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Arca Continental 3Q22 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 third quarter and first nine months 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: Thanks Melanie, and thank you, everyone, for joining our call today.

Before we review this quarter's results, I would like to take a moment to highlight an important announcement we made last month. As you are aware, we reached a long-term collaboration agreement with The Coca-Cola Company.

The new cooperation framework provides clear visibility of all important aspects of our relationship and ensures the long-term alignment of our growth plans and strategies for profitable growth, and positions us to continue improving service for customers and consumers.

We also acknowledge the great opportunities to develop a digital alliance to build an integrated ecosystem that creates value across the digital and physical worlds, enabling our customers to adapt to a more demanding and interconnected market.

This new relationship model confirms our vision and commitment to leading the beverage industry in Latin America.

Moving now to our consolidated results, I'm pleased to report that in the third quarter of 2022, we took another positive step in the face of a challenging macroeconomic backdrop.

Total consolidated volume grew 4.2% in the quarter, reaching 619 million-unit cases. We achieved sequentially stronger volume, cycling 7.1% volume growth in the prior-year quarter.

Total consolidated revenue increased 16.2%, to $55.7 billion pesos, as we continue winning at the point of sale, raising the bar with increased emphasis on flawless execution.

Consolidated EBITDA for the quarter grew 16.1% reaching $10.7 billion pesos, representing a margin of 19.2%, as we maintained strong topline momentum and sequential earnings growth across all our regions.

I will now go over the results across our markets, beginning with Mexico, where we sustained the strong volume performance and posted another quarter of record volume with over 100 million-unit cases for two months in a row.

Volume in Mexico grew a solid 5.1%, driven by sparkling and water categories, up 4.6% and 15.5%, respectively. In July, we surpassed again the monthly volume record, which we set in June.

We saw positive volume performance across all our channels. Traditional trade grew 1.5% and Modern trade grew 15%, driven by double-digit growth in Supermarkets. On-Premise channel posted a solid recovery during the month of September with volumes up 6.4% compared to 2019 and driving sequential expansion in single serve mix, up 0.7%.

Total net sales in Mexico rose 18.3% in the quarter to reach $24.9 billion pesos, marking the twenty-fifth consecutive quarter of net revenue growth.

Average price per case in Mexico in the quarter – not including jug water -, rose 10.7%, reaching $76.95 pesos.

We continue accelerating the expansion of AC Digital. At the end of the quarter, we reached more than 220 thousand registered customers in the traditional trade, of which 71% are quarterly buyers and accounting for close to 26% of the volume in this channel.

EBITDA increased 13.5% to $6.1 billion pesos, representing a margin of 24.5%.

We advanced our strategic intent to increase customer choices and play in more occasions with the launch of Topo Chico Tequila Seltzer and Topo Chico Margarita, as we continued expanding our innovation pipeline in flavored – alcoholic ready to drink beverages.

Turning now to South America, our beverage business continued its positive momentum and delivered a strong performance across the region with total volume up 6.4% in the quarter.

Total revenue was up 15.6%, reaching 10.3 billion pesos, while EBITDA increased 18.5% to $1.9 billion pesos, representing a margin of 18.3%.

Our team delivered solid sequential financial and operational results, supported by our affordable portfolio initiatives and the expansion of returnable presentations.

Our beverage business in Peru delivered strong sequential volume growth of 4.1%, cycling double-digit volume growth from the same quarter in 2021.

The Sparkling category grew 3.1% in the quarter with Coca-Cola and Inca-Kola brands sustaining positive momentum, up 2.6% and 0.8%, respectively.

Still beverages delivered strong 5.2% growth, driven by water category, as we continue with our dual commercial strategy with San Luis and Benedictino brands.

Single serve mix in Peru increased 3.9 percentage points, in line with the sequential recovery of the on-premise, convenience stores and leisure channels, all of them growing at double-digit rates.

Our beverage operation in Argentina delivered another outstanding quarter of volume growth, up 9.7%, cycling strong 26.5% volume growth from the third quarter of last year.

This marks the ninth consecutive quarter of volume growth, confirming the sequential improvement throughout the last two years.

The traditional trade was the best performer with 17.4% growth, as we continued refining our revenue management capabilities to maintain pricing in line with inflation while actively promoting affordability with returnable packages.

Moving over to Ecuador, our operation delivered sequential volume growth, up 7.6%, cycling a strong 12.2% growth from last year and driven by double-digit growth in the flavors segment, due to a strong performance in core brands Fanta and Inca Kola.

On-premise, supermarkets, and traditional trade channels delivered strong growth, as we continued promoting immediate consumption in Ecuador.

Single serve mix also benefited from this recovery, increasing 3.4 percentage points in the third quarter.

