Coca-Cola FEMSA Third Quarter 2024 Conference Call

Friday, 25th October 2024

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Participants

Jorge Collazo – Investor Relations Director

Ian Craig – CEO

Gerardo Cruz – CFO

Operator: Hello and welcome to Coca-Cola FEMSA Third Quarter 2024 Conference Call. My name is Melissa and I will be your coordinator for today's event. Please note this conference is being recorded and for the duration of the call, your lines will be on listen only. If you require assistance at any point, you may press star zero to be connected to an operator. I'll now turn the call over to Jorge Collazo, Investor Relations Director. Please go ahead.

Jorge Collazo: Thank you, Melissa. Good morning everyone. Welcome to this webcast and conference call to review our third quarter 2024 results. Joining me this morning are Ian Craig, our chief executive officer, and Gerardo Cruz, our chief financial officer. As usual, after prepared remarks, we will open the call for a question and answer session. Before we proceed, please allow me to remind all participants that this conference call may include forward looking statements and should be considered as good faith estimates made by the company.

These forward looking statements reflect management's expectations and are based upon currently available data. Actual results are subject to future events and uncertainties that can materially impact the company's performance. For more details on these, please refer to the disclaimer in the earnings release that went out earlier this morning. With that, let me turn the call over to our chief executive officer to begin our presentation. Ian, please go ahead.

Ian Craig: Thank you, Jorge. Good morning everyone. Thank you for joining us today. Our third quarter results reflect the resilience of our business and the ability of our team to execute our strategy with local focus. Despite facing unfavourable weather in Mexico and a tough comparison base from the previous year, our revenues and operating income grew double digits year on year. Strategically, we continue implementing initiatives to grow our core business and improve our service levels.

In digital, we continue progressing with Juntos+, reaching 1.2 million active users while enhancing our user experience with the development of new features. By the end of the quarter, 56% of our customer base were digital buyers, six percentage points ahead of the previous quarter. We are also encouraged with the rapid adoption of premium Juntos+, our loyalty program, which reached more than 920,000 enrolled clients at 21% increase versus the prior quarter.

Aligned with our strategic priorities, we remain committed to removing infrastructure bottlenecks to enable sustainable, long term growth. To this end, we are not only increasing CapEx investments, but also improving the efficiency of our bottling lines and optimising the layout and density of our warehouses across our territories. As with other parts of the world, weather events have increased in frequency and strength.

In less than a year, the state of Guerrero in southern Mexico is once again facing the consequences of a strong hurricane. With this in mind, we want to express our sincere support to all the people affected by Hurricane John. As part of our protocols, we have taken action to ensure the well-being of our collaborators and their families, as well as community actions undertaken together with FEMSA and our partners at the Coca-Cola company.

As we usually do, I will begin this call by summarising our consolidated results for the quarter. Then I will take a moment to dive deeper into key developments and highlights from our territories. At the close, I will hand over the call to Gerry, who will walk you through our division's performance. Now, moving on to review our consolidated results for the third quarter. Despite double digit volume growth in the previous year, we increased our consolidated volumes by 0.8% to reach 1.04 billion unit cases. This growth was driven mainly by Brazil, Guatemala, and our Central America territories. Offsetting volume declines in Mexico, Colombia and Uruguay.

Sparkling beverage volumes outperformed, driven mainly by brand Coca-Cola 2.8% growth. Still beverages grew 4.9% and bottled water remained flat, offsetting mid-single digit declines in flavours and bulk water. Despite the moderation in the pace of volume growth, total revenues for the quarter grew 10.7%, reaching $69.6 billion, driven mainly by our revenue management initiatives and favourable mix effects. Unlike previous quarters, this quarter saw a more neutral currency translation impact, with currency neutral revenues increasing 11.3%.

The positive translation effects from most operating currencies into Mexican pesos were balanced out by the depreciation of the Brazilian real and the Argentine peso. Gross profit increased 11.3% to reach $32.1 billion, leading to a margin expansion of 20 basis points to reach 46.1%. This increase was driven mainly by top line growth, easing raw material costs and favourable hedging strategies. However, these effects were partially offset by an increase in purchases of finished products in Brazil. Higher fixed costs and the depreciation of the Argentine peso.

Operating income increased 13.9% to reach $9.6 billion, with operating margin expanding 30 basis points to reach 13.8%. The positive effect from top line growth and favourable mix, coupled with cost and expense efficiencies, continues to mitigate margin pressures from higher operating expenses such as labour, marketing, freight and maintenance. Importantly, our

operating income for the quarter includes a favourable effect of approximately $340 million, driven by the recovery of insurance claims in Mexico related to the impact of Hurricane Otis in Guerrero, which affected the region in October last year.

Excluding this effect, our operating margin would have contracted ten basis points to 13.4%. Adjusted EBITDA for the quarter increased 18.4% to reach $14 billion, and adjusted EBITDA margin expanded 130 basis points to 20.1%. Finally, our majority net income increased 8.9% to reach $5.9 billion. This increase was driven mainly by operating income growth, which was partially offset by an increase in our comprehensive financial result and in income taxes.

