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Presentation

Lauren Lieberman

Okay. We're going to get started on our last session of the day. Really happy to have Garth Hankinson, Constellation's CFO with us today. So thank you very much for being here. A lot happened since we were here last year. So I think — ***indiscernible*** — the year.

Question and Answer

Lauren Lieberman

But I wanted to just start with the Elliott collaboration agreement that was announced in July. So our sense is this sort of a proactive step in terms of governance, capital allocation over the longer term rather than something that is intended to be a more active effort to come. So I was hoping you could talk a little bit about the nature of the relationship that's underpinning the agreement that you've come to with them and the types of discussions that you've had so far?

Garth Hankinson

Yes. Well, first of all, Lauren, thanks for having us today and thanks for all of you being here. Yes. So as it relates to our relationship with Elliott, I mean, it's been very, very productive and collaborative in nature. And quite honestly, we've benefited from hearing the perspective. They've shared with us certainly their perspective, which is fairly consistent with the feedback that we've received from and sought out from our other large investors and shareholders as well.

The conversations have focused largely on corporate governance, including Board composition. And again, their feedback on that subject or on that topic was similar with what we've heard from other by and our large shareholders. Beyond that, it's similar themes, again, to our other large shareholders with conviction around the beer top line. What the Beer margin profile looks like in a more normalized inflationary environment, the drivers and the path for getting our Wine & Spirits Business towards stated algorithm of low single-digit top line and high 20s margin – operating margin – operating margins.

And then just a continued conversation, as you said, around capital allocation and the discipline that Bill and I have been operating under for the last several years, but certainly still some concerns around some capital allocation decisions that were made in the past. So what has been a series of topics that we've had? Again, it's very similar to the feedback we've taken from our other investors. And clearly, on each one of those topics, we'll have more to share at our upcoming Investor Day.

Lauren Lieberman

So in the — ***indiscernible*** — about transformational change and more about the growth profile that I would argue undervalued for the growth profile. So maybe we can dig in a little bit into sort of like we can get pretty solid visibility into the volume growth over the next several quarters. In your first quarter, right, trends accelerated, and volumes have looked really strong in the tracked channels data. So I guess first thing is there good check in on kind of tracked channels relative to nontrack, overall depletions knowing that historically, that kind of relationship between track running ahead of depletions as kind of broken down. So we don't know what to make of the data or not to make of the data. So accelerating trends. Is that, in fact, what you're seeing in how should we think about that relative to depletion.

Garth Hankinson

Well, so first of all, we would agree that we're undervalued relative to our growth profile.

But it's absolutely true that our beer volumes have accelerated, beer performance accelerated through the first half of the year, pretty much as expected as we laid out the year. You'll recall that there are 2 drivers for this, and we were pretty open about this as we entered this fiscal year. One was that we expected retailers to roll back the incremental pricing that they took on top of the pricing, our second pricing move in the fall of last year. That largely has come to pass. And so we've benefited from that.

And then we've also benefited from the fact that the cold, wet weather that was being experienced in the – in California has improved. And so obviously, you've seen some acceleration in California, which has helped our overall trends.

As it relates to Circana, our syndicated data, the most recent 12-week period, we're running – our beer business is running about 13% year-over-year growth. And the delta that we've typically seen between syndicated data, specifically Circana and depletions has been more in that low single-digit sort of delta, if you will. That's increased recent in recent periods to be more in the mid-single digits. And the reason that we're seeing for that is that, that pricing rollback that I referenced earlier, that's largely taken place with the large main retailers, where we've seen some slowness in rolling that back has broadly been speaking in the independents.

And so we have – we've seen weakness in the independent channel relative to chains. On a much smaller scale, that's not is similar to what we saw during the pandemic where people migrated away from the on-premise and from independents into chain stores. So we've seen some of that here in the most recent data. In fact, you even see it in California, where this consumer, which is an consumer, which is an important consumer for us, has actually migrated away from the independent retailer and into the chain. So just further evidence that that's what we're seeing is a bit of a channel shift, if you will.

