Constellation Brands Inc, Q1 2022, Earnings Call 2021-06-29

Presentation

Operator

Welcome to the Constellation Brands Q1 Fiscal Year 2022 Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Following the prepared remarks, the call will be opened for your questions, instructions will be given at that time. I will now turn the call over to Patty Yahn-Urlaub, Senior Vice President of Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thanks, Jiji [ph]. Good morning, and welcome to Constellation's first-quarter fiscal '22 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 time. Thanks in advance. And now, here's Bill.

William Newlands

Thank you, Patty. Good morning and welcome to everyone to our first-quarter conference call. Picking right up where we left off in Q4, our Constellation Brands' team with the help of our distributors and retailers delivered another strong performance in Q1 of fiscal '22. While we overlap the pantry loading phase of the pandemic which led to record trends in off-premise tracked channels last year, our continued focus on brand building, aggressive investments in growth, and the continued efforts of our team and trade partners position us to deliver another strong year of performance consistent with our long-term goals. As Garth and I detail some of the highlights from Q1, there are several key factors we'd like you to keep in mind that constitute our points of differentiation, our competitive strengths, and reasons to continue to believe in the future growth potential of our business and our ability to drive industry-leading, total shareholder returns over the long-term. Number one, our strong portfolio of core brands across beer, wine, and spirits continues to gain momentum while offering a significant runway for growth in the years ahead. Nowhere is this more evident than in our beer business, which is off to an exceptional start, delivering double-digit depletions, shipments, net sales, and operating income growth due to ongoing strong consumer demand. Number two, we continue to be relentless about keeping consumers at the forefront of our decision making, and this is nowhere more apparent than in the strides we're making to strengthen our innovation capabilities and ensure we're capturing our fair share of growth in emerging categories. Number three, our investment in Canopy Growth, along with the continued efforts of the Canopy team are positioning this business to emerge as a leader in the global cannabis market as it comes to fruition and we inch closer to legalization in the US. And number four, our continued strong operating performance and cash flow generation enable us to resume share buyback activity with significant repurchases of more than $500 million during the first four months of our fiscal year. In addition, we announced this morning that we will execute an accelerated share repurchase program throughout the remainder of the second quarter to repurchase an additional incremental $500 million of shares. We believe this demonstrates our strong commitment to maximize shareholder value and we are on our way to achieving our $5 billion goal of which about 50% will be in the form of share repurchases. This activity is also driving an increase in our EPS guidance for this year. Let's transition to a more detailed discussion of our performance in the quarter. As mentioned, our beer business is off to an exceptional start, delivering double-digit net sales and operating income growth, as well as depletion growth of almost 11% in the quarter. Excellent execution during the Cinco de Mayo and Memorial Day holidays led to market share gains as Constellation remains a leading growth driver in the high end of the US beer market. Modelo Especial led the way as the number one share gainer in the entire US beer category and solidified its position as the number one brand in the high-end. It also became the number two brand in dollar sales in IRI channels, posting a depletion growth of 12% for the quarter. Modelo Especial continues to fire on all cylinders with no signs of letting up driven by ongoing strong execution of retail, impactful execution of high-profile marketing activations, and a significant increase in digital, social, and e-commerce media for properties like UFC, Gold Cup soccer, and the Summer Olympic Games to name just a few. Corona brand family growth was driven by a return to growth in on-premise channels, which now represent approximately 11% of our beer business volume, which accelerated and nearly doubled since fiscal ’21. During the quarter, we launched Corona Hard Seltzer Variety Pack #2, which continues to gain shelf space and is already more than half the size of Variety Pack #1 in dollar sales and appears to have about the same incrementality as Variety Pack #1 has to the entire portfolio. Meanwhile, Variety Pack #1 has held its distribution and velocity levels since the launch of Variety Pack #2 and our Hard Seltzer family remains in the number four market position. Earlier this month, we launched Corona Hard Seltzer Limonada. And while it’s early in the launch cycle, initial consumer response has been very favorable. Ultimately, we believe the Hard Seltzer category will be dominated by a few large brands in the long run, similar to the light beer category and we are positioning Corona Hard Seltzer to be one of those brands. We have plans to more than double our Seltzer and ABA capabilities this fiscal year and expect to bring another 5 million hectoliters of capacity online next fiscal year, giving us the flexibility to continue to expand with new flavors, new packages, and even new platforms in this space. Overall, the Seltzer category remains competitive. We believe it’s an important part of the high-end and we plan to drive for success with our ambition to ultimately be a top-three player in this space. Pacifico continued it's strong momentum, posting depletion growth of more than 35% for the quarter as the number four share gainer within the important segment driven by our focus on Gen Z consumers. As expected, during the quarter, Constellation's consumer takeaway trends in the off-premise IRI and Nielsen channels were muted due to lapping last year's pantry loading behavior at the start of the pandemic. Conversely, we experienced robust growth, especially in some of the more sizable non-tracked channels, including the on-premise which grew depletions 250% versus last year when this channel was essentially closed and the liquor chains, which grew almost 13% in the first quarter. These levels of robust consumer demand are impacting availability for certain packet sizes and certain geographies. We are working with our distributor partners to ensure consumers can continue to find our brands on shelf throughout the summer and we plan to make up some of this impact beginning in the third quarter. As a reminder, beginning in April of last year, our beer business had to significantly slow down production in Mexico due to COVID-19 restrictions. This led to out of stocks in the US marketplace during the summer month. Therefore, as we progress through our second quarter, which runs June through August, we'll start to lap these out-of-stock issues and we're already beginning to see improving IRI trends. Despite the short-term supply challenges we're facing, the momentum of our portfolio is stronger than ever, and our outlook for the remainder of the year remains extremely bullish. Our view is reinforced by recent four-week IRI trends that show Constellation's beer business is outpacing the high-end and continues to significantly outpace the total US beer industry. Now, moving on to wine and spirits. Our transformation of this business to a higher growth, higher margin operation continues to gain traction, and we made additional progress during the first quarter on a number of fronts, including furthering our fine wine and craft spirits strategy, building a robust innovation pipeline, advancing our DTC e-commerce and digital capabilities, while also implementing disciplined pricing actions, taking out stranded costs and executing other cost and efficiency improvements.