We remained focused on cost discipline, optimization, and affordability, as we continued investing in returnable bottles across sparkling and still beverages. To this end, we accelerated coverage of the new 300-milliliter “Universal Bottle” refillable format.

We also continued investing in market-focused initiatives, increasing cooler coverage. Year to date, we have installed over 11 thousand cold-drink units.

Tonicorp, our value-added dairy business, posted sequential double-digit sales growth in the quarter while capturing additional value share. Growth was driven by yogurt, flavored milk, and ice cream categories.

Product innovation is one of the main pillars of our commercial strategy. This quarter we expanded our yogurt segment with new flavors.

Our beverage operation in the United States maintained its steady momentum and delivered another quarter of solid revenue and profit growth with its seventeenth consecutive quarter of EBITDA growth.

Total revenue in the quarter increased 12.8% to $947 million dollars, driven by strong pricing due to the off-cycle price increase implemented during the quarter and better management of promotions.

Volume for the third quarter declined 0.9% to 116 million-unit cases. Sparkling Soft Drinks declined 0.7%. Brand Coca-Cola gained 1.5% with Coke Zero continuing to be the engine of growth, up 15.2%.

Our volume driving initiatives continued to shift volume into more profitable packages and delivered growth of 1.8% in sparkling beverages in immediate consumption packages and 9.5% in 7.5-ounce mini cans.

We launched two product innovations this quarter. The 12oz sleek can “Taste the Track”, as well as 20oz and 7.5oz “Dreamworld”, to drive demand for Classic and Zero packages.

EBITDA for the quarter grew 13.0% to $129 million dollars, representing a margin of 13.6%. OPEX to sales ratio improved by 90 basis points, as we continued investing to support employee retention and engagement.

We continued to make solid progress in our digital and innovation agenda with the expansion of our Trade Promotion Optimization tool, giving us a broader ability to collect great insights to optimize our promotional spend.

This quarter marked the end of this year’s collaboration with MIT’s Master of Business Analytics program. Through this partnership, we were able to design a methodology to define the optimal portfolio for each of our customers, tailored to their own characteristics.

Looking forward, the fourth quarter is loaded with great marketing activations such as the FIFA World Cup Trophy Tour and the holiday season, which will help us continue growing transactions and our top line.

In closing, our Food and Snacks business posted double-digit sales increase in the quarter, driven by solid pricing across all our operations.

Bokados in Mexico grew EBITDA ahead of sales, capitalizing on the resilience of the traditional channel and the recovery of the modern trade and wholesale segment, along with the acceleration of the e-commerce channel.

Wise Snacks doubled down on its cost efficiency program. Several productivity initiatives are in place, including SKU rationalization to focus on high performing items, streamlining of our supply chain to optimize freight costs and transportation logistics, among others.

Moreover, we are investing in new production lines in our Berwick facility to expand Kettle capacity to support the expansion of our Deep River brand.

And lastly, Inalecsa posted double-digit sales and EBITDA increases in the quarter, as we continued to reshape our portfolio to further increase our focus on affordability and innovation.

New product launches played a key role in our profitable growth strategy. This quarter we launched a new popcorn product line and rapidly gained share in this category.

We also continued to spark consumer-centric innovation with the introduction of a new cold cereal product line capitalizing on the strong brand equity of our leading confectionary portfolio.

I will now give you an update on our ESG initiatives.

Our team in Ecuador was honored by the international Women Economic Forum with the recognition "Iconic Companies Creating a Better World for All", for its consistent participation in the development of programs and strategies that promote gender equality, inclusion, and non-discrimination. Among the implemented initiatives was the program named “Desarrollo - Ambiente – Reciclaje”, which assists hundreds of small-scale recyclers by providing training and advice to ensure that their activities are profitable and efficient.

Furthermore, Coca-Cola Southwest Beverages and The Coca-Cola Company partnered to share the new packaging for Sprite and Dasani bottles with the Texas market.

The new packaging includes a transition to clear bottles from traditional green Sprite bottles, as well as 100% recycled plastic material. These changes help protect our planet by decreasing carbon emissions and minimizing new plastic, and they are a step forward in our goal to support our World Without Waste initiative.

Moreover, we reaffirmed our commitment to the Sustainable Development Goals at last month's Business Summit for Sustainability organized by the United Nations Global Mexico Chapter in Monterrey.

At this event, we pledged our support for the Women's Empowerment Principles and continue promoting an equal opportunities environment, while creating safe and inclusive workplaces.

We also reaffirmed our commitment to the Science-Based Targets initiative as part of our ongoing efforts to reduce our carbon footprint and recognize the importance of contributing to mitigate the global climate challenge.

