

Constellation Brands (NYSE:STZ)

November 17, 2021

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Company Overview

Constellation Brands (NYSE:STZ)



Company Overview

- Constellation Brands, Inc., (NYSE:STZ) is an U.S.-based Fortune 500 company in the alcoholic beverages industry. It operates as a holdings company which owns several subsidiary brands that produce and market beers, wines, and spirits.
- Founded in 1945 in New York by Marvin Sands, Constellation Brands currently employs over 9,600 people.
- Portfolio consists of the most popular beers such as multiple Corona and Modelo brand families.
- Constellation Brand's wine & spirits portfolio consists of 20+ luxurious brands sold mainly throughout the U.S. and Canada.
- Constellation Brands is the world leader in premium wine, the number one beer importer in the world and the number three beer company in the United States.

Products

Beer Segment



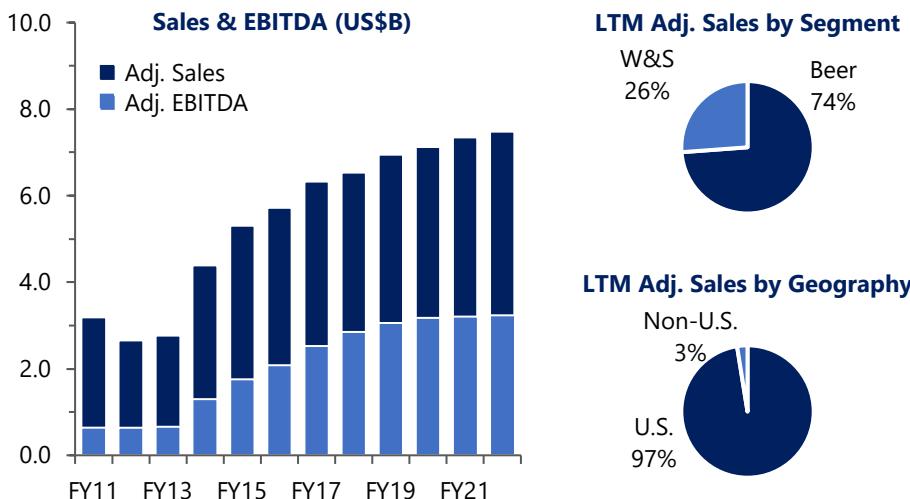
Wine & Spirit Segment



Key Statistics

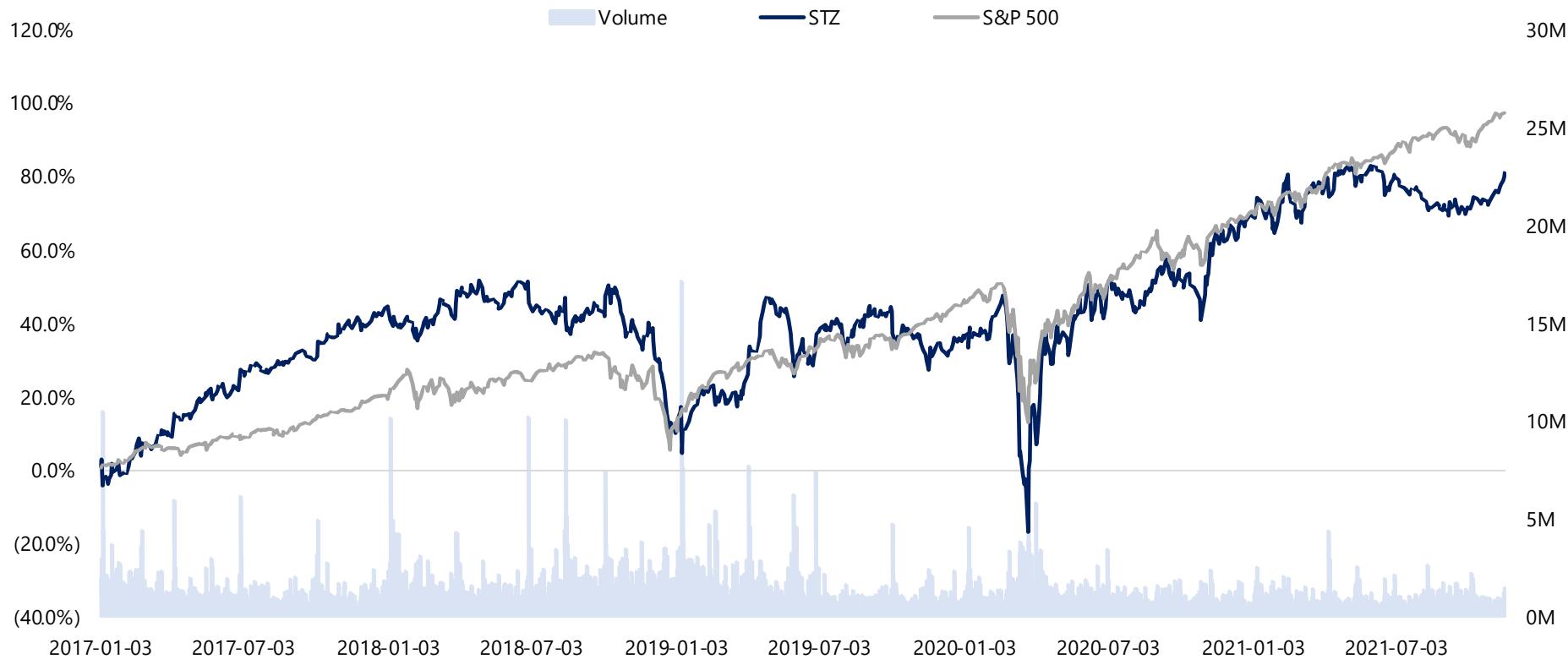
Ticker	NYSE:STZ
Share Price	\$234.02
52 Week Range	\$200.13 - \$244.75
Enterprise Value	\$52.91B
Market Capitalization	\$42.44B
NTM EV / EBITDA	28.33
NTM Price / Earnings	18.48
Dividend Yield	1.33%

Revenue Overview



Financial Information

Constellation Brands (NYSE:STZ)



Valuation Measures

Stock Price \$226.41	S/O 164M	Market Cap 42,440M	Trailing P/E 60.38x	TTM Revenue 8,788M	TTM EBITDA 3,250M	TTM EBIT 1,867M	Unlevered FCF 1,947M
Forward P/E 18.48x	TTM Price/Sales 5.0x	Beta 1.15	Ent. Value 52,910M	TTM ROA 7.08%	TTM ROE 6.78%	SI Float 0.67%	TTM EPS 3.87

Source: Bloomberg

Note: Market data as at November 17th, 2021.

Constellation Brands (NYSE:STZ)

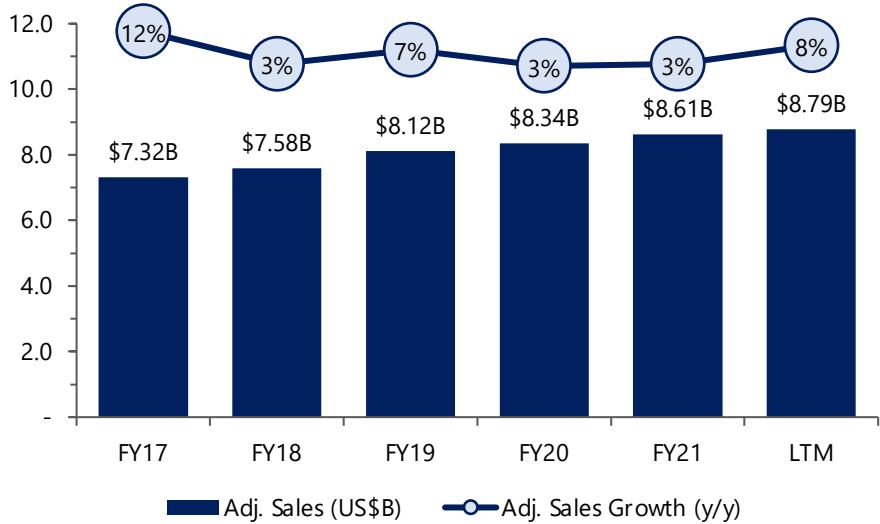


Operating Performance

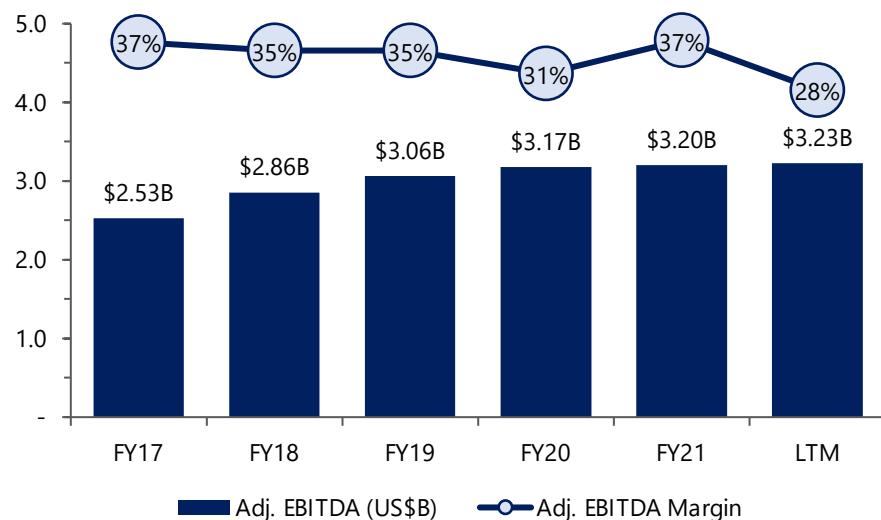
Constellation Brands (NYSE:STZ)