During the quarter, we made progress with the evolution of our fine wine and craft spirits business, especially as consumers returned to bars and restaurants in the on-premise channel. Our fine wine and craft spirits performance in the quarter was driven primarily by The Prisoner Wine Company, Robert Mondavi Winery, and High West. And we expect our enhanced capabilities in this space to begin to meaningfully inflect our wine and spirits business towards the higher end. Impactful innovations were also a driving force for growth during the quarter, including Meiomi Cabernet Sauvignon, Kim Crawford Illuminate, and The Prisoner Unshackled which were among the top 10 innovations across the high end of the US wine segment in IRI channels during the quarter. And we have a strong innovation pipeline planned for the remainder of the year, which includes the introduction of Woodbridge wine seltzers, The Prisoner's Saldo, Red Blend, and Unshackled Sauvignon Blanc plus Robert Mondavi Private Selection 100, a new lineup composed of 100% Cabernet Sauvignon and Chardonnay varietals. We've also been investing to build a world-class three-tier e-commerce team by expanding our sales and marketing resources, building new selling capabilities, investing millions of dollars where consumers shop, and integrating our teams to put focus and expertise closer to our accounts. While our three-tier e-commerce business is cycling the tremendous acceleration that was experienced last spring at the beginning of the pandemic, it is still growing 3 to 4 times compared to the spring of 2019 across beer, wine, and spirits. And the DTC portion of our e-commerce business saw impressive growth of 45% versus last year in the first quarter. We continued to forge partnerships with existing and emerging pure-play retailers like Amazon, Gopuff, and Wine.com. Omnichannel retailers like Walmart, Kroger, and Albertsons. And third-party marketplaces like Instacart and Drizly so that our consumers can shop whenever and wherever on their own terms. In addition, as part of our commitment to invest $100 million over 10 years and Black, Latinx, and minority-owned small businesses, we recently made investments in La Fete du Rose and Sapere Aude Sparkling Wine, both of these brands aligned with Constellation's premiumization strategy and present significant growth opportunities with differentiated high-end brands in growing sectors of the market. La Fete du Rose has taken a consumer-first approach to building a distinctive, authentic Rose brand that appeals to multicultural consumers. And Sapere Aude has taken an entrepreneurial approach to build a uniquely Californian sparkling wine with no residual sugars, low alcohol content, fine bubbles, and a refreshing brand identity that is simple and clean. We look forward to working with these brands and their dynamic founders to expand our access to key markets and consumers, and to help realize their full potential. At the same time, our Wine & Spirits results for the quarter were impacted by a convergence of isolated factors. First, our international brands like Kim Crawford and Ruffino, which are produced in their respective regions but sold primarily in the US are experiencing global supply chain logistics issues, including shipping delays and transport interruptions like so many other imported products. Second, we've experienced some start-up issues in certain markets associated with our route to market transition to Southern Glazer's Wine & Spirits, which now has distribution responsibilities across 70% of our US Wine & Spirits brand portfolio. This transition became effective April 1, and we expect the transition issues to be resolved in the second quarter. Lastly, like many ERP system implementations with a cut over to SAP, we have encountered a few transitional challenges which we don't see as a prolonged issue. Collectively, these issues caused some supply challenges in retail for some of our larger key brands which drove the negative depletion trend during the quarter. And while we are seeing lower inventory levels than normal for Kim and Ruffino, they continue to drive growth. Despite these temporary challenges, we are confident in our ability to accelerate the growth and profitability of this higher-end portfolio of industry-leading brands and achieving our targeted goal of 2% to 4% organic sales growth for the fiscal year. Moving on to Canopy Growth; the synergies between Constellation and Canopy Growth continue to create value for both companies. Canopy recently signed a US distribution agreement with Southern Glazer's Wine & Spirits for Canopy's Quattro CBD beverage portfolio which will be launched across seven US states with additional states to be added later this year, as well as their Martha Stewart CBD product lineup, which has seen early success extending into top-selling gifts for occasions, including Mother's Day and Valentine's Day was sold out prior to the holidays due to high consumer demand. Constellation and Canopy will continue to work closely together to develop Canopy's route to market strategy in the US. We remain optimistic about the prospects for federal US legalization during this congressional session and are bullish about Canopy's growth prospects and their ability to achieve profitability by the end of their fiscal year. As I close, I want to take a minute to thank our Constellation team members and our distributors and retailers for an excellent first quarter of business performance. Thanks to all of you, our strong portfolio of core brands across beer, wine, and spirits continues to gain momentum and we are well-positioned to deliver another strong year of performance consistent with our long-term goals. Our beer business continues to be a top growth driver within the US beer market and will delivering market share gains and accelerating depletion trends as consumer demand and take away remains extremely strong. Our higher-end Wine & Spirits brands continue to outpace the overall US market. We continue to strengthen our innovation capabilities to ensure we're capturing our fair share of growth in emerging categories. Our continued strong operating performance and strong cash flow generation allowed us to make significant share repurchases in line with our commitment to return $5 billion to shareholders by fiscal '23 and drove an increase in our EPS guidance for the year. And with that, I would like to turn the call over to Garth, who will review our financial results in the quarter. Garth?

