Transcription
Second Quarter 2003 Earnings Conference Call
August 13, 2003

Operator: Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to the AmBev conference call to discuss the earning results for the second quarter of 2003.

We inform that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a question-and-answer period. At that time, further instructions will be given.

Should any participant need assistance during this conference, please press *0 for an operator.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of AmBev's management and on information currently available to the company.

Forward-looking statements involve risks, uncertainties and assumptions, because they relate to future events and, therefore, depend on circumstances that may or may not occur in the future. The future results and shareholder values of AmBev may differ materially from those expressed and or suggested by these forward-looking statements.

Now I'll turn the conference over to Mr. Marcel Telles, Co-Chairman of the Board of Directors. Please Mr. Telles, you may begin your conference.

Marcel: Thank you and good morning everyone. Today again I have with me on the call from our management team: Luiz Fernando (our Sales Director); Juan (our Soft Drinks Director); Brito (our Director of Operations); Felipe (our CFO); and from AmBev's IR team, Tobias and Fernando.

Despite a challenging environment, characterized by significant depreciation of the local currency yoy (including the additional impact of our hedging policy), inflationary pressures, the increase in taxation, and an increase in the cost of some commodities, AmBev's Brazilian operations reported a 13.0% yoy EBITDA growth for this quarter.

We believe that this performance is evidence again that we are on the right track by sticking to AmBev's long-term strategy. More importantly, however, recognizing the tough environment, and as a result of the company's culture, and its ability to adjust the ship's direction if necessary, we undertook several measures and accelerated the implementation of some projects that should translate into important savings throughout the second half of 2003.

For instance, during the quarter we advanced significantly in: improving revenue management by shifting our mix towards higher contribution margin products. In the beer segment, Skol accounted for 56% of our sales mix versus 54% in the year ago quarter. On soft drinks, our core portfolio now accounts for 85% of sales versus 77% in the year-ago quarter. And Luiz Fernando and Juan will elaborate more on that.

Also, maximizing our distribution and execution efficiency, which is of paramount importance to dominate the point of sale; and, improving productivity and reducing costs, as evidenced by the fact that our efficiency improvements were able to almost fully offset the impact of the increase in the cost of commodities and other indirect costs. Once the impact of the commodities softens, we expect our efficiency and productivity improvements to become more evident. Importantly, these improvements are recurring and should be perpetuated going forward. And again, Brito and Felipe will talk more about these improvements going forward.

From a market perspective, during the quarter sales volumes of beer increased by 2.5%, while sales of soft drinks remained essentially flat (the core soft drinks portfolio was up 10.0%). Market share in both segments increased relatively to March 2003, illustrating the company's successful point-of-sale execution. In the beer segment, as of June 2003, AmBev now has the three leading brands in the Brazilian beer market, further consolidating our number one position.

Finally, this is the first quarter that includes three months of Quinsa to our results. AmBev's international operations generated an EBITDA of R$ 25 million, with Quinsa's proportional consolidation accounting for R$ 30 million of that. We have no doubt that the prospects going forward are exciting and we will continue working hard to capture all synergies, both on the cost and revenue fronts. Quinsa's 2Q03 conference call just ended and I am convinced that you had the chance to share its management enthusiasm about the company's prospects going forward.

I will turn now the conference on to Luiz, to talk more about sales and distribution.

Luiz Fernando: Thanks Marcel. In the second quarter we posted a 2.5% volume growth compared to the year ago quarter.

Market share was up 0.7 percentage point, reaching 70.1% in June. We continue to see the benefits of our obsession to improve on a daily basis point-of-sale execution - both on our own distribution networks as well as in AmBev's third party exclusive distribution system.

Importantly, as Marcel mentioned before, in June 2003 AmBev had the three leading brands in the Brazilian beer market. Skol, Brahma and Antarctica gained market share relative to March 2003.

We remain focused on our long-term growth pillars: on the revenue management front, this quarter, in the mainstream segment, we sold more of our higher margin brand – Skol - which increased its weight in our sales mix to 56% from 54% in the year ago quarter.

In addition, also helping our profitability, our packaging mix shifted towards lower priced, but higher margin, returnable 600 ml bottles, which represented almost 72% of our sales, compared to 69% in the second quarter of 2002 and 70% in the previous quarter.

Still on the revenue management front there is some other good news.

During the quarter, sales of Skol Beats were also rolled-out nationally and volumes increased by 80% sequentially.

Antarctica Original was re-launched and we expect a positive impact on volumes during the third quarter. Finally, we also launched dark Bohemia, whose sales were expected to end in September 2003, however, given the strong performance, sales should be over one month earlier than expected.

Concerning distribution and execution at the point of sale, direct distribution for beer increased by more than three full percentage points compared to the year-ago quarter and two full percentage points compared to the previous quarter.

Direct distribution accounted for almost 30% of our beer sales volume and roughly 35% of total volumes.

Moreover, we were also able to increase our market share in the bar channel by 1.1% compared to March, we now have a 74.2% market share.

Given the complexity of this channel, we believe that this growth evidences our further improvements on the distribution front.

Regarding beer net sales per hectoliter, they reached R$ 100.8/hectoliter in the quarter, up 9.8% compared to the year-ago quarter, mainly due to: the price adjustment that we did in October 2002 to compensate for higher costs and taxation; higher volumes distributed through our direct distribution system; and, also as a result of our strategic revenue management initiatives.

