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CONFERENCE CALL

Arca Continental 1Q21 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 and good morning everyone. I want to thank all of you for joining us today to go over our first quarter performance.

Let me begin by saying that 2021 is off to a good start, with positive top-line growth, strong underlying margin expansion and volume acceleration.

The unwavering dedication and commitment of our associates was fundamental to overcome a still challenging business environment and weaker consumer sentiment due to the ongoing COVID-19 pandemic.

Total consolidated volume grew 0.4% in the quarter, reaching 514 million-unit cases.

Once again, our beverage businesses in Mexico and the U.S. remained resilient and delivered a notable improvement in organic revenue growth in the first quarter.

Total consolidated net revenues rose 4.1% to reach $40.5 billion pesos.

Consolidated EBITDA grew 15.7% reaching $7.7 billion pesos, representing a margin of 19%, for an expansion of 190 basis points. This is the highest EBITDA margin we have recorded for a first quarter in 4 years.

First quarter results reflect the steady progress that we are making. Our financial and operating discipline, along with our market focus enabled us to take another step in the right direction in every market and deliver solid top and bottom-line results.

Now let´s review the performance and highlights across our operations.
Our beverage business in Mexico continued to show positive momentum, delivering another solid quarter of volume growth, up 1.4%.

Volume growth was driven by a robust performance in colas, sports drinks, and personal water categories, up 7.6%, 14.8%, and 2.5%, respectively.

The traditional trade channel continued to stand out with 7.6% volume growth in the quarter, while the decline in supermarkets and convenience stores moderated.

The mix of returnable presentations in Mexico grew 1.3%, as we continued investing in our new "Universal Bottle" to address the new buying patterns and consumer preferences for affordable, multi-serve presentations.

Total net sales in Mexico rose 9.4% in the quarter to reach $16.6 billion pesos, marking the nineteenth consecutive quarter of net revenue growth.

Average price per case - not including jug water -, rose 6.5%, reaching $68.37 pesos.

Moreover, we were able to grow value share in NARTD beverages, due to the excellent market performance in still beverage categories such as water, sports drinks, soy beverages and juices & nectars.

On the profitability front, EBITDA increased 24% to $3.8 billion pesos, representing a margin of 23.2%, for an expansion of 270 basis points. This is the 8th consecutive quarter of margin expansion, as compared to the same quarter of the previous year.
Notably, this is the highest first quarter margin in Mexico since the merger of Arca and Grupo Continental.

Turning now to our operations in South America, total volume was flat in the quarter, resulting from declines in Peru and Ecuador, which were offset by growth in Argentina.

The major concern now is the resurgence in COVID-19 cases as some countries are entering second and third waves.

The resilience of these economies is linked to the success of targeted restrictions and the underlying strength of business spending.

Total revenues in the region were down 5.8% in the quarter, reaching 8.8 billion pesos, while EBITDA declined 3.4% to 1.8 billion pesos, representing a margin of 21%, for an expansion of 50 basis points.

We continued driving affordability, doubling down on execution, and focusing on cost discipline to mitigate the impact on profitability.

We are optimistic that after a pandemic-driven recession, the economy in the region is expected to start a tame recovery in 2021 on the back of eased mobility restrictions.

In Argentina, our operation delivered sequential volume growth in the first quarter, up 4.7%, cycling a strong 2.7% growth from the same quarter in 2020.

Volume growth in the quarter was driven by both sparkling and still categories, up 2.2% and 51.7%, respectively.

Brand Coca-Cola showed its resilience, up 8%. Growth in stills was led by the Juice category, followed by Sports and Energy Drinks.

From a channel perspective, supermarkets and wholesale delivered strong improvements.

This quarter we launched in Argentina Coca-Cola With Coffee in a 250 milliliter PET presentation. This is part of the strategy to continue innovating our sparkling portfolio and offer consumers more alternatives in the zero-calorie category.

Turning to our business in Peru, volume was down 1.2% in the quarter.

We gained value share in NARTD beverages, driven by both sparkling and still categories, and supported by our affordability initiatives, particularly in multi-serve formats.

Brand Coca-Cola grew 10.8% in the quarter. Fanta also delivered strong 7.3% growth thanks to our affordability initiatives with 1.5- and 2-liter returnable packages.

The traditional trade and wholesale were the best performing channels, with 9.6% and 11.8% growth, respectively.

We accelerated the rollout of our AC Digital platform, expanding our B2B capabilities to more than 59,000 customers in the traditional channel interacting with us and placing orders through our mobile app on a regular basis.

Also in the quarter, we launched a new 7-liter package of our Benedictino brand to continue driving affordability in the water category.

We are encouraged by the latest economic reports showing that GDP and employment are accelerating in Peru due to reopening of various sectors, such as mining, manufacturing, and commerce. These areas have helped activity levels recover from last year's lows.

I will conclude my commentary on South America with our business in Ecuador.

Volume in the quarter was down 1.6%. The country faces the third wave of the pandemic with a sharp rise in new cases. The gradual easing of restrictions has been put on hold, and tighter measures were reintroduced, mainly relating to movement and curfews, but with some more stringent lockdowns in the most affected regions.

We executed targeted commercial initiatives focused on protecting portfolio affordability, as we continued expanding returnable presentations.

The mix of returnable packages increased 5.4 percentage points in the quarter.

We launched Sprite Peppermint and Coca-Cola With Coffee in limited editions and with great acceptance in the market.