Now, expanding into our operations highlights. In Mexico, our volumes declined 1.5% compared to double digit growth last year. This quarter's performance was affected by 50% more rainfall and lower temperatures than the previous year. Additionally, consumption patterns during the quarter moderated, driven by a deceleration in private consumption growth and overall economic activity. Against this backdrop, we continued implementing initiatives aligned with our priority to grow our core business.

For instance, the implementation of a revamped portfolio architecture enabled brand Coca-Cola volumes to remain stable year on year, driven by 6% growth in multi-serve one way presentations and 7% growth in Coke Zero sugar. In stills, growth was driven mainly by strong performance in brands Powerade, Fuze and Monster, as well as our Santa Clara dairy portfolio. In line with these initiatives and our commercial prowess. Our team has focused on expanding our customer base, successfully adding 70,000 new customers in Mexico year to date.

Furthermore, we continued advancing our digital transformation with Juntos+. This quarter, we added approximately 70,000 monthly active buyers to our app, reaching 405,000. Today in Mexico, digital orders represent more than 40% of our total, supported by the rollout of our loyalty program, with more than 260,000 customers redeeming points. Looking ahead, we are confident in the prospects for growth in our Mexico territory, driven by the continuation of consumption drivers such as increases in disposable income from real wage growth, social programs, infrastructure projects and nearshoring trends.

Consequently, we remain committed to expanding our manufacturing capacity by 4% in 2024, including a third new bottling line that is expected to begin production next month. In terms of our warehouse capacity, we are expanding pallet positions by more than 25% as compared to 2023, adding four new distribution centres, coupled with layout optimisations and increased productivity. Notably, we have expanded our primary distribution fleet by 13% and secondary distribution fleet by 6%, strengthening our ability to meet growing demand in Mexico.

Jorge Collazo: Moving on to Central America. Volumes in Guatemala increased 7.5%. Our initiatives to grow the core business continue driving outstanding results in a market that enjoys

a young and growing population, where consumers are moving from rural to urban areas. Guatemalan consumers are looking for convenience and affordability while rapidly increasing digital adoption. All these factors are tailwinds for long term growth.

To maintain this rapid volume pace, we are focusing on capturing white spaces in the market and improving our service levels. For instance, in 2024, we have increased our total customer base by 7% year on year, adding 9000 customers while our digital client base doubled as compared to the previous year. As we have mentioned in previous calls, Guatemala has doubled its volumes since 2017. Therefore, we need to increase production, warehouse and route to market capacity to enable future growth. To this end, we have added two production lines in 2024 and we expect to add two more next year. Alongside these efforts, our supply chain team is increasing the number of routes by 17% in 2024 as compared to 2023.

Now, moving on to our markets in South America. In Brazil, despite the suspension of our plant in Porto Alegre, we continue to deliver consistent volume growth of 6.3% year on year on the back of favourable weather and improving macro fundamentals supported by positive consumption patterns. We have continued to improve our service levels versus the prior year, reducing unavailability as well as increasing our client count and visit which have supported our positive results.

Additionally, our robust 360 degree plans, together with the Coca-Cola company for Coca-Cola Zero sugar, have continued to accelerate its volume growth to reach 59% year over year. Regarding sports and energy drinks brands, Powerade and Monster have achieved double digit volume growth of 52 and 15%, respectively. Leveraging the Olympics, Copa América and Copa Libertadores, as well as capitalising on other market opportunities. Year to date, our multi-category revenues excluding beer, grew 24%. This growth led our multi-category revenue mix without beer to reach 2% during the quarter. Align with our ambition to reach 5% of revenues in the coming years.

In digital, half of our clients are placing orders on a weekly basis with Juntos+. Additionally, our loyalty plan continues to gain traction with more than 100,000 clients redeeming points year to date. We have also launched a pilot of our new sales force automation tool, Juntos+ Advisors, which has already delivered promising results. Powered by advanced AI model, Juntos+ Advisors enhances our sales force capabilities, enabling us to support our clients to reach their full potential. This tool significantly complements our customers omnichannel experience, offering a more seamless and personalised interaction across all touchpoints. We expect to gather learnings from this initiative and expand the rollout to the rest of Brazil and other markets in 2025.

Finally, our recovery plan to reopen our facility in Porto Alegre is moving according to expectations. We have now resumed operations in our distribution centre. Initially a partial capacity while bottling up production is expected to resume gradually in the upcoming months.

We expect to operate at full plant capacity during the first half of 2025. In Colombia, as was the case during the second quarter, we continue to see a decline in consumer confidence and household expenditures. Consequently, our volumes for the quarter contracted 4% year on year.

