Investor Relations

Monterrey
Ulises Fernández de Lara
ulises.fernandezdelara@arcacontal.com
Tel: 52 (81) 8151-1525

Felipe R. Barquín Goris
felipe.barquin@arcacontal.com
Tel: 52 (81) 8151-1674

New York
Melanie Carpenter
i-advize Corporate Communications
Tel: (212) 406-3692
arcacontal@i-advize.com

Public Affairs and Communications

Guillermo Garza
guillermo.garza@arcacontal.com
Tel: 52 (81) 8151-1441

Arca Continental 2Q20 Earnings Conference Call Transcript
July 24, 2020 @10:00 AM CT

Operator: Good day, everyone, and welcome to the Arca Continental conference. All lines have been placed on mute to prevent any background noise. Please note that this call is being recorded. After the speakers' remarks, there will be a question and answer session, and instructions will be given at that time. For opening remarks and introductions, I would now like to turn the conference over to Melanie Carpenter of I-Advize Corporate Communications. Ma'am, please go ahead.

Melanie Carpenter: Thank you, Katie. Good morning, everyone, we hope you're all well. Thanks for joining the senior management team of Arca Continental this morning to review the results of the second quarter of 2020. The earnings release went out this morning and it's available on the Company website at arcacontal.com in the Investor Relations section.

It's now my pleasure to introduce our speakers. Joining us from Monterrey is the CEO, Mr. Arturo Gutiérrez, the CFO, Mr. Emilio Marcos and the Chief Commercial and Digital Officer, Mr. José "Pepe" Borda, as well as the Investor Relations team. They're going to be making some forward-looking statements, and we just ask that per usual, you refer to the disclaimer and the conditions surrounding those statements. We imagine that several of you are working from home as are some of our operators, so we just ask for your patience and hopefully we can get through this call as well as can be. And with that, I'm going to turn the call over to the CEO, Mr. Arturo Gutiérrez, to begin the presentation. So please go ahead, Arturo.

Arturo Gutiérrez: Thanks Melanie and good morning everyone. I want to thank all of you for joining us today to go over our second quarter and first half performance, as well as some recent developments related to the Coronavirus pandemic.

First of all, we fully acknowledge the COVID-19 outbreak and its impact on people's lives, our communities and the global economy. And as a food and beverage business, we recognize the important role we play in this crisis.

Of course, the safety of our associates, customers and consumers, remains our highest priority. We have established all precautionary and hygiene measures, deployed strict social distancing, sanitation protocols, working from home initiatives, as well as additional safety measures to support associates in the field or at production plants and distribution centers.

In the second quarter, the COVID-19 pandemic created challenges that were certainly unlike anything we've ever seen. Late March and April were particularly difficult, as confirmed cases began to add up, global economic growth was contracting, restrictions scaling up, closures were accumulating, and the resulting impact on consumer mobility had a significant effect on our performance.

Despite this, we saw an improvement in our results in May and June, as population mobility increased after economies gradually began to reopen. Throughout the quarter, we maintained our focus on serving our customers and consumers.

Moving now to our consolidated results, I'm pleased to report that our business performed relatively well through this unprecedented level of change.

Our second quarter and year-to-date results reflect the steady progress that we are making. Our market focus and operating flexibility allowed us to thrive in a complex environment, while maintaining profitability and market share.

Total consolidated volume declined 9.2% in the quarter, reaching 527 million-unit cases. Volume performance sequentially improved throughout the quarter.

Consolidated net revenues rose 2.3% in the quarter and 3.7% year-to-date to $42.9 billion and $81.8 billion pesos, respectively. Effective pricing and better management of promotions were key to improve the top line.

We fine-tuned our price/pack strategy by country. The sparkling category showed great resilience and continues to play an important role in our category mix. Premium brands continue to be relevant for consumers.

Returnable packages are again a proven vehicle to deliver affordability to consumers, particularly multi-serve returnable packages.

Consolidated EBITDA for the quarter grew 1.8% to $8.2 billion pesos, representing a margin of 19.2%. We are moving steadily with our disciplined plan to control our operating expenses and capital investments, and to manage our working capital effectively.

There is no doubt that COVID has impacted our business in many ways, but a closer look at the recent trends gives us a much clearer picture of where we need to continue to focus our efforts to come out stronger after this crisis.

Now, turning to our operations review for the quarter, let me start with Mexico, where mobility restrictions were not as strict as in other countries.

Total volume in the second quarter declined 4%. The COVID-19 pandemic had a negative effect on volume in most of our trade channels, particularly on-premise, entertainment and education, due to stores and venue closing for several weeks across our territories.

Although the pandemic resulted in general volume contractions across our product portfolio, some segments achieved favorable results. Colas, being our biggest segment, grew 0.8% in the quarter.

The traditional trade performed very well with a 6.6% volume growth in the second quarter, driven by solid growth in Colas, Santa Clara dairy and Topo Chico sparkling water, up 11.2%, 7% and 31.2%, respectively.

Total sales in Mexico declined 0.6% in the quarter, reaching $17.9 billion. Average price per case in Mexico, not including jug water, rose 3.9%, to $63.50 pesos, sustained by our segmented revenue management initiatives.

In the first six months of 2020, we gained value share across non-alcoholic, ready-to-drink beverages, outpacing the industry in Mexico, driven by water category and sport drinks.

Our wide portfolio of products played a key role in addressing the changing dynamics in the consumer landscape during this critical period of the pandemic.

EBITDA increased 8.9% to $4.9 billion pesos in the second quarter, representing a margin of 27.3%, for an expansion of 240 basis points. EBITDA margin for the year rose by 150 basis points, resulting from our effective pricing, combined with our disciplined focus on cost optimization, and a more benign commodity market.

We launched the program "Mi Tienda Segura" or "My Safe Store" to support customers in the traditional trade channel by providing sanitizing kits and other protection elements to ensure store owners and consumers safety.

These activities reached over 200 thousand customers and helped to reopen many closed stores.

Moving now to our beverage business in South America, total volume dropped 28% in the second quarter and 16% in the first half of the year, as early lockdowns battered economies by historic proportions.

