to grow our Premium mix. Premium volume continues to grow ahead of the industry and we will lead the Premium segment as we have done last year, not only as a total company, but we have done with Budweiser as well.

Another internal data that I cannot share numbers but give some flavor to you, the Premium brands that we have, their preference are way above the market share that they have. So we see for – again, the industry's standpoint and the portfolio that we have that's a strong one and it's evolving, has become even more stronger. A big opportunity for us to continue to grow in the years to come, including 2016.

Second one is the returnable and the off-trade. So the full year was kind of 14%, but we have months that went to 22%, 23%, in areas of 33%, even 40%. Depends on the affordability of each area. So we see a really – really a big opportunity. We see that this year can go even further. Last year was the first year that we pushed this initiative, so we have some logistic issues not only with us but with the trade to deal for the (40:30) off-trade. But again, all the customers understand that's good for them as well; it's good for everyone. So it would be a big initiative this year and the (40:43)...

Q - Luca Cipiccia {BIO 6914452 <GO>}

Sorry. The 14%, how does it compare with 2014? Just to have an idea how much it improved?

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

It was around 6%, 5% something like that. Or even 4%, I haven't here the right number otherwise I'll remind you. 5% to 4%. So – for big evolution, and a big evolution again, in a year that – I think that we had a strong finish since we started to push this initiative from March on. So there is a rhythm that we have to get to back this RGD (41:21) in the industry. Having said that, we expect this year to grow it even more because our base is more - base business, I mean their operation is more structured to grow it bigger.

In terms of price, and we always say that our natural revenue policy in the end is price in line with inflation in the long term and plus any taxes that have been increased. So this is the price policy. On top of that, mix will help the net revenue (41:54) for sure. Not only mix of brands, but mix of packs that we are working hard, and mix of regions as well. So all the mix management is something that we are obsessed about and I think they helped us last year big time, not only in terms of net revenue, but in terms of share as well as we understood regions and occasions that were under our fair share that we are able to boost. So that's my answer to the question.

Q - Luca Cipiccia {BIO 6914452 <GO>}

And Bernardo, are you afraid, are you seeing any risk of retailers pushing on the on trade, but you're pushing prices ahead of where you would like them to be or is that under control? It's pretty tight with inflation, general environment, the way things are going, do you see that risk anymore or it's not the case?

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

Luca, we have been explained for the retailers, actually more than twenty years that, I mean, a consumer price that goes ahead of the retailer price is not good for the consumer, it's not good for them, because they make less money, it's not good for the food industry. So, I think the operational excellence that we have is helping us to really get this message even more and assure the end price will be in line with what it should be, because it's good for everyone. Just as obsession, personally, I'm having - 20 years ago, I was a sales manager, (43:36) had me work on that. So I can assure you that's kind of a must have here in Ambev. So, no doubt that PTC, price to consumer will be in line with what it should be.

Q - Luca Cipiccia {BIO 6914452 <GO>}

Thank you. Thank you very much.

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

Thank you, Luca.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you.

Operator

And our next question comes from Antonio González of Credit Suisse. Please go ahead.

Q - Antonio González

Hello, Bernardo and Rittes. Thank you for taking my question. I have, first, a question on your cash flow from operations; obviously, it increased a very strong 48%. I would presume that some of the working capital improvements are permanent. And with your guidance for CapEx in Brazil down in 2016, I'd like to understand if you have any outlook for higher payout in the future or more of these small and mid-acquisitions like Canada that you're doing that we should expect to accelerate? That would be the first question.

Second, in terms of COGS; obviously, you will see a lot of pressure because of the currency, et cetera. I guess you already shutdown some capacity, that's my understanding, that you had shut down some capacity in 2015 already. I wanted to ask, if you can share with us how many hectoliters did you shut down? And is there any other step change that you can do to, I guess, partially offset these FX pressure?

