American Beverage Company
Compañia de Bebidas de Las Américas
Companhia de Bebidas das Américas
AmBev

Transcript

Fourth Quarter 2004 Earnings Conference Call
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Operator
Good morning ladies and gentlemen. Welcome to your AmBev fourth quarter 2004 conference call. [OPERATOR INSTRUCTIONS]
It is now my pleasure to turn the floor over to your host, Mr. Carlos Brito. Sir, the floor is yours.

Carlos Brito - Intro
Thank you very much. Good morning everyone. Thank you for joining us for the AmBev fourth quarter and full year results conference call today.

I'll be talking about the results and also I'll be providing some details on our North American Operations. Then I'll pass it on to Luiz Fernando who will discuss our Brazilian business. Then to Juan Vergara who will reveal all our Hispanic Latin American business and then finally to João Castro Neves, our CFO, who will give you further details on the financials and EBITDA and the below the EBITDA lines details.

First I'd like to start by saying that we're very pleased to share this set of results with you, and very proud of our accomplishments during this very successful year.

As of December 2004, we achieved market share in our core Brazilian Beer business of 68.1%, significantly improving on our 62.5% position in November '03, which was our lowest market share ever in that industry.

During the year '04, we made deliberate investments to build our brand equity and those investments paid off in market share gain. I am also happy to report that these investments did not diminish our Brazil Beer EBITDA margins, which, by the way increased by 200 basis points to reach 42%.

Beer Brazil was not our only highlight for the year. All AmBev operations contributed to the solid growth. EBITDA for AmBev (excluding Labatt) grew by 22% in real terms on a pro forma basis for the year.

AmBev as you all know is a meritocracy and we share results with our employees when we meet results. In '03 we had a tough year. It was a challenging year. Our targets were not met and therefore no bonus was paid.

At the start of 2004, all employees were focused on our core competencies to recover market share and preserve profitability. We also worked once more with reducing our fixed cost base and furthermore to fund all market initiatives. So this year, we're very pleased to say that we got to the results we will be paying out bonus.

Our Soft Drink business also reported impressive results delivering EBITDA growth of 62% in real terms. And substantially improving EBITDA margins which reached 30% and which would leave us a bench mark for the industry.

All Latin American operations outside Brazil contributed significantly to the fourth quarter results as well. Quinsa contributed to deliver outstanding growth in our Hispanic Latin American expansion outside of Quinsa presents a long term growth platform in a very profitable region.

Carlos Brito – North America

Now let me say a couple of words about our Canadian business.

First, let me say it's a pleasure for me to join the Labatt team. It's a great team with great, talented people. We have a great portfolio of brands in the great market Canada.

Second, we are committed to continue to grow the business in a sustainable and profitable fashion in Canada. So that's our commitment as we had in Latin America.

Third, Labatt delivered on the guidance as stated by AmBev for the fourth quarter of last year, achieving EBITDA of CAN$187m.

Moreover, I want to share with you some evidence supporting our enthusiasm in Canada.

First, the Canadian Beer market continued to deliver volume growth in '04, around 1%. Second, Labatt's consolidated market share remained stable throughout last year. All of us in Canada are excited about Labatt's value creation prospectus and we reinforce our commitment towards the cost reduction opportunities in revenue performance previously disclosed by AmBev.

Although it's too early in the game to comment on actions or achievements, I can anticipate that some major efforts are underway. And some of them are for the whole revision of our portfolio and price points. A little bit of revenue management in there as well, and also implementation of our zero base approach, zero base budget for our fixed costs structure.

Just a couple of examples of some things that we already see in the market place or within the Company as a result of those efforts.

First, we're re-assessing the whole price points and the role of our different brands within our portfolio. In January we did increase the price of our discount brand or our value brand proposition Lucky about 11% from CAN$23.7 in Ontario to CAN$26.4. That was pretty much followed by the market which increased the floor in Ontario markets. So that was something that was important for us.

Second, we're undergoing within Labatt a right size approach to our Admin structure and we eliminated 240 salaried people. We felt it was the right thing to do given the conditions we have in the market place and we had an opportunity to operate in a more efficient way. So that was a reduction of 15% when we talk about the salaried workforce.

Third, also in Canada, ZBB is well under way. We have in place today, the whole thing about the package, sub-package entities, the owners. So we have great visibility of our cost structure in moving towards, in delivering promised synergies.

So moving to fourth quarter results, I want to emphasize and clarify what was already said in yesterday's earnings release in relation to net sales decrease for the fourth quarter.

On the domestic side, the reasons for the volume drop in Canada are not related to Labatt's market performance. But mostly to the inventory build-up that took place in the fourth quarter of

2003 because of the end of the Montreal strike. So the Montreal strike ended pretty much around September and we had of course to load the trade back on through the fourth quarter of 2003. So that is one of the reasons why the '04 number came down volume-wise for Canada.

On the export side, Labatt's brand performed well the fourth quarter, increasing shipments by roughly 10%. However, due to the Canadian dollar appreciation, net sales per hectoliter came down as we had disclosed yesterday.