This is by far the region that was hit the hardest, mostly affected by tighter mobility restrictions, lockdown measures and social-distancing mandates.

Nevertheless, volume trends in our three countries have been steadily improving, as more points of sale are starting to reopen. And this trend is getting better week by week.

Total revenues were down 20.8% in the quarter, reaching $6.9 billion pesos, while EBITDA declined 48.5% to $825 million pesos, representing a margin of 12%, for a contraction of 650 basis points.

The pandemic is set to push the region this year into its worst economic contraction in over a century.

Let's turn to our beverage business in Peru, where total volume in the quarter was down 34.8%, and 20.7% in the first half of the year.

The downward trend in daily positive cases and the stabilization of active cases allowed the government to end the national quarantine on July 1st and gradually reopen the economy.

During the quarter, we executed targeted commercial initiatives focused on protecting portfolio affordability. We accelerated the introduction of multi-serve returnable packages supported by our new “Universal Bottle” packaging, with a wide variety of returnable products.

The traditional trade proved its resilience during this time of crisis. With close to a 16% volume drop in the quarter, it had a sequential improvement and in June it delivered 3% growth, reverting the negative trend of recent months. We also deployed new direct-to-home routes, adding over 7,000 customers to this new service model.

During the quarter, we doubled down on the deployment of our AC Digital platform, providing customers with the ability to place direct orders using a mobile app; currently over 20 thousand customers utilize this new capability.

In Ecuador, volume in the second quarter and the first half of 2020 declined by 28.2% and 15.7%, respectively.

The COVID-19 outbreak quickly escalated to one of the worst in Latin America.

A nationwide quarantine was announced on mid-March and mobility has been gradually eased since early May.

We adapted our service models to better service customers and consumers. We optimized our dynamic routing methodology to deploy new models such as: Home Route, Telesales and e-commerce.

Same as in Mexico, we continued strengthening our long-standing relationship with our customers in Ecuador and launched “My Safe Store” program.

We also reconfigured our portfolio and focused on core SKUs, optimizing the operation of our value chain to guarantee availability of our most important products and place special focus on providing affordability to our consumers.

Notably, our sparkling portfolio is already in a recovery trend, highlighting that Cola-Cola and Inca-Kola delivered positive results in the month of June, up 3.3% and 11%, respectively.

Tonicorp, our value-added dairy business in Ecuador, posted a double-digit sales decline in the quarter. Despite the slowdown in the economy, Tonicorp sustained value share across core dairy categories.

On a side note, we were honored to host President Lenin Moreno and other senior members of his cabinet to visit our plant last June. Our associates were praised for their outstanding work to secure supply of our products during this pandemic.

Shifting gears to our beverage business in Argentina, volume declined 10.3% and 3.4% in the second quarter and first six months of this year, respectively.

After the success of strict social isolation measures, the recent acceleration in COVID cases prompted authorities to announce a rollback of the limited flexibility put in place weeks ago. Mobility was restricted again, while all non-essential stores were forced to close.

Nevertheless, we continue to focus on those things we can control. We maintained rate pricing in line with inflation while actively promoting affordability with returnable bottle initiatives. Our mix of returnable presentations grew by a high-single digit in the quarter.

The recent launch of Aquarius flavored water in a 2-Liter returnable presentation is a great example of innovation and agility to provide affordable products during in a major contingency.

We adapted our Route to Market capabilities to address mobility restrictions by expanding our Telesales channel. We are balancing these customer contacts with our regular presale activity.

Also, at the end of April we accelerated the roll-out of the AC Digital corporate platform in order to expand our B2B capabilities for the traditional trade channel.

Turning now to our beverage operation in the United States, Coca-Cola Southwest Beverages closed out the second quarter with a solid performance.

Total revenues in the quarter declined 1.7%, while we sustained value share in NARTD.

Price per case for the quarter grew 2.7%. Price/Mix performed better due to the recovery of consumer trends and supported by our price-pack architecture, which aimed at pushing higher revenue packages such as Mini Cans in Large Stores, sparkling beverages in immediate consumption presentations, and Bodyarmor.

EBITDA grew 3.2% to $106.2 million dollars, representing a margin of 14.6%, a solid expansion of 60 basis points.

This result was achieved despite a volume contraction of 4.2% during the quarter, which was largely driven by store closures and restrictions in the market due to COVID-19.

In April, we saw the full impact of the crisis in our volume with a 14.4% decline for the month. Since then, volume has sequentially recovered, closing June on a positive note, up 4.5%, even with many FSOP customers still closed.

E-commerce has gained more relevance as we continue to adapt service models for our online business around myCoke.com and e-retailer customers.

Just in the second quarter, 38% of FSOP customers utilized myCoke.com as their primary order method, improving our profitability.

Our e-retailer business has more than doubled year to date. This channel consists of major customers, such as Amazon, Walmart.com, Boxed, goPuff and Sam's.com, among others.

Synergy plans in our US operation continued to deliver solid results. Despite the challenges presented by COVID-19, we were able to start full production and introduce the most advanced technologies at our new Northpoint facility in Houston. As the plant continues to ramp up, we are laying the foundation to deliver savings from consolidation of production and warehousing in the region.

This health crisis demonstrated that we can effectively adapt to change, deploying a new operational model to fit current market necessities.

Let me now close our operations review with our Food and Snacks business.

Wise Snacks posted a high-single digit sales decline in the second quarter. Deep River and small bag chip sales were impacted by shelter-in-place restrictions, particularly affecting Food Service/On-Premise customers.

Grocery channel was able to partially offset this decline with solid growth, mainly driven by potato chips, popcorn and pork rinds categories.

The e-Commerce channel performance remains strong, reaching its highest point in history. We continued developing more Click and Collect opportunities to capture a larger share of the digital shelf at key grocery chains.

Bokados in Mexico posted sequential low single-digit sales growth and solid profitability, driven by the traditional trade channel, despite the impact of store closures.

Inalecsa in Ecuador posted a mid-single-digit sales decline in the second quarter.

Something worth highlighting this quarter is Inalecsa's distribution expansion. Its recognized plantain chips brand, "Tortolines", is now available through Amazon.com.