And then just finally, a very quick follow-up on the tax rate comments on your prepared remarks, which is distributed IOC was actually up from R$4 billion to R$9 billion roughly, but the IOC tax shield was flattish year-on-year. Do you expect that the tax shield can go up next year? Is it just a timing thing or you're just already capturing the maximum benefit that you can from interest on capital? Thank you.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thank you, Antonio, for your question. So, if I'm going to recall, there are like three questions here. The first one is about the payout. I'm going to start there. Second one about costs, and then we move to the lower EBITDA and the potential impacts.

So, first of all, like we said in the call, the operational cash flow was up 48% to R$23.6 billion, and that's the consequence of what we do here. We manage the comp in order to maximize cash flow generation. And also that cash flow generation eliminates the non-cash nature of some financial expenses, reflects the cash spend on taxes, and includes a significant improvement in working capital that we achieved this year. So, working capital management is one of the focus of the company, has been already in the last couple of years, continues to be and we have no doubt about accelerate these efforts in the moment that we're living.

The second question in terms of costs and the cost pressure, I'd say, we try to explain not only in our reports but also in the speech what are going to be the main drivers that we're going to have for the cost reduction initiatives. But in short, we're always looking for opportunities to run our business in a more efficient way with no impact on our operations. So we have the Cost-Connect-Win platform, it's something that is not a program; it's not something that we're going to do for the next few months; it's not something that we're doing because of the price, it's something that we do continuously. We optimize our fixed structure as a whole on a day-to-day basis and that's what we do.

So, while inflation is up, overall declining demand also creates opportunities for better deals, that being like from a procurement standpoint or like from idle capacity from some of our suppliers. In the last few years, we have expanded the use of, for example, e-auction. So we're using that technology to help us to do that, from traditional raw materials purchase to services and a lot of different kinds of expenses. Technology also has been a significant source of efficiency gains. So from enhancing the sales hardware and software to an update of our time traffic like, Bernardo just said. So, in the end, there's no silver bullet, there's no capacity reduction, there's nothing we can comment on that direction. It is just cost managing as part of our DNA, and in tough times, I think this focus is even renewed or strengthened.

And the third part of your question which is like the below EBITDA part of the question, I will go through not only this specific item that you asked, but I'm going to do like a more comprehensive answer, so that we can tackle all the issues that may have arised on the below EBITDA question.

So number one; financial results, the main reason for the significantly net financial results difference from 2015 was the R$600 million non-cash expense related to the put option associated with our investment in the Dominican Republic. There is also around R$840 million derivative loss for the full year, which is essentially a running rate for the carry cost of our hedges. And then if you do an approximate calculation the carry of R$1.5 billion currency cost is hedged mainly in Brazil and Argentina, that's the number you're going to get. The quarter-over-quarter volatility generated by cash and non-cash mark-to-market gains and losses, and specifically in that line related to the interest rate differential moves between those currency pairs. So the spot to spot results closing to P&L to the COGS and the carry cost is counted in this line.

Number two and now going to more specifics on your question, when you look at the income tax and social contribution, it's very important to highlight that as per our cash flow statement reported today, income tax paid was R$2.1 billion which compares to R$2.5 billion for the full year 2014. The higher income tax and social contribution accrual expense in 2015 was mainly due to a non-deductible expense reported in the second quarter 2015 related to the R$230 million agreement reached between Ambev and CADE; the impact of the BRL devaluation also mainly with the higher withholding tax provision due to a tax variation associated with unremitted earnings from international subsidiaries; and close to R$350 million one-time impact from intercompany loss.

Regarding the IOC specifically, so first of all, the interest on own capital benefit the ETR and takes place on accrual basis. IOC is accrued based on the highest of: one, the pro rata of the best estimate for the full year to be paid out, which today is capped by our profit generation at (51:24); and two, the year-to-date interest on own capital already paid out. The cash benefit will depend on how taxable profit of Ambev will evolve and the timing of our cash tax payments. We always maximize it on a cash perspective, not based on the full year ETR, since it is the most efficient way to return cash to our shareholders.

So I think that – sorry to make a little bit of a longer explanation, Antonio, but I think that covers all your questions.

Q - Antonio González

That's very useful, Rittes. Thank you so much.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Thanks.