Comparing to first quarter 2003, our revenue per hectoliter remained almost flat, as slightly better pricing and more direct distribution were offset by higher taxation and the increase in returnable presentation in our packaging mix.

As anticipated in our last conference call in may 2003, during the second quarter the company decided to increase its prices to offset the cost pressure coming from the depreciation of the currency, inflation, the increase in commodity costs and further increases in taxation.

During June the company started to implement the price increase. AmBev started adjusting beer prices in one-way packaging and raised its returnable presentation towards the end of June.

The average price increase to consumers was of around 12%, thus below the inflation between October 2002 and June 2003 and in line with our strategy to keep real prices in line to consumers.

The price increase was not across the board. It varied per brand, per presentation and per region. Importantly, this year we decided to adjust our prices during winter, as we expect this strategy to improve our stake of the margin pool.

From our past experience, our market share tends to fluctuate from 70 to 68 per cent, depending on how fast our competitors follow our pricing initiatives. In average it takes them two months to raise prices.

That said, we expect a third quarter of single digits volumes decline, but remain confident that a regain of market share on the fourth quarter will place our volumes growth around 2 percent.

On the per capita front, we are very proud to announce the launching of Brahma light. Brahma light is positioned as low calories beer in the mainstream price market, targeting people whose main concern on beer consumption is the calories level. Initially, Brahma Light will be available in two different packages: can and long neck and the launching is restricted to Greater São Paulo, the most important market in Brazil.

Although it is really early to talk about results we are very confident. The response of both our distributors and point of sales was very positive. Moreover, Brahma Light will be supported by a huge advertising campaign starting on the first week of September; we will have TV commercial, magazine ads in the most important vehicles, high impact out of home media, differentiated point of sales material and sampling activities.

In summary, although our short-term volumes could be impacted, our long-term strategic pillars, thus the long-term value drivers of the company, such as growing per caps, revenue management and the obsessive search for improvements on the distribution and execution fronts, remain in place.

Thank you and I will now pass it to Juan.

Juan: Thank you Luis. This quarter in soft drinks, we obviously felt the impact of a declining CSD market and higher cost, but we gained share, we improved mix and improved pricing versus last year and versus the prior quarter.

Our EBITDA this quarter of R$ 39 million - that is about three times higher when we compare to the year-ago quarter - gave us an EBITDA margin of 14.2% in this last quarter which compares favorably to last year's 5.5% EBITDA margin.

This second quarter our net sales per hectoliter grew by 15% compared to last year. Our core portfolio - Guaraná Antarctica and Pepsi brands - grew in volume by 10%, and also grew in importance in our mix, now representing 85% of our sales, compared to 77% in second quarter 2002.

Market share for these two brands, our core portfolio, Guaraná Antarctica and Pepsi, reached 14.2% of the total market, that is up 1 full share point versus the prior quarter and up slightly over two points versus last year which was around 12.2%.

Despite the sluggish economic environment last quarter and our focus on higher value-added products, our total volumes remained essentially flat yoy.

In the cola segment, our Pepsi portfolio gained 360 basis points compared to March last year, with Pepsi twist still performing very well, achieving 3.8% of the cola segment in Brazil this last quarter.

In the Guaraná segment, Guaraná Antarctica gained share versus the prior quarter, and versus last year and continues to certainly consolidate its leadership in the Guaraná market.

We basically did nothing different this quarter. We just stuck firmly to our right few strategies focusing on few but profitable brands, focusing on few programs, although in complete synergy with beer and always looking at maximizing our profitability rather than volume at any cost.

Which, looking forward, is exactly what we will continue to do. I will now pass it on to Brito.

Brito: Thanks Juan. This quarter we have to recognize that we had some mismatch between real COGS and market consensus. We decided therefore to answer 5 basic questions that we think should be in every ones' minds at this point.

First question: why did COGS increased by 23.4% qoq? In the press release page 9, we depicted that almost 100% of this variation could be explained by means of foreign exchange variation, hedge cost this year vis-à-vis the spot rate and inflation that affected the part of COGS that is exposed to local currency. These effects together accounted for 98% of the increase or 23% qoq.

Second question: if this is the case, is it fair to say that the operations area, my area of responsibility, had no role in getting anything working for the company in this quarter, be it better negotiations or higher efficiencies? Well, this is not so as also explained in the press release on page 9. As a matter of fact we had some commodities that increased in dollar terms qoq, that is in real terms, for example, sugar 25%, PET 12%, oil 10%, and some local currency denominated commodities that also increased in real terms, that is over and above inflation, for example, corn syrup, that we use for beer, 28% above inflation, and energy 20% above inflation qoq. The efficiency gains that we realized in the quarter (for example lower extract loss for beer, better line efficiency, packaging line, and lower fixed costs, among others) offset almost all of these increases in real terms. It is also fair to say that the more favorable package mix also helped COGS this quarter.

Third question: why did COGS per hectoliter increase from 1Q03 to 2Q03, in a period where the local currency, the Real, appreciated against the US Dollar? One thing that helped the 1Q03 was the carryover effect of the raw material we have in house. Normally, this effect is not relevant, but this 1Q03 had a benefit from an inventory that was priced at 2002 Dollar hedge of 2.52, in the last four months, versus the spot rate in the 1Q03 of 3.49. This impacted mostly the beer business since we do have malt and aluminum tolling

operations, which had this foreign exchange effect on its pipeline inventory. This, for example, would explain almost half of the 7% increase 1Q03 versus 2Q03.

