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Presentation

Operator

Greetings, and welcome to the Constellation Brands Q3 Fiscal Year 2026 Earnings Conference Call and Webcast.

— ***Operator Instructions*** — As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to Blair Veenema, Vice President, Investor Relations. Please go ahead, Blair.

Blair Veenema

Thank you, Kevin. Good morning, all, and welcome to Constellation Brands' Q3 fiscal '26 conference call. I'm here this morning with Bill Newlands, our CEO; and Garth Hankinson, our CFO.

We trust you had the opportunity to review the news release, CEO and CFO commentary and accompanying quarterly slides made available in the Investors section of our company's website, www.cbrands.com.

On that note, as a reminder, reconciliations between the most directly comparable GAAP measure and any non-GAAP financial measures discussed on this call are included in the news release and website. And we encourage you to also refer to the news release and Constellation's SEC filings for risk factors that may impact forward-looking statements made on this call.

Before turning the call over to Bill and Garth, please keep in mind that, as usual, answers provided today will be referencing comparable results unless otherwise specified. Lastly, in line with prior quarters, I would ask that you limit yourselves to 1 question per person, which will help us to end our call on time. Thanks in advance, and over to your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question today is coming from Bonnie Herzog from Goldman Sachs.

Bonnie Herzog

Hope you're doing well and happy new year. I guess I had a question on your beer op margins. They came in a lot stronger than expected in the quarter despite the volume deleverage. So hoping you could talk further on some of the puts and takes behind this strength. And then thinking about your full year guidance, which you maintain, it does imply much more modest beer op margins in the fourth quarter, which I know seasonally is a lower quarter. But is there anything else that is expected to weigh on margins in this next quarter? Maybe aluminum, or if you could just talk through that?

Garth Hankinson

Thanks for the question, Bonnie, and happy new year to you. So first starting with Q3 margins. As you indicated, volume declines certainly were a headwind in the quarter. Additional headwinds in the quarter were tariffs, as you noted, logistics and then brewery maintenance. Offsetting those headwinds, we continue to make good progress against our cost savings initiatives. We had favorable pricing from the actions we've taken in both the spring and in the fall. And then there was a depreciation timing benefit that occurred in Q3, which was favorable on a year-over-year basis.

As we think about – or move to Q4, just to underscore what you said, it is our lowest quarter from a seasonality perspective, makes up about 20% of our overall volume. So fixed overhead absorption will be most amplified in this quarter. The depreciation benefit that we saw in Q3 will actually turn into a little bit of a headwind into Q4 as additional assets come online or are put into service.

And then tariffs will be a further headwind in Q4, really related to a couple of factors, one of which you mentioned, which was aluminum and the pricing of aluminum, which continues to be pretty strong. There is also the ongoing and as expected shift in product mix, so more to aluminum, from glass, and we'll see that in Q4. And then there's also a timing element to tariffs as to when the tariff gets accrued and goes into inventory and then when it gets released in the P&L. And that will be a bit of a headwind in Q4 as well.

Operator

Next question is coming from Nadine Sarwat from Bernstein.

Nadine Sarwat

Another one on beer margins, so perhaps with a longer-term perspective. So you called out a number of the factors in your prepared release and in your answer just now about the pressures that beer margins will face in Q4. So with that in mind, how should we be thinking about the 39% to 40% beer margins for fiscal '27 and '28 that you guided to back in April of last year? Is that something you still believe you can achieve? Should we be thinking of margins closer to where we were this year? Any color would be helpful.

And then if I could just squeeze in one more on depletions. Nice to see that come in, I think, ahead of some expectations. Any color on exit rate or what we're seeing in December? Is there any sequential improvement, or more of the same?

Garth Hankinson

Thanks, Nadine. I'll take the first question and then Bill will take the second. But as it relates to FY '27 and beyond, as we said back in our Q2 earnings call, we'll provide more color on what our expectations are for FY ’27 and beyond in our April earnings call. That’s our normal cadence, if you will. It allows us to see how the rest of the year unfolds from a consumer perspective and from a macroeconomic perspective as well. So more to come on that.

That being said, the guidance that we provided last April was given under a different set of macroeconomic conditions, and the macroeconomic environment has worsened since that time. So that will all go into our planning process and will be reflected in the guidance that we give in April.

William Newlands

And Nadine, relative to December, December came in roughly where we expected. It was fairly consistent with our expectations. For those of you who track the Circana/IRI data, you saw there was a very strong result against our business around the Christmas holiday. Noting, of course, that that’s a great reflection of the strength of our overall brands and the brand health that exists for our brands. And therefore, we were quite comfortable coming out of December as the first month of our last quarter of the year.

Operator

Next question is coming from Lauren Lieberman from Barclays.

