TRANSCRIPT

CULTIBA

First Quarter 2014

Earnings Conference Call

April 30, 2014

Company Participants

Mr. Juan Gallardo, Chairman & CEO
Mr. Carlos Orozco, CFO
Ms. Diana Gonzalez, Investor Relations
Ms. Kathleen Heaney, Breakstone Group

Analyst and Investor Participants

Karla Miranda - GBM
Armando Perez – Credit Suisse
Pedro Leduc – JP Morgan
Mauricio Sada - GBM

Operator: Good afternoon and welcome to the Cultiba's Fiscal First Quarter 2014 Earnings conference call. Today's call is being recorded. At this time, I would like to turn the conference over to Ms. Kathleen Heaney. Please proceed.

Kathleen Heaney: Thank you and good afternoon, everyone. Cultiba's first quarter of 2014 financial results were released yesterday after the market closed. A copy of the earnings release can be found on the Company's website at www.cultiba.mx.

As a matter of formality I need to remind participants that remarks made by Management during the course of this call may contain forward-looking statements about the Company's results and plans. Such statements are subject to risks and uncertainties that could cause the actual results and implementation of the Company's plans to vary materially. The words believe, expect, plan, intend, estimate or anticipate and similar expressions, as well as future or conditional verbs such as should, would and could identify forward-looking statements.

In addition, any projections as to the Company's future performance represent Management's estimates as of today, April 30th, 2014. You should not place undue reliance on these forward-looking statements and we do not undertake any duty to update forward-looking statements, whether as a result of new information, future events or otherwise.

Presenting on the call today will be Cultiba's Chairman and CEO, Mr. Juan Gallardo, and Chief Financial Officer, Carlos Orozco. Mr. Gallardo will begin with some opening remarks, after which Carlos will present a discussion of the Company's first quarter financial results, and then Mr. Gallardo will return and will have some closing comments before we open the call for your questions.

Now it is my pleasure to turn the call over to Mr. Gallardo.

Juan Gallardo: Thank you, Kathleen. Good afternoon to all and thank you for joining us today.

Two-thousand fourteen, as expected is a year of challenges, both at the macro level and within our industry. We started the year with unusually rainy weather which is not conducive, obviously, to Beverage sales growth, and also in January we saw the effects of some inventory build-up that occurred during December as an immediate logical reaction to the excise tax you're all familiar with.

Also impacting volume trends in the first quarter, a seasonably low period, as you well know, was the timing of the Holy Week, an important period of Beverage sales. In 2013, this period took place during the first quarter while this year, Holy Week will fall in the second quarter.

Much more significantly on the macro front, volume trends after a very tough January began to normalize in February and March was a reasonable month for our Beverage division, mirroring a steady volume recovery through the quarter. Directly affecting soft drinks, the excise tax has resulted in a new pricing environment to which both producers and consumers are still adapting.

Since mid-December we have passed along the entire excise tax to all applicable categories, resulting in a roughly 14% overall price impact in our portfolio of Bottled Beverages. Market dynamics have changed and will continue changing as consumers adjust to this new environment, and predictably alter some of the beverage choices they make on different consumption occasions. Our strategic capabilities, mainly driven by an attractive Beverage portfolio, and our execution excellence, continue to provide us with the flexibility to respond and adapt to this new environment.

We are clearly facing tough challenges in 2014 and I am certain our management at both our Beverage and Sugar divisions will clearly be up to the task. In sync with our business priorities, and in advance of the excise tax, our Team has made timely and difficult decisions, reducing the organizational structure and levels, a roughly 20% reduction of our top Corporate office headcount was carried out, and their responsibilities redeployed within the group. We have been improving our purchasing capabilities and continue to make consistent, efficient operational improvements among many other coordinated steps.

All of this provides the Company with an everyday more competitive and sustainable cost structure. We, however, have not and will not derail from our original strategy, and will continue to make the necessary investments to position our portfolio competitively within the new dynamics that the market demands. Our sustained investment plan will continue as originally set forth for growth.

We are encouraged as we have seen signs of recovery through the quarter. As a result, overall volume in the first quarter of 2014 was 364.6 million unit cases, basically flat with the same period in the prior year, and better-than-average industry growth. Carlos will provide in greater detail the breakdown between our Bottled Beverages and Jug Water volumes during his presentation.

