Constellation Brands Inc, Q3 2021, Earnings Call
2021-01-07

Presentation

Operator

Welcome to the Constellation Brands Q3 Fiscal Year 2021 Earnings Conference Call. — *Operator Instructions* —

I would now like to turn the call over to Patty Yahn-Urlaub, Senior Vice President of Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thanks, Jonathan. Good morning, and welcome to Constellation's Third Quarter 2021 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 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 schedule. Thanks in advance, and now here's Bill.

William Newlands

Thank you, Patty. Good morning, and Happy New Year, everyone. Welcome to our third quarter call. I hope you enjoyed the holidays and had an opportunity to enjoy some of our fine products in whatever form your celebrations took.

Before I jump into my prepared remarks, let me first acknowledge the disheartening and tragic events that unfolded in our nation's Capitol yesterday. I join other leaders across the country in condemning the violence that occurred. Instead, calling for a peaceful transfer of power that upholds our democracy and calling for peace, unity and stability as we move forward as a nation.

Now let's move on to a discussion of our business performance. 2020 was certainly a challenging year. And like many of you, we are happy to turn the page. As we do so, I'm mindful of the words of American novelist James Lane Allen who said, "Adversity does not build character, it reveals it." This is certainly the case for us. Our team rose to meet many challenges that surfaced in 2020. This included overcoming many negative impacts from COVID, most notably, a significant volume reduction in the on-premise, a slowdown in production of our Mexican beer portfolio heading into our busiest selling season and threats to the safety, health and well-being of our team members.

Despite all that, we continued to build momentum for our high-performing beer brands and launched Corona Hard Seltzer just as the pandemic started to gain steam in the U.S. Impressively, this remains one of the most successful new product launches in our company's history. We continue to transform our Wine & Spirits business, leveraging innovation to drive higher growth and margin performance while investing in capabilities needed to win long term, such as DTC and 3-tier eCommerce. And successfully working through the complexities of our transaction with Gallo, which, now that it is complete, positions our Wine & Spirits business to become a more meaningful contributor to our overall growth profile.

And we've also supported our communities by providing much needed assistance to those impacted by COVID and West Coast fires, by taking steps to achieve greater racial equity within our company, our industry and our surrounding communities, by once again earning recognition from the Corporate Equality Index as a great place to work for members of the LGBTQ community and by improving our carbon disclosure project ratings for climate and water stewardship.

While 2020 will be remembered for many things, what I will remember most is the character that was revealed by our leaders and team. Preventative measures implemented across our business helped mitigate impacts related to COVID while maintaining full employment resource levels. I continue to be inspired by their resilience, focus and determination for driving the success of our business, and this bodes extremely well for our future. Thanks to the tireless efforts of our team, our business partners, we delivered excellent third quarter results.

As Garth and I run through the highlights of the quarter, there are 3 things that I ask you to keep in mind. Number one, our beer business, the biggest catalyst of our growth, remains extremely strong with accelerating trends in IRI. Consumer demand for our core beer brands continues to be robust. The introduction of Corona Hard Seltzer has exceeded our expectations, and we're back to gaining share in IRI as we continue to recover from the slowdown in production earlier this year due to COVID. Number two, the completion of our transaction with Gallo to divest a number of our lower end wine brands priced at $11 and below at retail has set the stage for accelerated growth and profitability, driving focus more fully on a tighter set of powerful brands that already have traction with consumers. And number three, despite the challenges faced in 2020, we're on track to deliver another strong year of growth, consistent with our long-term goals.

I'm proud to say that our business remains healthy, allowing us to provide fiscal '21 guidance that, I'm sure you will agree, reinforces our strategic growth priorities and strong cash generation capabilities. This is truly a testament to the strength of our team and our brands. So let's dig a little deeper with a more fulsome discussion of our beer business performance in the quarter.

Despite the challenges posed by COVID-19, including the continued partial closure of the on-premise, which was down about 35% year-over-year, Constellation's beer business continues to be one of the largest contributors to U.S. beer industry growth, delivering depletion trends of plus 12% in the quarter. And while some depletion growth we saw this quarter included benefits from inventory restocking, the portfolio delivered accelerating underlying trends that align with our sales growth projection of 7% to 9% for the foreseeable future as consumer demand remains exceptionally strong for our products across the majority of the portfolio. In fact, Constellation's beer portfolio posted IRI consumer takeaway dollar growth of more than 15% for the third quarter.

As you know, the COVID-related slowdown of our beer production in Mexico earlier this year has impacted this year's shipment and volume net sales trends. The good news is that we've returned to a position of gaining share in IRI tracked channels as we continue to replenish inventories to more normal levels, which we expect to accomplish by fiscal year-end, a process that's actually taken a little longer than originally planned due to continued strong consumer demand for our brands.

So let's take a deeper dive into the key brands that drove these excellent trends for our beer business. The Corona brand family grew nearly 12% in IRI channels led by particularly strong contributions from Corona Premier, Corona Hard Seltzer and Corona Extra. With the launch of only one, one SKU to date, Corona Hard Seltzer continues to exceed our expectations and remains in a strong #4 position in the hard seltzer category. It also has the distinction of being the second fastest moving hard seltzer among major seltzer brands while continuing to maintain strong incrementality levels at nearly 90%.

Early next fiscal year, we plan to launch Corona Hard Seltzer Variety Pack #2, which will offer consumers the same great Corona taste and refreshment attributes while expanding to new flavors, including pineapple, strawberry, raspberry and passion fruit. Variety Pack #2 will be followed shortly thereafter by the introduction of another exciting new hard seltzer initiative. We believe these product launches will help further strengthen our competitive position in the fast-growing hard seltzer category, broaden our distribution reach and enhance our market share in the high end of the U.S. beer market. These initiatives will be supported with impactful marketing campaigns to strengthen and build upon our hard seltzer portfolio.

