Constellation Brands Inc, Investor Day 2016
2016-11-09

Presentation

Patty Yahn-Urlaub

Hi, everybody. Is my microphone on here? Looks like it is. So welcome. Despite the fact that it's been a tough market day, thank you all for coming anyways. And some of you assured me that you've been drinking a lot of our products since last evening, so I really appreciate that. Anyways, welcome, once again, to the Constellation Brands Investor Meeting. Thanks for joining us. I am Patty Yahn-Urlaub. I know many of you, but I'm from Investor Relations at Constellation.

Before we get started with formal presentations, I would just like to review today's agenda and cover some procedural items. This afternoon, Rob Sands, our President and CEO, will kick off the program. In addition, you'll hear from the leaders of our wine and spirits as well as our beer businesses who will share the strategic initiatives and opportunities they have underway and their plans for growth. They include Bill Newlands, who's President of our Wine and Spirits business; and after Bill, we'll take a short break. Then we'll resume with Paul Hetterich, President of Constellation's Beer business. And then we'll end the program with David Klein, our Chief Financial Officer.

In addition to our presenters, I'd like to introduce some additional members of our senior management team who are with me here today in the front row. So we have Mike Lee, who is CFO of our Wine and Spirits business; we have Bruce Jacobson, who is Chief Commercial Officer for Beer business; and we have Ben Dollard, who's CFO of our Wine and Spirits business – you're not CFO, right, You're Chief Growth Officer, sorry. Definitely not science, no good. They'll be available during the cocktail reception if you'd like the opportunity to speak with them. Then there'll be a general Q&A session that includes participation by all presenters after formal remarks have been completed. After that, as you know, is the best part. We'll have a cocktail reception at – where you'll have the opportunity to mingle with everybody, while sampling, of course, some of our fabulous products. The cocktail reception is going to be held right outside the ballroom here as soon as we're finished today.

So our session this afternoon is being webcast and will be available for replay on our website at www.cbrands.com through the end of our fiscal year and our presentation app will also be available through February 28, 2017. And last but certainly not least, I would like to direct your attention to these forward-looking statements and non-GAAP financial measures slides. And I'd also like to ask that you please silence your cellphone.

And with that, thank you. And I'll turn it over to Rob.

Robert Sands

Thanks, Patty. I said we ought to change it up today and start with the cocktail reception. What do you say? Well, it's great to be here with everybody today and needless to say, I know that the election of Donald Trump as President is on everybody's mind. So I'll make a couple of comments about that before we get going. And I would say, first, really on a positive note, I think that, in general, we believe that Republican control of the Congress, the White House will be good for business in general and will be good for Constellation, as it relates to a whole myriad of things, right, taxation, deregulation, repatriation, other economic matters.

Now I would say that secondly, it's way too early to really understand how President-elect Trump's policies on Mexico, immigration, trade, how all of those things will affect our business. I mean, if I stood up here and said that I know something that you guys don't, it just simply wouldn't be true. I mean, we've all heard all of the campaign rhetoric, and we all have our own thoughts on that topic, but there's – I know as much as you know about it. So it's going to take some time. We're going to see how things are going to develop. But I can say this, I don't expect it to affect our business in the short term. And as these new policies are developed, you can all be assured that we will respond accordingly, and we will engage in – with government also accordingly. So that's about the best that we can say at the moment. So I guess I would add that we've had a long history of working with our representatives from all levels of the U.S. government and from both political parties. And that I think that as Trump develops his plans, we will continue to engage with them.

So the business, which we're going to get back to in a moment, has been stronger than ever. And I think that the prospects across our beer, wine and spirits portfolio have never been better. We are in a very strong position right now. We have a very diversified portfolio of fast-growing, premium brands from the U.S. as well as other parts of the world and Mexico. And I can say that with regard to our Mexican portfolio, the consumer demand for these products has literally never been stronger. And we have to keep in mind that our Mexican portfolio are products that are authentic Mexican products. They've never been produced anyplace else, they can't be produced anyplace other than in Mexico. And, notwithstanding the election of Trump, we're proceeding with our investments and our expansion plans with our new Obregon brewery that we recently announced the purchase of, our expansion plans at Nava, which are entirely on track. We're now producing at a rate of over 20 million hectoliters there and moving towards 25 million and 27.5 million hectoliters, and we have progressed on the building of our new plant in Mexicali, Mexico.

So with all that said, as I say, let's focus on Constellation and our great business. It's been a long time since we've had one of these meetings; the last time that we met was over 3 years ago. And as many of you recall, because many of you who are sitting here now were sitting here then, the big news then was the – was related to our transformational beer transaction, which represented one of the most significant milestones in the entire history of our company. And I think that that's proved – proven to be the case.

Now at that time, some may have thought, okay, how can it get any better than this? Certainly, I had those thoughts myself. And the truth was is back then, 3 years ago, when we had this last meeting, we were just getting started. So let's take a look at some of the things that we've been up to. Play the video. Thanks.

[Presentation]

Robert Sands

So we've been up to a lot, as you can see. So I'm especially proud today to be accompanied by a few of our executive team leaders who have been instrumental in executing all of the accomplishments that you saw up there. Paul Hetterich, Bill Newlands and David Klein are all new to their current positions within the last 18 months, but collectively, boast more than 60 years of experience in the beverage alcohol business, giving them the perspective, vision, I hope wisdom, and leadership to succeed. Now they have worked with their respective teams to define the road map for our future, plan how to navigate it and implement the changes necessary to attain those milestones of success. Now we're working very closely together as a team to build a solid and sustainable foundation of operational excellence, financial strength and innovation for the future, all in an effort to sustain profitable growth and to build shareholder value.

So today, the Constellation team plans to reinforce why we like the categories and the markets that we currently participate in, why we think our competitive advantages make participation in these markets beneficial and why we believe we can win. We will share the reasons to believe our enablers of our future growth and the value we expect these initiatives to generate well into the future. And when David translates all of this into real numbers at the end of our day, you will see how and why we are targeting EPS growth at a rate of greater than 10%, that's greater than 10% over the next 3-year horizon. So I'm not sure that any of our peers in our CPG category – in our CPG space have committed to achieving this kind of exceptional level of growth.

Now, we didn't get there overnight, I think, as everybody here recognizes. This vision of our future is predicated on our accomplishments and the shareholder value we have already created. So I'd like to take a minute to share some of the most value-creating endeavors we have accomplished since our last Investor Day. We have delivered exceptional performance and continued growth momentum. It has been an incredibly dynamic and fulfilling journey marked by very strong financial performance, notable business milestones and select value-creating acquisitions. We have significantly increased the value of our stock by achieving milestones that produced double-digit growth in sales, EBIT and operating cash flow. And for 4 consecutive years, Constellation has been one of the top performing stocks in the S&P 500 Consumer Staples Index, growing more than 650%, 650% since 2012 when we began executing our beer acquisition. We've accelerated our growth across the business by strictly adhering to our leadership imperatives, which are focused on leading beverage alcohol growth, driving commercial and operational execution, all of this while applying business discipline and fostering an environment that drives a winning culture.

Our beer business continues to be a powerhouse for growth as the #1 brewer and seller of imported beer in the U.S. market. Last year, for the third consecutive year, Constellation's beer business solidified its powerful position as the #1, the #1 contributor to growth in the U.S., in the entire U.S. beer category, outperforming the U.S. beer industry key competitors and all other imports. As I like to tell our sales organization, you can't make that kind of stuff up, okay.

Because of this tremendous growth, we are making smart investments to ensure that we have the capacity, quality control and flexibility to meet and exceed consumer demand well into the future. As such, we continue to expand our brewery and glass plant operations in Nava, Mexico, while building an entirely new state-of-the-art brewery in Mexicali, Mexico. And we recently announced our plan to acquire ABI's brewing operation in Obregon, Mexico, which provides an immediate source of supply with a functioning brewery capacity for our iconic portfolio of Mexican brands. So overall, we're on schedule with all of the expansion activities in Mexico, and we are well positioned to enhance our operational platform to support the exceptional industry-leading growth of our beer business.

Now, last year, we entered into the U.S. craft beer market, right, with the acquisition of Ballast Point, which is the fastest-growing major craft brand in the United States and continues to be so. Ballast Point provides a high-growth premium platform that enables Constellation to compete in the exciting craft beer segment, further strengthening our position in the high end of the U.S. beer market.

Within our wine and spirits business, we have executed key management changes that have resulted in sharpened focus on premiumization, innovation and brand building. And from an operational perspective, we improved productivity and created efficiencies through our COGS optimization initiatives, and we are driving efficiencies throughout our wine and spirits manufacturing operations. And these actions are driving margin expansion and earnings growth.

Now, overall, we've made remarkable progress and have achieved excellent outcomes that confirm that we have the leadership strength and the right portfolio and the strong discipline to continue to be a leader in the total beverage alcohol category. So enough about the past. You've come here today about the – to hear about the future, and it all begins with our plans to sustain profitable growth and build shareholder value. It's our commitment to this strategy that drives our actions. So I want to provide some insights on the building blocks of this plan that we will call our leadership imperatives.

Our charge to lead beverage alcohol growth is about brand building and includes our priorities to grow high-impact innovation, brand equity and drive mix improvement. So enhancing operational execution is driven by our focus on executional excellence which includes our initiatives to win at retail, optimize operations and leverage our scale across TBA. And finally, delivering industry-leading shareholder return is all about value optimization and our efforts to refine pricing, execution, design to value and refresh our core non-focus brands. Now delivering industry-leading shareholder returns also includes our efforts to enhance our balance sheet and optimize our capital structure for the long term, in order to maximize our free cash flow and create capital allocation flexibility.

Now embedded in our overall long-term business strategy for premiumization and scale is a clearly defined vision for each of our businesses highlighted here. Keeping this strategy consistent over the last couple of years has allowed us to focus our energy on delivering growth. Knowing what we have accomplished, we are not letting up and now we will continue our charge towards growth that is sustainable and profitable.

So how do we sustain our current growth momentum? Let's start with a discussion of key favorable industry dynamics and our competitive position that supports this growth. It's our leadership and scale in TBA and the industry growth and premiumization trends across the categories in which we participate that have been key enablers of our success. And as you know, the U.S. market represents the vast majority of our profitability and our market participation. So total beverage alcohol is one of the most important consumer products categories for U.S. retailers and Constellation is the largest multi-category beverage alcohol supplier in the U.S. with solid market positions right across all 3 of the categories.

So let's start with the U.S. consumer, right. The U.S. consumer packaged goods, or CPG, category which has been growing at a rate of about 2% for the last year. IRI estimates the size of beverage alcohol category in this channel to be about $50 billion, growing at nearly 5%, which is more than 2x the rate of the CPG category. And from a consumer perspective, you can see that the lines are blurring within total beverage alcohol, as more than half of TBA volume comes from consumers who participate in all 3 categories; beer, wine and spirits. Now by contrast, those consumers who do not cross category lines represent a much smaller percentage of the total, right. Cross-category consumers not only represent the majority, they spend more on their average annual beverage alcohol purchases, which is an excellent selling point with our retailers, distributors and, of course, our on-premise customers.

So within TBA, Constellation has the necessary scale and clout as the #1 U.S. multi-category supplier of consumer-preferred premium brands across wine, beer and spirits. We are the #1 imported beer company in the U.S., and the world's leading premium wine company. So we could ask, why does all this matter? Why the emphasis on growing our TBA leadership? It is a highly important category in which to win with consumers, and it provides the greatest opportunity for you – for us to use our significant size and scale to take advantage of favorable premiumization and consumption trends across beverage alcohol categories.

Now, we are seeing several top retailers expanding their beverage alcohol presence by devoting more floor and shelf space to our categories, expanding the number of stores with alcohol beverage licenses and increasing product selection and brand support. They see this category as a key driver of growth for their businesses. And our discussions with these retailers as well as our on-premise customers have become more focused on total beverage alcohol planning, program development, alcohol planning and ensuring alignment with their strategic initiatives as they see Constellation as the expert in consumer insights and cross-category management. And we are able to leverage our scale and our leading market positions with marketing spend for cross-promotional opportunities within TBA. For example, we recently worked with a major retailer to cross-promote Corona and SVEDKA Vodka with our Côte d'Ivoire wine. The featured item grew more than twice the market rate during the program period. And each of the promoted brands outpaced the growth of the respective categories during this time frame. So let's take a minute to view one of our cross-promotional TV commercials advertising Corona and Casa Noble. This was first aired leading up to this year's Cinco de Mayo holiday.

[Presentation]

Robert Sands

Because it clearly shows the power of Constellation's total beverage alcohol leadership and is demonstrated by the fact that we contributed greater than 20% of TBA growth in the United States market last year as the #1 provider of retail sales growth. Now this is by a factor of more than 3:1 versus any beverage alcohol company. We've achieved our leading TBA position through our long-term efforts to premiumize our overall portfolio. Today, almost 95%, 95% of the TBA category growth in the IRI channel is driven by high-end beer, premium-plus wine and high-end spirits.

The premium segment of the off-premise channel in the U.S. is gaining momentum and driving overall market growth across TBA. As you can see, during the last year, the premium or high end of the market has significantly outperformed the total category growth across beer, wine and spirits. And for Constellation, the same trend applies across our own premium-plus wine and spirits portfolio, which is also the price segment where we expect to drive most of our wine growth going forward. And our high-end beer portfolio has also achieved growth trends that significantly exceed the market. In addition, you could see that the average price per case for Constellation's high-end beer product exceeds that of the total U.S. beer industry by almost 35%.

Ensuring we have the right portfolio of products to continue leading these premiumization trends is a priority for us and provides a runway for future growth beginning with our M&A strategy. So, as you know, acquisitions have played an important role in our history and have helped to make our company what it is today. In an industry where leadership matters in distributors and retailers, acquisitions can play a key role and complement our organic growth strategy. And as such, acquisitions can also be a source of growth for the company longer term. However, timing on the right opportunities is not predictable. If an appropriate opportunity presents itself and we choose to engage in future acquisitions, they would need to be premium, fast-growing, consumer-led, scalable, portfolio-enhancing and, of course, meet our strict financial criteria.

Now, within the last 2 years, we've added some great brands to our portfolio through select tuck-in acquisitions. And they fit these criterions that I just mentioned – these criterions. These investments represent prudent capital resource management and are helping to propel our growth model. We believe this type of strategic investing is absolutely the right thing for us to do for the health of our portfolio and the future growth prospects of the business.

So to prove my point, let's take a look at some of our recent acquisitions and their contributions to growth. Some of these are very new with great promise, but not yet fully realized. However, our track record for accelerating acquired brands gives us confidence, confidence in our ability to continue our success in this area. Take Meiomi for example, which is a great example of a brand that fit our M&A criteria as a premium, synergistic, high-growth, high-margin, accretive, complementary tuck-in to our existing portfolio of wine brands and an operating margin profile, right, that significantly exceeds the margin rate for our overall wine and spirits business. The right brands with the right financial profile like Meiomi and the others listed here can be effectively integrated into our distribution platform to provide synergies, scale and route-to-market benefits.

