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Arca Continental 4Q22 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. Ma'am, please go ahead.

Melanie Carpenter: Thank you, Katie. 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 2022. 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 you refer to the disclaimer and the conditions surrounding those statements in the earnings release.

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: Thank you, Melanie, and many thanks to everyone for being with us this morning.

Let me start by saying that we are pleased with our fourth quarter and full year results. Once again, we closed the year on a high note, delivering a solid top-line and volume recovery, operating margin expansion and remarkable free cash flow generation.

Despite continued volatility in nearly every region, we delivered an exceptional full year performance in 2022.

Total consolidated volume grew 0.1% in the quarter and 4% for the full year, to reach 2.4 billion unit-cases. This is the second year in a row that we achieved all-time high-volume marks.

Total consolidated revenues in the quarter rose 7.1%, to $52.6 billion pesos. For the full year, total consolidated revenues grew 13.3%, to $207.8 billion pesos, cycling 8.3% growth in 2021.

2022 was a year for the record books. I am proud to report that we surpassed the $200 billion-peso revenue mark for the first time in our company's history.

We continued effectively managing key levers of pricing and optimizing our promotional spend as we leveraged segmentation, analytics, customer, and consumer insights.

Consolidated EBITDA for the fourth quarter grew 9.4%, reaching $9.9 billion pesos. For the full year, EBITDA reached $39.6 billion pesos, up 11.9%, representing a margin of 19.1%.

While the year proved to be challenging, our timely pricing actions, coupled with tight control of expenses helped us to offset cost pressures in key inputs, maintain profitability, and enhance our market leadership.

And as we announced last quarter, we are moving forward with the new collaboration agreement with The Coca-Cola Company. We are excited about the potential to expand our consumer-centric portfolio and capitalize on the great opportunities that our digital alliance provides.

Let me now give you an overview of the performance and highlights of our five markets.

Total volume in Mexico for the fourth quarter declined 1.4%, cycling a strong 4.5% growth from the same quarter in 2021.

However, total volume for the full year grew 3%, to 1.3 billion-unit cases, once again breaking our all-time high annual volume record.

Volume performance was led by growth across all categories with sparkling up 1.8%, water 12.5%, and still beverages 2.8%.

The still beverages category contributed to 40% of growth in our Non-Alcoholic Ready to Drink portfolio in 2022.

We fully capitalized on the success of the FIFA World Cup marketing campaign and hosted the Trophy tour in Monterrey and Guadalajara, as part of its multi-country journey.

Brand Coca-Cola delivered a remarkable performance in 2022, growing 2.3% and posting its fifth consecutive year of volume growth, at a compound annual rate of 1.4%.

Net sales in Mexico rose 9.8% in the quarter to reach $22.2 billion pesos, marking the twenty-sixth consecutive quarter of net revenue growth.

For the full year, revenues grew 13.6% reaching $89.3 billion pesos.
Average price per case in Mexico - not including jug water - rose 10% in the quarter, reaching $78.04 pesos.

EBITDA in the fourth quarter increased 3.1% to $4.7 billion pesos, representing a margin of 21.1%. For the full year, EBITDA closed at $20.6 billion pesos, up 7%.

Single-serve mix grew 1.1 percentage points for the full year, confirming the sequential improvement trend. Growth in immediate consumption packages was driven by the steady recovery of the on-premise, convenience store and leisure channels.

The Universal bottle initiative continued to fuel growth as we expanded to more territories. These packages represent over 11% of volume mix within our multi-serve returnable portfolio.

We continued accelerating expansion of AC Digital. At the end of 2022, approximately 38% of our volume in traditional trade in Mexico was captured through this platform.

We also advanced with the rollout of our flavored alcoholic ready-to-drink portfolio, with the launch of Lemon Dou, and new reformulated flavors of Topo Chico Hard Seltzer.

In South America, total volume grew 2.1% in the fourth quarter, reaching 168 million unit-cases.

For the year, volume was up 8.9% to 602 million unit-cases and cycling strong double-digit volume growth in 2021. The traditional trade once again proved its resilience and confirmed the sustained recovery throughout the year.

Total revenue was up 1.3% in the quarter, reaching $10.4 billion pesos, while the increase for the full year was up 14.5% to $40.5 billion pesos.

EBITDA declined 6.2% in the quarter to $2.1 billion pesos, representing a margin of 20.6%, while for the full-year, EBITDA rose 14.6% to $7.9 billion pesos, a 19.5% margin, in line with 2021.

Revenue management and product reformulation initiatives, together with our focus on cost discipline and optimization, were key to maintain healthy profitability amid a decelerating consumer environment.

In Peru, volume was up 0.8% in the quarter, cycling double-digit volume growth from the same quarter in 2021.

For the full year, volume in Peru grew 7.9%, driven by sparkling, stills and water categories, up 7.8%, 8.4% and 10.4%, respectively.

We grew value share in the sparkling category, leveraged by changes in our mix. We saw a sequential positive trend in single-serve, up 3.1 percentage points in the quarter, supported primarily by the on-premise channel.

Nonetheless, we still see potential in this channel, which was severely impacted by the mobility restrictions in the last two years.

