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Arca Continental 4Q23 Earnings Conference Call Transcript
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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 Ideal Advisors. Ma'am, please go ahead.

Melanie Carpenter: Thank you, operator. Good morning, everyone. Thanks for joining the senior management team of Arca Continental this morning to review the results for the fourth quarter and full year of 2023. Their 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 Gutierrez; the CFO, Mr. Emilio Marcos; and starting this quarter, Jesus Garcia, the newly appointed Executive Director of Planning will be joining the earnings calls in place of Pepe Borda who is taking on a new role at the company. So, welcome, Chuy, which is what we all call him. They're going to be making some forward-looking statements, and we just ask that you refer to the disclaimer and the conditions surrounding those statements in the earnings release for guidance.

And with that, I'm going to go ahead and turn the call over to the CEO, Mr. Arturo Gutierrez, who is going to begin the presentation. So please go ahead, Arturo.

Arturo Gutierrez: Thanks Melanie. Good morning and thank you everyone. We appreciate you joining us today to discuss our fourth quarter and full-year 2023 results, along with insights into our outlook for 2024.

I am pleased to report that we delivered a solid operational performance with volume acceleration, positive top-line growth and substantial underlying margin expansion.

The dedication and professionalism of our team propelled us to achieve another year of sound financial results.
Volume continued to be a big contributor to this growth, underscoring the fundamental strength and health of our business.

And as many of you are aware, the past year posed persistent challenges to our businesses. Nonetheless, amidst the macro conditions, we continued to make steady progress and focused on delivering growth.

Now moving to our results.

Total consolidated volume grew 2.4% in the quarter and 4.3% for the full year to reach 2.5 billion-unit cases. This annual volume number marks a new all-time high recorded for any year in the history of our company.

Notably, this is the third year in a row that we achieved all-time high-volume marks.

We continue to see the power of the sparkling category in our performance. The Coca-Cola brand kept outperforming, with volumes up 3.6% in the quarter and 3.3% in the year, while increasing relevance within the category mix.

It is important to mention that our work to strengthen the traditional trade is paying off. This channel showed one of the best underlying performances across all channels.

Total consolidated revenue in the quarter declined 5%, impacted by the appreciation of the Mexican peso against other currencies, mainly the Argentine peso.

For the full year, total consolidated revenues rose 2.8% to $213.6 billion pesos, cycling 13.3% growth in 2022.

On a currency neutral basis, revenues grew 6.7% in the quarter and 12.8% for the full year.

Consolidated EBITDA for the fourth quarter grew 0.2%, reaching $10 billion pesos, representing a margin of 20% and an expansion of 100-basis points.

For the full year, EBITDA reached $42.4 billion pesos, up 7% for a 19.8% margin and a 70-basis points expansion.

On a currency neutral basis, EBITDA grew 10.9% in the quarter and 15.6% in the full year.

While the year proved to be challenging, we delivered important margin expansions. Our timely pricing actions, coupled with tight expense controls enabled us to offset pressure from higher raw material prices, particularly sugar and fructose.
Let me now spend a moment on the results across our markets and operations, beginning with Mexico.

Undoubtedly, 2023 was a year for the record books as we sustained strong volume performance throughout the year.

In the fourth quarter, unit case volume, not including jug water, grew 3.5%. Volume growth in the quarter was driven by sparkling and still beverage categories, up 3.5% and 12.1% respectively.

Total volume for the full year grew 4.2% to 1.38 billion-unit cases, breaking once again our all-time high-volume annual record.

This is the fourth time in the past five years that our operation in Mexico reached over 1-billion-unit cases in a year, demonstrating once again the strength of our beverage business in our flagship market.

Volume growth was broad-based across all categories and led by sparkling 3.7%, stills 9.6% and water 8.5%.

Remarkably, brand Coca-Cola delivered its 6th consecutive year of growth with a 1.8% compound annual growth rate.

We also saw a solid performance across all channels. Growth was driven by the modern trade with double digits. Traditional trade grew 2.1% and the on-premise channel has fully recovered, closing 2023 with 5.2% growth.

Total net sales in Mexico rose 8.7% in the quarter to reach $24.2 billion pesos, marking the 30th consecutive quarter of net revenue growth. For the full year, revenues rose 12.4% to $100.4 billion pesos.

Average price per case in Mexico in the quarter - not including jug water - rose 7.2%, reaching $81.02 pesos.

On the profitability front, EBITDA in the fourth quarter increased 11.9% to $5.3 billion pesos, representing a margin of 21.8%.

For the full year, EBITDA closed at $23.5 billion pesos, up 14.1% and reaching a 23.4% margin.

We continue accelerating the expansion of AC Digital. At the end of 2023, our traditional trade customer base reached 93%, with 60% of our volume generated through this platform for this channel.

Moving on to our beverage business In South America, our total volume was up 3.1% in the fourth quarter, resulting from positive volumes in Peru and Ecuador.