In this environment, our team implemented initiatives to provide affordability to our consumers in both single serve and multi-serve refillable bottles. As a result, we have increased our refillable coverage, driving 6% volume growth in these presentations year over year. Additionally, our team in Colombia remains focused on expanding our customer base. As a result, we have added more than 22,000 customers, 6% ahead of year end 2023. Despite softer top line growth in Colombia, our team's efforts in driving cost and expense efficiencies is driving profitability improvements.

Finally, our quarterly performance in Argentina. Although the impact on consumption during the year was worse than expected, macro indicators such as monthly inflation have continued to gradually improve, piercing the 4% monthly inflation figure. To best navigate this environment, our strategy is focused on maintaining our customer base and household penetration to be well positioned for the eventual economic recovery. This strategy has allowed us to maintain attractive price points as we offer convenience and promotions to our consumers. So far, this approach is working as we have been gradually recovering volumes throughout the year.

Consequently, we are reporting stable volumes for the third quarter compared to the previous year. At the same time, our team continues leveraging rigorous cost and expense controls while accelerating digital as an enabler. Year to date, our digital client base has doubled, and digital orders represent 30% of our total orders in the traditional trade. As we have mentioned in previous calls, we anticipate a gradual recovery in Argentina as our team continues executing a playbook that is allowing us to outperform and emerge stronger.

Reflecting on the first nine months of the year, we have progressed along the three key drivers that have been a priority for the year. Build on the growth momentum of our core business. Take Juntos+ version 4.0 to the next level with the deployment of advanced AI capabilities. And three, continue fostering a customer centric and psychologically safe culture for Coca-Cola FEMSA. As we enter the final stretch of the year, we remain committed to our strategy and the implementation of our sustainable long term growth model. With that, I will hand the call over to Gerry.

Gerardo Cruz: Thank you, Ian. Good morning everyone. Summarising our division's results for the third quarter. In Mexico and Central America, volumes declined 0.7% to reach 629 million unit cases. Volume growth in Guatemala and our Central America territories was offset by volume declines in Mexico. Revenues increased 9.6% to $42.5 billion, driven mainly by our revenue management initiatives and favourable currency translation into Mexican pesos. Gross

profit increased 10.7% to reach $20.7 billion, resulting in a gross margin of 48.6%, expanding 70 basis points year on year.

Our top line growth, favourable hedging initiatives and improving sweetener and packaging costs were partially offset by higher fixed costs. Operating income increased 11.3% to $6.7 billion, driven mainly by gross profit growth. Our operating margin expanded 30 basis points to 15.8%. As Ian mentioned during the quarter, we recognised the insurance claim payments in Mexico of approximately $340 million related to the impact from Hurricane Otis during the previous year. These effects offset an operating foreign exchange loss and higher expenses such as labour, marketing, and freight. Finally, our adjusted EBITDA in Mexico and Central America grew 15%, leading to a 110 basis point margin expansion to 22.1%.

Moving on to the South America division. Volumes increased 3.1% to 412.1 million unit cases. This increase was driven by the 6.3% growth achieved in Brazil and stable performance in Argentina, which offset volume contractions in Colombia and Uruguay. Our revenues in South America increased 13.6% to $27.1 billion, driven mainly by volume growth and favourable mix. These effects were partially offset by unfavourable currency translation effects into Mexican pesos, driven by the depreciation of the Argentine peso and the Brazilian real.

On a currency neutral basis, total revenues in South America increased 19.5%. Gross profit in South America increased 12.2%, leading to a margin contraction of 60 basis points to 42.1%. This margin contraction was driven mainly by higher sweetener costs, purchases of finished product, and currency depreciation from most of our operating currencies as compared to the US dollar. These effects were partially offset by decline in packaging costs and favourable hedging initiatives.

Operating income for the division increased 20.6% to $2.9 billion, and operating margin expanded 60 basis points to 10.8%. This margin expansion was driven mainly by operating leverage coupled with cost and expense controls across our operations. These effects were partially offset by margin pressures in Argentina, coupled with higher fixed costs and expenses such as freight and labour. On a currency neutral basis, operating income increased 25.7%. Finally, adjusted EBITDA in South America increased 25.8% to $4.6 billion, and adjusted EBITDA margin expanded 170 basis points to 17%.

Moving on to our comprehensive financial results, which recorded an expense of $823 million, as compared to an expense of $552 million during the same period of the previous year. In the third quarter, we registered an increase in our comprehensive financial results, driven mainly by a lower foreign exchange gain as compared to the previous year, coupled with an increase in our interest expense net, partially offset by a higher gain in inflationary subsidiaries as compared to the same period of 2023.

Finally, before opening the call to your questions, I want to take a moment to recognise our team's effort across all of Coca-Cola FEMSA to achieve the sustainability performance target related to our sustainability linked bonds in Mexico. As we announced last September, because of our investments in water efficiency programs, we achieved the water use efficiency ratio of 1.36l/l of beverage produced, a benchmark for the Coca-Cola system. This is a 21% improvement in water efficiency as compared to 2016. Thank you all for joining us in today's call. Operator, we are ready to open the call for questions.