And before I turn it over to Emilio, I want to acknowledge the hard work and dedication of all our associates. They have worked tirelessly through this difficult time and I am very proud of their efforts and commitment to serve our customers and consumers.

With that, I will turn the call to Emilio. Please Emilio.

Emilio Marcos: Thank you Arturo, good morning everyone and thank you for joining us.

As Arturo mentioned, the second quarter was very challenging, with April being the most impacted month. We saw different levels of impact across our operations due to mobility restrictions put in place in each country during the quarter. We had a sequential improvement in volume and profitability in following months driven by customers gradual reopening combined with operating efficiencies.

Since the beginning of the crisis in March, we deployed a detailed action plan and executed a crisis management strategy, which demonstrated our flexibility to adapt to adverse situations. As we mentioned last quarter, we focused our efforts in operating expenses like marketing and labor, where we already saw positive results across the quarter.

Consolidated Revenues in the second quarter grew 2.3%, mainly driven by an exchange rate benefit from our dollar operations, partially offset by volume declines in all operations. The tailwinds we experienced from lower raw material prices, mostly in PET and aluminum, outpaced the changes in mix, channels, categories, and presentations; therefore, contribution margin expanded by 40 basis points when compared to last year.

Our current Foreign Exchange hedges cover 80% of our 2020 needs at an average exchange rate similar to last year. Our aluminum hedging strategy is set up in a way to protect our business and at the same time take advantage of market conditions. In 2020, we hedged 75% of LME and 50% of MWP at lower prices than last year. We will continue to capitalize on the lower spot prices for our current and future needs.

In terms of expenses related to COVID-19, these reached $327 million pesos in the second quarter, which is higher than the previous quarter as we began to register these expenses in mid-March.

EBITDA for the second quarter increased 1.8% to $8.2 billion pesos, representing an EBITDA margin of 19.2% for a 10-basis points dilution compared to last year. The top-line pressure was compensated by better raw material prices and operational efficiencies. Excluding the operating expenses related to COVID-19, EBITDA margin for the quarter would have expanded. Year-to date EBITDA rose 3.5% reaching Ps. 14.9 billion pesos.

Synergy plan in our US operation continued to deliver solid results. We are on getting closer to achieve $90 million dollars in synergies over the 3-year period.

For the first half of the year, Net Income reached $2.3 billion pesos, a 17.1% decline, representing a margin of 5.4%. This was largely due to the lower operating income, along with an exchange rate loss resulting from our dollar cash position and the appreciation of the Mexican peso in the quarter.

CAPEX for the second quarter was $2.7 billion pesos, around 40% less than last year, as we have been reassessing all Capex investments to focus on how to best serve our customers during the pandemic while at the same time protect our liquidity. We expect CAPEX for the year to be less than 6% of sales.

As of June 2020, we had a cash position of Ps. 30.6 billion and debt of Ps. 59.5 billion pesos resulting in a net debt to EBITDA coverage ratio of 0.9x times. This demonstrates our capacity to preserve liquidity and maintain a healthy balance sheet.

In the second quarter, we paid off a maturing AC Lindley bond in the amount of US$ 62.5 million dollars, lowering our non-local currency debt exposure to US 47 million dollars in Peru.

During this crisis we will continue to look for and capitalize on opportunities to be a better company. While some of our operations have not yet stabilized, we remain positive in our ability to respond to challenging environments and rebuild our revenue streams.

Although we are still facing uncertainties and difficult situations, we are confident of the resilience of our industry. We have faced uncertainty in the past, and we have the right plans and people in place to come out stronger.

And with that, I will turn it back to Arturo

Arturo Gutierrez: Thank you, Emilio.

Many of you have followed Arca Continental for a long time, and you know our business has endured several crises.

It is part of our DNA to always be market oriented and to remain competitive, so with each crisis we learn new ways to stay lean, stay nimble, and to have the creativity to develop more competitive advantages.

Of course, the crisis that we are living today is of an unprecedented magnitude, but our approach has always been successful, keeping a long-term vision and focusing on preserving and strengthening our relationships with our customers, consumers and the community.

We believe that the negative impact of the COVID-19 pandemic on our business has already passed through the toughest point. Now, as we look ahead to the second half of the year, we expect our business to perform better.

Our company is built on a foundation of strength. We will continue to collaborate and leverage learnings across our entire organization to build on these strengths.

To conclude, let me say that Arca Continental is well-positioned to adapt and succeed over the long-term. We are confident in the resilience of the food and beverage industry and of our portfolio of brands and will continue to seek opportunities for regional expansion.

Thank you for your continued trust and support. Operator, we are ready to open the floor for questions.

Operator: Thank you. At this time, we will open the floor for questions. If you would like to ask a question, please press the star key, followed by the one key, on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue, please press star two. As a reminder, due to high interest and time, please limit yourself to one question. We will pause for just a moment to allow everyone the opportunity to signal for questions. Thank you. Our first question will come from Ben Theurer with Barclays.

Ben Theurer: Hey, good morning, Arturo and Emilio. First of all, congratulations on the good results in the quarter. I hope you're all safe and sound. I wanted to ask about returnable, your strategy there. I mean, clearly we've seen the benefits of returnable in the regions where you operated, with a shift from nonreturnable into returnable, which obviously helped you a lot in some of the base of cola volume. Now, looking into the US, it seems like there's almost none in returnable. Thinking more ahead, like in the context of ESG and affordability in combined ways, what's going to be your strategy on the returnable side to make this a consistent driver of volume growth, and also maybe the opportunity to elaborate within the returnable versus nonreturnable portfolio in the US?