Lauren Lieberman

Okay. Great. On the topic of pricing. Some really big changes in industry market share dynamics, right? The – I think you are now probably the leader in the market. Someone else was a leader before – who led pricing. So just kind of your thoughts around industry-wide pricing dynamics and how that will change is like it's a big dynamic known because we talked about the share shifts, but the knock-on effect is industry leadership and who takes the lead on pricing is something that's sort of yet to be seen, but you've had a very particular stand on pricing given the premium nature of portfolio.

Garth Hankinson

Yes. And from our perspective, our outlook on pricing around methodology just doesn't change, right? And I've seen some of the speculation that you referenced around who will be the pricing **— *indiscernible* —** And for us, we're just – as I say, we're going to keep that discipline. We take pricing on a brand-by-brand, market-by-market, SKU-by-SKU basis. That's resulted in us being – typically being to generate 1 to 2 percentage points of growth – revenue growth every year from pricing.

Obviously, in the last couple of years, the inflationary environment led to some pricing activity that was in excess of the high end of our range. But we think that the approach that we take is the right approach. It's obviously served us well. And clearly, what we don't want to do, we don't want to take pricing to such extent that it starts to impact our consumer, then impact the growth profile of our business. And so again, we will continue to be very, very methodical and disciplined and intentional around our pricing actions.

Lauren Lieberman

Okay. So thinking about potential growth drivers. Shelf resets have been also very topical in the last few months within the industry. Can you tell us what time line for changes at retail? Is that kind of in process now more in the spring there on shelf reset?

Garth Hankinson

The most tangible thing we've seen in the short term, by the way, has been that we've benefited from incremental features and displays. That being said, we are expecting that there will be further shelf resets in the fall, not – that's not dissimilar to what happens every year and that will be followed by more meaningful shelf resets in the spring.

Clearly, we think that we'll be a beneficiary there in part because the shift that I think you're seeing between some of our competitors just kind of highlights the fact that the low end of the market really isn't growing – the low end of the category is not growing yet, that the high end is. And you're seeing some of that acceleration in that premiumization back to more normalized trends. The delta between premium and our high-end and low-end beer right now is back to about 3.1 percentage points, and then Wine & Spirits is about 5.2 percentage points.

So we just think, overall, you'll see who will benefit from the continued strength of premiumization and our leadership position in the high end. More broadly speaking, we're going to continue to execute the shelf initiative that we started about 4 years ago. When we initiated or launched this program back in 2019, we were able to influence about 1,500 shelf resets. And in fiscal 2023, we influenced 17,000 and then in the first half of this year, we've influenced 13,000, right? So again, we're going to continue to work with our distributor and retail partners to influence shelf resets. We think that a retailer shelf is their most precious asset and they ought to be allocating that to the brands that are showing the most growth, have the highest turns and have the highest profitability and so that is something that is what our brands provide to retailers.

Even for brands like Modelo Especial, we think that there's a lot of opportunity for continued shelf gains. That's a brand that in the 10 years that we've owned it has more than doubled in size, growth accelerated, right after the acquisition growth has remained robust. In fact, last year, to look at our growth – our share growth of Modelo, we led the category in Modelo share growth. And we outpaced our nearest competitor by 1.5x. So clearly, a lot of growth in the brand, and we think a lot of growth left in the brand. Still not as fully distributed brands like Corona Extra even or some of it's another competitive set. So again, we think that there is a lot of opportunity for Modelo Especial as well as — ***indiscernible*** — portfolio. I mean even Corona Extra was not as distributed as some of its competitive set. And as we focus on other brands like Pacifico or Modelo

Chelada, still great opportunity for increased distribution for those brands as well.

Lauren Lieberman

Okay. And looking at Modelo Oro — ***indiscernible*** —, I guess 2 more months of data, right, since the launch. It also seems like a bit of right time, right place to some of the changes that have gone in the premium light segment and Oro being the reasonable trade up for people prefer to drink that type of beer. Just a few — ***indiscernible*** — What do you see in terms of kind of the core consumer that is coming into the Modelo Oro franchise and where is the brand facing volume from?