Operator: Thank you very much. As a reminder, if you would like to ask a question on today's call, you may press star one on your telephone keypad to register your question. To remove your question for any reason, you may press star two and you will be advised when to ask your question. Our first question is from Felipe Ucros with Scotiabank. Please go ahead.

Felipe Ucros: Thanks, Operator. Good morning, Ian, Gerry and team. Thanks for the space. So first a question on Brazil. Coke has posted a very solid results there. But in recent conversations you have mentioned that, even with the help of the neighbouring bottlers, you're still not being able to fully meet demand, from what I understand. And of course, it's costly getting products from third parties and further regions. In my mind, that kind of means that you have easy comps in southern Brazil next year as your plant ramps up, you kind of meet the demand fully and your unit cost starts going down. Am I thinking of this correctly? And then my second question is about pilots and multi-category. Just wondering if you can give us an update on how the pilots are going and your expectations for the next few quarters. Thank you.

Jorge Collazo: Hello, Felipe. How are you? Yes, I think you would be correct. The impact on Brazil, this this plant was about 10% of our capacity there. So in this low season, we have been able to be sourcing probably around 10 million unit cases from other bottlers. So it's a lot of volume that we have been sourcing from other bottlers, and we have been shipping from other regions in Coca-Cola FEMSA, and this has helped in the volumes. But these cases are not really profitable cases at all. They are intended just to maintain our competitive position.

So you're right that as our capacity comes back online, then there will be more favourable comps, just because those cases will have much less freight and cost attached to them. Also in line with that, obviously in the fourth quarter where we're in Brazil is high season, where it's going to be a lot more difficult to be sourcing those cases from other bottlers in the southern territories, because everyone is usually up to capacity. So that's going to have an impact there.

In terms of pilots and multi-category, I think we're moving along well. We're around one point -- for the total mix is around 1.6, I guess, at 1.6%. We have markets such as Brazil at 2%, we have smaller markets such as Uruguay and Panama around 10%, Costa Rica almost reaching 3%. So I think we're comfortable with our guidance that our ambition is to reach 5% of revenues, excluding beer. It's going to be a long journey, though. As you know, it's not easy

for our partners to unwind or include us as part of their distribution structure, but everything is progressing according to our ambition.

Felipe Ucros: Very clear. Thanks a lot for the colour and congrats on the results again.

Jorge Collazo: Thank you, Felipe.

Operator: Thank you. Our next question is from Alejandro Fuchs with Itau. Please go ahead.

Alejandro Fuchs: Thank you. Hello, Jorge and Gerardo and team. Thank you for the space on questions. Congratulations on the results. I have very two quick ones, if I may. First for Gerardo. On gross margin in South America, wanted to see if you could give us a little bit more colour in how to think about it going forward. I was a little bit surprised to see gross margin contraction year over year in South America while Mexico expanded materially. So maybe if you could give us some colour there would be helpful. And then the second very quickly on Juntos+ Advisors, I understand maybe a little bit too soon to tell right now, but wanted to see if you have any initial findings that you think are worth sharing, maybe in terms of frequency or average ticket that could help us. Thank you.

Gerardo Cruz: Thank you. Alejandro. First, on the gross margin question in South America, we saw pressure mainly coming from increasing sweeteners versus the previous year in gross margin. We also had some promotional activity in Colombia, as Ian mentioned in the prepared remarks. Colombia has been facing a tougher consumer environment driven by disposable income contraction. So we have done a lot of work in terms of promotional activity to position ourselves better. I think those are the main explanations that we have affecting gross margin.

Also, the effect of Argentina and the depreciation of the Argentine peso versus the dollar has put some pressure in gross margin. We think that the three effects that we're seeing in South America this quarter are short term effects. And we expect a more benign raw material environment and stable currency in Argentina as we move forward. So we would expect that gross margin would improve as we move forward.

Jorge Collazo: Also, Alex, just moving on to the second point. Juntos+ Advisor, just think of it this way. We can advance very rapidly on the app and the WhatsApp bot and advance very rapidly on our AI analytics. And what happened is both our bot and our app, with our AI analytics, we could do customised promotions by client. And our sales force tool, we were still on our legacy technology. So all of the activities and initiatives that we were filtering down via our salesperson had to be done by segments, not by client. So we were not utilising the full potential of our AI tools.

So what we're being able to do now with Juntos+ Advisors is we leverage our analytics to the fullest. So all of the promotions and the guided missions go all the way down to the client level. And all of these are done by AI analytics, and the feedback from our sales force has been just phenomenal. They're very excited. They're accelerating the rollout. We're finding out very good things on the ground. For example, we were curious visiting a client on why, even though it was one of our key initiatives, we were not promoting, I think it was a Coke two litre promotion. And our team went there and visited that client, and it had enough stocks of Coke two litre.