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

Thanks, Antonio.

Operator

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

Q - Lauren Torres {BIO 7323680 <GO>}

Yeah. Hi, everyone. First actually just a clarification on some of the cost guidance that you gave, I guess, I'm just trying to get a better sense of your visibility on the full-year guidance. Thinking about your hedges, maybe some of your key commodities, if there's any component of this guidance that could cause some upward pressure to this low- to mid-teens guidance? I'm just trying to get a sense of what you know now versus what will change over the course of the year that could make this a difficult or a more difficult hurdle to clear.

And then if I could ask just a second question on expansion and uses of cash. Listening to ABI this morning and talking about SAB and more diversification and expansion, just trying to get your perspective as far as where you see your opportunity is. I know it's probably premature to talk about ABI ventures and your potential role. But how do you think about investment outside of current market? Is it more about doing more of the same or there's more that we can talk about as far as inorganic expansion? Thank you.

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

Hello, and thank you very much for your question. First of all, I'm going to go with the guidance. And I think the guidance, we stand by our guidance, and so the guidance is the guidance. We're very carefully thought of and it is the guidance for the year.

If you move now to the uses of cash, I'm going to again highlight the fact that we had R$23.6 billion cash flow generation in 2015, of which we used R$5.3 billion in CapEx; R$1.2 billion in acquisitions, which in 2015 were mainly in Canada and the Bahamas; we paid R$700 million of debt; and returned to shareholders more than R$12 billion.

As you already – I'm sure in the call of ABI, you heard Brito (54:17) saying the SAB is an in-depth transaction, but that didn't prevent us in 2015 or in the past to look for opportunities for expansion in some specific markets. So again, in order to create sustainable shareholder value, we will always be maximizing cash flow generation and after that the allocation in the best returning yield asset.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

And one final comment here, Lauren. The cost part of the business is something that you control 100%. So it is part of our DNA to be a lean organization, to be an efficient one, and it will be here, no doubt about that. So our guidance, it's a very clear one and we are committed to get there for sure.

Q - Lauren Torres {BIO 7323680 <GO>}

So is it fair to say, off this cost guidance we would hope and should be another year of relatively flat EBITDA margin?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Lauren, we don't provide guidance for EBITDA, but I think we have the elements for you to use your assumptions and get to where you want. That's right. And by the way, if you want afterwards we can follow-up on that on a specific call. Thank you.

Q - Lauren Torres {BIO 7323680 <GO>}

Okay. Thank you. Yeah. Thanks.

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

Thanks, Lauren.

Operator

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

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

Hi. Good morning. I wanted to shift to the CSD in Brazil. And the CSD pricing which has been throughout the year below inflation and then definitely has lagged the Beer side with – as you have said, kind of, there's been more of an impact from the macro on the demand. So I just wanted to see how much of an opportunity do you see in going forward to move the pricing higher in 2016 to be closer to inflation?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

I think that for the year, for CSD, I mean the policy generally is the same. I mean, we are trying to get always price in line with inflation plus taxes. This is our main goal in terms of pricing policy, for Beer we're able to get there, for CSD was a little bit tough. But again, for 2016, we continue to try that as we have been doing in terms of guidance, in terms of policy, pricing policy in the last 20 years, 25 years. Price should be in line with inflation and should offset tax.

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

Okay. Thanks. And then just another question on the Beer side, I mean, you talked about the consumer behavior shifting. We've seen kind of over the years this shift toward in home or off-premise consumption. But did you see an acceleration in that trend last year? And then just, I mean, do you think the – just kind of bigger picture, what you're doing in returnable is enough to protect profitability or is there a concern about kind of what impact this has on margins longer term?

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

We see the out of home occasion a very profitable one, and I think that we have great programs and brands and the initiatives like the events (58:07). And so, we want to create entertainment in bars to continue to boost that and make sure that this occasion, very specifically in the bars, will continue to be a big and profitable one.

