Constellation Brands Inc, Q4 2020, Earnings Call 2020-04-03

Presentation

Operator

Welcome to the Constellation Brands Q4 Full Year FY '20 Earnings Conference call. — ***Operator Instructions*** — I will now turn the call over to Patty Yahn-Urlaub, Senior Vice President of Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thanks, Josh. Good morning, and welcome to Constellation's Year-End Fiscal 2020 Conference Call. I'm here this morning with Bill Newlands, our CEO; and Garth Hankinson, our CFO. As a reminder, reconciliations between the most directly comparable GAAP measure and any non-GAAP financial measures discussed on this call are included in our news release or otherwise available on the company's website at www.cbrands.com. Please refer to the news release and Constellation's SEC filings for risk factors, which may impact forward-looking statements we make on this call.

Before turning the call over to Bill, similar to what we've done in prior quarters, I would like to ask that we limit everyone to one question per person, which will help us to end our call on time. Thanks in advance, and now here's Bill.

William Newlands

Thank you, Patty. And let me add my welcome as well. Let me quickly frame up the key themes you're going to hear from Garth and me today. First, we delivered strong performance in fiscal '20, led by our beer business, which generated double-digit operating income for the year, with accelerating IRI trends as Q4 progressed, and that momentum has continued in the early stages of fiscal '21. We have ample brewing capacity to continue fueling the growth of our beer business in the medium term, and we're working with local authorities and government officials in Mexico to ensure we have ample long-term capacity as our business continues to grow and evolve.

Second, our high-end power brands and successful new product launches fueled performance in fiscal '20 that drove accelerating depletion trends in Q4 for our Wine & Spirits business as our premiumization strategy continues to take hold. And third, our strong performance and financial discipline generated record cash flow, reduced our outstanding debt and build solid momentum heading into fiscal '21. We'll talk in more detail about each of these areas, but before we go any further, I would like to take a minute to address current circumstances related to the COVID-19 outbreak. First and foremost, our thoughts and prayers go out to those affected by this terrible virus and to the first responders and health care professionals working to help those in need. We sincerely hope the increased efforts to more fully contain this virus gain strong traction soon. With this in mind, we operate with a customer-focused mindset, a genuine concern for people and a desire to make a positive difference in our communities that is core to our DNA, even more important today as our industry and communities face substantial hardships.

As such, Constellation, along with a number of our brands, has committed more than $2.5 million toward COVID-19 relief efforts that will directly benefit our business partners and communities now and through their recovery. Specifically, we are supporting the National Restaurant Association Educational Foundation Restaurant Employee Relief Fund, the U.S. Bartenders Guild and first responders who continue to support those in need in communities across the U.S.

I'm also extremely proud of the Constellation team for their continued efforts to meet the needs of consumers and to help keep the economy going while also keeping our people safe. The health and well-being of our employees is our #1 priority, and we've taken a number of preventative measures and provided a number of protections to keep our employees safe in our operations and out at retail and to ensure our continued ability to meet the needs of the market.

Our production facilities in the U.S., Mexico, Italy and New Zealand are operational, and our distributors are up and running. Our teams are also working hard to ensure our distributor and retail partners have ample supply of our products to meet consumer demand, particularly in the off-premise, which has seen accelerated growth as many restaurants and bars have suspended dine-in services to help mitigate spread of the virus. The off-premise channel represents 85% to 90% of depletion volume for both our beer and our Wine & Spirits businesses and over-indexes to the rest of the beverage alcohol industry in the U.S. versus the on-premise channel. These trends are reflected in recent IRI data ending 3/22, which shows accelerating consumer takeaway trends in off-premise channels. Specifically, we've seen IRI dollar sales growth for our beer business increase to 24% in the 4-week period ending 3/22 versus 12-week and 52-week trends of 17% and 12%, respectively.

For our Wine & Spirits power brands, we're also seeing accelerating growth of 23% in the latest 4-week period versus 12- and 52-week trends of 7% and 4%. During this time, we are focused on the channels the consumer is choosing, namely 3-tier e-commerce, direct-to-consumer and the off-premise, especially big-box grocery, mass and club channels, where we are working diligently to ensure high-end stock positions for our key SKUs.

We've also adjusted our marketing approach to ensure our consumer messaging is in tune with current realities and by shifting our focus to digital and social media platforms as sporting events and other major gatherings are suspended. Bottom line, we are well positioned to continue meeting the needs of consumers as well as our retailer and distributor partners. We will continue to manage our business with focus and discipline while remaining flexible and are willing to adapt as needed to shifting consumer behaviors. And I remain extremely optimistic about the long-term prospects for our business.

Now let's get back to those themes that I highlighted at the top of the call. As mentioned, our beer business once again delivered exceptional results in fiscal '20 and continues to be the leader in the high end and a cornerstone of growth in the U.S. beer industry. Imports continued to be one of the primary growth drivers in the high end and the total beer category, with Constellation driving 100% of the growth in this segment. The primary drivers of our beer portfolio growth continued to be our Modelo and Corona brand families. The trio of brands that comprise the Casa Modelo brand family includes Modelo Especial, Modelo Negra and Modelo Chelada and is one of the biggest forces in beer, delivering more than 20 million cases of growth to the U.S. beer category last year. Modelo Especial led the way as the top non-seltzer share-gaining beer brand in the U.S. beer industry, achieving depletion growth of more than 16%, an acceleration over the previous year's trend of 12%.