2020 marked the 30th consecutive year of Corona's iconic O' Tannenpalm commercial that it was airing on TV during the holiday season. As the longest-running beer commercial of all time, O' Tannenpalm demonstrates the strength and resilience of the Corona brand, including Corona Hard Seltzer, which continues to resonate with consumers and remains one of the most beloved consumer brands in the world.

Modelo Especial was the most significant growth contributor within our portfolio for the quarter. This exceptional brand has excellent marketplace momentum and achieved the #1 spot as the top share gaining imported beer in the U.S. beer category with depletion growth of almost 20%. Modelo continues to gain traction with general market consumers while sustaining momentum with its core Hispanic consumer, driven by the authenticity of the brand and our marketing efforts. The success of Modelo has been driven in part by impactful marketing initiatives that include high-profile sports programming with the NFL, NBA, NCAA Football, Spanish language soccer as well as an ongoing presence on Facebook and Instagram.

Finally, Pacifico was also a top share gainer within the import segment during the quarter, continuing its strong momentum with depletion growth of nearly 20%. We remain excited about the future growth prospects for this brand as we continue to increase awareness and expand distribution beyond its core market of Southern California. As we've said before, Pacifico has all the makings of the next big brand in our beer portfolio.

From an operational perspective, we plan to complete the 5 million hectoliter expansion of our Obregon facility in early fiscal '22, which is a slight delay versus our original plans due to pandemic-related construction slowdowns for this project last year. After the completion of the Obregon capacity expansion, we believe we will have ample capacity at the Nava and Obregon breweries to meet consumer demand over the medium term, which includes more than doubling our seltzer production capacity heading into the next fiscal year.

Overall, our excellent year-to-date results provide confidence in our ability to achieve 7% to 9% net sales growth in fiscal '21. In addition, we have increased our operating income growth target to 8% to 10% for the year. Now let's move on to the quarterly results for our Wine & Spirits business.

As I mentioned earlier, the closure of the Gallo deal and other pending transactions will include a series of actions which positions our Wine & Spirits business for accelerated revenue growth and operating margin performance going forward. We are grateful for the dedication of our Constellation team and the support and collaboration from Gallo and our business partners as we ensure a smooth transition.

With the completion of the divestitures, we believe the Wine & Spirits business is positioned to grow net sales low to mid-single digits while producing operating income growth ahead of net sales growth as the business works to take out stranded costs and execute against other cost, price/mix and efficiency improvements to achieve a 30% operating margin over the medium term. In the near term, we expect the remaining portfolio post the Gallo deal to generate fiscal '21 net sales growth in the 2% to 4% range.

With these transactions now behind us, our team can more fully concentrate resources and focus behind a smaller set of more premium brands to better align with consumer-led premiumization trends. During the quarter, we continued to see the staying power of these trends as premiumization continues to drive elevated growth across the total beverage alcohol segment, further reinforcing the transformation strategy for our business.

Our higher-end wine power brands at the greater than $11 retail price point outpaced the U.S. high end wine category IRI channels driven by Meiomi, Kim Crawford, The Prisoner Wine Company portfolio, all of which posted double-digit growth in IRI channels for the quarter. Overall, we expect these brands to be key growth drivers of the business long term and we are extremely bullish on the future runway for these higher growth, higher-margin brands. During the quarter, successful new innovation initiatives also contributed to top line growth, with power brand introductions like The Prisoner cabernet sauvignon and chardonnay varietals, along with Meiomi cabernet sauvignon, which has become this year's biggest ultra-premium wine introduction in IRI channels based on dollar sales.

In addition, several other innovation initiatives launched earlier this year continued to gain traction and drive growth, including brands like Unshackled from The Prisoner Wine portfolio, Kim Crawford Illuminate and Woodbridge spirits barrel-aged varietals just to name a few. And let's not forget Woodbridge wine go packs, which became the #2 innovation this year in IRI channels based on dollar sales.

We are also successfully driving our digital commerce initiatives which are gaining momentum. Since our acquisition of Empathy Wines, we have continued to make significant progress in leveraging their unique platform and capabilities across our portfolio within the DTC and 3-tier eCommerce space. We have launched several new DTC sites leveraging the Empathy platform, including The Prisoner Wine Company, Double Diamond and SIMI. We believe this category will be a meaningful pillar of growth for Constellation in the future.

In fact, our wine power brands competing in the eCommerce space are outpacing the overall wine category as our early investment in the category is providing us with a meaningful first-mover advantage. During the quarter, we became the first CPG company to partner with Instacart to feature our products on Facebook ads, propelling Constellation to the next level of 3-tier eCommerce media by enabling us to refine and optimize our ad creative and targeting based on real-time data. Furthermore, it is important to our growth and margin profile that we continue to invest in this space since DTC is heavily weighted toward the higher end of the wine category, as wines priced $20 and up make up nearly 90% of total DTC sales.

Now moving on to a discussion of our investment in Canopy Growth. We're pleased with the progress the Canopy Growth team has made in defining and strategically positioning themselves in the U.S. CBD and legal THC cannabis markets, which will be beneficial upon U.S. federal permissibility, which was probably enhanced with the change in the Senate that's occurred in the last 48 hours.