Leading to the off trade, I mean, there are many, many kinds of off traders. The big off trade, I mean the biggest ones and the smaller ones. So the big ones, I mean, we are able to continue to serve well as we've been doing in the past. But I think the trend to smaller stores, I mean, fits in our go-to-market, because you go pop by pop and so on. And so, actually I see an opportunity to get the returnable to grow the in home. And I'm not a little bit somewhat concerned about the mix of channels. I think that if the off trade can grow in a profitable way with the returnable helping us in terms of profitability, I think that's good. It's good for the industry. It's good for the business. That's what we see. We don't see one channel, one occasion and expense of the other occasion.

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

Okay. Thank you. And just one last question, on the top-line guidance that you gave, mid-to-high, just sanity checking it, I mean, it basically seems in line with what you did in Brazil last year, even though you had the growth of comparison days and you have higher inflation. Is there an underlying kind of reason for it, just the fact that the macro has deteriorated versus where it was last year or kind of any other sense for that top-line guidance would be helpful?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Hi, Jeronimo. This is Ricardo. Let me tackle this one. So we are facing a very challenging macroeconomic environment and our industry tends to be more resilient to others. But whenever there is a negative real disposable income growth, we have an impact in our business mainly on volumes. And the last and most important message that our top-line guidance already takes this adverse now into account. So in summary, I think that's it.

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

Okay. Thank you.

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

Thanks, Jeronimo.

Operator

Our next question comes from Alex Robarts of Citi. Please go ahead.

Q - Alex Robarts {BIO 3636824 <GO>}

Yeah. I guess, in keeping in line here with the one question policy, I'll go to perhaps a trickier line of questioning which is government risk. And it's clearly a hot topic, and I think as it relates to your industry and your company perhaps you can kind of comment on two sources of this. I mean specifically when you track the literature and a discussion around IOC, certain folks are more vocal about changing than others aren't in the government. What can you share with us about the risk of

IOC being modified this year high or low? And we appreciate that the commentary perhaps can be sensitive. But any ideas around your thoughts as to the sustainability of IOC in Brazil?

And kind of the second piece of government risk is really also related to taxes at the state level. So we've seen, I mean, ICMS at São Paulo state kind of get back into - or we've kind of lagging in terms of the rates of the other states. What sense or how could you comment on your view of other states moving or trying to increase their state beer tax rates as we saw in São Paulo? And I appreciate these are politically charged questions, but any comments around these two sources of potential government tax and risk to the business? Thanks very much.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Hi, Alex. Thank you. Thanks for your question. So I'm going to answer your question in like two parts. So the first one is the IOC, we cannot speculate on whether or not there will be a change or not in IOC Brazil, but we acknowledge that it is an important element in terms of how we allocate our free cash flow and manage our capital structure. So therefore what we can say is that if IOC changes in any shape or form, it could modify our target capital structure, and as a result, we would work on mitigating the potential impact of such a change in order to maximize return to shareholders.

And now the second part of the question is the risk of state taxes increase. So in Brazil each state has its own model, own tax rate, and there is always discussion ongoing. And similar to the discussion of how the Federal government (01:03:37) in recent years, the cold beverage industry holds a permanent and constructive dialogue with each state government with the intent of showing that a lower tax burden enables a greater potential for volume growth and further investments. And as a result allows tax collection to continue to grow with no pressure on inflation, job creation or investment. And then on the other hand, in case of any tax increase, as Bernardo just said, we have a positive (1:04:25) inflation and pass the tax increase also to our consumers.

Q - Alex Robarts {BIO 3636824 <GO>}

Okay. If I could - sorry, just to understand the first answer, if the IOC is modified, as you said you would kind of look at the capital structure options. Is it fair to think or assume that one option can be to change Ambev's capital structure to lever up? I mean is that a possible scenario among the scenarios that could be considered, if the IOC were eliminated or modified?

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

All right. We start by saying we cannot expect later on whether there will be a change or not. And so I think we shouldn't speculate. But then the point is we are - our day to day is to maximize shareholder value. So if there's a change, we have to put that in our model and fight for alternatives. And so that's what we're going to do. Thank you.