Our team delivered solid sequential operational results, driven by our affordable portfolio initiatives and the expansion of returnable presentations.
For the year, volume was up 7.1% to 637 million unit-cases and cycling a strong 8.9% growth in 2022. Total revenue was down 35.8% in the quarter, while for the full year the decrease was 9.2% to $36.8 billion pesos.

EBITDA declined 21.5% in the quarter to 1.7 billion pesos, representing a margin of 25.2%. For the full year, EBITDA decreased 10.8% to $7.1 billion pesos, for a 19.1% margin.

We continued reinforcing our revenue management strategies, quickly adapting our portfolio to address the challenging market dynamics, doubling down on execution, and remaining focused on cost discipline and optimization.

Our beverage business in Peru delivered another quarter of outstanding sequential volume growth, up 4.7%.

Total volume for the full year grew 9.9% to 333 million-unit cases, breaking our all-time high annual volume record since we started operations in Peru in 2015.

Volume growth for the year was broad-based across the portfolio and driven by solid performances with sparkling up 6.9%, stills 19.6% and water 20.1%.

We saw strong sequential growth across channels. Traditional and modern trade were the top performers in the quarter, up 2.7% and 15.7%, respectively.

Growth was supported by key investments in market-focused initiatives to expand cooler coverage and increase our share of visible inventory.

Over the course of the year, we installed more than 37,000 cold-drink units and nearly 90,000 racks. We will continue working using advanced analytics tools to optimize cooler placement, driving incremental volume.

Moving over to Ecuador, our beverage business posted solid 4.8% volume growth in the quarter, cycling strong 5.8% growth from the prior year.

Coca-Cola Zero Sugar, Sprite and Fioravanti led the remarkable 7.4% growth in the sparkling category, supported by the launch of the 1-liter glass refillable package.

Unit case volume grew 8.1% for the full year, as a result of the sustained positive momentum of the traditional trade, as we continued driving immediate consumption and promoting returnable packages.

Despite facing political instability, strict curfews, and a significant increase in insecurity, we managed to achieve positive results in Ecuador.

Tonicorp, our value-added dairy business, posted a mid-single digit sales decline in the fourth quarter.

Although the sharp slowdown in the economy and weakening consumer demand, we are sustaining market share in core categories: yogurt, flavored milk, and ice cream.
Moving to Argentina, volume in the fourth quarter was down 1.4%. The adverse macroeconomic environment prevailed in the latter part of 2023.

For the full year, volume grew 0.8%, following a strong 13.5% growth in 2022. Nonetheless, we continued to focus on the aspect of the business that we can control. That is the approach we have been following to achieve volume growth for the last three years.

We maintained pricing in line with inflation while actively promoting affordability and doubled down on our cost discipline and optimization efforts.
Despite the prevailing economic turmoil, we gained value share in Non-Alcoholic Ready-to-Drink beverages.

We stand firm in our long-term commitment to the country of Argentina. We are confident that our business has experienced and endured many crises that we have worked through successfully, keeping a long-term vision and focusing on our customers, consumers and, of course, the community.

I will turn now to our beverage operation in the United States.

Coca-Cola Southwest Beverages closed 2023 on a high note, delivering solid top line and bottom-line results, driven by effectively managing key pricing levers and optimizing promotions, together with our execution and enhanced customer and consumer insights.

Net revenues for the quarter rose 8%, to $1.04 billion dollars. For the full year, revenue increased 12.1% reaching $4.0 billion dollars.

Average price per case in the quarter grew 6.3% reaching $9.12 dollars, as we remained focused on the optimal execution of our most valuable packages and promotional spend optimization.

Volume for the quarter grew 1.6% to 114 million unit-cases. Colas were up 2%, flavors 2.8%, and stills 3.2%. Transactions grew 2.1%, as we continue to focus on high-revenue packages.

We saw positive volume performance across Small Stores and FSOP channels, up 8% and 2.8%, respectively.

Our volume boosting initiatives continued to shift volume to high profitability packages, such as SSD Immediate Consumption, up 4.6% and mini cans up also 4.6%.

For the fourth quarter, EBITDA grew 8.9% to $171.8 million dollars, representing a margin of 16.5%. This is the 23rd consecutive quarter of EBITDA growth.

For the year, EBITDA closed at $649.6 million dollars, an 18% increase with a margin of 15.9%. This is the highest EBITDA margin for the fourth quarter in any year since we acquired this operation.

Remarkably, our beverage business in the US has doubled earnings since we began operations in 2017, growing EBITDA at an CAGR of 14%.

Our market leadership position remained strong as we gained value share in NARTD beverages for both the quarter and the full year, with growth in both SSDs and stills packages.

Our territories in the US achieved one of the fastest share growth rates of the Coca-Cola system in North America.

Importantly, we deployed a new Business Transformation Office, a process that will facilitate the execution of strategic initiatives in 2024. The 2024 pipeline currently consists of 17 initiatives focused on IT, Profit Growth Management, Operations, and Supply Chain transformation. These initiatives will be a key component of our growth engine for the coming years and further drive our evolution to a people-driven digital bottler.

Throughout the course of 2024 and the coming years, the list of projects will expand to ensure the operational improvements required to grow top line results and drive optimizations across our P&L.

