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ARCACONTINENTAL

CONFERENCE CALL

Arca Continental 4Q20 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 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 for the fourth quarter and full year 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 Gutierrez, the CFO, Mr. Emilio Marcos and the Chief Commercial and Digital Officer, Mr. Jose "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. 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 Gutierrez: Thanks Melanie. Good morning and thank you everyone. We appreciate you joining us today to discuss our fourth quarter and full year 2020 results.
I am pleased to report that we delivered sound financial results and a solid operational performance.

We continued to demonstrate our ability to thrive during this unprecedented crisis and operate with agility, while always maintaining a long-term vision and focusing on strengthening our relations with customers, consumers, and the community.

In the face of an adverse operating environment, we are encouraged by the recovery and overall improving trends that we saw throughout the second half of the year.

Total consolidated volume remained flat at 0.1% in the fourth quarter. Volume performance sequentially improved throughout the quarter across all our operations.

Our businesses in Mexico and the U.S. were the main engines of recovery with both markets showing impressive resilience despite the conditions.

We continue to see the power of the sparkling category. The Coca-Cola brand kept outperforming, with volumes up 1.8% in the quarter, maintaining or increasing relevance within the category mix.

Still beverages were up 1.8%, driven by energy drinks, with volumes up nearly 12.3% in the quarter.

Importantly, the resilience of the traditional channel was once again confirmed. The largest of our channels in Latin America experienced the lowest decline and showed the fastest recovery during the pandemic.

For the full year, our total consolidated volume declined 3.8% to reach 2.1 billion-unit cases.

Consolidated revenue growth was 3% for the quarter and 4% for the full year, reaching record sales of $169.3 billion pesos. Our U.S. and Mexico businesses delivered solid mid-single-digit growth in the quarter.

On the profitability front, consolidated EBITDA in the quarter rose 7.7% to $8.6 billion pesos, representing a margin of 20.2%, for an expansion of 80 basis points.

For the full year, consolidated EBITDA increased 5.7%, a margin of 19%, for an expansion of 30 basis points, cycling a solid 110 basis points increase in the previous year.

Despite the closure of points of sale, we were able to increase profitability and expand margins across all our geographies.

Digital capabilities are playing a key role in the recovery. Analytics are now more relevant than ever and our B2B platforms have seen sizeable increases in online orders.

We also expanded partnering initiatives with our customers to increase our digital shelf space and visibility on their own ecommerce websites, and worked with digital-only customers, such as food aggregators to increase penetration of our beverage portfolio within food orders.
Now let´s review the performance and highlights across our operations.

Total volume in our Mexico beverage business grew 0.5% in the quarter. We maintained the positive momentum, cycling a strong 6.4% increase in the same quarter of 2019 and sustaining the sequential improvement throughout the year.

Volume growth in the quarter was driven by Topo Chico sparkling, personal water and colas. The jug water category posted a 1.6% volume growth in the year, as At Home consumption increased.

Volume in the traditional channel grew 5.4% for the year, as we've maintained an on-going dialogue with store owners to help them maintain normal operations, while supporting the opening of new ones.

Multi-serve mix packages grew 5.1 percentage points in the quarter and 5.7 percentage points for the full year, mainly due to the changes in buying patterns and consumer preferences for these formats.

In response to this market dynamic, we accelerated the introduction of the "Universal Bottle", in 2-Liter refillable format for sparkling beverages across all our territories.

Total net sales in Mexico rose 6.1% in the quarter to reach $17.9 billion pesos, while for the full year, revenue rose 3.1%.

Average price per case in Mexico in the quarter - not including jug water -, rose 5.8%, reaching $66.63 pesos. Our flexible price pack architecture and affordability initiatives enabled us to reach our goal of increasing prices in line with or above inflation rates.

We gained value share for the full year, outpacing the non-alcoholic ready to drink beverage industry in Mexico, driven by water, sport drinks, and juices & nectars categories.

Our broad portfolio of products played a key role in addressing the changing dynamics of the consumer landscape during the most critical periods of the pandemic.

EBITDA increased 8% to $4.1 billion pesos in the fourth quarter, representing a margin of 22.6%, for an expansion of 40 basis points and marking the seventh consecutive quarter of margin expansion.

EBITDA margin for the year rose by 100 basis points, as a result of our effective pricing, combined with our disciplined focus on cost optimization, our proactive hedging initiatives, and favorable negotiation of key inputs.

We continued our on-going innovation in sparkling beverages. This quarter we launched Topo Chico Twist, a very successful brand extension that was previously launched in the U.S. And with respect to Topo Chico Hard Seltzer, this brand is achieving solid positioning in our main markets, in key channels, such as convenience stores, supermarkets, and traditional trade.

Moving now to our beverage business in South America, total volume in the fourth quarter grew 1.5%, resulting from positive volumes in Argentina and mild declines in Peru and Ecuador.

Volume growth in the fourth quarter confirmed the sequential improvement trend, after significant declines of 28% and 11% in the second and third quarters.

Total volume for South America dropped 10% for the full year to 485 million-unit cases. The traditional trade has demonstrated its resilience during this time of crisis and established a strong recovery momentum across all three countries in the region.

Total revenues declined 7.8% in the quarter and 8.1% for the full year, reaching $32.8 billion pesos.

EBITDA increased 3.9% in the quarter to $2.3 billion pesos, with a margin of 26%, at an expansion close to 300 basis points.