And we are not only focused on acquisitions as we recently demonstrated through the announcement of the sale of our Canadian wine business. The consideration of this strategic action was the result of our ongoing efforts to identify, right, value-enhancing opportunities and the strength in the overall financial portfolio of our overall wine and spirits business.

Now another proof point of our focus on growth has been the creation of the Constellation growth organization, which Patty mentioned is headed by Ben now, which provides greater focus and coordination on the long-term growth opportunities across our beer, wine and spirits businesses. This team is accountable for accelerating innovation and new product development initiatives, leveraging strategic insights and consumer analytics and identifying synergies across total beverage alcohol within our national accounts organizations.

Now, we are currently focusing on some of the megatrends and consumer-led ideas, okay, that we believe will provide a foundation for future growth, including hybrid drinks, flavored beverages, new packaging ideas and effervescent products. In addition, we are investing in the best-in-class consumer insights, which in turn drive informed innovation and retailer execution across TBA.

So to further accelerate our TBA success, the scope of our growth organization also includes Constellation Ventures, a corporate venture capital function focused on identifying smaller-scale investment opportunities related to innovative concepts and emerging categories within beverage alcohol. Now Constellation Ventures connects us with entrepreneurial brands and technologies, and allows us to support consumer-proven products early in their life cycle. Our initial venture investments included Crafthouse Cocktails, Nelson's Green Brier Bourbon and the recently announced, Bardstown Bourbon distillery. And we are moving forward in a competitive and ever-changing industry. But we are well positioned to build shareholder value by focusing on remaining a best-in-class consumer products company and leveraging our competitive advantages as well as flawlessly executing.

Now, when you put this all together, Constellation stands out against the competition as a clear leader in beverage alcohol. We have a portfolio that is second to none and continues to evolve to meet consumer needs. Our people, our people are skilled and determinant and passionate about what they do, building strong relationships and delivering absolutely better results. And we are a recognized industry leader as demonstrated by this string of recently awarded accolades in recognition of our accomplishments.

And speaking of accomplishments, right, I thought it would be interesting to share with you a snapshot of the evolution of our company from inception to where we are today. Glad the stock's not still at $0.11. We've become a proven market leader, and we are operating from a position of strength. We cannot become complacent, and we must remain forward-looking and focused on fulfilling both our short and long-term goals.

So in a few minutes both Bill Newlands and Paul Hetterich will review with you their strategic plans to capture growth opportunities for their respective businesses. I could tell you that while their product categories are different, their business actions are tightly, tightly aligned and guided by a single set of overarching leadership imperatives designed to sustain growth and build shareholder value.

Now, the key learning that we hope you will take away from that, we firmly believe is that Constellation is better positioned today, better positioned today than it has ever been to generate this growth and build value as demonstrated by what I think is this very interesting visual. Here, you can see that we are one of a select few, a very select few of consumer-focused companies that possess the powerful combination of sustained revenue growth, strong profit margins and exceptional shareholder returns, 3 in the world.

And as a company, we have the focus and the drive to build on this value. And we look forward to continuing these trends in the years ahead.

It's a particularly exciting time to be part of Constellation Brands, and we thank you, of course, for all of your remarkable support of our business and our brands.

So now I'm going to turn the meeting over to Bill Newlands. Bill? Thank you.

William Newlands

Thanks, Rob. One might argue that I got a tough draw in this discussion today because, first of all, I have to follow Rob, who presents one of the best consumer product stories that you've ever seen. And then after me, you get to listen to Paul who's probably got the best story in alcoholic beverages that have ever been done. And I'm in the middle. But I'll tell you, I think we have a very compelling story about wine and spirits, and I'm going to tell you why.

It all starts with the category. This is a growth category, both wine and spirits. In addition, it isn't volatile. And I think back to 2009, during the financial crisis. Any of you who are following things like the automotive industry, you were looking at numbers down 20%, 30%, 40% at the top line. Crazy! The wine and spirits business was up. This is a resilient category with high growth, and it's is perfect for us. You look at our ability to grow the top line, our ability to grow the bottom line is driven in part by our capabilities. It's driven in part by the fact that the category is strong, and it's driven in part by our sheer size and our ability to get efficiencies that are the most within our sector.

It's also a category, as Rob noted, that's premiumizing. So today, you see more and more consumers stepping up, which gives organizations like ours the chance to put higher-margin, higher-growth, higher-profit scenarios in play. Now, most of this is driven by our consumer-led understanding. Rob put in place a growth organization about 2 years ago now with the full intention of making sure that all of our businesses were focused on being consumer led, make sure we are ahead of the curve. And that applies to a number of things. We're going to talk about some of those here in a few minutes, but innovation is one of those. Understanding what the consumer wants and being able to meet those needs is a critical part in a category where innovation is an important part of overall growth. It also is important with today's consumer, who is more and more interested in experimenting. And lastly, you wrap that all together with an extensive and great portfolio that can meet the needs of virtually any consumer desire, we think that's a winning formula.

So let's talk a little more about each of these. And let's start with something that you've already seen once today but I thought it was worth repeating. As an investment thesis, this is a growth category, both wine and spirits compared to many other things that you could look at in the CPG world. And when you look at the premiumization that's occurring and the ability to improve mix and pricing, it gives you the chance to not only have good volume growth, but also have profit growth and dollar growth that exceeds the volumetric growth.

Looking a little further. It's one of the best categories, and it's not prone to fads. As some other categories that will have their moments in the sun, we have a category that is prone to sustained success. Let's break that down just a little further. The U.S. is where you want to play. It is, by far, where the most money is and the same exact thing would apply to profit. The profit pool in this market is second to none. And I don't think I have to remind any of you in this room, this is primarily where we play.

The good news also relative to the U.S. market is the per capita consumption in both wine and spirits continues to grow and has over the last decade. The industry also is premiumizing, as you saw from Rob's slides. So as you go up the price ladder, the growth gets bigger, that's true in wine, it's true in spirits. Premium and up are where it's at. And it shouldn't surprise you then that our focus and where our growth is coming from matches that. The growth at the premium end of our business in both spirits and wine is – matches up with what the category has available to us as well. And the evolution of our portfolio to have more and more of our brands competing at the high end is a critical part of this as well.

Take a look at that. I probably should sit down for a few minutes and just let you look at some of these numbers because these growth numbers are pretty impressive. These are some, although not all, of our Focus Brands. And you look at the growth, and you see 31s and 26s and 17s and even our biggest brand, Woodbridge is up 6%. Those are 52-week basis numbers. 2 things I'd like to say. Many of these look a lot better on a 12-week basis. The Prisoner is up 46%, Black Box is up 38%, Ruffino Sparkling is up 42%. What's also interesting and this speaks to brand building and our brand building capability, 5 of these brands on this list are greater than 1 million cases. So these are not just small things that are growing leaps and bounds because they're tiny, these are big brands that are critically important to put a lot of profit at the bottom line.

And as I said, our portfolio is fairly broad, but it allows us to compete across all the critical segments in popular plus. We are #1, 2 or 3 in all of those segments, and we are spending time on both new product development and acquisition to fill in where we think we have the right to get more share within these spaces.

This is another slide I'd like to leave up for a while. If you're in a growth category that outperforms most of consumer products and you are the growth leader within that category, that, I would argue, is a tremendous story. We are the growth leader in premium plus and popular plus share over the last 12 weeks, and frankly, we have been for most of this calendar year. We are beating the market. And a lot of that comes from some change that has occurred over time within the alcohol beverage industry. And I thought these particular facts were kind of interesting because it talks to the younger consumer, people who are first getting started in the alcohol beverage consumption, that's the 21- to 29-year-olds. Today, we call those the millennials. 20 years ago, we called them something else. Today they're the millenials. But it's been an interesting evolution. If you look back in the mid-90s, 70% of consumption, 70% of what people 21 to 29 consumed was beer, 13% was spirits, 15% was wine. Today, that's changed quite a bit. So 20 years later, that's changed a lot. And what you've seen is spirits has more than doubled and wine's up 50%. So a lot of change has occurred within what today's younger consumer is doing when they enter and engage with our category.

They also, the millennials, are actually drinking more per occasion than what prior generations have done. Now since Rob made the point of saying that the management team has 60 years, I just would like all of you to know that I am not in the older column, I'm actually right in the middle of the baby boomers. So if any of you thought all that 60 years applied to me, it doesn't. And – but anyway, that number wouldn't apply to our household anyway, one way or the other. But it is interesting to note that the millennial consumer, when they are consuming wine, consumes more per sitting than what prior generations had done at similar time frames.

For those of you who attended our beer conference in January of this year, you probably heard me talk a bit about flavor and how the millennial consumer also thinks about the concept of flavor. And there were 2 points that I made. One is the amount of flavor today's consumer wants is a little different. They want more. They also want specificity. So – and I think I used the example, if someone wants acai, don't try to convince me conquered grape is just as good. It's just not the same. People are looking for specificity of flavor and are looking for amount of flavor. And that, of course, is something that is critically important to how we, as an industry, think about what we're going to do in new product development.

The millennial consumer also does things slightly different from what some prior generations had done. They put more faith in brand than in a varietal, which is actually pretty different also from what you see in some other generations. They're also a little bit ambivalent to where something is made. Now, I'm going to talk to that in a minute because we have a tremendous example of that within our portfolio. But please keep that thought in mind. I'm going to come back to it in a few minutes.

But lastly, as Rob noted in the TBA discussion, this audience, this community drinks more across beer, wine and spirits, all of them, than any other prior generation has before them. So the question I'm sure that would be on your mind is, what are we doing about all this? So let's talk about it.

Everything in our mind starts with the consumer. How, what, when, where and with whom are our consumers consuming? All of those, critically important. But that creates the foundation for us to do lots of other things. It allows us to do sensory. It allows us to do innovation. It's important with our brand communication. And it's important to how we think about refreshing some of our existing brands that have been in the portfolio for a long time. Let's talk about how we have applied many of those things.

I'm going to take you through our sensory approach because I think it's – in some ways, it's pretty simple. But in some ways, it's foundational to what we do in terms of putting the right product in the right package at the right time. So our sensory approach, I view it as consumer to the vineyard and back. What do I mean by that? We get consumers together, and we ask them a very simple question, what do you like? What do you like? And I know that sounds really simple. But what do you like? And our expert's capability to then determine what are the sensory attributes that are critical to why someone tells us they like something is really important. That then allows us to group those traits, so we can find trends, and we can find subsegments of population that we can put products in place so that they will buy and buy again.

That allows us to develop wine styles. And once we have those wine styles, we can then go all the way back to the vineyard and say, what do we need to do agriculturally to make sure that we are supplying the right product? What does our winemaking team need to do so that they are ready and producing the right liquids that go in the bottle? And lastly, what's the brand communication? What are we saying about our brands, so that the consumer, when they try it, is going to like it and they're going to repeat? That, in a nutshell, is our sensory process.

Let's talk about an example of a product that was the kind of birth, if you will, out of this process, Ravage. One of the things that we identified was we had an opportunity with men that we were not actually creating, that there was a chance to do something that's bigger and bolder and slightly sweeter, generally speaking, that had been often applied to women, but less to men. Men actually like it, but it needed to have edge. It needed to have attitude. It needed to do a lot of what you've seen in craft beer or what you've seen in spirits, in craft spirits, is it needed to have a little edge and a little attitude. And lastly, it needed to be big and rich and flavorful.

So we met that consumer demand. It was called Ravage. We then tested the selling story. So for 6 months, we did it a test market with one of the largest retailers in the country. We figured out what works. We figured out where we could enhance our proposition. And guess what? When we were ready to introduce this nationally, we had it locked and loaded. Our size and executional capability then, when it was introduced, allowed us to make sure that this product was in front of the consumer at any time, when and where they were prepared to buy. And guess what? It worked. It was – it's already, after 6-months introduction, standing as the 14th best super-premium cabernet, again, only after 6 months. And the better news is – I did this slide a few weeks ago, it's actually 12th today. So let's also give you a little flavor for how we're talking to the consumer about this. Can you run that, please?

[Presentation]

William Newlands

Our consumer understanding also gives us a chance to refresh brands that, quite frankly, were tired. And our Robert Mondavi Private Select is a good example of that. We have started a design-to-value approach across a number of our brands within our portfolio to say, what does the consumer value? P.S., what don't they value? And to make sure that we are providing things that are of value so that we can maximize our price realization across our category. And what we determined was, is that this was a bit of a tired business, and that we could upgrade it. And we did. We changed the bottle. We've put a little different product in the bottle in some instances. We introduced Bourbon Barrel Cabernet into this line. I wish we'd made more. We sold all of it, very fast, terrific new product. And how did it work? For a business that in IRI was pretty consistently off low-single digits, in the most recent 4 weeks, this business was up 18%. So again, putting it through our system of consumer understanding, design to value has allowed us to refresh a business that is now a significant contributor to our growth.

And then, of course, there's David Klein's favorite brand. I don't even think he drinks Sauvignon Blanc, but it's still his favorite brand because it's all around brand-building. Actually, it's not. It's his favorite brand because this is the single most profitable SKU we have in the wine and spirit business, and the margins are the best of anything we have in the wine and spirit business. But I think it's really important to note that it's not just nice that he's happy with it, so is the consumer. And it's shown our ability to brand-build on a business that actually was in pretty good shape when it was acquired. We've done digital advertising. We've done unique partnerships. We've increased our PR capability. And this brand is still on a brilliant growth trajectory of high teens for the last several years. So I don't blame you, David, it's all right. Can you please run the video?

[Presentation]

William Newlands

Our consumer insights has also allowed us to push the boundaries in 2 areas of innovation, packaging and product. Let's talk first about packaging. We have introduced, and in the middle of the slide, you can see the helix closure. This particular thing is something that we are the first to market in this country. It provides the sophistication of cork. So it's real cork, but it's got a beveled scenario in it that allows it to play like a screw cap. So you get the benefits of cork and the sophistication of real cork, but you get the ease that often people like and want around screw caps; first to market with that. We're very excited about that. That's been put on one of our new innovations, and I'll speak to that again in just a second.

Secondly, we're doing something fresh for the holidays around that important SKU that David's all excited about, our Sauvignon Blanc, bringing something new, interesting and exciting for the holiday season in packaging, during a time when Sauvignon Blanc is generally not as consumed as other times a year. And lastly, and I think I talked to some of you in January about this, the stacks project. Convenience is a big factor in today's consumer. Who has enough time in their lives? No one. So the idea of convenience of what this stackable product is has been terrific. You can either buy it in a 4-pack, meaning a 4-stack that bevels together. And that is the equivalent of a 750 package. Or for venues and stadiums, we can sell it at singles. So one of our test positions was the new Rams scenario in Los Angeles and we were selling thousands of these every game, thousands of these because it's convenient. And they're usually what has generally been consumed at venues, generally beer. This has opened up a whole new window for people who would like to experience wine as well.