Question and Answer

Garth Hankinson

Thank you, Bill. And hello, everyone. Our fiscal 2022 is off to a great start demonstrated by our strong segment operating results and cash flow generation. As Bill highlighted, our Beer business achieved double-digit depletion volume, top-line, and operating income growth. Our Wine & Spirits business is nicely positioned to drive accelerated growth and profitability from its portfolio of higher-end industry-leading brands, and our robust cash flow generation enabled us to resume share buyback activity, reaffirming our commitment to execute our goal of returning $5 billion to shareholders through dividends and share repurchases through our fiscal 2023. As Bill outlined, through June, we've repurchased 2.2 million shares of common stock for $523 million. In addition, this morning we announced that we entered into an accelerated share repurchase or ASR agreement to purchase $500 million of incremental shares which is expected to be completed no later than October of 2021. Please note that the ASR agreement constitutes of $500 million incremental share repurchase referenced in this morning's earnings release. As a result, we've increased our full year comparable basis diluted EPS to be in the range of $10 to $10.30. This range excludes Canopy equity earnings impact and reflects the decrease in weighted average diluted shares outstanding, driven by the year – the June year-to-date share buyback activity as well as the ASR agreement or approximately $1 billion of share repurchases. As such, we are forecasting weighted average diluted shares outstanding of approximately $193 million for our fiscal 2022. We plan to repurchase additional shares during the back half of the fiscal year in excess of the $1 billion of share repurchases previously outlined. However, we do not know the timing and cadence, and as such, these expected share repurchases have been excluded from our guidance assumptions. We will continue to update our outstanding shares accordingly when we report quarterly earnings throughout the fiscal year. Now, let's review our Q1 fiscal 2022 performance in more detail, where I'll generally focus on comparable basis financial results. Starting with Beer, net sales increased 14% driven by shipment volume growth of over 11% and favorable pricing. The increase in beer net sales was impacted by some miss shipping days and supply shortages as a result of severe weather events impacting Texas and Northern Mexico, early in the first quarter of our fiscal year. Depletion volume accelerated from fiscal 2021 year-end trends and achieved nearly 11% growth for the quarter despite overlapping the peak of last year's pandemic-related pantry loading behavior, driven by continued strong demand in both tracked and non-tracked off-premise channels, as well as the return to growth in the on-premise channel. On-premise volume accounted for 11% of total beer depletions during the quarter, which accelerated and nearly doubled since fiscal '21. As a reminder, the on-premise accounted for approximately 15% of our depletion volume pre-COVID and accounted for only 3% of our depletion volume in Q1 fiscal 2021 as a result of on-premise shutdowns due to COVID-19. Lastly, when adjusting for one extra selling day in the quarter, the beer business generated nearly 10% depletion volume growth, and in Q2 depletion selling days are flat year-over-year. Due to continued robust consumer demand and muted shipment volume driven by supply challenges due to severe winter weather early in the quarter, depletion volume exceeded shipment volume during the first quarter, resulting in lower than normal distributor inventory on hand at the end of Q1. Let me assure you, that we are fully producing and shipping products out of our breweries, however, inventories will remain tight throughout the second quarter as we enter our peak summer selling season. As a result, we expect distributor inventory levels to return to more normal levels during the second half of the fiscal year. Moving on to beer margins; beer operating margin increased 110 basis points versus prior year to 42.8%. Benefits from favorable pricing, SG&A as a percent of net sales, and foreign currency were partially offset by unfavorable logistics and operational costs and increased marketing. The increase in logistics cost was driven primarily by increased obsolescence resulting from initial conservative expiration dates on new SKUs, partially offset by the transition of a portion of our co-packing capabilities to our Nava Brewary. The increase in operational costs was driven primarily by brewery costs, largely due to labor inflation in Mexico and increased headcount and incremental spend to bring the additional 5 million hectoliters online at Obregon. These headwinds were partially offset by favorable fixed cost absorption related to the overlap of reduced production in the first quarter of fiscal 2021 due to COVID-19 safety measures. Depreciation expense had a minimal impact during the quarter as we began to depreciate the incremental 5 million hectoliters at Obregon late in Q1 but expect depreciation expense to ramp up during Q2. Marketing as a percent of net sales increased 70 basis points to 9.4% versus prior year as we have returned to our typical spending cadence which is weighted more heavily towards the first half of the fiscal year. As a reminder, marketing spend in the first half of the prior year was significantly muted resulting from COVID-19-related sporting and sponsorship event cancellations and/or postponements. As communicated last quarter, given the current state of activities in Mexicali, we will be unable to repurpose this site for future use. As such, an impairment of approximately $665 million was recorded for the quarter, which was excluded from our comparable basis results. For full year fiscal 2022, we continue to target net sales growth of 7% to 9% which includes 1 to 2 points of pricing within our Mexican product portfolio and operating income growth of 3% to 5%. This implies operating margin to land in the low to mid-point of our stated 39% to 40% range. As previously discussed, we continue to expect our gross margins to be negatively impacted for the fiscal year as benefits from price and our cost savings agenda are expected to be more than offset by the following headwinds. First, a significant step up in depreciation expense and other brewery expansion costs relating to the incremental 5 million hectoliters that was completed at Obregon earlier in the fiscal year. Second, substantial inflationary headwinds across numerous cost components. And lastly, negative mix as we expand our ABA and Hard Seltzer portfolios. As it relates to timing and cadence, as mentioned earlier, during the second quarter we will begin to see an impact from depreciating the incremental 5 million hectoliters at Obregon, which will be a significant margin headwinds for the balance of the fiscal year. Additionally, due to benefits from our commodity hedging program, we did not experience the expected cost inflationary pressures during this quarter. However, we expect significant inflation headwinds to ramp up during the second half of our fiscal year as current hedges roll off. In addition, we believe the depth and duration of inflationary pressures are becoming more uncertain as the year unfolds. Lastly, we continue to expect marketing as a percent of net sales to be in the 9% to 10% range for full year fiscal 2022 which is in line with fiscal 2021 spend of 9.7% of net sales. We expect to invest significantly during Q2 of fiscal 2022 to support strategic initiatives and continue generating strong marketplace performance throughout the key summer selling season. As such, 2Q marketing as a percent of net sales is expected to be in the range of 10% to 11% versus Q2 fiscal ’21 which came in 8.4%. Moving to Wine & Spirits; Q1 fiscal 2022 net sales declined 22% on shipment volumes down 38%. Excluding the impact of the Wine & Spirits divestitures, organic net sales increased 16% driven by organic shipment volume growth of 6%, smoke-tainted bulk wine sales, and favorable price and mix, while depletion volume declined approximately 8%. There are several dynamics to point out as it relates to organic net sales as well as shipment and depletion volume trends for the quarter. Starting with organic net sales and organic shipment volume; growth of 16% and 6% respectively was impacted by the following. First, smoke-tainted bulk wine sales accounted for approximately 4 points of the year-over-year organic net sales growth in the quarter. Second, from an organic shipment volume perspective, we under shipped depletions in Q1 fiscal 2021 as we were unable to fulfill excessive consumer demand driven by pantry loading, creating easy shipment volume compared to Q1 fiscal 2022. Conversely, we over shipped in Q1 fiscal 2022 as a result of the distributor transitioned to Southern Glazer’s in order to ensure that they had ample inventory during the quarter as there was a delay in transitioning Constellation inventory from canceled distributors to Southern Glazer’s. Moving to depletion volume trends; down approximately 8%, which were impacted by the following. First, we are experiencing a challenging overlap to the last year’s pandemic-related consumer pantry loading behavior. Second, as a result of the SAP transition, we experienced challenges that impacted the shipping process early in the quarter. While we were able to rectify the situation during the quarter, the timing of shipments throughout Q1 negatively impacted depletions and created out of stocks for some of our larger key brands. Lastly, global supply chain logistics issues, including shipping delays and transport interruptions have also created out of stocks in certain areas for Kim Crawford and Ruffino which are imported from New Zealand and Italy respectively. As Bill mentioned, we believe these challenges are temporary and continue to improve, and we expect to refill retailer inventory in Q2. Moving on to Wine & Spirits margins; operating margin decreased 540 basis points to 22.9% as mixed benefits driven by the Wine & Spirits divestitures and favorable price were more than offset by margin dilutive smoke-tainted wine – bulk wine sales and increased marketing and SG&A as a percent of net sales. Keep in mind that we're lapping lower marketing and SG&A spend in Q1 fiscal 2021 due to COVID and have a smaller business post the divestitures resulting in significant marketing and SG&A deleveraging impacting operating margins. For full year fiscal 2022, the Wine & Spirits business continues to expect net sales and operating income to decline 22% to 24% and 23% to 25% respectively. This implies operating margin to approximate 24% which is flattish to prior year on a reported basis, which shows significant margin expansion on an organic basis. Excluding the impact of the Wine & Spirits divestitures organic net sales is expected to grow in the 2% to 4% range. Lastly, please keep in mind that we will continue to lap significantly reduced marketing spend during Q2 as many of our planned media and event sponsorship investments were suspended or canceled in Q2 fiscal 2021. Furthermore, we continue to expect marketing and SG&A deleveraging as a result from the Wine & Spirits divestitures. As such, we expect marketing and SG&A to continue to be a significant drag to operating margins in Q2 fiscal 2022. Now, let's proceed with the rest of the P&L. Q1 corporate expenses came in approximately $55 million, up 8% versus Q1 fiscal 2021. The increase was primarily driven by higher consulting services and compensation and benefits, partially offset by favorable foreign currency impact. We continue to expect full year corporate expenses to approximately $235 million. Comparable basis interest expense for the quarter decreased 13% to approximately $87 million primarily due to lower average borrowings as we continue to decrease our net leverage ratio and ended the quarter at 3.06 times, excluding Canopy equity earnings.