For the full year, EBITDA declined 12.4% to $6.5 billion pesos, representing a margin of 19.7%, for a contraction of 100 basis points.

In Argentina, our beverage business delivered a solid 8.4% volume growth in the fourth quarter and 1.4% for the full year.

Volume recovery was driven by sparkling and still categories, up 6.4% and 46.5%, respectively. Brand Coca-Cola grew 11.1% in the quarter. Importantly, volume growth in our territories outpaced the beverage industry in Argentina.

We continued expanding our portfolio of beverages with new flavors of Monster to further strengthen our leadership in Energy. We also launched a new presentation of Aybal to continue driving affordability in the water category.

Let us turn to our beverage business in Peru, where total volume in the quarter was up 0.4% and declined 14.2% for the year.
We grew both value and volume share in NARTD beverages, leveraged by changes in our mix, as the sparkling category regains traction. In the water segment we also captured strong share gains driven by our dual strategy with San Luis and Benedictino.

The traditional trade and wholesale channels led the recovery in the quarter, with 16% and 3.1% growth, respectively. We will continue supporting the recovery of the traditional trade by driving affordability, while capitalizing on the brand equity of Coca-Cola and Inca Kola.

As part of the plan to strengthen our portfolio of non-returnable multi-serve packages, this quarter we launched Coca-Cola without sugar in a 3-liter presentation. Also, we launched Topo Chico Hard Seltzer across traditional and supermarket channels in Peru.

We doubled down on the deployment of our AC Digital platform, expanding our B2B capabilities; currently, over 34,000 customers in the traditional channel place orders directly using our mobile app.

Moving over to Ecuador, volume declined 0.7% for the quarter and was down 10.8% for the year. The country continued facing the worst economic downturn in recent history due to the Covid-19 outbreak.

Our sparkling category delivered sequential quarter-on-quarter improvement, driven by brand Coca-Cola, up 3.8% in the fourth quarter.

Still beverages also showed a positive volume recovery trend, highlighting the performance of our energy category. The launch of Monster Ultra has helped us consolidate leadership in this segment.

Tonicorp, our value-added dairy business, posted a double-digit sales decline both in the fourth quarter and for the full year.

We reconfigured our portfolio with products that combine high nutritional properties and affordability.

This quarter we launched the new yogurt brand Frush, at an attractive price-value proposition that allows us to better face the new market dynamics.

I will turn now to our beverage operation in the United States. Before I get into the financial and operational results, I'd like to share some important milestones.

We are about to enter our fourth full year of operation as a U.S. Coca-Cola bottler. Since embarking on this journey in 2017, we have faced many challenges, including major weather events like Hurricane Harvey, and now the Covid-19 pandemic.

From 2018 to 2020, we were able to build a strong foundation through our commercial and operational initiatives and be able to achieve sound financial results.

In just a three-year span we reduced our Opex to Sales ratio by 250 basis points to 34.3%. We grew EBITDA 17.4% to close to $400 million dollars and expanded EBITDA margins by 130 basis points to 14%.
2020 was a year like no other in history. But for us, it was also a year where we were able to prove our determination and deliver record-high results in this market. We closed the year with strong operating performance and solid EBITDA growth and margin expansion.

Moving over to our results, volume for the quarter declined 3.2%, reaching 106.4 million-unit cases. For the year, total volume was down 2.2%.

Topo Chico and Body Armor brands delivered consecutive strong volume performance, as we expanded our customer base.

Revenues in the U.S. declined 0.8% in the quarter to $705 million dollars. For the full year, total revenue grew 0.8% to $2.84 billion dollars.

Net price for the quarter grew 2.5% with a 2.7% true rate increase and a negative mix impact of 0.2%.

For the full-year, net price grew 3.1%, with a positive 3.5% rate and a negative mix impact of 0.4%, due to FSOP restrictions and a decrease in Convenience stores traffic.

Large Stores continued to outperform all other channels throughout the pandemic with 4% volume growth.

EBITDA grew 3.5% in the quarter reaching $107.5 million dollars, representing a margin expansion of 60 basis points, and marking the 6th consecutive quarter of EBITDA growth and margin expansion.

EBITDA in 2020 grew 7.3% to $399.1 million dollars, with a margin of 14%, and an expansion of 80 basis points.

We are pleased to announce that we have reached our 3-year synergy goal, with approximately $90.4 million dollars in synergies. Undoubtedly, a key enabler of synergies and productivity improvements was our new facility in Houston, Texas.

We were able to ramp up production and fully leverage these state-of-the-art capabilities, while increasing efficiencies, and consolidating production and warehouses in the region.

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

Wise Snacks in the U.S. posted high single-digit sales decline in the fourth quarter. The largest impact on sales due to the pandemic was in the “Up and Down the Street” channel, as small bag volume declined.

These restrictions also impacted our Food Service On-Premise channel, with Deep River sales down double digits, as 50% of restaurants and other outlets were closed either temporarily or permanently.

Our grocery business grew by a single digit across our major product categories, as consumers spent more time eating at home. Deep River expanded product coverage in over 1,000 new grocery stores of major retailers.
We experienced significant growth in our e-commerce channel with expansion of platforms, such as Wal-Mart online and Amazon.com.

Bokados in Mexico posted double-digit sales growth and profitability expansion, driven by the traditional channel.

We continued innovating with the launch of brand extensions of our tortilla chips category and added a new line of confectionery products to our portfolio, generating incremental sales and productivity, particularly in the traditional trade.