And then when you think about innovation for product, you have things like Meiomi rosé, which will be coming out this year. We will also have a rosé in Black Box, capitalizing on the strong rosé trend. Barrel-Aged, we have Bourbon Barrel-Aged in Robert Mondavi, which I've already spoken about, and Cooper & Thief. Cooper & Thief on the left is a $30 product. That's another one that we wish we'd made more. That sold out in the New York market in 8 days. So for those of you who are in New York, don't expect to see it because it disappeared almost as fast as we introduced it. Callie. Callie is focused on women, comes with the helix closure, the first in this market, an interesting proposition that has just been launched. Blends. Blends have been hot. We're adding a blend into Ravage, which I spoke to you about a few minutes ago, and introducing the 7 Moons product, which is on the far right.

Last, but not least, that I want to talk about is Casa Noble. Casa Noble, we really want to be the thought leader when it comes to tequila. So Pepe, who is in the original video that Rob showed, took our To Kalon reserve Mondavi barrels, so barrels that produce $300 bottles of wine, and he put aged tequila into them. And let me tell you, that stuff is awfully good. But it gives us a chance to do unique releases. And he's working on those unique releases, so that we can be the thought leader at Casa Noble. Oh, and by the way, if you'd like to buy one of those, they cost $1,200 per bottle. All of these things are consumer-led. They're all targeted to specific consumer groups, and they're all accretive. Every single thing we're doing is at higher margins than our average.

And then, of course, there's investing. And you saw this slide earlier. And 3 of these things, I'm sure you have a lot of experience with. But some of you may ask, why Charles Smith? Why did you buy these brands? Super and ultra-premium, it fits where we have an opportunity to develop a stronger and a better share. So it fits there. Secondly, this acquisition allows us to be the second-largest player in the Washington state Appalachian. As demand continues to go up for high-quality grapes, building the ability to have a stronger growing region in Washington was critically important to this. Third, it's unique. Do you see anything like this in our portfolio today? It's appealing to a consumer that we were not appealing to with most of the rest of our portfolio. And last, but not least, Charles is an amazing winemaker. He's not even a trained winemaker; an amazing winemaker who's done innovative things. And he is going to work with us on further innovation within our portfolio. So great opportunity there with the Charles Smith buy. And then, of course, there's High West, strongest thing going in spirits, high-end whiskey, craft. It fits all of those categories. High growth, it's tremendous. And as Rob noted, during his talk, the venture buy at Bardstown Bourbon Company was not an accident. That can help support the growth of this particular brand within our portfolio.

So many of you have asked what are we doing differently, because, obviously, our performance has improved over the last several months. So what are we doing? We're doing a lot of things to make sure that our execution is second to none. There's 8 of at them on the list, I'm going to talk to 2 or 3 of them here now. And let me tell you, this slide is not complete on purpose, but this gives you a flavor for how we think about the work that was done around demand spaces. So our demand space work allowed us to understand what consumers are doing, when they are doing it to make sure that we have the right product in the right place at the right time. And this is the way we thought about it. A lot of consumer research was done and put into this, so that we understand all the scenarios of what the consumer's doing, and then where we have brands to fit into those against particular price points and scenarios. As I said, this is not complete, but I want to give you a flavor for how we think about the demand spaces and how our brands are then positioned to make sure we can go after those spaces where we wish to compete.

Second, and I realize this slide's a little busy, but I think it's critically important. Account segmentation, ability to put the right product in the right place at the right time. So let me give you a flavor for this, and I'm using Ruffino in this particular instance to show the point. But we are putting every single brand in our portfolio through this account segmentation thought. So if you think about Italian restaurants, there's casual Italian restaurants, there are white-table-cloth Italian restaurants. Within those, there are some of those accounts where we have no Constellation product whatsoever. There are some of those accounts where we have some Constellation product, but not Ruffino. And then of course, there are those that have Ruffino. So by doing this account segmentation, we are able to understand exactly where we are not, where the velocity opportunities are. And that allows us to not only manage our selling organization, but to make sure we manage the distributor against those critical opportunities that present themselves across our brands. And we are doing this for every single brand that we have. I'm just using Ruffino as one example.

And lastly, technology, using technology in a sales environment. So if we walked out in the street and walked up the street, our geo-mapping capability would allow, if you were a salesperson of ours, to say these accounts in this general area are either on plan, ahead of plan, behind plan. And understanding that then allows us to say, do we have the right product in the right place at the right time? Because you get detailed account data that allows us to focus our execution against the critical velocity accounts that are either behind the 8 ball or where we have not performed to the degree that we'd like. So that's a third one about how we are raising our capabilities.

And I'd be very remiss if I didn't talk about people for just a minute because, to me, people are the key to sustainability. And we, in the last several months, have been able to promote a number of people from within our business to key positions within our leadership team. We've also brought in a couple of industry veterans, who have also added value to our team. But these people are all focused on winning. We're also spending a lot of time trying to understand who are our next generations of leaders. That will help to make sure that over the course of any horizon you'd like to talk, that we have sustainability in our growth profile.

Last, but certainly not least, operations. We are doing a lot in this area. I'm sure Paul will talk to some about some of the great technology that's going on in Nava. And I remember the first time I went down there, and I walked into the computer room, basically everything is done in this computer room. It's the size of this stage, give or take. And the whole thing is just all automated. It's fantastic and efficient and effective, and you can see why we want to go brag about it in a couple of minutes. We are raising our game in the wine and spirits area in a similar fashion, and making sure that we have the right technology in place to leverage efficiencies, so that we are raising our bottom line faster than our top line.

We're also doing a fair amount around asset utilization. We own a lot of the vineyards. Making sure that every single grape goes into the product that will maximize its potential and maximize the price realization against that is really important. So when we buy a Prisoner, we can move grapes up the pricing ladder and get more value for the grapes in some instances than where we have been getting them before. So asset utilization is really key.

International sourcing. Now I promised you I was going to bring this topic back up when I talked about the millennials, who don't particularly care where things are sourced. If you look at the most recent 4-week numbers for Black Box, it was up almost 50%. This brand is sourced internationally. In other words, many times, the product in this package is not done in California, which allows us to make sure we have the right quality, we have it at the right price and we have sustainable margins over the course of time. It's a great example of how we are looking at our pool of available resources much more broadly than just California, again, one of the big benefits of being a company the size of ours.

And lastly, over the last few years, we have aggressively rationalized our SKU base, making it much more focused, a lot of reduced complexity within our plants and being – giving us the chance at a sales level to put more and more attention on those SKUs, those focused SKUs that are going to drive higher profitability and higher returns.

So how does this all wrap together in a ball? We are in a strong growth category. We are the growth leader within that strong growth category. We are critically focused on the consumer and delighting them, day in and day out. As you go down the left-hand side of this page, where we are saying in the next 3 years, we will see mid-single-digit growth, we are focused on a number of things to do that. Broadening our spirits. You have a lot of opportunity when you're in sprits to have higher-margin propositions. That High West product has a very nice profile relative to its ability to create returns. And we are looking carefully at where else we have the right to play so that we put a further leg on that 3-legged stool that Rob talked about in total beverage.

Secondly, fine wine. The consumer's moving up and premiumizing. How do we better utilize our assets and drive more and more of our sales capability into the high end, where we can get even better returns on our great supply?

Third, sparkling. You will see, over the course of the next year, a number of places to enhance what we're already doing in sparkling. It's a growth category. Our Ruffino business and our Ruffino sparkling wines are growing like a weed. We have a number of other things that we'll be doing to enhance sparkling that we think can add a lot of value to our portfolio going forward.

Innovations. I think you saw from our innovation slide, we have a lot of good things. Ben and his team are bringing lots of unique opportunities that are consumer-focused and have a high probability of success because they are all researched and understood. So we know what we're getting when we introduce them. Ravage might have been one of the early ones. It certainly will not be the last.

And lastly, we're reinvigorating our core. Much like we did with Robert Mondavi Private Select, we are looking carefully at some of our brands to see where we can add additional value and turn some of those into growth leaders, rather than ones that are simply matching the growth rate of the category in which they play. So left side, mid-single-digit growth.

Going over to the right side, mid to high-single-digit growth in the EBIT line. Mix and price. The natural price to start this category, as we've said, is premiumizing. Everything we do, when it comes to innovation, is accretive, whether that be line extensions or new product development. So accretive innovation is a critical part of what we'll do.

Our asset utilization. I've talked about that 2 or 3 times now. But again, if there's – reemphasizing that, improving utilization of our assets through international sourcing. And a number of other characteristics is going to be very important.

And lastly, raising our executional capability, all of this being done with strong brand building. Building brands is a critical part of how we will deliver a great package. And in my humble opinion, this collection of things is a winning formula that stands up very nicely to virtually any other consumer product company that you'd like to talk about. Thank you very much.

[Break]

Patty Yahn-Urlaub

Hello. If everybody could take their seats, please. We'll get started. You certainly don't want to miss the beer presentation. Awesome. Thank you.

All right, Paul, are you ready?

Francis Hetterich

Sure.

Patty Yahn-Urlaub

Okay. Paul Hetterich, President of our beer business.

Francis Hetterich

Well, good afternoon, everyone. So we'll jump right into it. I'm pretty excited to be here to give everybody a flavor of how our strategy's evolved over the last 3 years, particularly as we sort of come out of the other side of the transom of becoming an independent brewer, which that journey started, as was mentioned earlier, just a few short years ago. So to do that, we need to put a few things into context. So we're going to walk through how we define and how we look at what we call the high-end beer landscape and then take a look at our position within that framework, and we'll talk about our growth targets and our aspirations going forward and then walk through the areas of where we're – and where and how we're investing to win. What I think you might find interesting is, throughout this, I'll weave in what are some of my own perspectives on the business and how we've adapted the strategy a bit since I became more immersed in the commercial side of the business earlier this year.

So I think if you read any business book, listen to any business scholar, listen in any business course, what would you hear about a sustainable, successful business? Well, you'd hear a number of different things, right. You'd hear you need to be in a growing category. You need to have favorable demographics. You need to have scale in whatever category it is you compete in, and you need to have leading brand or product positions and differentiated products. So you're going to hear a story of this business has all that and more, but first, what I want to do is sort of take you back to the beginning because it's going to underscore the consistent approach that's been used to build the business for over 30 years. So we'll go ahead and play that, please.

[Presentation]

Francis Hetterich

Some might too – be too young to remember what that device was, right, but that was actually 30 years ago.

So when you look at the industry, how the industry has transformed, there's really been 2 major transformations if you look over the last 60-or-so years. The first really emerged into what was the regionals. So locals became regional beers back in the '60s and '70s. What were defined as the regionals at that point, they got up to about 70% share of the category in terms of cases. Then that morphed or transitioned or transformed into the national brands, which was really fueled by advertising and marketing, which was going back to really led by AB and Miller and then Coors and subsequently MillerCoors. They actually grew their business to about 75% of the volume in the category at their peak during that period. But there was also sort of a semi-transformation within there, where the national domestic brands turned themselves into national light brands or domestic light brands, but they were the same brands essentially.

And now we're embarking on really the next transformation in the business, and that's all about the high-end emerging and commanding the most share presence and profit in the category. And this is where we'll spend a little time on this because at the moment, you can see it's about 1/3, 33%, 35% or so of the volume.

So a lot of people don't potentially think that the high-end is really what is dominating the business, but as we get underneath this, you'll see that there's a lot more to the story. And it really is all about – you've heard this in Bill and Rob's presentations, it's about premiumization. And premiumization is, as Bill pointed out, really a consumer megatrend. It's widespread. It's recession-proof. It's emotionally driven by consumers. It's been going on for a very long time. You go into the grocery store, just look in people's grocery baskets. Look in your own pantries. Look in your own closets. Look at the jewelry you buy. It's everywhere, okay. It's very prevalent throughout all of consumers' lives. It's taking hold a little bit – I would say a little later in beer, and we'll talk about why that is.

So here's a quick look at the last 10 years in terms of volume in the beer category. So fairly flattish, I'd say, right. So you can see 10-year CAGR, 40 basis points; 5-year, 50; 3-year CAGR, a little faster there actually at 90. But the real story is all in the high-end beer line, as you can see; so all other beer declining, all high-end beer growing over this period of time. But what's interesting and there's a lot of writing as of late in the business about volume's a real problem in the industry. But if you actually go back all the way to 1980, so the last 35 or 36 years, the CAGR is, I think, 82 basis points, okay. It had a low of like 60 basis points or 0.6 of 1% and a high of 1.1% growth. So this flattish in terms of total volume is not a new trend as far as the category goes.

So then I thought it'd be interesting to do a quick comparison to what we saw in wine over the course of time. And so what this chart does is compare wine's big premiumization boom to what beer has been doing over the same period. And what you can see is in that '95 to 2005 period – now this is dollars. So the previous 2 slides were volumes, this is dollars. Wine went from about 31% in dollars to 66%. That's when wine really transformed itself into a premium business. And then – and this is the category, obviously. And then it's been accreting about a point a year from there on out. You look at beer. It's been pretty steady at about a point a year, going back to the mid-'90s. But in the last 2 years, 2.5 years ago, there was a real inflection point, and it really started to step up. And this is why we believe we're really at the front end of the big transformation in beer in terms of the premiumization and high end taking hold. It's actually 47% of the dollar. So 47% of the consumer spend today his high-end beer. And 100% of the category growth has been driven by the high end.

So then what this slide does is take a look at defining what makes up the high end. And so this is interesting because I think the nomenclature that you read about, that the industry uses or IRI or Nielsen, the nomenclature doesn't – the vernacular doesn't really match up with how consumers think. And we'll get into that in a second, but the way we define the high end, it's a pure price filter, okay. So it's not like, well, you think you're craft or not craft. It's just a pure price filter. And you can see the difference in price is pretty dramatic. So low-end beer, which is primarily domestic beer, domestic light beer, averages about $19 case to the consumer. The high-end categories command $32 a case on average or $32.48, so a 71% premium. And that's why you see 47% of the dollars versus 33-or-so percent of the volume. But what's also interesting, if you look over to the right side of the chart there, brands, and Bill touched on this in the last presentation, brands are very, very important in beer. And so you can see in imports, the top 3 brands comprise 86% of the category; in what we call alternative beverage alcohol, 83%; and domestic super premium is essentially a one-brand category.

Then just moving over to the left. So there's 4 segments that make up the high end in the way we look at it. So it's imports, the largest piece, it's just shy of 40%; craft, the next largest piece at 27% today; and then a pretty close to an even split between what we call alternative beverage alcohol, which is FABs or – yes, FABs and cider and domestic super premium, which is really a one-brand category at the moment with Michelob Ultra. And they're all growing at about the same rate.