Tonicorp, our value-added dairy business, posted a double-digit sales decline in the first quarter. The overall dairy industry in Ecuador continued to be impacted by the effects of the pandemic. Despite the weakening consumer demand, Tonicorp grew value share, driven by yogurt and flavored milk categories.

Moving to our beverage operation in the United States, Coca-Cola Southwest Beverages closed out the first quarter with an outstanding financial performance, delivering solid profitability improvements and its 11th consecutive quarter of EBITDA growth.

Revenue grew 4.2%, reaching $692 million dollars. Net price grew 5.9% with a true rate increase of 4%, and 1.9% growth on mix driven mainly by high profit per case Transaction Packages.

Value share in Non-Alcoholic Ready to Drink beverages grew, driven by Monster, BodyArmor and sparkling water fueled by a Topo Chico and AHA combined strategy.

Volume was down 1.6%, cycling strong 3.9% growth from the same quarter last year caused by consumer pantry loading.

Moreover, the February snowstorm significantly impacted all of our operations in Texas and Oklahoma. As you remember, this winter storm was one for the ages.

Our associates were impacted in one way or another, whether it was from the record-breaking low temperatures, power outages, broken pipes, lack of water, or freezing roads. Despite this, our teams throughout the region were pulling together, supporting each other, and helping our communities, and customers.

From a channel perspective, Large Stores delivered positive volume in the quarter. Small Stores also started to grow for the first time since the pandemic, as we cycled closures that happened in early March of last year.

The FSOP channel closed with a double-digit volume decline, cycling the last period of pre-pandemic volume. During the first days of April, we have seen encouraging volume recovery as FSOP customers reopen.

We also saw an increase in volume during Spring Break, as consumer confidence increased following the availability of vaccines and lifting of mask mandates in Texas.

Importantly, the Dr Pepper portfolio had a strong start to the year with high-single digit growth.

On the profitability front, EBITDA for the quarter grew 26.1% to $99.5 million dollars with a 14.4% margin, a solid expansion of 250 basis points.

This is the highest EBITDA margin for a first quarter in any year since we acquired this operation in 2017.

We continued focusing on accelerating rollout of our Digital Playbook. This quarter, we reached 51% of our eligible FSOP customers accessing myCoke.com.

We hit the ground running with advanced analytics in 2021. We began by implementing the “Next Best SKU” initiative across our Convenience Retail channel with excellent results.

I will now finish our operations review with our Food and Snacks businesses.

Wise Snacks in the US posted a double-digit sales decline in the quarter, still impacted by store closures due to the pandemic, particularly in large metropolitan areas such as New York City.

Deep River is starting to rebound in Food Service with a strong month in March, delivering a double-digit increase and on pace with 2019.

We are actively pursuing new avenues to regain growth momentum by capturing additional points of sale with key customers, such as Target, Walmart, BJ’s, and Walgreens.

We are maintaining strong growth in the e-commerce channel, with sales more than double compared to last year. We are introducing product innovation as well as a new price architecture to continue capturing share in the digital shelf.

This year we are celebrating the 100th anniversary of Wise. This is an important milestone for us and proof of the long-lasting connection between our brand and consumers.

Bokados in Mexico posted double-digit sales growth, driven by solid improvements in the traditional and wholesale channels, and better management of discounts and promotions.

We accelerated deployment of our AC Digital mobile platform, across our snacks operation in Mexico. We are replicating core revenue management capabilities to improve profitability of this business unit.

Inalecsa posted a low single-digit sales decline in the quarter. Despite the slowdown in the Ecuadorian economy, Inalecsa consolidated its market leadership and captured additional value share in core salty snacks categories such as plantain, tortilla, and potato chips, as well as in the confectionary segment with Tigreton and Inacake brands.

I will now provide an update on the most relevant ESG activities in the first quarter.

Together with the Coca-Cola Company, we launched a new 13.2-ounce bottle in the US, made entirely from 100% recycled PET. We launched the new bottle for Coca-Cola, Coke Zero Sugar, Diet Coke, Sprite and Fanta. Next July, a 20-ounce version for smartwater will follow suit.

We also became one of the first bottlers to launch 20-ounce bottles made from 100% recycled PET across our territories in the US.

In another important highlight, our operation in Argentina was recognized by The United Nations Entity for Gender Equality and the Empowerment of Women, also known as UN Women, for promoting gender equality through both internal initiatives and the work we do in the communities.

Furthermore, Tonicorp was granted the Violeta Award for Best Corporate Practices by the Government of Ecuador. This is in recognition for our active promotion of jobs for women, our efforts to prevent violence against women, and strengthening equal opportunity processes within the framework of the policies promoted by the Ministry of Economic and Social Inclusion.

This reinforces our commitment to working on initiatives focused on supporting the role women play in the value chain, while striving to achieve gender equality in every country where we operate.

I will now turn the call to Emilio to go over our financial results. Please Emilio.

Emilio Marcos: Thank you, Arturo. Good morning everyone and thank you for joining us today to review our financial performance for the first quarter of 2021.

First and foremost, let me give a big thank you to our entire team for their commitment and hard work, which has been the key to consistently delivering strong results.

We are entering 2021 with a solid momentum, building on the strong foundations that led us through the pandemic: our ability to adapt to an ever-changing business environment and our discipline to protect profitability and yield strong results.

Moving to the financial results of the first quarter, Consolidated Revenues increased 4.1%, driven mainly by a positive volume performance in Mexico, and strong price/mix in Mexico and the US. This topline growth combined with our pricing and an effective hedging strategy in raw material prices, helped us expand the contribution margin by 70 basis points.