And so now I'd like to pass over to Luiz Fernando to give some guidance and some details on our Latin American performance. Luiz.

Luiz Fernando - Brazil

Thank you Brito and good morning everyone. Let me start by saying that I'm very excited with the challenges and opportunities of managing our Latin American business. My team and I are committed to keeping the company on track for long term growth while remaining faithful to AmBev's core imperatives. I'm also very pleased to have Juan's support managing our HILA operations while I focuse more on Brazil.

Latin America is currently enjoying some very positive momentum. We are capturing maximum value from that. I will address Brazil now and leave HILA for Juan to discuss in a moment.

As Brito mentioned, 2004 was a great year for us in Brazil. We brought our share of the Beer market back to around 68%. But not only preserving, but actually enhancing profitability. We also reaffirmed our 3 mainstream brands as the leaders of the Brazilian market and our Soft Drink business achieved benchmark EBITDA margins of roughly 30%.

Consolidated EBITDA grew 12.3% in real terms and our EBITDA margin increased 300 basis points to 39.9%.

Looking at some highlights from the fourth quarter results. Year volumes were up 14.3% supported by a solid market growth and market share recovery.

Net sales per hectoliter increased to R$122.8 due to more direct distribution in the sales mix, revenue management initiatives and a price increase implemented at the end of December. Prices were adjusted in a careful fashion with a different approach for each brand, package and region. The average increase was 5%.

Fourth quarter EBITDA margins were up 240 basis points to 44.2%. Despite the fact that sales and marketing expenses were higher than our previous guidance we delivered on our profit targets and clearly demonstrated the equity and health of our brands.

Soft Drinks continued to deliver a strong performance in Brazil with volumes up 6.2%. Market share reached 17.2% in December, stable in comparison to fourth quarter 2003 and EBITDA grew by 34.4% in real terms, with EBITDA margins reaching 32.4%. Consolidated EBITDA for Brazilian operations grew by 16.4% in real terms and margins increased 350 basis points to 42.5%.

We firmly believe that our achievements in 2004 were made possible by AmBev's solid foundation. Our strong proprietary distribution system, which has been carefully developed over the past several years, affords us a deeper understanding of market dynamics. We are more responsive to consumers' and customers' needs and better equipped to face new competitor initiatives.

Volumes sold through our proprietary distribution system reached from 46.8% in fourth quarter 2004, up from 41.9% in fourth quarter 2003.

While expanding our Brazil business system, we were also successful in consolidating our distribution operations in every Brazilian sales district. In the past, each district had 3 separate operators. As you know, our objective is to reduce these to a single consolidated operation in all regions. This will provide for improved execution and optimized brand portfolio strategy, while also allowing logistical cost savings and improvements in truck loading efficiency, warehousing and administrative expenses.

These efforts worked in those regions served by either proprietary or third party operations.

In addition to distribution initiatives, we have worked hard to reinforce customers' preference and loyalty to our brands. We're happy to say that our brand preference has returned to the same levels we had in the beginning of 2003.

We have made good progress from product innovations around Skol, Liber, Bohemia Royal Ale and innovative advertising campaigns for our 3 mainstream brands. We are also keen to improve our relationship with customers via greater exchange of ideas and better than expected service levels.

Our achievements over the last year are great reward for the hard work and remarkable commitment shown by our employees.

We enter 2005 with great enthusiasm and can offer the following outlook.

Brazil has experienced a virtuous cycle of growth and we expect that to drive Beer consumption upwards. In Brazil we expect this year to achieve a 5% volume growth, which should be a consequence of both market volumes increase in the higher market share than 2004. More specifically in market share, AmBev's average market share in 2004 was 66.6%. We reached in December 68.1%. In January, however, we backed 30 basis points. Nonetheless, that was expected as a consequence of the 5% price increase implemented at the end of 2004 which as usual is not immediately followed by competitors and historical can mix in December.

We reaffirm our commitment to maintain stable prices to consumers in real terms. And we are confident that the flow meters in place this year will provide a fair point of view for the industry field, reducing the discounting pressure for informal competitors.

On the Soft Drinks side, we work hard to preserve the high profitability we achieved and further boost those net sales.

Finally, we always remain committed to constantly improving our efficiency and obsessively reducing costs and expenses.

With that I would like to turn things over to Juan for a discussion of our HILA operations.

Juan Vergara - HILA

Thank you Luiz and good morning again.

As Luiz just mentioned, Latin America overall is facing a very positive momentum and we definitely want to leverage this opportunity to maximize growth in all the operations which we have established.

Our Hispanic Latin America or HILA business units delivered strong performance in 2004 and we are already working very hard to keep the pace in 2005.

In Southern HILA, that's Quinsa, Quinsa's management did a fantastic job across the board, including fully merging AmBev's assets into its business. On top of that, the region's economy is a whole continued to experience significant recovery versus prior years.