Canopy's core BioSteel beverages are now the official sports drink of the Dallas Mavericks, the Philadelphia 76ers and the Toronto Raptors and has several standout athlete and influencer partners, including the reigning NFL and Super Bowl MVP, Patrick Mahomes. In fact, Canopy predicts that CBD beverages can grow at a 35% CAGR through 2025 as consumer realize the compelling benefits from CBD beverages. In addition, BioSteel now has 2 exclusive partnerships with Manhattan Beer and the Reyes Beer Division, 2 key Constellation distributors, which will give Canopy the ability to gain traction in the U.S. market well ahead of its competitors in the emerging CBD space.

In September, Canopy launched a Martha Stewart branded CBD product line which is available on shopcanopy.com and several other outlets, including its new national distribution agreement with The Vitamin Shoppe retail locations, just in time for the holidays. Canopy will continue to seek strategic partnerships like the one with Martha Stewart to drive consumer awareness for these products. Overall, we believe that Canopy will be a significant long-term growth opportunity for Constellation, and we believe they remain best positioned to win long term in the emerging cannabis space.

In closing, I want to take you back to the key takeaways mentioned earlier. I'm extremely proud of the results of our team and what they have driven in the face of continued adversity. Our beer business, the biggest catalyst of our growth, remains extremely strong with accelerating trends in IRI. The completion of our transaction with Gallo to divest a number of lower end brands priced at $11 and below at retail has set the stage for accelerated growth and profitability.

Despite the challenges faced in 2020, we're on track to deliver another strong year of growth, consistent with our long-term goals. Our excellent third quarter performance drove strong cash generation, which, coupled with the finalization of the Gallo deal, enhances the financial profile of our business, enables further debt reduction and allows us to continue to execute our commitment to return $5 billion in value to our shareholders through fiscal '23. Our business remains extremely healthy, and these strong results are truly a testament to the strength of our team and our brands.

And with that, I would now like to turn the call over to Garth, who will review our financial results for the quarter. Garth?

Garth Hankinson

Thank you, Bill, and hello, everyone.

Constellation Brands continues to demonstrate its resiliency by generating robust financial results and continuing to focus on debt paydown despite a volatile environment and various headwinds driven by COVID-19. Specifically, during our third quarter, we generated comparable basis EPS, excluding Canopy Growth, of $3.16, an increase of 32% versus prior year, delivered strong operating margin and accelerating double-digit depletion growth for our beer business and increased operating cash flow and free cash flow by 14% and 23%, respectively, resulting in ongoing debt repayment and achievement of targeted net leverage, excluding Canopy equity earnings, as we ended the quarter at 3.3x.

As Bill mentioned, we are very pleased to have closed the transaction to sell a portion of our Wine & Spirits business to Gallo, including the Nobilo Wine brand, as well as closing the transaction to sell our concentrate business to Vie-Del. As an update, we expect to close the Paul Masson Grande Amber Brandy transaction within the next several weeks. Post transaction closing, we are left with a more focused and premium portfolio, which nicely positions our Wine & Spirits business to produce low to mid-single-digit top line growth while migrating to an operating margin of 30% in the medium term.

In total, at transaction close, Constellation received cash of approximately $560 million and the opportunity to receive up to $250 million in earn-outs if brand performance targets are met over a 2-year period after closing. We also received approximately $130 million related to the closing of the Nobilo deal and expect to receive approximately $265 million from Sazerac upon closing the Paul Masson Grande Amber Brandy deal.

In total, from all transactions, we expect to receive approximately $955 million before tax, and we expect the overall tax payments related to the transactions to be approximately $50 million, which are expected to be paid in fiscal ’22. The cash proceeds from these transactions will facilitate further debt reduction so we can continue to execute on our commitment to lower our leverage ratio and to return $5 billion in value to shareholders through dividends and share repurchases through fiscal 2023.

The cash proceeds received from Gallo reflect a significant inventory adjustment. Due to the prolonged timing of the Gallo deal, we were able to sell through a significant amount of finished goods inventory that was originally slated to go to Gallo. Also, as indicated last quarter, we have flexibility in how we source grapes to mitigate any shortages due to the wildfires. As a result, we decided to retain a portion of bulk wine inventory as we had a higher and better use for it as a replacement for smoke-tainted bulk resulting from the wildfires. Those 2 factors resulted in substantial cash flow for Constellation throughout the fiscal year.

Before we jump into the quarterly financial results, I'd like to provide an update on guidance. Due to the continued resiliency of our business and further clarity of the operating environment, we have issued fiscal 2021 EPS guidance and are projecting our comparable basis diluted EPS to range between $9.80 and $10.05. This range excludes future Canopy equity in earnings impact and accounts for the respective timing of the previous mentioned deal closures.

Now let's review Q3 performance and our full year outlook in more detail, where I'll generally focus on comparable basis financial results, starting with beer. Net sales increased 28% on shipment volume growth of 27%. Excluding the impact of the Ballast Point divestiture, organic net sales increased 30% driven by organic shipment volume growth of 28% and favorable price and mix.

Depletion volume for the quarter accelerated and achieved 12% growth as inventory levels improved and strong performance continued in the off-premise channel, which more than offset the impact of approximately 35% year-over-year reduction in the on-premise channel due to COVID-19. Depletions in the quarter benefited by approximately 3 to 4 points driven by inventory restocking.

While underlying consumer demand for our products remain strong, the robust shipment and depletion volume growth experienced during the quarter was enhanced by inventory replenishment at both the distributor and retailer level as product inventories begin to rebuild from a COVID-related slowdown of Mexican beer production earlier in the fiscal year. This resulted in Q3 year-to-date organic shipment and depletion volume growth of approximately 6% to 7%, which is in line with our medium-term goals and accounts for volume timing between quarters. Due to continued robust consumer demand, product inventories are now expected to return to historically normal levels during the fourth quarter of fiscal ’21 as shipment volume is expected to continue to outpace depletion volume for the remainder of the fiscal year.