Our Food and Snacks businesses posted a single-digit sales decline in the quarter and low-single digit growth for the full year.

We are doubling down on our profitability initiatives across all our snack divisions, as we continued accelerating on our pricing, productivity, and cost efficiency programs.

Bokados in Mexico posted sequential single-digit sales increase, driven by the modern trade channel, which was up 14.2% driven by effective pricing initiatives coupled with enhanced management of discounts.

Wise Snacks in the U.S. launched a special campaign to increase brand awareness of our core products and reconnect with consumers.

Inalecsa posted a low single-digit sales decline in the quarter. Despite the slowdown in the Ecuadorian economy, Inalecsa consolidated its market leadership in core salty snacks categories such as plantain chips, tortilla, popcorn, and confectionary.

And now I would like to go over the progress in our sustainability agenda.
2023 accurately portraits our efforts to strengthen our sustainable business model.

Arca Continental was recognized for the fifth consecutive year as a member of the Dow Jones Sustainability Indices for the Latin American Integrated Market.

Furthermore, we have earned a place in the Sustainability Yearbook by Standard & Poor's for the second time, underscoring our leadership in corporate sustainability.

The recognition is the result of our actions to protect water, advance the circular economy, reduce emissions, and support our communities.

In 2023, we received validation of our Science-Based Targets for emission reduction. We also announced a major expansion of PetStar, our circular economy model focused on collecting and incorporating recycled PET.

In 2024, we will continue our journey, as we foster the creation of shared value through profitable growth, operational excellence, environmental protection, and the integral development of our communities –within a framework of ethics, transparency, and responsibility.
I will now turn the call over to Emilio. Please Emilio.

Emilio Marcos: Thank you Arturo, and good morning, everyone. Thank you for joining us today to review our financial results for the fourth quarter and full year 2023.

We continued delivering positive results and a solid financial performance in the quarter, with EBITDA margin expansion across all our regions. These strong figures were mainly driven by our volume performance, an effective price/pack strategy, and tailwinds for most of our key inputs.

We should mention that due to the strong devaluation of the Argentine peso following a hyperinflationary context in the country, which was accentuated in December of 2023, our consolidated results were negatively affected.

However, thanks to the commitment of all our associates, 2023 was another successful year. Consolidated Revenues and EBITDA increased 12.8% and 15.6%, respectively, on a currency neutral basis. In addition, Consolidated EBITDA margin grew by 70-basis points, reaching 19.8%.

Now I will provide more details of our financial performance:

Consolidated Revenues decreased 5% during the quarter due to the appreciation of the Mexican peso against other currencies, particularly the Argentine peso. Taking into consideration Argentina´s hyperinflationary economy and derived from the political-economic changes in the country, during the month of December, a significant devaluation of its local currency was incurred. Due to this extraordinary situation, the effect of the devaluation for the first nine months of the year is shown in the elimination's column on the information by segments section in our quarterly earnings release. On a currency neutral basis Consolidated Revenues increased 6.7% in the quarter and 12.8% for the full year.

Gross Margin in the fourth quarter was 47.9%, 250-basis points higher than 2022. For the full year it expanded 140-basis points to reach 46.3%, mainly as a result of both a solid top line, and stable or lower prices in raw materials across our operations.

During the fourth quarter, Consolidated EBITDA reached $10 billion pesos, an increase of 0.2% compared to the same period of 2022. For the full year Consolidated EBITDA rose 7% to reach $42.4 billion pesos.

On a currency neutral basis, EBITDA grew 10.9% for the quarter, and 15.6% for the full year. EBITDA margin for the fourth quarter had a 100-basis points expansion, reaching 20%, consistent with the full year margin of 19.8%, which expanded 70-basis points.

Net Income for the quarter was 14.8% higher, reaching $4.5 billion pesos with a margin of 9.1%, expanding 160-basis points compared to the same quarter of 2022.

For the full year, net income was $17.5 billion pesos representing an increase of 12.9% versus 2022, and net profit margin increased 70-basis points, reaching 8.2%, supported by our solid operating income performance.

Moving now to the balance sheet:

Cash and cash equivalents at year-end were $22.1 billion pesos, and our total debt was $45.2 billion pesos, which translated into a Net Debt to EBITDA ratio of 0.5 times. The operating cash flow amounted to $27.6 billion pesos. Total CAPEX investment during the year reached 6% of sales, which was deployed in increasing production capacity and reinforcing our commercial capabilities to drive volume growth.

During January, we successfully completed the issuance of $6,050 million pesos bond in the Mexican debt market, in two tranches: one for $3,050 million pesos with a 10-year term at a fixed rate of 9.66%, and the other for $3,000 million pesos with a 3-year term at a variable rate equivalent to TIIE plus 10 basis points. The transaction was oversubscribed by nearly 2.5 times.

2023 was a strong year in which we capitalized on our solid execution and captured market opportunities through our digital and commercial initiatives.

We are well positioned to face a complex macroeconomic landscape, so that we may continue to drive value creation for our shareholders.