Garth Hankinson

So in it's still early days, we got a few more weeks and months at our belts, so to speak. But based on what we're seeing, we're pretty positive on what Modelo Oro can be for us. I mean it's already our top 10 Modelo share gainer in the U.S. And the incrementality has been better than what we saw in test markets. So again, those are reasons for optimism. It is – it does appear to be a bit of a different consumer right now as it relates to other light offerings. And so certainly with the Hispanic males, it's been quite strong, which, again, you don't see against other like peers. It also skews a little bit younger and tends to have a little bit – resonate a bit more with females.

So it is like I say, it's a bit of a different consumer. And for us, for our portfolio, it's very much a different consumer than what you're seeing from a Modelo Especial or for Corona

Light or Corona Premier. Again, all of that being said, what we are positive on it, it's a trend that we're going to have to continue to monitor. We're going to continue to look at consumer takeaway. We'll continue to look at incrementality. And then importantly, we look at repeat purchase. We want to make sure that, that's not just trial that we're getting, but that it really is something that resonates with the consumers as they come back to it.

And so we're already looking towards next year and what we might do differently next year. As you recall, this year, we came out with pretty modest plans in terms of total overall volume but also the number of SKUs that we are offering. We have 12-ounce 12-pack and a 24-ounce single-serve. So already think what additional of SKUs from a pack size we could be offering next year. But again, I mean, it's a brand that we feel pretty strongly about.

And now with the addition of this, we feel that across the beer portfolio and also why, and I'll come to that in a second, but across our beer portfolio, we have nice exposure to really 2 emerging consumer-driven trends. One is better mix. So obviously, there, we have Modelo Oro, we have Corona Light, and we have Corona Premier. But also in flavors, the strength of Modelo Chelada, which is now the size of Pacifico growing in double digits. On the wine side, some early – as it relates to betterment, we have good traction with Meiomi Bright and with Kim Crawford and from flavors perspective, we've had good traction with our Mi CAMPO and High West RTDs, as it's a bit of a nascent — ***indiscernible*** — based RTD brand, Austin Cocktails.

Lauren Lieberman

Okay. Great. Let's switch to the Corona brand family. So starting with Corona Extra depletion trends. Originally, we expect Corona actually grow modestly in fiscal '23 and ultimately we had 4% depletion growth for the year. But recently it has been slowed to low single digits. And from what we can see in tracked channels data — ***indiscernible*** — bit different than what you see. With volumes were kind of in line with the beer category which is down low-single digit. So what reasons the direction of the travel to the brand? What's working in terms of marketing? What is and what would you expect in terms of reasonable volume growth rate for Corona Extra over time?

Garth Hankinson

Yes. So Corona has returned to growth, for sure. I mean it's still a brand that's very important to us. It's a brand that continues to be – win the hearts and minds of the consumers. It's the most beloved brand in America, whether that's domestic or imported. And it's a brand that we're going to continue to invest behind. We have a number of strategic investments, marketing initiatives behind the Corona with sponsorships and things like – major like baseball as well as other large-scale marketing investments in live sports and other media, if you will.

So it's a brand that will continue to be very, very important for us. Beyond Corona Extra, we think about the Corona brand family. Obviously, this year, we launched Corona NA. We think Corona NA could be a nice — ***indiscernible*** — to the portfolio. If you think about the NA segment of the beer category, it's about 75% incremental to the category in total. And last year, NA was the fastest-growing segment within beer, grew about 20%. And so again, we think that this is as a new consumer and an incremental opportunity for us and that something we'll focus on going forward.

Lauren Lieberman

Okay. What about the pros and cons – it sets up to a strong start, but what about the pros and cons that you've seen in non-alcoholic beer with an existing beer brand versus the new market brand that doesn't have an alcoholic predecessor?

Garth Hankinson

So look, we firmly believe that innovating and extending off of broad shoulder brands makes a lot of sense. And if you think about the occasions for why someone might have a non-alcohol variant of a beer, certainly, having that off of an existing beer brand makes sense. That being said, we are exposed to non-alcoholic with other brands. In the broader portfolio, we have a couple of venture investments in a non-alcoholic brand called, HOP WTR, obviously made with hops. You kind of get the hoppy aroma from it, but it's non-alcoholic in nature, obviously, and a bit [saucy] like.