It is important to point out that we continue to benefit from many of the changes we implemented last year, both from the Product portfolio side and the operational side, which has helped us manage through the challenges. As a reminder, on the product side, our realigned portfolio of products and presentations serving all soft drink categories combined with our price packaging architecture, provided consumers in a timely fashion with an array of choices on each consumption location and at different price points. All of this, I must emphasize, complemented by a tremendous execution effort by our national sales force.

On the operational side we continued to see improvements in our cost structure. To date we are more than half way towards our goal of capturing the 900 million Pesos in synergies, and we are on plan to capture the remaining synergies by the end of this year.

Also, our Sugar division continues to build on a cost-efficient model, providing Cultiba with an incremental margin expansion despite a low pricing environment. Leveraging our nationwide distribution network to drive product sales and core brand penetration should continue to give us a competitive advantage. Most of our efforts this year are focused on increasing the productivity of all the investments that we undertook last year and to closely monitor changing consumption patterns so that we have the right products in the right presentation at the right time to meet consumer demand.

Equally important, as we navigate this new market environment has been the strength of our balance sheet. With debt pay down a priority last year, we entered 2014 in a very strong financial position. We expect our Beverage division to have paid down in full the 2.7 billion pesos borrowed at the year-end to take advantage of supply opportunities, and we will preserve a very strong financial position.

Because of all the conflicting signals surrounding the first quarter, this period will not be completely indicative of the trends that will characterize the rest of the year. It is too early to predict the speed at which consumers will fully absorb price increases derived from the excise tax, and it is also too early to determine how fast Mexico's economy will recover. We believe that by the second quarter we should be in a much better spot to provide you with a more defined path towards profitability.

With that, I will now turn the call over to Carlos who will discuss in detail Cultiba's first quarter's results. Thank you very much.

Carlos Orozco: Thank you Mr. Gallardo, and thank you all for joining us today. As Mr. Gallardo stated, the first quarter was challenging on both the macro and industry fronts.

Our total Beverage volume was flat in the first quarter of 2014 at 365 million unit cases. These lower sales of Bottled Beverages are partially attributable to a slow economic recovery and the other factors that Mr. Gallardo has already laid out.

Jug Water sales increased 3.8% in the quarter, partially offsetting a 4.2 percent decline in Bottled Beverages. Continued efficiencies in our direct-to-home routes, as well as improved executions throughout the country, contributed to this better-than-industry volume performance.

Beverage volume started off slow, but we are encouraged by the improvement we saw throughout the quarter, especially in March when we saw positive growth in both Soft Drinks and Jug Water. We expect our portfolio of brands and presentations, as well as optimized routes contributed positively to the Beverages division's results.

Moving to our P&L, financial accounting regulations require us to account for the new excise tax as part of our revenue. As a result, our total net sales in the first quarter of 2014 were 7% higher than the prior year. Excluding the revenue generated from the excise tax, Cultiba's total revenue declined 2.6% in the first quarter of 2014, reflecting flat volume and lower sales in both the Beverage and Sugar divisions.

The average revenue per 8 ounce case, excluding the excise tax, was 18.9 pesos in the first quarter, down 2% from 19.3 pesos in the same period of last year. Average revenue per case for Jug Water was 4.4% higher than the prior year, while average revenue per case for Soft Drinks and Bottled Water was basically flat with the same period of the prior year. Given the lower price point of Jug Water and its high percentage contribution to volume mix during this quarter, the average revenue per case for our entire portfolio was 2% lower than the same period of last year.

Moving on to costs and expenses, The excise tax also impacts our consolidated cost of goods sold which was 12% higher in the first quarter of 2014 compared to the first quarter of last year. Excluding the impact of the excise tax, consolidated cost of goods sold decreased 4% in the quarter, reflecting a change in our volume mix and improved procurement costs. As a result, our gross margin in the quarter increased to 41.3%, up from 40.4% in the same period of 2013. Our unit costs per case were 6.6% lower than in the first quarter of 2013, and we also reported a 4.4% year-over-year increase in gross profit per case.

