Conference Call Transcript
Investor Update Webcast
Arcos Dorados (ARCO)
January 26, 2022

Dan Schleiniger:

Good morning everyone. Thank you for joining our Investor Update webcast. With us today are:

- Marcelo Rabach, our Chief Executive Officer, And
- Mariano Tannenbaum, our Chief Financial Officer.

Today's webcast, which is being recorded, will consist of prepared remarks from our leadership team, which will be accompanied by a slide presentation, also available in the Investor section of our website, www.arcosdorados.com/ir.

To better view the presentation on the webcast platform, we suggest you scroll over the upper left-hand part of the screen and click on the arrows to maximize the slides. After our speakers conclude their opening remarks, we will answer your questions, which you can submit using the chat function on the left-hand side of the screen. You will need to minimize the slides to access the chat function.

I will begin by making the following Safe Harbor statement. Today's call will contain forward-looking statements and I refer you to the forward-looking statement section of this morning's press release and recent filings with the SEC. We assume no obligation to update or revise any forward-looking statements to reflect new or changed events or circumstances.

In addition to reporting financial results in accordance with Generally Accepted Accounting Principles, we report certain non-GAAP financial results. Investors are encouraged to review the reconciliation of these non-GAAP financial results, as compared with GAAP results, which can be found in the press releases and financial statements previously filed with the SEC on Forms 6-K and 20-F.

Unless otherwise noted, our discussion today excludes the results of the Venezuelan operation both at the Consolidated level as well as the SLAD Division, due to the country's ongoing macroeconomic volatility.

Marcelo, I'll turn it over to you now.

Marcelo Rabach:

Thanks Dan and thank you to everyone who has joined us on today's webcast. I hope you are all in good health and that 2022 is off to a great start for you and your families.

Today you will have an early view of our very strong fourth quarter, which included accelerating 2-year systemwide comparable sales growth and record quarterly profitability.

As we mentioned on our last call, we now have enough visibility to return to our three-year and long-term growth planning. So today we will go through our plans to re-accelerate restaurant openings and modernizations, with a focus on free-standing units. This plan is supported by strong cash flow generation and a solid balance sheet as well as continued McDonald's Growth Support.

Looking further into the future, we will also share our view of the robust 10-year growth potential for the McDonald's Brand in our territories. We will show you that the Brand remains underpenetrated and how we estimated the long-term growth potential. You will also learn how we are unlocking even more growth by deploying new technologies and restaurant designs.

Finally, we will take a closer look at how free-standing restaurants are emerging from the pandemic with structurally higher sales per unit. Both OFF-premise channels (namely, Drive-thru and Delivery) continue to be sticky with sustained sales growth. This is happening even as the ON-premise channels are recovering with a boost from the in-restaurant Digital platform, such as the self-order-kiosks in the Experience of the Future locations. We expect these trends to continue as the operating environment normalizes even more this year.

I'll start the fourth quarter 2021 update by going through 2-year comparable sales growth and then I'll turn it over to Mariano to preview how this impacted profitability.

We are very pleased with our performance in 2021 and are particularly encouraged by the positive trends in sales during the second semester of the year. Systemwide comparable sales growth on a 2-year basis gained momentum during the fourth quarter of 2021, rising 24.2% and beating accumulated inflation in most markets. Keep in mind that this compares with the very strong results we generated in the fourth quarter of 2019.

Brazil's 2-year comparable sales improved on the prior quarter's result, growing 5.7% on top of its outstanding fourth quarter of 2019. Seasonal sales trends returned to the market, with more normal, sequential growth between October and December. This growth culminated in over 1.0 billion reais in gross sales in December, a record monthly sales figure for the Division.

On our last earnings call we mentioned that the Company was reorganized into three divisions as of October 1st, 2021. NOLAD, which was made up of Mexico, Costa Rica and Panama, now also includes Puerto Rico, the US Virgin Islands and the French West Indies markets.

Comparable sales for the reorganized NOLAD division benefitted mainly from steady, strong growth in Mexico and Puerto Rico throughout the quarter. Several of the other markets were still dealing with government-imposed operating restrictions but saw improving sales trends, especially toward the end of the quarter.