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

Emilio Marcos: Thanks, Arturo. Good morning and thank you all for joining us today.

I'm pleased to report that we have reached another quarter of consolidated positive volume, double-digit top line and EBITDA growth as well as a sustained EBITDA margin compared to the same period of 2021. Despite a complex macroeconomic environment and increased inflationary pressures in all of our markets, our proactive pricing architecture strategy and operational discipline, were the key pillars to achieve this outcome.

Turning to the financial results of the quarter:
For the third quarter, Consolidated Revenues rose 16.2%, while year to date growth was 15.6%, led by volume growth obtained through our market execution and pricing strategies. On a currency neutral basis, Net Revenue grew 17.8% in the quarter and 16.8% in the first nine months.

During the quarter, Gross Profit increased 16.4% to $25.1 billion pesos. Increased pricing along with our consistent hedging strategy managed to offset any impact from raw material pricing, resulting in a 10-basis point expansion in the contribution margin. For the 9-month period, gross profit rose 14.1% to $69.4 billion pesos, but despite executing previously mentioned initiatives, gross margin declined by 60-basis points, due to the volatility in raw material pricing during the first half of the year.

Operating Income for the quarter came in at $8.4 billion pesos, a 23.5% increase against the same quarter of 2021. The Operating margin presented a 90-basis point expansion, mostly led by operational efficiencies and a strong top line, even though inflationary trends have remained on the rise.

For the first nine months, the Operating Income totaled $22.8 billion pesos, a 19.8% rise and 50-basis point expansion in margin compared with the same period of the previous year, driven by the previously mentioned initiatives. Discipline and learnings over the last couple of years remain engrained within the organization, leading to a 70-basis point reduction in our OPEX ratio to sales for the period.

In the third quarter, Consolidated EBITDA grew 16.1% to $10.7 billion pesos, with a steady margin of 19.2%. For the accumulated period, EBITDA grew by 12.8%, while the margin declined 50-basis points due to the previously mentioned inflationary pressures on the contribution margin.

Net Income increased 25.1% during the quarter, a 50-basis point expansion in net profit margin. Year-to-Date, Net Income reached $11.5 billion pesos, a 26.9% increase versus the previous year. Operating income growth as well as Financing Expenses contributed positively for both quarterly and year to date increases.

Moving on to the balance sheet:

Cash and equivalents at the end of September stood at $34.3 billion pesos, while total debt was $49.2 billion pesos, reaching a leverage ratio of 0.4 times. The strong position of our balance sheet provides us with the possibility to further assess any growth opportunities that may arise and continue to create value for our shareholders.

CAPEX was $6 billion pesos, as we continue to reinforce investments in our commercial capabilities as well as production, in line with current volume growth trends. This represents an increase of 23.5% when compared to the same period of last year.

All commercial and cost optimization strategies implemented throughout the first nine months of the year, give a solid foundation to mitigate any possible impacts. Looking ahead, we expect higher comps in fourth quarter 2022, as we continue to face volatility and challenging macroeconomic environment.

We are confident that our operational discipline and strong pricing capabilities should enable us to sustain our strong momentum for the remainder of the year.

Now, let me hand it back to Arturo.

Arturo Gutierrez: Thank you, Emilio.

This year, we have been able to consistently outperform and deliver outstanding results with pricing power, operational flexibility and a rigorous discipline in costs and expenses.

Nonetheless, we are aware that the uncertainty of today's economic landscape is likely to extend into 2023. Therefore, we will remain focused on further sharpening our revenue management capabilities, as consumers adjust and adapt to persistent inflationary pressures.

So far, demand elasticity has been in line with our expectations, however, we will continue closely monitoring consumption trends.

We will also continue accelerating our cost management initiatives and taking the appropriate actions to navigate input cost inflation and supply chain volatility.

Looking ahead, we remain optimistic and excited about the future of our business. We are encouraged by the opportunities that our new cooperation framework with the Coca-Cola Company will provide.

In summary, we are pleased with the progress and trajectory of our business and remain encouraged by the long runway for growth across our markets.

Thank you for the confidence you've placed in us.

And with that, Emilio, Pepe, and I will be glad to take your questions. Katie, please open the floor.

Operator: Thank you, sir. At this time, we will open the floor for questions. If you would like to ask a question, please press the star key, followed by the one key, on your touchtone phone now. As a reminder, due to high interest and time, please limit yourself to one question. We will pause for just a moment to allow everyone the opportunity to signal for questions.

Thank you. Our first question comes from Marcella Recchia with Credit Suisse. Your line is now open.