So the way these models work, and they take into account the particular situation of each client with its history and their surrounding area, is nothing short of amazing. They are also helping them. The sales team has goals on combined coverages, many other initiatives, and they have total visibility on a client per client level without having to carry around three or four sheets of paper to see how things are going. So we're very excited with it. Just think about it as putting our sales force on the same footing in terms of AI and the tools that they need as the clients that order digitally. Does that help, Alejandro?

Alejandro Fuchs: Yes. It was very clear. Thank you, Ian, and thank you, Gerardo as well.

Operator: Thank you very much. Our next question is from Lucas Ferreira with JP Morgan. Please go ahead.

Lucas Ferreira: Hi, guys. I hope you can hear me. My first question is on the Brazil, the Porto Alegre plant closure. Last quarter, you gave the guidance of $120 million impact on the results. I'm wondering if you have some visibility of how much it was this quarter, and if you have any sort of expectations for the full year, assuming you restart the plant fully, like you mentioned in the first or restarting now, but will be fully operating that plant next year. And how much you expect insurance to cover these losses? I believe it won't be fully covering, but I wanted to have an expectation of how much that could cover.

And the second question I want to get, if you can dive a bit deeper into Colombia. What's the outlook there after this quarter, which was more turbulent if you expect a rebound soon in terms of readjusting of go to market and pricing eventually and get Colombia sort of back on track. Can you put it this way? So how to think about the numbers for Colombia in the next few quarters. Thank you.

Gerardo Cruz: Thank you, Lucas. I'll start with the first one regarding power plant in Brazil. The impact that we recorded this quarter was for $200 million, mainly for incremental freight expenses, maintenance, all the cleaning process and labour expenses. We expect that the toughest impact we will face on additional expenses will be on the fourth quarter, mainly because of the higher volume that we have in high season, that quarter.

The insurance claim process, as you know, is a long one. We just talked about just having recorded the insurance claim payments this quarter from the Otis hurricane in Mexico that happened last year. Gladly, the process has been working quite well. The coverages that we have and the relationship that we have with the insurance company works very, very well. A very positive dialogue, and we expect that we should be covering most of these expenses as we move forward.

Jorge Collazo: In the case of Colombia, Luca, I think the third quarter was our most challenging one. You've seen year over year growth in Colombia. And start up very strong, almost 10% and 1% the second quarter then -4. And I think that given the comps in the fourth quarter where we have the effects of the tax comparable from November and December.

And just looking at that two year trend in Colombia, it's a lot more stable. So we will definitely expect a sequential improvement from the third quarter in the fourth quarter in Colombia and in terms of profitability as well. So it will be, let's say a stabilisation. So it will be, and we do expect, sorry we can't -- it's an expectation. We do expect a sequential improvement from the third quarter, which I think was the low point for Colombia for us. And we're no longer going to be cycling negative comps from the tax point of view.

Lucas Ferreira: Perfect. Thank you very much.

Jorge Collazo: Thank you.

Operator: Thank you. Our next question is from Ben Theurer with Barclays. Please go ahead.

Ben Theurer: Yeah. Good morning, Ian, Gerry, thanks for taking my question. I wanted to follow up a little bit on the digital platform and how it helps you maybe on pricing of products versus promotions, etc., because it feels like you had a very successful pricing kind of success in the quarter, right? Williams in Mexico down, but revenue is actually nicely up.

So just help us understand how the tools help you on your pricing architecture and your price policies within your different regions to deliver pricing that, at least on paper, looks like it was once again above general inflation levels. So really, just around how you use the tools. That would be my first question as it relates to pricing. And I have a quick follow up.

Jorge Collazo: Sure. Hi, Ben. So just taking a step back. The general way that we think of pricing is we want to make sure we grow our relative competitive position in the market in terms of share of revenues. And the pricing that we can get is really a solver to that as long as

we continue improving, even marginally. But we want to keep improving our relative competitive position. And really price is a function of what we can do within that context.

And also taking into account, particularities in areas that have been impacted by weather events or something like that, we want to make sure we maintain our affordability. That's like the general overall strategy and framework, Ben. And really what we have is the analytics team has developed very advanced RGM tools and price optimiser tools. Let us do -- like I mentioned before, we would have to review these monthly or quarterly segmented. And now it's done by customer just with a lot more a higher uplift in all of these strategies, much more targeted. So I credit this not with the front end digital tools, but really the back end AI advanced AutoML models that we have developed both on the pricing optimiser and RGM tools.

Ben Theurer: Okay. Perfect. And then as you think about rolling out the technology, and we've talked a lot in the past about version 4.0 and like the different iterations as it goes beyond the recurrent statues. What is like your thinking as well of rolling out these initiatives? Some of the other markets, particularly Central America, as it relates to just the digital platforms to really drive growth there as well.