Arturo Gutiérrez: Thank you, Ben, and good to talk to you. I hope you're well also. Yes, returnable, as you know, has been an important part of our strategy in Latin America for a long time. And it's based not only on affordability, because it allows us to have a more flexible portfolio and provide different options for consumers, and that has proven very effective, especially in times like these. And you see how it's worked in most of the countries. And it's not having the packages. It's about having the whole operation and the culture within our operation to work with returnables. There's many factors and variables and metrics that you need to track. It's not only launching packages. You need to have infrastructure, the supply chain and Route to Market adapted to that. Also, you need, obviously, to work with the consumer to create the habit of returnable. And if you see what we've done, in some countries, this has been a habit that has been solid in the market for years, as in Mexico and now Argentina. We're trying to create more of that in Ecuador, so that's been the strategy in Latin America. It also has that other dimension, which would be probably the sustainability aspect of those packages. And we've seen some of that, as you know, in Europe and other markets. And it could be a possibility in the future. We do not have current plans to do that in the US right now, but surely something to analyze as we move forward. One very interesting initiative that we have in Latin America that would connect with that idea is the Universal Bottle that provides flexibility, and makes it easier to manage the different brands and the complexity of the portfolio, using a single bottle. We even use that for still beverages in Argentina, as you know, so once we learn more about how that works and what kind of investment it requires, probably that would be an important learning as we move into other markets.

Ben Theurer: Perfect. And then just from leverage, I mean, you're well below what I think your target is. I mean, what are you going to do with all the capital once the crisis is over, and you don't need the liquidity anymore?

Arturo Gutiérrez: Yeah, we're focusing currently on the crisis, our capital allocation priorities are clear. You know, CAPEX is still a priority. We already need to analyze what are the requirements going forward. And certainly we're going to consider dividends or additional dividends in the future. Maybe, Emilio, you can comment more on that.

Emilio Marcos: Sure, Arturo. Thank you. Well, as Arturo mentioned, our capital allocation first - the first priorities are always CAPEX. That remains our top priority. However, we're still focusing on spending only the optimal. As we have mentioned, we implemented a strategy to reassess all CAPEX investment in the year. As you could see, our CAPEX for the first half of the year is much lower than the previous year. So again, we are assessing all CAPEX in each country, depending on the situation that COVID-19 is letting us. And again, as Arturo mentioned, the second priority would be dividends we pay. Dividends a couple of months ago, as you know, we have a payout ratio of at least 30 percent of our net income. We have paid around 40 - a little bit more than 40 percent in the past. And again, the Board could analyze the option for additional dividends if we see an improvement on this, and if we don't find any M&A opportunities. As you know, we are always looking for opportunities, evaluating any opportunities that could arise from this crisis. So again, we have CAPEX, dividends and M&A evaluation. However, we're focusing primarily on our day-to-day operations and protecting liquidity. We have some maturities the second half of the year, around US$200 million. And we have that covered. So we don't see any issues on that.

Arturo Gutiérrez: The other thing we should mention, Ben, is as you know, the shareholders of the Company delegated to the Board the approval of additional dividends, if that would be the case for the remainder of the year.

Ben Theurer: Okay. Perfect.

Arturo Gutiérrez: Thank you, Ben.

Ben Theurer: Thank you. And congrats.

Operator: Thank you. Our next question will come from Isabella Simonato with Bank of America.

Isabella Simonato: Yes, thank you very much. Good morning, everyone. I would like to explore a little bit more the expenses related to COVID, right? I understand that you've classified some of that as nonrecurring and some of that as recurring. If you could elaborate a little bit. What is in each pocket? What is being classified as recurring? And is each one of those more allocated? And also, when you think about what Coke mentioned about July volumes, right? Can you give us a little bit more color how you're seeing sequential volume improvements across the different countries? Thank you.

Emilio Marcos: Thank you, Isabella. I'll take the first one, Arturo, if you would like. Well, regarding COVID-19 expenses, we have registered the expenses in two different lines. And the main criteria is, if it's a one-time or very particular for COVID-19, or if there is an ongoing expense that will last for several months while the situation normalizes. So on the one hand, so June, we registered around 270 million pesos in nonrecurring, that related to some specific actions, as I mentioned, that we incurred during the quarantine period. Just to give you a couple of examples, in Peru, we normally pay for employees' transportation to get to the plants, and due to this quarantine, we needed to more than double the shuttles to assure and keep the social distance measures. So therefore, this cost of transportation has been more than double, so the additional expense is on the nonrecurring line, since it's just a temporary one. And another example is, for example, employees that have to be quarantined and has temporarily - they're staying at home - we're temporarily quarantining those employees, and we're paying those salaries. So the additional salary is nonrecurring, and the other ones are on OPEX as normal OPEX. And on the other hand, we registered around 135 million pesos in OPEX, and these are maybe sanitary expenses that we expect to have the remainder of the year. For example, consumables such as sanitizer, masks, gloves or any additional like office sanitation or some cabins that we have on our plants. So we have invested to protect the health of our employees, since we keep working as an essential industry. So looking forward, we expect to have some recurring expenses, as I mentioned, but should be declining to the extent that we get back to the new normal.

Arturo Gutiérrez: Yeah, I'll take the second part of your question, Isabella, with relation to volume. As we anticipated, our volumes in April and part of May, in most countries were the most affected, and we have begun to see a better trend in June. In every country, actually, we have sequential improvement month-over-month in the quarter. So as you know, South America is still the hardest hit of our operations, with gradual recovery. Mexico and the US are better so far. As you saw, the numbers for the quarter, but we're cautious with the surge of COVID-19 cases in those countries. So what's important here is to look at what is the factor that's affecting demand. There's a clear correlation between mobility and mandatory lockdowns and our volumes in the markets where we operate. It not only impacts consumers, it impacts mobility of our frontline salesforce, and many times, our salesforce requires public transportation. So that's what happened in Ecuador and Peru, most severely impacted again was in April and in May. So as soon as restrictions are lifted, sales react. Our categories and brands are very resilient. So we're looking at July. We don't see any big surprises, any big negative surprises there. In Mexico, similar trends in May and June. In Peru and Ecuador, which are the markets that were most impacted, we're still seeing declines, but gradual improvement, and what we've seen again in the final part of the quarter. Argentina has a tough comparison in July, but I think it's pretty much the same market situation as we saw in the final quarter of the second quarter as well. And the US is also stable, maybe a flat or slight decline in the month, something like that, but it's not different from what we're seeing in the last few weeks of the quarter. So the trend remains, and we're cautiously optimistic of the second half. It depends, again, if restrictions are again imposed or not. But so far, we're sequentially improving.

Isabella Simonato: That's very clear. Thank you.