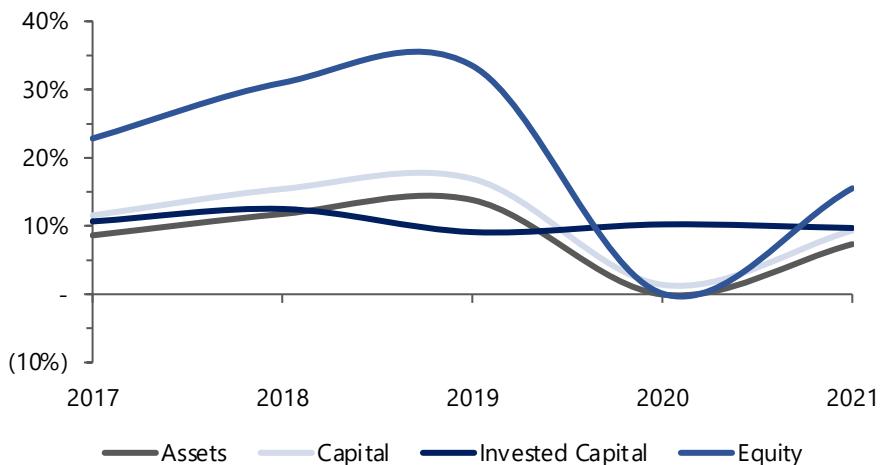
Topline Performance



EBITDA Margin



Returns



Liquidity

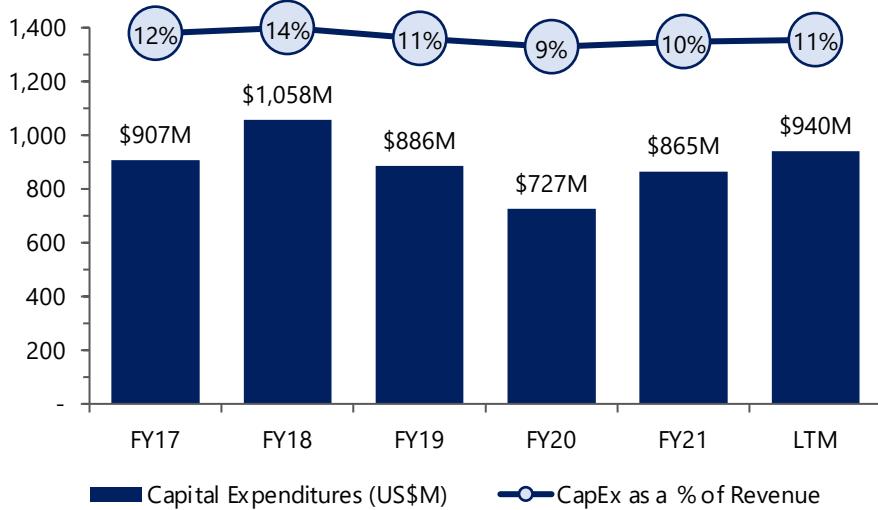


Capital Deployment

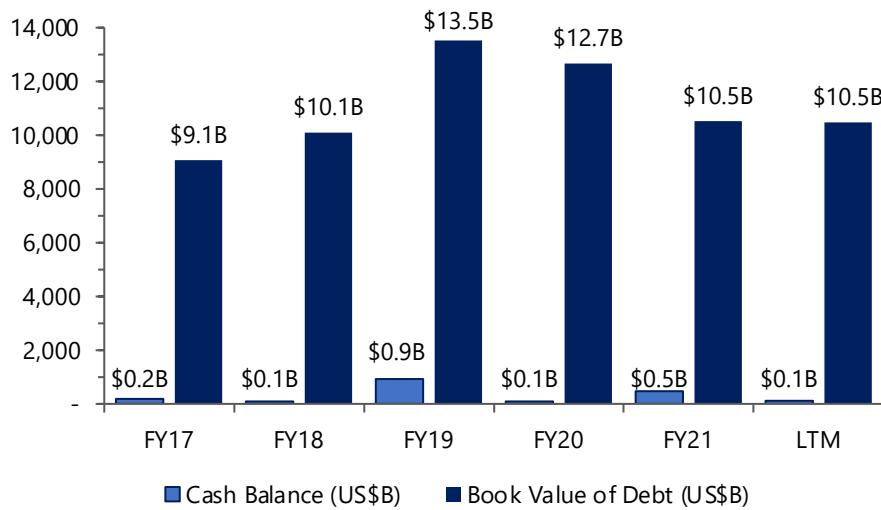
Constellation Brands (NYSE:STZ)



Capital Expenditures



Cash & Debt Trends



Capital Allocation Plan

- Cash dividends and share repurchases are funded through a combination of operating free cash flow, borrowings, and divestiture proceeds.
- During Fiscal 2021, they incurred \$864.6 million for capital expenditures, including \$693.9 million for the Beer segment primarily for the Mexico Beer Projects (expansion activities at the Obregon Brewery and Nava Brewery).
- Plan to spend from \$1.0 billion to \$1.1 billion for capital expenditures in Fiscal 2022, including approximately \$900 million for the Beer segment associated primarily with the Mexico Beer Projects.



- Plan to return \$5B to shareholders in share repurchases and dividends by year-end FY'23.
- ~60% complete as of second quarter fiscal 22.

Key Assumptions:

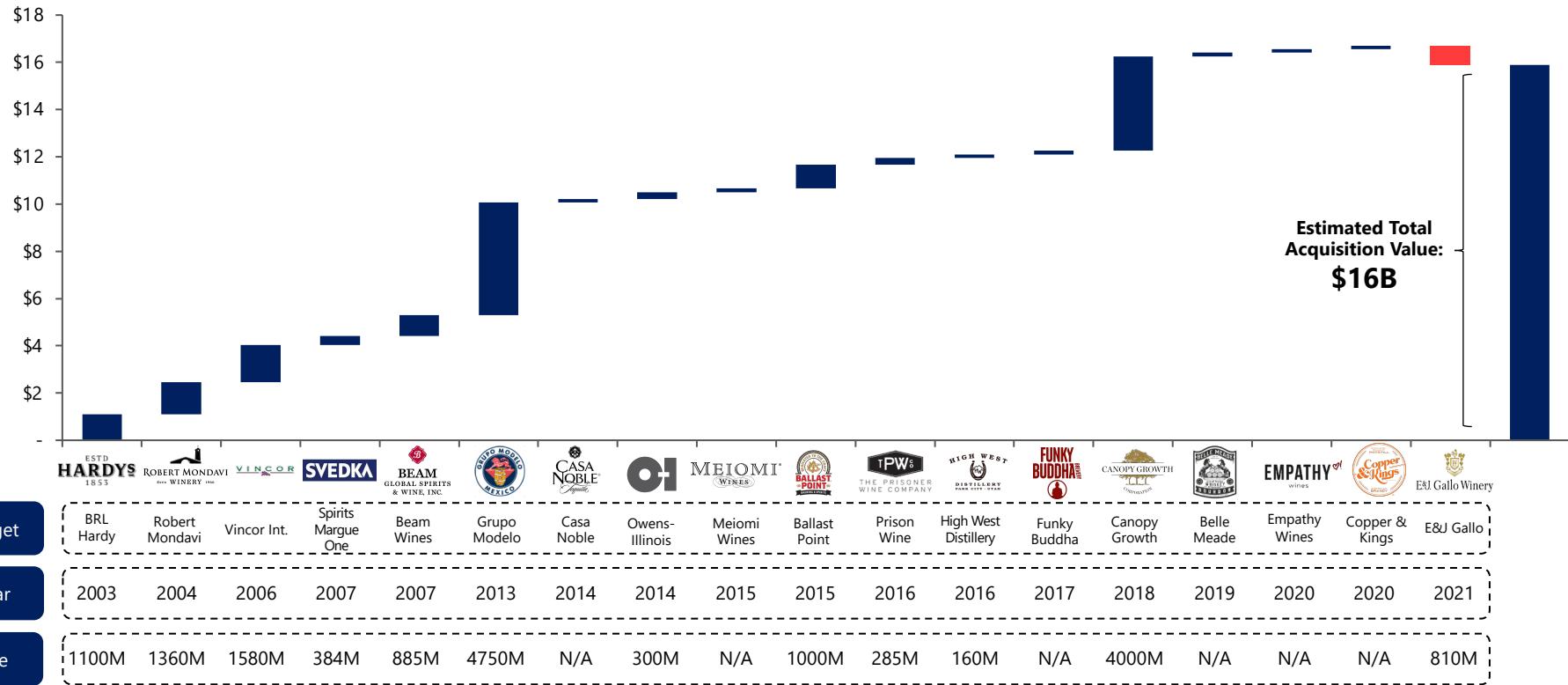
- Increase operating cash flow in-line with medium term growth vision
- Dividend payout ratio 30% range
- Committed to investment grade rating and leverage ratio in the 3.5x range

~\$2.5B Share Buybacks
~\$2.5B Dividends

\$5B Capital Return

M&A Activity

Constellation Brands (NYSE:STZ)



Canopy Growth

In January 2019, the drinks giant announced that it would be building a hemp extraction and product manufacturing facility in New York. Constellation has invested roughly \$4 billion in Canopy Growth since 2017 and has made an unrealized \$223 million net gain on its stake since November 2017.