Our previous guidance assumed free cash flow would be used to pay down debt versus share repurchases. However, as discussed earlier, updated guidance now reflects approximately $1 billion of share repurchases through the first half. As such, fiscal [ph] interest expense is now expected to increase and be in the range of $360 million to $370 million. Our comparable basis effective tax rate, excluding Canopy equity earnings, came in at 21.1% versus 19.3% last year, primarily driven by higher effective tax rates on our foreign businesses. We expect our Q2 fiscal '22 comparable tax rate, excluding Canopy equity earnings impact to approximate 20%. However, we continue to expect the full year to approximate 19% as expected stock-based compensation benefits are weighted more towards the second half of the fiscal year. Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. For Q1, we generated free cash flow of $602 million, which represents an 11% increase versus prior year reflecting strong operating cash flow and lower CapEx. CapEx totaled $114 million or 21% last year spend. This included approximately $86 million of beer CapEx, primarily driven by expansion initiatives at our Mexico facilities. Lower CapEx spend is primarily due to timing, as we have significant spending plan for the balance of the fiscal year. As such, our full year CapEx guidance of $1 billion to $1.1 billion, which includes approximately $900 million target for Mexico beer operation expansions remains unchanged. Furthermore, we continue to expect fiscal 2022 free cash flow to be in the range of $1.4 billion to $1.5 billion. This reflects operating cash flow in the range of $2.4 billion to $2.6 billion and the CapEx spend previously outlined. Moving to Canopy; in Q1 we recognized an unrealized loss of $745 million from the decrease in the fair value of our Canopy investments. This was excluded from our comparable basis results. The total pre-tax net gain recognized since our initial Canopy investment in November of 2017 is $366 million. In closing, I want to reiterate our expectations to continue to have significant capital allocation flexibility throughout our fiscal 2022, which will enable ongoing progress in returning cash to shareholders, while making strategic investments to support long-term growth opportunities. We believe the combination of strong cash flow and future growth prospects in both our Beer and Wine & Spirits businesses positions Constellation for success. The growth and margin profile of our high-end beer business is best in class and we expect it to remain as such well into the future while the transformation of our Wine & Spirits business is underway and we expect to continue to achieve margin expansion as we migrate to operating margins of approximately 30%. And with that, Bill and I are happy to take your questions.