Our beverage operation in Argentina delivered 1.3% volume growth in the fourth quarter and 13.5% for the full year.

Volume growth in the quarter cycled strong 17.2% volume growth from the same quarter in 2021 and marks the tenth consecutive quarter of volume growth, confirming the sequential improvement.

Notably, growth in still beverages accelerated 9.2% in the fourth quarter, driven primarily by Powerade.

Promotional activities as part of FIFA World Cup global campaign, played a key role in achieving these outstanding results.

We capitalized on all the excitement and emotion from celebrations of Argentinian football fans across the country.

As for Ecuador, our beverage business posted a solid 5.8% volume growth in the quarter and 6.6% for the full year, driven by strong performances of Fanta, Fuze Tea and Powerade brands.

We continued driving immediate consumption occasions to capitalize on the sustained recovery of the on-premise channel, up 5.0% in the quarter and 14.1% for the full year.

Single-serve mix also benefited from this recovery, increasing 2.8 percentage points in the fourth quarter to reach 34.4% of total volume.

We invested in market-focused initiatives, refining our price-pack-channel strategy and promoting affordability by expanding the portfolio of returnable presentations.

Tonicorp, our value-added dairy business, posted double-digit sales growth in the quarter, driven by strong growth in yogurt, flavored milk, and oatmeal categories.

We maintained our strong market share in core categories, driven by solid execution at the point of sale and product innovation.

Our ice cream category sustained its growth momentum as we expanded product coverage and strengthened a closer connection with consumers, thanks to our portfolio of high-quality products and ongoing innovation in the premium segment.

I will turn now to our beverage operation in the United States. Coca-Cola Southwest Beverages closed out the year delivering a strong operating performance and posting solid topline and bottom-line results.

Volume for the quarter grew 1.3% to 112.2 million-unit cases driven by sparkling flavors category, up 1.2% and water 14.6%.

We saw a positive volume performance across Large and Small Stores, up 2.2% and 0.7%, respectively. Our volume boosting initiatives continued to shift volume into more profitable packages and delivered growth in multi-serve packages, up 1.5%.

Volume for the year was up 0.7% reaching 447.9 million-unit cases.

Revenues for the quarter rose 15.5%, to $962 million dollars, marking the seventh consecutive quarter of double-digit revenue growth. For the full year, revenue increased 14.2% reaching $3.6 billion dollars.

Average price per case in the quarter grew 14%, fueled by growth in total transactions up 1.7%, as we continued to focus on 20-ounce packages and promotional spend optimization.

EBITDA for the quarter grew an outstanding 38.5% to $158 million dollars, representing a margin of 16.4%.

For the year, EBITDA closed at $550 million dollars, an 18.1% increase with a margin of 15.1% and marking the fifth-consecutive year of EBITDA growth in our U.S. beverage business, and increasing EBITDA at a compound annual growth rate of 13%.

Importantly, the FSOP channel continued its path to recovery, closing the year with a strong 3.1% growth compared to 2021.

We are optimistic that in 2023 this positive trend will continue, as outlets reopen and consumers increasingly return to restaurants, retail outlets, sporting venues and vacation destinations.

Furthermore, we kept making solid progress in our digital agenda, as we expanded our B2B platform, myCoke.com, to reach 83.7% penetration in the FSOP channel.

And to conclude with the review of our operations, our Food and Snacks businesses posted double-digit sales increases in the quarter and full year.

Profitability significantly increased across all our snack divisions, as we accelerated our productivity and cost efficiency programs.

Wise Snacks in the U.S. delivered triple digit EBITDA increases in the quarter and full year, driven by our segmented pricing initiatives and enhanced management of discounts and promotions, along with key initiatives to optimize logistics, reduce freight costs and product waste.

Bokados in Mexico delivered single-digit sales growth in the quarter and posted its twenty-first consecutive quarter of revenue growth, mainly driven by the sustained recovery of the traditional trade.

In Ecuador, our snacks business posted double-digit sales increases both in the quarter and full year, supported by growth in the traditional and modern trade. Incremental sales growth was also driven by the launch of our new popcorn and cold cereal product lines.

I'd like to close now with an overview of our ESG initiatives.

For the fourth consecutive year, our company was included in the Dow Jones Sustainability Indices for the Latin American Integrated Market.

In addition, for the first time, we were selected to be part of the Sustainability Yearbook, a Standard & Poor's publication that recognizes those companies that demonstrate leadership in corporate sustainability.

In the environmental arena, we entered the Climate Change A-List published by the Carbon Disclosure Project, which recognizes companies that are leading the way in reducing emissions, mitigating climate-related risks, and contributing to the low-carbon economy.

Furthermore, an as evidence of our commitment to our communities, we deployed more than 120 shared value initiatives and allocated $6.5 million dollars to amplify our impact across 200 social purpose organizations.

Moreover, I would like to highlight our water access initiative. Throughout the year, our company provided more than 2 billion liters of water to communities to help mitigate water scarcity challenges.

And with that, I will turn it over to Emilio. Please, Emilio.

Emilio Marcos: Thank you, Arturo. Good morning, everyone and thank you for joining our call.