SLAD also expanded its geographic footprint. In addition to Argentina, Chile, Uruguay, Ecuador and Peru, SLAD now includes Colombia, Venezuela, Trinidad and the Dutch West Indies markets.

The Division's 2-year comparable sales growth during the quarter includes the impact of Argentina's high inflation. More importantly, nearly all SLAD markets grew significantly above the period's accumulated inflation, notably Argentina, Colombia and Chile. Chile's growth also reflects a comparison with weaker results caused by social unrest in the fourth quarter of 2019.

The Three D's strategy continues to resonate with restaurant guests and the McDonald's Brand is even stronger as a result. Through our Digital platform, we are gaining a deeper understanding of consumer preferences and strengthening the emotional connection between our guests and the Brand. We offer the industry's widest range of value options and the greatest convenience for guests to enjoy their favorite McDonald's menu items. This includes the industry's largest free-standing restaurant portfolio, which represents a structural competitive advantage that we believe will last into the foreseeable future.

With that said, we think our results speak louder than words. Arcos Dorados' sales growth and market share gains have been consistent for the last several years. EBITDA and operating cash flow generation turned positive and accelerated since the third quarter of 2020 as well.

Over now to Mariano, who will give us some color on how we finished the year in terms of profitability.

Mariano Tannenbaum:

Sure Marcelo. Good morning everyone.

You just heard about the strong sales we generated in the fourth quarter of 2021. I am very pleased to tell you that this translated into our best quarterly EBITDA ever. We are in the process of auditing our results so we will provide the exact figures and margins on our next earnings call, but based on preliminary results we estimate fourth quarter 2021 Adjusted EBITDA surpassed the previous quarterly record established in the fourth quarter of 2019.

Our strategy is driving sustainable sales growth by taking advantage of an unmatched restaurant portfolio and we are also managing our costs and expenses effectively.

Gross margin was in-line with or better than 2019 both in 2020, and again in 2021, thanks to sophisticated revenue management and an outstanding, highly-localized supply chain. Payroll costs reflected significant productivity gains with the structural volume shift to more off-premise sales as well as government support that helped protect our team members' sources of income. Meanwhile, the development team has done an excellent job with rent expenses, which are already back to pre-pandemic levels as a percentage of sales.

Given this strong EBITDA performance, we finished 2021 with a very comfortable cash position. We have no major debt maturities until September of 2023 and, since our debt was issued with fixed interest rates and is about 50/50 swapped between the US dollar and the Brazilian real, we have also been protected from rising variable interest rates and currency fluctuations in the last several months. As a result, our Net Debt to Adjusted EBITDA ratio was below 2.0x as of December 31st, 2021.

We are excited about the direction of the business as we begin the 2022 to 2024 growth cycle.

As Marcelo mentioned we now have enough visibility to get back to long-term planning as well as our agreements with McDonald's for three-year restaurant openings, capital expenditures and Growth Support.

So today we are announcing our growth plan for 2022 to 2024. Over these next three years we expect to deploy about $650 million dollars in capex for:

1. At least 200 new restaurants openings,
2. Another 400 modernizations,
3. Maintenance of the existing restaurants across the region, And,
4. Initiatives to extend our leadership in the Digital arena such as:
    a. Developing more ways to enhance guest convenience and loyalty,
    b. Upgrading our IT infrastructure and,
    c. Expanding our Data Analysis capabilities.

Each of the next three years will see sequentially higher openings and investments than the previous year. The 2022 starting point includes total capex of $180 to $200 million dollars for:

1. At least 55 new restaurant openings,
2. Around 75 restaurant modernizations, as well as,
3. Maintenance capex and investments in Digital.

As part of the three-year plan, McDonald's has agreed to continue providing Arcos Dorados with Growth Support, which is expected to lower the effective royalty rate to 5.6% in 2022 and about 6.0% in both 2023 and 2024.