Lauren Lieberman

Want to talk for a second about capacity and CapEx. So in the slide deck, you reiterated the plans for 7 million additional hectoliters of capacity through fiscal ’28. I think that implies sort of heavier CapEx in 4Q tied to Veracruz. I just wanted to maybe get an update on how you’re thinking about the modular capacity build-out over the next couple of years, managing that against growth projections to support kind of what are really the optimal utilization levels. And particularly, when we think about the fiscal ’26 volumetric pace is going to be lower than what you kind of originally thought back in April, to your point, under a very different macro backdrop.

Garth Hankinson

Yes. Lauren, thanks for the call. So the approach on the modularity of the breweries is we'll continue with that approach going forward. As we've said over the course of the last couple of quarters, the way we'll manage that really is when we bring assets online, and we'll manage to bring – or we'll manage through the capacity in that manner.

What we've also said though is that when you're building capacity in a manner which we've been building capacity with long-lead items, you are making commitments to that spend. And our plan for this year is reflective of commitments that we've made on capacity expansion.

But again, we continue to monitor this and assess where the volume is expected to be. And again, we'll bring the assets online when we can. And to the extent we can delay or defer CapEx, we will. But there's a lot of long-lead equipment that goes into a brewery, and those commitments have been made.

Operator

Next question is coming from Rob Ottenstein from Evercore ISI.

Robert Ottenstein

Great. Moving more to – over to the brand side. The Pacifico brand has been an extraordinary success. It's still relatively small, but you've been working on it very diligently for 10-plus years or so. Just wondering, how – what you've learned about the brand over this time? How incremental is it? Any tweaks that you see in terms of the brand positioning and the pressure – the marketing pressure, investment pressure behind the brand for it to kind of get to what you think is its full potential, which my understanding is to be a very strong #3 brand in your portfolio?

William Newlands

Yes, Robert. Pacifico, obviously, has been a tremendous success to date, much in the same way that Modelo initially developed in the West of the United States and then has progressively moved East to become the #1 player by dollars in the United States. Pacifico is doing a very similar approach. It's the #2 brand in the State of California today. It skews younger relative to our overall portfolio and really has resonated well with consumers.

As you know, it's the #1 social – #1 on social media in terms of share of voice, and it has gained 1.5 points in the on-premise. So you're seeing significant gains in that arena as well. So we continue to invest behind this brand. As you point out, we think it's going to be a strong #3 in our portfolio as time goes forward. And you should expect to see us continue to put significant emphasis on this as it builds its way across the country, similar to what Modelo did several years ago.

Operator

Next question is coming from Dara Mohsenian from Morgan Stanley.

Dara Mohsenian

So you mentioned mid-single-digit distribution growth for the beer portfolio in the quarter. Just as we look out to calendar 2026 post the spring resets, do you think it's realistic you can drive shelf space gains for your portfolio with macros where they are? Or is that less realistic just given the weaker velocity we've seen over the last year or so? And maybe also you can just touch on the beer category itself and what you're hearing from retailers as we think about shelf space for the category in the balance of 2026.

William Newlands

Sure. Let's start with the distribution side. We continue to see distribution as one of our strongest opportunities going forward. Given that our portfolio gained share in 49 of the 50 states, we continue to earn additional distribution capability and distribution positions across the country.

Now those will probably change some. You've seen a radical increase in distribution around Pacifico, going back to Robert's question a moment ago, as well as Victoria, which also has grown double digits for the most recent past. So we continue to see distribution as a significant opportunity going forward.

Remember, Modelo itself, despite the fact that it's the #1 beer by dollars in the U.S., it still has 20% fewer PODs than the broader domestic players who we compete against. So there remains plenty of opportunity for distribution to be an important part of the future. That has been reemphasized by our Shopper-First Shelf, which has allowed retailers to recognize the opportunity to build a stronger section. And that will be a significant part of your category question, is as more people do Shopper-First Shelf, it will be better for the category and, as you would expect, on brands that are growing their share like ours are, it will be good for us as well.

Relative to the beer category overall, it still remains challenged. And it's largely around the Hispanic consumer. 75% of the Hispanic consumers are very concerned about the socioeconomic environment and they're being much more careful about their spending patterns, spending much more on what you would call consumer essentials versus other categories. So I think that's going to continue to be volatile going forward. But this is where our focus remains on controlling the controllables, and that is distribution, that's price pack architecture, that's doing the right things to set ourselves up for a successful future.

Operator

— ***Operator Instructions*** — Our next question is coming from Drew Levine from JPMorgan.

Drew Levine

I wanted to follow up again on the beer margins implied for fourth quarter given the low single-digit absolute COGS increase for the year. Implies gross margins, I think, something in the 47% range. I understand that it is lower volume, as Garth, you well mentioned. But I guess maybe if you could sort of provide a little bit more context on the expected head-wind from aluminum and depreciation that you mentioned, any sort of quantification there? I'm just asking because, I guess, last year in fourth quarter, volumes were down as well and obviously much stronger margin performance. So just on the margins, that would be great.