Moreover, the commodity prices that only peaked during the 2Q03 affected adversely the COGS in the 2Q03, as well as the inventory carryover into the 2Q03 priced at a foreign exchange of 3.49 from the 1Q03 versus a hedge dollar of 3.31 in the 2Q03.

Fourth question: where do we see COGS going forward?

There are a couple of points here: First, some important commodities have peaked during the 1H03 and that should have a positive impact going forward.

Although we have hedged ourselves against foreign exchange fluctuations, as Felipe will comment in a moment, we are not hedged against commodity fluctuations, with the exception of aluminum. In other words we buy the bulk of our commodities in the spot market and therefore we are exposed to commodity volatilities. Just to give you some examples: sugar, which peaked in the 1H03, has increased prices by 20+% in Brazil in local currency in the last 3 weeks of this quarter, but we think this upward trend is about to peak once more. On the other hand pet resin price decreased this quarter in dollar terms vis-à-vis 2Q03 by 18%. Also corn syrup prices decreased in nominal local currency this quarter over the 2Q03 by 11%.

The fact of the matter is that commodities are behaving better this quarter, price-wise, and with this scenario in mind we should expect that the efficiencies that we referred to a moment ago, that we are getting this year will begin to surface and will have a positive influence on COGS going forward and especially this quarter.

We upped our 2003 commitment, as Marcel mentioned, as a consequence of this scenario as well.

And the last question: are we studying some kind of protection for commodity pricing, other than foreign exchange and aluminum, going forward, to avoid short-term volatility?
Before anything else, let me say the obvious that is that we think we cannot beat the market in the long run in all commodities, of course.

What we believe we can do is twofold. First, have more contracts with our suppliers to avoid short-term volatility. Two, have more natural hedges like the one we have with the supply of Brazilian barley to our malting plants. During this 2Q03 this did not work 100% because of the bad barley crop we had in Brazil and the fact that we had to import barley to supply our malting facilities at, of course, a higher price.

I guess these are the relevant points about COGS and I would like now to pass it to Felipe.

Felipe: Thank you Brito, and good morning everyone. Our consolidated EBITDA reached R$ 550 million in the second quarter 2003, up 17% compared to pro-forma EBITDA in the year-ago quarter. Besides the initiatives on the revenue management front explained previously by Luiz Fernando and Juan, and on the variable cost front explained by Brito, AmBev's operating profitability also benefited from another decline in cash SG&A expenses of roughly R$ 36 million, and an improvement in the performance of our international operations.

Considering our commitment to reduce real costs and expenses by between R$150-R$200 million in 2003 versus 2002, on the SG&A front we achieved real savings of R$ 35million. This is the combination of recurring savings in SG&A of R$9 million in 2Q03 versus 2Q02 and the impact of the inflation for the entire period. In this amount we are already excluding savings of R$27 million that occurred during the quarter, but that we expect to incur going forward.

Direct distribution costs in Brazil increased to R$137 million from R$116 million in the year-ago quarter as the percentage of direct sales in Brazil increased to 34.6% from 32.5%. On a per hectoliter basis, direct distribution expenses increased by 10% to R$ 22.7 from R$ 20.7 in the second quarter of last year, and this increase is primarily the result of higher freight costs and higher direct sales volumes to bars and restaurants, which present a higher distribution cost per hectoliter relative to distribution to supermarkets.

Concerning net interest income, during the quarter we reported a net income of R$ 17 million for the Brazilian operations. The decline in net interest income is the result of two factors. First, although the Dollar coupon continued to decline during the quarter, the decline was less pronounced than during the first quarter this year.

Second, assets must be recorded, accordingly to Brazilian legislation, at the lower of market value or accrual basis. As the market value of our hedge instruments as of June 30, 2003 was higher than its accrual value, we had to book the assets based on accrual basis rather than at market value. Had the company been able to reflect its assets at market value it would have realized a gain of roughly R$ 96 million.

Our debt continued to be fully hedged. During the quarter we further improved our credit profile by reducing net debt by roughly R$ 80 million.

Finally, concerning our hedging policy of variable costs, you already know that it increased our cash COGS by R$ 41 million in the second quarter, as a result of an implicit hedge rate at the cash COGS level of R$ 3.31 per Dollar versus an average spot exchange rate of R$ 2.99. As mentioned in our last conference call, we started to hedge in April as the spot rate was around R$ 3.20 = US$ 1.00 and by applying the interest rate on top of that we come up with the implicit rate mentioned for 2Q03.

Going forward, we do not intend to unwind our hedge position, as the hedge was structured to eliminate volatility from our results. For the third quarter we estimate that our implicit hedge rate is around R$ 3.33, and for the last quarter of this year we estimate an FX rate around R$ 3.30.

Now we can move to the Q&A session. Thank you.

Operator: Thank you very much. The floor is now open for questions and comments. If you do have a question or comment please press the numbers 1 followed by 4 on you phone at this time.

And our first question comes from Mr. Gustavo Hungria. Please state your question, sir.

Gustavo: Hello everyone. My question is more in regards of your internal targets for the year. If you could elaborate a little bit more on that, I would appreciate. Just a comment back on the first quarter, I remember you had an internal target of growing EBITDA in real terms of something around 15%, and now I would just like to know if you are reiterating this or if you have changed your estimates for the year. And also if you could elaborate more on the price and volumes, I would appreciate it. Thank you.