We still expect pressure in some raw material prices beginning in the second quarter, particularly in PET and sweeteners. However, our hedging strategy will partially offset the rising trend in spot prices.

We reported an Operating Margin of 13%, representing a robust expansion of 290 basis points versus the same period of 2020. Consolidated EBITDA reached $7.7 billion pesos, an increase of 15.7%, a healthy expansion of 190 basis points to reach a 19% margin. Being the highest EBITDA margin for a first quarter since 2017. This is largely driven by the expansion in contribution margin, combined with a reduction in SG&A coming from our disciplined expense control.

In line with the latter, the SG&A to sales ratio decreased by 150 basis-points, mainly from a reduction in sales and marketing expenses, while administrative expenses remained stable. Our goal is to maintain OPEX aligned with revenue growth throughout the year.

As volume recovers across our regions, we expect that some SG&A expenses that were temporarily reduced during 2020, will gradually increase in the following quarters. We will look towards sharpening our revenue management initiatives and increase our holistic cost management efforts to mitigate some of these incremental costs.

Net Income for the quarter decreased 3.5%, primarily related to the harder comps from last year, where we registered a foreign exchange gain of $1.4 billion pesos from our strong cash position in US dollars, coming from a significant depreciation of the Mexican peso at the beginning of the pandemic.

Now, moving onto the balance sheet. On April 15th, a cash dividend of $2.94 pesos per share was approved at our Annual Shareholders' Meeting, totaling $5.2 billion pesos for a payout ratio of 50%, in line with our historical average. This dividend will be paid on April 27th.

Cash and cash equivalents in the first quarter stood at $35 billion pesos with a total debt of $56 billion pesos, resulting in a leverage ratio of 0.6 times.

CAPEX for the first quarter was $1.1 billion pesos, a decrease of 30% versus the same period of last year. We expect to invest close to 6% of sales during the year to reach around $11 billion pesos, prioritizing the allocation towards strengthening and innovating production lines, distribution and execution capabilities, as well as promoting digitalization and sustainability projects across our operations.

The strong results of the quarter continue to prove our ability to thrive and adapt during challenging times.

We will continue to capture and create value for our shareholders through a disciplined execution oriented towards volume recovery, deploy commercial and revenue management initiatives to maintain pricing in line with or above inflation, and improve cost efficiencies to protect our margins.

And with that, I'll turn it back to Arturo.

Arturo Gutierrez: Thanks, Emilio.

With the first quarter behind us, we see a challenging health and economic landscape continuing throughout the remainder of 2021. Despite this, we are executing on all fronts to drive performance and share gains.

We started the year with a clear objective to uphold the momentum of our business. This momentum is evidenced by our value share, which grew or maintained across our territories.
We expect volumes to remain positive mainly in the traditional trade, supermarkets, and all channels related to At-home consumption. The on-premise channel should start to recover, as the Covid vaccine becomes more widely available.

Single-serve and non-returnable packages should evolve favorably across our portfolio, with returnables leading our affordability strategy.
As we have said before, it is imperative that we keep focused on the long-term vision of our business with an aim on preserving and strengthening our relationship with customers, consumers, and the community.

As we look ahead, we will continue to invest and execute to advance our priorities. Investments will span across our supply chain and go-to-market initiatives and include an acceleration of our digital transformation and sustainability agenda.

It is important to mention that it has been two years since we made our first venture capital investment. We are actively engaged in both VC funds and startups, which has enabled us to stay at the cutting edge of technological developments and to start piloting solutions that are strategically relevant and can help make our business more efficient, sustainable, and future proof.

In closing, all of us who are part of Arca Continental are proud of the results we have achieved thus far.

We remain keenly focused on becoming more efficient, and swifter in adapting to the new market conditions.

This requires an even greater commitment to leverage our scale and continue growing, striving for excellence in everything we do.

Thank you for your continued support. I would like to now open the call for questions. Katie, we are ready for questions please.

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 Fernando Olvera with Bank of America.

Fernando Olvera: Hi, Arturo, Emilio. Thanks for taking my questions. I have two if I may. My first question is about Mexico. Can you elaborate more on how are you thinking about volume recovery for the remaining of the year and because it seems that you could return to pre-COVID level sooner than expected. And my second question is, what was the main driver of the margin expansion during the quarter and how should we think about margins ahead given that raw materials continue increasing, thank you.

Arturo Gutierrez: Thank you, Fernando and good morning. Let me address your first question first about Mexico. And, certainly, we performed very well throughout the pandemic and the first quarter, as you saw, we had an EBITDA growth of almost 24%. The margin was 25% one of the highest margins we've ever had -- 290 basis points expansion and this what the combination of solid volume - even though we were cycling growth and the first quarter of 2020 as you know, in Mexico the pandemic started affecting only the final days of the first quarter of 2020. So, it still was a tough comparison. But we had a very good price architecture, we were very disciplined, still disciplined in our OpEx in this quarter, and very good execution.

It's important to mention that we actually, were recognized by The Coca-Cola Company, with the Legacy Cup award for 2020 which is the recognition of the best execution in the marketplace in our operation in Mexico. So the volume, as you know was driven by the traditional channel and that has been the case throughout the last few quarters and we had very good performance across categories. that even our core categories continue to grow, colas and flavors grew this quarter and so I think it's a combination of an economy that continues to have a strong performance from the consumption standpoint, the traditional trade that also has been the engine for growth and in Mexico and in South America and if you see particularly the month of March, you can realize what would be the path for recovery in Mexico. In the month of March, you continue to see a strong traditional channel, but you start to see a recovery of the on-premise channel. So I think that obviously, as we have the baseline of 2020 for the on-premise would start to look really good for the remainder of the year. Raw materials were not a big impact in the first quarter in Mexico. I would say, in general, in our operation and maybe Emilio can expand on that. So we are very optimistic of the performance in our Mexico market for the rest of the year.