The details of this new plan are important to understand because simple unit growth does not tell the whole story. Total new restaurant openings from 2022 to 2024 is about the same as we delivered in the last pre-pandemic cycle from 2017 to 2019. But this time we are planning to open twice as many free-standing restaurants.

In fact, the plan includes the highest-ever three-year total of free-standing openings in Arcos Dorados' history! Around 90% of new unit openings in the next three years are expected to be free-standing restaurants, optimized to take full advantage of the Drive-thru and Delivery sales channels while still offering guests the aspirational and convenient experience of on-premise dining. Geographically, about 60% of new unit openings will be in Brazil, with Chile, Panama and Costa Rica accounting for a large portion of the remaining openings.

We plan to fully fund this investment plan with cash on hand and cash generated from operations over the next three years.

Marcelo Rabach:

With that preliminary view of the fourth quarter and formal guidance for the next three years, I would now like to share some "behind the scenes" insights into our planning process. Building a long-term growth pipeline depends on much more than just cash generation and architectural plans. It takes know-how, which we have developed, and time, which we have invested. You will see that when we talk about "potential" we are referring to an achievable target based on actual future restaurant locations and/or desirable trade areas.

One very important premise to understand is that the McDonald's Brand, and indeed the QSR industry, are still highly under-penetrated in our geography. Based on 2020 data from the UN, there were 10 times as many people per McDonald's restaurant in Arcos Dorados' territories as compared with the United States, which is its most developed market.

We know that there are important socio-economic differences between the US and Latin America and the Caribbean. But World Bank numbers tell us that the GDP per McDonald's restaurant in our territories, adjusted for Purchasing Power Parity, is still 2.6 times as high as the United States. In other words, our guests' purchasing power can support robust growth for many years to come.

To find those guests and assess growth potential, we take several approaches to build a consensus estimate on a market by market basis. The Technical, or "Desktop", Approach assumes that we can reach the same unit penetration rate as similar markets in more-developed geographies of the McDonald's System. The low-end potential target starts with the number of restaurants necessary to bring all our markets up to the Arcos Dorados average rate.

The upper-end correlates volume and store density in International Markets and then runs a multivariable model (including GDP, population and number of stores) for each Arcos market to compute a more realistic openings target.

The Empirical Approach assesses market potential at a more granular level. It starts with the Development team researching and monitoring thousands of minimarkets within our 20 countries, which they have done as part of their regular duties for more than 10 years.

They have identified specific Focal Points within the minimarkets for potential new restaurant openings. This includes projected growth in shopping centers, which have been an important contributor to unit growth in the past. Given the impact of the pandemic on consumer trends, we have re-assessed the potential for each of these Focal Points.

Comparing estimates from the Technical and Empirical Approaches, we arrive at a consensus estimate for each of our markets. We then validated our assessment with third parties including the McDonald's Strategy and Analytics team, real estate development experts and investment banking partners.

Our conclusion is that, over the next 10 years, we can open at least 1,000 new McDonald's restaurants in Latin America and the Caribbean.

In order to maximize sales, we have been introducing new formats and technologies to capitalize on migration trends and changing consumer preferences, such as:

1. Dedicated Drive-thru teams and volume-enhancing layouts,
2. Delivery pick-up windows that reduce wait times and improve execution,
3. Mobile Order and Pay that allows guests to choose where to receive their orders,
4. Digital Kiosks where guests customize their orders and avoid lines at the front counter,
5. And other innovative features such as vertical food transporters from the kitchen to upper or lower floors of the restaurant.

Restaurant designs are also changing, and we will be bringing more news on that throughout 2022. One experience that I would like to share with you today is the success of a relatively new restaurant in São Paulo on the iconic Ibirapuera Avenue.

This is a two-story restaurant, sitting at an intersection that optimizes both Drive-thru and Delivery. The unique design includes a second-floor kitchen to maximize first-floor dining capacity and capture more on-premise dining.

Two of the most important learnings from this location are that we can build free-standing restaurants on 50% smaller footprints in places where larger lots are hard to find. And, more importantly, penetration generates demand. Sales at the other nearby McDonald's restaurants continued to grow even after this new location opened, which means that we can unlock new trade areas by thinking outside the box and making it more convenient for guests to visit us.