Marcella Recchia: Hi, gentlemen. Thank you for taking my questions. I have just few questions on my side. First, on U.S. - can you give us a little bit of more color on the drivers of EBITDA margin expansion? And what's your view about the volume going forward, especially in case of a potential recession? And secondly, regarding the multi-category framework, following this new pilot program with Diageo in Mexico, would you consider also entering the beer segment in the country as just announced by KOF and Heineken? Thank you so much.

Arturo Gutierrez: Thank you, Marcella. Good morning. With respect to your first question, we're very satisfied with our results in the U.S., despite the volatility of raw material prices that we've seen, margins have been sustained and improved over the years as you've seen in our U.S. operation. I think very important for that has been our pricing strategy - pricing leadership, I would say, in the U.S. and also the focus on profitability of our packages, transactions, and any better mix in general.

Very important to say that for next year, we already have an important carryover for price for '23. So -- and obviously that will depend on mix changes. But all in all, it would be something around 6% carryover from all the off-cycle and other price movements that we've had in 2022. So that's very significant if you consider the profitability of business for next year, which is certainly going to be more challenging in some respects. But also, we're going to have better raw material comparisons, particularly inaluminum, and I would say more stable PET, maybe some impact in fructose.

The volume for our market still has to recover. We have an upside in the on-premise channel particularly, so that's another of the positive things going forward. And obviously, we will maintain our OpEx discipline as we've had before. So despite the headwinds, our expectation is to sustain our margins and to continue to have strong profitability for '23 because of those reasons.

With respect to multi-category framework, as we've said before, the whole concept is how we can leverage our capabilities - our go-to-market capabilities in our markets in Latin America. I think with new technologies, with our digital initiatives, we know that we can expand into other categories and the pilot that we're going to launch and we announced in Jalisco is an example of that, and certainly, beer would be a very clear opportunity.

As you know, we already sell beer in Argentina. We have a pilot in Ecuador that has been successful, and we have been having conversations and considering that opportunity for Mexico as well. We have nothing specific to announce at this point, but certainly, that is something that we are exploring and jointly with the Coca-Cola Company, we think it's a very important opportunity for our Mexican market as well.

Marcella Recchia: Perfect. Thank you much.

Arturo Gutierrez: Thank you, Marcella.

Operator: Thank you. Our next question will come from Ben Theurer with Barclays. Your line is now open.

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

Just following along the lines with the agreements and what you can do and how you can leverage, call it, the flexibility with The Coca-Cola Company now, so obviously you've stressed it just in your comments right now, there's a lot that you can do within Latin America with go-to-market. And I get it, there is a lot of white space just given the nature of the traditional channel. But, where do you see any potential to leverage what would be flexibility within the U.S territory? I mean, it's about one-third of your portfolio, but what could you envision or what could work out for you to also leverage the greater flexibility with Coca-Cola Company to potentially deliver things in the U.S aside from the beverages portfolio and your snacks?

Arturo Gutierrez: Thank you, Ben. As you know, the agreement that we assigned and this new collaboration framework refers specifically to Latin America. What we've discussed with The Coca-Cola Company - and this was actually a conversation at our global meeting with all bottlers is there has to be a model that would be adapted to the different markets around the world. So, this is something that represents a new form of partnership for Coca-Cola with bottlers around the world.

But certainly, the different markets would require different approaches to capitalize on the presence in the market and the infrastructure that you have in any particular market. So in the case of Latin America, we've identified very clearly those opportunities. And we would have to analyze what would make sense in the U.S. for our current go-to-market approach.

So at the end, the framework is about -- basically about alignment with The Coca-Cola Company. And if you think about the U.S. market, there are a number of things where we can have better alignment I would say, mostly in our stills opportunities going forward, and I think that would be our first priority in that market. But certainly, the big change in mindset, in paradigm, is that the whole system, bottlers and the company are much more open to explore opportunities beyond our core business.

And to understand that, we can do other things without affecting, even improving the performance of our core business. So that's something to be defined in the other markets.

Benjamin M. Theurer: Perfect. Thank you very much, Arturo.

Arturo Gutierrez: Thank you, Ben.

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, everyone. And thanks for taking my questions. The first one is regarding -- it's about Mexico. Regarding the pricing seen this quarter, can you give us a breakdown of how much came from price hikes and how much from mix?

And also can you comment if additional price hikes are needed to be able to recover your margin?

And just very quickly, given the strength of your balance sheet, how are you thinking about dividends towards the end of the year considering that you have distributed extraordinary dividends in the last couple of years? Thank you.

Arturo Gutierrez: Thank you, Fernando. I will turn it over to Pepe for the first part and Emilio for your second question. First part, I'll just tell you that price leadership has been so important for us in every market including Mexico, and it's not only about pricing and how much we have accomplished but also, what is behind that?