Q - Alex Robarts {BIO 3636824 <GO>}

Okay.

Operator

And our next question comes from Gabriel Lima of Bradesco. Please go ahead.

Q - Gabriel Vaz de Lima {BIO 16224058 <GO>}

Hi. Thanks for taking my question. So Bernardo, Ricardo, just two quick questions here. One is coming back to the premium beer, I appreciate the comments you made. So you've guided to the 10% which was your target in your volumes. So it seems that you've reached it earlier than expected, but do you have any target, a new target for the coming years as a percentage of your volumes? That will be very interesting to hear because that's important driver in your margin expansion.

And the second question will be with regards to market share, which declined a little bit year-on-year, if I'm making the correct calculations, this year it was 50 basis points down; and it was a little bit surprising because we have been hearing here in Brazil that competition has been very weak. One of your competitors posted almost 20% volume decline this year, so just wanted to understand if you have any comments here will be really interesting. If you implemented price increases earlier than last year or prices higher than competition, so any comments in that front will be really interesting. Thank you.

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

Thanks, Gabriel. I think that first question linked to the premium have been, discussing with all of you the trends that you see globally and here as well, so premium will grow and it will accelerate premium. We don't have a specific target, but I can assure you that's a big, big focus in our size, our site to have the right brands, the execution to assure that you continue to grow and grow and grow fast. So big bet for us, and we continue to really boost in accelerating.

Linked to the market share, I think that's a good question. I think let's talk a little bit about what I have been talking to you guys in terms of the platforms of growth. All we said to you that those things, I mean elevate the core, accelerate premium near beer are based on consumer needs and occasions and new occasions, understanding exactly where are the volume, the opportunities of volume, that we have not even seen.

And then this drives in all of them in terms of the core, in terms of the premium, in terms of the near beer to – innovation into new occasions. So innovations such as Senses, one important one, new occasion such as the key selling (01:08:11) branding moments like Carnival, like São João and so on. So (01:08:17) understanding in terms of the mix management, the mix of regions as well, in terms of the small series (01:08:24) doing pretty well. So in terms of industry and some of them, we are not growing a lot.

So those things we are tackling and they tackled a lot last year, big time. The fact is the instrument that measures share they are not perfect. So news (01:08:46) is a very good instrument to show some regions, some segments and so on. But unfortunately, they don't capture those innovations, those new occasions, those small cities that are key in the big core of the strategy that we are implementing. So because they don't reach on 100%, we can have a difference between maybe the (01:09:14) share and growing internal volumes. In the end, the final number that I pushed the team here to look, our industry wise SICAV (01:09:25) went down 1.8% and our internal volume went down 1.8%.

Maybe some inventories variances, more often here and there, but it seems to be that part of this one is not (01:09:41) because there are new occasions, innovations that they are not able to capture that.

So again, I think the final number that I'd like to really, I mean make sure that people understand, driving a better mix, the pricing agenda, a strong price agenda, I mean that's the pricing line of inflation we expected and so on. We'll be able to have our volumes in line with the industry. So that's the kind of what I can comment on that.

Q - Gabriel Vaz de Lima {BIO 16224058 <GO>}

Okay, okay. Bernardo, thanks. And just a final question on the – again on the effective tax rate. Just to wrap up, as far as I understand most of the increase in your tax rate was one-off and related to some volatility on the exchange rates and so on, but it seems that for me, there is – just really to confirm there is one structural change here that is on the higher taxation in Brazil because of this foreign profit, so that will be structural changes that might increase your effective tax rate going forward. So just wanted to understand and confirm if that's the correct way to view your tax rate going forward.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Okay. So, Gabriel, thanks for the question. This is Ricardo. We can follow-up with you in any detail that you want, but I'm going to just highlight again that the high income tax and social contribution accrual for 2015 was due to the non deductible expense in the second quarter. The impact of the BRL devaluation mainly with the higher withholding tax provision associated with unremitted earnings and the R$350 million one-time impact for intercompany. And we can follow-up and call Marino to reconcile that for you. Thank you.