Moving on to beer margins. Beer operating margin increased 330 basis points versus prior year to 42.6%. Benefits from marketing and SGA as a percent of net sales, foreign exchange and the Ballast Point divestiture more than offset unfavorable operational and logistics costs. The increase in operational cost was driven primarily by higher material costs, brewery compensation and benefits and depreciation, while the increased logistics cost resulted from strategic actions taken to expedite beer shipments from our breweries in order to accelerate inventory replenishment across the network. These headwinds were partially offset by favorable fixed cost absorption.

On an absolute dollar basis, marketing dollars spent during the quarter increased versus prior year. However, due to favorable leverage driven by increased throughput at our breweries, marketing as a percent of net sales decreased 170 basis points to 9.3%. We now expect full year fiscal ’21 marketing as a percent of net sales to be in the 9% to 9.5% range.

Now let’s discuss balance of year expectations and full year fiscal ’21 beer guidance. We expect net sales growth of 7% to 9%, which includes 1 to 2 points of pricing within our Mexican product portfolio. Excluding the impact of Ballast Point, we expect organic net sales to land in the higher end of the 7% to 9% range. We now expect fiscal ’21 operating income growth of 8% to 10%, which is an increase versus our prior guidance provided during the quarter. Furthermore, we expect full year operating margin to range between 40% and 41%, achieving margin expansion versus prior year operating margin of 40%.

Looking ahead to Q4, a couple of items to touch on from a margin perspective as the beer segment will experience some headwinds during the quarter. First, as a reminder, we took selective price increases this fall as we decided to stagger our annual price increases. And in some instances, these increases will shift in the beginning of our fiscal ’22. As a result, we saw pricing favorability muted in Q3 which will continue in Q4.

Second, from a COGS perspective, we will continue to incur incremental shipping costs due to actions we’re taking to accelerate the replenishment of inventory across the network. We also expect margin headwinds related to incremental headcount driven by the 5 million hectoliter expansion at Obregon, which is now expected to be completed in early fiscal ’22.

Lastly, we expect increased marketing spend to be the largest headwind to margins in the fourth quarter, driven by the shift in spend from the first half to the second half of the fiscal year. Our Q4 investment will focus on incremental media in both the NFL and NBA, incremental digital media and continued support behind Corona Hard Seltzer, which includes a holiday spot, leveraging the equity of the iconic Corona Extra O’ Tannenpalm ad. These incremental investments made during the holiday season and into the beginning of the calendar year will provide continued momentum as we head into fiscal ’22 and the spring selling season.

Moving to Wine & Spirits. Q3 power brand depletion volume accelerated and achieved nearly 4% growth as these brands continue to win in the higher end and across the majority of price segments in the U.S. wine category. Overall depletion volume declined 1%, which reflect the brands recently divested.

Wine & Spirits net sales increased 10% on shipment volume up 3%, driven by our power brands as well as strong innovation contributions. Excluding the impact of the Black Velvet divestiture, organic net sales increased 13%, reflecting shipment volume growth of approximately 7%. Q3 net sales results outperformed our previously communicated expectations primarily due to incremental shipments from the brands recently divested driven by the timing of the Gallo deal.

Operating margin decreased 200 basis points to 24% as benefits from price and mix were more than offset by higher COGS and increased marketing driven by the shift in spend from the first half. Higher COGS was mostly driven by unfavorable fixed cost absorption of $20 million, resulting from decreased production levels as a result of the wildfires. This came in slightly favorable versus what we originally anticipated and guided for the quarter. However, we still expect to incur approximately $10 million of costs in Q4 associated with unfavorable fixed cost absorption due to the wildfires.

During the quarter, we also recognized a $26.5 million loss in connection with the write-down of certain grapes as a result of smoke damage sustained during the wildfires. However, these costs were excluded from Q3 comparable basis results. We have insurance coverage that partially covers losses from grapes from our own vineyards, and we're actively pursuing reimbursement from our insurance carriers. As we continue to work through our processes, additional write-downs of certain bulk wine inventory may be needed for the fourth quarter of fiscal '21, which would be excluded from comparable basis results as well. As a reminder, we do not expect a material impact to our ability to meet consumer demand for our excellent portfolio of products.

Even though margins for the segment took a step back during Q3, the underlying fundamentals of our consumer-led premiumization strategy continue to shine through as significant mix and price were generated during the quarter. Strong shipment volume mix was driven by some of our fastest moving power brands such as Kim Crawford, Meiomi, The Prisoner brand family, and we're continuing to see benefits from the pricing actions we took on both Woodbridge and SVEDKA at the beginning of the fiscal year.

Moving along to balance of the year expectations and full year fiscal '21 Wine & Spirits guidance. We now expect fiscal '21 Wine & Spirits net sales and operating income to decline 9% to 11% and 16% to 18%, respectively, which reflects the closing of the Gallo transaction, including Nobilo and the concentrate transaction as well as the Paul Masson divestiture. In addition, we expect the retained portfolio post divestitures to grow net sales in the 2% to 4% range this year.

Looking ahead to Q4, a couple of items to touch on from a Wine & Spirits segment perspective. For Q4, we expect power brand depletion volumes to be muted due to the following: first, we are lapping strong Q4 fiscal '20 Woodbridge volume buy-in ahead of the price increases that went into effect on March 1. Second, we are also lapping solid Q4 fiscal '20 innovation driven by the rollout of Unshackled. And finally, we are continuing our efforts to rightsize inventory on hand at several chain retailers in key states to allow for better inventory management going forward.