Going to the northern part of HILA, that is all countries in Hispanic Latin America which exclude Quinsa, our people that work very hard to complete a very sizable chapter for growth. And we already see some benefits showing up. For several of the Pepsi distribution systems have been substantially upgraded, both in Peru, as well as in the Dominican Republic. In Peru, with AmBev Brazil-like direct distribution being established not only in Lima, but in other major cities in the north. In the Dominican Republic, AmBev sales tools and sales technology are quickly and -- I would say -- very successfully being implemented in the direct distribution system, which came from our partner Embodom.

The launch of Brahma in Ecuador, which took place in October 2004, was very well executed and we estimate our share to be in the mid-teens. Very interestingly in Ecuador, and differently from prior experiences, we're selling at price parity to the market leader.

In Venezuela, strategy worked and led to positive EBITDA and consistent share growth.

More specifically, in relation to 2004 fourth quarter, HILA delivered EBITDA of R$182.3m. That's a growth of 33.7% and that accounts for 10.3% of AmBev's consolidated EBITDA.

Quinsa delivered in Brazilian GAAP figures, 10.5% EBITDA growth in dollar terms, which was operationally driven by high beer volume growth in Bolivia and Paraguay, very successful price repositioning in Argentina and EBITDA margins stable at the 27% range.

And on top of the operating performance, Quinsa's share buy-back public offer last September increased our economic stake in the Company to 54.8%, which is 5.1 percentage points higher than December 2003. Quinsa's overall contribution for fourth quarter EBITDA amounted to R$150.3m which represents over 80% of HILA's total contribution to EBITDA.

Northern HILA, again which are those countries which exclude Quinsa within HILA. Northern HILA operations also posted positive results, contributing an EBITDA R$32m with the largest contributor still being our Soft Drinks business, of which Embodom in the Dominican Republic is the largest operation.

Some highlights of the Soft Drinks business in the fourth quarter.

First, in the Dominican Republic, which sustained share at the 60% level. In Peru, as mentioned earlier, the expansion of our direct distribution system into major cities in the north, also supported by a very careful selection of third party distributors in rural areas, had a very positive impact in our distribution levels.

Also in northern HILA Beer business Cerveceria Rio from Guatemala, posted strong results, both in Guatemala and in Nicaragua, while Cerveceria Nacional in Venezuela was very well armed, I would say, both in the industrial and logistical fronts to take full advantage of a very strong market recovery, which ended up delivering a volume increase of 39% and a positive EBITDA in Venezuela.

Overall, Beer profits however were impacted, as planned, by the sales and marketing expenses related to the October launch of Brahma in Ecuador. Which, as I've just mentioned was in the mid-teens share level already in December, selling at price parity to the market leader.

Moving into 2005, we are fully focused both on the organic growth of existing and established operations as well as the completion of our Beer plants in both Lima and Santo Domingo, which will enable us to enter both Beer markets.

That said, we will always keep our eyes open for new opportunities. For example, a few weeks ago we went ahead with the expansion of Cerveceria Rio from Guatemala with the distribution of Brahva into El Salvador.

Thank you and I will now pass it on to Joao.

João Castro Neves – Bottom line and capital structure

Thank you Juan. Good morning everyone. I will guide you now on the lines between EBITDA and net income.

Starting then by EBITDA, the contribution of each AmBev's business units provided consolidated EBITDA of R$1.7b in the fourth quarter, representing 66.2% growth. That is compounded by a 23.5% organic growth and 42.8% growth through new investments.

Also, I wanted to highlight the 15.4% growth in EBITDA per share achieved this quarter when AmBev first consolidated Labatt results for the full period. The substantial growth achieved on a per share basis demonstrates, in our view, the accretion potential underlying AmBev's operations.

Quickly passing to depreciation. The 37.9% increase observed to R$284m is a consequence of AmBev's expanded footprint, to which the major contributor is Labatt. The higher stake in Quinsa and AmBev's enlarged direct distribution system, also contributed to higher depreciation.

Moving to provision for contingencies, in this case, 2 major impacts can be named as the drivers for such a higher than usual expense, which amounted to R$183m. First, AmBev legal advisers indicated that the current labor dispute should be reclassified from "possible" to "probable", demanding the Company to approve provision of R$128m.

In addition to that, AmBev also booked a provision of R$39m related to an ICMS dispute in which the IRS questioned AmBev on the accounting of ICMS tax due, suggesting AmBev paid less than it should actually have done.

I will address now other operating income and expenses, whose net amount represented a loss of R$103.6m. This specific line in the P&L became much more relevant for business where the goodwill from AmBev is booked. The first thing to mention, total goodwill amortized in relation to Labatt in the fourth quarter amounted to R$266m. The current net balance for Labatt goodwill booked in AmBev's balance sheet is R$16.3b. In addition to the amortized goodwill related to the merger of Labatt into AmBev, additional R$422m goodwill was amortized this quarter, which relates to past transactions.