This last quarter and year-end results reflect the resilience of our business in a complex macroeconomic environment.
We delivered a solid financial performance in the fourth quarter, with high single-digit consolidated top line growth and an EBITDA margin expansion of 40-basis points. Although we still faced some pressure from raw material pricing volatility, this was offset by our effective price/pack architecture, operating discipline, and hedging strategies.

It is important to highlight that this year, our consolidated volume continued with a solid performance, already surpassing pre pandemic levels in all the countries where we operate.
We are pleased to report that in 2022, our US beverage operation reached an EBITDA margin of 15.1%, an expansion of 50-basis points from the previous year.

This represents an important milestone for the organization, as we have achieved the EBITDA margin level that we set as our target after the acquisition of these territories.

And now moving onto the results:
Consolidated revenues grew 7.1% in the fourth quarter, mainly driven by the solid performance of our operations in Mexico, US, and Peru.

For the full year 2022, consolidated revenues increased by 13.3% to reach $207.8 billion pesos, reflecting our effective pricing strategy and the solid volume performance throughout our operations.

Cost of goods sold increased 8.1% during the fourth quarter and 14.5% for the twelve months of 2022, mainly driven by increases in key inputs.

In the fourth quarter, SG&A grew 5.5% reaching $16.7 billion pesos, while for the full year it increased 11% reaching $63.9 billion pesos. Despite the inflationary pressure and challenging labor environment, our operational discipline and continuous search for efficiencies led to a 70-basis point reduction in our SG&A to sales ratio.

In the fourth quarter, Consolidated EBITDA reached $9.9 billion pesos, an increase of 9.4% and a margin expansion of 40-basis points compared to the same period of 2021, while for the full year it rose 11.9% to reach $39.6 billion pesos.

Net Income for the quarter was 24.2% higher, reaching $4 billion pesos with a margin of 7.5%, an expansion of 100-basis points from the same quarter of 2021. For the full year, net income was $15.5 billion pesos representing an increase of 26.2% from 2021, mainly driven by a strong top-line and efficiencies in SG&A.

Now, let´s turn to the balance sheet:

Last November 28th, an extraordinary dividend of $3.0 pesos per share was distributed, reaching a total dividend of $6.18 pesos per share for the year, which led to a payout ratio close to 90% of retained earnings and a dividend yield close to 3.8%.

As of December, cash and equivalents were $27.8 billion pesos, with a total debt of $46.9 billion pesos and a net debt to EBITDA ratio of 0.5 times.

For the full year of 2022, our operating cash flow was $30.7 billion pesos. The CAPEX investment reached $9.7 billion pesos, which allowed us to reinforce our production and commercial capabilities to keep pace with the current volume growth trend.

Our financial performance for 2022 demonstrates our ability to thrive and adapt during challenging times. We are confident that in 2023, our disciplined OPEX and CAPEX execution, consistent hedging strategies and the ability to capture market opportunities through our digital and commercial initiatives, will enable us to protect profitability and continue driving value creation to our shareholders, even in the face of recession fears and a still uncertain global economic outlook.

That concludes my review. Back to you, Arturo.

Arturo Gutierrez: Thanks, Emilio.

Our performance in 2022 is a direct result of successfully executing our strategy and demonstrating that we're operating from a position of strength, proving once again that our business remains resilient in the face of macroeconomic uncertainties.

As we look ahead to this year, we anticipate that inflationary headwinds across commodities, labor and utilities will persist and continue to weigh on both our consumers and our business. In this environment, we must maintain our disciplined approach to pricing. We will adjust prices to at least offset the inflation rate in each of our operations while maintaining affordability and value in our portfolio.

We expect our consolidated revenues to increase high single digit. We anticipate a further recovery of volume and mix and continue managing our key levers of RGM, promotional spend and scaling innovation across our businesses.

Additional recovery of the food-service and on-premise channels, as well as a resilient consumption at home should also drive volume and a better mix in 2023.

We plan to invest 6 to 7 percent of total sales towards CAPEX, continuing with our disciplined approach of investing in market execution capabilities and accelerating our digital agenda.

It is important to emphasize that the digital and technology investments that we've made over the past few years have been strong contributors to our top line growth.

In summary, although 2023 will be challenging, we are confident that the resilience of our business and the strength of the relationships we have with our customers will be key to sustain our market leadership.

We are making a difference in our industry and believe we have the right foundation to drive sustainable growth and deliver increased shareholder value in 2023 and beyond.

That concludes our remarks, operator we are ready to open the floor for questions please. Thanks.

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.

Thank you. Our first question comes from Benjamin Theurer with Barclays. Your line is now open.

Benjamin M. Theurer: Perfect. Thank you very much, and good morning. Congrats on the very strong results.

Arturo, maybe the one question I wanted to ask just in light of some of the outlook you've just given on growth in terms of top line, et cetera. Can you also help us put that in context with what you're seeing on the cost side, raw material pressure, ingredients pressure? How do you think about the balance between high-single-digit top line growth but then obviously still cost pressure that's likely going to persist? So just to get a little bit of sense of profitability across the region. Thank you.