And lastly, Inalecsa posted a mid-single digit sales decline in the quarter. On a full year basis, sales also declined mid-single digits.

We accelerated the pace of adoption of our AC Digital commercial platform across our entire businesses in Ecuador. We are replicating core revenue management capabilities, with a strong focus on segmentation, promotions, and discounts.

Let me close with sustainability - a core business strategy fully embedded in our operations, focused on managing risks and opportunities to preserve, generate and share value. We are conscious that this cannot be achieved without the full integration of environmental, social and governance aspects into everything we do.

Throughout 2020, in response to the COVID-19 pandemic, our focus was to deploy a comprehensive emergency response plan to provide our associates with a safe and healthy work environment. We also focused our efforts and resources towards the most urgent needs of our communities highly affected by the pandemic, following three main levers: Number one, by supporting the healthcare system, government institutions and non-profits organizations. Second, helping vulnerable groups and third, protecting our value chain, particularly our customers in the traditional channel.

Furthermore, we made significant progress in the implementation of our World Without Waste sustainable packaging strategy. We aim to collect a bottle for every bottle we sell, regardless of where it comes from, by 2030.

We were also honored to be included in the Dow Jones Sustainability Index for Latin America for the second straight year, and in the FTSE4Good Emerging Index of the London Stock Exchange for the 5th consecutive year. Both indexes recognize publicly traded companies with the strongest commitment to best environmental, social, and corporate governance practices in the world.

Our determination to be assessed based on the strictest international standards and our progress in several global sustainability indexes, is in line with our principles to operate with transparency, ethics, and fairness, while creating a net positive impact on the ecosystem together with the well-being of our society.

With that, I will turn the call to Emilio to go over our financial results. Please Emilio.

Emilio Marcos: Thank you, Arturo. Good Morning everyone, thank you for being here with us today to review our financial results for the fourth quarter and full year 2020.

In line with the second and third quarter, we delivered a strong financial performance in the last three months of the year, with an EBITDA margin expansion across all our operations. This was driven by our pricing strategies combined with an overall recovery in channels, tailwinds in key inputs, and our deployment of the cost optimization and savings plan announced at the beginning of the pandemic.

Thanks to these efforts, we had a strong finish in an unprecedent 2020, where our past experiences in difficult market conditions, allowed us to quickly turn to initiatives that would prioritize our associates' wellbeing, improve our strategic partnership with our customers, and service our consumers evolving needs.

And now moving onto the results:

In the fourth quarter, consolidated revenues increased 3% and 4% for the full year, driven by the strong pricing in Mexico and the US.

Cost of goods sold were up 2.3% during the quarter and 3.3% in the full year. These increases are mainly related to FX rates and the concentrate price increase in Mexico, which were partially offset by lower PET prices.

The contribution margin in the quarter and for the full year posted a 40-basis point expansion, primarily driven by the benefits of our pricing initiatives and PET costs, which compensated for the slower volume trends.

Consolidated EBITDA for the fourth quarter roses 7.7% reaching $8.6 billion pesos, resulting in a margin of 20.2% for an 80-basis point expansion compared to the same period last year. This improvement was achieved thanks to the disciplined execution of our efficiency plans established at the onset of the pandemic and the contribution margin expansion. It is important to mention that our comparables are cycling a strong fourth quarter performance in 2019, where we registered a 210-basis point expansion.

I'm proud to announce that in 2020 we achieved two significant accomplishments. The first one, as Arturo already mentioned, the achievement of the 90-million-dollar synergy plan in our U.S. beverage business. Let me give you the breakdown by main P&L line: 20% from revenues, 50% Cost and SG&A efficiencies, and 30% from strategic initiatives that includes the benefits from the new Northpoint facility.

The second important accomplishment is that we reached 2.3 billion pesos in cost savings, as part our disciplined plan to align the operating expenses to the top-line performance. Breakdown of these efficiencies: 47% comes from marketing expenses, 16% from labor and 37% from other initiatives such as transportation, production yield improvements, and third-party services.

Also, we continue to see a decline in the expenses related to COVID19, as we reached $106 million pesos in the fourth quarter. This was all registered as a recurrent expense and was 33% lower than the previous quarter.

Comprehensive cost of financing registered $1.5 billion pesos in the fourth quarter compared to $967 million pesos last year, primarily driven by an exchange rate loss of $959 million pesos, resulting from our cash position in US dollars and the depreciation of the US dollar versus the Mexican peso. Net Income rose 7.8% to $2.5 billion pesos, for a margin of 5.9% and an expansion of 30-basis points compared to the same period in 2019, despite the exchange rate loss.

Now, moving onto the balance sheet.

On December 23rd, 2020, we distributed a second extraordinary dividend of $1.0 peso per share, which led to a payout ratio of around 94% of retained earnings and a dividend yield close to 5%.

Cash and cash equivalents at year-end stood at $27.3 billion pesos with a total debt of $50.6 billion pesos, which translated into a Net Debt to EBITDA ratio of 0.7 times.

In 2020, total CAPEX stood at $6.6 billion pesos, an overall decrease of around 42% compared to last year. We expect CAPEX to be close to 6% of net sales in 2021.

Our solid performance in one of the most challenging and unprecedent years in the history of the company is a testament to our adaptability and resilience when faced with the hardships of an ever-changing business environment. In 2021 we will continue to focus on delivering strong results by capturing and creating value for our shareholders, through four key aspects of our operation: 1 - recovering volume levels, 2 – continuous deployment of commercial initiatives and innovations in the market, 3 - maintaining the disciplined control of operating expenses and 4 - protecting the liquidity of the business.