Apart from goodwill, the other major relevant impact on other operating items was exchange rate gains in foreign investments, which amounted to R$156m. As well as goodwill, this is a non-cash impact represented by the volatility in Reais of investment in AmBev's balance sheet denominated in foreign currency. As in the case of Quinsa and Labatt.

Nevertheless, there were actually cash or cash related items classified as other operations. The most relevant of them was a gain of R$89m related to tax incentives granted to AmBev. While this is not exactly a cash inflow, this gain represents a tax shield that will improve cash flows in the future.

On the other hand, AmBev had other operating cash loss of R$15.8m related to PIS/COFINS charged on other operating income. The most relevant income charged in this case is the interest on own capital paid by AmBev's subsidiaries to the Holding Company. It is important to mention, however, that this loss is more than compensated by the tax shield provided by interest on our equity.

I will address now AmBev's financial results.

In relation to AmBev's financial results specifically, allow me now to guide you through the most relevant lines.

In the fourth quarter, AmBev booked financial income of R$23.8m. Interest expenses of R$104m. A net expense of R$11.9m related to hedging cost of AmBev's foreign currency debt which relates to the interest rate differential from the dollar and real and R$37m paid in taxes charged to financial activity, mainly Brazilian IOF and withholding taxes generated by the service of AmBev's senior notes traded in the U.S.

The remaining balance is due to a number of distinct concepts.

We get down to non-operating expenses. In this case, the only major impact is the severance provision of the R$198.9m accrued in Canada for the restructuring at Labatt mentioned by Brito. The cash reimbursement for the severance costs are expected to be in the first half of '05.

Net income before taxes and profit sharing achieved R$859m representing an 87.6% increase. In a per share basis, income before tax and profit sharing amounted to R$15.74m improving by 30.2%, even including goodwill amortization. As well as EBITDA per share, this figure demonstrates the accretion potential of the Labatt deal.

Moving now into income tax, we provisioned R$280m in the fourth quarter, representing an effective tax rate over reported earnings of 37.9%. This is pretty higher compared to the historical average of AmBev. The explanation for that, apart from the non-deductible goodwill, is related to AmBev's regular tax plan strategy, which is based on an underlying assumption of purchasing power parity between the real and the U.S. dollar. Because of the significant appreciation of the real in the fourth quarter, that strategy worked backwards, increasing the tax rate instead of reducing it. In order to provide you with some evidence on that, I recall AmBev's effective tax rate in the second quarter of '03 of 39.6 when Brazil experienced a similar currency appreciation.

In terms of guidance, it is too premature for us to precise which should be the effective tax rate on the profit lines going forward. We're still revising tax planning strategies to come out with an optimized alternative.

Finally, net income after profit sharing and minority interest amounted to R$459m, 6% higher than '03. Net income per share, however, decreased 26.4% to R$8.42. I point out, however, that such a decrease is fully explained by non-operating items I have already addressed. Namely, the severance cost provision in Canada, goodwill amortization, the higher tax rate, and on top of that, an abnormal comp for the financial results in '03, which were a very positive impact, by hedging effects carried over from '02.

Finally, I would like to share some thoughts regarding capital structure and destination cash flow. First, AmBev had, as of December 31, consolidated net debt of R$6.3b in a pro forma basis. Considering an EBITDA at Labatt of CAN$647m for 2004, the implied net debt to EBITDA ratio is of 1.2 times. Accounting for the dividend payment in February, that figure should have slightly increased to range between 1.3 and 1.4 times. Going forward, that should serve as a reference for AmBev's leverage.

On the cash flow side, I can anticipate that CapEx for consolidated AmBev should be stable at roughly US$450m per year and also that the Company does not need to hold any excess cash on the balance sheet.

The preferred alternative for pay-out will always be the most AmBev can pay in interest on own capital. The remaining balance should be paid out in optimized EVA perspective. However, I anticipate we care to preserve AmBev's free float so that our stock provider a world-class liquidity for shareholders.

We will open now for questions.

Questions and answers

Operator
[OPERATOR INSTRUCTIONS].
Our first question is coming from Bob Ford of Merrill Lynch. Please go ahead.

Robert Ford
Good morning everybody. Congratulations on the quarter. I wanted to ask a question with respect to your brand development in Brazil during the quarter. Particularly in January. I understand you lost 30 basis of market share. However, I'm sensing that you're actually growing your higher margin contribution brands and it appears as if you're taking the hit in your [indiscernible], particularly Antarctica. Can you talk a little bit about why that's occurring and perhaps a little bit about how you can try to migrate more volume into higher contribution brands and perhaps -- I understand that you're stepping a few points over for [indiscernible] investments. Can you talk about how that flows into the strategy as well please?

Carlos Brito
I think Luiz can pick up that one.

Luiz Fernando
Yes, Brito. As we said, we increased prices in December and we lost 30 basis points market share in January. Of course, part of this loss occurred in December since Nielsen takes data from December and January when reporting the January results. And the losses were caused both by the price increase and by a worse channel mix. Always in December supermarkets grow a lot and we have a lower market share in cans, in the segment. So what's why we lose market share in December every year if you compare to November for example.