Arturo Gutierrez: Sure, Ben. Thanks for your question. Well, as you saw in '22, we did have a high raw material cost environment and certainly impacted our margins. Our pricing strategy last year was very effective to mitigate that impact as was our OpEx discipline throughout the year. '23 still looks challenging in several raw materials, but we're expecting some commodities to start cooling off during the year. Probably the most relevant impact for the year would be fructose in terms of pressure, but in -- or sweeteners in general, but we are expecting a better environment in comparison with PET cost and with aluminum, although it will remain high, but in comparison, it will be, in some cases, better, especially aluminum in the U.S. and some of the PET comparisons in South America. We also have some hedges for some of those inputs. So I'll ask Emilio to elaborate more on that.

Emilio Marcos: Yes. Thank you, Arturo, and thank you for your question, Benjamin. In fact, we've seen a slowdown in the second half of the year regarding raw material prices. So we expect that to continue for this year, but the only issue, as Arturo mentioned, is sweeteners. Basically, in Ecuador, we still see higher prices this year in sugar for Ecuador, the other raw materials we expect to continue the slowdown that we started to see in the second half of the year.

Regarding hedges, for 2023, we have hedged 75% of aluminum and 80% of fructose in Mexico and U.S. and 80% of sugar in Peru. And all these hedges are below 2022 prices or in line with inflation. So we are really well covered there. And as you know, in Mexico and Argentina, we have integrated with our own sugar mills. And regarding FX, we have hedged 50% of our U.S. dollar needs in Mexico and 80% of U.S. dollar needs in Peru at a lower current levels. So we feel comfortable with those hedges. But we still – well, we still have some fears recession fears and volatility, we're still looking for any opportunities that we can improve or increase our hedges.

Arturo Gutierrez: But all in all, that would mean that we have a positive perspective on our margins for the year.

Benjamin M. Theurer: OK. Perfect. Thank you very much.

Arturo Gutierrez: Thank you, Ben.

Operator: Thank you. Our next question will come from Alan Alanis with Santander. Your line is now open.

Alan Alanis: Thank you so much. Congratulations, Arturo, Emilio and Jose. I hope you can hear me well. A couple of questions here. The first one regarding alcohol products in Mexico. Could you talk a little bit about this strategic relevance that they're having? I know that they're very small, you mentioned the 40% of your growth was coming from still beverages, that means that 60% is still coming from sparkling. I wonder how much -- what's the potential and what's the outlook -- the strategic outlook for alcoholic beverages in Mexico.

The second question is you mentioned that water was the main driver volume in Texas, that's 15% for the U.S. operations. What's driving such a strong growth in terms of bottled water in Texas, and how sustainable that'll be? I guess those are the critical operating questions.

And any update that you can give us on capital deployment and M&A, lastly, that would be highly appreciated. And again, congrats on the results. Thank you.

Arturo Gutierrez: Thank you, Alan. I'll turn it over to Pepe. Just to mention briefly about our strategy in terms of alcoholic beverages and how -- that has several dimensions. It's not only about incorporating products to the portfolio and -- it's actually increasing relevance to customers with certainly a broader portfolio, improving our frequency at the point of sale and having the right partners in the right categories that would fit our execution and our distribution operation, and also to complement our strategy to build a digital ecosystem in the traditional trade in Latin America.

So it has several dimensions as we do that. And we know that the most adjacent categories for that would be certainly beer and some alcoholic beverages. As you know, we've been selling beer in Argentina for many, many years and it's becoming quite relevant in our portfolio. So we know that, that is a very complementary part of the portfolio. But now it goes beyond that as we expand our scope and as technology is incorporated in our go-to-market model.

So I'll let Pepe to elaborate a bit on that and also on the performance of water in the U.S. market.

Jose Borda: Thank you, Arturo, and thank you, Alan, for your questions. As Arturo was saying, our multi-category strategy is twofold. We're selecting partners and categories that generate more synergies with our portfolio with joint execution and distribution, and beer and spirits also fall within these categories. The beer pilot with Heineken in Ecuador has shown important synergies with distribution and volume growth along with also important mix of premium beer that is important in that category, which have increased our customer base. And most importantly, the penetration of our brands in the customers that we share in both categories has increased.

In Peru and Mexico, we expect to have pilots running with one of the main beer producers by the end of this quarter. And as Arturo said, our experience in Argentina has shown and proven that this category is very synergistic with our base business. Also in spirits, we already launched a pilot in Guadalajara, partnering with Diageo. We are increasing Diageo's brand's coverage in the traditional trade and also cross-selling with also NARTD mixers. But still, it's too early to have the results.

On your other question about water in the U.S., it's mainly -- what it mainly growing is Topo Chico that is growing, SmartWater, that is also growing importantly. And those are profitable water products and we are participating in the plain water with Dasani brand. So that's mainly bringing our volume up in the U.S.

Arturo Gutierrez: And just addressing your final point, Alan. We're keeping the same strategy with respect to capital allocation in terms of what we've said before for dividends and share buybacks. And you also know about M&A, what has been our approach. We're going to continue to be patient and prudent about the possibilities of growing inorganically, mostly in the beverage space in the regions where we operate. So there's nothing in particular to add to that at this point.

Alan Alanis: Got it. No, that's very clear. Congratulations. I mean, just really quickly in terms of capital deployments in alcoholic beverages. Andina announced that they're opening -- they're building a brewery basically in Brazil. Is that something that you would consider in some of your territories? I mean, it sounds like the potential for alcohol is pretty big. So it could mean you would also build your own production capacity for alcohol?