Volume, even though it's not going to be spectacular. We did have a significant decline in volume last year anyway. So even if we don't recover the volumes of the prepandemic scenario, the business is profitable. We have better execution in the market, and we're rolling out many of our digital initiatives. I think we sometimes we don't talk about that in the middle of the crisis, but we are convinced that has been making a difference and it's going to continue to make a difference in the market as we are improving in our performance and reducing stockouts through our suggested order algorithm in our B2B platforms. AC Digital is being rolled out. There are a number of things that we believe are very important for this year and for the future in Mexico. So this continues to be a very solid business unit.

With respect to margins going forward, our goal for 2021 is to protect margins. As you know our margins have been very high in the last quarters. We've been growing consistently in margin quarter-over-quarter and we're going to have some headwinds going forward with some of the commodity pricing. It's not the case in the first quarter and we have some hedges that are going to be important to mitigate that impact as we move forward.

So, I would mention probably a few factors. One is our pricing strategy in line with or above inflation we plan to keep that. The mix of our categories and channels are going to be relevant for the margin and it's hard to predict at this point how that is going to evolve. We do have some carryover -- positive carryover of pricing from 2020 to 2021. So that's going to be good for our margins. We are being more effective in the management of discounts in all of our operation that also is going to be very effective and our efficiency plans are still delivering good results in our OpEx ratio to sales. So those that I would say would be the main factors; maybe Emilio wants to expand on that.

Emilio Marcos: Thank you, Fernando for your question. I would just like to add regarding the first quarter. We expanded margin 190 basis points; 70 of them are coming from pricing as Arturo mentioned. We did not experience any increases basically stable raw materials in the first quarter, so that positive. And then volume it’s a little bit positive, but it's a positive effect put fourth and then there's 150 basis points coming from efficiencies and expense control; some of them are coming from synergies in the US, some other efficiencies implemented in other countries, it's important to mention that we improved margins in all the operations in all the countries except Peru. So, that's also important to mention. So we have a positive trend in the future as Arturo mentioned. So basically in summary our pricing, the mix is really important, it has a positive impact on margins. And then the efficiency plan that we implemented last year.

Fernando Olvera: Great. And just very quickly. One last question, how are you thinking about the recent changes in outsourcing and what change can you expect?

Arturo Gutierrez: Yeah, we've been an operation based on what has been approved. We do not expect a material impact as a result of that. The number of people under that model for us in Mexico, and where we need a restructure is not that significant will not be a significant impact. There's still some work to do, and we're working to integrate them to the structure that would be in compliance with the new regulations. So we'll continue to work in that regard and mitigate any impact we can have in their operation.

Fernando Olvera: Great. Thank you so much.

Arturo Gutierrez: Thank you for Fernando.

Operator: Our next question comes from Ben Theurer with Barclays.

Ben Theurer: Hey, good morning Arturo, Emilio. Thank you so much for taking my question. And obviously congratulations on result that was really strong. Now in Mexico you've made everything clear. So I want to switch focus and gears a little bit on the U.S. and what's your expectation, outlook there particularly now that you're basically one year into the launch of the facility? So just if you could share with us what your expectations are going forward in terms of profitability is heading once food service comes back in and how you think about the shift between multi-serve single-serve going forward; we still saw that obviously impacting but we're seeing already strong margins, but that even with a not so strong volume environment so just to get a sense of where could margins be if volumes are actually in a normal level.

Arturo Gutierrez: Yeah. Thank you, Ben. Well, certainly, we're very pleased with our performance in the U.S. This is our 12th consecutive order of EBITDA growth and the ninth consecutive quarter margin expansion of that operation. We just celebrated our fourth anniversary of the integration of the U.S. business unit into Arca Continental. I think we could demonstrate the resilience and strength of the strategy that we followed throughout the years. And we're reaping some of the some of the benefits of projects that we started a few years back and that has resulted also in margin expansion as we saw, despite the volume contraction in the border and we were cycling high volume from first quarter of 2020. And also, we have to have in mind that we had this February snowstorm that impacted in fact all of our operations almost for a complete week in the month of February.

So, even with that, I think we performed really well, the economy in the U.S., especially in the State of Texas is improving day by day the consumer confidence has increased. And as you know, the capacity of businesses and on-premise revenues has been increased as well, and the statewide mask mandate has also ended so it's a much better environment. We've been able to sustain prices at a very good level, even with a change of the mix. Remember that in the U.S., the shift in the mix of channels works in a different way sometimes than what you see in Latin America. So if you look at the channels in the U.S., large stores have been driving growth for the last few months and quarters and in the month of March, we had a decline in large stores, but this was basically with the comparison of first quarter pantry loading in 2020. But we did have an increase in the on-premise channel for the first time in the month of March. It increased almost 11% in volume in March so that is a positive sign of recovery, although you also need to be aware that sometimes the on-premise market might result in consumption that has less profitability than the at-home market. So we're trying to drive consumption towards the bottles and cans formats also on the on-premise market, something to have in mind.