Marcel: This is Marcel here. The 15% magic number is one of our internal numbers and relates to our remuneration. It's the threshold above which we begin to get paid on a variable basis. So everyone here is very personally committed to this number, although the Company doesn't give guidance on this growth of results.

Gustavo: OK, and regarding your volumes and prices per hectoliter, if you could elaborate a little bit more on your expectations for the year. I know that you talked a little bit about the next quarter, that you should be expecting some drop in volumes, but if you could have more detailed comments for the year.

Marcel: Well, basically what we see for the year is a 2% volume growth, but again that always depends on the market. We still see a lot of resilience in the market for beer in Brazil, although most other markets are very, very soft and we are attributing any decline in volumes during the first months of this sub-quarter basically to the fact that we have increased very aggressively prices and competitors have historically lagged a lot on following us, as they are now, I mean, no one followed those prices yet. Revenue per hectoliter, I mean, make your calculations, but you know that we basically raised our prices around 12%.

Gustavo: Thank you.

Operator: Please hold while we poll for the next question.

Our next question comes from Celso Sanchez, from ING. Please state your question.

Celso: Hi, good morning. I have a couple of questions actually. The first one is pretty straightforward. Is there any way you could quantify for us the benefit of the hedge last year in the 2Q02? In other words, just like the 29 million was a negative impact this year, of the hedge, last year I presume there was some benefit in that quarter, and if you could quantify that for us that would be the first question.

Brito: Hi, this is Brito. Yes, in terms of variable costs, or COGS in the second quarter last year the benefit was R$ 9.9 million, and, on the other hand, this quarter the negative impact is around R$41 million, for the quarter, in terms of COGS.

Celso: But of the 9.9 million, can you tell me how much of that was beer? I know that 29 million this year was beer. How much of that helped the Brazilian beer?

Brito: Sorry, I don't have the numbers here with me, but I can have it handed over to you.

Celso: OK, that will be great, thank you. The second question is a bit more about the revenue management. Can you give us more of an update, or a bit more color perhaps on the Bohemia in terms of penetration volume growth relative to the total portfolio, pricing activity, anything really? Just to give us a sense of how that's progressing, I thought that was a very interesting story when you had the conference in March and I just wanted to get an update. Thanks.

Brito: Bohemia didn't do very well this last quarter. Still we have a 4% growth in the first six months, and we believe that these bad results in Bohemia this second quarter is basically São Paulo, because here we depend a lot on supermarkets and supermarkets did very badly these last three months and 50% of our volumes, the Bohemia volumes, still depend on São Paulo. So, although we are doing very well in other areas, as we depend a lot on São Paulo we felt bad, and we hope for the next month, of course, as other markets keep on growing we can recover some of these volumes and maybe other brands can recover part of the volumes, like Antarctica Original and Skol Beats and Brahma Light. They are growing very fast, so we believe some of these volumes that we lost can be recovered with the rest of the mix and, well, let's see what happens with the São Paulo market in the next two months.

Celso: Is there any indication that things have picked up in the 3Q yet or is it still consistent with the 2Q results?

Brito: It's too early to say.

Celso: OK, and with respect to Brahma Light my understanding was that the Light segment tends to be a Premium segment, or Super Premium if you want to call it in Brazil. Is this a conscious decision to try to push it more mainstream? I would have thought that you would have tapped it to the higher price segment with the light beer.

Brito: Yes, although we call it a Super Premium, since we are targeting 5% price over the leader, basically over Skol, it is lower than Bohemia or Antarctica Original. So, it's Premium because we compare with Skol.

But it's not the same price as Bohemia and Skol Beats, for example. So we think there is a lot of volume to take from the market.

Celso: Do you think it will be incremental volume or what allowance for cannibalization do you think there might be?

Brito: Of course, some of that will be cannibalization, but it's focused on consumers that want low-calorie products. So, we believe that there are a lot of consumers that could increase volume for us and it's per capita and, of course, it's with a better price. Even if there is a cannibalization that will give high margin to that point.

Celso: OK, thank you.

Operator: Thank you very much. Our next question comes from Alex Robarts. Please state your question.

Alex: Yes, hi. I wanted to drill a little bit more into the volume trend here, and I have a few questions on this. I mean, first of all, just to understand, I know the beer price increase starts in June. I wanted to get a sense of about when did it end. Was it in July? More specifically, was it at the end of the month of June? And maybe some color as to what you've been seeing so far in July, as far as the volume impact there.

The second volume question relates to the Premium segment talked about in March in Rio, this segment being very attractive at 8% to 10% growth rate. Is this the kind of rate that we saw in second quarter and is this still a number that you might expect for the year?

And the third volume question that I found interesting was this idea that with the core brand and soft drink growing 10%, it seems that really the other brands are either 15% of your portfolio was significantly in double-digit negative territory. And is that kind of a conscious decision? Or was there a pricing action there? Really, those were the issues on volume.

Juan: OK, let me answer on the soft drinks first. As far as the non-Pepsi and non-Guaraná Antarctica brands, yes, they have declined, and yes, it is a conscious decision. We believe very much in being extremely focused, we know there is opportunity in those other segments as well, but our strategy, which has been doing few things, a few right things in extreme synergy with beer, brought us to focusing on Guaraná Antarctica and Pepsi which are growing very nicely. So, it is a conscious decision that we, for the foreseeable, medium and short-term future will maintain because we see significant room for growth still for both our Guaraná Antarctica and Pepsi.