I would say in general, that we have much more robust processes for pricing in every market. And I think, what you've seen now is the result of how those capabilities have been rolled out in every market. For the specific details, I'll turn it over to Pepe.

Jose Pepe Borda: Thank you, Arturo, and thanks Fernando for your question. As you know, we always aim to maintain a balance between market share, profitability, volume growth and that is based on our world-class execution and segmentation; and our aim is to always increase prices in line with or above inflation. We will continue to utilize pricing as one of our key top-line drivers leveraging our installed RGM capabilities and segmented brand price-pack architecture, maximizing the pricing decisions.

In Mexico, what I can tell you in the total AC for example, in 2022, 74% of our incremental volume is coming from single-serve presentations. That's why on top of the two rate increases that we are having, also the mix is working in our favor. In Mexico, specifically, we are growing our price 8.6% versus previous year and this comes from a balance of a true rate increase of 8.2%, coming from price increases in the first and third quarter, focused primarily on single-serve and even though single-serve is growing as I said, and also a carryover of 3.1% from previous year.

And also, we have a positive impact of 0.4% as single-serve mix is growing 1.3 percentage points versus previous year. And that is coming because we're capturing the gradual recovery of immediate consumption channels and the launch of specific packages as the 250ml PET multi-category platform as entry packages. For the rest of the year, we have already 8.4% of carryover and we are going to enter 2023 with at least a 3% carryover for next year.

As we said, maintaining that balance between share, profitability and volume growth, we will evaluate another increase in December, if we see there is space for that, and we can do it.

Emilio -- I think I'll pass to Emilio for the other question.

Emilio Marcos: Yes. Thank you for your question. Regarding dividends, as you know, we have a policy to pay 30% of retained earnings, which we already did with an ordinary dividend of Ps. 3.18. At our shareholders' general meeting, it was approved that the Board could have authorized any extraordinary dividend as we did in the past two years. So that may come in the next month if there's no M&A operation or transaction. So we'll have to wait for the rest of the year if that's approved by the Board.

Fernando Olvera: Great. Thank you so much.

Arturo Gutierrez: Thank you, Fernando.

Operator: Thank you. Our next question will come from Sergio Matsumoto with Citigroup. Your line is now open.

Sergio Matsumoto: Hi. Good morning. Thank you for taking my questions, Arturo, Emilio and Pepe. My questions are about Mexico. First, you mentioned 15% growth from the supermarket channel. Just wanted to get some color on whether - how much of that was due to the water sales, due to the tap water shortage or perhaps it was a base of comparison that was done for you. And also how does digital platform help in that channel? That's the first question about the supermarket.

And the next question is, more broadly, with all the talks about nearshoring and reshoring back to Mexico, are you seeing any tangible observation you can point to or is it still a lot of discussion so far? Thanks.

Arturo Gutierrez: Yeah. Thank you, Sergio. I will address your second question first and then turn it over to Pepe for the first part. And with respect to nearshoring, this is a very important point and it's not only a conversation, it's a reality of investment in many parts of Mexico. But I will tell you that Mexico is really segmented in that regard. If you look at Northern Mexican, some other regions that have the infrastructure to attract that investment, there's been a lot of activity.

There are some restrictions, actually labor has been one of them and some other infrastructure restrictions, but there is a lot of investment coming in to those parts of the country, particularly in the north part of Mexico in the border towns and here in the northeastern part.

I participate in a group with the Mexican private sector that is working on making recommendations to the governments of Mexico and the U.S. to precisely capture investment opportunities for the region. And this is called the U.S.-Mexico CEO Dialogue. And we have companies in the U.S. and in Mexico that participate and I co-chair the investment section of that initiative. And I can tell you that we've identified a number of supply chains, actually 11 supply chains that are going to be relocated or could be relocated to our country and we presented to the government, actually to the President of Mexico, and Senior officials of the U.S. two very concrete opportunities among those 11 supply chains that would come here and what is required.

So these are not only conceptual ideas, tangible plans and also investment that is already coming in into the sectors that previously existed here in Mexico. So I think that's going to be a tremendous opportunity for Mexico, having a free trade agreement, having just the logistics advantage with the U.S. for the next few years. As you know, supply chain is going to regionalize around the world. So, that's a very important point, Sergio. For your first question, I'll turn it over to Pepe Borda.

Jose Pepe Borda: Thanks, Arturo. And thanks, Sergio, for your question. First of all, regarding the growth in the supermarket channel, yes, in the quarter, we grew 15%, but it's pretty much a revaluation from what's happened in the last three or four years of the pandemic.