Modelo Especial is now the #4 beer brand overall in the U.S. beer market and the best-selling beer in major markets like Chicago as well as the states of Nevada and California, where sales of the brand are greater than the 2 biggest premium domestic light brands combined. We plan to invest at record levels this year for Modelo to reach more consumers and to increase the brand's appeal among total market consumers. We'll accomplish this through innovation, investment in Spanish language media and targeted programming. And we'll extend the brand through new pack sizes, such as our 7-ounce Modelito, a popular format, particularly in C-stores; innovation with new product offerings, like Modelo Chelada Mango y Chile; and we're testing new spirits, barrel-aged offerings on a smaller scale that remain true to the essence of the Modelo brand and align with consumers' desire for more flavor. I'm talking about Modelo Reserva, which is a golden, sessionable, refreshing lager with a 5.5% ABV that will be available in test markets in tequila and bourbon barrel-aged options.

Modelo's strength with Hispanic consumers continues to fuel the growth of this brand. And with more than 1 million Hispanics reaching legal drinking age each year, combined with our continued efforts to broaden our appeal with general market consumers, we believe we're only scratching the surface of where this brand can go.

Our flagship Corona brand remains the #1 imported brand family in the U.S., selling just shy of 150 million cases in fiscal '20. In fiscal '21, we'll embark on a comprehensive master brand restage for the Corona brand family that drives a more cohesive look and greater consistency in marketing communications across sub-brands as well as new heritage and experiential programs designed to strengthen the bonds consumers already have with Corona. We're also excited to launch a new cause marketing program focused on protecting our beaches through our partnership with Oceanic Global, a leader in ocean conservation. We believe this program will further deepen the emotional connection Corona consumers have with the brand.

Corona Extra is the seventh largest brand in the U.S. beer category and remains the #1 brand in New York City, Miami, D.C. and is the top 3 brand in 8 other major U.S. markets. Brand equity for Corona Extra remains extremely strong, and sales have accelerated in IRI, with 4-week and 12-week trends outpacing their corresponding 52-week trends. We remain bullish on Corona Extra's future potential, knowing that there are several large DMAs, that based on high per capita income, are right for Corona Extra growth.

In only its second year as a national brand, Corona Premier grew depletions nearly 19% in fiscal '20 to 10 million cases and became the #5 growth brand in the U.S. beer category, with distribution continuing to grow double digits. In just 2 years, Corona Premier has achieved an ACV of almost 75, which is similar to some brands that have been around for decades. This brand is perfectly positioned to capitalize on the macro trends of betterment and premiumization as consumers trade up from domestic lights, and we have plans in place to continue building traction for this brand, including winning with Hispanic consumers who comprise about 30% of its consumer base.

In fiscal '20, Corona Refresca became a 3 million-case brand in its first year, with a variety pack becoming the #5 top-selling new beer in IRI. This now gives Corona an ownable play in the ABA space, delivering tropical flavors to a range of consumers. To capitalize on the success of Refresca, we will be extending the brand into the high-ABV, FMB space this fall, with the launch of Corona Refresca Mas 24-ounce cans with 8% ABV in tropical berry and mango citrus flavors.

We are very excited about this year's Corona Hard Seltzer launch, which is off to a strong start and has already achieved an ACV approaching 50 in its first month of national launch. As we said before, the hard seltzer category continues to grow at a break-net clip, and we believe it's here to stay. As an aside, our recent venture investment in PRESS seltzer provides a wonderful complement, with a unique value proposition and price point as we believe the hard seltzer segment will price-stratify over time.

Our Pacifico brand grew depletions more than 13% in fiscal '20, which represents an acceleration over the previous year. Pacifico is the #7 beer overall in California, where it continues to grow double digits. In fiscal '21, our plans will focus on continuing to win in California while further expanding awareness and trial in key DMAs across the country. This includes a 40% increase in digital marketing investment, including our first national YouTube buy, a new sponsorship with the L.A. Chargers and continued partnerships with the Summer and Winter X Games, which will help us to do just that.

In addition to our continued focus on accelerating growth for our core beer franchises, we're also leveraging innovation and domestic production capabilities to launch new-to-world brands that allow us to compete in growing sectors of the high end. Our recent launch of Two Lane, in partnership with country music star, Luke Bryan, is a great example. This beer plays in the domestic high-end sessionable space and delivers on the refreshing taste consumers want with only 99 calories, 3 grams of carbs and 4.2% ABV. In fiscal ’21, Two Lane will be available in select markets in the southeast.

In support of our efforts to build brands consumers love, our commercial team continues to work with our 3-tier partners to ensure we deliver world-class execution at retail. This includes increasing adoption of shopper-first shelf principles by making it easier for consumers to shop by organizing shelf flow in ways that help maximize growth and profitability and by meeting consumers where they are going by allocating space based on future growth opportunities and ensuring highly incremental packages with high velocity are represented with adequate holding power. We currently have 6,000 retailers that have implemented shopper-first shelf principles. And those who have embraced this program have seen solid increases in overall growth and profitability for their category. As you can see, we believe fiscal ’21 holds great promise for our beer business, with a healthy core master brand innovations and emerging brands poised to grow.

From an operational perspective, we continue to make strategic investments in our beer business to ensure we have the capacity, quality, control and flexibility to support the continued growth of our business in the medium term based on our forecast. The capacity we’ve built in Nava plus Obregon when completed at the end of this year will enable us to provide more than 400 million cases of beer, which is ample supply for several years to come. We also completed construction of furnace #5 at our Glass Plant adjacent to our Nava brewery, which now supplies 60% of the glass needs for that brewery, resulting in significant logistics savings.

Earlier this week, I met with Mexican President, LÃ³pez Obrador, and his team in Mexico to discuss our brewery construction project in Mexicali. Our discussions were constructive and surfaced several options for consideration. We will continue to work with local authorities and government officials in Mexico to reach an optimal solution for our business. We've had a positive, mutually beneficial relationship with Mexico for more than 30 years, and we fully expect this to continue.