Jorge Collazo: Well, we're growing faster than we had planned at the start of the year. So the only two countries that we will have left is Argentina and Uruguay, which will be rolled out in the first quarter. So version 4.0 will be available in all of KOF. The results are very good in Central America as well. The feedback is very positive. It's stable. It's growing quickly. So we have nothing to add on that. It's faster than schedule and will be done by the first quarter.

And I come back to bend what I what I mentioned to Alejandro from Itau, which is the Advisor. That's something that's going to give us a big boost. Juntos+ Advisor, just think of it, we still have a large proportion of our sales that go through our pre-seller. And even as sales from our pre-seller go down in mix towards our digital channels, we're still going to keep our feet on the street. And this tool allows it to drive all of these guided initiatives, guided missions that include execution missions, new product introduction mission. So it's just going to be a big boost to the other 70% of our sales that went to other channels. So I think that's going to be a big uplift that we didn't have visibility on. And it's surprising us to the upside in what we're rolling out in Brazil.

Ben Theurer: Perfect. Congrats. Thank you very much.

Jorge Collazo: Thank you. Ben.

Operator: Thank you. Our next question is from Fernando Olvera with Bank of America. Please go ahead.

Fernando Olvera: Hi. Good morning, everyone, and thanks for taking my questions. And the first one is related to Mexico. If you can comment more about the volume decline that you registered during the quarter and mainly in water. And it would be great to hear your thoughts about consumption environment going forward. And my second question is related to Argentina. If you can expand on the recovery that you are seeing

Fernando Olvera: because it seems that it's going faster than expected. And what is your outlook for coming quarters? Thank you.

Jorge Collazo: Hi, Felipe. How are you? I think in Mexico you have to think of it in two main drivers. That it's very hard for us to quantify what comes from which of these two variables. But the first one is, I think our region in Mexico, had a huge increase in rainfall and precipitation. So it was 50% higher than the same quarter of last year. Total precipitation as of September of 2024 was already 6% higher than precipitation for the full year of 2023.

So I think we're very grateful that we received all of this rain because it solved all of the water reservoir levels, which were low, and now they're all above 60 plus percent. So we have very good water levels in the reservoirs in our region. But the downside of it is that it did have an impact on consumption. As you know, our consumption relates to precipitation very directly, and we had a lot of rainfall. And it also complicated our Acapulco plant as well and our logistics in general. So that was one cause there. And that's probably going to be maybe a recurrent weather pattern with this new climate reality, these more extreme heats and rainfalls.

And then on the other part, you have a decrease in economic activity. So I think there were quite a bit of payments and help that might have been advanced before elections. And we enjoyed the benefits of that in consumption. But when you look at gross disposable income, the monthly Economic Activity Indicator IGAE for August and September, and you see sequential declines versus what we had at the June levels. So it is true that Mexico has been slower. And we see this across categories. I think beverages is probably more impacted in our part of the country because of this hurricanes and tropical rains. So those are the two effects that we see.

Like we mentioned in the call, I think we're very positive in Mexico in general in the medium term, Fernando, because we're going to be having many infrastructure projects in our corner of Mexico. Now, it's going to be the Queretaro, Mexico City train line. The other projects continue on track with expansions, as well. Then the government has announced new also social programs, and all of these translate directly to increasing disposable income and consumption of our category. So I think our view on Mexico is positive on wages and positive on consumption for us. So that should be good in the medium term.

And then we have Argentina, which I think we developed a good playbook there with a local team. We went in there knowing that it was going to be a very acute crisis, and we had to maintain or we wanted to maintain household penetration and customer base. And we took affordability very seriously, expanded it, reduced our gap in competitive gap versus the other competitors that were out there. And I think the playbook played out very nicely where we had flat volumes for this quarter and hopefully we can have positive volumes for the fourth quarter.

It's going to be a very slow and gradual recovery because the crisis has been sharp. But I think the government is taking many right actions and gradually we are recovering. And the playbook that was laid out is working very well. So I think we're positive on Argentina, but we want to be cautious that it's not -- I don't think it's going to be a V-shaped recovery but a gradual recovery there. And that's what we're seeing. So far so good.

Fernando Olvera: Great. Thank you so much.

Jorge Collazo: Thank you. Perfect.

Operator: Thank you. Our next question is from Lucas Murphy [?] with Morgan Stanley. Please go ahead.

Lucas Murphy: Hi, everyone. Thanks for taking my question. I have one on Mexico, particularly on margins. We finally started to see sugar prices behaving a little bit better on the margin and translating into a better gross margin environment for Mexico. So I wanted to hear our latest thoughts thinking about next year. How comfortable are you that sugar in Mexico could continue to be a tailwind for your margins, for your costs? We know that the Mexican prices are not necessarily correlated to international quotes, but there was a relevant recent uptick on international sugar prices. We also have a weaker Mexican peso. So just wanted to hear your latest thoughts on how sustainable you think this tailwind can be for the Mexican division coming into 2025. And that's my first question.