If you go back to numbers against 2019, we see that the traditional trend channel has grown over 8% and the modern trade has grown around 10%. And the on-premise channel is the channel that despite growing 15% in this quarter, still is below 2019 figures for the year-to-date, but catching up already minus 3% in September, and that comes mainly because the entertainment channel, cinemas, and those have not recovered yet, but the restaurants and bars already have.

Water category has grown around 16% not only in Mexico, also in South America growing 13%. So, specifically to your question, the water category has benefited from events in the last quarter, but that's come mainly across channels, not specifically in supermarkets.

Regarding the digital platforms, we do have EDS, electronic data interchange with most of our biggest supermarket channels since a long time ago. And we always perfect those systems and work together with them to make them as seamless and as profitable as possible. Hope that answers your question.

Sergio Matsumoto: Yes, it does. Thank you, Pepe and Emilio. Very interesting. Thank you.

Arturo Gutierrez: Thank you, Sergio.

Operator: Thank you. Our next question will come from Felipe Ucros with Scotiabank. Your line is now open.

Felipe Ucros: Thank you. Good morning, Arturo, Emilio and Pepe. Congrats on the results, and thanks for the space for questions. A couple on my end. The first one is on returnable, right? As inflation rises and it starts getting to the breaking point for the consumer, how do you manage returnables to provide affordability? Are you proactive on making it more available in the market? Or do you wait for the consumer to start sort of pulling it?

And just also wondering the role that Universal Bottle plays in this given that the portfolio is somewhat different from what it used to be the last time we had a recession throughout the entire region? Just wondering, if the rollout of Universal Bottle is where you wanted to be and you're very prepared for this? Or if there's a little more to go with the Universal Bottle before getting into recession?

And then, I'll make a follow-up question about snacks.

Arturo Gutierrez: Yeah. Thank you for your question. Good morning. With respect to returnables, I'll make a general point and then turn it over to Pepe. I would say, it's certainly a very deliberate strategy for us in our Latin American markets. And it becomes more relevant precisely when there are difficult economic times. And we've been doing this for many years. And the point here is that, it's not only about presenting the options to the consumer. It's actually an operational capability that we have.

So, it requires a coordination. It requires – your know, distribution capabilities are different. It's harder for someone just to start doing returnables overnight. It requires investment certainly on the one hand. But also a way of operating that is different to a normal, more simplified business with one-way packages and that is why we -- what we're doing -- and also introducing the bottles to the market and doing it that in a most effective way so that they can be used and they can end up with a consumer that would precisely buy those type of packages.

So it's a pretty sophisticated capability, I would say, and we've developed that. If you see our mix of returnables in the different markets, we've been very successful in some markets, Mexico, Argentina. I think we have a good opportunity in some other of those markets where Ecuador it's becoming very relevant, for example. So we've been focused on that opportunity, same thing as Peru. And in that regard, Universal Bottle has become a very important part of that strategy. So I'll let Pepe comment on details of Universal Bottle.

Jose "Pepe" Borda: Thanks, Arturo. And thank you, Felipe, for your question. As Arturo was saying, the Universal Bottle is one of the most important initiatives in LatAm as it helps us increase the mix of affordable options, not only in Coca-Cola but also in flavors and stills and that is going to be even more important in a recession environment in the near future.

Today, Universal Bottle multi-serve packages represent around 20% of our total multi-serve with a returnable portfolio in LatAm. And during the next year and the next years, we will go into continue developing returnables and the Universal Bottle. As Arturo said, this is a long-term play. In the short-term, mixes can go up or down because of the specific promotional activity, but the long-term aim is to increase our offering in Universal Bottle in the longer run.

In the short term, we've had some supply chain limitations in production due to shortage of glass in some presentations. And as this continues to get solved within the next month, we're going to be able to further expand our Universal Bottle and refillable options, and thus increasing our consumer base, protecting the bottom of the pyramid.

Felipe Ucros: That's very clear guys. Thanks. And maybe if I can do a follow up on snacks, you know. In Mexico, I think, Bokados had double-digit top line and EBITDA now for something like six quarters in a row. Similar with Inalecsa, I think my count is at five quarters or even maybe a little more. And Wise didn't see the same in EBITDA but it's four quarters of double-digit topline. So clearly, snacks are doing very well. So just wonder -- if this is just still a recovery from the pandemic? Or if you're already above that and still growing at these rates because execution and turnaround plans have gone better than you expected? And then, more importantly, maybe what's the long-term plan for this business?

Arturo Gutierrez: Yeah. With respect to snacks, the operations at Latin America were less impacted, I would say especially, Bokados in Mexico, was more resilient. In Ecuador just because of how difficult was the situation with COVID, we had a bigger impact. But in general those businesses have been more stable for a profitability standpoint.