Arturo Gutierrez: Well, if it makes sense, surely we would analyze. It's not something that we are exploring at this particular time.

Alan Alanis: Got it. Thank you so much and again congratulations for the results.

Arturo Gutierrez: Thank you, Alan.

Operator: Thank you. Our next question will come from Thiago Bortoluci with Goldman Sachs. Your line is now open.

Thiago Bortoluci: Yes. Hi, good morning, everyone, and thanks for taking the question. Congratulations also on the results today. Maybe I have a question for Arturo. Arturo, you've been commenting for a while, right, around the potentials from this new cooperation agreement with Coke. Obviously, there are multiple touch points to address here and I guess multiple areas of opportunity for you to capture. I'll just like your help to comment and elaborate a little bit more and help us make this more tangible in terms of water, the specific areas for further growth that you envision maybe for the next 12 and 24 months arising from business-related agreement with Coke Group? Thank you very much.

Arturo Gutierrez: Yes. Sure, Thiago, and thank you for your question. For us, this has been a very, very important transformational agreement of what we've reached with The Coca-Cola Company because it certainly goes beyond our traditional relationship with our partner in our core business. So this has several objectives as we align our strategy with them.

I think the key word, again, as we've said before is alignment. We want to operate as a unified system, although we certainly are separate companies and each of us has particular roles, but we want to be much better coordinated and aligned on what we do. And that starts with our core business. I think we are in a much better position now to align on our plans, to have a joint planning process, to set goals. And more than goals, to identify what are the enablers and investments and the capabilities that are required to reach those goals.

We, first of all, the first premise is that we still believe that our core business and the core categories have a significant potential for growth in all the markets where we operate. And so the first idea of the agreement is how can we align to capture that growth in the different channels, in the new categories or the new sub-categories that we've been launching in our operation. So that's going to step one.

Step two is what Pepe was describing. As technology has been incorporated to our operations, we've identified that it's a better way to manage the complexity of the portfolio in the market. So that's what presents the opportunity of expanding into alcoholic beverages and other products that are certainly adjacent, as Pepe was explaining, to our current portfolio, meaning they have a very similar go-to-market model. They might go in the red truck, they have a similar approach to customers. And then other products maybe that are not as compatible with our go-to-market model. But certainly there are some of the links in that model that would apply to other products. And that's where the multi-category opportunities arise and this is a big, big change in paradigm of years ago where we thought that we had to be focused on our core categories, and that it was very hard to expand without hurting sales or the focus on those categories. Now, with technology, with all the new capabilities, we know that can be done and the pilot has shown that.

And the third dimension of this agreement would be the digital ecosystem. That's a completely different ballgame. This is creating more relevance with the customer. That probably would ramify into a number of other opportunities in the digital space which as you know, we have been exploring on our own. And if you look at what we have been doing with Yomp! in the last few years, we have 19,000 active customers with Yomp! Premium. That means a platform that has this connection with the customer in the digital space and it brings new opportunities including the collection of data.

So now as we bring Coca-Cola into that partnership, again, it strengthens our presence in the store and the collaboration will also drive us into scaling this further, although we think that we've achieved now a scale that has validated the model. So I think in summary, those three aspects would be the most relevant for our perspective of a long-term relationship model with the company.

Thiago Bortoluci: That's super clear, Arturo. Thank you very much, and once again, congrats on the results.

Arturo Gutierrez: Thank you, Thiago.

Operator: Thank you. Our next question will come from Fernando Olvera with Bank of America. Your line is now open.

Fernando Olvera: Hi. Good morning, and thanks for taking my questions. Very quickly, regarding your sales guidance for the year, I mean, can you comment what is the performance that you expect by division? And the other question is given the improvement in single-serve in 2022 mainly in Mexico and South America, can you give us some color of what are you expecting regarding mix to behave this year, and how are you seeing it by division? Thank you.

Arturo Gutierrez: Sure. I'll turn over the second part to Pepe, and thank you, Fernando. Let me just talk a little bit about volumes and sales going forward in this year. The guidance we've provided is based on several factors, some positive aspects for volume growth this year, and I'll mention probably the most relevant. One is the expansion of our AC Digital platform, which we know that not only provides a new connection with customers but actually increases sales and that still has an opportunity to continue to grow as we've seen in the last few months.

We continue leveraging analytics to boost sales as well, segmentation, defining optimal portfolio or suggested order and something that's also very tangible which is the recovery of the on-premise channel, which is something that has not fully occurred except maybe for Argentina. But for most of our markets, we're still not at pre-pandemic level. So there are several reasons to believe that we still have room for growth, even though we, as Emilio said before, we're facing a macroeconomic headwind in the year.

And I think these would apply mostly to every one of our markets, the factors that we mentioned. There's some additional things in some of the markets. We expect every market to grow and in the case of Mexico, there's some additional things that we should mention which is how we're capitalizing the near-shoring of investment for a territory. So that's also a very significant factor that impacts positively a business. If you see the recent investment in Mexico, maybe more than 70% of that is coming to Arca Continental's territories. And so that's going to be an important positive impact in the economic dynamics of our territories.