As we look forward, we will keep progressing on our digital agenda efforts, evolving our commercial models to best serve the changing needs of our customers and consumers, while maintaining our operating discipline.

With that I complete my review. Now, back to you, Arturo.

Arturo Gutiérrez: Thank you, Emilio.

Throughout 2023, our business demonstrated robust performance, showcasing our ability to operate with agility. We fully capitalized on our strong execution and management capabilities to confront the challenges in our industry.

As we look ahead to this year, some of our markets will remain volatile as they deal with economic uncertainties, fluctuating currencies, and other systemic issues.

While Argentina and Ecuador may not yet experience a tailwind scenario, we anticipate sustained growth in our key markets such as Mexico, Peru, and the US.

In response to the prevailing economic conditions, we will maintain our disciplined pricing strategy, adjusting prices to at least match the inflation rate in each of our markets.

Nonetheless, further actions will depend on the consumer environment as the year progresses.

As for revenues, we expect a high-single digit increase in currency neutral terms, with positive contributions from volume growth and mix.

Our capital expenditure plan allocates 6 to 7 percent of total sales to further strengthen market execution, expand manufacturing and end-to-end supply chain capabilities, while advancing our digital transformation agenda that will fuel the momentum in our markets.

We trust the flexibility that we have built and our ability to manage what's around the corner.

Our solid institutional foundation, robust financial position, commitment to exceptional service, and a cohesive company culture are the pillars driving our confidence in achieving profitable growth in 2024.

We thank you and appreciate your continued support. Emilio, Chuy, and I will be glad to take your questions. Operator, please open the floor.

Operator: Thank you, sir. 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. 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.

We will take our first question from Thiago Bartolucci with Goldman Sachs.

Thiago Bortolucci: Yes, hey Arturo, Emilio, good afternoon everyone and congrats on the results. I have two questions. Starting with, I think, the most common pushback that you hear, it is regarding per capita consumption in Mexico. We all know it is super high on absolute terms, but although the comps may not be easy, you keep surprising us and the market to the upside in terms of growth, right?

The weather in the fourth quarter might have played a role. We understand it, but still, cola volumes, for instance, are 7% higher than pre-pandemic, and this is just to use one example, right, within a number of others. How should we think about growth in Mexico going forward? And what is the lever for this growth? Is it getting more customers to the distribution network, taking fair share of wallet within your existing customers, is there opportunity to further develop the core portfolio or should we be leaning to more innovation and new categories going forward? This is on Mexico.

If I may, just another one in the U.S., despite - we are hearing, right, and we continue to hear a lot of headlines – on the opportunity and high elasticity, your true rate is growing comfortably above inflation, and volumes continue to expand in the same way, and you alluded to market share gains. How will you be approaching demand going forward in terms of pricing versus volumes? How should we think about this balance and now that your profitability there has broken into 15%, is there where you want to be, or should we imagine there is space to go further into the profitability path? Those are the questions. Thank you very much.

Arturo Gutiérrez: Yes. Thank you, Thiago. Let me address the first part first, which is related to Mexico. And certainly, we had a very good fourth quarter - very good year. I would say, to consider growth of 4.3% in the year, and this is cycling a 4% growth in 2022. So it is quite remarkable that our flagship market continues to grow at that rate. And I would say that conceptually, there is still plenty of opportunity to grow as - really, we are continuing to replace noncommercial beverages.

So the point is, what are we doing and what are those opportunities? Some of those you mentioned, there are some that are the basic things that we do and where we still have headroom to grow. And just to mention a few, our supply chain still has opportunities to improve, as you know, to better service demand in that market.

And that is part of what we are doing. We are investing in capacity in 2024, including two new production lines, two new warehouses, more than 250 additional routes, which is kind of the basic stuff that we continue to do.

Our execution also has opportunities as we evolve into a new go-to-market model in Mexico, expansion of coolers, using new analytics, innovation, and portfolio with adjacent categories and also the opportunity on premise market that still is not at the level of the pre-pandemic.

So - but there are other things that are more, I would say, on the innovative side, which are basically our digital platforms, which continue to evolve. And if you look at how that has developed and expanded coverage, and it has been proven to drive incremental value.

In December, we reached almost 60% of our volume, the traditional trade through AC Digital. And that is on the one hand, it reinforces our leadership in our core business, but also it presents new opportunities to expand our business. And as you know, we are piloting multi-categories, with beer, spirits, and groceries.

And also our new analytics and we can expand on that later have also brought new possibilities for growth in the future. So again, there are basic things that we continue to do, and we find growth there and also the new technologies that we are adopting.

And I would say, finally, we are also taking advantage of very positive market dynamics in the territories where we operate in Mexico. The near-shoring of investments to Mexico is a reality, and that is happening mostly in the states where we operate in Mexico. So that is also an important headwind.

Let me address your question on the U.S., where certainly, we have also had a great year. Our margins expanded, our EBITDA continues to grow, and we expect growth momentum to continue into 2024 and to keep increasing market share as well.