In order to select new sites and markets, we apply in-house tools, methodologies and processes we developed locally or that are available within the global McDonald's System. Although time constraints limit us to this very-high-level description of some of these tools, we hope it provides a better understanding of the level of sophistication required to actually capture long-term growth potential.

Mariano Tannenbaum:

Now that we know where, how and why we can re-accelerate inorganic growth, let's talk about organic growth drivers.

Drive-thru and Delivery sales have been very sticky, which has led to structurally-higher sales per restaurant. Remember that during the third quarter, Drive-thru sales grew double-digits in local currency, even with the gradual recovery of on-premise channels. Delivery grew better than 40% in local currency across the region and was even stronger in Brazil, where Delivery sales in Brazilian reais grew to more than 3 times that of the next closest competitor.

Not surprisingly, the greatest beneficiary of the Three D's Strategy has been the free-standing restaurant. Sales per free-standing restaurant were almost 25% higher in 2021 than 2019 in local currency. This represented growth of about 1.4x the blended inflation rate for the period, which means we generated real, sustainable, structurally-higher sales per restaurant.

Meanwhile, on-premise sales are enjoying a boost from the in-restaurant Digital platform. We have more than 800 EOTF restaurants in our footprint. All of them include self-order kiosks that gained in popularity compared with the pre-pandemic period.

Guests value the ability to customize their orders and prefer to avoid lines at the front counter. In fact, self-order kiosks accounted for more than 50% of on-premise volume in EOTF restaurants in 2021 versus less than 30% in 2019.

This is important, because the self-order kiosk also generates a 15 to 20% higher average check compared with the front counter in most markets. These two factors are contributing to the organic growth of existing EOTF restaurants and will also help drive organic sales growth in the 400 or so restaurants we will modernize in the next three years.

Marcelo, back to you for some final thoughts.

Marcelo Rabach:

Thanks Mariano. When the pandemic began, we reacted quickly and decisively to stabilize the business. More importantly, we kept our focus on the long-term. The Three D's strategy helped us navigate the last two years more successfully than any other restaurant company in the region and we believe it will continue to pay dividends in more normalized markets.

We are the first-movers in Digital and have only begun to scratch the surface of what is possible in the future. Drive-thru is here to stay and no other operator has as many free-standing locations or operates Drive-thru as efficiently as we do. And Delivery has created a new consumption occasion that has remained sticky, even as on-premise dining recovers.

This will generate sustainable, long-term value for our shareholders. The Three D's help us run great restaurants, delivering the best guest experience in the industry and creating an even stronger emotional connection with the world's favorite QSR brand.

We also committed early-on to serving our communities and protecting the environment. You can learn more about the six pillars of our Recipe for the Future, by downloading the global restaurant industry's only audited ESG report from our website.

Finally, we remain committed to prudent capital allocation and risk management for the long-term benefit of all stakeholders. And, while there is still a lot of work to do, we are very pleased with our progress so far and the momentum we continue to see in the business.

Dan, we are ready to start the Q&A session.

Dan Schleiniger:

Sure Marcelo. In order to get started, please minimize the presentation slides so that you can access the chat function on the left-hand side of the webcast platform. I will be moderating today's Q&A session so please limit yourself to one or two questions so that I can read, understand and convey them to our speakers. We will now pause briefly to compile your questions.

Jim Sanderson, Northcoast Research (via webcast):

Could you provide the distances between nearby stores already built and the new smaller footprint store for Drive Ibirapuera, the case that you presented with digital and off-premises being higher than the new store, and whether digital and off premises is higher at the new store? And how does this compare to traditional cannibalization when a new store open in markets where McDonald's is already present?

Marcelo Rabach:

OK, Jim, thanks for the question. This particular mini market, this trading area, it is a relatively high penetrated mini market. But what we found is the opportunity to put this new restaurant in a very important focal point, which is the cross of a high-transit avenue with another high-transit street.