The other important impact in our U.S. operation is that we're still seeing some of the benefit and the carryover of our synergy plan for last year, even though we completed the projects in 2020, we still some positive carry over. And an example of that is our North Point facility that you mentioned. We're very proud about how that facility is operating where we have five production lines, the PT lines with in-line blowing, that provides significant efficiency. And the cost per case significantly improved. Water usage is at a very good level at 1.3 and we have a number of other things there also for environmental standards to be best-in-class. But we've seen our semi-automatic picking system in North Point which builds a pallet according to customer orders now fully operational, that also brings efficiency and savings to our U.S. business unit.

So we think that we are in a very good position to capture growth as we move forward. We are also in a good position in terms of commodity pricing for the year based on the hedges that we have for aluminum, both LME and Midwest premium for the rest of the year. And very important also that we continue to build capabilities and to roll our capabilities in the marketplace, both digital capabilities, new models to service our customers in the U.S. and there's growth to capture there as things return back to normal in the market, and we move to a more balanced consumption mix across the channels.

Ben Theurer: Okay, thank you. Have you actually tried to quantify the impact from the storm?

Arturo Gutierrez: From the snowstorm in February. Well, it's hard to quantify. If you look at isolated the whole week, the operation was really paralyzed. But then you have some additional consumption after that. So it's hard to isolate just the week. If you looked at it separately you would think it's a much higher impact, probably that at the end it would be. I think we were able to mitigate most of it, and what we did in the market the following days. But still, we don't have a specific number for that.

Ben Theurer: Okay, that's okay, I'll leave it here. Thank you very much and congrats again.

Arturo Gutierrez: Thank you Ben.

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

Alan Alanis: Thank you so much. Good morning, Emilio and good morning, Arturo. Congratulations for the report. Very, very, very impressive. A couple of questions, one around capital deployment and dividends. The first question would be, I mean, you are under 1x net debt EBITDA very, very comfortable what's the likelihood that you will increase your dividend beyond the payout ratio that Emilio mentioned, the 50% of the net income…that would be the first question.

And the second question, I mean I know that the agreement with The Coca-Cola Company is confidential and you cannot give the details and so forth. But you do mention that some of the increase in the cost came from an increase in the concentrate so we have to ask about that. What can you tell us specifically about two things: the timing of how frequently the agreement changes, is that a quarterly, an annually thing, and second, is it based now on profits at the operating income level versus how it was just in the past when it was directly at the revenue side. Those would be the, I guess, three questions or two questions, on with two aspects. Thank you so much.

Arturo Gutierrez: Yes, thank you, Alan. And thank you for your question. Let me address the first point first about dividends. And well as you know, last year we had additional dividend payments throughout the year based on precisely that analysis; what's our leverage and what are the uses of our capital and what are the expectations that we might have for that particular year. This year -- actually last week we had our annual meeting for the company and as you know in Mexico, that's where dividends are approved. So aside from the dividend that was approved to be paid now, the shareholders authorized the board to approve additional dividends for the rest of the year. So that, gives you the idea that it's something that would be under consideration from the circumstances for the rest of the year for sure. But we cannot assure anything, of course…but what's important is that we don't have to convene another annual shareholders meeting to do that. We can do that at a board meeting.

So, regarding our relationship with The Coca-Cola Company, well we have an agreement with them, and it's generally a more complex relationship that we've had before, but it's also I would say a much more balanced relationship. We think that negotiations are now more equitable and more stable. This is not something that changes on a quarterly basis to your question. We do have some annual revisions of where we are standing. And again, this is not only about incidents pricing and concentrate. It's other issues that are on the table. So you've seen, even though concentrate prices have increased in the case of Mexico, also their participation in some key areas and investments, you know, marketing expenses and even co-investments in CapEx and product development have also changed. So this is part of the negotiation. That's why we don't want to get a convey the message that this is kind of a, one-variable negotiation, there are many other things that are on the table. So think about the universal bottle in Mexico that we've rolled out. And this was very important for our strategy, for the company strategy. So they contributed to that investment significantly. I think that was around US$10 million, correct me if not and they would participate. So again, this is an example of how those negotiations take place and how we manage this relationship to preserve our margins. I think our margins are also a good indication that this is a good model and it's turned out to be beneficial for both.

Alan Alanis: That's very clear. Very useful. A much more balanced relationship and then again, congratulations for the results. Thank you so much for taking the question.

Arturo Gutierrez: Thank you, Alan. Good to talk with you.

Operator: Our next question comes from Lucas Ferreira with JPMorgan.

Lucas Ferreira: Hi, gentlemen. Hi Arturo, hi Emilio. Thanks for this space to ask questions. My first question is I want to go back to that margin discussion. Certainly, you guys are on a very sweet spot now in the first quarter given the price increases, not much impact on the raw materials side yet. But even listening to KO's comments in their conference call, it feels like this cost discussion is going to be going to be much more of like a 2022 discussion than a 2021, might be tougher for you guys. So my question is a general question looking at the market dynamics, your channels, looking at your pricing models…so how comfortable do you guys feel about maintaining your profitability going through this kind of massive wave of increasing costs like -- not to mention PET, sugar, aluminum and others eventually kind of later this year or 2022 when eventually it's going to feel like the full impact of all this massive inflation we are seeing today. So many CPG companies, other food and beverage companies are already increasing prices. So if you guys feel comfortable about maintaining the profitability going forward with the levers you have in hand. And then I can ask the second question later, thanks.