And then we have exposure to the functional water space with venture investment called Karma. So we're not going after the non-alcoholic cadence strictly with Corona entity. We do think in those instances, those occasions where you're looking at the non-alcoholic beer doing it off of a brand like Corona makes a lot of sense.

Lauren Lieberman

Okay. Because surprisingly maybe you said that you're finding it incremental in terms of consumer. I would expect incremental in terms of the occasion, but not necessarily for consumer?

Garth Hankinson

Yes. Well, — ***indiscernible*** — statements, 75% incremental from the category.

Lauren Lieberman

Okay. Great. Maybe you can talk a little bit about your view on our latest perspective, let's say, the U.S. consumer more broadly. Inflationary pressures have been easing on kind of key expenses. I know we've got impairments about to kick in. But any impact on beer line behavior, any kind of changes of late and maybe focusing — ***indiscernible*** — in particular?

Garth Hankinson

Yes. So everything we watch is really very closely or I mean everything that we're seeing is the consumer continues to be really resilient. And we haven't seen a lot of impact due to the macroeconomic environment. Those I stated previously, we've seen the — ***indiscernible*** — trend to continue, and we've gotten back to differences between the high end and the low end in both Beer and Wine & Spirits that are reflective of the historical delta, right? So that's very positive.

Obviously, you haven't seen a slowdown in any of the tracked channels from our brands, which I think has proved positive that the consumer remains resilient. And one of the metrics that we tend to track very, very closely is buy rate. And buy rate remains strong across Beer and Wine & Spirits. In fact, we're seeing year-over-year buy rates increase, so continued growth in buy rate. And we've actually seen that that's true for the Hispanic consumer as well.

Lauren Lieberman

Okay. So might there the upside to demand this year?

Garth Hankinson

We feel really good about – we feel good about being able to deliver on the plan that we set out earlier this year. And the acceleration through the first half of the year gives us conviction that we can meet those targets.

Lauren Lieberman

Okay. Great. the kind of drivers of growth in line with what we've just broken through, I'm just curious though about flexibility in terms of capacity, that demand and volume both has been strong. I think the cap dynamics could still remain a little bit choppy. So I don't know how much that's created a draw on the non-cap business. So just any update on the dynamics you're seeing in the marketplace and supply chain development to keep up?

Garth Hankinson

Yes, Lauren, I mean we're in the best position we've been in from a supply standpoint since we've owned these beer brands. I mean if you recall, for the first number of years, really for the first probably 8 years to be on these brands, it's been hard for us to keep up with demand from a capacity standpoint, so much so that we were running these breweries at very high utilization rates.

As we announced little over 1.5 years ago, we've made big investments and continue to make investments in capacity in Mexico for not just the continued growth – strong growth of our beer brands, but also to give us some incremental capacity. You will recall that through the last 4 years, we've had some – we've had some what I'll call — ***indiscernible*** — events that have resulted in disruption to our operations. One was COVID obviously, and the second was a winter storm in Texas that — ***indiscernible*** —

So we've made this investment in incremental capacity and then we're layering out [2 million hectoliters] of capacity this year, 5 million hectoliters at Obregon that we already commissioned in the first quarter. You have another 5 million hectoliters coming on at the end of the year in our — ***indiscernible*** — facility. So by the end of the year, we'll have 52 million hectoliters of capacity, which then gives us a lot of optionality to be able to — ***indiscernible*** — production to meet any changes that we see in demand.

Lauren Lieberman

Okay. What would you say if you have like a target utilization rate that you want to migrate towards?

Garth Hankinson

Yes. Keeping in mind that, again, when we weren't able to meet – we weren't able to necessarily — ***indiscernible*** — we were running – we're going to keep up with demand, we are running at over 90% utilization. Once we have all our capacity fully up and commissioned, we're going to be more at industry level standards in that 70%, 80% range. So very much more running these like you traditional brewery.