Thanks to the changes in the design, we were able to put that freestanding in less than half, in fact, regular lot for a freestanding. And what we saw is that, in the closest restaurant to this one, which is about 1km from this restaurant, we saw no impact in terms of sales. And basically, what we saw is that these new restaurant captured some additional sales available in this trading area that the existing restaurants were not capturing.

It is true that there were, and there are, some competitors restaurants close to these ones, so, for sure, the impact on those ones should be important.

But this is very encouraging because in big cities like Sao Paulo, like Bogota, Buenos Aires, Mexico City, Santiago in Chile, typically, in very dense population areas, having the opportunity to access big lots is not that easy.

So we are very encouraged with the results of this restaurant because we can offer the full McDonald's experience. We can operate drive-thru, we can operate the delivery in a very efficient way, and we have a high capacity in terms of dining area because we have put the kitchen on the second floor, and with the transporter, we send the food to the front counter, the drive thru and delivery area with a very lean operation, a very smooth operation.

So we are very encouraged with the restaurants, and obviously, this unlocks many opportunities in in big cities, like the ones I mentioned before, across the region.

Dennis Reiland, Private Management Group (via webcast):

Could you discuss labor cost trends in your markets?

Mariano Tannenbaum:

Thanks for the question, and good morning, good evening to everybody. During 2021, we have seen important gains in in this line, mainly from productivity gains in the stores. Remember that we have seen many sales going off-premise, and that brings productivity and decreases labor costs for us, and we are very happy with the development of that line. As you know, is the second in importance in terms of costs for the Company.

Going forward, as we expect to continue delivering strong sales through off-premise, but also increasing on-premise sales, we are expecting to maintain the gains that we have seen so far in 2021, with the exception, maybe, of the government support that we received in some markets due to the pandemic and the closures of our restaurants that occurred in 2020, but also in some months of 2021.

So it is going to be a challenge, but we are sure that we will be able to maintain the good results that we have seen in that line going forward.

João Andrade, Bradesco BBI (via webcast):

Thank you for taking my question. How did you model the competition's expansion into your 1,000 restaurants potential?

Ulisses Argote, JPMorgan (via webcast):

Thanks for the call. Great to see improving trends. What countries do you foresee being the main focus point for growth? And what do you think are the key drivers in those regions to support this growth?

Marcelo Rabach:

Thanks to both of you for the question. I think that the first thing to reinforce here is that, not only for the McDonald's brand, but indeed for the QSR industry as a whole, the region, many of our countries, are still highly underpenetrated.

So I think, based on the experience of these past few years, that competition will grow, too. I think that the main difference we are planning to execute going forward is the shift to a more freestanding focus expansion.

In fact, as we told you in the opening remarks, we will open twice as much freestandings in these three years, from 2022 to 2024, than in the last cycle, 2017 to 2019, prior to the pandemic.

This is a more difficult store type to develop, because typically between you find the right site and make an agreement to buy it or to rent it, until the moment you turn the key and open the restaurant, depending on the market, it takes from 12 to 14 months up to more than 24 months in some markets.

So I think that this is important for us, and we were reinforcing our development teams in most of our markets in order to build this pipeline, and we are very pleased with the results we saw in recent openings.

If you take a look at our openings in 2020 and 2021, most of those were freestanding units, the kind of restaurants we are planning to open going forward. And in almost every case, our sales are beating projections and the returns are pretty good.

So we think that the competition will grow, too, but I firmly believe that we are in a very strong position in order to capture the best sites in the region thanks to the strength of our brand, and particularly, thanks to the average unit volume we have, which is typically much higher than our competitors.

And in terms of the markets, as we mentioned during the opening remarks too, we still have some markets which are below the average rate of penetration of our Company. If you take a look to the markets where we announced we will be focusing on this coming three years, obviously Brazil will continue to have the majority of the investments, we are calculating that around 60% of our openings will be in Brazil. And then there are other markets which are important for us with strong results, volumes and profitability, like Chile, Panama, Costa Rica and others that will follow Brazil.