Some of you have asked about our operations. Let me just say that we are being exceedingly careful to protect our people and to maintain ultimate safety. With that said, over the past several weeks, we've taken steps to build ample product supply across our warehouse and distributor network in the U.S. We have close to 70 days in the system. And we've shifted resources to accelerate production of high-volume SKUs for key off-premise accounts. Our facilities are currently operating, and we remain confident in our ability to continue meeting the needs of U.S. consumers and do not expect any near-term service disruption to retailers.

Shifting now. Our Wine & Spirits premiumization strategy continues to show promise as our business closed out fiscal '20 in a position of strength, posting accelerating power brand depletion growth and operating margin improvement in the fourth quarter. Fourth quarter power brands' family depletion growth accelerated to more than 4%, led by double-digit growth for Kim Crawford, Meiomi and the Prisoner brand family as this collection of brands continued to outpace the total U.S. wine market. Operating margin expansion was driven by our focus on more efficient price promotions with our mainstream power brands as well as market share gains in the higher end of our portfolio, with Meiomi and the Prisoner family contributing strong mix trends.

Innovation continues to fuel growth as we capitalized on innovation trends in consumer-driven growth segments. Our introduction last quarter of Unshackled by the Prisoner wine company has been extremely well-received. We further capitalized on barrel-aged wine trends with the introduction of new offerings from both Woodbridge and Cooper &

Thief. Since launching our first barrel-aged wine series a little more than 2 years ago, we have sold well over 2 million cases, and that number continues to climb. In response to the consumer-led trend around convenience, we launched Kim Crawford wine in a can. And our Crafters Union brand remains the #1 growth driver in the can wine segment.

We're also excited about the recent launches of SVEDKA botanical flavors and Ruffino organic Prosecco, which align with consumer trends for flavor, betterment and sustainability. Bottom line for fiscal '20, our Wine & Spirits transformation focused on premiumization continues to gain traction. Our higher-end power brands are driving mix and margin expansion. Our mainstream power brands are outgrowing the competition. And our innovation initiatives are fueling growth through velocity and distribution gains. Heading into fiscal '21, we are committed to investments in bold innovations, compelling marketing campaigns and immersive brand experiences, with a specific focus on top markets and accounts in priority DMAs.

We'll continue building momentum by further leaning into our premiumization strategy and maximizing growth opportunities for our power brands through compelling marketing campaigns for Woodbridge, Kim Crawford, Meiomi, SVEDKA and the Prisoner. We're instituting greater pricing discipline, consistent with strategies that have proven very successful in building strong brands in other parts of our beverage portfolio. And we'll continue to leverage the power of existing brands with strong equity. We remain committed to mix and margin-accretive innovation and growing sectors of the Wine & Spirits categories that align with consumer trends. We have a strong innovation pipeline planned for the coming year, including upcoming line extensions for Ruffino and SVEDKA Vodka in the RTD space, the launch of a new High West pre-mix cocktail in the spirit space and the expansion of our highly successful barrel-aged wine program. You can also expect us to introduce new-to-world brands in the wine category. In addition, we plan to leverage the success of shopper-first shelf initiative developed by our beer business by adapting and implementing this program for Wine & Spirits retailers in fiscal '21. We recently took pricing on our Woodbridge brand beginning March 1, and to date, we have seen no negative impact from this action due to the consumer need to stick with tried and true brands in this time of uncertainty. We are actively supporting this price increase with marketing investments, including national TV, as well as digital and social advertising.

We are in the final phase of completing the revised Gallo deal, and we continue to work with the FTC primarily on the brands that have been excluded from the original deal. We have communicated our intent to retain the Cook's and J. Roget brands, and the FTC is currently reviewing our business plans to support these brands in the future. In addition, the FTC is vetting the potential buyers we have identified for Paul Masson Grande Amber Brandy and our concentrate business. We continue to work, in collaboration with Gallo, to satisfy all FTC obligations, and both companies are fully committed to getting this deal done. With each step, we are marching closer to the finish line, and we expect to close the deal around the end of our first quarter.

Finally, we're very encouraged by the steps David Klein is taking in his new role as CEO of Canopy Growth. David and the Canopy team recently announced they are focused on 4 key areas: improving Canopy's connection with consumers; instilling greater focus and discipline across the organization; defining a visible path for profitability and positive cash flow; and building the company's credibility with key stakeholders. Canopy continues to be the global leader in total cannabis sales, with a leading market share in Canada. The company recently took steps to rightsize its business to better align with consumer demand and position the company for long-term success. Canopy just launched its first cannabis beverage product, Tweed Houndstooth & Soda, which has received an overwhelmingly positive consumer response, and they plan to roll out additional beverage products over the last few months. And I can tell you, they are awfully good. These are game changers.

They also have completed their first shipments of cannabis-infused edible chocolates and JUJU Power 510 batteries in December of 2019. We expect further revenue growth as products like vape, edibles and beverages gain traction in the marketplace now that Rec. 2.0 products have been legalized in Canada. Canopy remains best positioned to win long-term and to face challenges associated with this current economic environment as many competitors without access to capital show signs of trouble.

In closing, we reached the conclusion of an excellent year in fiscal ’20. Our path to these impressive results was paved with great execution and consumer obsession in growing our core business, supported by investments, to enhance our portfolio and our operations. We are now facing an increasingly challenging operating environment and rapidly changing market conditions. As you can see from our press release, we are not providing formal guidance. However, we’ve provided the targets that are included in our original fiscal ’21 plan prior to the COVID-19 crisis. My goal in doing this is to reiterate that our strategy remains unchanged and to provide the confidence we have in the growth prospects for our core business as I continue to feel very optimistic about our long-term opportunities.