So, yes it is conscious and yes there is pricing behind that. If you look at it in the last 18 months, those brands increased pricing significantly above Guaraná Antarctica and Pepsi to a minimum discount level for those brands.

Brito: Well, we implemented our price increases from the end of May, we started with the cans, and we finished that at the end of July with the long necks. Basically, what we did is to differentiate when to raise prices through the packages, and we differentiated price increases through brands. So, Antarctica, Brahma and Skol in different areas have different raises. But, basically, what we do is that we are going to have just one price increase this year and we differentiate during the time some market strategies, but for the rest of the year we don't see any room to increase more prices. So, that's it. You asked about the impact in July. It's too early to say, we wouldn't like to comment that. Of course our competitors are still deciding how to implement the price increases. So I would like to not say anything about our volumes in July, but, of course, we suffered since they did not follow us immediately. In the Premium segment, our expectations are for higher growth in the Premium portfolio than the mainstream portfolio. We still have expectations over 5% to 10% so that will depend a lot on how Brahma Light goes in the second semester, and we expect we can give you some more information next quarter.

Alex: OK, great. Just the very last one, more of an interesting thing I noticed in the 20-F about you purchasing roughly 1 million Quilmes B-shares through, I guess, June 16. What's the thinking on purchasing these shares in the open market in Quilmes? Maybe you can shed some light on, you know, I know you have the right option to buy more, but what would be the kind of thinking behind buying more?

Felipe: Alex, hello, this is Felipe. Basically, from the agreement we have with Quinsa we may buy up to 12 million of B-shares in the marketplace. We already bought roughly one million as disclosed in this 20-F, 13-D, sorry, and, basically, it's an option; it's a liquidity option for those shareholders that want to live and see liquidity in the marketplace. We are providing liquidity to them.

Alex: So further purchases really are going to be based perhaps on some of those Quilmes shareholders that are teamed to sell. Is that it?

Felipe: Yes.

Alex: Thank you.

Operator: Thank you very much, and our next question comes from Pablo Zuanic. Please state your question.

Pablo: Good morning, everyone. Felipe, one question in terms of pricing. I'm just trying to get an idea of your approach in terms of revenue management in the first half. If you could just give us, what would have been your revenue per hectoliter in the 1Q and in the 2Q, if there had been no tax increase during the first half of the year, or in the 2H02? Is it R$ 3, is it R$ 8 per hectoliter? I'm just trying to gage that, thank you.

Felipe: Probably we would have to do this calculation. I mean, we didn't have this figure available on a net basis, but we could provide you this information. No problem on that.

Pablo: OK, and then, I guess if you can expand in terms of the impact on the revenue per hectoliter in the 3Q and 4Q. I mean, simplistically, one could take the 2Q number and multiply by, you know, 1.12, but that's your point-of-sale price increase. I would assume that when the prices are flat the increase at the factory should be higher than that, am I correct in assuming that?

Felipe: Yes, you are correct.

Pablo: OK. And then, if you can expand in terms of sensitivity by channel. Considering prices, it seems to me that volumes can suffer in July as much by a 12% price increase at the bar level. I mean, they will understand that supermarkets may be more sensitive to pricing, but, is really the bar channel that more sensitive? Will people buy more Schincariol, more Kaiser because you guys increased prices?

Brito: No Pablo. Actually we felt that in both channels, in bars and supermarkets. But we raised can prices in May. So we had suffered that before, in cans, then all the price increases in bottles of 600 ml occurred the end of June, during June, so that is why in July we felt more in bottles, that's it.

Felipe: Pablo, adding to your prior question, basically the tax increase from the 1Q to 2Q this year affected our net sales per hectoliter, like R$ 2 per hectoliter.

Pablo: Right, OK, thanks. Just the two last questions. In terms of your effective tax rate, you know, it was 34% in the 1Q, almost 39% in the 2Q. What can we assume for the second half? It seems to me that you haven't made use of your tax carry-forwards. Is it an idea to make use of that in the 4Q mainly, or, what are we assuming for the second half in terms of, assuming that the currency stays relatively flat now? What could be the effective tax rate?

Felipe: We use in the long-term, on average, tax rate from 15% to 20%, but depending on the Dollar volatility you would see ups and downs on the tax line as you saw during the 2Q. Basically, when the currency devalues in Brazil, we benefit from having a deductible expense inshore while a non-taxable gain offshore and the reverse happens. I mean, when the Real appreciated during the 2Q we had the opposite, in fact that explains, basically, such a higher tax rate we incurred during the 2Q. It's always hard to forecast, but I think it's fair to work in the long term with something from 15% to 20%.

Pablo: OK, thank you, just the last question for Marcel. Assume that if I look at the transaction with Antarctica and with Quinsa, you know, either you have taken control in those transactions, or you have taken a 50% control, and I guess Quinsa eventually taking control. If a 30% stake in a brewery in Latin America were available, would you guys buy that just to keep a 30%, or would you need to have the assurance publicly disclosed, but eventually you would take control of that hypothetical brewery?