So we are taking a closer look to every and each single market, and we will pursue any opportunity for good returns all across our region. There is no market where we say we are done. We will take a look at each one of the 20 territories we operate.

Jeronimo de Guzman, INCA Investments (via webcast):

Now that you have returned to profitability levels closer to 2019, how much further upside do you see in margins, and where are the biggest areas of opportunity?

Mariano Tannenbaum:

Thank you, Jeronimo, for the question. In fact, in 2019, if you remember, we had a 10% EBITDA margin. We are confident that when we finalize the numbers for 2021, we will be in a similar range.

And for 2022, our outlook, of course we do not give margin guidance, but what we can tell you is that we have been doing in the last two years a lot of cost management exercises in every single line of our P&L. We improved our food and paper, we improved our labor costs. We negotiated with landlords to have all the rent expenses in line. We just mentioned the agreement with McDonald's in order to have the service fee aligned with the interests of McDonald's and Arcos Dorados for growth in the region, lowering the royalty payments. We have been doing a lot on the fixed costs as well.

So I think that in the next phase, for 2022 and onwards, we will be able to maintain and of course we will try to improve our margins. And I think that improvement will come mainly from a recovery from our sales.

We did a lot already, as I've mentioned, on the cost side. And now that we are getting out from the closures and the quarantines and different restrictions that the government imposed during these last two years, we think that the improvement will come from leverage on sales.

Our business is a volume business, and as long as we continue recovering volumes through on-premises and off-premises sales, we are sure that that will be the boost on our margins by diluting all our fixed costs.

So I think that it will come from there, from a recovery on our sales. And we already mentioned all the things that we are doing to recover sales that were very successful in 2021, and they will be even more successful in 2022 and onwards.

Thiago Bortoluci, Goldman Sachs (via webcast):

Marcelo and team, thanks for the update, and congrats on the outlook. From which regions in Brazil should we expect this expansion coming from, and what are the implications for ROIC in the short term and the long term?

Could you please break traffic and ticket trends down for the strong preliminary results shared for the 4Q21?

And how have the recent spike of Covid and the return of some restrictions been impacting your performance in 2022?

Marcelo Rabach:

Hi, Thiago, and thanks for joining us today. Beginning with which regions in Brazil, as I mentioned before, we are unlocking some opportunities even in regions or mini markets where we typically thought in the past that we were OK with the amount of restaurants we had in those areas. So I think that we still have opportunities in regions where we have most of our restaurants, namely

Sao Paulo, Rio, or even the states of Sao Paulo, Rio de Janeiro and Minas Gerais, the three states in the south, Brasilia.

There are many, many cities where we typically see a lot of McDonald's restaurants, but even in those cities, there are still opportunities to increase our footprint and to continue capturing additional demand.

So I would tell you that our growth in Brazil will continue to be balanced. And it is important to mention that, looking at the past, we have typically a big proportion of our openings coming from new shopping malls.

As of today, we do not have enough visibility in terms of when that industry will resume its own growth with new shopping malls. But for sure, those will be additional opportunities to those we are already looking at in terms of freestanding units, and typically that happens all across Brazil.

In terms of the break between traffic and ticket trends for the 4Q21, we continue to see a very strong performance in terms of average check, because drive thru and delivery, which are two business segments where average check is typically higher than in other ones, those two channels have demonstrated to be extremely sticky, and we continue to see even growth in those two business segments. So average check continues to leverage our sales.

Meanwhile, the on-premise channels, particularly from counter and dessert centers, continue to recover, but we are still below the traffic we have in those two business segments when compared to 2019.

Finally, on my side at least, in terms of the spike on Covid and the return of some restrictions, I would say that, in terms of the restrictions we are facing these days compared with 2020, or even the beginning of 2021, we are in a much better position.

So far, as of today, we are facing some restrictions in terms of hours of operations because there are some curfew in some islands in the Caribbean region, like Puerto Rico or the French West Indies. And then there are other markets like Ecuador or Peru, where we are not allowed to use 100% of our capacity in the dining rooms.