Arturo Gutierrez: Yeah. Thank you, Lucas. Let me talk about profitability starting with pricing I guess, which is a very important factor. As you know, our goal is to capture prices in line with or above inflation. We've been leveraging our capabilities, and we've implemented effective price pack architectures in every market. So far, I think we've been successful and this is based on -- again on renewed capabilities in our operations. So, if you look first at Mexico, we're going to have a positive carry over from last year in terms of pricing, and in the U.S. as well. So we expect that to be in line with our target. There are some effects there in Mexico, obviously, returnability has an effect on price sometimes, but it's a good effect even though overall price may not be as high as one-way packages, profitability is still very high.

The evolution of the on-premise market is a very important factor also in Latin American markets and connected with that is our mix of single serve presentation. So it's a hard to predict where that is going to go in the next few months and that's where we're not providing guidance at this point but we think it's connected also with the mobility restrictions in, especially in South America. But, prices in South America have been impacted by mix more significantly. It’s important to mention that. But I think we're in a good place in every country with respect to price and also with respect to the management of discounts. This is one of the two largest digital initiatives that we have in the advanced analytics space which is how to better manage our prices and promotions. And maybe Pepe can add some additional comments to that because it's very important for our profitability going forward. The other elements are raw materials and pricing of commodities that we know where that is. We'll know where that is going. Our volumes will only help because the volume continues to grow in Mexico and the U.S. It's going to have a significant recovery. We expect that in Ecuador and Peru. And in Argentina, it's growing. It's one of those units where probably it had a less challenging baseline to begin with before the pandemic so price is certainly going to help. And the other is our efficiency in the management of our OpEx. I think all the learnings that we captured during the pandemic are going to be very useful going forward. So I think the combination of that even though with the scenario of commodities for the future is still a positive scenario for us in general but I don't know, Pepe, maybe you want to add about what we're doing in terms of promotions and management of promotions.

Pepe Borda: Yes, Arturo, thank you. And thank you, Lucas, for your question.

Just regarding pricing I think we are in a very good position. Specifically in March, when we analyze price versus previous year, that was positively impacted by category mix where we're cycling high volumes from water panic purchases, March may be a little high, but going forward we see four main impacts with different impact by margin: the carryover from the increases made last year, that immediate consumption recovery across countries, although with different speeds, but all going in the same direction, new package launches, especially in the U.S., like the 13-ounce bottle that is very profitable and we are going to roll-out.

And then, as Arturo mentioned the trade promotion optimization as we roll out the capabilities in all the operations. This capability was deployed on August 20 in the Mexico business where we've been able to reduce unproductive promo spending by almost 20 points. In Latin America, we are already replicating this capability and we will deploy it gradually in Coca-Cola Southwest Beverages starting with local accounts focusing on the retail channel. So, we feel confident that we have the tools to manage the pricing.

Lucas Ferreira: Perfect. Thanks, Pepe and Arturo. My second question is somewhat correlated to this is you guys mentioned a couple times in the introduction about investments in digital, about the, let's say the hard seltzers and the launches of new products in the portfolio. So my question is regarding SG&A -- how much investments you're going to have to do this year relative to last year, which was more of a turbulent year, I would say. So my question is basically if you're going to have to speed up a lot your investments and should we see that specifically SG&A line growing, let's say, more than inflation or growing relative to your sales?

Arturo Gutierrez: Yeah, with respect to investment, 2020 was not a typical year, that's for sure. We had a much less rate of investment throughout the year. And 2021 will go gradually back to normal. It was not in the first quarter where we're still cautious and I'm still comparing with a prepandemic scenario. But as we move forward, we expect CapEx to be probably around 6% of revenue in the year, which is, I would say pretty much a normal ratio for our operation. Maybe Emilio you can expand on our investments and CapEx.

Emilio Marcos: Yes, thank you for your question, Lucas. Yes, we expect this year - - as Arturo mention last year was around 4%. So this year, we expect around 6% and that's going to be allocated towards, as I mentioned already in my speech, some production lines improvements, some coolers, of course, as always, go-to market capabilities to enhance our competitive presence and execution at the point of sale. And as you mentioned, also, some investment will go through automation and digitation processes across our value chain and to modernize some IT systems. So, that's part of our CapEx and also some investments towards sustainability benefit for our communities and some investments in energy efficiencies and our distribution channels. And talking about countries, I think around 50% will go to Mexico and I would say around 25% to U.S. and the other to the rest of Latin America countries. So basically, you're right, some of those CapEx will go to our digital initiatives that we have.

Arturo Gutierrez: And with respect to SG&A, that is going to increase versus our baseline 2020, but that would be also in line with our growth in revenues throughout the year so we maintain healthy ratios through all of it.

Lucas Ferreira: Thank you very much.

Arturo Gutierrez: Thank you, Lucas.

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

Felipe Ucros: Hi, Arturo, Emilio. Congratulations also on the results, I'll sign myself up to what everyone else said, very strong results. Let me start with a question on digital analytics. You guys talked about the suggested order and how it had another good volume contribution in Mexico. I was just wondering if you have an accumulated number for how much this has contributed since it was rolled out. If I remember correctly, I think the first time we had you to talk over with us about this about four years ago, you had a pilot and the pilots were already contributing, but it seems you continue adding to that contribution. So I don't know if you have an accumulated number that you can give us on that. And if you have thought about what's the peak contribution from this, and I'll have a follow-up question after that. Thank you.

Arturo Gutierrez: Yeah. Thank you, Felipe. Let me explain to you how this operates in our commercial processes so that you have a better idea of what we're doing. At the end, what we are trying to do is to reduce out of stocks, so increase the availability of our ideal portfolio at the point of sale. So you have to make some assumptions on how that is going to translate into additional sales as you capture those white spaces probably in the traditional outlet. So we've measured out of stocks and we have demonstrated that the model reduces effectively out of stocks in the market place.