Same thing for the expansion of returnable packages in all four regions. That's also going to be an important initiative that will bring us additional volume. And one thing that we have to mention and this is mostly an opportunity, something what we were not operating at our ideal standards last year. It's that we had a number of supply chain disruptions in most of our markets. So we've also identified those as an opportunity, as an upside for 2023.

So I mostly wanted to mention those factors that are part of the building blocks of our plan and that would get us very conservatively to grow in every one of our markets. And looking from what we've been seeing in the first few weeks of the year, I think we're on the right track. I mean we have a good momentum in almost every market. So we're optimistic about -- again about the year and also positive about the guidance we've provided.

With respect to the mix, the mix has also been very important as we have improved average prices of 2022. And as the on-premise market recovers, that's also again an opportunity to improve mix. But I'll let Pepe expand a bit on that.

Jose Borda: Thanks, Arturo, and thanks, Fernando, for your question. So just adding to what Arturo is saying, as you know, the pricing and packaging architecture, and our installed RGM capabilities are key in our pricing strategy. So as you said, volume mix will also be a key component of our strategy as we continue promoting and executing more profitable packages.

For example, in the case of Mexico, the tailwinds in that sense will be the immediate consumption channel recovery that Arturo said, and the launch -- the expansion of the --for example, the 250ml PET bottle, centric packages in all the categories. In the U.S., for example, we have also the positive mix effect, driven by single-serve bottle, especially the 20ounce bottles. So we expect mix to be also an important part of our pricing for next year.

And that will be complemented by the carryovers that we have for next year. Because of the price increasing that we did in 2022, we have to give you some numbers. In Mexico, the carryover for the next year is 6.4%. In the U.S., we are entering 2023 with a carryover of 6.2%, 4.8% in Peru, 4.4% in Ecuador, and 30% in Argentina. So that also helps us to drive our pricing for the next year.

Fernando Olvera: Great, thank you so much.

Arturo Gutierrez: Thank you, Fernando.

Operator: Our next question will come from Alvaro Garcia with BTG Pactual. Your line is now open.

Alvaro Garcia: Hi, good morning, gentlemen. A couple questions on my end. One, just a quick follow-up on the sales guidance for 2023. You mentioned high-single digits. I'm just curious if that's FX neutral or not? Peso's obviously been very strong. We calculate a couple points of headwind there, I'm not sure if that considers the stronger peso or if it's on an FX neutral basis? And I'll wait to ask my second question.

Emilio Marcos: Yes. Well, thank you for your question, Alvaro. No, we're not considering a stronger peso. It's really difficult to predict. So we're basically considering a flat exchange rate so that will impact that number talking about revenue, but --

Alvaro Garcia: Great, that's very clear. And then my second question is going back to multi-category. Just wondering how you're balancing pilots on the Coke truck versus increased traction at Yomp!? And again, a lot has been made of the sort of the magnitude of the potential opportunities. So any sort of comment on sort of when you might sort of scale these pilots would be very helpful. Thank you.

Jose Borda: Thank you, Alvaro. So as I said before, our multi-category strategy is twofold. In one side, we're partnering with partners and categories looking for synergies, and that's where beer and spirits, for example, fall. There's another set of categories in which what we aim is to generate platform stickiness, and increase our share of wallet with our customers. In those categories, we might use only parts of our Route-to-Market capabilities, and mainly emphasize the use of digital assets.

We already have a multi-category platform operating in Ecuador representing more than 40% of our customer share of wallet, with also beverages, berries, dairy, salty snacks, pastries, and all, 15 other categories. And beer is also going to complement this commercial ecosystem. So in Mexico, we have been learning for the past three years with Yomp! Express. And being just a wholesaler is not a good business per se, our aim is not to become a wholesaler, but to generate stickiness with our ecosystem.

With the LTRM just signed, we are starting joint commercialization and distribution pilots with the Coke portfolio in Monterrey and Guadalajara. But our aim is to evaluate the right portfolio and Route-to-Market strategy. This will include using our complete distribution system, including Coca-Cola trucks for some products or only our digital platforms for other products. And we are in pilot phase in that arena. And having said that, Arturo mentioned it but Yomp!Premium continues healthy growth; we’ve reached close to 20,000 customers and positive EBITDA and we're generating insightful data that helps us to boost our core business sales.

Arturo Gutierrez: And then, also, we increase the loyalty of those customer. So you have to think about this as connected -- the business of selling other categories might be more attractive than beer initially. The other categories may not be a great business at some point, but it does reinforce the strength of the platform. The cost of switching might be lower for the customer, but not if that is interconnected to the rest of our digital ecosystem and that's what we're trying to do and identify what the points of connection are within the current go-to-market model. And so the trade-offs are there are probably if you use more of the red truck it’s added complexity but increased profitability. So we are figuring out what would be the best one, especially for those other categories that are not as adjacent as would be beer and spirits.

Alvaro Garcia: Great. Very helpful color.

Arturo Gutierrez: Thank you, Alvaro.

Operator: Next question will come from Sergio Matsumoto with Citigroup. Your line is now open.