Marcel: I think that we would like to have this pass because in the end I think that what we can add to any operation is people and processes. Unless you have some degree of control, or at least a pass to control, that will be very difficult to implement from a minority position or a simple board position. But again, I mean, each case is a case but theoretically we're very hands on and we like to be very involved in what we buy or with whom we associate ourselves.

Pablo: Thank you very much.

Operator: Thank you very much and our next question comes from José Gavin. Please state your question, sir.

José: My question was already answered, thank you.

Operator: Thank you very much, and our next question comes from Robert Ford. Please state your question sir.

Robert: Hey, good morning guys. My first question had to do with Brahma Light. I was curious as to why light beers have failed in the past. My understanding is that most recently, in Venezuela, they've taken the market by storm, and if there is any lesson to be learnt from your experience in Venezuela that are transferable to Brazil. And I'm mostly curious as to how the batch values of Brahma Light will overlap with those of Brahma in Brazil.

Juan: Robert, this is Juan, let me answer about the past. I was a little bit involved in that in the past. First, obviously, the market has evolved significantly, and so has our understanding and our know-how in developing new products. So, we certainly did a much better job this time around than we did the previous time. The two previous attempts, those were definitely not…, we were more tactical at the time that we introduced Light than strategic as we did this time. We felt it was the right moment for different reasons, for times at whatever time back in the early nineties and late nineties and these were launches that we decided, developed and executed in both occasions in, I would say, less than a month. This time around it took us over a year, almost two years, to get the right product, the right packaging, the right marketing and, again, the market is much more prepared given the Skol effect, I mean, in the market to receive the Light product. That answers your first question. I don't remember your second question.

Robert: I was curious as to how the batch values of Brahma Light will overlap with those of Brahma.

Juan: It is definitely positioned as an extension and all the marketing package has been designed to add to the overall Brahma brand equity. You know, we will be reinforcing product positioning all the time and it's not a niche product but it's a low calorie option for beer drinkers in general. If I remember right, you mentioned

Venezuela, and our reading of the Venezuela phenomenon is more of a flint bottle phenomenon than a Light phenomenon. So, they're not necessarily comparable. I'm extremely optimistic about Brahma Light, that was back in the site visit early in the year. It was an obvious answer to many of the questions that were raised during the site visit, but it was obvious that we could not answer and disclose everything that we were going to do because this is our big launch this year and we're very, very enthusiastic about it.

Robert: I share your enthusiasm. My understanding is that Skol is historically positioned as a lighter beer, the beer that goes down round, right? How do you minimize the potential cannibalization against your power brand?

Juan: Well, we're talking about calories and not about light and that's one of the big differences. We are, yes, projecting some cannibalization, but we are projecting entry into new occasions. We are projecting weekday usage because of the calories issue that today we are not getting and that's why consumption is so concentrated on weekends.

Robert: Is this a product that could be found in different milliliter glass? If you get good indications in September, October, by December can it be in 600 ml returnable glass?

Juan: I wouldn't say there's a date for that but the answer is if the product performs as expected, yes, that would be certainly an alternative.

Robert: I was curious with respect to cooler placements this year. My understanding was that they would be beefed up a little bit so I want to get an update on CAPEX specifically with respect to cooler placements this year. And we're also hearing of a shake up in terms of the distribution of Molson and perhaps, things sound like they could make a material impact in terms of their point-of-sale execution and I was wondering if you're noticing anything of that nature in July as well.

Luiz Fernando: Now, let me answer your first question, the cooler. Based on some bad results in maintenance, and in spare parts for replacement, we decided to reduce our program from 100,000 to 70,000. This last quarter we faced problems with cooler producers, which is exclusive. So we decided to reduce speed and recover equipment in the markets that were not performing very well. We are committed to guaranteeing return on these investments and we learned that discipline, maintenance are very, very important. So, during the last three months, we reduced speed and now we recovered the speed but, of course, we lost some time and we had to reduce 30,000 installments this year. We still believe it's a very, very strong program, we'll continue to reinforce execution to guarantee that they all perform well. You have a second question.

Brito: This is Brito, just a comment on Molson. What we hear is pretty much public information. What we see in the marketplace is what I can tell you. They had a problem with execution that they made public; they had a problem with the bottlers in terms of alignment. They are trying to decide who does what and how, and, of course, the reading is that it has to be that they are going through a transition period, with, I think, some reflects in the marketplace. But we begin to see some action that they are taking in terms of hiring a new team, putting in place distribution in some key areas, and, I mean, of course we are getting ready for a comeback and we do expect a lot because they have the Kaiser brand and they have the Coca-Cola distribution system and then Molson as a world-player behind them in terms of knowledge. So we're just getting ready here for when their comeback comes.

Robert: Great, thank you very much.

Operator: Thank you very much and our next question comes from Marco Vera. Please state your question, sir.

Marco: Hi, good morning. That was a very articulate and comprehensive statement about conflicts and you addressed several points. Just a technicality. Are you in fact intending to swap your QIB stake for Quilmes shares at all?

Brito: Just a second, please.

Marco: OK, since, now that I have you on the roll, can you update us on Central America. It seems that there are better Pepsi trends there and, can you also update us on other exploratory projects and investments?