Q - Gabriel Vaz de Lima {BIO 16224058 <GO>}

Okay, Ricardo, thank you. Thank you, Bernardo.

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

Thank you, Gabriel.

Operator

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

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

Hi. Good afternoon, guys. I really do just have one question. On the third bullet point of your guidance, and I appreciate that you do give a lot of thought to this, but the Brazil cash SG&A growing low single digits, especially if it's one to two rather than three or four, does seem a little low in light of double-digit inflation in Brazil, the Olympics this year, et cetera. So I'd like to understand if you can share what is your inflation assumption in this model? And perhaps how much money roughly in tens or hundreds of millions or whatever is there going to be in marketing spend behind the Olympics? I guess one-third element that could play into this guidance is whether it assumes bonus accruals or payments in each year of much differing amounts.

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

Jose, thanks for the question. I think first of all we always support our brands and the trade in the proper way. And we always we do that. We're here for the long term. So no concerns at that point in the Olympics, it's very important for us, and we'll take the opportunity to make it even bigger, not only in Rio de Janeiro, but take advantage of being one of the sponsors to use this (01:13:26) to help even more the brand that's doing, by the way, pretty well.

So in terms of the support of (01:13:33) this is the answer for you. In terms of the cost, I mean, it's the inflation. It's X or Y. I think that in a crisis like that, our values, our culture, our (01:13:47) is here, makes all the difference. So we think definitely of that you can be more creative, we can be more innovative to work with better efficiencies, to put the technology to help us, to have this ownership mindset, to really work in a lean way and offset that.

So this guidance, it's a challenging one, but it's a one that we'll get it, so – for sure. It's – that's – in a moment like that, my part is here, make the difference and make sure that things that we control will get there. So that's my comment in terms of the costs of the SG&A.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Okay. And – sorry. Go ahead.

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

No. That usually, I mean given that you have back-to-back recessions here, achieving better efficiencies, since I know you do this every year, clean slate type of budgeting, it just gets more and more difficult to do, especially in an environment of high- single-digit inflation, but if you can't share that assumption or whatever, that's – I understand.

A - Ricardo Rittes de Oliveira Silva {BIO 15184017 <GO>}

Yordan, again, thanks for the question. Just as we, while inflation is up, overall decline in demand also creates opportunities and helps us to get better deals. And so, like we said in the last year, we managed to do that. We are very confident that this year it's not going to be any different and we will manage to get the non-working money out of the system to compensate parts of that inflation and a large part of that. So that's as far as we can go.

And on top of that, we see that we still have some other questions in the queue, in the line, and we already are more than ten minutes delayed already. So we're not going to be able to answer those questions but we will reach out to everybody who is in the line to try to solve any doubts or questions that they have.

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

Okay. Thanks a lot.

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

Thanks, Jose. Thanks for the question.

Operator

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

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

Thanks. Now I think we have a final message is just due to Jose, and I think that in a moment like that of crisis that we know, that we acknowledge that it's out there mainly in Brazil.

I mean talking about Brazil specifically, it's our culture, our values of our team as our ownership mindset that can make all the difference. So we will not be able not only to work in the cost side, but be more creative to drive top line with that. So even with some being more lean, more cost focused, with the creative team that we have here, with this ownership mindset, I'm pretty confident, 100% confident that we will deliver our guidance, and more than that, we'll build the future.

I think that every time that we have crisis here in Ambev, we are able to build and to make boost some options and bets that you have. That I think at the end of that specific moment Ambev were even more stronger. So we are here for the long term, big, big time. We know that the short term is very important and we work hard on that and we have a strong plan and I'm confident of this. But we'll build things that will help us to be even more stronger in the long term, starting working much, much better, and I mean opening gaps and closing gaps I think to our brands and execution in the marketplace. So count on us to continue to deliver in 2016 and the years to come.

Operator

And ladies and gentlemen, this concludes our presentation.

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

Thank you.

FINAL

Bloomberg Transcript

Operator

Thank you for attending today's presentation. You may now disconnect.