Arturo Gutiérrez: Thank you, Isabella.

Operator: Thank you. Our next question will come from Felipe Ucros with Scotia Bank.

Felipe Ucros: Hi, Arturo and Emilio. Thanks for the space for questions, and I hope your loved ones are doing well. So the first one I wanted to focus on, and kind of a follow-up on what Isabella already asked, and it has to do with the sequential improvements. Obviously you laid out that it has to do a lot with mobility, but you know, in some countries or in some regions of the country, the COVID curve is increasing, right? And following a different path. So I wanted to ask specifically about Texas, where the curve is still increasing and at a pretty rapid pace. Do you see any risks in the third quarter that maybe we'll see a reversal in that region?

And then, I had a second question which has to do with all the digital and analytics programs that you guys have been implementing and doing so well. A lot of these measures that you have taken are reliant on algorithms that use historical data, so I wanted to ask you how those algorithms have been performing? For example, the suggested order during this period where everything that worked in a certain way historically has been kind of thrown out the window and is working differently. How did that digital aspect perform during this space? Thank you.

Arturo Gutiérrez: Thank you, Felipe. Let me talk about the US first. As you saw, we closed the quarter with a solid performance. A very good month of June, by the way. And if you look at the channels in the US, we know that the food service on-premise channel is the most affected during the quarter. It was, I guess, something like 48 percent down versus previous year. But it was better in June than May and better in May than April, so we still have a positive trend there. We don't expect that to improve much. The large stores mostly are getting that volume from the away from home market. The smaller stores, the convenience retail, is also improving. And so as I said, we expect the trend to continue to be improving in the third quarter. But we're cautious about it, because as you said, you know, there are some restrictions that could be imposed based on the surge of cases. The last few days in Texas have been better. The trend has been improving in terms of new cases. So that's good news. And obviously that would result in decisions of public policy for the state, which would affect the mobility and the reopening of customers. So what we're discounting is that on-premises is still going to be down, and maybe for the second half of the year. Some of those outlets might not even be open. But still the volume is solid from the large store and small store segments. Just to give you an idea of mix, our large stores and small stores in the US in the second quarter were 91 percent of the mix of volume. And on-premise food service was about 9 percent. So again, even if that remains slow, we're still going to be able to have good volumes as consumption shifts across the channels.

Talking about digital, I guess the key here has been to integrate those digital initiatives into our current processes. I will let Pepe talk a bit more about this, but it's not a separate list of projects that we're pursuing. It's how we enhance the processes that we already had in our commercial activities, so one of them would be, as you said, the advanced analytics tools optimizing our discounts and promotions they're one important initiative. And the one that you mentioned the suggested order quantity, that algorithm has proven very effective, not only in Mexico, we're also using it now in Peru, and the same principles apply to the US operation as well. The other important thing there is the data. One thing is to create the models, and another thing is to have the quality data and the big data from the market. And we are in a very good position there as well to incorporate data that we collect. And we're collecting more data as we also roll out other initiatives like what we used to call Brio, now it's called Yomp - that company is collecting significant data from the market, data that is the sale-out of customer that we can have. So we're incorporating that into our analytics approach, and that gets to a more refined model every time. So we're now working on the next best SKU model for convenience stores in the US as an example of how we have one basic idea, and then you continue to improve that with enhancements of the original model. But maybe Pepe could add to that. Pepe, please?

José Borda: Thank you, Arturo, and thank you, Felipe, for your questions. I think one of the key benefits of having an in-house analytics team as we have is that we have been able to adjust our models in real time, you know. In the beginning, we changed, for example, as suggested, all the algorithms to our extensive portfolio to make sure that we could direct our sales reps and our conditions to what we wanted to focus on selling. And we've been adjusting them. Obviously we took a hit in conversion rates in the first weeks, but we've been adjusting them as we go, as Arturo said, with different information. And as of now, we are getting pretty much the same type of conversion rates that we had before the pandemic. So we're adjusting. We are getting information, and we are moving in real time. We had a pretty ambitious advanced analytics agenda, but with the crisis, we have focused on mainly four things. As Arturo said, number one promotions that was and is one of our main goals, to make sure that every single promotion dollar we spend is well spent. And we've made great progress there. Suggested orders – ensure that suggested orders is really helpful for our customers and for our sales reps. Cooler and asset allocation, making sure that every asset that we take is placed in the right place and focusing on the role of direct to consumer and how to capture and prospect the best consumer household-based. So we've been adapting and I think we have very good results from our analytic efforts. I hope that helps.

Felipe Ucros: Yeah, that's very helpful. Thanks a lot for the color, guys.

Arturo Gutiérrez: Thank you, Felipe.

José Borda: Thanks, Felipe.

Operator: Thank you. Our next question will come from Marcella Recchia with Credit Suisse. Marcella, your line is open. Please make sure your phone is not on mute.

Marcella Recchia: Hi, Emilio. Hi, Arturo. Hope you are well. Just two quick questions here from my side. The first one would be about margins in Mexico and US, if you see this level of margin sustainable for the rest of the year going forward? And the second one is about US synergies. If you believe that synergies can go beyond the $90 million planned, expected in the beginning of the process. So that's it. Thank you very much.

Arturo Gutiérrez: Thank you, Marcella. Let me first talk briefly about margins in Mexico and in the US. Maybe Emilio can expand, and then I'll talk about US synergies as well. You know, the margins in both countries are the result of several factors, as you know. First is our effective pricing. And this is not only our rate, because you know, mix has impacted negatively our average price, but also, the better managing of discounts and promotions connecting to what Pepe just mentioned. I think we've been much better doing that, and we have incorporated new tools to do that. So that's one part. And that certainly is sustainable in the future. Second, we've had, as you know, tailwinds in some of our basic raw materials, particularly PET, although there's an impact in Mexico from the devaluation, so it kind of offsets that. But we have good pricing for PET resin, for aluminum, not necessarily for sweeteners, but certainly for those other basic inputs.