We had a positive start of the year. And we have developed a new growth algorithm for that market that will bring incremental revenue, using technology to simulate pricing and package scenarios that the price - well, we expect that to be at least in line with inflation, but our aim is to balance volume, transactions, revenue and market share and find the optimal mix for profit growth.
There is still an opportunity to grow in transactions, which is what we have been doing, and that is what has brought profitable growth in the market. So we are implementing a new phase of our suggestive order algorithm in the U.S., and that has proven to drive incremental volume.

We are scaling our trade promotion optimization tool, which is a very important tool for pricing - for net pricing. And also, we have an opportunity to improve in our supply chain and there are a number of initiatives there that we are implementing and to also improve in our efficiencies in OpEx with also a long list of projects.

So we are expecting to at least maintain our margin and even expand that in the medium to long term.

Thiago Bortolucci: That's amazing. Thank you very much, Arturo and congrats on the results again.

Arturo Gutiérrez: Thank you, Thiago.

Operator: We will take our next question from Fernando Olvera with Bank of America.

Fernando Olvera: Great. Good morning everyone and thanks for taking my questions. I have - my first question is about Peru. If you can comment about the solid EBITDA margin expansion that we saw in this operation that went from 24% to 27%. And how are you seeing the margin expansion in this country, which seems to be already very high? How do you expect it to perform next year or in 2024?

And just a quick one, if you can explain the 17% decline on depreciation and amortization.

Arturo Gutiérrez: Thank you, Fernando. I will address the first part, and I will turn it over to Emilio for your question on depreciation.

With respect to Peru, well, another one of our most important markets, as you saw, we had a remarkable year with growth in the business and in profitability. And we have gone even beyond the margin that we planned initially when we first acquired this operation. We expect, as in the case of Mexico, to grow in 2024 in volume. And the opportunities are similar in this market.

We continue to invest in operational capabilities to service demand. There are probably more upside opportunities in some of the basic things that we do such as increasing our reach, increasing the expansion in cooler placement, the returnable platform, the expansion of stills categories, probably those three are not as developed as we have in Mexico or the rest of Latin America. And we are using digital tools and analytical capabilities also.

Peru is one of the markets where our AC digital platform has developed the most, also more than 60% of the traditional trade volume is ordered through the platform in the Lima region. So we expect to maintain stable margins throughout the year as we also are going to be pricing pretty much in line with inflation, and we have an outlook for raw materials where probably sweeteners are going to be more challenging and more stable than PET going forward. So we expect those very high margins to be stable throughout the year.

Let me turn it over to Emilio for your second part of the question.

Emilio Marcos: Thank you, Arturo. Yes, well, the decrease in depreciation and amortization, Fernando, is basically because of two reasons. One, as you can recall, we have been investing a lower ratio on CapEx between 2020, 2021 and 2022, around 4% to 5%. But the main reason for the decrease is the FX effect, a lower exchange rate on peso versus dollar. On a currency-neutral, depreciation and amortization would have been increasing 2.2% in the quarter and 4% in the year. So it's basically FX.

Fernando Olvera: Great. Very Clear. Thanks very much.

Arturo Gutiérrez: Thank you, Fernando.

Operator: We will take our next question from Felipe Ucros with Scotiabank.

Felipe Ucros: Thank you, operator. Good morning, Arturo, Emilio, Jesus and team. Thanks for the space. First, I have a question on pricing negotiations. We all saw what happened at PepsiCo at Carrefour in Europe a few weeks back. And obviously, things are different in each region. But just wondering if you could talk about the climate around pricing negotiations with retailers in your key regions? I'm particularly interested in the U.S., but of course, any comments you could give us on the other regions, that would also be welcome.

And then the second question is on Argentina. We obviously have been seeing that every company has suffered a lot with the operation there and in the sharp devaluation. But one of the commonalities we are seeing is that companies are being able to move prices freely. And thus, even though the consumers are in poor shape, margins tend to expand in most of the companies that are operating in Argentina.

So just wondering if that is just a temporary thing while you adjust salaries and other expenses again with inflation or if you think there is kind of a permanent margin increase due to the pricing action that you did after the new government came in?

Arturo Gutiérrez: Let me address the first part. The pricing in our markets, our strategy, as you know, is to increase prices in line or above inflation in every business unit. And we have a good track record in that regard. We have been able to accomplish that. So really, the question is how do we approach it?

And I think it is a combination of capabilities, which, as you know, continue to be refined. We have actually a new tool for price optimization that has been first deployed in Mexico, and that reduces the time to analyze price adjustments and increase the frequency of changes and that will capture incremental value. So this is a tool that actually we are going to be deploying in all of the Latin American market. So it is an example of how we continue to use analytics to improve our effectiveness.

But the overall approach when you think about our customers is that we find a way to create share value in the market with our customers. And again, we have proven, not only for our results, but also for our customers, that this is something that is a win-win proposal. And that requires also the continuous monitoring of pricing dynamics and competitiveness in the market.