Well, our mix is stable now. Skol, Brahma, Antarctica are stable. During last year, Antarctica grew more than the other brands. This has to do with our strategy and its performance -- Antarctica performance in São Paulo specifically. We did very well in São Paulo. In December Skol performed very well and we believe with all this strategy we have developed when we discussed the mainstream brands, Skol should grow more than Brahma and Antarctica during 2005.

We don't have the same pressure we had last year. We have a more stable market, even after our price increase, both in January and February. So we believe that Skol should perform better than the other 2 brands during this year.

Bohemia is doing very well. We had a very good beginning this year with Bohemia Pielsen. We implemented some price initiatives to reduce price consumer without reducing our price to retailers. Since October last year, the brand is performing very well, and the same is happening with Liber, for example, the non-alcohol beer that we had launched last year. We have 5 to 10% premium over our Kronembier, our non-alcohol beer, than we had in the past. But we are prioritizing the Liber as the super-premium brand and Liber is performing very well. It now accounts for almost 50% of non-alcohol beers. So we believe that the portfolio should perform towards the higher margins in 2005.

Robert Ford
Thank you very much Luiz Fernando. The other question I had was with respect to the Coke bottlers. It's clear that they're working harder to develop a returnable price point in brand named Coke and when they do that it's probably going to have some implications for you in terms of perhaps a more superior value proposition for lower income segments. I was wondering how you respond to the growing availability of returnables and what does that imply for you in terms of price points.

Then lastly, can you share with us some details in terms of your strategy to lobby for flow meters in the CSD business in Brazil?

Luiz Fernando
I'll take the first one and then I'll give it to João to answer the flow meters. You're right. Coke has implemented several initiatives to find new price points in the market, both for returnables and non-returnables. Based on our analysis, they've been more successful in the non-returnables bottles, the 2.5 and the 3 liter bottles. And it is exactly what we are developing, and we have all the plans to have some news in the next few months. But more in the big bottles, 2.5, 2 liters, where we are being successful they are being more successful than in the returnable bottles. We really don't see them improving their market share in this specific segment since consumers are really learning to like more the non-returnables and price proposition doesn't seem to be very successful in returnables.

And then the investment required in CapEx to change all the lines and in the bottles, for returnables, would not pay back for us.

João
Thinking on the flow meters, we are very optimistic. The government has given its go ahead with the flow meters. Our scenario is that by year-end, just like we had in beer, we have them installed for the industry. We have internal goals for this and we are quite confident it will happen, it will come true.

Robert Ford
So, are you saying by year end 2005, you anticipate flow meters at your main plants.

João
That's correct.

Robert Ford
Thank you very much.

Operator
Thank you. Our next question is coming from José Yordán of UBS. Please go ahead.

José Yordán
Good morning. Just a couple of questions on your comment on how to return cash to shareholders. If your dividends are going to be limited by interest on capital thresholds and you want to keep the liquidity the same in the PN shares, how do you return the cash otherwise? Or is limited buy-backs still consistent with high liquidity for the PN shares, which I assume it is, as the R$1b level. Does it really detract a lot from the liquidity until a few years out?

That's the first question and the second question may be -- looking at 2 or 3 years after you've captured all the synergies on Labatt, it's going to be pretty tough as a company to grow 15% in real terms EBITDA per year. How does the management plan to reassess the performance targets for the bonus payments, if at all?

Carlos Brito
João can you take the first one and I'll take the second one?

João
Okay. For the first one, basically, we believe we will be able to pay close to R$1.0b to R$1.1b in interest on own capital. So the limitation is quite high, so this will account for nearly 25% of the cash we'll generate in 2004 to give you a reference on that. All the additional cash, as I said before, we will continue with use dividends and the share buy-back programs.

José Yordán
Sorry. What was the first thing?

João
The first thing I said. Interest on capital which will be the number one alternative, would probably be close to R$1b.

José Yordán
Right.

João
Then the second will be dividends, just like we did also this year, and the third will be the share buy-backs.

José Yordán
Okay. Great.

Operator
Thank you. Our next question --

Carlos Brito
Just a second. I didn't address the second question for Jose. I think you asked about the 15% growth, right?

José Yordán
Yes.

Carlos Brito
Okay. We think that -- in a way -- we all got used to look at, for example, Brazil, with no growth, in terms of country, as it has been the case for the last 5 or 6 years. When Brazil starts moving like it has done in the second half of last year, then we're very optimistic that '05 will be the same. Then you see that there are still lots of sources for growing our bottom line if you look at Brazil alone. Then you have to look at the synergies as you mentioned. So there are synergies to be captured in the next couple of years, as we announced, and we are very confident we can deliver on them. Also, you have the whole Latin American expansion opportunities that will continue to add to the bottom line. So we're very optimistic that we can continue to pursue the 15% real growth as an internal target, even after all the synergies have been captured.

José Yordán
Okay. Thank you.