Marcel: Well, we're going to launch in Guatemala next month. We have a lot of free PR, press to discuss, everyone is excited about a new entrance, a new brand, so, it's a perfect environment to come to a market where the consumer has not been very well treated in the past. It's one of the highest prices for beer, I would say probably in the world. So, I think that both the consumer and the trade are kind of expecting us and that is very nice, like we did in Argentina, in the beginning. We have a great team of young up-incomers there, and it's their lives, they have to make or break, so we think positively and as a means of expanding into other Central America countries.

We have a great partner there, one of the best Pepsi bottlers in the world, in my opinion. So, distribution is not taken for granted, but it's a huge step in getting access to the point of sale. So, Guatemala is this way: it's a small market but interesting and profitable margin pool when there is

a possibility to expand into other countries. I mean, there are countries there where we saw competitors paying close to one billion for getting into those markets and, I mean, we're doing that in the 30 to 50 million range so, we're comfortable with that. The same thing applies to other ventures, we are very intent to go into Peru, and also Peru could be a natural exporter to Ecuador. We already have land, we already have equipment, we already have the team. We're beginning to move there.

Marco: Great. And from Guatemala, since you're making a fixed investment, it's a very exciting project. You mentioned expanding to other countries; you're going south and north, or just south?

Marcel: South. And our partners, we got a big offer here. Our partners there have the distribution of Pepsi in two other countries and we are looking into a third.

Marco: Thanks.

Operator: Thank you very much and our next question comes from José Yordan. Please state your question, sir.

José: Hi, good morning. I just have a question, going back to the Brazilian volume growth potential. A couple of years ago when AmBev first got started and hit a stride you used to mention that you thought you could grow volumes at one and a half times the rate of GDP growth. And it seems to me from the last couple of years that have past that the market has basically been flat even though GDP has grown about 1.5% and, of course, it may be a problem with measuring the size of the market which is never easy in Brazil but, what would be your explanation for the lagging growth of the market versus GDP if, in fact, you think there is one and, do you still expect the same kind of multipliers going into the future?

Marcel: I think that maybe the most relevant relationship is not directly to GDP but with disposable income and, although GDP is growing, you have less disposable income, at least stable disposable income in this period. On top of that, I mean, quite frankly we had to compensate a lot of what happened in terms of our costs, in terms of devaluation, with price increases. We are still managing to keep our price increases to the consumers to stay below inflation. That's a long-term proposition for us. By having said that, the total amount of disposable income didn't grow at all at the same pace of inflation. Actually, it declined. So, I'll say that, at least for this period, the things don't relate, on the long run I mean, we still are confident. But it's still a bet on the country. I mean, it was the highest growth country of the world in terms of GDP in early 70's of this century and then kind of moved sideways for 20 years or something. So, the potential is here, the people are here, we see a lot of sound policies being put in place right now. So again, it's a huge bet on the future.

Other things, I mean, our market is affected by consumer confidence so, when you have a period like we had for the last 12-18 months, where people were kind of unsure if the country was going to heaven or hell, I mean, everyone kind of holds back a little. Actually, as I mentioned earlier, we were very surprised at how resilient the market has been to all those external factors, price, consumer confidence, disposable income, when put into the context of what is happening with other consumer products and what's happening, let's say, with the supermarket sales in Brazil.

José: In a scenario of relatively stable currency and so forth, internally you would expect the growth of the market to get back to the sort of 2% to 3%, 4%?

Marcel: Definitely. If we really see a scenario where the right things continue to be done, when people recognize those things are providing a stable environment for both investment and consumption, and the country starts to grow again, definitely. And remember that, on top of that, you always have the per capita opportunity.

José: And there's no problem right now with substitute products such as *cachaça* or anything else? Has there been a fluctuation in those prices that could affect positively or negatively the consumption of beer?

Marcel: No, our basic problem is with our competitors. I mean, into the beer segment we still have a lot of tax evaders. You know, most of the initiatives we've been sponsoring or working together with the government and we hope that most of them will take place by the second semester of this year to the first semester of 2004. You also have Kaiser, which has a strategy that's probably like ours in soft drinks. They're following us in terms of pricing and seen how much affected their volumes were. I'll guess that unless it really hurts them in the cash flow, they will hold for a period before increasing prices.

José: Thanks a lot, Marcel.

Marcel: You're welcome. Operator, are there any other questions?

Operator: Our next question comes from Lore Serra.

Lore: Thanks. I'll make this brief because it's been a long call. Those comments were helpful on commodity costs, inflation, but I guess I'd still like to understand if you look at the most important commodities for the beer operations, malt and barley. You mentioned that you had a bad domestic crop and had to import. Could you give us some direction and hopefully some quantification of how you expect those commodities to perform in the next couple of quarters, compared to where they were in the 2Q? You made it clear that it has peaked, but could you give us some sense of how much do you think that the decline could be?

Brito: Yes, I mentioned here at the beginning of the call that we did have some commodities behaving in a much better way price-wise this quarter as opposed to the 2Q. For example, on the soft drinks side, PET decreased in Dollar terms by 18% and we already had this fixed for this 3Q. So this is something that we can say for sure. And, on the beer side, an important one that is the corn syrup, that we use with the malt together, declined, in nominal local terms, by 11%. And that's also fixed for the entire 3Q. So, other than that Lore, I think, some of the other things I mentioned and the questions I tried to answer at the beginning of the call.