But even with those restrictions, we are doing well, in line with consolidated labels with our expectations for safe growth in the first couple of weeks of January. So, I would say that we are in a good situation in terms of the restrictions, and as it was the case for other areas of the world, what we are seeing is that in many cases, the omicron wave of the pandemic starts very fast and get in very high numbers early, but at the same time, once that peak is reached, it goes down very fast too.

So, on top of what I already said, this is a relatively low season for us in terms of sales. Remember that the second semester is the stronger for us, particularly months like July and December. So in this moment of the year, the impact is not that great on.

Mariano, if you want to cover the fourth part of the question.

Mariano Tannenbaum:

Great, Marcelo. In terms of returns, we are confident that there is still a lot of opportunities for growth and that will not affect the returns we have been achieving so far. First, as we mentioned, the off-premises sales that we are seeing in the freestanding units are increasing the returns on those type of investments, and that is why we are concentrating the majority of our openings in freestanding units.

Freestanding units have seen an outstanding and an amazing increase in sales due to delivery and to the incredible performance of delivery and drive-thru, and we think that now, with consumers coming back to our restaurants, the opportunities are even further.

So we have always approached the investment return expectations based on long-term value generation, and we still think that the opportunities are there, mainly in the freestanding units.

So we think that the plan that we just announced regarding growth for the next three years is completely aligned to maximizing returns for our shareholders through investments in freestanding units, on the digital initiatives that we are pursuing, plus the modernization of existing restaurants.

So we think that the returns are there, the opportunity is there, it is a matter of executing the strategy correctly, and we are sure that we will do that.

João Andrade, Bradesco (via webcast):

Can we expect royalties moving back to 7% after this growth cycle?

Joaquin Ley, Itaú (via webcast):

Congratulations on the results. How should we think about royalties after 2024 in the context of the projected step up to the 7% that's in the MFA for 2022?

Mariano Tannenbaum:

As you know, in the MFA, we paid 5% of royalties from August 2007 to August 2017. The first step up occurred in August 2017 to August 2022, where we are due to pay 6%, and after August 2022, we should be paying 7%.

So far, we received growth support from McDonald's starting in 2017, where the effective royalty rate that we paid was 5.2%, in 2018 we paid 5.4%, in 2019 we paid 5.5%. 2020 was the only year when we did not receive growth support directly because we did not grow because of the pandemic, but we received other types of support from McDonald's, like delay in royalty payments and deduction in the marketing fund.

In 2021, we resumed the growth support and we are expecting to pay for the full year less than 5.5%. As we mentioned, recently, for 2022, we are expecting to pay 5.6%, which is, of course, below the mandatory rate, and we expect to have 6% for the next two years.

Even though it is still too early to say what will happen after 2024, what we can tell you is what happened in the past. Since 2017 until now, with the only exception of 2020, which was a very particular year, we always received growth support from McDonald's. And that shows the alignment between both companies. Arcos Dorados is providing all the growth and capturing the potential for growth in Latin America, and McDonald's is providing the growth support to capture this opportunity.

So we are very pleased with the agreement we have so far that, as we just mentioned, applies for 2022, 2023 and 2024, and we are confident that, based on the history, we will be able to maintain a similar agreement for the years coming after that.

Roberto Browne, Morgan Stanley (via webcast):

Can you please share your expectations for delivery penetration in 2022 and going forward? Should we see a positive impact of delivery on margins at some point, or maybe just incremental USD, but a lower percentage margin?

Robert Ford, Bank of America (via webcast):

Congratulations on the strong sales, and thanks for taking this question. Can you discuss your expectations for delivery in Brazil and the expected impact of the UberEats exit in that market?

Marcelo Rabach:

Thanks to both of you for the questions. In terms of the general delivery outlook for 2022, what we are expecting, what we are planning, what we are seeing in the first two or three weeks of January is that delivery will continue to contribute with additional sales for the Company.

Obviously, we saw a tremendous growth during 2020 and 2021. But the good news is that, even with the on premise channels recovery in terms of traffic and sales, delivery sales and delivery of average orders per day per restaurant are still very high, even growing in some markets.