Also, let me provide an update on marketing cadence for the remainder of the fiscal year. In the first half of the fiscal year, reduced marketing spend provided margin benefits due to timing as we shifted spend from the first half into the second half of the fiscal year. Originally, we expected a majority of the shift to impact Q3. However, we now expect the shift in spend to be more equally distributed between Q3 and Q4. We are also expecting incremental investment in Q4, creating strong support for our power brands as we propel our momentum into fiscal '22. This will result in an increase in year-over-year spend for Q4.

Now let's proceed with the rest of the P&L. Fiscal year-to-date corporate expenses came in at approximately $171 million, up 15% versus Q3 year-to-date last year. The increase was primarily driven by increased compensation and benefits, unfavorable foreign currency losses and an increase in charitable contributions primarily driven by COVID-19 support efforts, partially offset by reduced T&E spend. We now expect full year corporate expense to approximate $240 million.

This is a good spot to provide an update on our SAP S/4HANA implementation. I'm excited to announce that the final phase of our SAP implementation is scheduled to go live on March 1, 2021. We have various business continuity processes and resources in place to ensure this transition goes as smoothly as possible and look forward to updating everybody on our efforts during our Q4 call. As a reminder, we expect corporate expenses as a percent of net sales to decrease by the end of fiscal '22 once our digital enablement activities are fully implemented and we begin to eliminate redundant IT costs, allowing us to realize benefits of the new platform.

Comparable basis interest expense for the quarter decreased 7% to approximately $96 million, primarily due to lower average borrowings as we continue to decrease our leverage ratio. Fiscal '21 interest expense is now expected to approximate $390 million.

Our Q3 comparable basis effective tax rate, excluding Canopy equity earnings, came in at 17.7% versus 17.5% in Q3 last year primarily driven by higher effective tax rates on our foreign businesses, partially offset by an increased benefit from stock-based compensation. As indicated last quarter, we expect our full year fiscal '21 comparable effective tax rate, excluding Canopy equity in earnings impact, to approximate 19%, which would imply an increase in the Q4 tax rate driven by the timing of stock-based compensation benefits.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. We generated free cash flow of $1.9 billion for the first 9 months of fiscal '21. This represents an impressive 23% increase and reflects strong operating cash flow and lower CapEx. We are projecting full year fiscal ’21 CapEx spend to be in the range of $800 million to $900 million, which includes $650 million to $750 million of beer CapEx as we expect an acceleration of spend during Q4, driven by the 5 million hectoliter expansion at Obregon. Furthermore, we expect fiscal ’21 free cash flow to be in the range of $1.7 billion to $1.8 billion and operating cash flow to be in the range of $2.5 billion to $2.7 billion.

Moving to Canopy. In Q3, we recognized a $770 million increase in fair value of our Canopy investment. These were excluded from comparable basis results. The total pretax net gain recognized since our initial Canopy investment in November of 2017 is $834 million, which increased significantly from Q2 driven by Canopy’s robust share price movement during the quarter.

In closing, I’d like to reiterate our capital allocation priorities. As we’ve navigated through a challenging and volatile economic environment throughout the first 9 months of our fiscal year, we believed it was financially prudent to focus on paying down debt and further reducing our leverage ratio. As a result of our strong cash generation profile, we’ve reduced our net debt by $1.2 billion since the end of fiscal ’20, which has led to further reduction of our leverage ratio to our target range. These financial strides, coupled with the fact that our business has continued to remain resilient through this economic environment, now provides us with the flexibility to be opportunistic and resume share repurchase activity in the near term as we remain fully committed to our goal of returning $5 billion to shareholders through dividends and share repurchases through fiscal ’23. We are also pleased that the Board of Directors recently authorized an additional $2 billion for share repurchases.

And with that, Bill and I are happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from the line of Dara Mohsenian from Morgan Stanley.

Dara Mohsenian

So beer depletion growth was obviously strong in the quarter, even ex the retailer inventory rebuild on an underlying basis also. Just looking going forward at beer depletions, can you discuss your level of comfort that once we cycle COVID in March, you're back to sustained high single-digit beer revenue growth going forward, in line with the long-term goals, do you expect to return to historical levels of share gains also? Basically, just wanted to get an update on your visibility there on beer depletions and market share, particularly given the comments on high single-digit beer revenue growth in the foreseeable future. And then also maybe can you just touch on if there's any risk, specifically in fiscal Q4 with the rising COVID case counts and weaker on-premise trends before we cycle the COVID impact from last year in March.

William Newlands

You bet. So let me try to unpack that a bit. Yes, one of the benefits that we've seen as our business has been moving through the year is that we are getting back to our long-term trends that we have previously announced. And that's driven, quite frankly, by the strength of our brands. Modelo in this quarter was nearly 20% depletion growth. Pacifico was the same. These brands are resonating with consumers. And keep in mind, that's all being done, which relates to your second question, with on-premise trends that are really not very good. Year-to-date, on-premise for our beer business is off 53%.

So I think the fact that we have produced these kinds of results with that environment speaks to the strength of our beer portfolio and the long-term positioning that we have for those brands. You then throw in the fact that we are more than doubling our capability in seltzer next year, and I think we should expect to see, consistent with our long-term trends, the growth profile that we've previously stated.

Operator

Our next question comes from the line of Bonnie Herzog from Goldman Sachs.

Bonnie Herzog

I have a question on your full year beer operating income growth guidance of 8% to 10%. Although you revised it higher, it actually still implies a pretty big hit to your beer margins in Q4. So I just really wanted to better understand why this is the case, especially as I look at the easy year-over-year margin comp and even factoring in the year-over-year increase you just called out in terms of marketing spend. So I guess I'm really wondering if you're simply being ultraconservative on the upside in operating income growth for beer or is there something else.