So we - I think we have been able to do that with more precision in a more segmented way also. And as you know, the complexity of our price pack architecture is very important for that purpose. And also, we have evolved to a more efficient price pack architecture in each one of our markets. Even in the most challenging market, as it relates to price negotiations, which is the U.S., you have seen in the last few years, we have been very effective in implementing those price adjustments. And this is something that we don't do on our own. As you know, in the U.S., this is a collaborative effort with the Coca-Cola system in the U.S., including Coca-Cola North America. So I think, again, it is based on improved capabilities, improved collaboration, and the results have been very positive so far. We expect to remain that way.

And with respect to Argentina, yes, we are certainly facing a very difficult environment. The end of 2023 and the beginning of 2024 has represented a very, very challenging situation with reduced consumption and an impact in our sales volume.

So what are we doing? We are basically focusing on those things that we can control, which are affordability strategy, expanding returnables, some single-serve packages. Our constant review of our precisely pricing strategy to offset inflation and labor costs and freight costs as well, and also implementing operational efficiencies and exploring new distribution agreements. When this happens, we have spare capacity in our distribution system that we can also use for some adjacent categories, which is something that we have done better recently.

So, we don't expect improvement in margins this year, actually, this is going to be a transitional year. First half of the year will be tough. Second half, we see a recovery. And also taking into account that we have had several years of improving top and bottom-line results in Argentina, we have a high-volume comps both in 2023 and in 2022. So, it is - we have very good years. This is going to be a transitional year, and we expect by second half to regain growth and also improve our profitability.

Felipe Ucros: If I can do a follow-up, Arturo. You caught my eye how well you did in stills in most countries. And I imagine, there are a host of factors contributing to that from universal bottling to many other things like innovations. But just wondering if you could go through what we think are the most important factors moving the needle here. It was surprising to see it so generalized across the regions.

Arturo Gutiérrez: Your question is, what are the most important factors in Argentina or in general?

Felipe Ucros: In stills, in stills. I was surprised that in stills you did very, very well across most countries.

Arturo Gutiérrez: Yes. Stills categories are an opportunity, I would say, in every market where we operate. If you see Latin America and you just compare the mix of stills categories versus more developed markets like our own U.S. operation, you can identify clear opportunities where there has to be focused on execution and also a stronger focus on stills.

I would let Chuy to elaborate a little bit on some of the categories that have the most opportunity, he was operating the Peru market, which is a great example of that. I will just say finally that in the U.S., although those categories are more developed, this is where we are also attaining most of the growth, like enhanced water and sports drinks and energy. Most of the growth is coming from those categories.

But I will let Chuy expand a little bit on some of categories in Latin America.

Jesús García: Thank you, Arturo and thank you, Felipe, for your question. New product launch was key as part of our overall strategy. We worked really hard to understand what were the right price package options for us to offer to the market, and we were able to launch new products related to flavored water, energy, tea, that were very successful in all of our markets.

Felipe Ucros: That explains it a lot. Thank you very much Chuy and Arturo.

Arturo Gutiérrez: Thank you, Felipe.

Operator: We will take our next question from Alvaro Garcia with BTG.

Álvaro García: Hi Arturo, Emilio, Chuy, and all the best for Pepe in his new role. A couple of quick ones on my side. One, I would like to zoom in, maybe for Emilio, on - I know sugar prices have been annoyingly high in Mexico, but what the outlook was for fructose in both - I guess, for Mexico and the U.S.? So, the outlook for fructose.

And then the second question is on Mexico. You mentioned in the release that modern trade was up 13% year-over-year. You also mentioned the traditional trade is still growing. So, sort of what is going on in the modern trade to see that type of growth? That is I suppose the question.

Arturo Gutiérrez: I will take the second part and then I'll turn it over to Emilio. As you see, channels in Mexico continue to grow. Modern trade grew faster recently this year. But the traditional trade continues to grow. And in recent years, it has not always been the case. As you know, throughout the pandemic, our traditional trade grew faster. And - but there is a strong recovery of supermarkets and convenience stores as we move into 2024 as well.

One thing that we are doing, and it is important - it is probably a part of what will represent growth in the modern trade going forward is that we have a new go-to-market model for some of our supermarkets and also convenience stores in Mexico as we deliver directly to the stores, DSD, improving execution, and that has proven incremental volume.

It does not really explain what we have seen in the past because this is mostly a recovery and rebalancing of the channels, but we know there is a room to capture incremental volume in the modern trade, precisely because some of the stills categories that we serve through - indirectly through Jugos del Valle - are now going to be delivered on a DSD basis. So that is going to be important for additional growth in that channel.

So, I think it is - we have a healthy and balanced mix of channels, and we are going to continue to capture opportunities at each one of them. Same thing for the on-premise market, which still has some room to recover.

And with that, I will turn it over to Emilio to talk about sugar prices and fructose.

Emilio Marcos: Well, as you know, we use high fructose only in Mexico and U.S. We expect spot prices for high fructose this year to be a little bit above inflation. But we have already hedged 70% of our needs in Mexico and U.S.