Empathy Wines

In July 2020, came the acquisition of Empathy Wines, a digitally-native wine brand that strengthens Constellation Brands position in the direct-to-consumer and eCommerce Markets; this acquisition supports Constellation Brands' focus on meeting the evolving needs of their consumers.



E&J Gallo Divestiture

In January 2021, Constellation Brands closed its transaction with E.&J. Gallo Winery to divest a portion of Constellation's wine and spirits portfolio. The aggregate transaction price was approximately \$810 million and with the closing of this deal, it has positioned Constellation's wine and spirits business for accelerated revenue growth and operating margin performance.



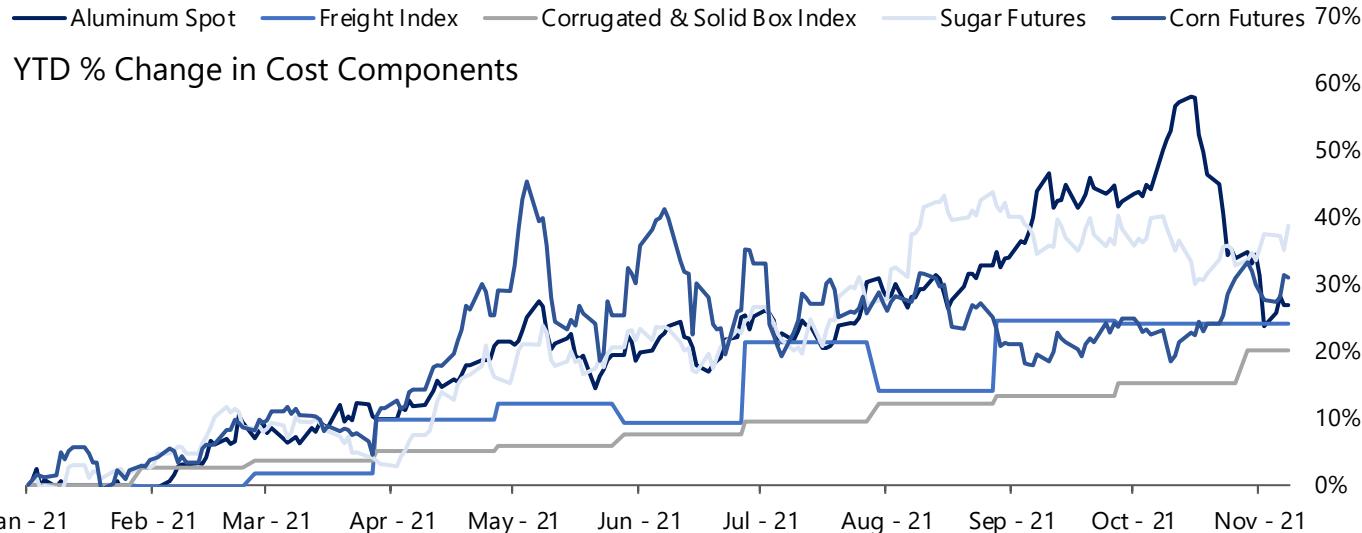
Macroeconomic Overview

Extrinsic Factors

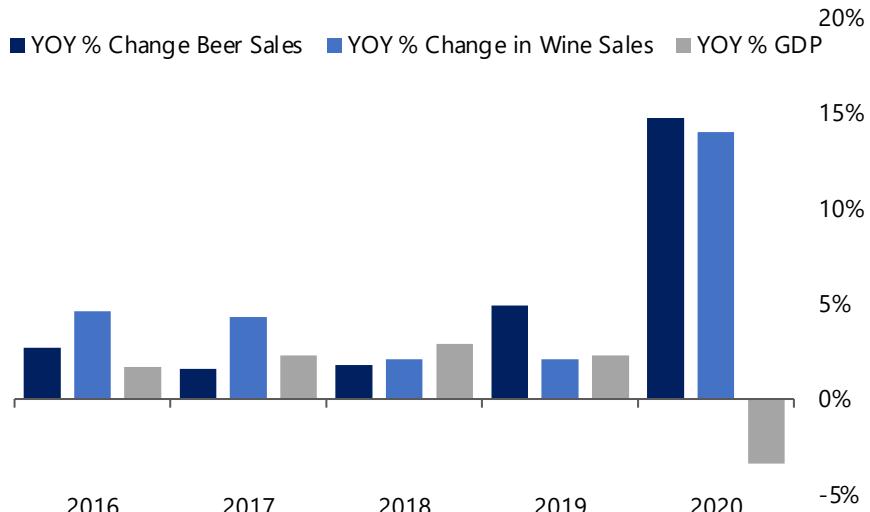
Per Unit Cost Breakdown



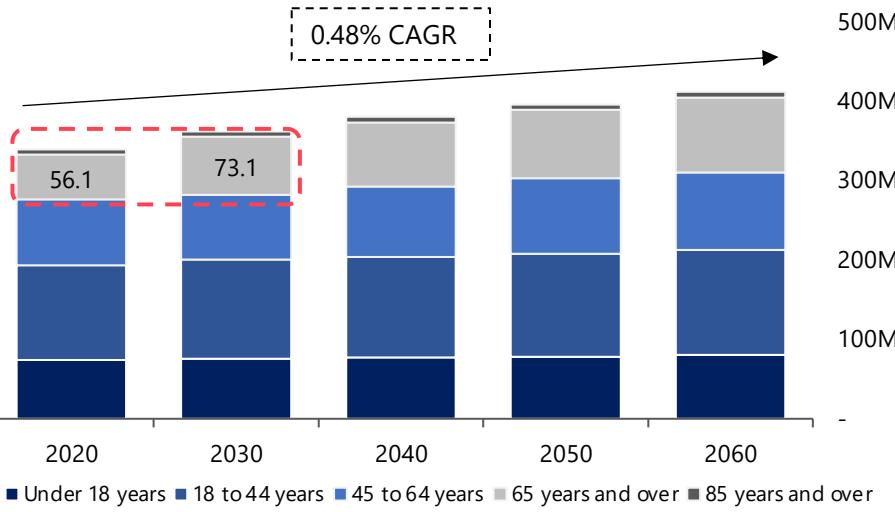
- Packaging, 45%
- Freight & Logistics, 25%
- Labor & Overhead, 15%
- Raw Materials, 15%



Beer Consumption VS Wine Consumption VS GDP



United States Population By Age Group Projections



Industry Overview

Insights & Trends

Key Industry Trends

Consumer Preference Shift to Premiumization

- Consumers habits have shifted away from traditional beer brands that offered a limited portfolio at reasonable price points to products offering better quality and more enjoyable experiences
- Major players are focusing on increasing portfolios through acquisitions to enhance premium offerings to consumers and gain back lost market share