The 2Q was too much the worst case, I think, in terms of commodity pricing, some carry-overs compared to the 1Q. And I think for the 3Q will be more optimistic because we do see commodities heading down, at least so far and again, by spot, it's hard to give any guidance on that. And we also see opportunity for our efficiency efforts to emerge as these commodities also behave better. We do have a set of things that we have to accelerate to try to offset some of those commodities nominal, real term increases, and I think this will pay off and more than offset, and some of the commodities will emerge now in the 3Q.

Lore: OK, the 11% just to be clear, is versus the 2Q, and you think …

Brito: For the 2Q.

Lore: For the 2Q. And you think is representative for your beer raw material costs, although it is only one item?

Brito: No, I wouldn't say that. I just gave one example of the corn syrup prices. At this point I wouldn't like to commit with a very particular number in terms of raw materials, I'm just giving you the trends and what we expect. Again, we'll buy commodities in the start, they're going down, they could go up and it is very hard to commit.

Lore: And what percentage of your raw material and beer are the corn syrup, roughly?

Brito: I don't have the numbers here with me, let me see if we have it here. If not I will give you in call, but I don't have the numbers here on top of my head.

Lore: OK, and just a question for Luiz Fernando. I mean, you mentioned that, Marcel just mentioned that Molson hasn't followed you yet. I assume that lower priced brands don't. I'm just wondering when you're anticipating, maybe some reaction, whether there is any question in your mind, whether or not this price increase can stick?

Brito: Lore, just one thing, Brito here. I just got the number. The corn syrup is about 25% of our beer raw material.

Lore: Thanks.

Brito: OK.

Luiz Fernando: Lore, we have been hearing from sales force in different places, in different areas in Brazil, since two weeks ago, that they're going to raise their prices, but they haven't done that yet. We haven't seen that yet. So, we believe they are preparing to raise prices and it should happen next month, next week. So, I expect that during August they'll increase their prices. I hope they do.

Lore: OK, thanks.

Operator: And once again, if there are any final questions or comments, please hit 1 followed by 4 on your phones at this time.

Thank you, and our next question comes from Dan Kwiatkowski.

Dan: OK, that's right. Thanks very much. First question is about market share. Your volume grew 2.5%. Molson's were down 27%. Who is picking up the remainder of the share there?

Luiz Fernando: Could you repeat that, please?

Dan: You only grew 2.5% in beer; Molson was down 27% yoy. So, who is picking up the rest of the beer share, could you share with us what that share is at the moment?

Luiz Fernando: First thing, I don't have your numbers to compare, but you have to consider some aspects. First, that they don't have distribution all over the country, so they depend a lot on the São Paulo market, and that shrunk a lot, much more than what happened in the other areas in Brazil. So, São Paulo is suffering since its industry is supermarket dependent. Then you have to consider that cans are much more important for them than are for us and then the supermarkets affect their volumes, and that doesn't mean that we can recover these volumes.

We believe that supermarkets shrank since we raised, comparing bottles with cans, our mix went more to bottles than to cans and, of course, their volumes should have fallen more in cans. Then you have to consider that not necessarily the market volume is flat. Our 2.5% is, of course, a

consequence of our market share increases too. So, it doesn't mean that all their volumes should come to us, of course, some of our competitors, other competitors, gained 1% point in market share, but the market is not necessarily flat.

Dan: Was that Schinchariol picking up that 1% or was that divided between all the rest?

Luiz Fernando: All the rest.

Dan: OK, the second question is on the flow meters. What has the progress been on that? When do you think they will start to kick in?

Felipe: This is Felipe, right now we are working with the government in order to get the full specifications and to approve the suppliers. We are expecting the final legislation being released until the end of this year and flow meters will start to be installed once we get this final legislation.

Dan: OK, thanks. On further state taxes, do you expect any other states to increase taxes, over the course of the next year?

Felipe: Well, they normally increase taxes gradually throughout the year despite the fact that taxes are fixed, or at least most taxes are fixed. On a per hectoliter basis, from time to time they collect the new price level at the marketplace and they make some adjustments. Then we do expect that to grow gradually next year. But it will depend a lot on our price strategy and our ability to roll back consumer prices. If we are successful in doing that, probably taxes won't increase that much.

Dan: OK, thanks. On the price point of light beer, can you talk about that in comparison to the rest of your portfolio and what the contribution margin of light beer is as compared to your portfolio?

Luiz Fernando: Well, price should be 5% over the leader, basically Skol in most of the country, and margin should be 10% to 15% over the average margin.

Dan: OK, great. And then the last question, it's more of a technical question. In terms of the buyback, in terms of purchasing Quilmes shares, could you share with us why is more useful to buy your own shares rather than buying Quilmes shares?

Felipe: We basically have a buyback program here at AmBev. We are buying ON shares and PN shares rarely in the marketplace. It's an on-going program and besides that, we have this ability to buy up to 12 million Quinsa Class B shares.

Dan: Considering where prices are today, is it not better use of your cash to buy your own shares, dedicating more money to buying your own share rather than buying Quilmes shares?

Marcel: This is Marcel here. We are buying as much shares as our program allows, and we are basically extending it. But those are not excludent and we do want to provide liquidity to Quinsa shareholders.

Dan: Thanks very much.

Operator: Thank you very much and at this time I would like to turn the floor back over to our host, Mr. Telles.

Marcel: Well, thanks to everyone. It has been a very long conference call and I hope it was worthwhile, and I'll see you all next quarter. Bye.

Operator: Thank you very much. This does conclude today's teleconference and have a wonderful day.

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