My second question is also on Argentina. But if you could elabourate a little bit better as it pertains to your strategy. I think that it is safe to say that today you have a strategy that is looking more tilted towards a volume performance, maintaining volumes, and I think that the flattish performance is actually quite impressive, especially compared to other players that have operations in the region. But I wanted to know, what about your margin perspective? Are you guys being able to perhaps offset a more conservative pricing environment with more efficiencies? So just wanted to hear your thoughts on margins in Argentina. That's it. Thanks for the time, guys.

Gerardo Cruz: Hi, Lucas, and thank you for your question. I'll start with Mexico. Gross margin, we saw margins expanding this quarter, mainly on the back of things that you mentioned. Better outlook or better situation in the sweeteners cost as well as packaging and also revenue management initiatives that allowed us to perform better in gross margins this quarter. As we move forward, and looking at the general raw material environment, we do expect stability. We do expect sugar to continue to be a tailwind locally in the Mexican market. But in general, we don't expect to see pressure. So that should continue to be something that will help the performance as we move on.

In terms of Argentina, the general strategy has been, as you mentioned, to favour volumes, to gain relative scale. We have learned in many years that during tougher situations, we usually come out stronger at the other end. So this is what we're favouring. Trying to position ourselves better in terms of affordability. Understanding that consumers are at a complicated situation and that has proven to be a good position for us.

Jorge Collazo: I think if you think of it in terms of margins, we did have a contraction this year. Both of the overall EBIT as well as in terms of margins. So this double digit contraction in EBIT and I think we contracted 200 plus basis points on margins. I think our next year, for example, we should see the reverse of that. High double digit growth on EBIT, maybe 100 plus points on margin. But it's a gradual recovery that's going to take it's time, Lucas.

Lucas Murphy: That is very clear. Thanks.

Operator: Thank you. Our next question is from Antonio Hernandez with Activest [?]. Please go ahead.

Antonio Hernandez: Hi. Good morning. Thanks for taking my question. Congrats on the results. Just wanted to understand regarding, you expanded the operating margin, gross margin and EBITDA margin. But looking at the difference between the EBIT margin expansion and the EBITDA margin expansion and seeing that they're not operating non-cash charges grew, well, higher than sales and higher than other metrics year over year. Could you elabourate a little bit more on that, and the drivers of that growth and maybe core operating non-cash charges? Thanks.

Gerardo Cruz: Thank you, Antonio. We would have had

Gerardo Cruz: a better performance in EBIT margins similar to what we saw in EBITDA margins, but we had two main virtual effects that affected EBIT margins more. The first one is the one that we've been talking about for the past few months, which is a depreciation of the Mexican peso and the non-cash effect that, that has on dollar denominated accounts payable.

The second effect was a reclassification of a guaranteed deposits that should have been in the balance sheet as accounts receivable and had been registered in the P&L. So we corrected that effect. But in terms of the full year, this effect is neutralised in full year numbers. This was for an amount of about $220 million.

Antonio Hernandez: Okay. Thanks for that, colour. And just a quick follow up on what you mentioned, weather headwinds and all the different challenges in terms of volumes in Mexico. But if there was anything of that volume performance driven by stock-outs.

Jorge Collazo: Hello, Antonio. It's Jorge here. Yes. Actually we did have also an effect of stock-outs in Mexico, mainly at the beginning. And so it's something that, as you know, we have been seeing in Mexico. And that's one thing that we think we're going to take advantage of next year, because as Ian mentioned, we have been expanding capacity in Mexico. If you look at his prepared remarks, he expanded a lot, not only on the bottling facilities that we are expanding on the capacity, but also in warehouse capacity, in route to market, in trucks and also in the primary distribution, secondary distribution. So we don't see that as a big of an impact going forward.

But still in the third quarter at the beginning, we did see a little bit of an impact there from stock-outs. And I think it also explains and I will connect a little bit of the question from Fer, because if you look at category performance in Mexico, actually brand Coca-Cola outperformed, but because of stock-outs, we did have an impact on flavoured sparkling. So it explains the stock-outs.

Antonio Hernandez: Perfect. Thanks for that, Jorge. [inaudible].

Jorge Collazo: Thank you.

Operator: Thank you. Our next question comes from Thiago Jardim with Citi. Please go ahead.

Thiago Jardim: Yes. Hello, Ian, Gerardo and Jorge. The first, congrats on the results and thank you for taking my questions. I'd like to explore two topics here. The first one is focusing a bit more on Brazil. So just wondering here what you're seeing for the region, specifically in terms of profitability for next year. We understand here that there could be positive impacts first from operating leverage, as the Porto Alegre plant gets back online and hopefully we have some product mix from the Coca-Cola Zero.

And my second question would be, so continuing here with the Coca-Cola Zero, we understand it has a lot of potential. We've seen very good acceptance of the product here in Brazil. So just

wondering, maybe not specifically for Brazil, but for other regions. What's the potential you're seeing here for this product in terms of like market penetration and specifically also profitability? So whatever information you can share with us, we'll appreciate it here. Thank you.