Carlos Brito
Thank you.

Operator
Thank you. Our next question is coming from Tania Sztamfater of Unibanco. Please go ahead.

Tania Sztamfater
Hello everybody. I'd like to know, in terms of your direct distribution, we saw a high progress over the fourth quarter. I'd like to know if you have a target if you already want to reach 50% participation in 2005? And if you actually want to increase to more than 50% of the direct distribution participation in beer volume sales?

Luiz Fernando
You're right. We'll probably achieve this 50% direct distribution during 2005. This was our target since we started implementing the new distribution system. We don't have a plan to extend that more than 50%. Of course that could happen, depending on the marketing environment, in opportunities to add more direct distribution to the actual direct distribution centers, so to reduce fixed cost in per HL base. But it's too early to say that we will go for more than 50%.

Tania Sztamfater
Okay. Thank you.

Operator
Thank you. Our next question is coming from Celso Sanchez of Smith Barney Citigroup. Please go ahead.

Celso Sanchez
Hello. Good morning. Just a couple of questions on pricing. In Brazil, the 5% that you announced at the end of December. You said in the past that your goal was to keep consumer prices flat in real terms, which suggests keeping inflation on a year by year basis. By our estimates I think that'll be a little below what we're looking for, for inflation. Is 5% your target for inflation for the year or do you see phasing in another price increase over the course of the year? That's the first question.

Luiz Fernando
Well part of the price increase as to do with 2004, part of it has to do with 2005. So if you compare our net sales per HL on a year per year basis 2004 with 2003, that's exactly what we've done. We've kept the net sales practically in real terms base constant. And that's exactly what we're going to do in 2005. Of course we foresee some opportunities to more revenue management initiatives. That's exactly what we did with last year. So some adjustments during the year in brand strategies or in new initiatives based on our proprietary sales system. But of course the guidance to keep prices in line -- price to consumers, in line with inflation is sustained.

Celso Sanchez
Okay. Thank you. Then the second question has to do with Canada. You talked a bit about having raised the pricing on Lucky about 11%. But it seems to us that that's still about 26% or so below the mainstream pricing. Since pricing is such an important driver in the past of profitability, can you relate for us how you see things evolving over the next several quarters, or couple of years in terms of that price gap and if you see prices -- do you think you'll be able to increase the gap if the lower end segment that has been having a lot of potential it seems in the Labatt side doesn't increase its prices along with you?

Carlos Brito
Hi, this is Brito. The problem with the discount segment that we have today is mainly in Ontario which is of course is very important because it's the biggest province, but it's not countrywide. We don't have that kind of problem -- the same magnitude of problem in the other provinces or other regions.

In Canada, you're right with the move from CAN$23.70 in the case of 24 to CAN$26.40, 11% increase, we are now 26% below our core domestic premium price point of CAN$35.50. So we think that is only sustainable if we go back to support our new proposition with innovation and good positioning. The relevant position with consumers. So we've been doing a lot of consumer research to understand why consumers do buy this brand or that brand. So again, as I said in my opening speech, we're reassessing the role of brands and the price points within our portfolio and we still need a couple of months to do that.

In the meantime, we have to recognize that the way we deliver results in Canada, at least for this year and indeed for the next year, will have to be more well rounded I think. Instead of being 100% based on price increases or 80% or 90% based on price increase, you have to be more balanced. That's why we started the year with the right sizing of the salaried workforce and also with the ZBB initiatives. So we're very confident that we can deliver on the synergies announced and be even a little over that. So we're counting on that to give us a break so we can deal with the discount threat in Ontario, put this to bed, solve that question, before we can proceed with price increases as in the past.

Having said that, there are a lot of revenue management initiatives, as opposed to general price increases across the board that we'll be executing, and we are executing, throughout the regions and our portfolios on a SKU basis and on a regional basis.

Celso Sanchez
Just to follow up on the administrative reduction in the fourth quarter. Is that something that was above and beyond the synergies that wasn't contemplated as part of the plan or was that part of the plan that was done a little bit earlier than the '05 sort of start date?

Carlos Brito
It was above the synergies. Above and beyond the synergies.

Celso Sanchez
Okay.

Operator
Thank you. Our next question is coming from Alex Robarts of Santander. Please go ahead.

Alex Robarts
Hi guys. The first question just really on marketing spend this year in Brazil. I guess the first question just really on marketing spend in Brazil this year. I can appreciate the kind of ramp up in 4Q with this price increase and such. But can you give us a sense of where that might move this year versus '04? And specifically, as I look out and we've seen some news about the Brahma brand launch through the InBev network. And I guess March 17 was one date that we saw. When this brand gets rolled out kind of in the export context, does the marketing spend come -- well fall really within InBev? Do you participate at all and do you plan to participate at all in any of the marketing spending?

Carlos Brito
Luiz, why don't you take the first one. I'll take the second one.