That concludes my review of results. Back to you Arturo.

Arturo Gutierrez: Thank you, Emilio. For those that have followed Arca Continental throughout the years, you know that we´ve been through many challenging times before and worked our way through them successfully. And so far, the global Covid-19 crisis has not been the exception.

Our company is well-positioned, with a clear vision and purpose. We are entering 2021 carrying forward the positive momentum of 2020, confident that our record of steady annual revenue growth will be extended throughout the current year.

Combined with our cost optimization and efficiency programs, we firmly believe that this should allow us to continue delivering solid profitability in the upcoming quarters.

We expect volumes to maintain a positive momentum mainly in the traditional channel, supermarkets, and all channels related to At-home consumption. We also expect single-serve and non-returnables to evolve positively, with returnables leading the way.

In conclusion, these results, as well as the agility and the speed with which we have adapted, gives us confidence that we will emerge stronger from this pandemic, able to leverage our scale to capture the growth opportunities ahead.

One final comment related to guidance. It is unclear when economies will return to their pre-pandemic dynamics. We continue to see new surges of Covid-19 cases across the world and vaccination availability is drastically different in every market.

Given this continued uncertainty under the current climate, we feel it's prudent to hold off on providing 2021 guidance. Thank you for your consideration regarding this.

I will now hand the call over to the operator. Emilio, Pepe, and I will take all questions you may have. Please Katie.

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.

Our first question today comes from Alvaro Garcia with BTG Pactual.

Alvaro Garcia: Good morning, gentlemen. Thank you for the call. I have many questions. But if I had to leave it to 2, I would say, look, first question is for Pepe, which I'm very curious as to -- a bit random, but it's on QR codes specifically. You've obviously seen sort of a renaissance of the use of QR codes in the region and whether or not that's an opportunity for you to drive loyalty, to drive better promotions. And if you have anything on that front?

And then my second question would be on margin dynamics into this year, and this is maybe a little bit more for Emilio and Arturo. The operation in 2020 is obviously a lot less complicated, a lot more simple…less travel for management. You mentioned lower transportation. I'm curious as -- when you're thinking about margins in 2021 and the business, let's say complicates that a bit with a little bit more on trade and whatnot, a little bit higher PET prices relative to this year, what you're thinking maybe higher level for margins into 2021?

Arturo Gutierrez: Thank you, Alvaro. Let me address your second question, and then I'll turn it over to Pepe after that. And Emilio, you can jump in anytime. With respect to margins, certainly, despite the uncertainty and complexity of the pandemic, we had a very good year in 2020 from the perspective of margins.

We had an expansion as you saw of about 40 basis points in the fourth quarter and 30 basis points for the full year, and the result of this was effective pricing strategy. Certainly some tailwinds in raw materials, but we had a very strong program of saving initiatives. I would say that, that part continues in 2021. Some things are, obviously, the implementation of initiatives in a crisis mode, but some of the things are learnings that we will continue to apply as we move forward. So what we have now is a continuous effort to identify efficiencies and capitalize on those learnings for 2020.

The key highlight, I would say, for the fourth quarter was that all of our large operations expanded margins with a significant recovery in South America, as you saw. And that, I think, reinforces our ability to be successful in times of crisis, especially in deploying efficiency initiatives and controlling discretionary OpEx.

So as we look forward for 2021, our objective is to regain growth and protect our margins. Volume growth, that is going to come gradually, the first quarter of 2021 is going to look very similar to the quarters during the pandemic last year. We're still comparing to the prepandemic scenarios.

But our expectation is to price in line with or above inflation, across our markets. We're going to have some increase -- slight increase in raw materials during the year, but we're going to continue to have a strict cost discipline in SG&A.

So those would be the building blocks, I would say, for sustaining margins in this year. We expect, as I said, to continue to have efficiencies, and we believe we have the opportunity to identify new value creation initiatives. I think we're going to continue to improve our ability to be profitable under these very, very challenging circumstances. So with that, I will turn it over to Pepe for your first question on your QR codes.

Pepe Borda: Thank you for your question, Alvaro. Digital payments is 1 of our focus in the digital arena. In the B2B part of the business, AC Digital in LATAM, myCoke in the U.S., Yomp! in LATAM, and AC Mobile, all these tools, in all of them, we are improving the digital payments capabilities. Specifically talking about QR, QR code adoption is still small, but growing. In Mexico, there's this government initiative called CoDi that has not catch up yet, but it's supported by most of the banking system. In Peru, digital payments and QR codes are more developed. And in the U.S., as credit cards are widespread, we haven't seen that much of demand for us. In the B2C arena, yes, we are moving with touchless vending with payment through QR codes in all our operations. And in the B2C business here in Mexico and in LATAM, we are -- we will be ready to accept QR codes within the next 1 or 2 quarters.

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

Alan Alanis: Congratulations on the results, and I hope you're safe after the weather conditions you had in Monterrey yesterday. My question -- I mean, I'm going to make 3 big questions, and I don't expect them to be exhaustive on the answers. You can just answer some bullet points. First, a little bit of context. I mean the 3 of you are shareholders of Arca, and you know basically that the stock is where it was 5 years ago. And I think that everyone listening to this call is very interested in the stock price. And I mean your stock is a consensus buy by the sell side, and you beat expectations, yet the stock is not moving. So I do want to share with you the same questions that I get from investors when I'm talking about Arca, and ask for your help in terms of what should we tell these investors. And the main pushback from 3 areas, and whatever you can expand on these 3 areas? I know that this is a quarterly call, so you have to be brief, but it will be highly appreciated.