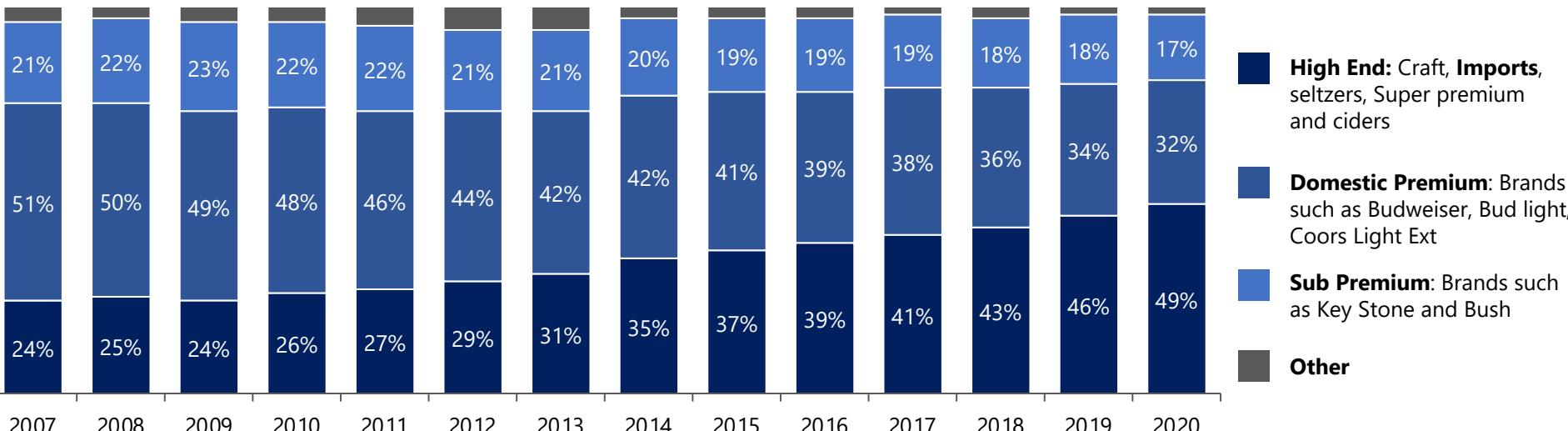
Specialty and Beyond Beers (SB & BB) Causing Fragmentation

- The rise in popularity of SBs (flavored, dark – crafts, stouts, etc.) and BBs (ciders, hard seltzers, etc.) has caused fragmentation among leading beer brands in the industry due to new market entrants

NOLO (No & Low Alcohol) Trend Among Younger Demographics

- US has seen a decrease in youth drinking rates in the past 20 years, fueled by a desire to live a healthier lifestyle and preference to flavors and tastes

Shift To Premiumization Based on Shipment Data



Sources: Deloitte, Bloomberg, IBIS World

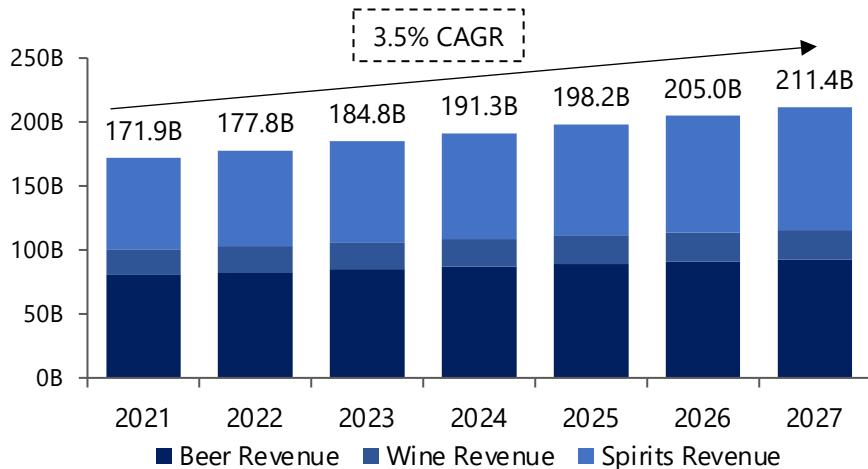
Constellation Brands (NYSE:STZ)

Industry Overview

Key Measures & Competitors

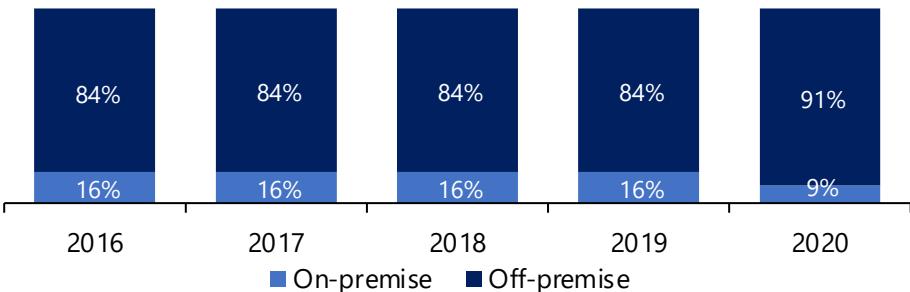


Industry Outlook



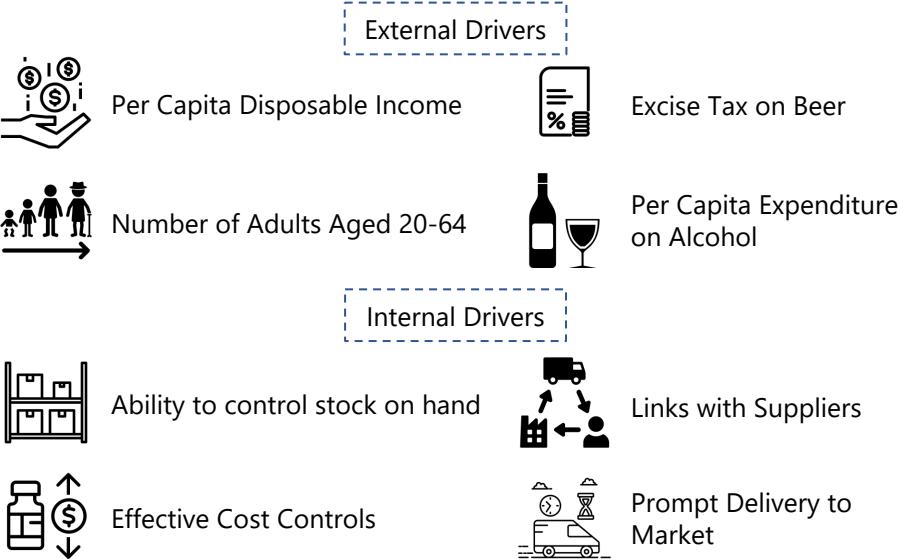
Constellation Brands is poised well to take advantage of growing market share of premium offerings in Wine & Spirits

North American Industry Channels



- On-premise channels offer higher margins than off-premise channels due to premium brand mixes, and lower packaging cost with a higher volume of kegs.
- On-premise US sales are 88% of 2019 third quarter levels, and Canada is sitting at 80% of third quarter levels.

Industry Drivers



Key Players By US Market Share

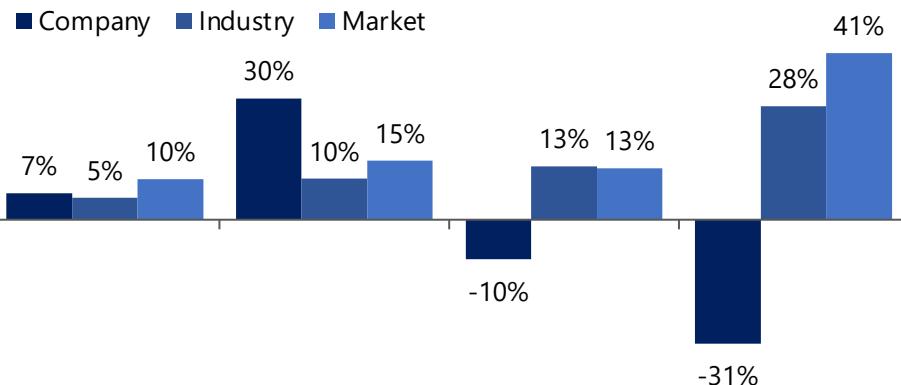


Industry Overview

Constellation Brands vs. Industry



Growth Comparison



Forecast Annual Revenue Growth Forecast Annual Earnings Growth 5 Year Historical Earnings Growth 1 Year Historical Earnings Growth

- Negative earnings growth due to 1-off decline in earnings in 2020 due to losses on sale of security & write-offs the past 12 months

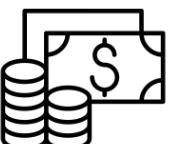
Competitive Advantage



- Relationship with distributors
 - 70% of wine and spirits volume is expected to be distributed by Southern Glazer's Wine & Spirits

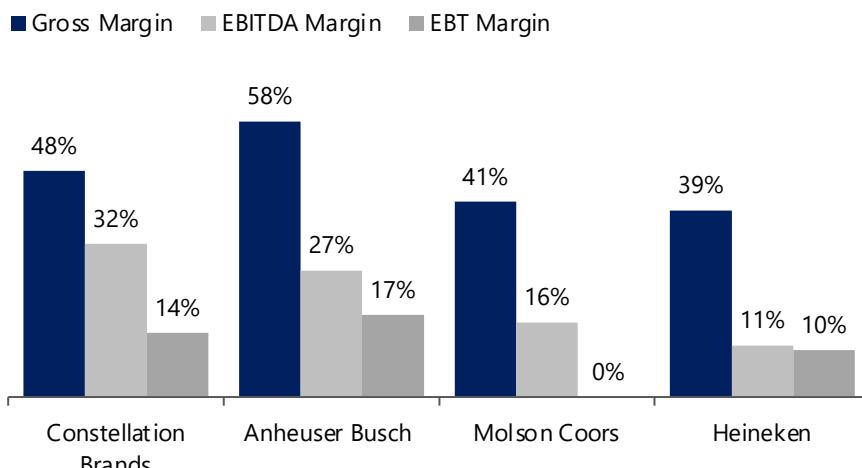


- In house manufacturing facilities in Mexico – cost advantage
 - Exclusive importation agreements with the suppliers of imported Mexican beer products