In the case of Wise, we did have a significant impact, particularly in Deep River with our on-premise and on the go markets during the pandemic and mostly in the northeast of the U.S. which is our -- one of our main markets. So I would say that for Wise, this is more of a recovery of the business and it's been a great recovery. We've been posting double-digit sales increase and we've also improved profitability. The Deep River portfolio keeps growing profitably. We're capitalizing on e-commerce and we're focusing on RGM practices and SKU rationalization and also on restructuring our whole distribution network in the U.S. So it's a -- I would say it's a much bigger transformation that what is going on in Wise. We're very satisfied, but I wouldn't say that we are at the point of stability of that business. Yeah, we're heading in that direction I would say for 2023. And that business - going to the final part of your question, it's probably less synergistic with the rest of our operation if you compare that with Latin America, because we operate in different markets in comparison to what we do in Mexico and Ecuador in the U.S. So, we still are working on improving that operation, but certainly not as connected to our beverage business as it is in the Latin American markets.

Felipe Ucros: Very helpful color. Thanks, guys.

Arturo Gutierrez: Thank you, Felipe.

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. Arturo, Arca team, congrats on the results and thank you for taking questions. I'd like to follow up also on the enhanced cooperation agreement with Coke. And my question is regarding inorganic opportunities, right? So I'd just like to understand with this better alignment of the interest and a common focus on pursuing further growth, does it change at all the position Arca might have on driving further consolidation into Coke's broad distribution system going forward? And where the firm currently is in terms of potential M&A and inorganic deals going forward? These are the question, guys. Thank you very much.

Arturo Gutierrez: Thank you, Thiago. Well, I would say that, the context of M&A and inorganic opportunities remain the same. And what we've said is that, we believe that the system is still fragmented in many regions around the world. And that fragmentation presents opportunities. And just based on what we've seen before in operations, not only in our company but if other bottlers and how value has been captured through scale, what we've said is that this business became over the years much more a business where economies of scale were relevant than the past when you had smaller franchises that didn't require the benefits of scale as much as we have right now. And not only because of larger customers and more complex distribution, but also some of the capabilities that we talked about in RGM and digital sometimes require scale and also ESG initiatives, those kind of things.

So, the business requires more scale, there's a fragmentation. So, the normal thing to happen for the future is more consolidation. So, as we said, we want to participate because that is first of all the mandate that we have from our Board. We have the financial capability and more importantly, I think we have developed the capabilities to integrate businesses not only in our original markets which is Latin America, but also in the U.S. So that the success we've had in the U.S. over the last five and a half years has been very important for us to demonstrate how we can leverage those capabilities for further growth.

On the other hand, those transactions require patience because the business was very resilient, some of the companies and the owners are satisfied with where they are and not prepared to take strategic decisions sometimes at this point. And on our side, we have been very prudent about valuation of businesses and cautious about making sure the synergies are captured and creating value for us as we integrate and acquire. So nothing to announce at this point, but I think the opportunities would arise over time because I think that's just the natural trend of our bottling system around the world.

Thiago Bortoluci: That's great. Appreciate it. Thank you very much.

Arturo Gutierrez: Thank you, Thiago.

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

Lucas Ferreira: Hi, everybody. Two follow-ups on the multi category. Maybe the first one for Pepe. If you can give, Pepe, an update on how Arca is ready on a B2B, let's say, digital capabilities to leverage the multi-category across the region? So how is the adoption of your clients to, let's say, online order taking? How much you interact with your B2B clients on an online basis? And because, that, I think, is a key part of the success, right, for the multi category strategy. So how advanced you are in that? How -- what are the challenges?

And maybe the second one for Arturo, on that discussion from the previous question, Arturo, just wanted to understand, if -- well, you guys have been super vocal about M&A opportunities in the U.S., but correct me if I'm wrong, but U.S. is much more mature than Latin America in terms of distribution. You have a very like, say, consolidated food service delivery network. And while in Latin America it's much more like fragmented, so, this is where you guys could add most value to the small mom and pop shops. But, does it mean that you're going more multi-category now?

Makes like maybe opportunities for consolidation within Latin America more interesting than they were before? Or not necessarily, you guys think that M&A in U.S. could probably be the next big step for Arca?

Arturo Gutierrez: Yeah. Thank you, Lucas. Maybe I'll address the second part, Pepe, if that's okay, and then I'll turn it over.

Jose Pepe Borda: Okay.