In Mexico, our hedges are above 2023 prices but in line with inflation and below spot prices. So, we are well covered there. And for U.S., 70% of our hedges are below 2023 prices and current spot prices. So again, our hedge strategy is working well, and we are well protected on sweeteners with high fructose.

Sugar prices, as Arturo has mentioned, is the one that is - we expect to be - to still the pressure is the one that we expect higher prices than 2023. We believe there will be less pressure than last year, but we still have higher prices than 2023.

And as you know, in Mexico and Argentina, we have our sugar mills. So, we will offset part of the - or mitigate part of the impact on volatility of the market. But regarding high fructose, we are well there.

Alvaro Garcia: Great, thank you very much.

Arturo Gutiérrez: Thank you, Alvaro.

Operator: We will take our next question from Renata Cabral with Citibank.

Renata Cabral: Hi, Arturo and Emilio. Thank you so much for taking my questions. I have two. One is about the capital allocation. We saw the announcement of extraordinary dividends. My question is more towards the company appetite for M&A going forward?

And my second question would be about the Coca-Cola No Sugar. We see this product growing a lot in the regions that you are operating. So, I would like to hear some updates about the opportunities you see about this product on Arca's portfolio?

Arturo Gutiérrez: Let me talk about M&A first, and I will turn it over to Chuy for the second part on opportunities for Coca-Cola Zero Sugar.

As we have said before, we are always evaluating opportunities for M&A, especially in the beverage space. I think the fundamental premise is that there is still - there is still a lot of value to be captured through consolidation. I would say, in every region in the franchise system around the world, if you see the map of the system, you will immediately conclude that there is an opportunity to be more efficient, and that means value to be captured.

We have looked at opportunities in Latin America, the U.S. and our approach is to maintain a balanced position so that we can capture those when they are ready. And there has not been a lot going on recently. And we don't feel pressure to rush into any deal because we don't believe that there is any strategic deal that we need to do to maintain our leadership or our profitable growth for the future. We will approach any opportunity as an opportunity to create value from an economic point of view. So that is what we will continue to do.

And I think we are in a very good position to be patient and expect something to happen in the future. In the absence of any of those transactions and depending on market conditions, we will continue to look for opportunities to return value to investors, as we have done before.

So, with respect to Coke Zero Sugar, this has been a tremendous opportunity for growth of sparkling and for growth in brand Coca-Cola. I think maybe the best example has been a Coke Zero in the U.S. where sparkling has been a category with limited growth. And this particular extension of Brand Coca-Cola has been very successful in the U.S. market.

Maybe, Chuy, you can provide a little more detail on how we have performed with Coca-Cola Zero Sugar?

Jesús García: Thank you, Arturo and thank you, Renata. And that performance has been pretty much the same across markets. So, we see an increase in the mix going from regular to low calorie options. We believe this is going to make the category or the cola category more dynamic, and we expect this performance to continue ahead.

Renata Cabral: Very clear, thank you.

Arturo Gutiérrez: Thank you, Renata.

Operator: We will take our next question from Lucas Muse with Morgan Stanley.

Lucas Mussi: Good morning, team. Thanks for taking my questions. I have two quick ones. The first one is related to digital. I just wanted to hear your thoughts on what is next here. You guys have been doing an amazing job in terms of the AC Digital. 60% of your volume is in Mexico already done through the platform. So, I just wanted to hear your thoughts on what is going on next. Where do you see better levers to be more efficient, generate value for digital initiatives? So, I just wanted an update on that.

And the second question is, I just wanted to hear your thoughts on - you talked a little bit about our hedges, sugar, fructose, how does that combine and what are your expectations? How are you seeing margins evolving into 2024 for the Mexico and the U.S.? That is it.

Arturo Gutiérrez: Thank you, Lucas. I will address the first part, and then I will turn it over to Emilio, just to also make some comments on margins, and he'll we will give you some detail on hedges.

With respect to digital, we could spend a long time talking about what we have been doing. I will try to make a brief summary of our objectives and the opportunities in our different initiatives.

First, this is a great opportunity to strengthen our leadership in the market, first of all, our core business. To broaden our portfolio, to have a more direct and continuous connection with our customers and to make connections within our portfolio through cross-promotions and to also get more information of the market.

At the same time, this is going to be an opportunity to create new opportunities for monetization of the platform in the future. This is something that we are not modeling yet, but we certainly know that once that we have this customer base that now is 91% of our traditional trade and 60% of the volume by the end of Q4.

So think about this, this is 850,000 registered customers. And of those, 70% are active users. That means $2.4 billion of annual running rate revenue is now generated through AC Digital based on our sales of last December. So this is a tremendous opportunity. And coupled with our new agreement with the Coca-Cola Company, our LTRM agreement, which was critical now to have an alignment on this new initiative.

So again, first, it improves our core business. Second, opens new opportunities. What we are developing is a new best-in-class digital mobile platform for our customers and frontline workers at the same time with a better user experience, powerful features, with generative AI, even FinTech opportunities, capabilities for multi-category to create a marketplace. We are also developing a loyalty program for the traditional trade. And we have integrated our Yomp! venture with AC Digital in one large B2B2C digital ecosystem. So we believe this could be very powerful going forward.