The first one is, what is the top line growth algorithm of this business? I mean, can this business grow volumes again? I guess that's the first pushback that we get. The second one we get specifically for Arca has to do with, can we get comfort that in capital deployment, your -- any acquisition that you do in the future would be accretive and would make sense for the shareholders. And the third and 3 keyest one is I mean what is -- what evidence do we have that the relationship with the Coca-Cola Company is improving and not getting all the surprises that the changes in concentrates are coming in a surprising way, at least for the market. Any comments on those 3 fronts would be highly appreciated, Arturo? I don't know if that makes sense.

Arturo Gutierrez: Yes. Thank you, Alan. Let me address your points. First, with respect to the volume, this is the story of some of our mature markets over the years. And you know the history of our industry, especially in Mexico, as volumes continue to grow, and we continue to identify new opportunities for growth in the future. I think that is -- that continues to be our current perspective. 2021 is different -- certainly, we're going to be comparing ourselves to the year where the pandemic hit the hardest, which is 2020. The first quarter is going to, as I said, going to look similar.

But if we look after that, I think we should be comparing to the prepandemic situation, that would be our baseline. And again, 2021 is another atypical year. We don't expect volumes to go back to that prepandemic scenario, but we are going to go back to a path of growth in all of our markets. And if you look at that growth, it comes from opportunities from within our core categories, and it comes also from the growth of new categories. If you think about our system as a bottler in general is to connect our leading brands and opportunities for consumers with our customers and the relationships that we have. And I think we've proven to be successful, not only in the traditional categories like brand Coca-Cola, but in new categories that have appeared and now we are leaders in the marketplace, if you think about some of the stills categories in Mexico. And what we're also doing in the U.S. with Topo Chico and BodyArmor and Monster.

So probably growth is going to come more from those categories to the extent they're profitable. I think it continues to be a success story going forward. It's not going to be spectacular growth, I agree, from a volume standpoint, but it's going to be consistent and also brings the opportunity of inorganic growth in the future. You could think of the company as a whole, as we continue to see a very fragmented Coke system around the world and in our regions as well. And that connects to your second point, which is capital deployment and M&A projects. And well, certainly, that -- what you said is certainly a priority to make sure that these projects create value for our shareholders. I think, again, our track record has demonstrated that we are very cautious about that and valuations, and we are going to continue to be prudent.

We are open to evaluate attractive opportunities that could arise and -- even could arise from this crisis in the markets where we believe we can expand our capabilities, and we continue to have, as you know, a strong balance sheet position with low leverage. So we're actively looking but taking into account precisely what you said to make sure that these create value for us. And maybe that we need to be patient and we ask investors to be patient for the same reason. But we, at the same time, believe there are many opportunities because we have the possibility of expanding our practices on the one hand, and we see very natural synergies in our markets, even in territories that are not neighboring to ours as we've seen in the past. And the relationship with Coca-Cola also kind of connects with that because we need to have, as you know, their blessing and their collaboration in these potential projects.

So we are convinced that our relationship with Coke is much better than before. And I know you're worried about concentrate pricing, but in the past, this was pretty much unilateral and without any discussion. Now we have ongoing negotiations. And we have certain guardrails under which we decide whatever we need to do. And we also have KO’s participation in key areas in our investments, marketing investments and even some of the CapEx, as in the case of the Universal

Bottle that we're deploying in Latin America, where they contribute. And this is not let's say, the traditional model under which we operated with them. So I think we're very pleased with what they're doing and with our dialogue and collaboration with them.

Alan Alanis: That's very, very helpful. Thank you so much Arturo and stay safe. I really appreciate you taking the time to go over the three points, thank you.

Operator: Our next question comes from Carlos Laboy with HSBC.

Carlos Laboy: Arturo, in North America, what does your channel mix look like versus prepandemic? And as you look to rebuild the food service opportunities in North America, how do you see the volume and margin opportunity? And maybe another element to that question is, is it -- are you looking to rebuild it maybe differently than you were before?

Arturo Gutierrez: Thank you, Carlos. Great question. Let me tell you how the channels have evolved in the U.S. for us in the last quarter as compared to the rest of the year. As you know, large stores in the U.S. have been more resilient and they continue to grow. They grew 4% in the fourth quarter, and they grew even more than that, I guess, in the year as consumers increase their at home consumption.

But if you look at the on-premise channel, it's still declining. It was more than 30% down in the fourth quarter. And throughout the last 3 months of the year, it declined less, I would say, by the end of the year, but still it's a full year decline of minus 32%. And so the mix has come down to 11% of our total volume in the U.S. So that is eventually going to recover. But it's going to be gradual. We still see some of those outlets that have not reopened or even if they reopen, as you know, they're not operating at full capacity. And probably, that's going to take some time. And some of these outlets or these distribution channels, maybe are not going to recover in a longer time because, as you know, on-premise includes everything that is not a large store and a convenience retail. So think about events or concerts or those kind of venues, that's going to take a longer time. So we certainly need to adapt to that, to your point. And at the same time, some of the channels are getting that volume. It's been migrating to other channels that, in some cases, could be more profitable to us, especially if we move from fountain beverages to some of the can -- and bottle and can packaging. And that's certainly favorable for us in the future. So we will continue with the development of transactions in the future. We saw transactions actually growing in sparkling and stills for 2021.