When we look at the beverage alcohol category, we are generally a recession-resistant industry. In previous recessions and downturns, the TBA industry has generally been noncyclical and only minimally affected. Bottom line, we manage our business for the long term, making tough but necessary decisions to adapt to consumer trends while always looking forward to deliver what’s next. We will continue to quickly adapt to rapidly evolving market dynamics, which is the continuation of who we’ve always been.

Now with that, I would like to turn the call over to Garth, who will review our financial results for fiscal ’20 and our financial focus for ’21. Garth?

Garth Hankinson

Thank you, Bill, and hello, everyone. Fiscal '20 marked another great year for Constellation Brands. We produced strong beer operating performance and cash flow results, while our Wine & Spirits power brand strategy continued to gain momentum as marketplace performance for these brands outpaced the overall U.S. wine and spirits category for fiscal '20. Specifically, in fiscal '20, we grew comparable basis diluted EPS, excluding Canopy equity earnings, by 6%. In addition, we generated record operating cash flow of almost $2.6 billion and record free cash flow of $1.8 billion. We also reduced debt by more than $1.4 billion and came within our target leverage range. And we returned over $600 million of cash to shareholders in dividends and share repurchases.

Before going into further detail on fiscal '20 results, I want to take a moment to discuss the rapidly changing market conditions due to the impact of COVID-19. To echo Bill, while the COVID-19 outbreak and situation is unprecedented and creates a lot of uncertainty and volatility, one thing remains clear, we will continue to be agile in the marketplace and actively manage and responsibly navigate our way through this crisis. Constellation is a strong cash flow generator, has ample liquidity, financial flexibility and significant capacity under our $2 billion revolving credit facility. Additionally, we remain committed to maintaining our investment-grade credit rating, which allows for flexible access to capital markets at more favorable rates. Furthermore, as Bill mentioned, we continue to work in collaboration with Gallo to satisfy all FTC obligations, and both companies remain fully committed to finalizing this transaction. As such, upon close of the Gallo transaction, we expect to receive approximately $850 million in cash, which we plan to use for debt paydown to further advance and progress – to further advance the progress we've made to reduce our leverage and maintain it within our targeted range.

More on fiscal '21 in a minute as I want to continue to expand on the fiscal '20 financial performance we delivered before the COVID-19 impacts began to unfold, where I'll generally focus on comparable basis financial results.

Starting with beer. Net sales increased 8% primarily due to shipment volume growth of 6% and favorable pricing. Depletion volume growth for the year came in at 7.5%, while depletion volume growth for our import portfolio grew 8%. As expected, depletion volume growth was higher than shipment volume growth primarily due to the FY '19 year-end shipment timing benefit that reversed during our fiscal '20, most of which occurred in Q4. Beer gross margin increased 120 basis points to 55.6% driven by favorability in pricing and FX. Our operational cost and efficiency initiatives helps offset the impact of inflation on costs such as materials, labor and freight. Marketing as a percent of net sales increased 70 basis points to 10% primarily driven by increased investment for the Modelo and Corona brand families and in support of our innovation activities, including Corona Hard Seltzer, which came in at the higher end of our previous guiding range.

As a result of the above-mentioned factors, we achieved record full year operating margin of 40%, an improvement of 70 basis points.

Moving to Wine. Net sales declined 6% on shipment volumes, down approximately 8%. Full year net sales results outperformed our previous expectations primarily due to stronger mix benefits from our power brands in Q4 driven by The Prisoner Unshackled and Meiomi. Depletion volume declined 5%, while power brand depletions were up 2%. We remain confident that our premiumization strategy is working as power brand trends accelerated as we finished fiscal '20.

Operating margin decreased 50 basis points to 26% as mix benefits and favorable SG&A were more than offset by higher COGS primarily reflecting increased grape cost and an increase in marketing as a percent of net sales driven by our premiumization and innovation activities. Corporate expenses came in slightly better than our previous guidance, finishing at $224 million, up approximately 13% versus last fiscal year. The increase was primarily driven by an increase in insurance costs, higher incentive compensation and a ramp-up in IT spend to support our SAP S/4HANA implementations. Those increases were partially offset by a reduction in consulting costs.

Comparable basis interest expense for the year increased 11% to $429 million. This primarily reflects additional interest expense related to the funding of our incremental investment in Canopy growth in November 2018, partially offset by our debt paydown during fiscal '20. Our comparable basis effective tax rate, excluding Canopy equity earnings, came in at 16.1% versus 18.2% last year. This improvement was driven by lower effective rates from our foreign businesses, partially offset by a lower level of stock-based compensation benefits. While stock-based compensation benefits were lower on a full year basis, the benefit came in higher than expected during Q4, which drove the tax rate favorability versus our previous guidance.

Now let's review Q4 results. Beer net sales increased 9% primarily due to shipment volume growth of 7% and favorable pricing. Depletion volume growth for our import portfolio showed continued strength, growing over 11%. When including an unfavorable impact from Ballast Point, total beer depletions were up 10.8%, including the benefit of an additional selling day in Q4. Beer operating margin decreased 120 basis points to 39.3% as increased marketing and SG&A spend was partially offset by benefits from pricing and COGS. Marketing as a percent of net sales was 8.7% or 230 basis points higher than Q4 last year driven by marketing investments and spend timing. Wine & Spirits net sales were up 1% for Q4, while shipment volume was down approximately 1%. As stated earlier, power brands continued to drive mix benefits. Operating margin increased 120 basis points to 28.9% primarily due to mix benefits and lower marketing and SG&A spend.