Garth Hankinson

Yes. Thanks, Bonnie. Yes. So we did increase the range a little bit there, as you said, 8% to 10%, and we did increase our margin outlook closer to 41%. So we feel really good about that margin profile, by the way. But you're right, that does imply some bit of dilution, if you will, in Q4. So let me just give you some of the elements that make up that.

As we said, the biggest driver of that is going to be marketing because we think it's important that we continue to spend behind the brands and support the brands, particularly Corona Hard Seltzer. And so there's going to be a significant increase in marketing spend in Q4. Additionally, we have a couple of COGS-related headwinds in Q4. One is, as we've had even in Q3, which is freight and logistics as we're doing things to expedite shipments into the U.S. to ensure that we're increasing our inventory levels to more historical levels. And then furthermore, under COGS, we also have increased headcount in Obregon as we get ready to turn on the next 5 million hectoliters of capacity at Obregon. And we also in Q4 have some brewery maintenance that we shifted out of Q3 and into Q4. And then finally, the last thing is just as we talked about, the staggered pricing increases that we've taken this year, which we staggered them through Q3 and Q4 and some will flow into the first quarter of next year. So all of those together is what's leading to a bit of a giveback on margins in Q4.

Operator

Our next question comes from the line of Bryan Spillane from Bank of America.

Bryan Spillane

So a couple of questions. First one just on, a question related to seltzer. And I guess the question is really just as you look at it going forward and again, thinking about an aspiration to be a top 3 player, can you just give us your thinking now in terms of how we should think about, is that going to include launching new brands? And also just thinking about Topo Chico and Coke working with Molson Coors, would you be open to maybe partnering with some other companies' brands in order to sort of put more lines in the water, I guess, in seltzers?

William Newlands

Sure. Obviously, the seltzer category continues to remain strong. As we've said, we plan to more than double our capability in the seltzer area for Corona Hard Seltzer in the coming year. I mean the fact that we've done as well as we have with one SKU this year, one variety pack, we think, is pretty impressive and certainly ahead of what our expectations were. But keep in mind, we also have our toe in the water on some other things.

Funky Buddha in Florida has performed extraordinarily well in the seltzer category in that particular market, and we are extending that some in the coming year. We have a minority investment in PRESS, which has also done extremely well in the seltzer category. So we have our toes in the water in a number of ways. Certainly, Corona Hard Seltzer is going to be our lead play, and we think that is where the majority of our growth in that category will come from. As we said, we have a second variety pack that we're introducing at the beginning of the fiscal year. And then we have a couple of other things we might be doing which you'll hear more about as we go forward.

Operator

Our next question comes from the line of Nik Modi from RBC Capital Markets.

Nik Modi

Yes. Happy New Year. Just 2 questions for me. Bill, there's been some, obviously, controversy around Corona Seltzer given what some of the data has said in terms of deteriorating share trends. So I was hoping you could just provide some context around what everyone's seeing versus what you guys are seeing in terms of that brand from a supply/demand imbalance perspective. And then just as the brand continues to grow, are you going to have enough capacity to effectively execute the hard seltzer lemonade launch later in the year? And then my kind of secondary question is on Corona Light. Obviously, the brand has struggled relative to the other Corona franchises. I'm just curious what the plan is there over the next 1 to 2 years.

William Newlands

Sure. As it relates to Corona Hard Seltzer, we are more than doubling our capacity in that particular franchise for the coming year. And as you know, and you've commented, we're extending that into additional pack opportunities. We've sold everything we could make this year. And we were very pleased with the performance. And frankly, that was, as I said earlier, that was a bit better than we expected to do. So we're quite pleased with where we stand in the overall seltzer market. And certainly, with the more than doubling of capacity next year, we expect to remain a very strong player and a top 3 player in that particular segment. Keeping in mind, Nik, we have the second best velocity in the category with that particular brand with one SKU. So I think as we're able to broaden our distribution reach on the shelf, I think we'll be very pleased with where seltzer is when we're sitting here a year from now.

As it relates to Light, obviously, a lot of our work, a lot of our time and energy has been spent on Premier, which we're very excited about, continues to be a big growth profile for us. So I think we need to think about the Light business in conjunction with what we are doing across the overall light category, Premier, Corona Light, et cetera. And I think, obviously, Light has been hurt some. However, the trends actually have been quite good during this COVID time frame.

Operator

Our next question comes from the line of Vivien Azer from Cowen.

Vivien Azer

Bill, it seems pretty clear you guys have a lot of your sleeve on the hard seltzer front with clear market share gain aspirations. But I was wondering whether you could comment at all on the deceleration that we've seen in hard seltzer in scanner data over the last 6 or 7 months and how that informs what you think is kind of a better normalized growth rate for the category going from here?

William Newlands

Yes. I think the one thing that we've probably seen a bit of is some seasonality this year. And it's not unusual, I don't think, as you get more and more people into the category, you get more consumers who are either less frequent users or experimenting in the category. And oftentimes, there's some movement within categories when that occurs. You couple that with there's a bit more seasonality that we've seen this year than what we had seen in prior years. So I still think it remains a very strong growth category. It grew, if you remember on our call last year, we anticipated or I made the comment that I thought it would at least double in 2020 calendar year. And in fact, it did more than that as a category, and we still see strong trends. So we think this is going to continue to be a growth category, although it's obviously, like any other category, it's difficult to continue to grow at the pace that they've been growing.

Operator

Our next question comes from the line of Kaumil Gajrawala from Crédit Suisse.