The other part that's been so important is that we've launched this savings program in our operation. And we've been very, very effective in our savings and efficiency plan. We have been working to manage expenses through the crisis, committing to reduce OPEX across the board without affecting our operations. So I think that is a very effective way to adapt to the current circumstances. And we have a team effort in place. We're using the same methodology that we're familiar with in the integration of businesses in other cases. So we've been doing a number of things, and many of those are learnings, I would say, that would be sustainable going forward. So we're very positive about margins, and I think we've even implemented some things that we needed to do anyway and sometimes a crisis situation forces you to do it faster. So that's the reason why we're confident about OPEX going forward. Certainly, this was a factor for Mexico going forward in terms of margins. And going forward looking if you look at the year to date numbers, probably that's something where we could aspire for the remainder of the year. Maybe, Emilio, you want to add to that.

Emilio Marcos: Well, regarding Mexico, only maybe two things. One is that, as you mentioned, mobility restrictions have not been as strict as in other countries, and also, another aspect, the traditional channel, as you know, is our most important channel, has been growing in the last two months. So that's also been an important aspect on the results and the margins that we have in Mexico, and as Arturo mentioned, we've been able to reduce OPEX on the quarter compared to last year as a result of this crisis management program and other initiatives to control expenses.

Arturo Gutiérrez: Let me talk now briefly about synergies in the US, because we're on track with our plan to get to our $90 million in synergies. This is going to be implemented throughout this year. There is some carryover for 2021 based on actions that we're taking during 2020. So we're good there in terms of most of the hard synergies. So if you look at our operational synergies, very important is our Northpoint plant in Houston that is delivering - it's actually delivered now about $13 million in synergies; some in 2019, some in 2020, and still we'll be seeing some of those going forward. Same thing for procurement, lightweighting of bottles, moving to different kind of pallets - a number of things. Those are the hard synergies that we expect to get our target. But talking about upside opportunities that we have not included in our plan. Some of the things are hard to measure and to track, especially on the revenue side of synergies, because we want to be very rigorous about how we measure in our optimization of the operation. But certainly there are some things that even more transformational, I would say, on the revenue side that should bring additional value to our operation. It's hard to see them now in the middle of the crisis, but basically they would be in two different areas. One would be a better execution at the point of sale. We've been improving that, and if you look at our Picture of Success execution and how we're improving our interaction with the customer in every channel, that's certainly something that is going bring additional value. And connected to that, our go-to-market models, the models that we've been evolving, first in the on-premise channel, which again, it's not been reflected now for obvious reasons, but those are things that are going to be delivering value in the years to come. And we're going to be incorporating new models to the large store segment as well. So if you think about those initiatives, together with the revenue management, maybe the three more transformational things that we're doing in the US, and those are not accounted for, those two, in our $90 million plan.

Marcella Recchia: Okay, very clear. Thank you very much.

Arturo Gutiérrez: Thank you, Marcella.

Operator: Thank you. Our next question comes from Emiliano Hernandez with GBM.

Emiliano Hernandez: Hi, good morning, Arturo and Emilio. Thank you for taking my question. Just a quick one here. Considering FX cost pressures may come in Mexico once your hedge has expired, how do you see bodes for raw material prices during the rest of the year, and would it be your plan to increase prices in Mexico in the near term?

Arturo Gutiérrez: Thank you, Emiliano. Maybe you can take that question, Emilio.

Emilio Marcos: Sure. Thank you for your question, Emiliano. Well, as we have mentioned, regarding raw material prices in Mexico, we have much better prices on PET in all countries. So that's a benefit that we have in our operations. Then, sugar, as Arturo also mentioned, sugar is the only one that we have our own sugar mill. Sugar prices are higher than last year. So that's the only raw material that have a higher price than last year. On high fructose, high fructose prices in dollars, are better than last year. And we also consume aluminum - aluminum prices are lower than last year. So overall, we have a better cost structure on raw materials in Mexico, basically in all operations.

Regarding FX, in Mexico, we have 80 percent of our US dollar needs covered at exchange rates on levels of last year. So we have that benefit on our costs on our raw materials. And in fact, we started hedging some needs for next year, and I think it was a month and a half ago when we saw a window below 22 pesos, so we started covering for next year. So overall in Mexico, we still have or see the same benefits for the second half of the year as the one that we have in the first half. And regarding prices. I don't know, Arturo if you… Well, our strategy has always been, as we have mentioned, also, to increase prices above inflation. So we're on track on that. And that's basically in all countries. I don't know if you want to add something else, Arturo, regarding pricing.

Arturo Gutiérrez: Yeah, well, basically, that's our goal this year. No exception.

Emiliano Hernandez: Thank you very much.

Arturo Gutiérrez: Thank you, Emiliano.

Operator: Thank you. Our next question comes from Alan Alanis with Santander.

Alan Alanis: Hi, good morning, everyone. Thank you, Emilio and Arturo. I hope you and your families are well. I have a more strategic question regarding categories of sparkling versus still and specifically regarding bottled water. And how do you see this evolving? I'm a bit surprised that the biggest collapse that you've seen, and the only one I've heard double digit decline year to date in your sales has been water, bottled water. But noticing that both, that for many years, the driver of your growth was still beverages. So could you help us understand how this whole pandemic is evolving or shifting the consumption patterns of still beverages and specifically regarding water? And how can that affect your long-term profitability, and what actions would you take to address those issues? Thank you.

Arturo Gutiérrez: Hello, Alan, and thank you for the question. I hope you're also well. What we've seen in categories, and probably I would let Pepe elaborate on this, but what we've seen in categories in the last few months is something very, very unique to the situation that we're going through. I think we're going to be cautious about maybe extrapolating some of the trends that we've seen in the past months, about what is going to happen in the future, because there's some consumer habits that changed, but many of those are affected by consuming at home versus away from home, and just the crisis situation that we're going through. I guess most of the trends that we have seen before are going to continue as we move into more of the low calorie, more into the stills beverages. As you know, stills has been growing more than sparkling in most of our markets. I would say in all of our markets, I guess, in the last few years. So we expect that to continue. I don't think in that regard the pandemic has revealed anything different. I would say that if you ask me what are the changes that are going to probably remain are more in the channel dynamics and our go-to-market and how we get to the consumer. I think some of those changes that we've seen during the pandemic are going to stay, like digital platforms and those kinds of things. I would think that in categories, things are going to continue to evolve similar to what we've seen in the past. But I would let Pepe elaborate or add to that idea. Please, Pepe?