- Focus on premium Wine & Spirits products leading to margin expansion and capturing growing market share

TTM Margin Comparison



- Lower EBT Margin due to write offs and depreciation of long-term assets that are still highly functional

Credit Position

	Standard & Poor's	Moody's
	BBB	Baa3
	BBB+	Baa1
	BBB-	Baa3
	BBB+	Baa1

Competitive Position

Industry Major Players



Beer



- World's leading brewing company founded in 1717 Leuven, Belgium operating in NA, EMEA, and AP
- Acquired Grupo Modelo for 20.1 billion, (2013) and related **Grupo Modelo** completed the sale of its U.S business to **Constellation Brands** for 4.75 billion (2013)



- Molson was founded in 1786, and Coors in 1873 with core operations in North America and Europe
- In 2005, Adolph Coors merged with Molson Inc, creating Molson Coors
- Agreement with Heineken granting right to distribute and sell certain **Heineken** products in CA



- Founded in 1864 in Amsterdam and owns over 165 breweries in more than 70 countries worldwide
- Currently second-largest brewer in the world since merger of Anheuser-Busch InBev and SABMiller
- Notable Brands: Heineken, Dos Equis, Tecate, Strongbow Ciders, Tiger, Red Stripe, Amstel Light

Wine



E&J Gallo Winery

- Family winery founded in 1933 by the Gallo Brothers; distributes products in over 100 countries
- Leading winemaker with famous brands including Black Box, Yellow Tail, and Barefoot
- In 2021 E&J Gallo acquired 5 wineries and 30+ brands from **Constellation Brands** for \$810mm



- Established in 1981; the world's second largest winery by volume and is management-owned
- Headquartered in California and markets its products in North America, Western Europe, and Asia
- Portfolio of Wines: Cupcake, Franzia, Flipflop, Almaden, Foxhorn, Concannon, and other brands



- Headquartered in Melbourne, Australia in 2011; formerly wine division of Foster's Group
- Acquired majority of assets from Diageo's US and UK wine operations in 2015 for US\$600 million
- Notable Brands: Beringer, Penfolds, Wolf Blass, Stags' Leap, Beaulieu Vineyard, Chateau St. Jean

DIAGEO

- British multinational alcohol company; focused on distributing spirits and Scotch Whiskey
- Targets Net Zero carbon and 100% of renewable electricity across all direct operations by 2030
- Notable Brands: Johnnie Walker, J&B, Cîroc, Smirnoff, Baileys, Captain Morgan, Guinness, Tanqueray

Beam Suntory

- American subsidiary of Suntory Holdings a Japanese multinational brewing and distilling company
- Suntory Holding purchased US firm Jim Beam for 16 billion forming company that is today
- World leader in premium spirits with brands including Jim Beam (world's #1 selling bourbon brand)



- Founded in Cuba in 1862; family-owned spirits company with a portfolio of 200+ brands and labels
- Adopted packaging approach (2020) reducing 80% plastic in Bacardi, Grey Goose, Bombay, Dewar's
- Notable Brands: Bacardi, Grey Goose, Bombay Sapphire, Patron, Martini, Dewar's, Cazadores

Investment Thesis I: Investment into Core Beer Distribution Growth

Constellation Brands (NYSE:STZ)



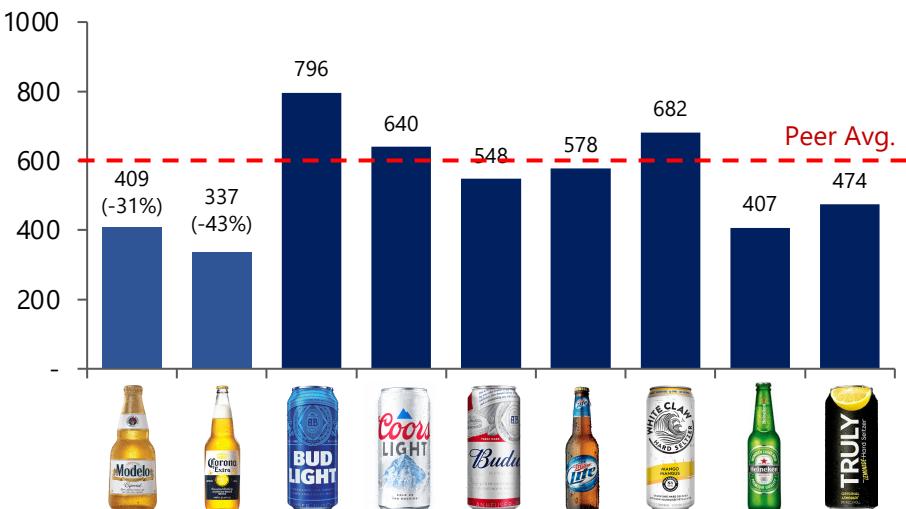
FY2022 Management Commentary



- "Our business strategy for the Beer segment focuses on leading the high-end segment of the U.S. beer market."
- "[This strategy includes] focus on growing our beer portfolio in the U.S. through expanding distribution for key brands, as well as innovation and continued expansion in construction activities for our Mexico beer operations."
- "Key elements of our strategy [are to] realize operating efficiencies by expanding and enhancing production capabilities and maximizing asset utilization, strengthen relationships with wholesalers and retailers, [and] expand distribution of our product portfolio."

Beer segment strategy has pivoted from attempting entry into the low-end beer space, to expanding its popular high-end beer brands.

LTM Brand Total Distribution Points (TDP)



Source: Company Filings, Nielsen

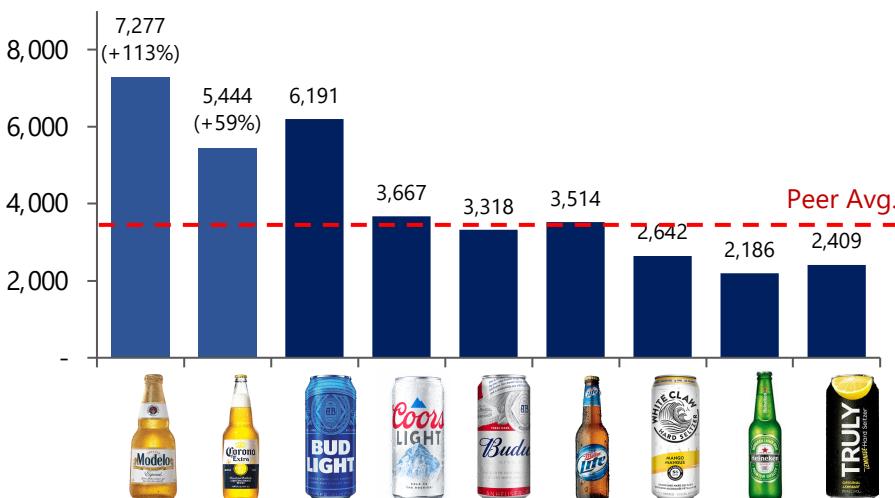
Increasing Supply Capacity



- Obregon Brewery – early 22 planned expansion project to be completed increase in production capacity to 39M hectoliters
- Nava Brewery – tripled production capacity since 2013 acquisition
- Glass production Plant – adjacent to Nava Brewery, 5 operational glass furnaces supply ~55% of total glass annual supply for Mexican Beer Brands
 - Long term glass supply agreements with other glass producers
- Plans to spend \$1.0B-\$1.1B in capex for FY22 - \$900M towards beer segments
- Mexico beer projects expected completion by FY25
- Current production capacity at 34M Hectoliters, expected capacity in FY 25 54M hectoliters



LTM Brand Velocity (TDP / Sales)



Constellation Brands (NYSE:STZ)

Investment Thesis II: Well-Positioned Brands for U.S. Demographic Trends

Constellation Brands (NYSE:STZ)