And at the same time, we are continuing with our original idea of having a platform of point-of-sale users. We now have more than 20,000 customers using our platform with - and this is now profitable, by the way, which is very hard to accomplish, and is generating data and insights that we use for our core business.

What's next here is that we are evolving and adapting our go-to-market model, now that we are connecting digitally with most of our customers, to invest more time and value-added processes in the market, with the customers and generate incremental value.

So this is, again, a tremendous opportunity for our core business and also for other adjacent initiatives that will come from that. And so I will stop there. And again, there is a lot of detail that we could provide if you are interested.

With respect to margins going forward. Well, I will let Emilio talk about that. I can say that we are basically looking to sustain our margins going forward. We have some favorable scenarios in some of our raw materials like aluminum and pretty stable PET, probably some of the sweeteners are more challenging, but I will let Emilio elaborate on that.

Emilio Marcos: Thank you, Arturo, and thank you, Emilio for your question. Well, let me just first mention our expectation about our main key inputs. As we mentioned, we expect prices to be stable or better than last year and together with our hedge strategy that we have already mentioned about high fructose, the only one that we expect to be higher than 2023 is sugar.

But regarding the other prices, for example, for aluminum, we have hedged 80% of our needs in Mexico and U.S. at a lower price than 2023. So again, the only concern is sugar regarding key input.

But considering all that, and with what Arturo already mentioned about what we expect for this year, consolidated sales to grow in high single digit on a currency-neutral basis and continue with all this price adjustment that we mentioned and the strategy, commercial strategy, digital transformation.

We feel very well positioned to face all this challenging macroeconomic environment and to protect, as Arturo mentioned, margins for next year on a consolidated basis. So also that is including Mexico and U.S.

Lucas Mussi: Thank you, team, very clear.

Emilio Marcos: Thank you, Lucas.

Operator: We will take our next question from Carlos Laboy with HSBC.

Carlos Laboy: Yes, good afternoon, everyone. Arturo, you said that you have a new scope for driving a balance of volume transactions, price mix and suggested order. And you talked about other digital gains, too. But you don't see 2024 as a margin expansion year. Can you expand on where you do see upside in 2024? Is it in the volume and transaction side of that tool? Is it on market share gains? Is it on innovation or maybe on finally sealing some adjacent category agreements? Where do you see the most promise in 2024?

Arturo Gutiérrez: That is an interesting question. We did analyze those opportunities. I would say first, in general, as I said, we expect stable margins going forward, but there would be some business units that would have bigger challenges. Obviously, one would be Argentina, where we don't expect that. It is important to note that Argentina, as of the end of the year was only 1.2% of our total EBITDA. But we don't expect margin expansion there.

We expect stable margins in our larger markets, the U.S. basically. And even in Mexico, some opportunity based on growth going forward. Those would come mostly from our core business. We are not expecting those new ventures to move the needle yet, although it is an opportunity for more the medium term.

Where do we see most of the benefits? We expect to be prices in line with inflation, but we still expect volume to grow. We found opportunities that are so basic just to service demand better and improve our fill rates in markets that have grown a lot recently and improve our infrastructure and manufacturing and in warehousing.

And also, we see a better raw material environment in some cases. So it is mostly the basic building blocks that we are looking at this year. And certainly, some of those other opportunities will materialize in the future.

Carlos Laboy: Thank you. If I may just follow up on a related matter there. When you look at the spirits category and adjacent categories, what is the most differentiated benefit that you can offer these potential partners? And what is the complexity that takes a long time for these deals to apparently close?

Arturo Gutiérrez: Yes. Well, I think the benefit - first of all, I have mentioned that the basic premise for any of those initiatives is how will that impact our core business because the old paradigm, and you have been in the industry for a long time, is that you should focus on your core and don't get distracted.

So first, this is amazing, how - probably with the evolution of technology - we have been able to start selling some of the categories, and not only sustaining our volume in the core business and core beverages, but even improving it.

And so this relates to the work that we do in the market, which is a combination and talking about what we bring - what the benefits that we bring - is the combination of logistics, obviously, of a wider reach in the market in the traditional trade, but also the relationships that we have with customers and that we have built over the years. And as we've talked, this is really the great competitive advantage of our system, how it is not only the distribution effort, but how we can connect with customers better. And we continue to improve that since now, we are [inaudible], so now our conversations at the point of sale will be used for expanding our presence and our leadership in the category.

So - and this - well, certainly, it has taken longer than we intended initially. First is we wanted to make sure that these categories were certainly complementary to our core business. I think that has been demonstrated now. And now it is a matter of the negotiations of the details. But we are moving in the right direction. I can tell you that.

Carlos Laboy: Thank you.

Arturo Gutiérrez: Thank you, Carlos.

Operator: Thank you. This concludes today's Q&A. I would now like to turn the call back over to management for closing remarks.

Arturo Gutierrez: Thank you, operator and thank you all for your participation in this call today and for your continued interest in Arca Continental. Our investor relations team is available for any further questions you may have. Have a great day.

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

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