Arturo Gutierrez: Yeah. With respect to M&A, there could be some differences as we evaluate synergies, as you say, and I probably could agree with that. But still, I think it makes a lot of sense for us to look for opportunities. I --certainly, we won't discriminate, if we have opportunities in either part of the continent, if it's the U.S. or Latin America and whether it's acquisitions or some other creative way to integrate business. So, we're -- even though that might be the case, it really won't change our approach into trying to identify potential opportunities to integrate and synergize in the future. We're convinced that there are synergies in the U.S., Latin America, and maybe even other markets which are not our focus at this point, probably for different reasons, as you say. But we have enough information about the U.S. now to know that they're real and very concrete synergies to be attained.

With respect to multi-category and the B2B opportunity, I think with the signing of the new collaboration agreement, we have now the possibility of integrating much better what we had been doing in terms of B2B multi-category in our own independent approach through Yomp! over time, now with what we have been doing with the B2B of AC Digital for Coca-Cola. But I'll let Pepe expand.

Jose Pepe Borda: Thanks, Arturo. And thanks, Lucas, for your question. So, as Arturo was saying -- while we continue optimizing the current business through digitization, our main focus today is converging this present forward approach of optimizing the current business and optimizing and digitizing our commercialization with a future back approach of digitizing the traditional trade, multi-category distribution and the direct-to-consumer channel.

As with the LPRN signed, we are starting to integrate Yomp! with AC Digital in one B2B2C digital ecosystem aiming to become the best solution for our traditional trade and continue being perceived as the best partner for the traditional trade. And we've talked many times about it that why are we doing this is because we want to increase sales of our current portfolio and optimize our current cost to serve.

We want to expand our portfolio. We want to develop and strengthen the traditional trade and our partners with them and maybe and probably another one that is getting more insights from all this experience to help the other three. As of last quarter -- as of the third quarter, the AC Digital in LatAm reached 550,000 registered customers, which represents close to 70% of the customers in the traditional trade and accounting for 23% of the volume in the last quarter. We plan to close the year with close to 35% of our traditional trade sales through digital channels.

To give some perspective, year-to-date 2022, $420 million of revenues have been through digital channels. If we only take October ‘22 and make it a 12-month running rate, that number is already US$1.1 billion, that are going through our digital channels in the traditional trade. And for the next year, this number would be between $2 billion and $3 billion with WhatsApp and the integration of Yomp! and AC Digital. And why this is important? Because we have seen that customers that adopted AC Digital as their ordering channel, have experienced at least between 3% and 5% sales growth versus non-adopters, putting 11% more orders and selling 15% more SKUs.

So, we plan to increase it. And in the U.S. also -- in the U.S. during the third quarter myCoke sales footprint reached US$116 million, that's 29% over the previous year. We saw 80% of our eligible monthly customers using myCoke during September. We have made significant progress in digitizing customer engagement aligned with our go-to-market and service model strategy. So, we are moving in that direction in all of those channels. I hope that was helpful.

Lucas Ferreira: Yes. Super helpful. Thank you very much.

Arturo Gutierrez: Thank you, Lucas.

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

Rodrigo Alcantara: Hi, Arturo, Emilio. Nice talking to you again. Just to continue the discussion, you mentioned at the beginning of some investments in new capacity. I was wondering if you can comment about that and any other projects that you have in the pipeline there to increase your production capacity perhaps on the snacks in Mexico and in the U.S.? Thank you very much.

Arturo Gutierrez: Thank you, Rodrigo, and thank you for your question. Yes, I think that, as we move into a post pandemic scenario, we've identified that we require to invest for growth in every one of our business units. And the investments that we have in our plan are in the typical basic things that we invest year-over-year. It's, as you know, in coolers, especially assets for the market, and our warehouses and renovating our facilities and trucks, obviously returnable bottles as I mentioned before. Probably, now we're going to have more focus in some of the investments in our supply chain to make sure that we have enough capacity to satisfy demands.

Now that we've had some disruptions and supply chain in the peak season this year, we've identified opportunities going forward. So most of those disruptions I would say, were external from suppliers and from the freight and other supply chain issues, but there are some things that are internal as well. So we are thinking about new distribution centers as some of the major metropolitan areas that we serve, some new production lines and very importantly we're investing in Topo Chico lines. So I would say that that would be the most relevant if you can call extraordinary investment although it's really part of our operation. But we're installing new lines in our Topo Chico facility precisely to face the growing demand for Topo Chico both in Mexico and the U.S. I would say that that would be -- those would be the most relevant items and but in terms of the level of investment, that would be consistent with what Emilio has been telling you over the years.

Rodrigo Alcantara: Okay. That's very clear. Thank you very much.

Arturo Gutierrez: Thank you, Rodrigo.

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

Arturo Gutierrez: Okay. Thank you. And thank you all for participating in our call and for your continued interest in our company. We look forward to speaking with you again soon. Have a nice day. Thank you.

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

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