And then another follow-up just on the depletions in the off-premise, I think were down 2.9%, ran decently ahead of where we saw both Nielsen and Circana end up in the third quarter, it's the second quarter in a row that's happened. So wondering what you're seeing in the independent channels, if it's just sort of a function of easy comparisons, or are you seeing any sort of encouraging trends in that channel?

Garth Hankinson

Yes. So just to reiterate on the margins, what the headwinds were, and again, you noted that it is our low seasonal quarter. Just for clarity, again, it's 20% of our overall volume for the fiscal year. As I mentioned, depreciation, which was a benefit for us in Q3, will be an incremental headwind in Q4 because incremental assets are being placed into service. So that will be a headwind in the quarter.

And then on tariff, as expected with tariffs, aluminum pricing has gone up, so the tariff has gone up. There's been an ongoing shift in our business, in our portfolio towards aluminum. That's continued through the fiscal year, right? So we'll see the impact of that in Q4. And then there is a timing element around tariffs, which is you incur the tariff when you bring it into the U.S., but then it doesn't run through your P&L until you sell it on. And so given the way tariffs have layered in through the year, there's going to be a higher tariff impact as expected in Q4.

Another minor impact, headwind in Q4 is there were some expenses that we expected to incur in Q3 that had pushed into Q4. That's just timing. So a bit of a benefit in Q3 versus a headwind in Q4.

William Newlands

Relative to your question related to depletions, I think a couple of things to keep in mind that you don't always see. Some of the regions have less tracked channel coverage, and those have been stronger, on-premise. A year ago, Modelo was #5 on draft, today it's #2. I already mentioned when I was answering Robert's question on Pacifico, that we picked up significant share with Pacifico in the on-premise as well. So some of those areas that are not as easily tracked have gone in our favor, and that certainly has helped the depletion layout versus what some of the expectations were.

Operator

Next question is coming from Gerald Pascarelli from Needham & Company.

Gerald Pascarelli

Question for Bill. Just despite the continued macro pressures, your depletions have remained relatively consistent this year, just kind of down 2.5% to 3%, so not getting materially worse. Your Beer Business continues to outperform the category. It looks like scanner showed a little bit of an improvement in December. So just curious how you're thinking about a potential recovery, if at all, in your Beer Business looking out over the next year when you just consider some of the obvious tailwinds, the easier compares, the benefit of the World Cup, those types of things. Any color there would be great.

William Newlands

Sure. Obviously, we're cautiously optimistic that we're on the sort of the plateau of where the business will be. But it's been really tough to judge; the volatility has been great. What – so it's very hard to say that you've sort of hit the bottom.

When you look at our Omnibus study, we continue to see Hispanic consumers being particularly concerned. There seems to have been a little bit of uptick with the broader market community. And as I alluded to earlier, Christmas week was particularly strong for our business. But I think that's more reflective of when consumers are coming out and they're buying. They continue to buy our brands because of the brand health of those brands.

There are some things, as you point out, next year, World Cup is a great example, where there will be things that are beer moments. And certainly, we believe our beers will help to support those beer moments. But it's very difficult to project at this point how this is all going to go. A lot of it is going to relate to what the – how the consumer is feeling and how they're feeling about the sort of macroeconomic issues that exist today.

Operator

Next question today is coming from Robert Moskow from TD Cowen.

Robert Moskow

Thanks for the question, unfortunately, it was also Gerald's question. But maybe if there's a way to think about it just quantitatively, your Hispanic consumer really started feeling the pressure in February of last year. You kind of see it in the data. And I guess what we're all kind of wrestling with is, once we lap that initial shock of restrictions on immigration policy, is it possible that it just gets a little bit less bad? So instead of mid-single-digit declines just theoretically with this cohort, since you're lapping the initial shock, it could be a little bit better than that?

William Newlands

Well, we hope – we assume that you – we hope you're correct. That would be a lovely outcome. The thing that we consistently see, and as you know, and we've said this in prior quarters, we track it by ZIP code. And with ZIP codes that have greater than 20% Hispanic representation, it still remains very challenging. That has seen some improvement in ZIP codes with less than 20% Hispanic representation, and you see a lot of volatility state by state depending on what is going on with immigration policy in particular markets. So all of those factors have been why it's been very difficult to predict, because you do have that volatility that goes on state by state, market by market.

It's why we continue to talk about controlling the controllables. It's why we continue to talk about and put ourselves in a good position to win. It's why we have focused on the things that are working in our favor, things like Pacifico and Victoria, Modelo Draft, Corona Sunbrew, Corona Non-Alcoholic, all of which are working very well against our business and are positioning us not only to have near-term success, but for the long run as well.