Lauren Lieberman

Okay. Great. Just to round up the year discussion, I want to just bring up your margins. So definitely, pretty – you've offered a lot more color — ***indiscernible*** — 38% margins in fiscal '24. So I was just curious what you see as the potential for margin improvement beyond fiscal '24 and particularly to the extent that inflation pressures continue to ease?

Garth Hankinson

Yes. I mean I think we've been clear, and the biggest headwind we faced in the near term was indeed the high rate of inflation, right? We typically plan on inflation in our beer business to be around that 4% to 5% and then manage – we manage that in that inflationary pressures through the combination of increased volume, taking price and then finding operational efficiencies, which were really be going.

But in recent years, we've had this accelerated inflationary environment. Keeping in mind that 2% to 4% that we typically plan on last year, right in fiscal 2023, inflation was in the low double-digit range, kind of more than 12%, 13% in aggregate across the portfolio. This year, obviously, inflation improved, but we still have a – we're still experiencing inflation in aggregate in the high single digits. So that's what's going to – that's the biggest driver for us in the next few years is keeping inflation and getting it back to its more historical level and then some of those input costs rebalancing, if you will. We're doing everything that we can to control those, so to speak.

So again, we continue to take our pricing. We'll continue to — ***indiscernible*** — than we anticipated. We continue to execute our cost savings initiatives. In fact, this year in our first quarter alone, we've taken $2 million of cost out. And so there's obviously more come to through balance of the year. Looking forward a little bit, one of the things we've been pretty clear about for the last several years is that we will continue to face some headwinds around — ***indiscernible*** — in this incremental capacity. So that's something that obviously we've planned for and get in a more normal inflationary environment, where it offset that through the volume growth and the pricing and the cost initiatives. But that's something that we'll continue – that could be a bit of a drag for the next couple of years.

But again, one of the ways that we're managing our depreciation is the very modular approach that we're taking through our capacity expansion. As we've said, we're adding capacity at existing sites as well as Veracruz, but we're doing this in a way that we can control some of the timing around the actual spend as well as when capacity comes online, so that we're able to react to any changes, plus or minus in demand signals.

And then furthermore, we're identifying – back to the cost savings initiatives, we're identifying ways to make our employees more efficient. We announced last year that we were able to unlock $2.5 million of incremental — ***indiscernible*** — just through capacity or just through operational efficiencies. And obviously, that cost much less than adding incremental — ***indiscernible*** — capacity.

Lauren Lieberman

Okay. Great. And — ***indiscernible*** — So as your segments remain challenged. So kind of what gives you conviction in your outlook for getting to down 50 basis points, up 50 basis point net sales growth — ***indiscernible*** —?

Garth Hankinson

Yes. Obviously, there's been some headwinds to the overall Wine & Spirits category, more specifically on that mainstream price segment. And so that — ***indiscernible*** — But what gives us convincement we can overcome some of those – the category dynamics is maybe – the progress that we've made over the last few years on the strategy evolution, right?

I mean, this was a portfolio that a couple of years ago, about 65% of it – 65% of our net revenue — ***indiscernible*** — above that, but now the inverse.

We've seen really good traction with those key brands pricing — ***indiscernible*** — Meiomi, Kim Crawford, Prisoner, all outpacing their respective — ***indiscernible*** — segments. — ***indiscernible*** — out of brands like Mi CAMPO and Casa Noble. So again, I mean, that's partially what gives us conviction is just the rebalancing of the portfolio and the performance that we're seeing for those brands at the higher end.

The other thing that gives us conviction is another key element of the strength — ***indiscernible*** — we've migrated away also from being almost strictly a U.S. wholesale business and to be one that's more diversified in omnichannel in nature. Obviously, you've heard us talk about the last few years around focusing on higher growth opportunities in the international markets as well as the direction with DTC. We see DTC broadly speaking with direct-to-consumer as well as through e-commerce. And those are – particularly the DTCs, not only faster growing, but it's higher margin just given the mix of product that it runs through that change, so to speak.