Operator

— ***Operator Instructions*** — Our first question comes from the line of Bonnie Herzog from Goldman Sachs. Your line is now open.

Bonnie Herzog

Thank you. Hi, everyone.

William Newlands

Hey, Bonnie.

Bonnie Herzog

Hi. I was actually just hoping to get a little more color on the out-of-stock pressures you've been facing. We're aware that you guys had temporarily stopped orders during the end of May given how strong demand was in relation to your forecasted supply. So, first, are these caps still in place? And then, specifically, have you seen these pressures maybe get better or worse in June? And finally, are there any specific impact on certain SKUs or pack sizes or was this just more broad-based in your portfolio? Thanks.

William Newlands

Sure. Obviously, the two main things driving the tightness of inventory are first and foremost, robust consumer demand. Our consumer demand has been well in excess of what we anticipated. And in my opinion, that's always good news. The second piece of that obviously was the point that Garth made and I made in my script, which is the power outage that occurred at the end of February, which has made for a somewhat tighter inventory position than we would normally want to hold. With that said, all of that will take care of itself over the course of the fiscal year. It's quite different, quite frankly, from last year where we mainly produced the SKUs that represented 75% of our total portfolio. This year we're producing all of our SKUs. So, it's very different from what we saw last year. And while we do expect tightness during the course of the summer, we're working actively with our distributors to make sure that we are providing the right mix of product to make sure that we continue to supply the very strong demand we're seeing against our portfolio.

Operator

Thank you. Our next question comes from the line of Nik Modi from RBC Capital Markets. Your line is now open.

Nik Modi

Yes. Good morning, everyone. So, just quick housekeeping, Bill, you wouldn't mind sharing perspective on June depletions. I know the month isn't over yet, but any early color would be helpful? And then, the broader question is, during the pandemic, many brands including Constellation's portfolio of beer brands gained a lot of new households, and I was just wondering have you done a postmortem on what those new households look like? Have you recruited new consumers into the portfolio that you weren't recruiting prior? I mean any context around that would be really interesting.

William Newlands

Certainly. So, first – your first part of your question — ***indiscernible*** — and you're correct. Well, it isn't over yet. We're very enthused by how June is setting up and is certainly consistent with our long-term algorithm, assuming we finished the last couple of days strongly. So, we think June is going to look pretty good. Secondly, relative to households, Nik. We obviously are continuing to develop and broaden our reach across our core brands, particularly in beer. If you think about Modelo and Garth I think said this in prior quarters, we are rapidly increasing our penetration in the non-Hispanic community. It's a little difficult for us at this point to break that out of how much of that was COVID versus non-COVID, because we're just seeing such an acceleration of Modelo, not only in its core Hispanic market but in the broader market as well. So, it's a little difficult for us to put an exact percentage on any of those things. What I would say is, we are gaining consumers in our portfolio that has been obvious and we expect that trend to continue. Part of that has been driven by our innovation agenda. We are meeting more consumer needs, more consumer drinking occasions than we ever have before because of our successful innovation agenda across the whole portfolio, across the company. So, I would expect that we're going to continue to see some acceleration, bringing new consumers in because we are opening up occasions for those people to come into our franchise.

Operator

Thank you. Our next question comes from the line of Lauren Lieberman from Barclays. Your line is now open.

Lauren Lieberman

Great, thanks. Good morning. I was curious about the beer pricing. Its price mix was north of 2% and I was just curious if you could talk a little bit about how much of that was driven by mix? Or if there is some greater pricing starting to come through in the market? And your thoughts broadly on pricing for beer this year? Thanks.

William Newlands

Sure. We continue to keep our algorithm about beer pricing as we have said on prior calls. We see it as a 1% to 2% growth profile over the course of the year and we're sticking with that. We think that's appropriate given all the factors that we weigh when we decide about what we're going to do with our pricing. I think it's also important to say, our number one growth driver in our business continues to be Modelo, which is very accretive on a mix basis. So, as we continue to see all of our businesses grow, when you see that kind of acceleration in Modelo it certainly is mix accretive to us as well. So, I think both of those things were additive in the quarter and we would expect them to be additive over the course of the year.

Operator

Thank you. Our next question comes from the line of Kaumil Gajrawala from Credit Suisse. Your line is now open.

Kaumil Gajrawala

Hey. Thanks, everybody. Digging into the supply or maybe connecting the supply issues with depletions and how you're thinking about inventories getting better in the back half? Does that – think that you're being running at a 10, looks like you are continuing to run at — ***indiscernible*** — adjusted. Do you need depletions to really start to come off maybe back to that high single-digit range to get inventories back to where you want them to be? Or do you feel like just the abatement of any of the supply pressures will be able to get you to where you want to be? Thanks.

William Newlands

We'd expect that the abatement of supply issues to take care of themselves over the course of the year. Remember, I think we probably made this reasonably clear. We lost several points of top-line growth because of the power outage that occurred at the end of February in Northern Mexico and in Texas. So, we certainly had a muted shipping scenario. We will expect to pick that up over the course of the remainder of the year. And we're still expecting demand to be very solid. So, we are fully expecting to meet the demand that we'll see in the marketplace, which we continue to say will be in that 7% to 9% range over the course of the year.