Sergio Matsumoto: Yes, good morning. Arturo, Emilio and Pepe, thank you for taking my question. I want to go back to the cooperation agreement question. And this has been in place for five months and appreciate the color you gave on the possibilities. Are there any changes that you would like to highlight that took place in the last five months that wouldn't have occurred under the old agreement, perhaps in the way you invest capital or launch products or go-to-market within the core business of non-alcoholic?

Arturo Gutierrez: Yes. Thank you, Sergio. I don't think there are any tangible changes in that aspect. Most of what has changed has been in our interactions with the Coca-Cola company, and mostly that foundation of the culture of the relationship. And that's what we've been working. We’ve actually had meetings with top leadership of both companies, where we define those principles and we've been working on the planning process as well, on the setting of goals and those sort of conversations are the ones that we've had.

I would say in a very positive way, not that we didn't have good conversations, but I think that we've become closer in those interactions. One good example is particularly the digital space and the initiatives that were -- the pilots and the initiatives that we’re undertaking, those are coordinated and we have the input of people from the company, and they're part of the meetings and the committees and the decisions now. So it’s mostly in that level that we've made progress in the last few months. I think that -- again, that would be the foundation of how the growth is going to come in the future.

And another example to what Pepe was explaining a minute ago is that the Coca-Cola Company is now participating in Yomp!, not only in decisions but also contributing to the expenses and the cost of operating Yomp! and that also reflects the commitment they have to go beyond the core business.

Sergio Matsumoto: Okay. That's very helpful. And if I could add another question. You mentioned the distribution order management technology in the United States. Could you give some color on that and which part of the distribution logistics this technology would enhance?

Arturo Gutierrez: Yes, I'll turn it over to Pepe for that.

Jose Borda: Yes. Mainly the focus is on more dynamic routing and getting efficiencies in the way we distribute our products. We are working -- and working means not only in the U.S. but also in Latin America. We are also creating a fully automated logistics network with expanding digital platforms such as network design, transportation management system, telemetry, et cetera. And we're in the midst of implementing company-wise, a whole integrated business planning platform to optimize our supply chain in partnership with Blue Yonder.

Arturo Gutierrez: So that impacts mostly primary distribution.

Sergio Matsumoto: OK. Very helpful. Thanks to you and congrats.

Arturo Gutierrez: Thank you, Sergio.

Operator: Thank you. Our next question will come from Lucas Ferreira with JP Morgan. Your line is now open.

Lucas Ferreira: Hello, everybody. Thanks for the space for questions. My first one is a follow-up on your comments on, I guess it was Arturo's comments on the near-shoring. So just wanted to understand a bit better the opportunity you see there with the larger investments – is that region of Mexico growing faster? Given the already high consumption per capita, do you see this as more of a volume opportunity or more of a mix opportunity, pricing? And how do you see that playing out? So when you compare the standards of consumption of Northern Mexico, let's say with the U.S., so what are the gaps you see that could flow and benefit you.

And the second question on the multi-category, I know that U.S., it's a very, very different market from Latin America, it's much more mature market in terms of logistics and supply chain, et cetera. So my question on multi-category is that there's something you see that you could be done in the U.S. as well? Maybe to compete with some service or distribution company. Is that any category that sounds more obvious for you to jump in as well, or it's just more Latin America opportunity?

Arturo Gutierrez: Thank you, Lucas. Let me talk about near-shoring first. And as I said, this is a very positive impact in our business. It's certainly an indirect impact as the economy is -- continues to be activated here in the North and certain parts of Mexico. And that is now becoming very, very visible as the way just how the world has been evolving provides a very, very important tailwind for this part of the world. And I've been actually working in a group with the Mexican private sector to identify the supply chains that would be logical to be relocated to the region to the Mexico/U.S., region or North American region based on USMCA and obviously logistics convenience. And we've identified 11 supply chains that make a lot of sense to be relocated and that is already occurring. They're not connected to our beverage businesses. This is something again that it's indirect but we will see the impact of that and how that would be reflected.

Well, as you said, it will be certainly growth in volume. The per capitas may be high, but this is again, the same story that we heard over the decades, per capitas have been high and the volume and the market continues to grow. And we still think there are many opportunities there to develop categories that are not as developed. And now we have the comparison with the U.S. where you see those categories and subcategories being developed and you don't see that as much in Latin America.

It has sometimes something to do with purchasing power, as you said, the mix is going to improve also. And that connects to the possibility of consumers to buy some other of the relevant value-added categories, which has happened in the U.S. So if you look at, if you compare those markets, it's still, the U.S. is lower margin but on an absolute basis EBITDA per case is higher, because of that I mean, we have much more variety of those value-added higher price per case products. That going to happen naturally as the economy develops, and that's been happening mostly in the states of Nuevo Leon and Coahuila, Chihuahua, San Luis, which are states where we operate. And again, I said that the data that we have is that more than 70% of the new investment, is coming into to the Arca territories in Mexico. So I think that's going to be important, not only '23 but in many years to come as those supply chains continue to be relocated.

And second with respect to multi-category, the opportunity to go beyond the traditional categories for now would be Latin America. In the U.S., as you know, there's some regulatory restrictions in alcoholic beverages and go-to-market is certainly, I should say, more sophisticated and complex. We do have the snacks business in the U.S. which operates independently, but currently, we are exploring the expansion innovation and categories in the U.S. only in the beverage space.