So this is a bit of an interesting chart. Now I'll put this up – I put this up here, and I'll caveat it by – this is IRI data, okay. So it's IRI for whatever is measured in these major DMAs. And I put this up here not necessarily for the specific position of the brands because the IRI sample varies a bit in some of these. I put this up here because if somebody was to have said to you 5 years ago, 2 of the top 5 brands in markets like these will be high-end brands, I think you would have told the person they're crazy, never going to happen. Why? Well, the holy grail of beer has always been about 100-million-case brands that are top 5 brands. That's what – there's only been about 15 of those ever created in the category. So lo and behold, what do you see in all of these markets today? 2 of the top 5 brands are high-end brands. And if you were to look at #6, #7, #8 and so on and so forth, you'd see that most of those up-and-comers are high-end brands. They're growing dramatically, different than everything that's not highlighted on here. So there's not a question in our mind in that what would this look like in 3 years' time. It will be 3 of the 5 brands, maybe 4 in some of these markets. And then what's going to happen in the next-tier market as the demographics change? Those markets are going to look like this. And then what's going to happen in Middle America, okay, as the demographics change? Those markets are going to look like this. And this is why it's going to be a continuum over a very long period of time. It's funny, too. There's a lot of people who look at our business and think that it's a Southern California phenomena, right. But you look at this and say, "Well, sure, it's Los Angeles, but then it's also Northern California." Oh, and then you go over to Chicago and then you go down to Texas, and let's come up to New York City here and then go all the way down to Miami. It's not a Southern California phenomena.

Here's another example of what underscores what we believe really captures – visually captures the high-end opportunity. So since 1980 or so, we've been in a fairly flattish category, as I've said, up a hair to maybe 1%, depending on the year or the period and – but you've seen major shifts go on. So we don't believe that the domestic national brands, the red line, or the domestic light brands, the blue line, that trend is not going to change. The game for those businesses, that's all about eating each other's share, okay, and it will be a seesaw back and forth in terms of who's going to win and how they're going to win at different periods of time. The upper-right-hand part of that dotted box basically is what is going to be new high-end cases, and we'll walk through exactly how that gets comprised. But if the category remains flattish, those are all going to be new cases that are available; a lot of margin pool there, by the way.

So this is a chart that steps through that growth, okay. So this is at a category level, not specific to Constellation. So when I say category level, I'm talking about the high end. So today, a little over 1 billion cases; 3 years from now, we believe it will be about 1.2 billion cases or an incremental 170 million cases. Probably, that would equate to $1 billion or so of supplier profit.

So where this comes from and a little bit of – Bill touched on this a little bit, but we're very fortunate that back, I think it was, about 7 years ago at Crown, when the Crown management was trying to convince ourselves and Modelo to put incremental investment in the business through marketing, one of the tools that they were turning to was to start to develop a foundation for what we call marketing mix analysis or what the industry calls marketing mix analysis, which is a drivers and drags. And we'll go through – these are basically the drivers and drags on the category here, and I'll walk through those in a second. But this has actually turned out to be quite fortuitous for us in that it takes quite a bit of time to set this up and then to be able to work with the data, to really believe the data, invest behind the data and test and learn within all of that. It probably took 3 or 4 years to get that foundation in place, and it's just basically using big data. So it's just a whole bunch of regression modeling of data from all kinds of sources, not just what the beer category does but it's what fuel prices do and what unemployment does and every piece of data you can grab, and it projects it forward. And we found it to be actually quite accurate and quite telling and great in terms of us understanding how to direct our investments and how to measure whether we're getting the payback on the incremental investments.

So this, I’ll walk through it, is the reason to believe that the high end is going to grow 170 million cases. And then as we go a little further, you’ll see why should you believe that we’re going to capture more than our fair share of that 170 million cases as we go forward. So 80% of the gain is – really comes from 3 buckets. The first 3 buckets you see there, which are drivers of the business. So one is distribution and new products. Well, you say, "Why is there distribution opportunity?" There’s distribution opportunity because high-end brands are generally under-distributed versus low-end brands in the category, and we’ll come on to that in a second. Innovation also tends to be weighted more toward the high-end categories or subcategories. So that’s the first biggest driver to the category growth.

The next is in-store merchandising. So why is this an opportunity? Well, this is an opportunity because the high-end today gets about 32%, maybe 33% of the merchandising relative to its 47% of the dollars. So it’s very underweighted. This goes back to – you’ll see as we go through this, there’s sort of the prevailing mentality on the whole industry that it’s all about the case volume. So everything sort of centers around where is the center of gravity of the volume in the category versus looking at where is the margin, where is the growth.

The next piece is consumer demand and demographics. Last presentation, I think, touched on some of these points quite nicely and high end – 56% of the high-end consumers are millennials. So millennials plays very well into this, and Hispanics index up a bit within this millennial consumer base. And so there’s an extra lift because of Mexican beer comprising a large piece of the high-end category.

Then there’s a couple of drags on the business, drags being pricing. Well, why is pricing a drag? So as prices go up, it’s an elastic category and volume comes down a bit. But we’ll talk about why pricing long term is important.

And then there's substitution and total beverage alcohol blurring. Rob and Bill really touched on this. So there's all this craft cross-category fertilization going on. So that's actually a drag and eating into some of the beer category. But all in all, you look at the high-end beer category, we see a 5% to 6% CAGR over the next 3 years, which is pretty dynamic when you compare it to other consumer categories that were put up earlier.

So this slide deals with a couple of different facets. One, it's interesting, this industry vernacular thing, really, it bugs me a little bit because you read all the stuff and it's like no consumer ever went to the store and said, "Well, I'm going to a store to buy a 6-pack of premium domestic light beer." They don't talk that way, right. But yet everything we read about and all the reports we have segment everything that way. But you go back 6 years ago or so, consumers sort of bucketed beer in 5 different buckets in their mind, okay. There was premium beer, which is the super-premium and the import and the craft space. There were coolers. They didn't really call them FABs or ABAs or ciders. It was cooler-type products; light products or light beer; domestic beer or value beer.

So you would think that as the categories premiumized and fragmented that perhaps those buckets would have fragmented. But lo and behold, it hasn't in the consumer's mind. It actually has been simplified for them. So they think about beer in 3 broad buckets. One is actually a pretty small bucket, okay, probably 2%, maybe 2.5% of the total beer business, okay, which is specialized and local, so super local craft, really very – names that aren't necessarily well known. And then they talk about better beer in the middle, sort of the middle of the category it'll say, which they mean high-end domestic. They mean imports, they mean mainstream craft, and they mean the – what we call the ABA category. And then they refer to everything else, which is still 2/3 or 65% or so of the volume, as just regular or cheap beer, okay. It's entry-level beer essentially in their mind.

And so the other thing that's interesting about this is when you look at the consumer decision tree – so the left-hand side of this says pre-store decision, okay. So 50% of the beer purchases, before the consumer leaves their home or wherever, goes to the store, they already have their brand in mind. They know what they're going to buy. Then there's 50% of the beer that is purchased, where they make their mind up upon getting in a store. Decision #1 is what – which of the 3 buckets am I going to. Decision #2 is basically brand, again underscoring why brands are important to the consumer, in the millennial consumer in particular.

So now we'll move into looking at dollars in growth because I think that this is where it potentially gets interesting for the – all the different peers in the business, not just ourselves as a supplier or as a brewer but for our distributor partners and retailers.

So this is a quick look at largest companies in the beer market in the U.S., what their percent of high-end beer is, so what their share of high-end beer is. So you'll see, starting on the left, we've got a 25% of high-end beer. We actually just surpassed ABI this past summer, and we're growing at a much faster rate than them. So they're about 24% of the high-end category. These are dollars. And they're not growing. We're growing about, I think, about 2.5x their rate in high end. So this gap is going to widen, but it falls way down then after that. It falls down to an 11% share in Heineken. They're not growing. They're losing share on the high end. And it falls down to MillerCoors, who has an 8% share of the high end, okay. They are losing share in the high end at the moment, not growing as fast as the category; Boston Beer, losing share in the high end. So it fragments and gets the scale, dramatically falls off after ourselves and ABI.

But here's the other interesting facet of this. When you look at people's portfolios' composition, so what percent of their sales do they derive from high-end beer, obviously, we're 100% high-end beer. In ABI's case, they're 23% high-end beer, 77% low-end beer;

Heineken, high percentage, pretty well-weighted other than

— Audio Gap —

to high-end beer; MillerCoors, 85%/15%, so 85% low end, 15%, high; Boston Beer, 100% high end. Then down below, I won't walk through them all, you can see the number of brands and SKUs that each company has. But this relates to a big competitive advantage that we have as a company in that we're 100% high end. So we have no tail, okay, which most businesses have a tail, and that's always something to struggle with. We have no conflicting category bias as far as low end versus high end goes. And our focus versus everybody else's is we're hyper-focused because of the number of brands and SKUs compared to these folks. But what really started to occur to us is there really is no objective high-end advocacy in the category. So all of the set work historically, most of the set work is done by AB and then MillerCoors does a fair bit of it, but it's really pretty dominated by ABI and historically has been. But what do they have to do when they wake up every day? Sure, they want to grow their high-end business, but they've got to worry about the 77% of their business that is in the low end, which, if you remember a few charts ago, has been going like this for a very long period of time.

So as we go a little further and then you say, "Okay, everybody knows we've been winning and we've actually been winning pretty big." So you look back over. You can do interesting things with data, right, take 4 weeks, 12 weeks, a year, take this data, whatever you want, but we looked back over the last 3 years. So since we went on this journey to become an independent brewer, how have we been doing? And so we've actually captured 30% of all dollar gross sales of beer over the last 3 years. So 30% of all of the category growth – not just in high end, okay. So this is total category. Who had the fast-growing brand in dollar growth over that period of time? Modelo Especial captured 15%. So half of what we captured was Modelo Especial over this 3-year period. We've got the #1 category position in the high end with Corona, the #3 category position with Modelo Especial. #2 is Michelob Ultra, by the way. We've got the #1 dollar share in the high end. As I spoke about, we just actually garnered that or surpassed AB this past summer, and we're accreting on that lead now. And we were the #1 dollar growth contributor in craft over the summer months with Ballast Point.

So then you say, "Okay, well, that's interesting, but maybe it's just happening in certain areas," but the fact of the matter is we're winning in every state and every region. And then if you're somebody that thinks, "Well, you're just a Southern California phenomena," where we have our biggest shares at the moment, take a look at the West, okay. It actually threw on 1.6 points of share over this period. California, specifically, was faster than that, greater than the 1.6. So the other markets that make up the West were a little slower, okay. So it's not just a California phenomena. It's not just where we're building new share. We're actually accreting to shares that are already quite large. You have to go back, I think, to the early '80s to see any major supplier that has been putting on this kind of share. I think it was AB in the early '80s is the last time you'll see any major supplier that added this kind of share. And that – this is depicting just the fiscal year. So it's 6 months, but if you look at the 2015 data or our last fiscal year data, whichever way you want to cut it, we were putting on the same kind of share then as well. So it's not just a recent trend.

Then you say, "Well, I don't know. Maybe it's just all happening in one particular element of the trade." But no, no, it's happening in all channels. So it's happening in every state, okay, every region, but also in all channels. And you can see we're winning big where big really matters in convenience, and we'll touch on that in a couple of seconds. So 32% of the beer category goes through convenience. We're actually up 16 points in convenience this fiscal year-to-date. You can see – you read a lot about the on-premise environment being down. We're up. Why are we up? Because the on-premise environment is down in total volume, but they're figuring out how to premiumize, right, how to put more dollars through, okay, on fewer consumers coming in. You look at the right side of this, and this is the part that is a little astounding to me in that the other major competitors are losing share on the high end. You can say sort of, "How could that be with all of the dynamics that are going on in terms of the growth in the consumer pool that's attracted to the high end?"

Now we'll move on to how our growth targets and our growth aspirations, how it fits in the context of this. So in prior meetings, you've heard us talk about a couple of different goals. A couple of years ago, we talked about a goal in FY '14 of doubling our business, of doubling our business over the 10-year horizon. So we were going to go from 180 million cases to 360 million cases. Well, we're tracking ahead of that, okay. So we're well on our way to 360 million cases, but it will happen sooner than FY '24 based on our current growth.

You also heard us talk about a different goal that goes back some time. I think for the last 5-plus years, we've talked about aspiring to achieve a 20% dollar share of the total beer category, which was sort of – that's a goal that Bill Hackett had developed, which is sort of his BHAG at the time, right, like how could we ever become 20%? It's in reach for us as we sit here today. That's the only reason we put those Xs off to the right here.

But as we've come to understand a little bit more about what's going on in the high end and how we're going to play, and it's not going to be Corona and Modelo that carry us forever in terms of being a leader in the high end, we've needed to widen our lens a little bit. So it's not a whole new strategy. It's just a broadening of how we look at it. And it's more than just dollar share. It's more than just being the #1 imported beer company. It's more than just being the folks that have Corona and that hot brand, Modelo. It's about leading and influencing this high-end landscape. This is the Patty slide.

So how do we put this into context? On the net sales line, we believe we can grow high single digits, so faster than the 5% or 6% volume growth you saw on the high end a couple of slides ago. Why is that? Okay, we can get a greater share of it, and we're going to step through that in a second to see where we have more opportunity or we're weighted to opportunity there. We'll also take annual pricing of 1% to 2%. And right now, I think it's fair to say that we've got a lot of moving parts. So I might say that our COGS are a little noisy in some respects because of the moving parts and bringing on new capacity and weaning ourselves off the ISA with ABI and all of the things going on. But at the end of the day, beer is a commodity-exposed product, okay. So it's really about the raw material and packaging. Can freight come out of these? And we'll step through what that looks like in a couple of minutes. And so at the end of the day, if you're commodity exposed, you've got to be able to take price. But you've got to have strong brands. You've got to be building your brand equity to be able to command the prices.

So then on the EBIT side of things, we believe we can grow high single to low double digits. Why is that? Well, we've got – we're coming off the interim supply agreement from ABI and bringing the production in-house. We've got pricing benefits. We've got expansion of our own glass supplies, so our JV glass. There's more glass coming online from that. Then we've got some minuses on that. There's going to be a big depreciation ramp-up as there has been. And we're in a pretty favorable FX environment, commodities environment, at the moment. And we've been making marketing investments, which is a big piece. We'll walk through that. It's a big piece of why we believe we're being successful with our brands.

So this was the waterfall for our business that maps back to high single-digit growth versus the 5% or 6% growth. And our biggest drivers are no different than the biggest drivers that are driving the high end that I talked about a second ago. But what we did here is I tend to think about them in 2 different buckets, okay. On the left side of this, which is about 70% of where the gain is, these are areas that you need to be able to influence and you've got to execute. You can't just sort of sit with the distribution you have today and the feature activity you have today and the velocity you have today and expect to grow high single digits. So these are areas that our strategy needs to influence and we've got to execute against.