Gerardo Cruz: I'll start with the first one, Thiago, good morning, regarding profitability in Brazil. As I mentioned, I think in one of the previous questions, fourth quarter in Brazil, we do expect to see higher pressure from the Porto Alegre deficit in capacity. As you know, we will be recovering that capacity mainly during the first quarter of next year. So we do expect the high season in Brazil to have a higher impact in freights and whatever we're being able to buy from other franchises, both from Coca-Cola FEMSA and other bottlers.

Obviously, we sell at zero profit to maintain a position in the region. So that will present a challenge in terms of profitability. We do expect demand to continue to perform, but in terms of supply, we will be limited, so that will pose some pressure. As we move forward to next year, and I think we talked a little bit about this as well. Next year, with the plant coming back online and all of the things that we're doing there as a result of the disaster that we had, we do expect that that will be a tailwind for 2025.

Jorge Collazo: Also, I think in terms of Coke no sugar, Brazil has been an inspiration for all of the markets. It's doing very well, growing very high double digits. And the good thing that I can say is probably Mexico was the one market where we have been having a tougher time with Coke Zero. A very small proportion of the mix, almost 3% compared to 20% in Brazil in Cola. But what we have been seeing now in Mexico is it's finally starting to accelerate.

So in this third quarter, we had high single digit growth in Mexico. We're trying to emulate the Brazilian playbook, which is a 360 degree playbook with entry price points, the right packages, influencers, a 360 degree plan, properties such as music festivals, soccer, and also in and out for the brand like Oreo and other flavour varieties. The one bright spot that I would say outside is, it's starting to accelerate in Mexico. It's too early to say that this is sustainable. But if we can keep this up and emulate what we have done in Brazil, in this other very large market, could get very positive results.

Thiago Jardim: Fantastic. Thank you very much.

Operator: Thank you very much. As a reminder, if you would like to ask a question on today's call, you may press star one on your telephone keypad to register your question. Our next question is from Ulises Argote with Santander. Please go ahead.

Operator: My apologies, Mr. Argote, your line is a little bit -- we cannot hear you. Apologies to our hosts. We cannot hear Mr. Argote's line. Perhaps he could submit his question offline.

Jorge Collazo: Yeah, maybe, Ulises -- Hello, Ulises?

Operator: Mr. Argote, if you'd like to try one more time.

Ulises Argote: Is it better now?

Operator: Oh, yes it is. Thank you. Please go ahead.

Ulises Argote: Oh, thank you very much. Apologies there. So the question was more around market share dynamics in Mexico. I was wondering if you could provide any colour on how this has been evolving more recently, particularly given that the volumes that we saw in Mexico are kind of declining for the third quarter. And in this sense, maybe how you're kind of tying this on your pricing versus volume strategy heading into next year. Thank you guys.

Jorge Collazo: Yes. Hello, Ulises. I'm glad you managed to sort that out there with the audio. Yeah. Regarding market share in Mexico, I think what we have seen is a little bit of a mixed performance because what we have been focusing on with the strategy, as you know, we have been discussing is reversing the trend that we had in brand Coca-Cola. So with the current environment where we are in, we have been protecting share in brand Coca-Cola. But in hindsight, I'm connecting that with stock-outs as well, as we mentioned in the previous question, we have had some share erosion in flavours, and as a result there is a little bit of loss of share in the sparkling. Cola has been just slightly down.

I would say, this has not been a bright spot. We reversed the trend last year and this year we lost share. I attribute that mostly Ulises to the stock-out situations. That has pretty much been sorted out. So we are hoping to now start seeing a stabilisation and recover to our balanced and sustainable growth strategy. But this year Mexico has not been a bright spot in share, and I attribute most of that to our underperformance in supplying our customers.

Ulises Argote: Perfect. That's very clear. And any comments into how you're thinking on pricing volumes, maybe on this backdrop into next year?

Jorge Collazo: I think I mentioned before that we want to make sure we recover our competitive position. We have plenty of points, almost 500 basis points of share that we need to recover in Mexico. So that's a big objective for us. And the pricing that we will display is really a solver of what we can do while maintaining the strategy of gradually recovering the share erosion that we have had over the last ten years. So it's really a solver. And we want to

make sure this is a scale game that we improve our relative scale position. So it's dependent on that, Ulises.

Ulises Argote: All right. Very clear. Thank you very much.

Jorge Collazo: Thanks.

Operator: Thank you very much. As we have no further questions, I would like to turn the call back over to Mr. Collazo for any closing remarks.

Jorge Collazo: Well, thank you, everyone, for your interest in today's call for joining us today. And as always, myself, the rest of the investor relations team, we are available for any remaining of your questions and we look forward to seeing you very soon. Thank you.

Operator: Thank you very much. That concludes today's conference. We appreciate your participation. Have a wonderful weekend.

[END OF TRANSCRIPT]