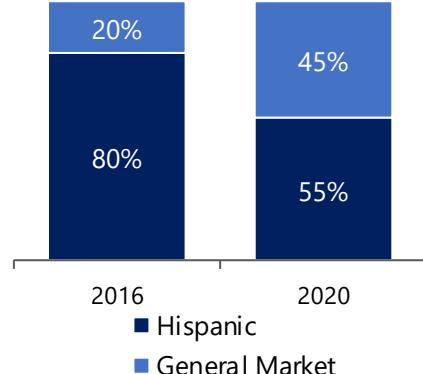
Management Commentary

- "We are very fortunate with our Mexican beer portfolio to have the strength of brands that we do. These are iconic authentic brands from Mexico that our Hispanic community is very much behind, and we continue to see strength and growth."*
- "Modelo is one of the chief growth drivers of our beer business. Modelo Especial has become the #3 beer brand in the U.S. market, and it continues to accelerate, part of -- it does that for a number of reasons. One is it continues to have a disproportionate SKU in the Hispanic community, which is a growing demographic in the United States."*
- "We are seeing such expansion in not only the core Hispanic market, but in the broader market as well."*

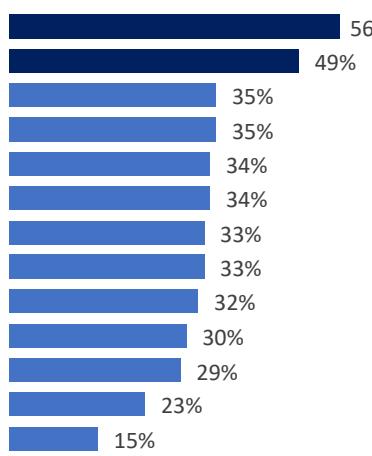
Core beer brands customer loyalty in the Hispanic community will be a continuous revenue driver

Strong Brand Loyalty For Core Brands

Modelo's Consumer Mix (2016 vs 2020)

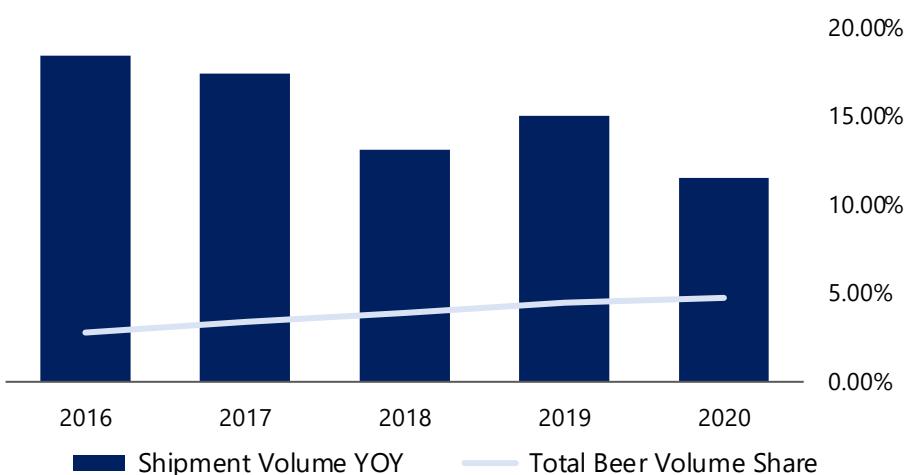


Brand Affinity



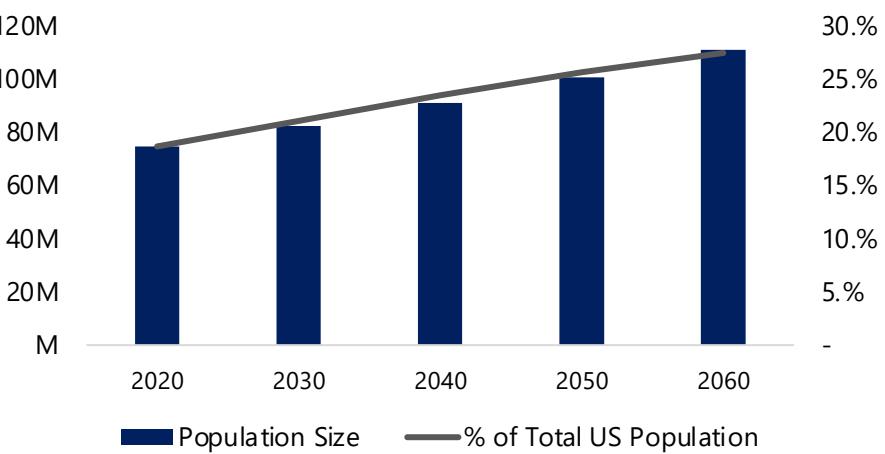
Core Beer Brand: Recent Success

Modelo Strong Performance Past 5 Years



Constellation's Strongest Brand has Opportunity to Expand

Hispanic Population in the United States

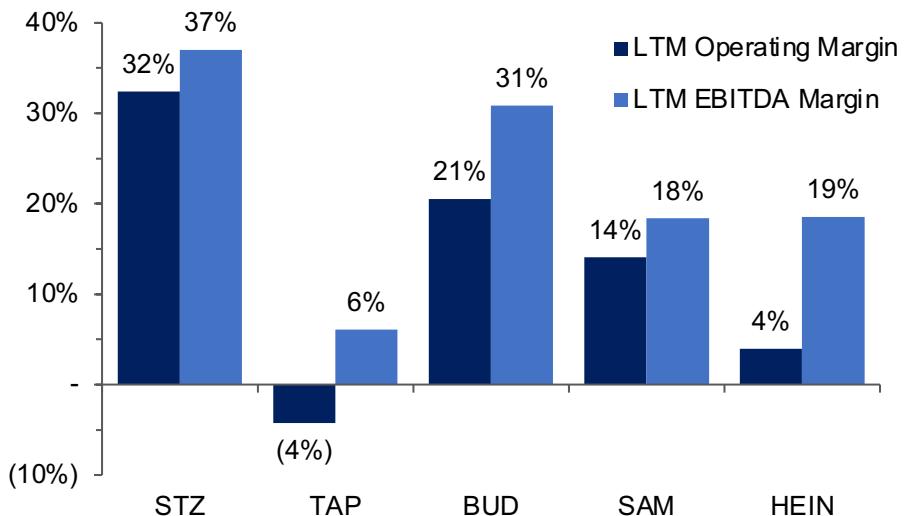


Investment Thesis III: Margins Resilient to Industry Headwinds Relative to Peers

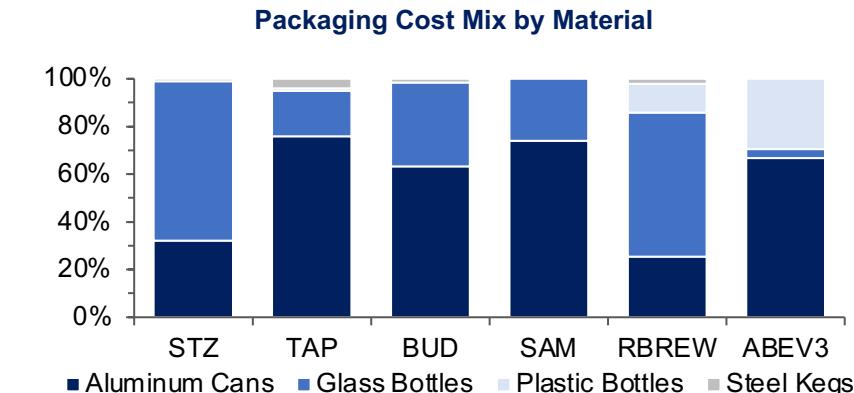
Constellation Brands (NYSE:STZ)



Best-in-Class Margins

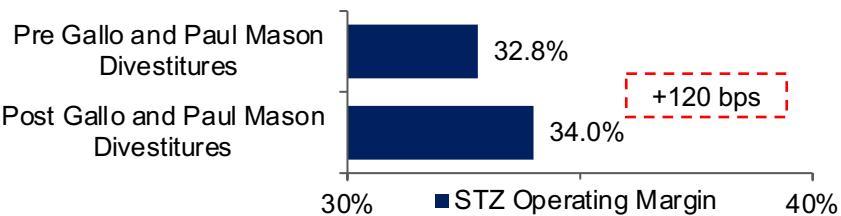


Inflation Resilience



Constellation's packaging mix has low exposure to commodity price inflation relative to its peers, with aluminum only comprising 32% of packaging costs, compared to peer average of ~60%.

W&S Premiumization Focus Accretive to Margins

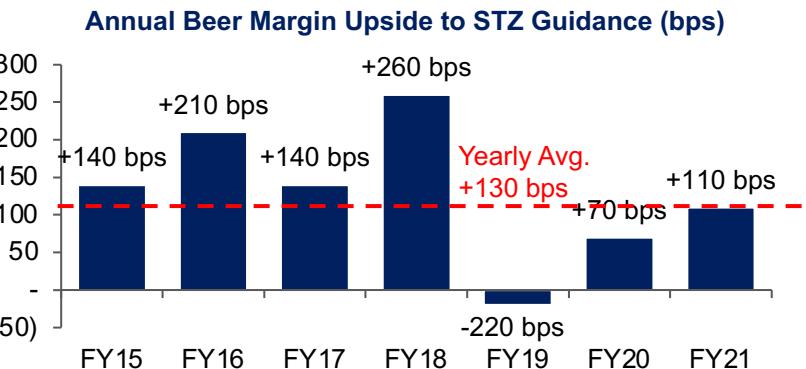


Constellation's strategic shift to exit the low-end wine and spirits space and premiumize its W&S portfolio is accretive to its margins.