So we've got a lot of core brand distribution upside, and we'll walk through what some of that looks like in a second. So we've already got products that are proven that just aren't well distributed yet, which goes to the execution point. We've got innovation. So you're going to see in a minute we filled up our innovation pipeline pretty well at the moment in terms of – since we just came online with our expansion at Nava this past June, we're ready to start innovating and have a number of things that we'll be test marketing and introducing early next calendar year.

Then in in-store merchandise, I talked about that. The high-end category is 75% of what it should be in terms of feature display and merchandising activity in the store relative to its dollars. And you sort of say, "Well, why would a retailer even do that? If all of their growth is high end and 47% going to 50% of their dollars is high end, why are they under-weighing where they're merchandising?" Again, it goes back to the industry has been a little bit of geared around this case volume to sell more cases, and it's the cases that are selling today that you should throw all the activity toward.

And then consumer demographics. I touched on that, millennials and Hispanics. Well, we obviously get a tailwind on the Hispanic piece because about 40% – if you look across our portfolio and weight each of the brands, about 40% of our demand is Hispanic.

These are of some of the key distribution opportunities we have. So this isn't necessarily on the if-come, if you will, like we have to innovate to capitalize on more distribution. We've got a number of products that are doing quite well that are not in full distribution at the moment. It's just a little bit of a fluke that they're all cans except Ballast Point actually.

And then you look at places where we have put more emphasis and we've put more resource into things like category development and category management and partnering with select C-store chains. So you – and it's made a difference. So you look at what's going on for us in C-stores at the moment, this 24-ounce Pacifico can we introduced about a year ago was the #1 new SKU nationally in IRI through the C-store channel. You look at single serve. So single serve is actually a trend that's doing quite well not just with imports and our products, but you see it even with domestic beer doing quite well. But 85% of the single serve business is done through C-stores. And C-stores, the people that shop there, they're weighted a little bit more to millennials than the average off-premise account, and they're a little over-indexed. They're quite a bit over-indexed on Hispanics as well. So again, that plays well to us.

And then you look at on-premise. Why are we growing high single digits versus the industry, low single digits to maybe negative lately? Well, right now, in the on-premise, draft is becoming incredibly hot again. So all of the sudden, now everybody's back to putting draft in. So they ripped it all out over the last 25 years in many instances. Now it's all going back in because they're figuring it out that it's a lot more profitable and it's a big trade-up opportunity. And so the trade-up comes through premiumizing the offerings. So what's interesting to me in that is what some of the operators, folks like Buffalo Wild Wings, for instance, who we've done a lot of work with, what they're figuring out is they'll make a little trade-off, okay, on their percent margin, but they get a lot more dollars. So if a domestic beer costs them $1 a pint, let's say, they get $5 a pint. They make $4, okay. If a high-end beer costs them $2 a pint, they'll go ahead and charge $9, okay, lower margin, okay, on a percent basis slightly but doesn't cost them any more to run the restaurant, okay. They don't really have any inventory cost because it gets dropped off every week from the distributor. So premiumization is starting to catch on in the on-premise world, and we're obviously capitalizing on that because we're 100% high end and 100% premiumization trade-up for them. That was my favorite slide, by the way.

So one of the big learnings for me as I started to focus on the commercial aspects of this business, well, the first – one of the first learnings was we – and everybody reads about this, that 90% of the beer is sold out of the cold box and off the shelf. You can almost – displays are almost irrelevant in the beer business compared to the wine and spirits business, but the relevancy is that actually, they go to feed the cooler. So the cooler gets restocked and you don't run a lot of out-of-stocks if you have displays in the store, but the consumer doesn't purchase off a display. So the battleground is all at the shelf, so different than wine and spirits, as I said.

And then as I sort of trampsed around the country, visiting with distributors and customers and going in and out of accounts, it didn't matter where I went. Everywhere I'd go, the domestic set always looked the same, always looked the same. So it looked the same in that it flowed from MillerCoors up to Bud, and brands were all what we call blocked. So you see on the left-hand side there. That's Bud Light and Bud there predominantly. So their blocked, it's consolidated. And there's a price flow and a trade-up mentality. So this is all like FMCG, like, 101, right. This is like what everybody learned, like, 40 years ago, okay. You block your brands, okay. You put them in a trade-up position, and you need to have them in the right part of the set. So there has to be a flow that maps back to the consumer.

So then everywhere I'd go, I'd see the high-end set. There was no rhyme or reason to it. Sometimes, I'd see it on the right. Sometimes, I'd see it on the left. Sometimes, brands are blocked. Usually, they're not. ABA and craft, there's no rhyme or reason to how those are embedded in the set. So I started asking all kinds of questions and I could ask – I could be the dumb new guy. So I could just – "Well, why is this?" They were like, "Well, that's the way AB writes the set. They control all the mouses, okay?" So since they control the mouse, that's the way it gets set. It's like, "Well, it's interesting. Why does Bud look like that?" Everything else, that happens to be Modelo there on the right, and you wonder, "Well, that would have really been hard to move his mouse around to like sort of put the Modelo all over one another, right." But there's probably a method to the madness there.

So I started to ask some questions about, "Well, how should craft be set?" "It doesn't matter as long as it's all together." This is what Miller people say. This is what AB people say. Then you talk to retailers. The retailers are thirsty and they're starving for information. "I don't know if I should set it in the warm or the cold or in both places. I'm out of cold space. I'm over-SKU-ed, and nobody's helping me." It's just like, "Oh, stick all the craft together." "Well, should the craft be like next to the domestic beers? Should it be next to the imports? Should it be next to the ABAs?" "No, as long as it's all together," same thing.

And so it was amazing to me that there were no standards seen in the high-end area of the category. And you might say, "Well, why don't you guys do something about it?" Well, I understand sort of where we got to where we were, right. We got to where we are today primarily for many years of building brand Corona. So originally, we were just happy to get into the store over the last 30 years. And obviously, it was going to go into the import set at that time. Then we were happy to get more Corona in. We didn't really need to be the person or the company that had to worry about, "Well, how is all this going to set? How's the set going to flow?" And we're going to be able to bring insights to the retailers in terms of, "Well, you know, ABA shouldn't be over here because they interact more with spirits and certain types of wine products. So they should always be down at that end of the set," for instance. And this is where we see a huge opportunity, particularly with the share that we have at the moment and the opportunity that we have, which is really to bring some order and some basic principles, right. Again, this is not like rocket science. This is what's been going on in consumables or consumer categories forever in the grocery store. But there really is – it goes back to there's a lack of advocacy for the high end because all the other suppliers are a bit torn in that they've got to try and keep that low end shored up.

And it goes to things like – so I went back and told you okay, brand's a very important consideration. So – and then, usually package, like can versus bottle, comes after that. So if I'm a Bud Light can consumer and I – let's say that was my pre-purchase decision. So I made my decision before I went to the store. I go to the store, "Well, do I really need 8-ounce cans, 12-ounce cans, 16-ounce cans, 6 packs, 12 packs, 18 packs, 24 packs, 30 packs? Do I really need all that selection? Because if one of those wasn't there, was I not going to buy the brand?" Of course not. And this was going to be the big opportunity for the retailer on how they can remix their space.

So then you look a little further and you look across the other tiers in the industry and say, "Well, okay, maybe there's a mix difference between where the consumers spend their dollars and where the rest of everybody makes all their money." And so we did some analysis on this and said, "Okay, well, no, retailers are making – they're driving 48% of their gross profits." So 100% of their growth – I might say more than 100% of their growth because everything else is declining. So it's making up for the decline and then capturing whatever growth there is there. And distributors are actually making 49% of their profits off of the high end, yet there's a complete mismatch in terms of where people are prioritizing their resources, their investments and their allocation of priorities and merchandising.

So now I'll quickly touch on demographics a little bit and specifically Hispanic population. So no secret, so you look in the middle of this and you say, "Okay, well, Hispanic population as a percent of LDA – it's the legal drinking age, population growing." You might say, "Well, 15% to 18%, it's not a big deal," but it's actually a 20% change over that period of time and you're talking about a lot of people here. So that's obviously very favorable. You look at the median age of Hispanics. It's younger, okay. That plays well, right, with millennials and what's going on in high end. So it's younger than the total population. And the Hispanic consumer is very, very brand loyal, and they spend more, as you can see, on the bottom left here.

So now I'll touch on marketing a little bit. So as I mentioned a few minutes ago, the cornerstone to our approach for a long time now has always been mining consumer insights and, as more recently, last 4 or 5 years, using marketing analytics, okay. So that's sort of the new thing now, right and the business school of marketing is all about analytics these days because we have all of this data at our disposal. We can go, like, grab any piece of data known to man these days. And then it's about finding distinct and ownable positions. And if we don't really have one, if we can't find one, then we don't invest. And this discipline, I think, for us, came natural because as being an importer, it was pay as you go. We were never going to go place a big bet with our profits as an importer, okay. We would want Modelo to do that. So the discipline in the organization is a great foundation for us to work off of because again, we've been somewhat pay-as-you-go model over 30 years. But now as we've honed this analytics skill set, we can really see where we're willing to take the bets and what the return is and how fast we're going to get the return. And then it's about staying true to the essence and consistency of that essence as far as the brand goes. And so it's like we probably could play that commercial but not for the beeper today, and it would still be relevant, right, based on how we market the brand today.

So Corona Extra. Last year, we set a record, 117 million cases, so a record for the brand. This year, we'll set yet a new record because it's growing quite nicely this year; #1 high-end brand, #1 imported brand. The equities this brand has are just so incredible. It goes from the iconic bottle to the lime ritual, to the Find Your Beach consistency, to the #1 Hispanic-preferred brand. The other thing, the way I sum it up for a lot of folks is find for me examples of where – go on vacation or go to some beach location or you don't even – just go anywhere, for that matter. Go out. Take a look around. How many products do you think you could see where you could actually see, okay, in a family setting, okay, a grandmother or a grandfather with their child and their grandchild, okay, all drinking Corona and all very proud to drink Corona? I can't think of another product that actually spans generations that way. This brand is about 35% Hispanic, by the way, in terms of its consumption.

Then you go to Modelo. That's going to be our next 100-million-case brand. So this was last year's volume at 79 million, and we're growing north of – well north of that this year, and it's not long before we cross the 100 million threshold. So I guess we'll be the 16th of the 17th brand to join that top 5 100-million-case club, which is quite an accomplishment when you think about the beer business over 50 or 60 years; #2 import brand; more importantly, #3 high-end brand. So the equities about this brand are more about heritage and authenticity versus sort of laid-back and relaxed and fun with Corona. And so Hispanics would say about this brand – they would say, "This is my beer and I'm proud to drink this beer." Non-Hispanic, millennials in particular, would say, "Well, this is sort of a cool beer because it's a non-mainstream beer," sort of like the 100-million-case brand that nobody has ever heard of in that environment. But millennials don't want to be very mainstream.

Then we look at Corona Light. This really sort of tags along with the trend of Corona. This actually features some new packaging we're coming out with this year. So I think it plays off the equity a lot stronger. But it's actually the #7 high-end brand. So on one hand, you might say, "Oh, it's a small brand of 16 million cases," but there's only 6 other brands in the whole high end that are bigger than it. And we've got a lot of distribution opportunity still on this brand, and that's really because years ago, when we were in the dual-importer scenario, Cambrinus really focused on Corona Light as their second priority after Corona Extra while we, in the Barton territory, as we called it, in the West, we were very focused on Modelo as the second priority to Corona Extra. So there's a real imbalance between – on where we do Corona Light business.

And then you look at Pacifico. Pacifico is a very interesting story in that it's really entering a whole new chapter. It's been around a long time, and it's been very weighted to Southern California for a long period of time. And it's – actually, historically, its volume base is very – is heavily weighted to Hispanic, so 48% Hispanic on the brand. We started to add some media into the West, and we introduced this 24-ounce can. Then all of a sudden, just like – I don't know, I think, well, earlier this year, all of a sudden, we're growing at, like, 20%. And we're growing at 20%, like, everywhere, growing at markets in the East, growing markets in the West, growing in the center of the country. And we started to look at what's really going on here. And what's going on here – and it's what Bill Newlands touched upon, which is millennials. It's not really about the place or the origin, okay. They're – millennials and craft drinkers are discovering this beer. And they're discovering this beer as well, I don't always want to drink like a really hoppy IPA particularly if I want to consume a few beers or more than a few beers in a particular session. So what's their sessionable alternative? It's not Bud, it's not Coors Light, and it's probably not even Corona in that instance for these folks because they want to find something that's more discoverable and mainstream. So there's a bit of a groundswell here, and we'll talk about – in our innovation efforts, of the potential we think we have with this brand to really capture more of a general market appeal with it and really invest and build our distribution behind this brand. And I don't know, maybe one day, somebody will stand up here and say that's the next 100-million-case brand we have now behind Modelo and Corona.

Then very quickly on Victoria. This is really – this is virtually 100% Hispanic. It's the second largest brand in Mexico, but that doesn't necessarily mean that it's going to be the world's greatest thing in the U.S. But it's a very focused and steady build. So we think it's got long-term potential, but it really follows behind the other brands I talked about in terms of where we prioritize it.

And then, of course, Ballast Point. So Ballast Point has been consistently moving up in the rankings of top craft brands. We're now closing in – or we're at #12. And this is a brand that's all about its home-brewing roots. It's all about that it's a place to go and experience the beer with the tap rooms in the restaurants that we have, and it's all about their quality and their innovation.

So now I think I'll – what I'll do is I think we're going to play some commercials because I think it better brings the brand to life than me telling you about the essence of the brands.

[Presentation]

Francis Hetterich
— *indiscernible* — and I think perhaps other folks, other categories are sort of just looking for like a unique campaign. But this is all about this rigor of taking the insights, doing the analytics, doing the testing, making sure we've got the scores and then we're willing to invest.

So as I touched upon a few minutes ago, we've – last 3 years, we've been transitioning from importer to brewer, and with that comes a number of places to invest and how we've been investing. And so now we can virtually influence a wide array of activities compared to years ago when we were just an importer. And the way we think about this is, is there's the marketing investments, which we'll talk a little bit more about, there's expanding our portfolio, so expanding into other parts of the high end. Again, what will carry us long term in terms of being the leader of the high end, is not just going to be Corona and Modelo. It will need to be other things as well in addition to those brands; our innovation agenda, how we're going to start to truly influence the high-end category and, of course, our capital expansion.

So as far as marketing goes, we've consistently been investing more marketing in the business as the business has grown. So it's been fairly constant as a percent of net sales, maybe up a little bit, depending on the year, but we keep putting money back into our marketing efforts because it's a big piece of what's driving our volume growth. And at the end of day, how do we measure it, okay? We measure it through whether it's producing higher velocity for our brands and whether it's helping drive more distribution on the brands. And as you can see here, in both the on and the off, we've been gaining points of distribution on the on-trade, about 5%; the off-trade, about 9%. And our velocity is up mid-single digits. So this is the proof that we know that we're getting the return for the marketing that we're putting back in. And I would say Corona, it's really – in the last couple of years, is really now starting to really punch at its weight in terms of spend, in terms of the share of voice it has within the category for its advertising spend where historically, we really – we under-punched our weight, and that really is a byproduct of coming from an importer environment.