Operator

Next question is coming from Filippo Falorni from Citi.

Filippo Falorni

Happy new year. I wanted to ask on the beer pricing environment. You had 1.5% pricing in the quarter, but you have also some negative mix from package types. Can you discuss like how you're thinking that would evolve going forward? Should we still think this dynamic continues?

And then maybe if you can touch on like some of the initiatives that you did with Modelo Oro and Corona Premier in terms of the price adjustments. Are you seeing a volume uptick as a result of the price adjustment there that could we see some more – in some more other brands to try to respond to the macro environment?

William Newlands

Sure. We continue to project 1% to 2%. We still think that's an appropriate level. As you know, it will vary higher or lower within that range depending on the market conditions that we face. But to your point, we are quite pleased with the initial work. As many of you know, during this past – or this past calendar year, we adjusted Oro and Premier pricing to be more in line with the average price point the consumer was expecting for light beers. We're very pleased with what that looks like. Our trends on Oro and Premier have both improved, and we're pleased with that positioning.

It also points to price pack architecture, which is also an important part of what we have done. We have added 7-ounce in a number of forms and formats in different states, to again meet the needs of consumers who are concerned about price points because of their socioeconomic concerns and financial concerns that exist at the moment. Again, all of those things are trying to meet the consumer where they are today, and that process will continue going forward.

Operator

Next question is coming from Peter Galbo from Bank of America.

Peter Galbo

I maybe just wanted to ask a clarifying comment from your prepared remarks about the fourth quarter specifically. You talked about an expectation of year-over-year volume declines in the Beer Business to improve, I think, in the first sentence. And I just, I wanted to clarify whether that is a shipment comment, a depletion comment, both potentially, but that we should still be expecting kind of a negative in the fourth quarter and whether it applies to both ships and depletes in beer.

William Newlands

Garth will add on to what I'm about to say, but as we've made note – we made note in our last quarter, we expect over the course of the last 2 quarters that ships and depletes will be basically equal. As you saw, there was some minor variation in this quarter. You would expect that to probably reverse itself next quarter. But over the course of the 2, third and fourth quarters, we expect depletes and ships to basically be exactly the same. Anything you want to add to that, Garth?

Garth Hankinson

Bill, that's precisely right. And the comment was specific to billings, so to your point, so that the second half of the year billings and depletions are largely aligned.

Operator

Next question is coming from Bill Kirk from ROTH Capital Partners.

William Kirk

So a different type of question. In December, President Trump signed the executive order pushing to reschedule cannabis. I guess if that happens, how would it impact how you think about your exposures to that segment? And then on the ban on intoxicating hemp and intoxicating hemp beverages, in some states, those have become kind of a real market. Do you think you'll benefit if those products go away, those intoxicating hemp beverages go away?

William Newlands

Obviously, we have shares in Canopy that we still have available to us. And I think that could ultimately be interesting as that market develops. But we don't engage on a day-to-day basis in the cannabis business today. I think – we have not seen a significant issue related to our Beer Business related to hemp. It has mostly been around ready-to-drink and ready-to-serve scenarios where there seems to be interaction there, and that seems to be where most of the interaction has come.

But admittedly, consumers make choices around their disposable income and what – where they choose to spend money. And therefore, as this develops, that's certainly something that we're going to be quite aware of and keep our eye on closely.

Operator

Next question is coming from Michael Lavery from Piper Sandler.

Michael Lavery

I was wondering if you could maybe just elaborate a little bit on how to think about World Cup. It's, as you pointed out, just a driver of occasions. But have you – can you give a sense of maybe what you've seen in the past in terms of maybe a positive lift, or any changes to your spending approach? I realize you're not a sponsor. So do you still plan some ways to kind of spend additionally around it or just kind of benefit from occasion momentum? How should we think about just what impact that might have both on the top line side and maybe your spending side?

William Newlands

Sure. As you would expect that this is a big sporting element for the coming year. Sporting elements tend to be big beer moments. It's also a sport that over-indexes in the Hispanic community. All of those things, therefore, over-index into our business. So we would expect as the consumer engages with that event and the various games that will attest to those, that will have some incremental benefits for us. We will remain as diligent as we always are to get the right promotions and to get the right shelf presence and floor presence around that particular time.

We'll also have in-game media, TV media. As you know, Modelo is the #1 share of voice and Corona is the #3 share of voice in traditional media. All of that will be done consistent with investing against sports, which has been the focus of our attention anyway. So we believe that has an – that creates an opportunity for a strong window of time for beer generally and more specifically to us.

Operator

Thank you. We've reached end of our question-and-answer session. And that does conclude today's teleconference and webcast. You may disconnect your lines at this time, and have a wonderful day. We thank you for your participation today.