And then you have to try to analyze and figure out how much is that going to convert into additional volume. So we've started actually making some pilots and comparing with control groups and we had growth of 1% and 1.5% around that, of volume versus the control group. But as you continue to roll that out then you don't have a control group any longer. So you just have assumption based on your initial calculations of how that is impacting, but then we has the pandemic, so the situation certainly changed. So it was harder to estimate in isolation what is the true impact of the suggested order? So the number we had originally was I guess the average was 1.3% of increased sales versus the control group. But then you start rolling that out gradually across the operation. So I'll let Pepe expand on that.

Pepe Borda: Yes. Thank you, Arturo, and thank you, Felipe for your question. Yes, as Arturo was saying this is an ongoing process. We started…the first models we built were just focused on reducing out-of-stocks on the key packages of the portfolio mainly suggesting quantities of those packages. And we got very positive results and that's probably what we discussed in the previous meeting. Then after that, we rolled that out and then we included the sales potential by category per customer. And then that helped us to develop portfolio suggestions per customer. And as Arturo was saying, we then rolled that out and then we didn't have a control group to measure with.

And the third step is to develop the next best SKU model and we have a model that has the three models and then balances per customer the weight of each of those models. So as Arturo was saying, the numbers that we have found looking at target groups versus control groups have been around 1.3, 1.5 volume increase in Mexico around between 2 and 2.5 in South America and we are currently rolling the next best SKUs in the convenience retail in the U.S. What we've seen up to now is that we have expanded 5% in SKUs with a repurchase of nearly 70%. So looks like we are offering the right SKUs for the right customers. I hope that answered your questions, Felipe.

Felipe Ucros: Oh, that's fantastic color and congratulations on what you guys are doing on that front. It's really leading the sector on that side. Maybe I can do a follow-up, Arturo, on the Midwest premium. I was looking at the series in Bloomberg and it's at the highest that it's been in quite some time. I have thought that we would see somewhat of a normalization with the change in government and all that. But it seems that it hasn't happened. I don't know if you can talk a little bit about what's basically pushing that dynamic.

Arturo Gutierrez: Yeah, well, we've seen levels, as you say, of Midwest premium throughout 2020, probably over 300. We were under 300 at some point and I guess in the second quarter, when many things changed in terms of commodity pricing. And that is, again, stabilized at the end of 2020 above 300, which is still a lower number than we had at some point when some of the aluminum duties were imposed remember maybe three years ago. But the scenario going forward is that it's going to be still at that level.

We have the advantages as Emilio explained, that we have hedged some of our requirements, or most of our requirements. I would say for aluminum in the U.S., maybe around 90% of our requirements for both LME and Midwest premium pricing. So it's going to be that very positive for us, but certainly, as we move forward, the number, the spot price for the U.S. is going to come up for the remainder of the year. That's the expectation. It might go again in the 400-plus level that is what is expected, but that's not going to impact our own results because we have hedged that in the level of pretty much of what you saw in 2020.

Felipe Ucros: Okay. That's great news. Then maybe the last one really quickly on the possibility of buybacks. Arca has been sort of re-rating continuously over the last few years. At which point, I know buybacks are not at the top of the list of your capital deployment, but at what point do you start discussing whether it would be a good statement at a certain valuation to start buying Arca shares. If there's ever been a criticism from the market about bottlers, it has been the multiples at which they have done M&A, and it seems that at these points where you guys can buy the best bottlers at the cheapest prices in a decade, we're sort of not seeing it. What's the importance of making that statement to the market?

Emilio Marcos: Yes. Thank you, Felipe for the question. Well, as we have explained our capital allocation, first always CapEx to our operations. And last year, we did as Arturo's already mentioned, the number second capital allocation for us has been dividends. And last year we paid two additional dividends and Arturo already explained that on the shareholders' meeting we have now at the board level in order to pay any additional dividend. So that's another option for capital allocation. But number three and that's something that we been working really hard on the past months and years is M&A. We're always looking for inorganic growth and we always have on the pipeline some analysis in order to pose a deal. So we always have that expectation and that priority.

And talking about buybacks, there's other considerations in order to – it's not that easy. There's some other issues in complexity for buyback so that's why for us we still have the other options as main priorities before any buybacks. Now the share price has been going a little bit higher. So that's good for everyone. But again we still have the other priorities before any buyback. But it's always an option.

Felipe Ucros: Okay, understood. Thanks for the color.

Emilio Marcos: Thank you.

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

Carlos Laboy: Yes, good afternoon everyone. My first question relates to refillable bottles. If you could expand for us, please Arturo on where you are as a percentage of mix in your main markets on refillables. But more important than that, what I'm really after is your vision on how much higher these might go over the long-term, especially now that the ESG value of these refillables is really increasing. While we're on the subject of refillables if you could also comment on how these are helping you as a premiumization tool for driving pricing to open up your price pack ladder on the upper end of the scale. And do you see an effort from The Coca-Cola Company to market the environmental merits of these refillables further helping you and putting I don't know, an environmental halo of nobility over the entire portfolio that maybe helps you with pricing.

Arturo Gutierrez: Yeah, thank you Carlos. Good to talk to you. I think refillables continue to be a very important strategy and now with that added factor that you mentioned traditionally. As in Latin America they have been very important to provide affordability in a portfolio like ours and that's what the role they've been playing and that's why they've been so important across our markets.