José Borda: Thank you, Arturo, and I think you pretty much said it all. What we've seen here is something very specific for the pandemic. I don't think that these three months have changed the way people interact with our brands and our categories, specifically in terms of water. Water is such a favorite that it's mainly consumed in single serve packages in away-from-home occasions. And precisely those are the occasions that have been reduced a lot since the restrictions in mobility. So water has dropped because of that. And with the still beverages, for example one of the categories that is suffering the most is juices. And one of the biggest consumption occasions for packaged juices is the breakfast away-from-home occasion. And for example, that occasion has also been reduced a lot, and people are making juices at home. Same thing with isotonics. People are not going to gyms. They are home, so to complement what Arturo is saying, we don't see, at least at these days, I mean in what was happening before the pandemic, but it's more a reaction to the current closures and mobility restrictions affecting the different channels.

Alan Alanis: That makes sense. So basically, you're saying this is very temporary the situation. Now, quick follow-up on that same line of thought. The milk category - Santa Clara. What dynamics are you seeing there in terms of consumption, share and so forth?

José Pepe Borda: Yes, and for example, in the milk, Santa Clara. Give me a minute. I'll get the exact numbers here. The Santa Clara category is growing 10 percent in the last…and we're seeing the same thing in Ecuador, for example. One thing is that plain milk is still growing and value added and value-added dairy that, for example, the desserts and the yogurts that kids consume at school, those are not growing, also, because of the reduction in mobility, but in general, the dairy categories are growing double digits.

Alan Alanis: Got it. That's very clear. Thank you so much to all. Have a great day, great week.

José Borda: Thank you.

Arturo Gutiérrez: Thank you, Alan. Good to talk to you.

Alan Alanis: Thanks.

Operator: Thank you. Our next question will come from Carlos Laboy with HSBC.

Carlos Laboy: Good afternoon, everyone. Arturo, you had higher penetration of FSOP as a top priority coming into 2020 in the US. With the COVID-19 disruptions, do you have a sense of maybe what proportion of your clients in Texas might not reopen, and how this affects the FSOP channel opportunity and your plans? But if you could also take a step back and kind of give us the big picture on how you see it unfolding over the medium to long term, it would be helpful.

Arturo Gutiérrez: Yeah, hi, Carlos, and thank you for your question. You know, that's a very important point, the one you make about the how on-premise is going to evolve. I think that is the single most relevant factor when we look at volumes for the remainder of the year. We believe a significant percentage, now that you ask it, of those outlets are not going to be reopening for the rest of the year. And we don't know exactly what that is. I've seen different estimates from the team. I think we would need a crystal ball to know exactly, but it's not going to be insignificant. That's what we believe. Again, it's still only 9 percent of our mix in the past quarter, but how that, again, recovers in the next 12 months or so is going to be important to how we recover our volumes. One thing that it's important to consider there, Carlos, is that some of that volume was not that profitable. And to the extent that it's replaced, even with a case pack of cans, it's more profitable than some of that fountain volume that was sold through the on-premise channel. So that's probably the positive note there. But certainly that is the single factor that would affect our volumes going forward, because we're always saying, large store, small store recovery. If you look at the month of June, large stores in the US, in our operation in the US, grew almost 14 percent. And small stores grew 6 percent. But on-premise was still down 30 percent, even in a month that we saw the reopening of Texas. So that tells you a lot about maybe what we'll be seeing in the market in months to come.

Carlos Laboy: Thank you. You don't get a lot of opportunities to see a business like this restart from zero across so many stores, so I mean, you view that as an opportunity, it sounds like?

Arturo Gutiérrez: Right. It's going to be an opportunity, because as you know, we're serving better those customers, and we need to also reevaluate the portfolio that we have in those customers, as we go into more of the immediate consumption, more into the Topo Chico or the transaction packs that we know are better for our business.

Carlos Laboy: Thank you.

Arturo Gutiérrez: Thank you, Carlos.

Operator: Thank you. Our next question will come from Mohammed Ahmad with FGP.

Mohammed Ahmad: Hi guys. Thank you very much for taking my question. Hope you're all doing well. Just two quick ones. One, if everything stays as it is in terms of FX rates and the raw materials rate, based on what you said, does that mean that they'll be substantial headwinds for Mexico margins next year, since you'll be probably rolling from a peso rate of sub 20 to 22, 23 kind of range? And the second question is, can you just give us the mix in Texas between FSOPs, well you did already, 9 percent, but small stores and large stores as well? Thank you.

Arturo Gutiérrez: Yeah, hi, Mohammed. I'll answer the second part, and Emilio can take the first question about FX and margins going forward. Maybe I'll just make a general comment. If we look at margins in the US, you know, traditionally, large stores have been about half of our volume. For example, in the second quarter of 2019, it was about 53 percent. And small stores was 30 percent, and the on-premise was something like 15 or 16 percent. Obviously, those mixes have changed significantly in the last few months, just based on the performance in each of those channels. So large stores didn't have a very good month of April after the pantry load that we saw in March, but then they recovered and grew double digit in the months of May and June. So that got the mix of the large stores to close to 60 percent. So again, the mix is changing as a result of the current crisis and the pandemic, but as a general rule, large stores will be like half or a bit more than half. Small stores will be 30 percent. And the rest will be around 16. But on-premise - you have to think about that not only as restaurants and bars, we include there every other customer of any kind in that large segment, but still the smallest of all. And again, now it's only 9 percent.

With respect to Mexico, we've seen an improvement in margins, as you've seen, compared to last year, even under the current situations. So we're seeing a very good scenario for raw materials this year, and we are also getting good pricing, and our savings efforts have been successful so far. So I'd say that we're satisfied with the margins that we're seeing. They're among the best, I guess, that we've seen in any single quarter in Mexico. Probably haven't checked that. Probably that's one of the best that we've seen historically, the margin in Mexico for the second quarter, so it's hard to improve that, but maybe, Emilio, you can add to that.