STZ is restructuring W&S portfolio with a focus on organic growth and margin expansion. Both metrics have improved so far.

Remaining ~\$130M of stranded costs from the Gallo divestiture; margins should continue to benefit as stranded costs are removed.

Beer Margin Guidance



STZ's management tends to guide conservatively in forecasts. We believe that this, alongside inflation fears, has caused the market to underestimate STZ's future margins when pricing the stock.

Risks and Catalysts

Mitigated risks and attractive catalysts display strategic management decisions and high business quality

Risks

Increased Costs Per Case



Increased costs for commodity's increase the overall COGS for each case. Raw Materials accounts for 15% and Packaging accounts for 45% resulting in 60% of cost being impacted by the sharp rise in commodities



Mitigations

Commodities Inflation



Aluminum has seen sharpest increase over the last year, industry mix is usually ~60+% cans whereas as STZ is less exposed with a mix of ~33% Cans and ~67% glass bottles

Slowing Beer Sales Growth



67.3% of revenues are generated through the sale of beer. Diminishing growth affecting financial conditions could adversely impact operations



Premiumization



While the low-end beer market is decreasing in size, the high-end beer market, which includes beers such as Modelo and Corona, is forecasted to grow healthily in the foreseeable future

Canopy Investment



Canopy Growth investment remains a key source of risk with equity losses continuing through at least FY22 and the FDA guideline timetable remains elusive



Potential of Canopy Investment



Canopy's successful rollout of cannabis beverages, as well as other Rec 2.0 products has helped Canopy gain momentum, STZ remains confident that this investment is consistent with their long-term strategy to identify, address and stay ahead of evolving consumer trends

Catalysts

Improved Supply Chain Dynamics



STZ now brews >75% of its beer at Nava, most efficient brewery in U.S., few people needed due to high levels of automation and close proximity to packaging lines and glass furnaces

Freight: STZ biased towards rail, ABI and TAP trucks



STZ brews in just two locations in Mexico, and then ships beer largely by rail to strategically located distribution centres in the U.S. Trucking prices are up much more than rail, due to a shortage of truck drivers

Share Repurchases

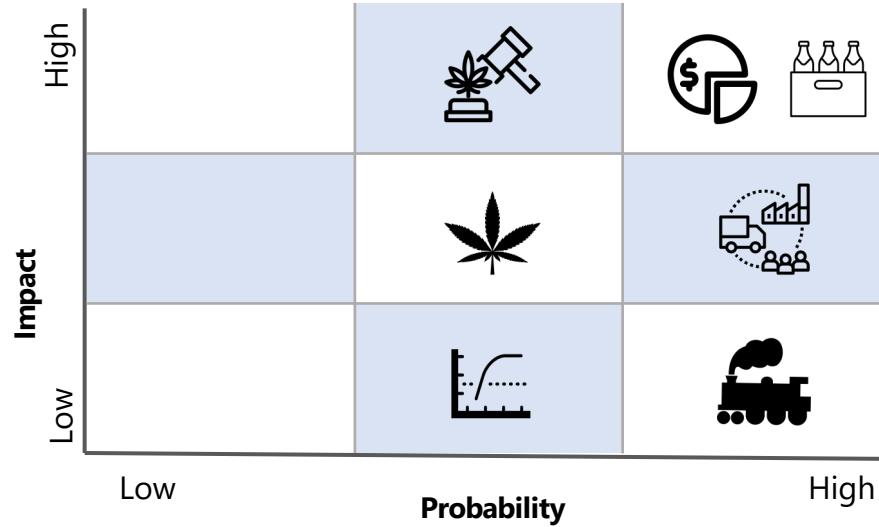


Constellation Brands has fulfilled 60% of its share repurchases and dividends from its original plan to return \$5B to shareholders, with its estimated completion by year-end FY23

USA Cannabis Legalization



If the U.S. Federal Government legalizes recreational use of marijuana, Canopy can enter and penetrate the U.S. market with its cannabis beverages, edibles and concentrates used in vaping



Comparable Companies Analysis

Constellation Brands (NYSE:STZ)



Peers	Price 6-Aug-21	Market Cap	Enterprise Value	EV / Revenue	EV / EBITDA	EBITDA Margin	ROE	ROIC
Content Companies								
Anheuser-Busch InBev		120,793M	215,164M	4.1x	11.4x	14%	2.92%	4.64%
Constellation Brands		42,580M	53,384M	6.1x	21.5x	37%	2.92%	5.30%
Diageo		89,200M	102,588M	1.9x	5.4x	33%	38.92%	10.60%
Royal Unibrew		39,920M	165,787M	18.9x	66.8x	26%	14.29%	20.30%
Molson Coors		10,410M	17,400M	1.7x	2.1x	8%	-1.58%	-0.01%
Boston Beer Company		5,890M	5,868M	2.7x	30.1x	7%	7.14%	9.54%
Average				5.9x	22.9x	21%	17.45%	8.39%
Median				3.4x	16.5x	20%	10%	7%
Brown Forman Corp		33,539M	34,869M	9.6x	30.5x	37%	31.90%	16.60%
Davide Campari Milano		39,918M	42,549M	5.4x	20.8x	22%	12.47%	6.90%
MGP Ingredients		1,610M	1,851M	3.3x	16.3x	18%	16.25%	12.46%
Crimson Wine Group		202M	181M	2.6x	37.8x	7%	1.09%	-0.17%
Average				5.2x	26.3x	21%	15.43%	8.95%
Median				4.3x	25.6x	20%	14%	10%
Weighted Average				5.6x	24.6x			
Weighted Median				3.9x	21.0x			
Constellation Brands		42,580M	53,384M	6.1x	21.5x	37%	2.92%	5.30%

EBITDA	Multiple					Upside Vs Downside				
	20x	21x	22x	23x	24x	-33%	-27%	-21%	-16%	-11%
2,000M	40,000M	42,000M	44,000M	46,000M	48,000M	-	-	-	-	-
2,500M	50,000M	52,500M	55,000M	57,500M	60,000M	-7%	-2%	3%	7%	11%
3,000M	60,000M	63,000M	66,000M	69,000M	72,000M	11%	15%	19%	23%	26%
3,500M	70,000M	73,500M	77,000M	80,500M	84,000M	24%	27%	31%	34%	36%
4,000M	80,000M	84,000M	88,000M	92,000M	96,000M	33%	36%	39%	42%	44%

Source: Bloomberg

Note: All dollar amounts in USD.

Constellation Brands (NYSE:STZ)



Discounted Cash Flow Analysis

Constellation Brands (NYSE:STZ)



- Discounted cash flow analysis with an assumed WACC of 7.48% and a transaction close date of Dec 31, 2021
- Terminal value based on perpetuity growth methodology with an assumed growth rate of 2.0%

Cash Flow Summary	FY 2021A	FY 2022E	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E	Terminal Value & Implied Share Price
Revenue	8,614.9	8,681.4	9,565	10,092.1	10,742.7	11,352.8	11,836.1	Terminal UFCF \$3,431.7
Revenue Growth %	2.8%	0.8%	7.2%	7.3%	6.1%	5.7%	4.5%	Terminal Growth Rate 2.00%
EBITDA	3,181.9	3,192.6	3,539.9	3,934.2	4,286.05	4,660.4	4,984.9	Terminal Value \$70,680.8
EBITDA Margin %	36.9%	36.8%	37.8%	39.0%	39.9%	40.9%	41.8%	Discount Factor 0.65
EBIT	2,888.1	2,879.6	3,190.9	3,527.2	3,838.0	4,155.4	4,429.9	PV of Terminal Value \$45,858.4
Less: Taxes	(492.6)	(571.4)	(587.7)	(633.9)	(674.7)	(715.8)	(749.2)	PV of UFCF \$11,252.5
NOPAT	2,395.5	2,308.2	2,603.2	2,893.3	3,163.3	3,439.7	3,680.7	Implied TEV \$57,110.9
Add: Amortization	293.8	313.0	349.0	407.0	448.0	505.0	555.0	(-) Debt 10,470.1
Less: Capital Expenditures	(864.6)	(965.6)	(1,124.0)	(1,133.0)	(957.0)	(898.0)	(779.0)	(+) Canopy Stake Value 951.0
Less: Change in NWC	(603.1)	179.0	(50.2)	(27.0)	(38.0)	(30.0)	(25.0)	
Unlevered FCF	1,221.6	1,834.6	1,779.9	2,140.3	2,616.3	3,016.7	3,431.7	Implied Equity Value \$45,689.9
Discount Period	1.0	2.0	3.0	4.0	5.0	6.0		FD Shares Outstanding 167.3
WACC	7.48%	7.48%	7.48%	7.48%	7.48%	7.48%		Implied Share Price \$273.1
Discount Factor	0.93	0.87	0.81	0.75	0.70	0.65		Implied Margin of Safety 20.6%
PV of Unlevered FCF	1,707.0	1,530.7	1,724.0	1,960.8	2,103.6	2,226.5		