And so when you look at what anchors our media, live sports is really the anchor to that. And the reason for that is it's still the medium with the most reach, our targets, so millennials and Hispanics, watch 2x more TV per day than they do consume on digital, by the way. So – and the Hispanic demo – getting to them through Spanish language TV is incredibly efficient. So you don't have to spend a lot, and you can get a tremendous frequency of your message with them. And it also augments innovation. So things like the can spot you saw for Corona or even the Casa Noble, Corona spot that Rob showed. And then you get on-premise value through this as well. So I don't know, it's hard to like go to any bar or restaurant, not see a TV behind the bar and invariably, what's on the TV? Live sports. So it plays well to our demo. And then of course, you complement that with digital and social. I got an interesting statistic the other day, which is more about tomorrow's consumer, but the statistic was that today, teenagers are consuming 9 hours of social and digital, like that's crazy, right, compared to 1.5 hours basically for millennials. So I'm sure that this mix will transform over the course of time as the demographic changes.

And then in the top-right box, I think it's interesting to talk a little bit about how we do retail promotions because Bill Hackett would tell you if he was standing here, they, back in the day, virtually invented the holiday Cinco de Mayo here and making it a big promotional opportunity, which is true. And the idea came up from that it was too hard for Corona to get into the promotional rotation for Memorial Day, July 4th and Labor Day, which is like when it all happens for beer in the summer. So this was a way to get a jump start on it, worked very well. So now we're able to carry Cinco right through. And this past summer, I think 2 summers in a row now, we've won Memorial Day, we've won July 4th and we've won Labor Day in terms of our share and our promotional activity. But now we came up with yet another one, I think, which we're only about 2 years into the making on this, which, all of a sudden, is taking on a life of its own, and that's the Day of the Dead, okay. And so now, all of sudden, there's a big promotional opportunity on November 1, in-store and on-premise, where people are celebrating their lost relatives, okay. So it's a Mexican holiday, Day of the Dead. And so now we're able to start to carry ourselves from pre-Cinco right through early November. And it's incredible how we're able to create these events and then really capitalize on them and leverage against them.

Then you look at a couple of other facets of this. So we're starting to

— Audio Gap —

years ago, we didn't really have, I'll say, the scale to necessarily warrant the investment.

But now — ***indiscernible*** — in particular are becoming destinations for folks. So we've got a number of these new logos at the bottom and I'll give you an example of one, whether it's the L.A. Rams returning to – or the Rams returning to LA and they're — ***indiscernible*** — few years, so at the LA coliseum, that's a picture of what you see when you walk in to the coliseum and we put 3 different bars in there. So we have a Corona bar, a Modelo bar – a Corona beach bar, a Modelo bar and Ballast Point bar, fantastic exposure. And these are like just going to the concession stations and down, take one of these — ***indiscernible*** — the whole experience around the brand. We've put in about 500 massive plays that we otherwise wouldn't have gotten because of the Rams 27th — ***indiscernible*** — and then we brought draft into the market because we needed Corona Extra draft for the venue in particular. So we've leaped back into the on-trade and we've already activated about 400 — ***indiscernible*** — is on its way to over 1,000 by the end of the year. So these work very well. You can go – I could go through all of them but I won't, but we think those are a great way to activate the brand. And our record – our core demographic loved Leicester [ph].

So now we're talking about expanding our portfolio on the high end or how we think about these other segments of the high end. So the first piece to that's in imports. So imports was the largest piece of the – where we think we could have grown — ***indiscernible*** — So we've got great brands. We're playing where – we're playing in the categories that are meaningful within imports. So we're well positioned to capitalize on what we have.

Then we go to domestic super-premium. We're not so crazy about that category and it's a lower-priced tier. So these our high-end customers, so it's $26 a case versus the average of $32 for the high end which makes it more difficult to compete in process. But there are attributes in that. It's really a 1-brand show we'll take a look at — ***indiscernible*** — we think there could be interesting playoffs which will — ***indiscernible*** — And then the alternative beverage alcohol. So that's the category there — ***indiscernible*** — so this is like a 30-year story as well. I think we'll certainly grow that and it's backed up with — ***indiscernible*** — When you look over 30 or 40 years, the pie has just gotten bigger. And it's $36 a case, and it doesn't cost what a craft beer is about — ***indiscernible*** — so it's a big profit. So this is an area that we're very actively in our growth innovation area looking at restoring how can we get into those category — ***indiscernible*** — but we're — ***indiscernible*** — looks fairly promising that really it's going to be an organic build and about leveraging other assets, could be other beer brands. It could be spirit brands, it could be wine brands. Because the trick to being successful in ABA is you've got to carve your own space. It's not about being the best product [ph], okay? The world doesn't need more — ***indiscernible*** — They don't need more — ***indiscernible*** —

And then craft. So we touched on craft a little bit. So craft, we still think even though this has taken its share of knocks, everything you read about the category, but craft has slowed down a bit in total. And there's a lot of — ***indiscernible*** — out there. And you just sort of have to get underneath it a little bit and see, well, what's really driving craft — ***indiscernible*** — So if you look at the last 5 years of the craft category, 100% of the growth has been what we would call locals and regionals. So regionals — ***indiscernible*** — 100% of growth. So it's not a new trend that's a large brand — ***indiscernible*** — declining a little bit more than some that are in the fridges — ***indiscernible*** — And so we don't believe it's doom and gloom at all for the category; we believe it will continue to grow and garner a bit more share and be a big piece of the category, we estimating, say, 500 million cases when we look out. And for us to play — ***indiscernible*** — in the high end, we aspire to – we'll probably need to earn let's say a 10%, 12% share in that category over the course of time. And how are we going to do that? Well, we're going to do that through Ballast Point and — ***indiscernible*** — There's a chunk of that share for us over the course of time.

We're testing some organic initiatives at the moment, so we created a Mexican-inspired beer called Tocayo, which has been in test in Chicago and seems to have some legs and then — ***indiscernible*** — our core competencies which we can use to get better insight and what we know about the Hispanic consumers and accounts, okay, and target ourselves in that area initially. So — ***indiscernible*** — trying to create like our own Ballast Point from scratch. And we're also starting to look at the venture areas for what could be new — ***indiscernible*** —, what's the next Ballast Point, what's the next — ***indiscernible*** —? They're out there, and it's going to happen.

Then we'll take a look at investing in innovation. So the way we think about innovation, there's 2 things going on. In October of next year, so October '17, we have a new micro-brewery and R&D facility coming up at Nava. And what they're going to be charged with and what we're building the infrastructure around — ***indiscernible*** — this really is, it's 3 areas: one is quality, so consequently, to make the kind of money that we make and sell — ***indiscernible*** — we sell that quality is paramount. So they'll be able to do a lot of things to serve the history [ph], quality, finding new raw materials and testing new raw materials for us.

Then there's product innovation, which will process some of – put some of that in. And this is an area that we call cost innovation. And the reason that we believe the cost innovation is important in the long term, that's all about how can we extract cost out products without sacrificing quality. That's going to be important going back to the fact that — ***indiscernible*** — All of this then, every single year, year in, year out, — ***indiscernible*** — offset your cost — ***indiscernible*** — it was to have a systemic way in the company to seek cost out at some risk, okay, to offset some of that. And we think there's all kinds of opportunity there. And you might say, "Well, why don't you go get that out — ***indiscernible*** —?" Well, — ***indiscernible*** — became a brewer and we're trying to become a much bigger brewer in terms of what we're adding. And we've got to be careful — ***indiscernible*** — while we're growing the footprint. So there's going to be a time and place for when we start to implement all that. But we're already committing projects underneath this as an organization to get out there.

So when we look at product innovation priorities, it falls into 3 buckets: Leveraging the equity of existing brands like Corona Modelo; expanding our presence in flavors and styles, so — ***indiscernible*** — and as a Mexican brand; and then the new platforms and market opportunities, that's more along the lines of the — ***indiscernible*** — special.

So now we're going to look at Corona. This slide is — ***indiscernible*** — we've got a lot going on. This is probably more innovation that Corona has seen, well, certainly more than any year in its existence and any — ***indiscernible*** — but probably more than the brand has seen in the last 10 years.

And so in this year, and early next year, we have a number of different things. And this spans the whole range of opportunities. And I tend to call it, it's – what are we doing? We're stretching the brand a little bit. We're not – we need to stay true to the essence of this brand. So there's opportunities to stretch it, but not all of a sudden like Corona, it's not going to come out with an IPA, okay. It's not going to come out with an amber-colored beer. It's not going to come out with a cider, okay. So how do we stretch and preserve the equity? So some of them, I'd say is a little more blocking and tackling, so the new light packaging. But the light – the current light packaging is sort of akin to what the can used to look like and just through changing the can graphics and putting a little more emphasis on it, we went from 3% of our mix to 6% of our mix. So we think that there's that kind of opportunity under Light actually. Then you can see what we'll do with Summer packaging, which is the way to bring the brand's essence to life on the can. I talked about the draft. So those are all, let's say, a little more tactical or close-in kind of things. And then things that push the envelope a little bit. So 2 concepts here. One is taking Familiar, which today is this 32-ounce bottle that we have of Corona, and extending it to 6 packs and 12 packs and 12-ounce bottles. And what we think that this is going to work well for, it's really about folks that want – Hispanics that want to celebrate traditions and the heritage of Corona. And we're going to do this in more developed markets, okay. Because if you look at Corona, it's got a whole continuum of what's going on. You take Southern California, it's pretty well-developed for Corona Extra at the moment. Trends aren't as robust there. Then you look at New York City right here, I think Corona is still growing at double digits, okay. So we don't want to start stretching the brand until we've maximized the core opportunity. When we are a bit more mature, we think that we can plug in something like Familiar here and prop up the brand and not hurt the equity.

Then to the far right, this ties into my comment on how can play in the attributes that are attractive to the consumer about Michelob Ultra, but not necessarily at that price point. So we're going to be going into test market in March. And this will be the first time that we've ever actually put a product in test that we will spend at consumer waste in some of those markets, so that it gets a fair shake to see what can we actually drive in terms of velocity and how fast can we drive the distribution. And so it's a product called Corona Premier, which is going to take all the attributes that they tell us that they – consumers tell us they like about Michelob Ultra, which is I want full strength alcohol, so 4-ish percent alcohol. I want low carbs. I want low calories and I don't want too much taste.

So that's what they say, #2 high-end brand. So hard to say that it's not a good formula for them. So we're going to be coming out in 4 test markets with this. Now we'll also have to do a lot of measuring cannibalization to see how does it interact with Light, how does that interact with Extra. And to the extent that it is cannibalizing there, is 1 plus 1 equaling a lot more than 2, because if it's not, then it's not doing what we want it to do within the franchise. But we're actually pretty excited about this.

Then you look at Modelo. So what's going on with Modelo, we just this year unified the brand under Casa Modelo. It was being sort of thought about as 3 different brands: Negra Modelo, the Chelada product and Modelo Especial. And so we unified the graphics on it. And we think that this is a platform that we can extend pretty dramatically long term. So this can go to places that you wouldn't – that we wouldn't take Corona. This could go to heavily hopped beers. This could go to ABA-style products, okay. It could go to a lot of places. We still have tremendous potential, distribution potential in particular in what we have, so I would say it's early days. Our first innovation – next innovation will be next year where we're coming out with a another spicy Chelada, so another version of our Chelada. So that's one more about extending. We can see extend the brand versus, I'll say, sort of incrementally stretch it.

And I already touched on really building Pacifico, which started with the 24-ounce can, we're activating a lot of draft. So I would say after Modelo, our second-largest priority for draft handles would be Pacifico because of the emergence of this new positioning and platform that seems to be working with millennials. We're coming out with 12-ounce cans and we're getting prepared. We're going to heavy up the advertising we have been doing in '18 and then in '19, we're probably going to do a national push on this, so really drive the distribution as hard as we can nationally because it has low penetration overall at the moment and support it with advertising.

And then on to investing in high-end leadership. So this is really how we define, well, what does it mean to be a leader in the high end? This defines success for the organization. So we define success is that we are thought of from the retailer and distributors as the thought leaders – the company they go to when they want to understand all – some of the things that I pointed out like, well, where should I put craft beer, warm and cold? And where should – how do I maximize my assortment in selection? And how am I going to find more space in the beer category? And all those kind of things. So that's really, I'll say, an industry sort of centric or a trade-centric pillar.

The next is being the preferred insight – consumer insights provider. So I think we've been great as an organization, actually, at mining those insights in terms of the marketing that we've developed and using the analytics. But we haven't necessarily been able to take that fully out to retail and the distributors. And one example of it would be, so you saw those waterfall charts I put up. We're actually now able to do those waterfalls on a brand-specific basis on a market-specific basis, so we can actually take them to our biggest customers, okay. The biggest distributors and say, you usually hear, "While I grew 10% last year, I don't know. Geez, I don't know I'm going to go grow 10% again next year. It's going to be hard to do that all over again." Well, we can show them through the drivers and drags process why that's possible and exactly what it's going to take for them to do that. How many points of distribution; how they're going to have to ramp up the merchandise. It's pretty powerful tool because it gets them to buy into the goal a lot easier than, "Well, I want to keep growing."

And then ultimately, at the end of the day, it's about being the share, the profit and the growth leader not just as a supplier, but as at distributors and with retailers.

So shelf management, just very quickly here. So I touched on that on that one slide. The reality is where we are in beer, which is interesting, because I think it's different in other categories of the store, non-alcoholic beverage categories that are much more sophisticated and probably because they're not in a 3-tier system, but days of supply, okay, and space to sales has no relationship to gross profit and dollar margin, right. So everybody went from space to sales. If I'm selling 50% of the beer, it doesn't matter what you're making, I need 50% of the space. Then they went to days of supply because everybody went out on an out-of-stock bender and got tired of hearing about out of stock so everybody's rabid about measuring days of supply. Even though in a lot of instances, I could say, "Oh sure, you've got 3 days of supply, but I had to leave like 3 sections of the shelf empty behind the front – the 2 facings out front." So it's a bunch of dead space for the retailer. So where has all this got to go into the future? It's all got to go about leaning into the future data. It's leaning in into the trends. Where are they deriving their growth? And where are they going to drive their growth and their margin from? Because that's going to make 2 things happen. There's going to be a shift in space over the course of time, and we need to make that shift happen faster than it has been. It's going to happen automatically even if we don't augment it. But the retail and distributor can benefit from it happening faster. And it's actually going to make the high end a lot more shop-able for consumers. I don't know how many people have gone like into a craft beer aisle or section as of late. But it can be a bit mind-boggling. We're not doing ourselves any favor with consumers when the shelves are set that way.