So one of the things that's important for that is to expand e-commerce and our digital platforms. Those 2 factors will be critical, myCoke.com and its expansion as we connect with some of the customers, and also our e-commerce initiatives in the U.S., this has been growing significantly as a result also of the shift in the channels going forward. So I would say that those would be our biggest opportunities. If we think about the new reality in the U.S., even after the health crisis is contained, we believe this is going to be a continuous strength going forward.

Operator: Our next question comes from Ulises Argote with JPMorgan.

Ulises Argote: Congrats on the results and thanks for the space for questions here. One on the U.S. Now that you completed the original synergy plan there and congrats, by the way, on doing that in such a complicated year. But I wanted to see if we can maybe get more color on the margin outlook here for the U.S. operations, right? So I remember you have mentioned before, there are still opportunities beyond that original $90 million plan. So just wondering if you can provide some color here on how you're thinking on the trends and the main drivers for that going forward.

Arturo Gutierrez: Yes. Thank you, Ulises. Well yes, as I said, we had a very good year. In 2020, we had a margin expansion. And I think the team has done a tremendous job in managing the business during the crisis in every aspect, in pricing, in managing our promotions, in managing this shift in the volume across channels that I just mentioned and adapting to the change in the consumer needs and also in, especially in managing the OpEx throughout the year. Part of that was the synergy program that was put in place, as you know, years back, but part of it was also adapting to the situation and finding new opportunities.

And as I said, that effort is going to continue. Some of the OpEx has to come back during 2021 as volumes recover. But there are other efficiency opportunities that we've identified, and we'll continue to support our healthy margins going forward. And very importantly, our pricing strategy is going to continue. So we expect to increase prices above inflation once again in 2021, and we want to highlight that because I think it's very important and also the way we manage our discounts and promotions as opportunities we have in our -- in the analytics space going forward. The raw materials, as you know, might not be as favorable if you compare year-over-year, but the other factors are certainly going to get us to very healthy margins going forward as well.

Just to mention one thing. There is a natural erosion in margins that continues under normal market operations, which would be the growth of the still beverages. It doesn't mean that they're not profitable, but it's just -- from a percentage point of view, that might result in certain erosion. But even with that effect, we've been able, as you see, to grow margins and if we compare with -- there's not a lot of public information in the U.S., but I think we have very good margins if we compare to other players in that market. But we’re still going to find opportunities and also to grow the business in general. We believe that the demographics of Texas are very favorable. This is a region that offers continued growth through its demographic profile. The influx of various industries that you see as driven by investment incentives. So that is also an opportunity for improving the profitability of our business in the U.S.

Ulises Argote: Congrats again on the strong results.

Arturo Gutierrez: Thank you, Ulises.

Operator: Our next question comes from Sean King with UBS.

Sean King: A question about the CapEx guidance for 6% in 2021. I mean I usually think of coolers as, I guess, the main focus area for CapEx. With what you mentioned about the changing consumer behavior and how that could be different going forward, I guess, how much of that cooler -- or how much of that 6% should I think of as sort of delayed upgrades versus expanding the overall cooler footprint?

Arturo Gutierrez: Thank you, Sean. Maybe I can turn it over to Emilio to explain some of the CapEx breakdown for you.

Emilio Marcos: Yes. Thank you, Arturo. Well, thank you for the question. As you know, we aligned our capital expenditure last year to the needs of each of the operations based on the volume of each of the operations, that's why our CapEx was lower than last year. It was 4% of sales, and it was below our budget of the full year. So in that regard, we are prioritizing investments in essential projects. And basically, CapEx, as you mentioned, are based on the business needs. And one of the main allocation are coolers, replacement, of course. And also, I think the main one for last year and maybe this year also was returnable packaging.

As Arturo mentioned, we're investing in the Universal Bottle, so that's part of the -- I think that's the main CapEx for 2021, returnable packaging. And while the second one may be coolers and IT capabilities for execution, that's another main chapter on CapEx for 2021. That's basically how it's the main investments on CapEx for 2021. And I would say that half of the budget for CapEx for this year will go to Mexico. Again, that's where we are mainly investing in Universal Bottle this year. And the second could be U.S. and then Peru, also in returnable packaging.

Pepe Borda: And Emilio, if you let me add. This is happening on the growth of e-commerce and new channels. I think for the short to mid-term, coolers and refillable bottles will still maintain to be the big chunk of our CapEx investments.

Arturo Gutierrez: Yes. But aside from just replacement, we are strategically investing in those areas, particularly returnable products considering the situation of the markets in Latin America.

Operator: Our next question comes from Antonio Hernandez with Barclays.

Antonio Hernandez: Actually 2 questions. The first one is, what is your outlook on input cost pressures for the year? And follow-up would be regarding current weather conditions in Texas. Have you seen any operating or any type of headwinds?

Arturo Gutierrez: Yes. Thank you, Antonio. Let me talk a little bit about inputs, and maybe Emilio, you can elaborate on that. The situation for main raw materials, as you saw for last year, was positive. PET prices, for example, were lower compared to 2019 across every region last year, on average, maybe 20% less, and we captured the benefit of such a decrease.