Luiz Fernando
Okay. Alex, well first let me comment on the 2004 marketing expenses. We had a guidance we had to spend more, mostly in the last quarter, since we've understood competitors and exactly what they did actually, they would invest more in December. And Kaiser and Schincariol re-launched. They had new campaigns in December. At the same time that we were increasing prices. So we decided to increase our investment to support our brands during this period.

Marketing expenses for 2005 for Beer should be in line with 2004 in nominal terms. And we'll spend something like R$25m more in Soft Drinks in order to support our profitability. That's basically what's going to happen. So Brito, why don't you take the second one?

Carlos Brito
Okay Alex, in terms of the second one. Yes we're very excited and we're on track for the Brahma in our introduction through the InBev system. I'm not going to give you a whole bunch of details. I'm sorry about that. But we're still in the planning phase. We should have some news about it in March. Part of the negotiations going through is exactly the split in the marketing investment and also the transfer pricing and the whole issue of margin pool with AmBev and InBev. So that's been negotiated as we speak.

Alex Robarts
Okay. So it is probably perhaps safe to assume that there could be a portion of that that comes onto the AmBev books. Is that a fair assumption?

Carlos Brito
It could be. But also could have -- also do count an increase in terms of net sales because of all the exports that we're going to be doing from Brazil. So that's also part of the equation.

Alex Robarts
Okay. I guess the second question is more on the strategic side. You know there have been obviously various comments starting in January and then I think there was something yesterday as well about what, or how you are looking at outright acquisitions specifically? The Bavaria example. I know there has been also some mention in Venezuela. Could you just give us a basic update in how you look out at this kind of activity as far as where you see things happening? What might be the hurdle rate and kind of just give us some color there please?

Carlos Brito
Well we could make a first comment on that and maybe Joao could follow if you want to jump in. I mean I think our position strategy has always been one of EVA based type approach. So I meant we've always committed ourselves to doing things that make sense for our shareholders on an EVA approach. And we'll continue to pursue opportunities. We still see some holes when you look at Latin America and as Juan said, we just started in some countries with the connection with the Pepsi franchise. A very successful fashion. So that's one way to go about it.

But again, it has always been EVA approach. I don't know if Juan or Joao can add anything to it?

Juan Vergara
No further comments.

Alex Robarts
So Bavaria at US$9b is something though that's not in the books? Is that?

João
No.

Alex Robarts
Okay. Final, just to kind of clear -- I mean Venezuela going through I guess a devaluation today and just any thoughts on how you might be thinking about that. I mean is the budget for you guys there still at the VEB$1,900? I mean what kind of adjustments might be needed there as far as Venezuela is concerned?

Juan Vergara
That's not an issue. It's absolutely on the dot of what we had planned. So we already have plans for that and everything is in place to continue business as usual exactly on the dot as planned.

Alex Robarts
Great. Thank you.

Operator
Thank you. Our next question is coming from Lore Serra of Morgan Stanley. Please go ahead.

Lore Serra
I have a couple of questions as well. Let me start in Brazil with sort of a general question. You guys are talking about 5% volume growth this year and obviously it's going to be an uneven year because you have the market share gains that are largely concentrated in the first half. I would expect you to be growing well in excess of that 5% in the first half. But I guess my question is, if you think about the second half where the comparison base gets difficult, I guess it has become difficult for us to analyze the underlying market trends because of some of the inconsistencies in the Nielsen data. I guess I'm wondering do you think you can grow in the second half of '05 in an important way? I guess what I'm trying to say is that the volume growth was very impressive

in absolute terms in the second half of ’04 for you guys. But a lot of it was just recapturing the volume lost in ’03. Can you build upon that and maybe if you higher volume growth for the year in Brazil this year?

Carlos Brito
Well Lore, you're right. You're absolutely right when you think that first semester will be an easy comp compared to last year based on market share increase and market growth. But we believe in the second half of the year we can still grow against last year. Of course that depends on all the interest rates being increased by the government. We never know exactly impact that it will have in the long-term. Government now says that this is -- the interest rates should not increase any more. But we haven’t seen the impact in the market yet.

But we are confident that we can still grow from 1 to 3% compared to second half last year since our volumes started growing only in September. So we have at least July and August to increase. And still in December, we did not have good weather in Brazil. So we still think we have some opportunity to increase volumes in the second half of the year.

Lore Serra
Terrific. Next, just moving to Canada briefly. I mean we've heard the Molson-Coors people talk about targeting their marketing spending on some of the core brands a bit more. And increasing the marketing spending behind Canadian and Coors Light. As we think about AmBev finding additional synergies at Labatt, should we think about that falling to the bottom line? Or do you think you might need to be increasing marketing spending in Canada from the current levels?

Carlos Brito
Well Lore, again our plans for Canada is 15% EBITDA growth for this year in nominal terms. And what we’re trying to do in Canada for this first year is really to rebalance the way we look at the business. Try to get more of the synergies in year one. Try to get from the right side in ZBB some internal funds. And you're right, I mean if we need to also invest behind our brands as we've done in the past to support, especially in Ontario, the price premium that we have to date to the discount segment.