Moving to fiscal '20 free cash flow, which we define as net cash provided by operating activities less CapEx, we generated a record $1.8 billion compared to $1.4 billion last year. This represents an impressive 34% increase. Free cash flow improvement reflects strong operating cash flow and lower CapEx in the beer segment. CapEx totaled $727 million or 18% below last year's spend and in line with our most recent guidance. This included approximately $520 million of CapEx for our Mexico beer operations expansion. Furthermore, through fiscal '20, we've cumulatively spent approximately $700 million in capital related to our Mexicali expansion project.

Moving to our full year fiscal '21 P&L and cash flow targets. Given the unprecedented COVID-19 events that began to abruptly and dramatically impact consumers in the marketplace almost concurrently with the start of our fiscal year and given the related uncertainty, volatility and fast-moving developments that have evolved over the month of March, we do not believe it is prudent or appropriate to provide formal financial guidance for fiscal '21 at this time. With that being said, we thought it would be helpful to highlight some of our key financial targets assuming a normalized environment for fiscal '21 prior to COVID-19 as reference as you think through your modeling and scenario work given the changing marketplace dynamics.

For pre-COVID-19 fiscal '21, the beer business targeted net sales growth of 7% to 8%, which includes 1% to 2% of pricing within our Mexican portfolio. Including the impact of the Ballast Point divestiture, organic net sales growth is 8% to 10%. Operating margin in the 39.5% to 40% range as investments for the Corona Hard Seltzer launch as well as inflation headwinds primarily related to glass, raw materials, transportation and labor costs in Mexico are expected to be greater than the benefits from product pricing and productivity initiatives.

Moving to Wine & Spirits. For pre-COVID-19 fiscal '21, the Wine & Spirits business targeted net sales and operating income decline of approximately 30% to 35%. This assumes the revised Wine & Spirits divestiture transaction with Gallo and the separate divestitures of Paul Masson Grande Amber Brandy and the concentrate business close around the end of Q1 fiscal '21, while the separate but related agreement to divest the Nobilo Wine brand to Gallo closes by the end of Q2 fiscal '21. Lastly, the plan to retain the Cook's and J. Roget sparkling wine brands is also included in our pre-COVID-19 target for fiscal '21.

Our pre-COVID-19 expectation for Q1 Wine & Spirits results assumed a decline of 25% to 30% in sales and operating income due to the following factors: unfavorable Q1 FY '21 comparison due to a very strong quarter last year for the brands to be divested; sales of the Black Velvet brands are not included in this year's Q1 result as a result of the divestiture late last year; and distributors have ample supply of brands targeted for the Gallo divestiture as they assumed a fiscal '20 year-end close on the transaction.

Our retained portfolio of power brands in the Wine & Spirits business, including Cook's and J. Roget, targeted net sales growth of 2% to 4% on a pre-COVID-19 basis for fiscal '21. Other pre-COVID-19 target assumptions include: interest expense in the range of $385 million to $395 million; comparable tax rate, excluding Canopy equity and earnings, of approximately 18%; weighted average diluted shares outstanding targeted at approximately $195 million; and operating cash flow in the range of $2.3 billion to $2.5 billion.

This is a good spot to discuss a few items around capital management and deployment. As you would expect, we are reviewing in detail all expenses and capital expenditure plans for refinement and flexibility to make sure we prioritize and optimize this spend given the current business conditions and economic environment. While our Wine & Spirits EBIT is moving down in fiscal '21 due to the planned divestitures, we are maintaining our current quarterly dividend rate. In addition, we remain focused on our goal of returning significant capital to shareholders, balanced between dividend payments and share repurchases. However, in the short term, given the uncertainty around the COVID-19 impact on our business, we will be maximizing free cash flow and utilizing that free cash flow to reduce debt and leverage. We believe longer term, we retain the full flexibility to fulfill our $4.5 billion commitment over time.

In closing, I want to reiterate that Constellation is a strong cash flow generator, has ample liquidity and financial flexibility. We remain focused on prudently navigating through the challenging environment presented by COVID-19, and we'll look to provide updates, including full year guidance, as more factors become known. With that, Bill and I are happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog

So I wanted to get some clarification on the Mexican government's decision which determined that alcohol is nonessential. And I just wanted to make sure I understand what you're sharing with us today that, if I heard you correctly, you are not suspending your production, but what I'm hearing is a lot of the other brewers are suspending. So I just wanted to make sure I heard you correctly. And then curious to hear how you see this situation evolving and maybe what your contingency plans are. You did share with us some of the, I think, finished inventory that you have on hand to meet the U.S. demand. But I just kind of wanted to understand where you're at with that specific situation.

William Newlands

Sure. So as we stand today, we are currently operating. We also have, as I noted in my script, roughly 70 days through the system at either – and that does not include at retail, that is purely that we have or our distributors have. So we are fairly confident that we will see no disruption at retail from our operations, and we'll be able to meet consumer demand as it continues.

Operator

Our next question comes from Kaumil Gajrawala with CrÃ©dit Suisse.

Kaumil Gajrawala

Bill, I think you mentioned that you're working through a series of options on what's going to happen with Mexicali. Like obviously, we don't know which of those options you'll take. But could you at least give some insight on what your options are from this stage?

William Newlands

We're not prepared to go through what the exact options are. What I would say is this, we had a very productive meeting with the President and his team. I think there is a mutual agreement that we have been a strong player in Mexico for 30-plus years and that that strong relationship is going to continue and that we will have solutions for the long term to make sure that we are able to meet the strong consumer demand that we continue to have for our brands. So while I'm not prepared to talk about the specificity of that, we are very comfortable that our discussions will yield strong medium- and long-term benefits for our business.

Operator

Our next question comes from Vivien Azer with Cowen.

Vivien Azer

I was just hoping to go to the on-premise, off-premise mix still very helpful in terms of contextualizing the revenue mix. But Garth, I was wondering whether you could offer any insight into the margin differential given the presence of kegs in the on-premise. And then as a follow-up to that, is it possible for you guys to move cans and bottles that are no longer being sold in the on-premise into the off-premise with your distributors?