Operator

Thank you. Our next question comes from the line of Sean King from UBS. Your line is now open.

Sean King

Great, thanks for the question. Yes, I appreciate the color you gave on the on-premise at 11% and I guess that's greater than 250% growth for beer. But was that at the close of the quarter? Is that like the average of the quarter overall? And inside that, what are you seeing in terms of draft amount [ph]?

William Newlands

Yes, that's the average over the course of the quarter. As Garth pointed out in his remarks, that still is below what we were pre-pandemic but it's a really big increase to what it was last year. So, we still think certain markets are developed more quickly than others as we've said in prior discussions, as well. So, we certainly expect that's going to continue to be an accelerator over the course of the summer. And let's face it, I think it would be fair to say there's a lot of pent-up consumer demand to simply go out of your home, that people are looking forward to the opportunity as some of the COVID restrictions come off. We would expect to see some continuing acceleration in the on-premise channel as we progress through the summer, recalling that the on-premise channel was a fraction of what it was last year versus the prior year. So, we think that's all are going to take good care of itself as the year goes on.

Operator

Thank you. Our next question comes from the line of Bryan Spillane from Bank of America. Your line is now open.

Bryan Spillane

Good morning, everyone. A question for Garth. Just wanted to follow-up on the commentary around inflation becoming more uncertain. So, just maybe if you can comment on two things related to that. What areas – so what types of inputs are becoming more certain, is that freight, is it packaging, labor cost? Just trying to understand kind of where the potential pressure points could be? And then, if you could tie to that as well, if we step back today versus where we were at the beginning of the fiscal year, can you give us a sense of just how much flexibility has been eaten up by inflation coming higher? Or are you in the same place in terms of just flexibility to hit your profit growth goals this year? Thank you.

Garth Hankinson

Yes. Thanks, Bryan. And just as a reminder, when we issued our Q4 guidance, we talked about inflation and we said that, overall, we are expecting inflation kind of in the low to mid-single-digit range. And that was taking into account that on any given line item within our cost structure we were seeing the inflation kind of the low-to-high single-digit range. We have – as we talked about at that time, we have a pretty effective hedging policy in place and we entered the year in a good position as I said. So, as we look out this year, first of all, the outlook for inflation still kind of remains the same. Our outlook as well as sort of the external advice we get on this is still that inflation is going to have a bit of a spike but it's going to be temporary in nature. The question just is like how temporary, right? It seems as though that kind of blip, it might take a bit longer to kind of come down from there. And so, the things that we're watching mostly right now really are around as you indicated, logistics and transportation, and labor, and those things are somewhat intertwined if you will. The labor market has made it difficult to get dedicated trucking lines and so, that's becoming more and more competitive. So, that's absolutely a concern. We continue to watch aluminum and then we look at natural gas to – or glass, right? Glass, because glass is impacted by natural gas. So, those are the areas we're kind of most watchful for as we go through the year. I said it, as we sit here today, we're feeling like we're in a similar position to be able to cover our inflationary headwinds as long as they don't get significantly worse as we go through the year.

Operator

Thank you. Our next question comes from the line of Eric Serotta from Evercore. Your line is now open.

Eric Serotta

Great, thank you. Bill, hoping to get a little bit more granularity as to what you're expecting from the Hard Seltzer category and the broader ABA category or the ABA category more broadly? And related to that, you reiterated that you're more than doubling Corona Seltzer's capacity this year and you'll have the additional 5 million hectoliters of ABA capacity at Nava I believe for next year. If your forecast on ABA growth don't pan out, how flexible is that capacity to produce traditional beer?

William Newlands

So related to the Hard Seltzer capacity point, we're still expecting that the Hard Seltzer category is going to grow somewhere in the 30% to 50% range, somewhere in that range this year overall. And obviously, we did roughly 10 million cases last year with one SKU. We've introduced our second Variety Pack. We're very excited about that process so far and Limonada is just hitting the market really as we speak. I got to remind you again, what I said earlier, which is despite doubling the size of our ABA and Hard Seltzer capability for this year, the number one growth driver in our portfolio will remain Modelo, irrespective of that significant growth. So, we are very comfortable with our growth profile across the business. What I would say is, this is – we do have significant flexibility around the capacity that we put in and how that can be used within the business. And many of the things like packaging and so forth, really serve as the entire business anyway. So, we do have a fair amount of flexibility depending on if there's any changes in any of the particular sub-segments of the beer category at any point in time. We've worked very hard to make sure there is flexibility within our production capacity capabilities so that we can adjust to any change in consumer demand.

Operator

Thank you. Our next question comes from the line of Chris Carey from Wells Fargo Securities. Your line is now open.

Chris Carey

Hi, thank you. So, I actually have a question just about Wine & Spirits. Price mix has been a good story in the business, that's accelerated this quarter, obviously, margins got hit. I'm just trying to frame where you think we are on the path to the medium and longer-term margin targets here? We knew there was always going to be a step back before recovery and certainly, it seems like the price mix and premiumization of the portfolio can deliver what you think it can. But we also have a much more inflationary backdrop and things are evolving. So, I wonder if you can just maybe take a look at this quarter and how it informs how you're continuing to look at the capacity of this business to deliver those margin targets over time and perhaps the timeline on what you think that can happen?