For 2021, however, prices are on a slight upward trend concerning PET, but we have already hedged around 30% of that volume at a level that is maybe moderately above our 2020 prices. With aluminum, we also had lower prices compared to 2019 and, for this year, we expect prices

to be similar to what we paid because we've hedged at a very good level our aluminum, particularly for the U.S., which is our biggest consumption. We have hedged around 90% of our needs for 2021. And in terms of sweeteners, fructose remained stable last year. We expect it to be also slightly higher in 2021 as the market driven by exports to China and some bad weather has moved upward. So we've already hedged also some of our needs – more than half of our needs for 2021. And sugar prices will remain fairly stable but at higher levels compared to what we observed in 2020.
So if you need more detail, we'll be happy to provide.

And with respect to the situation in Texas, well, really, this was a very severe storm. We're still being impacted. We have also the situation with the power outages. So we're dealing with that crisis. Certainly, operations are not normalized yet. That's what I can say. But we have to deal with that crisis today and in the next following days.

Operator: Our next question comes from Felipe Ucros with Scotiabank.

Felipe Ucros: Congrats on the results. Maybe if I can start with hard seltzer. You have now 2 quarters of Topo Chico in Mexico. So I was wondering if you could tell us what we've learned about the product category? How consumers look at it? And what do you expect for the future of this type of product within the portfolio and within the system as well?

And then the other question is a little bit of piggybacking off of what Alan asked. But it did jump at me that the report mentioned 90% reopening of customers on the on-premise channel. So I wanted to ask you what that means about the other 10%, does the 90% imply that at that point, the over 10% is probably not coming back? Or do you expect them to come back just at a delayed timing?

Arturo Gutierrez: Yes. Thank you, Felipe. Let me talk about Topo Chico Hard Seltzer first and maybe Pepe can elaborate on that. As you know, this is a natural extension for the Topo Chico brand, and it's one of the fastest growing categories, as you know, in beverages in many markets. It has premium pricing. And it competes in a separate segment from NARTD beverages. So it makes a lot of sense for us. We have launched it, as you know, in Mexico in the third quarter of 2020, in Peru in the last quarter, in the fourth quarter of last year. And it's going to take some time until we capitalize the full potential of the brand. But we continue to increase coverage, especially in large cities as in Mexico, Monterrey, Guadalajara and also in Lima. So maybe, Pepe, you can add some detail, right?

Pepe Borda: Yes. Thanks, Arturo, and thank you for your question, Felipe. We're using our existing sales and distribution mechanisms complemented with higher focus on e-commerce and also using third-party distributors with experience in alcoholic beverages where needed. In Mexico, we are reaching almost full coverage of the modern trade, both in Monterrey and Guadalajara, and we are gradually increasing our presence in the traditional trade and on-premise channels. We are now starting to expand to the major cities in our territory as we obtain the licenses to sell alcohol in those territories, and we learn more about this type of the business. While the category is still small and will take some time to develop, initial, I would say, unofficial market share figures show a good acceptance of our brand, our positioning -- and we are positioning ourselves in the first or second place in the category amongst the players in Mexico.

In Peru, it was just launched in December in the traditional trade and supermarkets and will roll out in the rest of the channels in the following months. So the category is still very small, but I think we are in a very good situation to expand and to be a very important player, if what happens in this category is similar to what has happened in the U.S.; and also, we are prepared for the potential launch of other flavored alcoholic beverages in the near future.

And if you -- Arturo, if you let me start with the other questions. When we talk about 90%, around 90% opening of the on-premise channel, this comes combined with very severe capacity restrictions going from only 25% to 50% of the available space, so that's what has kept this channel. It started on a path to recovery. We started to see minus 60%, minus 80%, and we are pretty much in every country in minus 30%, and we're seeing that also in this month. So this will take a while, but we've seen that when mobility starts to increase, this will recover, but this channel will definitely be hit for a while.

Arturo Gutierrez: Yes. But I think that's the most relevant point that it's not only about the number of open customers, but the capacity to operate them, because as you know, that varies across our different markets. But it's not 100% in any market. Sometimes it's 30%, 50%, the highest that we have is probably 75%. So that's really where the impact mostly comes from at this point.

Felipe Ucros: Great, thanks for the color guys. If I can do a follow-up on those. Maybe you can comment a little bit on the on-premise. What I'm looking for here is kind of if we can find an implied failure rate. So obviously, a lot of clients have opened and still very restricted, but what do you think is going to happen with the other 10%? Are they going to come back at all? Or should we assume that, that extra 10% is just not coming back?

Arturo Gutierrez: Well, it's not a 90% across all our markets. If you look at Mexico, it's around 98% now. So if you think about that trend, you can be optimistic about U.S. and Peru, which are lower than 80 but certainly, we don't know if the dynamics of the U.S. market can be somewhat different. We are more confident that Mexico, Ecuador, Argentina, they're on a trend to go back to where they were in terms of numbers, number of customers, but not -- again, on capacity of operation.

Felipe Ucros: Makes a lot of sense. And then I don't know if you can comment on this, but Pepe did mention that you guys were preparing for launching other categories in the near future on alcoholic bevs. Anything you can tell us there?

Arturo Gutierrez: Well, yes, we believe there's an opportunity in the category called the flavored alcoholic beverages, specifically. And that's why the learnings from the launch of Topo Chico hard seltzers, as Pepe was explaining, are very important for us, not only for this particular brand, but for a pipeline of ideas that we've discussed with the Coca-Cola Company.

Operator: Our next question comes from Marcella Recchia with Credit Suisse.