So those are some of the drivers of what gives us conviction that we can hit the high end. As it relates to being in our margin targets, we'll obviously benefit from all of those things top line driven that I just mentioned the channel shift towards more higher price, higher-margin products. Obviously, the other benefit – we will continue to – continue to take price in line. We've talked about this before. We're taking the discipline that we have in beer pricing and applying that to Wine & Spirits, which as a category historically, not from very disciplined in pricing, we see benefits in that – in those activities.

We'll continue to do all of the cost takeout work that we've initiated a few years ago that may have the right product in the right format in the right packaging. — ***indiscernible*** — in terms the cost of glass because in the case of [wine], but also has the benefit of rate logistics — ***indiscernible*** — initiatives on the cost optimization — ***indiscernible*** — beer. And then just being very, very disciplined around spend and marketing and in SG&A.

That being said, as we were clear at the beginning of the year, unlike Beer where 55% of our sales will occur in the first half of the year and 45% in the second half — ***indiscernible*** — Wine & Spirits were 55% will occur in the second half of the year versus the first half of the year. And we do think that there is a little bit of a tale of 2 halves as it relates to our Wine & Spirits business.

In Q4 or Q1 of FY ’23, we had a big sort of shipment quarter and that created overlap in Q1 of this fiscal year. And then also, last fiscal year in Q4, we did some rebalancing to better align shipments and depletions. And so that will be an easier comp for us in the second half of the year. And then again, through the second half of the year, we’ll see that continued mix shift towards the high end and keep in mind that, this is a fairly normal seasonal year for us. And so you’ll continue to see that Q3 is our biggest quarter. So that’s what gives us conviction broadly speaking on the turnaround and conviction to be able to deliver the year.

Lauren Lieberman

Okay. And so — ***indiscernible*** — 28% to 29% margins are still the right longer-term benchmark to your business?

Garth Hankinson

Yes. We have – obviously, we’re going to talk more about both of our business in terms of the midterm outlook, but we haven’t changed any of our – we haven’t changed any of our algorithm.

Lauren Lieberman

Okay. We see a few minutes left, but I wanted to sort of end this conversation back where we started, and that's on structural changes you've made to build more trust with investors. So you've added Senior Independent Director to the Board, sort of broader board refreshment and government enhancement process and the single-class — ***indiscernible*** —, of course. So are there any more Board changes in the near term? And maybe what should investors take away at kind of the context for adjustments in particular?

Garth Hankinson

Yes. So first of all, both Bill and Luca are great additions to the Board. Obviously, they add significant financial expertise, which is going to be helpful to the Board. And — ***indiscernible*** — management as we continue to focus on the long range planning and capital allocation.

After the reclassification occurred, the Board was very committed to – performance — ***indiscernible*** — and as such, engage with a leading — ***indiscernible*** — to a have a look at Board composition, Board capabilities, diversity of thought. And so it's – there'll be more that will come out of that. We want to ensure that we've got – obviously, we've got good governance. We think there have been a series of things that have happened over the last 9 months.

You referenced the declassification. Obviously, there's been – there's been change in the Chair as well as 2 additions to our Board. But we'll go through this process, again, focusing on what capabilities do we want our Board to have. We want to ensure that we've got — ***indiscernible*** — We want to ensure that we've got a Board that's focused on the right things. And to extent that there is any incremental changes, obviously, we'll announce those in due course, but it's a process that's underway.

Lauren Lieberman

Okay. Are there any particular capabilities that you can think of – you are looking for – important to be adding to the Board at this point?

Garth Hankinson

The most immediate concern is one of the one that we already addressed, which was the lack of true financial expertise. We were limited really to kind of 1 member who really qualifies having that. And so that was clearly the #1 hole in the portfolio. I don't want to get out kind of the Board process to see like what the next most critical thing is. But suffice to say, we're doing a real introspective. Again, to the extent that there's anything else, we'll share that in due course.

Lauren Lieberman

Okay. Great. Well more to come this fall in Investor Day.

Garth Hankinson

More to come this fall at the Investor Day.

Lauren Lieberman

So join me in thanking for Garth for being here, and we'll go to a breakout after this.