Garth Hankinson

Thanks for the question, Vivien. So to your first question, the margin differential, there's no margin differential for us between on- and off-premise because that goes through – that all goes through distributors. So same margin for us. As it relates to the question as can we move product out of the on-premise to the off-premise...

William Newlands

And let me touch on that, Vivien. In many instances, distributors will pick up and redistribute supply where necessary or where a particular channel like on-premise has effectively closed in many markets. So yes, that, in fact, often does occur. Obviously, there's some format differences in terms of what people use in particular channels. But yes, it does occur. Just to reiterate a piece of your question as well, we are multiple points across both beer, wine and spirits, less reliant in on-premise than the industry overall. So our business has been skewed historically and still is to the off-premise channel, which in an instance like this is very valuable. But that's not to say, as you've heard, that we haven't recognized the many challenges that our friends in the on-premise are having at the moment. And we, as a company, and many of us as individuals have made significant contributions to help those who are in need at the moment and who have run into very challenging times for those who are in the on-premise.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan Spillane

Garth, maybe just 2 quick modeling ones for you. One, in terms of the on/off-premise split for spirits and – Wine & Spirits and beer, could you give us a sense in the fiscal '21 plan that was unaffected by COVID, what was the growth expectation in those 2 channels? So what were you expecting for home versus growth at home? And then second, if you could give us a sense within both segments of just fixed and variable costs as we kind of want to run through sensitivity to be able to get a rough sense of fixed and variable costs.

Garth Hankinson

Now Bryan, would you mind repeating the first part of that question around the margins? I just – I didn't quite catch that.

Bryan Spillane

So the second part is just trying to get an understanding of what is fixed versus variable costs within both the beer and Wine & Spirits segments.

Garth Hankinson

Yes. Okay. So the fixed versus variable cost is, for both businesses, is they skew highly towards variable, call it somewhere in the neighborhood of 2/3 variable and 1/3 fixed, maybe a little bit higher in some cases. On the beer side, the variable costs really are around freight and packaging. And in Wine, it's grape cost and packaging. Then I believe your – the first part of your question was around the on-premise versus off-premise growth rates. And for on-premise growth rates, we were modeling in flat, and for off-premise, it was mid-single digits.

Operator

Our next question comes from Nik Modi with RBC Capital Markets.

Nik Modi

Bill, just a question on retail. I mean we are hearing that resets are being pushed back – spring resets are being pushed back. And I just wanted to get an understanding of impacting you guys because, obviously, there's a lot of new products coming in the marketplace. Corona Seltzer has gotten into the market, but not at full distribution. So if you could just give us some of the puts and takes in terms of how that's going. Are you getting just more space as your A-level SKUs and replace of some of the new products that were going to come out in the market? Any thoughts around that would be helpful.

William Newlands

Sure. You bet. We're seeing – first of all, obviously, there was – and particularly in March, there was a lot of heavy-up pantry-loading, people buying particularly those brands where they had a lot of comfort. And of course, many, many of our brands across beer, Wine & Spirits all fit into that. So that was obviously very helpful. Keeping in mind, Nik, the seltzer, much like Refresca did, goes into a different space. And seltzer has obviously been a very hot category. You see a lot of that product on the floor with us and with competitors as well. So – and we've already – in just the first month, our team and our distributors have done an outstanding job of getting the product out in the market. We've almost achieved 50% ACV in the first month, which is, again, record speed.

So we think as time goes forward, you're going to continue to see core SKUs, critical SKUs being very important. And in fact, we have made some adjustments in our production footprint to make sure that those core SKUs are fully available throughout the supply chain because that's something that we think will occur in the near-term until consumers spend more time in stores. We've also seen a very rapid uptick in things like 3-tier e-commerce, click and collect. Our company had its single biggest, in Wine, had our single biggest direct-to-consumer week we've ever had last week as consumers, again, found alternate ways to continue to buy our products.

So I think just to summarize that, you're going to continue to see critical SKUs being stronger distribution positions. But we've been very pleased with our distributors' ability to continue to get critical new products. Remember, most of the new things that we're doing this year are master brand extensions. So they are consistent and part of strong brand families. That, particularly at a time like this, I think, is important because the consumer often, during recession- or recessionary-type behavior, seeks out those core brands that they have a lot of personal comfort with. And again, our brands, fortunately, are part of that set.

Operator

Our next question comes from Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

So I wanted to ask more of a longer-term question. In past cycles, we've seen some trade-down occur in the beer category in a recessionary environment, including back in 2008, 2009. Can you just spend some time discussing how your product portfolio might be more or less at risk from a macro slowdown versus past cycles on a theoretical basis, sort of ex the COVID situation, you're at a much higher share level today, your brand mix has changed over time? So I just was curious for your perspective on the degree of trade-down risk or macro sensitivity maybe versus what we've seen in the past cycles?

William Newlands

Yes. And I joked with Garth earlier today. I guess if you're old enough, you've been through a couple of these cycles, so I have. What we expect to see is this. Brands are even more important at a time like this because many people are seeing the opportunity, and our category is one of those, for simple pleasures in life. Let's face it, the more people are sheltering in place, the more that they look for those small pleasures in life. And our category is one of those that addresses that. But you often see even stronger brand behavior that occurs during this time. So let's take our Woodbridge wine brand example. We have seen significant pickup in the month of March for that brand because, as I said in my script, it's a tried-and-true brand. People know it. They appreciate the quality for the price/value relationship that exists there. And we've seen quite a bit of an uptick against that brand.