Kaumil Gajrawala

A question, maybe housekeeping on the new share buyback. It's $2 billion on top of the remaining $1.9 billion. Is this on the same time line as your original $4.5 billion kind of cash return to shareholders or is the additional $2 billion stretch down over some more extended period given there's been a little bit of time?

And then secondarily, could you maybe comment a bit on your distribution trends during the period in which your supply chain got supply constrained versus now that supply is starting to come back if there was an ebb and flow there in any particular direction in terms of what we're seeing?

Garth Hankinson

Yes. So I'll answer the first question there. So in terms of, you're right that the $2 billion we just announced is in addition to the $1.9 billion. The additional $2 billion is to give us further flexibility around share repurchases. And we're still committed to the $5 billion return to shareholders, half of which is share repurchases through the end of fiscal '23.

William Newlands

And relative to distribution trends, we were actually quite pleased with our ability to hold shelf presence. As you know, and we said in prior calls, we focused our attention on the

20-ish SKUs that represented more than 75% of our total portfolio during the time when we had a slowdown in production. So that allowed us to expand and extend some of those SKUs on shelf and allowed us to maintain our position.

Obviously, now that we have been able to raise our production rates and we are filling in some of those scenarios that had occurred, we're quite pleased that we're maintaining and in fact, growing our distribution platform going forward. Keeping in mind, in many instances, retailers did not do shelf resets during the COVID time frame just because of the pandemic. So we're very comfortable with our distribution platform. And we think that given some of the things we have coming down the path, we'll be able to extend that going forward as we have every other year.

Operator

Our next question comes from the line of Lauren Lieberman from Barclays.

Lauren Lieberman

I just want to talk a little bit about wine. It was really nice improvement in the power brand depletions versus the first half of the year. So I was curious if you could talk a little bit about what drove that. Maybe there was some pull forward given the net sales outlook of kind of 2% to 4%, so curious with those dynamics. And then also just the pricing and promotional environment in wine, the space where Kim and Meiomi play is certainly premium priced, but it feels like there's been kind of a bit more discounting activity out there. And so just kind of curious on your perspective on pricing at that price point where you play.

William Newlands

Sure. Lauren, we're seeing 2 or 3 things in the wine space. First of all, given there's been some change in how the consumer purchases, more DTC, more 3-tier eCommerce, consumers are going with brands that are tried and true, and we're fortunate to have some that are extremely well received. You noted a couple of them. Meiomi has done extremely well, Kim, The Prisoner Wine Company. These are brands that are trusted by consumers and loved by consumers. And that certainly helped the process, particularly as people's shopping patterns change some.

Secondly, our innovation agenda has worked extremely well. Things that we did earlier in the year, like Unshackled, has done very well as well as some of the newer things that we've done. We noted in my brief prepared remarks that Meiomi cabernet sauvignon is one of the strongest individual entries that occurred in the entire industry this past year. And you add into that, The Prisoner cabernet and The Prisoner chardonnay, we did very well with our innovation agenda as well. And I don't think we have seen, I would slightly disagree with your comment that there's been a more aggressive environment or an aggressive promotional environment. Fortunately, the robust demand that we've seen in many of our power brands above $11, where we had lots of double-digit growers, our demand has been very strong, and that has been the single biggest driver of our improved wine results is the sheer demand for our products. And the fact that the consumer is looking for our brands and products that they have great faith in, especially as their shopping patterns have changed some.

Operator

Our next question comes from the line of Robert Ottenstein from Evercore.

Robert Ottenstein

I just want to drill down a little bit more into the accelerating depletion trends that you saw in the quarter, which were quite marketed. I mean do you think this is just purely a function of the greater availability of your brands on the shelf or increased media spend against them, the timing of your price increases, an improving consumer? Just trying to get a little feel for those different drivers. And then tied into that, how do you see the distribution gains looking in terms of calendar 2021?

William Newlands

Sure. I mean there were a number of factors that weighed in on the improved performance. It starts and it always will start with the strength of the brands. And certainly, as we were able to get our inventory position into a much better place during the quarter, it was reflected in our results, and it was reflected in the demand consumers had. Remember, we had roughly 15% growth across the beer portfolio in IRI during the quarter, extremely robust growth, especially given the fact that on-premise was a drag to say the least. Fortunately, again, we are a little less susceptible to the on-premise than some of the overall marketplace, but the sheer strength of our brands was a critical factor.

No question, some of the depletion pieces Garth noted in his remarks were driven by our replacing some of the inventory that had decreased during the time when we were not able to produce. But I think we do need to keep in mind, at the end of the day, it's all about consumer takeout, and consumers are strongly demanding our critical brands.

Operator

Our next question comes from the line of Kevin Grundy from Jefferies.

Kevin Grundy

Congratulations on the strong results. Bill, the question relates to the competitive outlook, building on Lauren's question from wine, but I'm going to kind of ask it from a beer and seltzer angle for the upcoming year. So the context for the question, given the obvious challenges from the pandemic this past year on-premise, out of stocks this past summer, et cetera. Many in the industry, including you guys, were really unable to support your brands sufficiently with marketing budgets cut rather sharply. So my question is, what is your outlook? How are you guys thinking about the next 12 months in terms of the competitive backdrop, specifically around pricing and brand support as the industry returns to health? Do you foresee a more competitive backdrop than we've seen in the past as companies try to reinvigorate the top line or do you expect a generally rational environment?

William Newlands

I think it's tough to tell what others will do. What I'll tell you is what we plan to do. We plan to continue to spend in that 9% to 10% range of our marketing spend in our beer business. And we've got a lot of good things to talk about. We're extending our investment against Modelo. We'll be reintroducing Refresca this year. Despite the tremendous performance, we have things like Refresca that we just stopped producing, and we're going to reintroduce, even though it had a tremendous start before the pandemic hit.