Garth Hankinson

Yes, Chris. Thanks for the question. So, as you indicated, the topline is doing quite well. So, we're very pleased with our transformation as it relates to top-line growth. In terms of the margins journey, what we've always said around that is, it was going to take us about two years post divestiture to get to the 30% operating margins. And in order to get to about 30% operating margin, it was going to take a number of different things. There was pricing, there is mix, there is the cost takeout that we've talked about previously, stranded cost takeout of around $130 million, not all of which will fall to the bottom line. Some of that, we will reinvest behind the brands to make sure that we have strong brands that can generate the topline growth, as well as other initiatives around footprint optimization as a result of that the Gallo divestiture, not only did we share a large number brands but we also shared seven wineries, seven facilities with that transaction. So, there is a footprint optimization, as well as doing some cost optimization to make sure that the products we're putting in the bottom-most reflect what the consumers are looking to get when they pick up those brands. So, that – we're well underway. We certainly didn't sit back and wait for the transaction to close to identify those cost savings, those initiatives. So, we're just now executing against those. But as you say, we're at that interim period where the business is a bit deleveraged. And so, until the rest of those cost comes out, we – you will see that kind of – that downward blip as you noted this year as we move to the 30% operating margins at the end of sort of two years post divestiture.

Operator

Thank you. Our next question comes from the line of Kevin Grundy from Jefferies. Your line is now open.

Unidentified Analyst

This is actually Greg [ph] on the line for Kevin. Just one quick follow-up question on some of the on-premise channel trends that you guys have been seeing. Many of your peers have noted that it's been running in front of plan so far in terms of the number of reopenings, the velocity that they've seen. You guys gave some helpful context on what you've seen over the last quarter, but maybe could you talk about how your expectations for the full year have changed? Have you seen the reopening phase faster than you thought it would be? And maybe how you think that would impact full year results? Thank you.

William Newlands

Sure. Let me take that one, Greg. The – we have seen it accelerate tremendously. But as we've seen over the course of the last 18 months around the pandemic, you often see some things where you get starts and stops and things improve in certain states and don't improve in other states, and so on and so forth. I think the important thing from our perspective to look at is, while we've seen 250% growth in our depletions in the quarter versus prior year, the overall percentage of our business that the on-premise represents is still a bit less than it was in fiscal year wherein calendar – excuse me, calendar year '19. So, we still think there's still some opportunity and acceleration to come. We also have had an exceptional – and our distributor network does an exceptional job of winning the times that matter, things like 4th of July, Labor Day. We did it with Cinco de Mayo, we did it with Memorial Day. So, we still think there's going to be some good opportunities for acceleration. The challenge to predict how much of the channel shifting that occurred? There was a massive amount of channel shifting that occurred a year ago when you went heavily to the off-premise. You're now seeing the on-premise comes back on and the IRI and Nielsen data has been somewhat muted. So, we also have seen, as we noted in our scripts, a significant increase in our three-tier e-commerce and direct-to-consumer across the business. So, how all those channels sort of shake out is a real question. I think the encouraging part remains. The consumer demand against our business across all channels that we can track has been extraordinarily strong and we're excited and we think that will continue irrespective of which channel the consumer chooses to engage in.

Operator

Thank you. Our next question comes from the line of Andrea Teixeira from JPMorgan. Your line is now open.

Andrea Teixeira

Yes. Thank you for taking the question. So, I wanted to just follow on this one, this last commentary Bill on where consumers are engaging. And it seems like, as you said – you just said now that it's still below the calendar '19 level. So, can you comment a little bit of how you see that transition? Like your consumers are still engaging at home and the consumption of your – obviously, your big brands is still very stronger at home despite the shift and how you're seeing that? And then, just a clarification on also on the inventory and shipments. Is it fair to say that given that you have a very easy comp on the production in April, right? So, going to have a lot of like inventory that you haven't built yet, but is still on transit from Mexico. Is that something that gives you some comp for that? Even though you said you only see the normalization by the third quarter, that the second quarter is still going to be a very strong shipment quarter.

William Newlands

Sure. So, let's start with question around the on-premise. Keep in mind, based on what we can see, per capita consumption has remained pretty steady throughout the pandemic. It's just that where and how people consume has moved around quite a bit. So, it's really difficult to precisely predict how consumers are going to operate. And I think it's going to vary, as I said a moment ago, quite a bit by state depending on the individual restrictions and whether or not certain states are still allowing takeaway from a restaurant environment for alcoholic beverages, some are not. So, until all this dynamic plays itself out, I think it's going to be very difficult to predict exactly how the consumer will land. Other than I would say some of the sheer shopping behavior where you see three-tier e-commerce and direct-to-consumer changes are going to continue. As we've said in prior calls, we have made major investments to increase our capability in three-tier e-commerce and direct-to-consumer, and I'm very glad that we did. It's playing out well and it's showing tremendous takeaway in those sectors which have grown around the pandemic. As it relates to inventory, we continue to believe we're going to have a very solid year. We're in a good position to make up the challenge that was the one-time challenge around the power outage that occurred in February, and we expect to have, as we've said, a very strong year and that I would expect would include the second quarter which is upon us.

Operator

Thank you. Our next question comes from the line of Steve Powers from Deutsche Bank. Your line is now open.

Steve Powers

Hey, guys. Thank you very much. I know you've got a lot of questions already, Bill, but just to round out that last topic on beer supply. I guess is there a ceiling we should think about in terms of how much you're just physically able to ship in 2Q? I think consensus has you shipping around 100 million cases in the second quarter relative to the 85 million in the first quarter. And I guess just given all that you said, I'm just trying to understand or dimension whether that kind of step up is doable in broad brushstrokes or in the back half? And then, I – what I really wanted to ask about was for Garth, just – you ran through a number of items, very helpfully that will kind of weigh – explain the beer margin trajectory sequentially and what will weigh on beer margins over the remainder of the year. If you could provide any more detail there, may be a rank order just in terms of the items we should be focusing on is having the biggest impact there, that would be very helpful. Thank you. Thank you to both.