We've seen the same thing with Kim Crawford and Meiomi and The Prisoner, brands that the consumer appreciates and likes. Similarly in beer, when you have a brand like Modelo, that's the #4 brand now in the entire U.S. beer business, you've got a brand that has a great deal of trust and you're seeing the trends that support that. Fortunately, Modelo and Corona are 2 of the most trusted brands in the consumers' mind, and therefore, we feel very comfortable that we will actually get a disproportionate amount of benefit that occurs when people go to the more tried-and-true brands. That's what we saw in 2008. That's what we saw in the previous recession before that, that those tried-and-true brands end up winning. And we think our brands are well positioned across beer, wine and spirits to take advantage of that. There's a little less experimentation during a recession environment. And that's why those core brands, like ours, will do very well.

Operator

Our next question comes from Lauren Lieberman with Barclays.

Lauren Lieberman

My question was just continuing on the – going back to the conversation about Mexico production. If we do, in fact, get to a place where you need to curtail production, even though that you've had no disruption to the retail and to sell-through, how should we think about the margins, right? So if you shut down the plant for a month, we think you get a good amount of pressure on margin, but does that even out when you ramp back up as you come out of this? So just kind of thinking about a very, very short-term question, but just trying to understand how we should think about that impact on profitability.

William Newlands

Well, again, I'm going to repeat myself, but I hope you'll bear with me on it. We continue to operate in Mexico. And as long as that is a consistent statement, and we expect that it will be, we wouldn't expect that there would be any significant issues around our margin structure. Obviously, a lot of things factor into that, not the least of which is the peso and various other things that occur during times like this. But I think the best way to think about it is we have 70-plus days in the pipeline for our beer business, and we expect to have no disruption in our ability to produce product and deliver it to retail.

Operator

Our next question comes from Kevin Grundy with Jefferies.

Kevin Grundy

Bill, I wanted to pick up on the on-premise, off-premise dynamic. I know this is a difficult question to answer, and I can appreciate that you don't want to give guidance, but maybe even qualitatively, I think what a lot of investors are kind of wrestling with is how much of the unprecedented weakness in the on-premise channel is potentially going to be captured in the off-premise. And we've seen big pantry-loading at this point, but really hard to make conclusions on what's going on in terms of how quickly consumers are going to – will destock their pantries. So any comments you have potentially on how much of the on-premise weakness will potentially be offset by the off-premise?

William Newlands

Sure. You bet. Admittedly, this is somewhat unprecedented. So I think we need to all be careful with specificity of answers because in the other recessionary periods, while you saw decreases in the on-premise, you didn't have shutdown in the on-premise. So it is a little different. With that said, channel shift is not unusual during recessionary times. And you're obviously seeing that now, in part because the on-premise is, in many markets, is largely closed. What – again, if you are in the 85% to 90% range for us in the off-premise to start with, the need to see some increase in channel shift is less significant than it is for someone who is more weighted to the on-premise.

Let's take March as an example. And admittedly, there was some pantry-loading that occurred during that month. It more than made up – the off-premise more than made up for the on-premise loss that occurred during that time frame. It was an excellent month. But we're always reticent to be – to project that forward because you don't know what the consumption profile will be. I'll repeat what I said a minute ago because I think it's a very true comment. People look for small pleasures in their life when you are in situations of recession. Multiply that by the fact that most of us are now sheltering at home. Those small pleasures – our business is one of those small pleasures. And I think that will be advantageous for our business going forward.

Garth Hankinson

As long as we're on the on- and off-premise question, let me just go back to clarify Bryan's question around the growth rates related to on- versus off-premise. Bryan, I gave you a bit of an incomplete answer. So what I gave you is 0 on-premise growth and mid-single digits. That was really for Wine & Spirits as you think about their total sales being in that 2% to 4% range. On beer, total sales, we're targeting to be 8% to 10% on an organic basis. So the on-premise would be in the sort of low to mid-single digits and off-premise would be the remainder.

Operator

Our next question comes from Rob Ottenstein with Evercore.

Robert Ottenstein

I was just wondering if you could talk a little bit about how you may be adjusting your marketing spend and what sort of flexibility you have on your contracts. Obviously, you do a lot with ESPN. A lot of sports, UFC and a lot of these events just aren't going to happen. So is there maybe some kind of breakout that you can give us in terms of what is fixed for this year or let's say, the calendar year, next 12 months, and what areas you can possibly save or redirect?

William Newlands

Sure. It's – this is also, as you would expect, a bit of a moving answer. Some things you've seen have been postponed. Therefore, we are not – while we may not spend it in the first quarter, we might well spend it when the events do occur, assuming they do. What we have done is that we have adjusted – Jim Sabia and his team, in both Wine & Spirits and in beer, have done a fair amount to move to more digital and social media efforts, which is actually good. That's very consistent with where the consumer is going anyway. So we do have quite a bit of flexibility to move things around. When you have cancellations, let's take the NCAAs. That is a cancellation. So choices are then made as to whether or not we reproportion that type of spend that we have into other formats or we don't. Those decisions are ongoing. It would be difficult to give you a definitive answer at this point in time around that. We will try to do that going forward as we more thoroughly understand what is canceled versus what is delayed. Until we have a better handle on that, it would be very difficult. But suffice it to say, one of the traits that we have seen with our marketing group is to be very nimble, and they are being very nimble, adjusting on the fly to more digital and social environments from things where we can't do live sports, as you know.

Operator

Our next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira

As a follow-up on the comments about the production in Mexico, in your discussions, Bill, with the Mexican government, in order to stay open, could you prove that your production facilities are safe enough to remain operational through the end of April? And then as a follow-up to the margin commentary, how much of your Mexico business denominated costs are hedged at this point in light of the devaluation of the Mexican peso?