Marcella Recchia: I have 2 quick questions. The first one, if you could give us some trade update for the first 1.5 months across territories. And the second one is more towards a portfolio perspective. If you could give us some color on what has driven the weakness of flavors category within sparkling volumes? We have seen that this category has decelerated since before the pandemic. So just to understand what's going on and what has been done to accelerate the category volumes?

Arturo Gutierrez: Thank you, Marcella. What I can tell you about the start of the year is that it is not very different than what we've seen during the months of the pandemic last year. We're still comparing to -- obviously to a prepandemic scenario. And we, in fact, had a good start of the year in 2020. So it's a similar situation, the consumption across channels is similar, as I mentioned, the on-premise channel is still the most impacted. A lot of that volume has shifted to other channels, particularly traditional channels in Mexico and Latin America continues to be strong. And we also continue to be very disciplined in our OpEx to preserve our margins.

So you should expect a similar start of the year as what we had in the latter part of 2020. As we move through March and April, I think that is going to change, but we're going to have the comps of the highest impact of the pandemic, especially in South America. So we're going to be having the baseline of 2019 at some point within our operation to make sure that we have the clear goals of going back to the prepandemic volumes and growing from there. And the other trend during the pandemic is that the Cola brands were more resilient, and that's been affecting flavors. There are some other factors there in the U.S. - availability of packaging and some things like that. But certainly, flavors have been more impacted. So I'll turn it over to Pepe to elaborate on that.

Jose Borda: Yes. Thank you, Arturo. Thank you for your question, Marcella. Yes, as Arturo was saying, COVID in many categories, COVID has led to consumers to reduce trying new products and focusing on their most trusted and loved brands. And that has really helped our volume in Coca Cola, and that has hit the volume in flavors. That as you said, Marcella was not having a good performance before -- even before the pandemic. In some operations, we also have had to make choices due to limitations in labor or in supply chain, as Arturo was saying, in the U.S. with cans. And we also had to make some choices as diminishing Crush in Argentina. That is the brand that gives us the lowest margins. Flavors have also been impacted by the contraction of the eating and drinking channel where flavor sales over-index from other channels. Looking forward, we expect flavor brands to benefit from the Universal Bottle as we will be able to offer more availability in affordable presentations in flavors as well our innovation pipeline. I hope that is helpful, Marcella.

Marcella Recchia: That’s very clear, thank you.

Operator: Our next question comes from Fernando Olvera with Bank of America.

Fernando Olvera: I have 2 if I may. Can you elaborate more on what explains the strong margin expansion in South America across all countries are they the tough comps that you were saying? And how should you think about margin in this first quarter? And my second question is ahead of the Annual Shareholders Meeting based on the cash you distributed last year, I mean how should we think about dividends?

Arturo Gutierrez: Yes. Thank you, Fernando. I'll turn it over to Emilio to talk about both margins and dividends. And I can just mention briefly that in South America, we maintained the same focus, as I've explained for the rest of our operations. As you saw, our pricing is focused on being in line or above inflation. We were -- we couldn't accomplish that goal in Peru and Ecuador because of the change in mix mostly. But certainly, we had other factors that were very important, for example the reduction in OpEx in those countries was significant. I think it was a much bigger effort than even we anticipated at the beginning of the pandemic, very, very successfully. And also, we had the tailwinds from raw material pricing both in PET and some of the sweeteners. Our own sugar mill production in Argentina, that's helped a lot. It compares very favorably, maybe 35% below market references in Argentina for sugar, and that resulted in much better margins.

Also, the volume for the fourth quarter in South America started to improve. If you see, we have a very clear sequential improvement for volume in the fourth quarter. So, we expect that trend to continue in terms of volume. Although we still are facing the crisis with the COVID cases in – all across the region. But we continue, at the same time, to be very disciplined in our spend. Emilio?

Emilio Marcos: Yes. Thank you, Arturo. I only would add that basically, it's really impacted by mobility restrictions. As Arturo mentioned, if you remember, the second quarter we had volume declines of around 30% and then the third quarter, around 15%. And then fourth quarter, we had a positive volume in South America. Of course, not in all countries, but we have a very positive trend on volume that really helped margins, of course, top line and then reflected on the margins. And also, as we already explained, the saving initiatives that we implemented basically the fourth quarter in South America had a very good result on that. So we were able to improve margins 290 basis points in the fourth quarter, but unfortunately, we were not able to meet the same margins as last year, and we were down 100 basis points. But I think with this positive trend, we're positive on improving margins and go back to the same levels of 2019 in South America.

Arturo Gutierrez: So I think first, we have the capacity to adapt. I think that would be the most important thing to highlight, to adapt to the new circumstances and we've been impacted on the top line, but we've been able to maintain a profitable operation. I think that's key as we look to our future and, you know, volatility that we see eventually in Latin American markets. So -- and with respect to dividends, Emilio?

Emilio Marcos: Well, as you know, we paid last year an additional dividend on the month of December. We have the policy of payout of at least 30%. Last year, it was not any M&A activity, the Board approved an additional dividend. And we -- at the end, we had a payout ratio of around 94% of retained earnings.

Of course, we, as already, Arturo mentioned, our capital allocation, our CapEx and then dividends and M&A. So if there's no M&A this year that the Board could approve also an additional dividend this year, but we don't know yet. We're always looking for growing also inorganically and very actively in M&A, as Arturo already mentioned.

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

Arturo Gutierrez: Thank you. As always we appreciate your support and confidence. All of us at Arca Continental hope that you stay safe and well. Please reach out to our investor relations team for any additional questions that you may have and we look forward to speaking with you again soon.

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

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