And then a couple of stabs on distributors because I think if you sort of look at this superficially and you say, "Well, okay, Constellation, you have x percent share, and sure, you sell at a higher price so your gross margin is a little higher than that," but if you peel this back a little bit more and you say, "Okay, what do we really – what's the benefit that we bring to our distributors?" we're not just a secondary supplier. We're becoming more and more a primary supplier. So this just shows what our alignment is. So Constellation AB houses versus Constellation MillerCoors houses. About 1/3 of that AB business, okay, is in Southern California. Right now in Southern California, we're either equal to AB or just on their heels in the next 12 to 18 months, and we'll be equal to them. So that's sort of an anomaly because you won't find another part of the country where AB houses, which are generally 70% to 80% AB profit derived and then 20%, 30% of other stuff where we sell as – or we don't sell as much volume, we deliver as much gross profit as they do to the distributor. So there's a different dynamic there. Then you look at MillerCoors. And about our 4 largest groups, so multistate groups, multi-house groups in the MillerCoors system, that's about half of that business or about 1/3 of our overall business. In 2 of the 4, we already are the #1 gross profit provider and closing in on the #1 volume provider. The other 2 of the 4, in the next 12 to 18 months, we will become the #1 gross profit provider.

This is going to keep happening and happening. And so I think it's an important dynamic because everybody sort of looks at the system is, "Well, it's AB-controlled or MillerCoors controlled." It's not that way at all. It is in most of the AB system, but the MillerCoors distributors have changed dramatically over the course of time. And we can get more out of this. What does it mean? Well, we can get them to invest more and co-op more with us, okay. We can get them to put incremental resource in, okay. We can get them to give us more priorities on a monthly basis than we're currently getting. So there's a lot of weight that we believe that we can bring to this.

And then of course, there's capacity. So that's a little – trying to figure out how this is working here. Okay. So we're going to play a little video. It will show you what's been going on down at Nava.

[Presentation]

Francis Hetterich

So the yellow box here by the way is what we acquired originally 3 years ago and then that picture is about 1 month old. And it's hard to like get the magnitude from the video or looking at the picture like this, right, of the scale of the thing. But it's bigger than life in some regards. I mean, you look at what we put on, there's over 2.2 million square feet of like buildings that we've put on. There's 5 million – I don't understand how this is the case, but 5 million cubic yards of concrete. Can you imagine that, 5 million? So just think about that for number of days, there's only 1,000 days that have past, okay? But like how much – how could you even make that much concrete? But we did. There's 16 miles of rail that we put in the place, so 1 loop around the place is about 10 miles, okay. So as I said, it's hard to envision the scale. But this is 1 monster-sized facility.

Now fortunately, we've been able to do all that. We did it on time as far as what our DOJ requirement was, but more importantly, what our product need was. But we did all that while continuing to produce record levels of volume at the plant. It didn't disrupt. So some people talk about, "Well, could we have disruption?" Well, it didn't disrupt our Nava production at all while we did this. And we pretty much engulfed what was the old area of the plant with construction around it. So we feel really good about where we're at and the team that we assembled to get this done.

Then, of course, in Mexicali. Everybody knows about our Mexicali brewery, which we retooled that a bit to do – our first leg of expansion will be 5 million hectoliters instead of 10 million. We're on track for December of '19. These are just some pictures of what's going on there at the moment. It basically is about – it's footings and foundations is where we're at.

And then of course, as Rob touched upon, our recent announcement about acquiring the Obregon capacity, which as he pointed out, look, this is immediate functioning brewing capacity. So that's a big plus. It's smaller scale capacity, which will help augment innovation even further in these – in the near term while we continue to build out Nava and get Mexicali up and running. And it takes a little bit of pressure off of Mexicali. And depending on exactly what our demand is going to be, come December of '19 and what our peak build looks like and all that, this is going to help take a little pressure off the system because it's been pretty full, okay, up to now.

And then, of course, we have this other small little thing going on, which this is the glass plant that we've been doing, which – that's pretty enormous too in terms of size. So we commissioned the second furnace in July of this year that we're actually ahead of the efficiency levels. In fact, I think it's one of the best startups that OI has ever seen in their whole system. In July of next year, we tack on to the next furnace, followed by another furnace in January. And you can see the matrix of glass suppliers below that. So not only were we doing all that work at Nava, in the backyard of Nava, we were doing this.

And then I think everybody understands this isn't different than what we've communicated before in terms of when the capacity legs come on and how it rolls up and hey, look, everybody I think over the course of the time would say, "Hey, the wine business was pretty capital-intensive," which it is, because it's about inventory. But the beer business was pretty capital-intensive on this front end. So we get that. But obviously, the returns are there to warrant the investment.

A quick look at our COGS structure. Not dissimilar to what folks I think have seen before here. So packaging is a bit of the name of the game here. Glass is 60% of the 45%. So glass is big for us because we're weighted to glass versus say a big domestic supplier. Followed by freight and logistics. We're dragging our product a long way compared to domestic suppliers, right. And that's just a function of who we are. We are sort of a unique-sized company, right. We're nowhere near the size – volume that MillerCoors or ABI is. But we're also not like this little craft brewery as well. So we're dragging a lot of product around over a long-distance. And then you can see labor and overhead and raw materials. But that goes to the point on the freight and logistics and the packaging, while – why we're fairly commodity-exposed or inflationary-exposed there over the course of time.

And then how we bring it together in terms of how we think about ROIC on the business. So it's about expanding the supply, as we just went through, which is costing a lot of money. And then we got to continue to fuel the demand, which has been working out quite well for us. And so we're going to obviously, fill up the supply. That's what's going to drive incremental ROIC. It's about cost optimization. So as I said, there's going to be a time and place that once we've got the capacity filled up, then there'll be lots of things that we can do to optimize the capacity and optimize within our footprint.

And then it's about investment in innovation. So up to now, as I said, as an importer, we've been fairly pay as you go. Never took too much risk in terms of investment ahead. And we understand the paybacks on our investment there quite well. So as we go forward, we'll start to take a little more investment on some of these innovations like Premier because we could drive that rather than take 10 years to build it, maybe we can build in 5, but it might take a bit more investment on the front end or Pacifico, for instance, but using the same discipline that we've used to believe Corona and Modelo to date. Even Ballast Point is a good example of perhaps there's marketing that can be infused into that brand to drive its distribution and drive its velocity that much harder.

And with that, that's my last slide. Patty gave me a lot of slides, but it really is all about inspiring and leading the next transformation. And as I said, it's sort of a different story when you peel it back a bit as to what's really going on in the high end of the beer.

So with that, I'm going to go to David Klein.

David Klein

Thanks, Paul. Sorry, my slides are not going to move around apparently. So hello, everyone. Hopefully, we're all learning something today. I didn't know we owned a locomotive. Did you see that in that video? 2 locomotives. Okay. Well, anyway. Well, anyway I appreciate the time you've spent with us today especially as we move into the home stretch of our presentations.

So I get to see many of you throughout the year. I'm particularly excited to be here today with the senior team. This is a fantastic opportunity to see the outstanding people that we have leading Constellation. And I think it's really the combination of great brands, strong leaders and business discipline that's produced the results that we're showcasing for you today and will continue to drive the results for you in the future.

You can see from the presentations that Rob, Bill and Paul made that our business has changed a lot since our last Investor Day. My goal is to highlight how everything you heard today translates into a financial algorithm, which delivers best-in-class total shareholder return. I can assure you that the 4 of us wake up every day focused on building shareholder value. So we've been outperforming the S&P 500 for a long time. We've built value by creating scale and premium-izing our portfolio through building brands that we've either created, like The Dreaming Tree, or acquired, such as Robert Mondavi, Kim Crawford, Corona and Modelo.

We've also been vigilant about divesting of brands and businesses when they no longer fit our objectives, so that we can redeploy capital to more attractive areas of our business. We continually look for ways to improve our returns by investing in our business capabilities and optimizing our business model, which has significantly strengthened our financial profile.

In addition to these business activities, we return cash to shareholders through share repurchases and our dividends. So as a result of this work, we've significantly outperformed the S&P 500 on a 5-, 10- and 15-year cumulative basis. But I think as importantly, we've been consistent in that outperformance, having beaten the average 11 out of the last 15 calendar years.

3 years ago when we held our last Investor Day, we were just completing the Modelo acquisition and defining how we would operate as an independent beer company. That transaction diversified our sales and EBIT base and created an opportunity for us to expand our operating margins by 860 basis points through the end of FY '16.

And while most of the investor focus has been on margin expansion in beer, it's important to note that operating margin expansion also took place in our wine and spirits business. Due to strong business performance since the Modelo transactions, our net sales have crossed the $6 billion mark and EBIT approached $2 billion. And as you saw on one of

Rob's slides, we're one of an elite group of consumer products companies, which produce spectacular results, such as net sales of 16%, EBIT growth of 23% and EPS growth of 29%.

Our business generates a lot of cash. This year, we expect to reach $1.6 billion of operating cash flow based upon the midpoint of our guidance range. Paul highlighted the Mexican beer operations investments we're making to support our growth. You're all aware that we're investing nearly $4 billion in Mexican production between fiscal '14 and fiscal '21. Given the growth and profitability of our business, we're confident in the returns which will be generated by this investment. And the peak spending for these projects is expected to occur in fiscal '17 and fiscal '18. A decision on the need for future expansion will take place as we assess consumer demand over the next 2 years. And, of course, when our beer CapEx normalizes, there'll be a significant step up in free cash flow, which will be used to drive further value for our shareholders. We expect to exceed $1 billion in free cash flow by FY '19.

In the past, we've managed to – we've managed our leverage ratio to stay within a range of 3 to 4x net debt to comparable basis EBITDA. While the beer transaction moved our leverage to 5x, we quickly delevered due to strong business performance and were able to get back into our targeted range by Q1 of fiscal '16. Since then, even with the capital investments in Mexico and funding for acquisitions like Meiomi and Ballast Point, we've been operating within our targeted leverage range. In fact, we ended Q2 at 3.4x. The broad range represented by 3 to 4x made a lot of sense when we were a much smaller company. But now given our size, we believe we need a more specific target for leverage. So we're now planning to manage the business to operate at 3.5x net debt to comparable EBITDA. We believe this best optimizes our weighted average cost of capital while providing us capital allocation flexibility.

From a near-term perspective, we remain focused on finishing out a very successful fiscal

’17 within our previously provided guidance range. As a reminder, the midpoint of our guidance calls for 17% EPS growth over fiscal ’16. So now I’d like to outline the financial profile which Rob, Bill, Paul and I expect to achieve over the next 3 years. Think of this not as guidance, but targets that represent the bar we’ve set for ourselves. We’re very optimistic about our prospects for continued growth and are confident in our ability to perform at a best-in-class level. So let’s start with beer.

As Paul outlined, we expect high single-digit sales growth as we grow volumes ahead of the high-end category; pricing of 1% to 2%, which is in line with our recent history; continued COGS improvement, including glass sourcing and the benefits from the termination of the Interim Supply Agreement with ABI. These benefits will be partially offset by the increase in depreciation expense and normalization of FX and commodity rates. We already operate at margins that are best-in-class in North America, and we’ll continue to work diligently to maintain that position. However, we also understand that we create the greatest amount of shareholder value by working to profitably and sustainably drive our top line. So we intend to invest in return-generating brand-building in the form of marketing, sales-execution capability and innovation in order to fuel best-in-class performance at the top line. This will result in high single-digit to low double-digit growth for our beer EBIT.

Now switching to our wine and spirits business. We’re expecting mid-single digit sales growth as we grow volume in line or better than the U.S. wine and spirits category. We expect to continue to benefit from healthy mix trends and a more disciplined approach to pricing, which has recently begun to produce results. Our wine and spirits EBIT will also benefit from innovation focused on higher-priced, higher-margin opportunities and improved asset utilization across the business. As in beer, we plan to fund marketing investments to increase customer engagement, make investments in sales execution and support innovation initiatives. We therefore expect mid- to high single-digit growth of our wine and spirits EBIT. When you tie these together, we anticipate solid net sales growth of mid- to high single digits on average over the next 3 years, accompanied by high single-digit EBIT growth. And then lastly, lower interest rates on our fixed rate debt and anticipated lower effective tax rates will leverage our EBIT growth into EPS growth of more than 10%.

So I think it's probably a little dicey to talk about tax rates today. However – so you could probably throw the slide out when we're finished. But this is our best estimate at the moment. So over the past 3 fiscal years, our effective tax rate has averaged 30%. We're evaluating tax accounting changes for 2 areas that I'd like to review with you. First of all, we currently account for foreign earnings using the assumption that they will be repatriated and we accrue U.S. tax on these earnings. However, we only pay taxes on these earnings at lower foreign tax rates. So while we've not completed our review, we expect to assert that we will indefinitely reinvest our earnings of some of our foreign subsidiaries. This accounting election will allow us to record tax on some of our foreign earnings using foreign jurisdiction tax rates rather than the higher U.S. tax rate.

The second tax item relates to the treatment of stock-based comp. And you've probably seen this start to appear with some of our CPG competitors. So for excess tax benefits related to stock-based compensation awards, current accounting requires benefit recognition into the equity account and the cash tax benefit comes through the financing section of the cash flow statement. There's a new accounting rule which Constellation will adopt starting in fiscal '18 that requires this benefit to be recognized as a reduction of tax expense in the income statement. It also requires the benefit to be presented in the operating section of the cash flow statement. This benefit can fluctuate significantly, depending on the timing and level of stock option exercises.

So as a result of these accounting changes, we expect much more volatility in our effective tax rate on an annual and quarterly basis than we've experienced in the past. But directionally, when assuming the implementation of these changes, we believe that our effective tax rate will be in the mid-20% range, with a cash tax rate that runs about 500 basis points below the effective tax rate. The lower targeted cash tax rate is really due to the tax deduction we receive from goodwill and intangible asset amortization related to acquisition.

I'd also like to note that given the similarity in tax rates between Canada and the U.S., we expect the pending divestiture of our Canadian business to have minimal impact on our overall tax rate.

Operating at a 3.5x leverage target, combined with our ability to generate cash creates financial flexibility for us. Our top priority for cash is making investments to support the sustainable growth of our business. Our priorities include investing in beer production capacity, new product development and innovation and marketing, brand-building and sales execution.

Next, we intend to grow our dividend as we did this fiscal year when we increased our quarterly dividend by 29%. With a payout ratio targeted at 25% to 30% of comparable basis net income, as our net income grows, so does our dividend. Based upon our growth targets, we expect to see our dividend grow at a rate greater than 10% on average over the next 3 fiscal years.