William Newlands

So Garth, I'll take the first half of that. Let me just tell you some of the things we've done. And we've done this in Wine & Spirits as well as beer, and I think it's important. As I said, our employees are our #1 priority. We are testing for temperature as people enter our facilities. We are keeping social distancing in our facilities to make sure that people are safe. We have changed how we run shifts in our plant to make sure there are not an overlap of shifts in case there are any issues that occur with people's health. So we are doing everything humanly possible to make sure that we continue to operate in a safe and effective manner within all of our operating facilities. The same is true of that in New Zealand and Italy as well. So first and foremost, we are taking great care to make sure we are operating correctly.

I think that will likely be respected by the government of Mexico. They have obvious concerns for their entire economy as our country has great concerns for our economy to make sure that people are being protected. And I think the kind of steps that we are taking to make sure that we are protecting our people, we believe, is best-in-class. We are keeping track of everything possible to ensure the safety of our employees, and that effort will continue. Garth, do you want to touch on the second piece?

Garth Hankinson

Sure, on the hedging piece. So as it relates to both commodities and on currency, we're current – for the current fiscal year, fiscal '21, we are hedged on both fronts in excess of 80%. We are using this period of time though as we see some movements on commodities and in currency to layer in additional hedges for the next couple of years. So we could see some further benefits in coming fiscal years.

Operator

Our next question comes from Laurent Grandet with Guggenheim.

Laurent Grandet

So 2 follow-up questions, actually. One, you said you will focus on the core brands going forward, I mean, and that makes sense. I would like to understand if Corona Seltzer is considered as a core brand and being – will be one of your focus points for the next 2 months. That's one question. And the second one, I'm sorry to come back on this manufacturing in Mexico, but this morning, again, I mean, one of your competitors said that on Sunday, April 5, Grupo Modelo, will suspend beer production and distribution operations. So as you've got 70 days of inventory, and obviously, you want to be kind of a goodwill with the Mexican government on the Mexicali brewery subset, so why – I mean there is something I don't understand. Why are you – have you decided to go against some of the government decision in that specific subset?

William Newlands

So let's tackle your first question, which is Seltzer. Certainly, our Corona brand family, since we approached 150 million cases of product in fiscal '20, is one of the critical things and critical brands that we have within our portfolio. The Seltzer, as you know, is one of the fastest-growing subsegments within the alcohol beverage business as well. Therefore, the combination of the great Corona branding plus the hot category of seltzer is a wonderful combination, and we're expecting that that's going to be an important part of our success story for fiscal '21.

I do need to be very clear with you. We are not doing anything against what the government of Mexico is suggesting. We certainly – our company is known for respect, being respectful of the laws and approaches of any company, of any country in which we operate, and that certainly will continue. I have no comment regarding a competitor and what they are choosing to do or not choosing to do. I personally would suggest you ask them. What I would say is, today, currently, we are operating, and we will continue to do what's appropriate under the restrictions that apply or don't apply in any company and in any country in which we operate.

Operator

Our next question comes from Bill Kirk with MKM Partners.

William Kirk

So on the 70 days of inventory in the system, how much of that is in Mexico? But I guess, it will show up in the 10-K, but how much of it is in Mexico? And how much of that is actually allowed to leave Mexico and into the United States? Is that allowed to come over the border right now?

William Newlands

So to answer your question, the vast majority of that answer is in the United States between either the inventory at our distributors or in our DCs. So the vast majority of it, I would say, in excess of 80% of that's already in the United States.

Operator

Our next question comes from Bill Chappell with SunTrust.

William Chappell

I just want to go back to Mexicali, and I understand you can't talk about where it goes from here. But can you maybe give us an update on how much money has been put into it? And then any kind of color on how you've got this far down the path and we got to this stage?

Garth Hankinson

Yes. So I'll take the first part of that. To date, we have spent approximately $700 million in CapEx in Mexicali.

William Newlands

So what I would say is that there are a lot of decisions that have been made as time has gone on. As you know, there have been changes in government during the time that this facility has been started. What I would say is this. We've been operating in Mexico for 30 years. It has been a tremendous partnership with the people of Mexico and with the government of Mexico and with the local states within Mexico. We remain extremely confident in our long-term ability to meet the consumer needs in the United States for the critical brands of Modelo, Corona, Pacifico and other related brands. So I don't feel that it does anyone any good to micromanage the approach to the situation. What I would say is we're going to have a very solid solution for our long-term prospects, and we certainly appreciate the government's engagement with us on that topic.

Operator

Our next question comes from Sean King with UBS.

Sean King

I got a wine sale question. Is it safe to say that the escalating COVID-related work stoppages and disruptions could have an impact on the, I guess, achievability of the new timing? Or was that already baked into your new outlook?

Garth Hankinson

So thank you for the question. Now we think that the COVID situation is baked into the current time line. That being said, I don't know how much more disruption COVID-19 could have in terms of the government's ability to work. But I can tell you right now that the FTC continues to be actively engaged in our conversations and in the review of this process, and we've factored all of that into the time line that we provided.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Bill Newlands for any further remarks.

William Newlands

I would just like to thank everyone for joining our call today, particularly in these challenging times. I believe we've done an excellent job of building vital momentum in fiscal '20 as we head into what admittedly will be a volatile start to our new fiscal year. Through our strategic initiatives and priorities, we are positioning Constellation for sustained long-term success, and we'll continue to quickly adapt to the rapidly changing market dynamics as we navigate through fiscal '21. As the environment evolves and more factors become known over the next few months, we hope to be able to provide much more clarity on the prospects for our business for the year in which we are in.

I would like to thank you all again for joining the call, and I hope you and your loved ones remain healthy and safe during this unprecedented time. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference call. Thank you for participating. You may now disconnect.