IMPLIED SHARE PRICE SENSITIVITY

Perpetual Growth Rate	WACC				
	6.5%	7.0%	7.5%	8.0%	8.5%
1.5%	288.5	253.8	225.0	200.7	179.9
2.0%	322.1	280.7	246.9	218.7	195.0
2.5%	364.2	313.5	273.1	240.1	212.6
3.0%	418.4	354.7	305.2	265.7	233.5
3.5%	490.8	407.6	345.4	297.1	258.6

IMPLIED TERMINAL MULTIPLE SENSITIVITY

Perpetual Growth Rate	WACC				
	6.5%	7.0%	7.5%	8.0%	8.5%
1.0%	27.4%	12.1%	-0.6%	-11.4%	-20.5%
1.5%	42.3%	24.0%	9.0%	-3.4%	-13.9%
2.0%	60.9%	38.5%	20.6%	6.0%	-6.1%
2.5%	84.8%	56.6%	34.8%	17.4%	3.1%
3.0%	116.8%	80.0%	52.5%	31.2%	14.2%

Quantitative Analysis

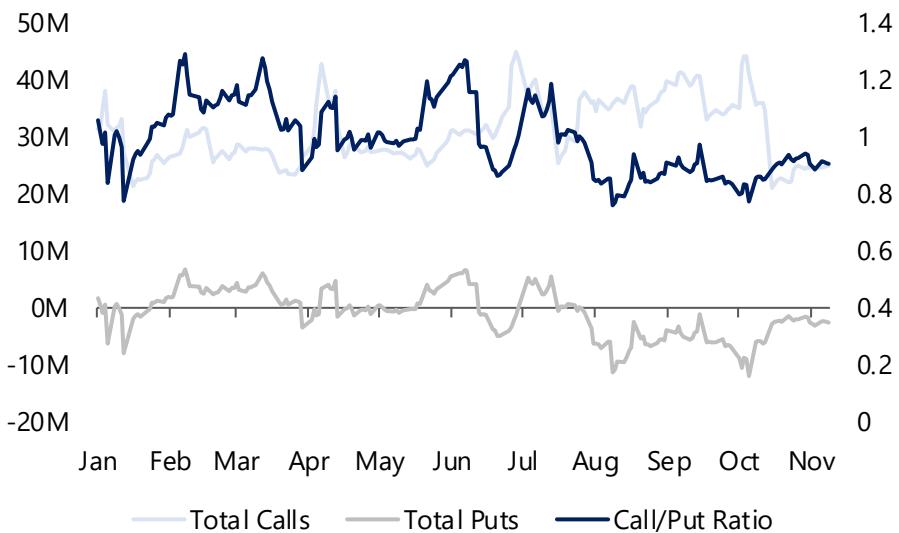
Constellation Brands (NYSE:STZ)



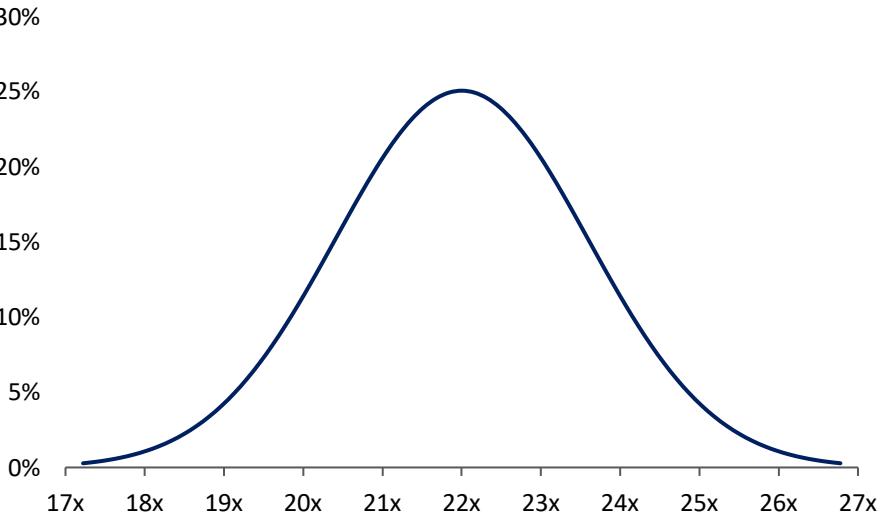
EV/EBITDA Historical Valuation



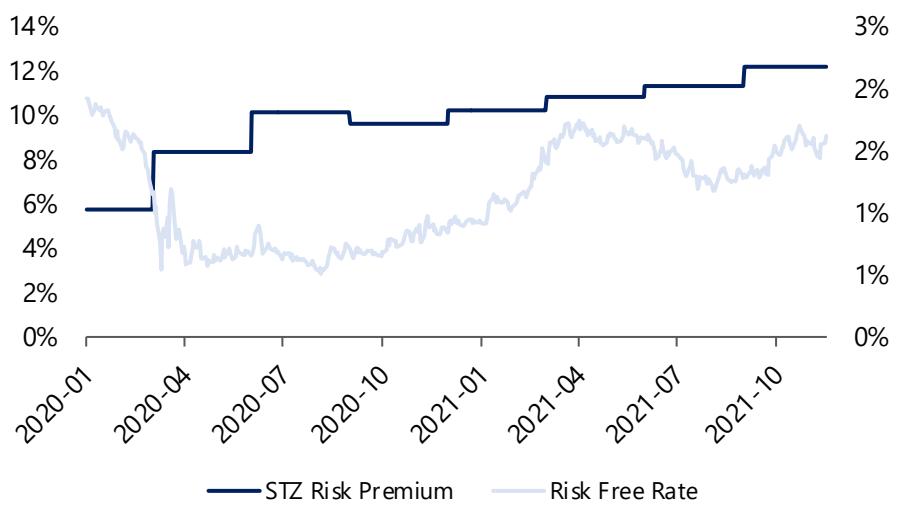
Derivative Ratios



Z Score EV/EBITDA (1Y Forecast)



Risk Premium



Source: Bloomberg

Note: Market data as at November 17th, 2021.

Constellation Brands (NYSE:STZ)

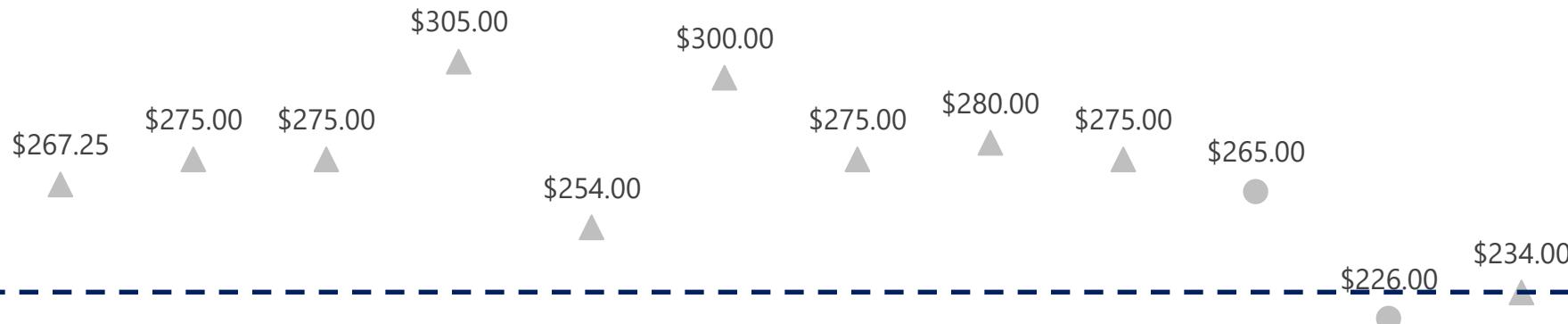


Valuation Overview

Constellation Brands (NYSE:STZ)



Select Analyst Ratings



EVERCORE

Jefferies

Morgan Stanley



JPMORGAN

CREDIT SUISSE



GUGGENHEIM



Implied Value

Analysis	Price	Weights
Discounted Cash Flow Analysis	\$273.10	40%
Analyst Targets	\$269.45	20%
Comparable Company Analysis	\$260.31	40%
Target Price	\$267.25	100%
Current Price (11/17/2020)	\$234.02	
Implied Return	14.19%	

Conclusion

- We believe Constellation Brands is undervalued in the current market
- We recommend a Buy with a price target of \$234.02 representing a ~14% return with a timeline of 12-16 months

Disclaimer

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Thank you for listening!