So we are still planning to grow delivery sales at a slower pace than in the previous two years. But we have a team in place, a multidisciplinary team, a squad in place at regional level. That is why we have very strategic relationships with the main 3POs. We are working with different models, depending on the country. In many countries, we operate with two, three or even four 3POs, and in other markets we have an exclusivity model, which is the case, for example, of Peru. And we have some hybrid markets, I would say, like Brazil, for example, where we have some restaurants that only operate with iFood and other restaurants that operate with more than one operator.

In the case of Brazil, specifically, and to Bob's question, we were not affected materially by the decision of UberEats to be out of the food delivery business that they announced recently.

Having said that, we continue to monitor the situation and looking at every single country in order to decide which is the best model to operate this important business segment that represents still more than 10% of our sales.

And on top of that, in terms of margins, I would say that we are in a pretty strong position. Delivery has been very accretive for our business in recent years, in the last couple of years, and we are making all we need to do in order to keep that contribution going forward. We have very strategic negotiations with different 3POs, and again, we have maybe the competitive advantage that we can see with each of those 3POs.

In most of the cases they operate across the region and have conversations, discussions and negotiations involving all the markets where we operate. Just one brand, one company operating the brand, and we can take advantage of that scale and very good deals for us and for the 3PO at the same time to grow the business, which has been the focus in recent months and years, and will continue to be in 2022.

Anik Mutsuddy, American Trust Investment Advisors (via webcast):

If there is an increase in cost for food products such as grain, beef, et cetera, how does Arco plan on managing higher input costs moving forward?

Mariano Tannenbaum:

Thanks for the question, Anik. In fact, we have been facing those pressures in the last couple of years. And if you see our gross margin, we have been improving our gross margin, even though we faced pressures in terms of costs, mainly in beef, mainly in proteins, but not only there, as you mentioned in other grains as well, given the rising commodity prices.

But maybe I can explain a bit how the gross margin works for our industry and how we have been managing that. The cost side is one very important part of the gross margin. And so far, we have been dealing with that because we have a very strong supply chain team. We are, in most markets, the largest buyers of the products we buy, and we have been dealing with the same suppliers for many years where we have a very long relationship and we have been able to maintain or to avoid cost increases that maybe other competitors have not been able to do that.

So, in terms of cost negotiations or cost pressures, we have been able in the last couple of years to maintain costs in line.

But on top of that, we have pricing and the product mix. And in terms of pricing, we have been very successful in our revenue management strategy. Our digital platform allowed us to do segmentation and to price differently, according to the choices of consumers. And on top of that, all the segments we have, such as delivery or drive thru that have been gaining weight within our total sales, have a higher average ticket that, at the same time, improves our gross margin number.

So overall, we have several tools to improve our gross margin. That is what we have been doing so far in the last two years. In an environment where there are cost pressures, because we cannot deny that, we are, within the industry and within our closest competitors, by far, the most successful company that have been dealing with these cost pressures. And that's why our gross margin improved in the last year, when in many other companies you have not seen that.

On top of that, and the last part of the question is that we have a large geography, we have 20 markets and we do not have the same reality in every single market. For example, we have protein pressures or rising meat prices in Brazil that are not exactly the same as in other markets. So our geography also is helping to balance our gross margin line at a consolidated level.

Daniel Schleiniger:

Thanks, Mariano. I acknowledge that we have still several questions in the queue. Unfortunately, we have reached the end of the period that we had allocated for today's call.

First of all, obviously, thanks everyone for their participation today, for the attention, for the level of interest that we have seen on today's call. We will be following up with each of that still have a few pending questions, some of which are a little bit detailed as well. And so I think they are better handled offline.

Thank you very much for your interest. In seven weeks, March 16th, we will be reporting our 4Q results. You will have the full P&L, the full financial statements audited at that point, and we will be able to get into some of the other questions that we receive today as well into more detail.

So again, thank you very much. We hope today's webcast illustrated how strong the trends are in the fundamentals of the Arcos Dorados business model, and we look forward to speaking again in our March earnings call. Until then, please stay safe, and have a great day.

END OF WEBCAST