Our total SG&A expense was 3.3 billion pesos in the first quarter of 2014, up from 3.1 billion pesos in the same period of 2013. SG&A as a percent of revenue increased to 43.5% in the quarter, primarily due to channel focused sales and distribution expenses that we were unable to leverage in full due to lower volumes in the quarter. These operating expenses are necessary as we continue to position our Product portfolio, and we should see the benefits of these investments when the market returns to more normal levels. As volume improves during the coming months, we expect to achieve operating leverage in the Beverage division and SG&A costs as a percentage of sales should decrease.

Our consolidated EBITDA was 386 million pesos compared to 618 million pesos in the same period 2013. The decrease primarily reflects lower volume and sales at the Beverages and Sugar division, and the resulting lack of operating leverage, as well as lower revenues overall.

On the positive side, the Sugar division continues to be margin accretive despite operating in a low Sugar price environment. Our consolidated EBITDA margin in the quarter was 5.1%, down from 7.9% in the same period last year. As we continue to achieve synergies and improve operating leverage throughout the businesses, and as volume growth returns, we expect to see margin improvement.

Focusing on the Beverage business, revenue in the quarter was 6.9 billion pesos compared to 7.1 billion pesos in the same period of last year, down 2.2% primarily due to lower case volume sales. This revenue figure is net of the excise tax. Including excise tax income, our revenue in the Beverage division was 7.6 billion pesos, up 8.4% from the first quarter of 2013.

Again, our SG&A expenses reflect channel-focused sales and distribution initiatives that are necessary to maintain brand awareness and grow sales over time. So while the additional SG&A has provided the Company with an incremental brand presence for its products and portfolio, we were unable to fully leverage these expenses.

Also, during the first quarter of 2014, the Beverages division incurred severance costs of close to 50 million pesos, as the Company continues to right size its cost structure to improve efficiencies and a leaner Management structure.

We continue to make progress with achieving synergies and improving our cost structure, however, these improvements were masked in the current quarter as a result of the lower volume I just mentioned. As a result, Beverages division EBITDA of 359 million pesos was 20% lower than the same period in the prior year, and the Beverages division EBITDA margin of 5.2% was 120 basis points lower than the same period of the prior year. However, it is worth mentioning that adjusted for this one-time expense related to Management restructuring, our EBITDA margins were practically flat at the Beverages division.

Over time we expect to benefit from our marketing investments and our continued extraction of synergies, which should drive improvement in operating income and EBITDA from current levels.

Our consolidated financing costs in the first quarter of 2014 were net expense of 68 million pesos compared to a net expense of 7 million pesos in the same period of last year. Following our refinancing activities in the fourth quarter of 2013, the cash interest payments during the first quarter of this year were 12% lower compared to the same period of 2013.

The Beverages division reported a net loss of 247 million pesos compared to a net loss of 150 million pesos in the same period of 2013. On a consolidated basis for Cultiba, we reported an accounting loss of 314 million pesos in the first quarter of 2014 compared to a net loss of 23 million pesos in the same period of the prior year.

Moving on to the balance sheet and cash flow, during the fourth quarter of 2013 we refinanced some existing debt, improving our Debt profile even further. The Beverages division also restructured its long-term debt during the fourth quarter of 2013. As a result, Cultiba's net debt as of March 31, 2014 was 5.8 billion pesos, which implies a net debt to EBITDA ratio of two times. Of note, the Beverage Company still has 1.7 billion pesos of debt related to advanced raw material purchases in December 2013.

Adjusted for this short-term debt, our outstanding net debt is 4.1 billion pesos and our net debt to EBITDA ratio is 1.5 times. As Mr. Gallardo mentioned, we expect our net debt to continue improving throughout the year, both at the Beverages division and on a consolidated level.

In conclusion, although first quarter volumes were essentially flat with the prior year quarter, our financial position remains solid and we continue to see improvements in our cost structure, providing us with the necessary funds to support our operations.

Before we open up the call for questions, I'm going to turn back the call to Mr. Gallardo.

Juan Gallardo: Thank you very much, Carlos. In very simple terms, in conclusion, number one we are staying the course, committed to our initial strategy and convinced that this is the right path. Second, we have in place the human, technical and financial resources to carry this out successfully, and we want to take this opportunity to thank you for your trust and your support, which clearly motivates and commits us.

Thank you very much. We can open the call up for questions now.

Operator: If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Again, it's star, one to ask a question.

We'll take our first question today from Ms. Karla Miranda with GBM.