William Newlands

Yes, you bet. So, let me start with the first half, and then Garth will cover the second half. The one thing that we haven't mentioned today, but it's an important one is – but we did mention it in prior quarters. Our Obregon, opening of the extension of Obregon was delayed roughly a quarter last year – at the end of last year, because we weren't able to construct during COVID. So, that is certainly going to help our inventory position as we move forward as that's now up and running. It's not running as efficiently as it will once we get everything locked and loaded because it's just a normal startup. But it's certainly helping the situation and we certainly expect to be able to meet consumer demand during our key summer selling season as I said earlier. We're being – we're working very carefully with our distributor network and our retail partners to make sure that we are able to meet the demand. Admittedly, the demand has been robust and continues to be very strong, but we are expecting to be able to meet that demand, and certainly, Obregon is a big helper in that area. Garth, you want to take that out?

Garth Hankinson

Yes. Just to follow-up on the margin question. So, as we stated in Q4, really, it's those three big drivers of depreciation, inflation, and mix, and those are really kind of equally weighted in terms of the impact on margins. So, on the depreciation front, that was – we have an increase of about $65 million this year, and that's comprised of Obregon full year — ***indiscernible*** — in the glass joint venture [ph], depreciation as well as some other things. Inflation, I think we've covered, and the fact that it's more in the second half of the year as our hedges kind of roll-off. And then mix, I think mix is also something that's going to impact us again more as we go through the year because we started the year really with kind of one SKU in Corona Hard Seltzer Variety Pack #1, Corona Hard Seltzer Variety Pack #2 was just launched at the beginning, and then we launched Limonada here in June. So, there will be a more mix impact as we go through the balance of the year as well. But really it's equally – the impact is equal across those three buckets.

Operator

Thank you. Our next question comes from the line of Laurent Grandet from Guggenheim. Your line is now open.

Laurent Grandet

Thank you. And hi, everyone, and thanks for squeezing me in the queue. Up to recently — ***indiscernible*** — penetrate most from these spending household about 15% for the right kinds were to a record as a test was not pleasing — ***indiscernible*** — So, now with new bolder flavors, Seltzer and brown/black [ph] targeting specifically Hispanic, we are seeing household penetration within Hispanic going up to 25 to 35. So, my question is do you see that as a risk to your portfolio of Mexican beer? And if not, why? And what are you doing to reach more Hispanic consumer with your current Seltzer portfolio? Thank you.

William Newlands

Certainly. Well, as you know, we are very fortunate with our Mexican beer portfolio to have the strength of brands that we do. These are iconic, authentic brands from Mexico that our Hispanic community is very much behind. And we continue to see strength and growth. As I've said you, I think – not to you, but I've said in prior calls, we continue to see opportunities with Modelo/ The household penetration with Modelo despite the rapid growth of Modelo is still not at the level of Corona as an example. We're also seeing over-development in the Hispanic community with our Corona Hard Seltzer. So, we are reaching into that community by again meeting new occasions and meeting new consumer needs with those particular products. So, we are very comfortable with the growth profile that we see in the Hispanic community with our iconic portfolio from Mexico and we think the Seltzer element is going to be an important and hopeful part of continuing the relationship with the Hispanic community, recognizing that we're also doing a great job of expanding those brands into the non-Hispanic community as well.

Operator

Thank you. Our next question comes from the line of Trevor Stirling from Bernstein. Your line is now open.

Trevor Stirling

Hi, good afternoon, Garth, and Bill. Two quick questions from my side, please. As you sit today and you compare with three months ago, have anything changed to change your point of view either for F22 or the outlook? I think the second thing related to that, given the cadence of inflation you talked about given the aluminum spot price staying as high as these and those hedges rolling off, historically, you've had that 1% to 2% pricing algorithm. Do you think that might need to change 12 months out?

William Newlands

I'll take the price part, Garth. Maybe you take the first part. Relative to the price, we continue to believe 1% to 2% is going to be our long-term expectation. We think that balances appropriately the dynamics that occur with price sensitivity when you raise your price and recognizing, it does obviously help you cover any inflationary effects during the course of the year. So, we're pretty comfortable, that algorithm of 1% to 2% is the right answer, that balances all of those factors and we would see that continuing well into the future.

Garth Hankinson

Yes, in terms of the first part of that question, the Q1 changed our point of view for the full year. I would say that at this time, it's too early for us to make any changes to our outlook for the year given one-quarter end. The one thing that I would highlight, right, as Bill noted in his script, depletions in our beer business exceeded our expectations as well as the expectations of our distributor, our retail partners. So, that's something that we'll watch very, very closely as we move through Q2 and through the balance of the year. And look, when – as we go through the year and we do see changes to our business, we'll be sure to update you all on our guidance expectations. But as of right now, we're very comfortable with the guidance that we provided and reaffirm today with a bit of a tick-up on our EPS related to the share repurchase program.

Operator

Thank you. At this time, I'm showing no further questions. I would like to turn the call back over to Bill Newlands for closing remarks.

William Newlands

Thank you, everyone for joining our call today. I think it should be clear, the fiscal ’22 is off to a strong start, providing us with continued momentum as we head into our key summer selling season. Our powerful collection of consumer connected brands across beer, wine, and spirits continues to gain traction and we are well-positioned to deliver another strong year of performance consistent with our long-term goals. Our robust cash flow generation allowed us to make significant share repurchases in line with our commitment to return $5 billion to shareholders by fiscal ’23 and we look forward to updating everyone throughout the fiscal year, as we expect to make continued progress during fiscal ’22. In closing, I’d like to wish all of you a happy 4th of July and hope that your celebrations with family and friends include our fantastic beer, wine and spirit products. Thank you, again, everyone and have a good summer.

Operator

This concludes today’s conference call. Thanks for participating. You may now disconnect.

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