Lore Serra
Okay. And lastly, just on InBev USA, a couple of quick questions. One is how important is it a priority for AmBev/Labatt to improve the focus on the Canadian brands in the U.S.? And in general, can you help us understand what are some of the changes being implemented at InBev USA with the exit of the FEMSA brands and what kind of changes are being made organizationally to adjust for that?

Carlos Brito
Well starting from the end, I mean at InBev USA with the exit of the FEMSA brands is finally that organization is able to control its own destiny. So what we've done was that the back unit, it was an autonomous unit which merged with Labatt USA to form one company. So that was in September last year. And now InBev USA decided to focus its actions on the 3 global brands which is Stella, Beck’s, Bass and in the future Brahma. So the 4 global brands and also on the Canadian brands.

So I mean that’s you know your question in terms of how InBev USA changed in the second half last year with the exit of the FEMSA brands.

Lore Serra
But there have been--

Carlos Brito
We think that distribution in the US even with InBev USA not having the FEMSA brands anymore is that they are still very interested in our portfolio brands because the premium segment continues to grow in the U.S. and the margins are very, very good.

Our distributors, they make 50% more on a case of our brands as opposed to the Buds and Millers of the world. So they're very interested and continue the partnership they have with us and so with InBev USA.

In terms of the Canadian brands, it represents around 4 to 5% of our EBITDA in Canada. So it is very important. And as Canadian business we're very interested in continuing to pursue growth in the U.S.

What we're doing for '05 is that we are changing a little bit the strategy in terms of supporting the brands as opposed to '04 and '03. In '04 and '03 we tried to get our brands, Canadian brands, to be national in the US. Now we learn that 70% of the volume really comes from trading in 3 to 4 States and we would like to make the most out of it before we go to other states. So in '05 we will see some increased investments behind the brands in those key States as opposed to trying to get into a national brand status.

Lore Serra
Thank you.

Carlos Brito
Thank you.

Operator
Thank you. [OPERATOR INSTRUCTIONS]. Our next question is coming from Victor Galiano of HSBC. Please go ahead.

Victor Galiano
Hello there. Just on current trading in Brazil. You've already said that there is -- that the recovery is pretty robust and there's quite a lot of consumer activity. But can you give us a bit more color in terms of how you expect that continuing during the year? And is there any evidence of any sort of revival on the part of Kaiser? Thank you.

Luiz Fernando
Well Victor, as I said the first half of the year should perform compared to last year very well. And comparisons for the second half will be tougher. We still believe we can grow in the second half. So probably, based on our January and February results I could say -- what I can say now is that our first quarter should be around 10% over last year. That's all I can say now.

Victor Galiano
Great.

Luiz Fernando
Going forward we believe we still have opportunity to grow based on our employment increase in Brazil, exports in Brazil. So money is entering the country, so the country should keep growing. Probably not as fast as last year, but everything that we read, everything that we have listened from the government is really optimistic. So this is what we can say now.

Victor Galiano
Do you see some trading up in terms of brand consumption?

Luiz Fernando
Bohemia is performing very well. We've implemented some price initiatives in order to reduce price to consumers. Not reducing our price, but reducing price to consumers. Convincing the trade that they can have a lower margin that they have now in Bohemia but still have a much higher margin there than the other brands. And we are very confident that Bohemia will perform very well this year.

Victor Galiano
Thanks.

Operator
Thank you. Our next question is coming from Ronaldo Santana of Deutsche Bank. Please go ahead.

Ronaldo Santana
Yes good morning. In terms of the tax rate, what can we expect going forward given the non-deductibility of the Labatt goodwill in 2005?

João
Hello. As I mentioned in my earlier statement, a bit early for us to give guidance on the effective tax rate as we're still deciding on the tax strategies and the tax claim that we have for this year.

Ronaldo Santana
Thank you.

Operator
Thank you. Our next question is coming from Chris Pitcher of UBS. Please go ahead.

Chris Pitcher
Hi there. Just a quick follow up question from Jose really is basically you're happy with the degree of leverage in the business at the moment. But we note that at the InBev presentation that you've received investment grade rating from S&P at the end of last year. Has this increased the likelihood of you being able to refinance some of the higher coupon debt in your debt portfolio at the moment? I was wondering if you could comment on the outlook for that?

Carlos Brito
Yes. From what I heard it was hard to understand your question. Your voice kept going away. Basically in terms of the investment grade, we do see an opportunity as we refinance to get lower borrowing rate. That's where we stand.

Operator
Thank you. At this time there are no further questions. I'd like to turn the floor back over to the speakers for any closing remarks.

Carlos Brito
Well this is Brito here back. I would like to thank you very much for spending the time with us. We're very proud of the achievements we had in '04. Very optimistic about '05. So we'll meet you in the next quarter. Thank you very much. Have a nice day. Bye bye.

Operator
Ladies and gentlemen, that does conclude today's teleconference. You may disconnect your lines at this time and have a wonderful day.