Emilio Marcos: Yeah well, if we're talking about the second half, as I mentioned, we don't expect any changes on raw materials. And again, the volume trends will always depend on the mobility restrictions here in Mexico and the reopening of some of the channels especially FSOP. But if you are asking about next year, well, next year, the only variable that I'm sure will not be better than this year is the exchange rate, since we have a very good hedge this year. But for sure, we will have better volume trends, so that should be compensating the effect of the negative on the FX for next year. For next year, also, raw materials, we don't see any main changes on pricing yet, so again, among the main variables, I think volume will be better next year, and exchange rate will be the only one that for sure will be higher than the one that we have right now, since we have a very good hedge, as I mentioned.

Arturo Gutiérrez: And the other part is OPEX, where even though we've seen a very good rate of OPEX to revenue, it's not really fixed, if you look at our business, especially in the summer months, where we have seasonal hiring of people, so we've been very effective in managing that. If volumes recover, you necessarily have to adjust your OPEX to that as well.

Emilio Marcos: And the other positive thing is that if we have the other channels reopening, those, the mix of single serve will improve compared to this year's, so that also will benefit our contribution margin for that mix. So again, it's going to be a combination of all these variables. But again, we expect some positive effects for next year - again, volume, mix, single serve.

Mohammed Ahmad: Thank you very much, guys.

Arturo Gutiérrez: Thank you, Mohammed.

Operator: Thank you. Our next question will come from Sergio Matsumoto with CITIGROUP.

Sergio Matsumoto: Hi, good afternoon. Thank you for taking my questions. Arturo, you mentioned a little while ago about the US on-premise that you are planning on a go-to-market model. And you used the word "transformational". I'm just curious if you could elaborate on that on what type of go-to-market model you were implementing. And the second question is on the mini-can. Can this be deployed in other countries, or is this mostly a US-centric thing based on the consumer habits in the US? Thanks.

Arturo Gutiérrez: Thank you, Sergio. Well with respect to go-to-market in the US, as I said, this is one of the transformational things that we have been doing. And based on our experience in other markets, and it's only the structure of the market in the US is different, but the basic building blocks are the same. And when you talk about go-to-market models, you want to be as effective in your relationships with the customer and controlling your costs to serve at the same time. What we observed in the US is that we were doing a lot of activities that were not as productive or created value as they should. And we were not serving customers, or we didn't have that personal connection that we thought we should have with customers in the US. And if you have on-line ordering, for example, it works very well for order-taking, but there has to be some activity to develop the accounts. And when you get closer to the customer, naturally, your business improves. So that's a very simple description of what we're trying to do. And it translates into new roles, into new routines, into new metrics of people on what we try to accomplish, and accountability of people that are visiting, Obviously more visits to customers that maybe in the past we thought they were kind of taking care of themselves, because they were ordering sometimes on line, or it was just a routine of order-taking. Now, we're trying to really create shared value with the customer, and that is what we're all about. Think about what we do in Mexico or in Latin America or South America. It's the same thing. We approach the customer, not as a delivery system. We actually create value with them. And that is what we needed to do more in the on-premise market in the US. So we have rolled that out in the last maybe year or so with very good results. Obviously they're not shown now. But I think that's something that's very promising for the future. With respect to mini-cans, I think that's an interesting opportunity, not only in the US, but it's different in the other markets, as in Mexico, where cans are more of a premium package, so we've had mini-cans in Mexico, and larger cans and mini-cans. You know, we have all the different variety of packages that work for the different consumption of cases. So we do have them here in Mexico, and it's another opportunity to have these smaller packages for the immediate consumption. They work really well, and they are a profitable package also.

Operator: Thank you. Our next question will come from Paul Trejo with Goldman Sachs.

Paul Trejo: Hi guys. Thanks for the time. Arturo, I just wanted to check on one thing, I know that reemphasizing the focus on ROIC and being more stringent in terms of CAPEX. Can you talk about working capital and how you guys have tried to be more efficient on that side of the business? Any update there? Thank you.

Arturo Gutiérrez: Yes. Thank you, Paul. I hope you're well. Well, working capital - we didn't mention that, but it's a very important aspect of the operation, especially in times like these, where everybody is facing a complicated situation. So we are following and tracking that very rigorously. And that has been also improving across our operations, even under the current circumstances. Maybe, Emilio, you can better elaborate on that, please.

Emilio Marcos: Yes, well I should say that the operations have been dealing with this very well. As Arturo mentioned, the situation is not easy. Many customers are not even opening and the management of account receivables, as you can see in our balance sheet, has been improving and it's been, we have been reducing the receivables. On the other hand, we've been working, also, with our main suppliers in order to improve our terms. That also reflects on our working capital. So as you can see, we have improvement on working capital in the year. And again, that's a result of our very good management on all operations. That's one key aspect of the business that we follow very closely in all of our meetings following one of these aspects of the business. Liquidity - we're protecting liquidity, as we have mentioned, not only working on these issues, but also on expenses, and controlling any expenses that are not really needed under this situation.

Paul Trejo: Thank you, Emilio. Can we expect some of the gains to hold from now on, especially on kind of the accounts payable side?

Emilio Marcos: Expect any gain?

Paul Trejo: Other than -

Emilio Marcos: The accounts payable -

Paul Trejo: So, the adjustments that you guys have done so far, extending, I guess, somewhat terms. Is that kind of like the new normal, and was it just something special because of the coronavirus situation?

Emilio Marcos: Yes, well, some of the terms that we have been negotiating are going to stay, and some others are just some temporary terms. So we should - again, that's one of our main priorities on working capital, and we should be able to maintain those levels.

Paul Trejo: Got it. Thank you very much, guys.

Emilio Marcos: Thank you, Paul.

Arturo Gutiérrez: Thank you, Paul.

Operator: Thank you. At this time, I would now like to turn it back over to management for closing remarks.

Arturo Gutierrez: Thank you. On behalf of Emilio, Pepe, the IR team and myself, I'd like to thank you for the trust you've placed in Arca Continental and for taking the time to join us today.

We are available for any follow up questions you may have. Thanks again and stay safe.

Operator: Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

# # # #