So let me give you some numbers about the mixes that they represent across our markets. In Mexico, refillables so far this year are about a third of our volume - - 33%. In Ecuador it's about 29%. In Argentina, it's higher than that, it's more than 40% and this, obviously, as a result of the situation that we've seen in that country for a number of years, it's become a much more important strategy. And in Ecuador, it's also getting close to 30%. And that, in the case of Ecuador in particular, we've been very focused on that strategy which was not as strong in the past. So it's so important as we also structure our price pack architecture versus our competitors in all those markets. And it provides different options for consumers and it's been very, very effective especially in times like these in downturns of the economy. So we think that we have the conditions to continue to pursue that strategy in Latin America, we have the expertise.

This is not only about introducing bottles. You have to have the commitment and there's significant investment there. But it's also you have to have the expertise of how to run a returnable package model. And it's a culture that needs to be created in the market and with our customers. Then the fact that sustainability is becoming more important as we move forward especially in developing countries -- in developed countries, excuse me. In Mexico, as we've introduced the universal bottle that also provides a new opportunity to promote refillables in our markets and even with a more efficient management of our bottle stock inventory which we've been doing in the last year. So that provides also some possibility of thinking in our U.S. market in the future as well, thinking about that other dimension, which is the sustainability aspect of the packages as we have seen in Europe and in other markets.

So we have been considering a pilot test also for the U.S., we continue to analyze that possibility. In the meantime, it's going to be a fundamental part of our strategy in Latin America, and now strengthened with the universal bottle roll-out in all of our markets.

Pepe Borda: To add just to all the important points you mentioned, Arturo, I think in the mid-term, we see a lot to gain with the deployment of the universal bottle in all of our markets, as Arturo mentioned before, we're investing a lot behind these and this permits us to have refillable bottles for products that we weren't able to have because we had to invest in specific glass for that. So we're seeing better volumes in flavors, in beverages and that is going to be an important revenue engine within the next years. Where are we going to get what is the feeling? I think it is too early to say, but we plan to have increasing revenue mix from refillable bottles in the next years.

Carlos Laboy: Thank you. Just one quick one. You made a passing comment on diversity at the end of your comments today. But, it can come across as corporate speak so often, but I want to congratulate you and Jean-Claude, because when I go to the U.S. and I look at your markets there, there's so many brilliant women in your Senior Management ranks and sales and marketing. And this is really rare for us as analysts to see in this industry. And so many of your retail counterparts are women and the way they engage with your clients is impressive. So congratulations. I hope you can do this even better. It's obvious when we go through the marketplace, that this is a real issue for you, not a corporate speak issue.

Arturo Gutierrez: Yes it is. But we also acknowledge that there's a lot to do. We still have a long way to go. Thank you, Carlos.

Carlos Laboy: Thanks.

Operator: Our next question comes from Victor Tanaka with Morgan Stanley.

Victor Tanaka: Hi, good morning everyone. Thanks for the question. You touched base on M&A so I was wondering if you could provide us an updated view on M&A across the region, where you see the most compelling opportunity post pandemic? And related to this question, what would be the maximum levels of leverage you will be willing to achieve in the case you see M&A opportunity? That would be my question. Thank you.

Arturo Gutierrez: Thank you, Victor. Thank you for your question. Our approach to M&A has not really changed and before the pandemic and throughout the last few months, what we've been thinking about is opportunities within the beverage and snacks space and in the geographies where we operate. Basically, it's the Americas and it's in our current businesses and mostly focused on beverage opportunities in partnership with The Coca-Cola Company as is our core business. So we think we are very good positioned for that, because as was mentioned before we have the financial capacity, we have been also prospecting some of the commercial supply chain capabilities, which are so important. After four years in the U.S., we feel much more confident that we could be successful integrating businesses throughout the region in the Americas.

And also we have a strong partnership with The Coca-Cola Company. We talk about that frequently, and I think that provides additional opportunities for the future as well. We've also been working on our own talent pipelines to be prepared for that. So, it's hard to predict where something could arise and at the right, also, valuation. So we will continue to look for transactions, as I said, in the Americas with special focus in the markets where we operate. And for that, going back to your financial capacity we're going to have a conservative approach into leverage. We're usually aiming for a 2x to 2.5x leverage ratio as something that we would feel comfortable with, I would say, going forward.

Victor Tanaka: Thank you very much. And just a follow-up on your top line evolution can you give us any color of what you're already seeing in terms of volumes in April for both Mexico and the U.S. and how your volumes are trending relative to what you were expecting before April started taking into account the tricky comparison base now?

Arturo Gutierrez: Yeah, we're going to be looking internally to, both last year as is normal, but also to our original pre-pandemic baseline as we look at volumes for the rest of the year and look at 2019. But just looking at the recent trends, and if we see what's happened in this first quarter, and what happened in the month of March, or at least in the final days of the month of March, it gives you an idea of how volume is going to evolve for the rest of the year. And it's different in our different markets. As we know, U.S. has a faster recovery and same for Mexico. So we're not going to see a growth in volume as high as maybe in South America in the second half of the year because the comparison is different. South America, on the other hand, is still struggling with mobility restrictions and some of the effects of the pandemics in Peru and Ecuador. So that's going to take a little longer, we believe, but we had a much more severe contraction in volume in the second quarter of 2020. So we're going to see that recovery gradually in the next quarters of the year, probably stabilizing by the end of the year. And then 2022 would be our most likely return back to our original baseline during that year in 2022.

Victor Tanaka: Thank you. That's very helpful.

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 interest in Arca Continental. Please reach out to our Investor Relations team for any questions you may have and have a great day.

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

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