Operator: Thank you. Our next question will come from Rodrigo Alcantara with UBS. Your line is now open.

Rodrigo Alcantara: Hi. Thanks guys, Arturo, Emilio. Thanks for taking my questions. Just a couple quick ones here. Was curious on the breakdown, but by channel in Mexico, right? You mentioned 12% volume in supermarkets, 4% in on-premise channels, right? So it sounds to me like the issue this quarter was like mom-and-pop and perhaps proximity channels in the modern trade as well. So I was just curious if you can comment the growth on those channels, what happened there and how you have seen volume growth in those channels in the last few weeks. That would be my first question.

And the second one very quickly on the U.S. and you continue to surprise us there on what you can achieve in terms of profitability. So just curious, if you can give us any or you have any idea without giving any formal guidance, but any idea on where do you foresee the EBITDA margins in the U.S. on a long-term basis? Thank you very much. Those will be my questions.

Arturo Gutierrez: Thank you, Rodrigo. For the first, I'll turn it over to Pepe. Just mention briefly that when you look at channel performance in any particular quarter or even in the year '22, it has to be connected to how those channels have performed throughout the pandemic. There's been significant recovery in some of the channels that had not been performing as great in the last couple of years, but I'll let Pepe to expand on that.

Jose Borda: Exactly, Arturo. And Rodrigo, to give you perspective on these. When you compare to 2019, the traditional channel is growing 7.4%, and the modern trade is growing 8.8%, while the on-premise channel is still below minus 9%. But that is mainly driven by the entertainment channel, which was the most impacted and has not recovered, however, the eating and drinking channel has already recovered or is in recovery in the end of 2022.So what we're seeing in the short-term is just a rebalancing of the channels to the pandemic effect.

Arturo Gutierrez: And Rodrigo, with respect to the second part, the profitability in the U.S. First of all, we're certainly satisfied with the performance in the U.S. not only in terms of the margins, this is one of the operations where we increased margins in '22, despite the challenging conditions for raw materials, especially aluminum and PET pricing. But even more importantly, the EBITDA on an absolute basis continues to grow. Fourth quarter '22 was the17th consecutive quarter of EBITDA growth in our U.S. business which is also something that we're very satisfied with. As we look forward and taking into account what Emilio explained about input pricing, we're very confident that we are going to be continuing to grow overall EBITDA and maintain the margins that we've attained so far.

Rodrigo Alcantara: That's great. Thank you very much.

Operator: Thank you. Our next question will come from Carlos Laboy with HSBC. Your line is now open.

Carlos Laboy: Yes. Good morning, everyone. Congratulations on the quarter. Just to stay with that previous question a little bit longer, which of the dynamics that drove margin improvement in Q4 do you think might most contribute further margin gains in the U.S.?

Arturo Gutierrez: Yes. Thank you, Carlos. That's a very relevant point that you're making. This has actually been the focus of how we manage the business in the U.S., because this is an operation where we always present this chart with two axes. One is the change in mix. And the second is the gross margin of that particular category so we can identify that effect very clearly and very graphically. And the big opportunity certainly should come from growth in single-serve, growth in transaction packages, growth in the on-premise market and recovery of the on-premise market, in particular which, still is way, way below the pre-pandemic levels, 20% below pre-pandemic levels.

So if you look at both channels and packages and look at that chart, there's still some opportunities continuing to grow, any of those packages that are above the $3, $3.3 gross margin per unit case mark. And that's what we continue to focus our commercial strategy. So I think that's been a change and a very effective approach of our team in the U.S. to connect kind of the strategy in the market with the profitability of a certain packages. So that's how we sustain margin even in this environment where raw materials were very challenging in terms of price.

Carlos Laboy: And if I may, just on refillable. Refillables last year seemed to be going in the wrong direction, going down. Do you see any changes in the pipeline for growing refillables better and faster?

Arturo Gutierrez: Yes. Refillables is one of our priorities in Latin America, Universal Bottle has proven successful. This is one of the initiatives that's very important. And also, as we're going to be seeing a challenging also macro conditions in some of the markets, this will continue to be a very important strategy and an important investment for each one of our Latin American markets. So we expect that to maintain probably at the current level, maybe grow in some particular markets, mostly to balance our price pack architecture.

I think refillables will be maybe more important in Ecuador. I don't know If you agree with that Pepe? That's probably where we have a more challenges in terms of competitive environment. It's very important in Argentina as well, which is the highest mix of returnables in any of our markets. But also Peru and Mexico would be very focused and in some of the multi-serve packages for returnables.

Jose Borda: And Carlos, just do to add up to what Arturo was saying, it's important to take into account that during 2022, as we said mix has gradually shifted from returnable to not returnable due to the recovery of the modern trade, and the on-premise channels. So --and also, it's important to say that we had limitations in production due to short of some returnable glass presentations. So that probably -- that is not going to happen in 2023.

Carlos Laboy: Thank you.

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

Arturo Gutierrez: Thank you, and as always, we thank everyone for your time and interest in Arca Continental. Please reach out to our Investor Relations team for any questions you might have. Have a great day.

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

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