Karla Miranda: Hi. Good morning. Good afternoon, actually, everyone. Thank you for taking my question. Juan, Carlos, I have two questions. First of all, I was wondering if you can explain just a little bit what happened to the working capital this quarter. Why didn't it reflect the full reversal of the advanced purchases made last quarter? As far as I remember, the advanced purchases were made for the raw materials of the first quarter of 2014, so I was wondering when we are going to see these reversals. The other one was regarding further price increases to transfer inflation to the consumer; when should we witness that? Thank you.

Juan Gallardo: Thank you, Karla. How are you? With respect to your first question, working capital, well, first of all bear in mind that both of our businesses are cyclical. So the first quarter always demands additional working capital from the fourth quarter. In particular, the advances—you still see them in our balance sheet because we cannot cancel them until we consume them in full. So we expect that by the second quarter you should start seeing in our balance sheet those advances begin to decrease. However, you are seeing the benefits of those discounts that we obtained in our improved cost per case.

Now with respect to price increases, first of all, if you see the prices that we've taken in those categories that were not impacted by the excise tax, well, we have already raised pricing with inflation, and in fact a little bit more. With respect to prices for those categories that were impacted by the excise tax, as mentioned before, I want to reiterate that we have already passed on in full the tax, and it will depend on market conditions and our ability to pass on inflation throughout the rest of the year.

I would just add, Karla……just adding to that. We have made an enormous effort in our total cost structure of our operations so that that reduction in those costs, and we'll see it over the period of the year, should also help us to improve our margins and to absorb part of the inflation that you were mentioning. So there are two drivers to the inflation concept: one is this reduction of the cost structure and the other one is, of course, whatever market prices we're able to pass on in timely fashion further on.

Karla Miranda: Thank you very much, Juan.

Operator: As a reminder, it is star, one to ask a question. We'll take our next question from Armando Perez with Credit Suisse.

Armando Perez: Hi, Juan. Hi, Carlos. Thanks for the call. My question is again on prices. Competition reports that price increases of 2 to 5% after the excess tax, and I just want to know, when you mentioned earlier that you were waiting to see market reaction before you increase prices again, have you not increased sales prices above the excess tax; and if you could share it with us, the price increase per category, that would be great. My second question would be if you have some color on the affects of the tax reform in your tax rates. I see that this quarter you have a tax liability despite having operating losses. Thanks.

Carlos Orozco: Hello, Armando. First of all, with respect to prices, yes, indeed; I mean we have already passed on all of the tax in those categories affected by the excise tax, but we have not passed along any additional inflation.

My understanding is a bit different with respect to competition prices, but I guess that's something we will have to evaluate in detail. With respect to basically Water, you can see out of our financials that we've already had a price increase of 4.4%, and it may be even higher.

Juan Gallardo: In Jug Water

Carlos Orozco: So—in the case of Jug Water we are recovering above inflation. Now with respect to the tax reform, bear in mind that when you see our financials we normally register the taxes that we are reserving and those are calculated based on last year's revenues. So those are not necessary reflective of the cash taxes that we will be paying this year.

As we mentioned in the last call, we have close to a 50 million pesos impact due to the consolidation. We will be reflecting that in the second quarter. Other than that, our effective tax rate basically remains close to 30%.

Armando Perez: Okay. Thanks a lot, Carlos.

Operator: Our next question comes from Pedro Leduc with J.P. Morgan.

Pedro Leduc: Thanks for taking the question. If you could elaborate a little bit how you guys see the efficiency margin gains in the Mexican Beverage operations. I mean, I understand they were pushed forward a little bit, but do you still see them, reaching more like last year's levels and margins at least for—at least later on in the year; and how is it going compared to what you previously expected on this efficiency fronts? Thank you.

Juan Gallardo: Thank you. Well, let me start by mentioning that what is within our control, which is basically the synergies that we are capturing, we feel pretty confident they we're going to fulfill that commitment that we have with respect to the 900 million pesos. Just reminding everyone, this year we are set to capture 450 million pesos of those synergies, number one; and number two, we have already started seeing the benefits of better procurement in our unit costs. So as we start seeing volumes pick up, we do expect to go back to the margins we've seen in the past, but obviously that's the big question: how fast will we see those volumes recover. But you can rest assured that we're doing everything that is within our control to have the right cost structure in place, and I think the numbers of this quarter talk for themselves in that respect.