So we expect it to certainly be a competitive marketplace, but demand remains strong. And that's certainly to our advantage because our brands have performed very well in that mix. As we've said, we are going to continue to invest behind our brand. Our brands respond extremely well. Jim Sabia does an outstanding job with his team about making sure that we get tremendous returns against the dollars that we spend against our brands. And we expect that, that sort of intelligent approach to investment behind our business will continue. And then when you add on the fact that we will be adding additional products into the mix that we will invest behind, I think we're going to have a very robust and aggressive year in building our brands for the future.

Operator

Our next question comes from the line of Andrea Teixeira from JPMorgan.

William Newlands

The COVID new issue.

Operator

Still not hearing you. Should I move on to the next questioner?

William Newlands

Yes, please.

Operator

Certainly. Our next question comes from the line of Sean King from UBS.

Sean King

First off and apologies if I missed this, but is there any color you can provide on the quarter-to-date depletions now that we're 5 weeks in? Are you still reloading shelves? And then secondly, sort of looking longer term at the on-premise, your historic exposure, I guess, under-indexes the industry in like a pre-COVID world. As we think about the re-opening, will that continue to be the case based on the way your brands are positioned around occasions or could there be incremental shelf or incremental share gains in that channel as that trade focuses on higher velocity brands?

Garth Hankinson

So as it relates to our current depletions through the first month of the quarter, depletions continue to perform in line with where they are so far through the fiscal year-to-date. And the expectation is that they'll continue like that through the remainder of our quarter. And then on the, I'm sorry, could you repeat the second part of your question?

William Newlands

Which channel, we missed which channel you were referring to. I'm sorry.

Sean King

Sorry, I was just referring to the on-premise and that you historically under-index the industry and if there's an opportunity going forward that, that mix could actually have incremental share gains with the portfolio?

William Newlands

Well, certainly, that historically, as you said, we have under-indexed in that, and we're seeing wide variability depending on what month, what state, what market, what city as to what's going on in the on-premise. That's been, frankly, the most difficult thing for any of us in the industry to project as to where it's going to go and how it's going to go there. What I would say is, we have very focused business plans against each channel. We plan by channel, as you would expect, and by customer. And we would certainly expect to have a strong showing in the on-premise once we get back to something resembling normalcy, acknowledging that the general consensus within the industry is that we are going to have a smaller on-premise coming out of the pandemic than we had going in just because of the challenges that, unfortunately, many of our important accounts have had during the pandemic.

Operator

Our final question for today comes from the line of Chris Carey from Wells Fargo.

Christopher Carey

So I guess I just wanted to talk about capital allocation just to end things, but from a bit different perspective maybe than how it's been addressed so far. I guess in July Constellation had noted that after exercising that last batch of Canopy warrants that it was going to see how things unfolded in the U.S. and Canada. I mean I'd argue that Tuesday's Senate results made the U.S. a much more tangible opportunity for cannabis much sooner. And I wouldn't expect maybe Canopy spending to be as inefficient as it was in Canada. But certainly, U.S. expansion requires money. And I just, I wonder if your thought process on these warrants has changed at all in the medium term because this thing could certainly pick up a bit sooner and how that factors into this renewed commitment to buybacks and just any perspective there. And I guess just on top of that, apologies for the long question at the end of the call, but that could also impact Canopy's profitability. Is that an acceptable outcome? And so just any color there.

Garth Hankinson

Sure. So just on capital allocation in general, our capital allocation priorities remain consistent with what we said earlier this year, which is continuing to pay down debt and getting into and maintaining levels inside our targeted leverage ratio that we're comfortable with, and we've made good progress on that this year. So far, we've brought our leverage ratio down about 59 basis points from where we started the year, about 39 basis points since the end of Q2. And we announced earlier this week the early redemption of another $500 million in notes. So we're going to – that continues to be priority #1.

And then I will say, we are fully committed to the share repurchase program that we've previously announced, which is to return to shareholders $2.5 billion worth of capital through share repurchases by the end of our fiscal '23 as well as dividends to make up the balance. As it relates specifically to the Canopy warrants, there's still on the next batch of warrants, there's still 2 years left on those. So we don't need to make a decision anytime soon. Even with the performance of Canopy's share price, they're still not in the money. So we'll make the decision on those warrants much more closely to when they mature or to their termination date.

William Newlands

I would also just add to that, what Garth said. Keep in mind, Canopy has already had – is already well prepared for the U.S. market relative to their investments or their prepared investments in both Acreage and TerrAscend, plus their cash position. So we would certainly expect that if there is any speed up in the federal legalization that Canopy is well positioned to be a winner in the U.S. market going forward.

Operator

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Bill Newlands for any further remarks.

William Newlands

Well, I'd like to thank everybody for joining our call today. Despite the challenges faced in 2020, we're again on track to deliver a strong year of growth, which is consistent with our long-term goals. We're confident in the resiliency of our business. Our beer business remains strong as demand continues to be robust, while our wine and spirits premiumization strategy continues to gain momentum and is further enhanced by the completion of the Gallo deal.

The health of our business has allowed us to provide fiscal '21 guidance that reinforces our strategic growth priorities and strong cash generation capabilities. This, coupled with the closure of the Gallo transaction, allows us to continue to execute on our commitment to return $5 billion in value to our shareholders through fiscal '23. As a reminder, during our next quarterly call, we will be providing our guidance for the upcoming fiscal year.

Thanks again, everyone, for joining the call, and I wish you all a safe, happy and prosperous New Year. Thank you.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.