Pedro Leduc: So basically we'll be waiting for volumes to pick up again, and you would return to profitability, right? So what is in your control is pretty much on schedule, you would say?

Juan Gallardo: Yes.

Pedro Leduc: Great. Thank you.

Juan Gallardo: Clearly on schedule.

Pedro Leduc: Perfect. Thank you.

Operator: As a reminder, it is star, one to ask a question, and our next question comes from Mauricio Sada with GBM.

Mauricio Sada: Hello. Thank you for taking my question. I see that a representative part of your drop in EBITDA comes from a decline in your Sugar business contribution. So my question is what we can expect from the Sugar business going forward and the impact of that to the consolidated base.

Carlos Orozco: Morning, Mauricio. First of all, bear in mind that the first quarter always magnifies the size of the Sugar business within Cultiba. Remember that the first quarter is seasonally low cycle for the Beverage business. So as we progress into the second and third quarters, we'll see the Sugar business go back to its normal dimension within Cultiba.

This year we're still seeing a very low price environment. Our price mix within our Sugar business is close to 15% below; last year. However, as Mr. Gallardo mentioned, we have continued to reduce our production cost, so that has allowed us to continue to have an incremental EBITDA margin. It's not as strong as it was during the first quarter of last year; however, we expect that margin to be accretive throughout the year. Our production has continued to increase. We continue to see a lot of efficiencies within our Sugar business, so what we expect of the business throughout the year is to sustain this incremental value for the Company.

Mauricio Sada: Okay. Thank you.

Operator: As a final reminder, it is star, one to ask a question today, that's star, one. It looks like we have a follow-up question from Pedro Leduc with J.P. Morgan.

Pedro Leduc: Hi, yes. Thank you for taking the follow-up, and that would be regarding, the initial thoughts you have in the second quarter in the light of what was previously mentioned here, competitors probably increasing price at the end of the first quarter; and on the other hand, we're reading from the public trade and supermarket chains that inventories ended 1Q with excessive levels, so how is it trending for you guys, I mean if you have any initial views there? Thank you.

Juan Gallardo: I think that your question is enormously important to us. Obviously, we mentioned that January was extremely tough, February being somewhat less tough, and March beginning to look more like normality. I think that is happening across the industry, and clearly with that trend and with the fact that the second quarter is always a significant contributor mostly because of weather conditions—and this case even eliminations of some first quarter elements. I think we see our second quarter as something that should bring us back to greater levels of profitability.

I mean, we feel comfortable that we're doing everything we needed to do; that we have in place everything we needed to have in place to be able to achieve that, and we're going to be extremely, extremely careful in terms of what pricing mechanisms happen within the market so that we can react in a timely and competitive fashion, because as you can see very well, volumes have an enormous impact on our bottom line and we want to make sure that we're able to preserve our volume base and increase it over time. So the second quarter is looking very encouraging, I would say.

Pedro Leduc: Okay. Great. Thank you.

Operator: It appears there are no further questions at this time. Mr. Gallardo, I'd like to turn the conference back over to you for any additional or closing remarks.

Juan Gallardo: Well, I think most of you have had a long day of hearing about the bottling industry, as I can imagine, and I just want to tell you that we're very, very appreciative of your interest and your support. We're doing what needs to be done and we will keep you posted.

We feel today that as we look forward to the rest of the year there is no doubt that we are every day seeing a much clearer path and one where we will, of course, be successful.

Thank you very much all for your attention and your presence here today.

Operator: Once again, that does conclude today's conference. We appreciate your participation.

ABOUT CULTIBA

Organización Cultiba, S.A.B. de C.V. is a holding company with a majority interest in one of Mexico's largest bottlers of soft drinks and jug water, and the exclusive bottler of PepsiCo beverage products in Mexico. Carbonated, non-carbonated soft drinks and jug water are marketed under its own brands as well as third party brands. Its beverages division has 44 bottling facilities in Mexico and is the only bottler with nationwide distribution. As a holding company, Cultiba also owns and operates 3 sugar mills and has a 49% interest in a fourth one in the western region of Mexico. The Company is listed on the Bolsa Mexicana de Valores, where it trades under the symbol CULTIBAB. For more information, please visit www.cultiba.mx.

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