As outlined by Rob, we expect that we will – there will be opportunities to enhance our portfolio, primarily through select tuck-in acquisitions. These will be focused toward high-growth, high-margin brands that enhance our portfolio. For example, brands like Meiomi and Charles Smith, which have light-asset basis, can be efficiently integrated into our operating and selling platforms, are highly margin-accretive and provide attractive investment returns.

We're also prepared to buy back stock to mitigate dilution from employee stock-based compensation, and to repurchase shares opportunistically. We expect to aggressively deploy all of these tools to create shareholder value while maintaining a commitment to return to our 3.5x target. And to prove our point, in fiscal '17, we've invested in high return-generating CapEx, we've executed financial profile, enhancing M&A, increased our dividend and repurchased shares while our leverage ratio remains near the 3.5x mark.

Given the continued strengthening of our credit profile, strong operating cash flow and flexibility under our revolver, we believe we're well positioned from a debt service standpoint and are pleased that the – with the very manageable maturity ladder that we've built over time. At the end of August, we redeemed $700 million of 7.25% senior notes. We have another $700 million of 7.25% senior notes coming due in May of 2017. So looking out from their interest rates on our notes moved down considerably with rates ranging from 3.75% up to 6%.

Our bank debt agreements are in place through fiscal 2022, and reflect attractive low-rate financing with interest rates generally tied to LIBOR plus 1.5% to 1.75%. And the blue bars on this chart represent prepayable term loans, about $2 billion of which is international debt, which will be used to absorb foreign cash flow generated by our beer business. At the end of Q2 fiscal '17, the blended interest rates for the company was just above 3.5%. So overall, we feel our debt structure provides us with significant flexibility in order to continue to drive value.

So as we conclude our presentations this afternoon, we believe our strengths lie in our great brands, strong team and business discipline. We've provided you with the reasons to believe that we can continue to outperform our competition and deliver value to our consumers and our shareholders. When you tie all this together, including our ability to leverage strong routes to market and strong operating platforms and attractive consumer category, a business which generates EPS compound annual growth above 10% and also delivers significant cash flow, we think Constellation is a compelling investment, which can produce significant value for our shareholders.

Our team is committed to delivering industry-leading returns in the future as we have in the past. We think we have the right brands, the right leadership and the right strategies to do so.

So I want to thank you for supporting Constellation Brands and for enjoying and sharing our products. And I look forward to hearing your questions, which will take place after Patty has organized us for Q&A. Thanks.

Question and Answer

Patty Yahn-Urlaub

Okay. I think we're just going to wait a second. I think the guys are going to bring some chairs up here so we can set up for Q&A. As they're doing that, I just want to – we have a couple of people out in the audience who has a microphone. So if you want to ask a question, I'll recognize you. And if you could ask your question into the microphone so that everybody on the webcast has the benefit of hearing your question, that would be really great. And then as soon as we're done with Q&A, we'll head out to the cocktail reception, which is going to be right outside here. And I also think we have a gift for you. So thank you very much for being with us today. So that's the benefit of making it here today. You'll get a little present, which is excellent. And I don't know where our chairs are. So maybe we can just get you to just bring the chairs, maybe just bring a few chairs here up on the stage. Sorry about that.

Executive

Do you want us to bring our own chair?

Executive

Bring – grab a chair.

Executive

It's a BYOC.

Patty Yahn-Urlaub

Bring your own chair. I know — ***indiscernible*** —

David Klein

We feel like we're doing a lot of improvising today, so we'll bring some chairs.

Patty Yahn-Urlaub

Thank you. Here we go. Okay. So who wants to ask the first question? Vivien? Tom, if you could get Vivien a microphone that would be great. Thank you.

Vivien Azer

Vivien Azer of Cowen. So just to touch on beer, and I know there's a lot of open questions after the election last night. But as we think about the targeted algorithm on the top line for high single-digit growth and think about the composition of your consumer base today at roughly 40% Hispanic. As you were formulating that target, how did you see that evolving in terms of the mix of your consumer base? Like what are the drivers of that?

Robert Sands

Do you want to take that, Paul?

Francis Hetterich

Sure. Well, it goes back to the slide that was in the presentation on – we didn't – we assumed the Hispanic shift that you saw in that slide, or the — ***indiscernible*** — I should say, not a really a shift. And the same growth that we've been seeing on millennials. So that's all baked into the number. We didn't put the specific numbers on what each one of the bars was in our build.

Vivien Azer

So maybe just to follow up on that. Maybe it'd be helpful, can you offer a little bit of historic context then, like how has that mix shift evolved in terms of your reliance on Hispanics?

Francis Hetterich

Well, I'm trying to think – let me…

Executive

I think over – well, I think, over time, we generally talk about Corona being about 30-ish percent Hispanic and Modelo Especial being about 60% Hispanic. That's been the case for several years, which is interesting because we're not growing our brands just because more Hispanic people are buying the brands. We're growing our brands because the brands are becoming more popular with the entire market in the U.S.

Francis Hetterich

Our 40% Hispanic won't tick up much.

Patty Yahn-Urlaub

Okay. Come over, Judy? Judy Hong?

Judy Hong

And I don't mean to overshadow the positive business presentations that you've given, but I just wanted to just get a little bit of sense of what we should be thinking about as the potential impact from the election. I fully appreciate it's early, and there's a lot of moving parts. But what kind of conversations have you already had with the people in Washington about the trade and innovation issues, to the extent that you can share with us what sort of message will your regulatory affairs people be kind of talking to Washington about as it relates to these issues? And then to the extent that there's some tariffs that gets imposed, how should we think about managing for margins versus, obviously, you've got a big capacity coming online, so sort of balancing margin preservation versus the capacity?

Robert Sands

So maybe I'll comment on some of that, Judy. I would say that number one, there's a lot of space between now and any time that I would say, tariffs would be implemented on beer coming from Mexico to the United States. And I think to a number of your questions, first of all, there's a lot of things that would have to happen before there could be tariffs of the nature that the President-elect has potentially talked about relative to goods imported from Mexico. First of all, NAFTA, who would have to withdraw from the North American Free Trade Agreement, that is possible, although it would be perhaps a difficult thing to do politically and otherwise, but it is possible. Then number two, there are no tariffs on imported beer, period, from any jurisdiction anywhere in the world. So you would withdraw from NAFTA and there would still be no tariff on beer per se. A tariff would have to be implemented then against beer and it would be – it's unclear whether that can be done simply by a Presidential Act or not. And more importantly, it would probably require a withdrawal from the WTO as well if a tariff was implemented against beer. And it would then allow for retaliation by Mexico against various U.S. goods. So there's a lot of things that would have to occur. And this is why I say, there's sort of a long period of potential – there's a lot of space between right now and that kind of thing occurring. Then, of course, if that kind of thing did occur, we would be evaluating the possibility of passing on those tax increases if that seemed to be the best way to handle the matter. I'm sure that the whole beer industry would be looking at the implications of that, meaning our competitors would be looking at the implications of that as well and how that might create any opportunities for themselves. So I think the whole thing remains sort of way too unclear to speculate at this point in time what kind of impacts, if any, that this would have on the business. We obviously, will be considering that and thinking about what contingency plans might be put into place. Now you also asked about what conversations we've had. There's a number of other elements too, okay. First of all, we produce Mexican beer in Mexico, right. Mexican – our products have never been produced any place other than Mexico. Can't be produced outside of Mexico per the nature of our agreements and so on and so forth that we have. Plus we would never desire to try to duplicate the product outside of Mexico. Obviously, it wouldn't be a Mexican product anymore, mainly because I think that, as you can see from our marketing and what you know about the consumer, it's – with respect to our products in particular, right, it's all about the authenticity of the product. It's a well-known product in Mexico. It's consumed #1 beer product, #1 beer, right, Corona in Mexico. It's consumed by Mexicans, it's considered an authentic Mexican product. So it's not really the same thing, right, as making air-conditioning units that were formally made in the United States, making them in Mexico to take advantage of lower U.S. – lower Mexican labor costs or other costs. And in fact, all that is relatively unimportant to us. It's not why we produce the product in Mexico, and to take advantage of anything related to manufacturing advantages of Mexico versus the United States. So hopefully some – those kinds of things would also be taken into account in the type of decisioning that would occur relative to what kind of product and exactly how a tariff might be imposed, right, on certain types of products that may relate to components for instance, that could be manufactured in the United States or anywhere that are simply being transferred to Mexico and taken – we won't have any of that kind of thing to a large degree. So – and then lastly, actually, the – you asked about what kind of communications we have. We have had communications with some of our political representatives about the sort of – well, I'll say the economic impact of our business from the production of our goods in Mexico to the sale of our products and consumption of our products in the United States, right. We produce our products in Mexico and sell it almost entirely within the United States. We've done our own economic impact studies on this that basically show for every job that we create in Mexico or that we have in Mexico, we're creating 10 jobs in the United States. So again, ours is a little different animal than perhaps what has been specifically targeted in the political rhetoric. And we have been and will continue to communicate these types of things as I will say the policy on Mexico develops as Trump actually takes office and as I assume he will consider what his position is relative to, as I said, the kind of rhetoric that was discussed during the campaign. So I go back to the very first thing I say, a lot of space between here and there. We expect no impact probably whatsoever in the near term relative to any of this. And then, look, as you saw in Paul's presentation, and this is probably the most important fact, right, the consumer demand for our beer is stronger than it has ever been before. Not only do we not see that abating or diminishing, right, we actually see consumer demand for our specific product – actually we've seen it accelerated. It's actually been quite, as you know, from our conversations, right, but very hard to predict. Almost impossible in that you wouldn't come back and just say, "Oh well, it was 13% next year and on a huge base. We think it's just going to accelerate to 14% or 15%." We would never predict that kind of thing. So I think that the good news is with the very strong consumer demand for our products, a product like Modelo Especial, which as we just talked about, has a very – it gives a very high Hispanic and is now expanding into the general market. We don't see any of those trends really abating. So I think that, that continues to bode very well for the business. And then we have the whole rest of the business, right, which is an extremely diversified portfolio now of very high growth, very high margin brands. You saw that the algorithm that David put up, right, on the wine – and actually, Bill, on the wine – anticipated wine and spirits growth in sales and EBIT. And that's going to be a very strong future contributor to the – for the business as well. I mean, that portfolio has sort of turned that corner where now our high-margin, premium growth brands are outstripping sort of the historical tell of the business. And so now you're seeing sort of the growth and the margins flowing through. I mean, if you just took a look at our wine and spirits business as it's sort of configured at this very moment or going into next year with the sale of the lower-margin, lower-growth Canadian business, the purchase of these very fast-growing, high-growth, high-margin brands, in and of itself, there are very few consumer products companies that would exhibit those characteristics in terms of sales growth, EBIT growth and EBIT margin. I mean, how many consumer products companies have operated profit margins of nearly 30%, right, like just our wine and spirits business do. Not to bring up a sore topic. But I mean, we spend all our time talking about how big the margin can be or not on our beer business. But you've got a wine and spirits business that's already almost at the pinnacle of any consumer products company and operating profit margin as anticipated nearly 30%. So it's all a pretty good story. And I think it's going to continue to be a good story, notwithstanding the Trump election. And that's – the only other point I'd make is that with the Republicans having the Congress and the White House, I would expect, as again, the campaign rhetoric has suggested, that there's going to be a lot of pro-business things that are going to be put in place. If you've taken a look at the sort of the Trump tax plan that he put forth, and some of the things that he has suggested relative to corporate taxation, lowering the corporate tax rate to 15%; his views on repatriation, which is almost a bipartisan view today. So I think it's probably going to happen. These things are all deregulation. These things are all going to bode, I think, very well for our business and probably business in general as well. So there's some silver lining in all of this cloud.

Patty Yahn-Urlaub

Okay, next question, Nik. Tom, Nik's right back there. Thank you.

Nik Modi

I feel like I'm sort of left out from freestyle rappers, while they get to...

Robert Sands

What are you boxing out? Chicken, chicken.

Nik Modi

Okay. So 3 really quick questions. First, the Kim Crawford marketing test that you're doing in Texas, just wanted to get quick update on that. Second, Bill, if you can just talk about the innovation pipeline kind of how you would rate it today versus where it was when you actually took over the wine and spirits business just to give us a sense of comfort on kind of the forward growth curve. And then third, scanner data suggested Ballast Point sales to point of distribution has actually started to decelerate or come down, and I don't know if that's a data issue or if you could provide some clarity on that, Paul.

William Newlands

So let's start with the question of innovation. I think we had a dearth of new product development a couple of years ago. I think the pipeline now is very strong. You've started to see some of those come into play. Obviously, I used the example of Ravage today. It's not the only one. Our Callie collection is coming out this year. Those are both new brands. The thing that I probably underspoke about a bit is where we are enhancing, in the same way that Paul talked about enhancing Corona, with closed-in extensions to existing brands. We're doing the same thing on the wine side. So I showed the example of adding rosé to Meiomi. Rosé is a very strong category. It's one where we're under-shared, as Rob tells me at least on a weekly basis, but we're adding that into Meiomi. We're adding it into Black Box. We're also going to do something with Charles Smith around that scenario. So we're looking at our innovation pipeline really as 2 things. What are we doing – purely new brand basis, as you saw, 7 million's up there, which is extending into a price point where we don't have a red blend, but also extending on core franchises where we think we have the right and the consumer is ready to come along with us. So I'm actually very pleased about the pipeline. I think we've got a lot coming in. I'd say it also applies in the spirit arena as well. Ben and his team are spending a tremendous amount of time making sure that we have a fully developed pipeline. I think, as I recall when we met back in – at the Baird conference, we said, this year, this year we're in, was going to be the one that was a little light because a lot of the pipeline was being developed. I'm very excited about what the pipeline looks like going forward. Relative to Kim, the results were – while we raised our price, we actually saw a doubling or so of the takeout. So…

Patty Yahn-Urlaub

This is the Texas test.

William Newlands

That's the Texas test, yes, specifically that. And to the point where we're extending exactly what we're doing in digital into a number of traditional markets because it was so successful. So that was very positive.

Robert Sands

And before we switch over to Ballast, the thing I'd like to add to that, Bill, I was kidding about me loving Kim Crawford. I just want to clarify that the power of our wine business, when focused on the right brands, right. So you take Kim Crawford as a brand that has GP margins somewhere in the mid-60s. And it's a brand that doesn't – that's growing in IRI in the kind of low to mid-20s, and it doesn't use a lot of working capital because it's a white wine, and we very quickly get it into market after harvest. So it's a brand where, if I describe it to people, hey, we have this brand that's growing 20-some percent and has 60-some margins. They're kind of scratching their head and saying, is that one of your beer brands, the margin seemed a little high or is it a spirits brand. Well, no, it's actually a wine brand. So the wine business can be a very good business.

William Newlands

And that's why he likes it.

Patty Yahn-Urlaub

He likes the taste, too.

Francis Hetterich

So on Ballast Point velocity. Yes, that has come down a bit. It's not necessarily – it's not an integrity of the data information, but I think you have to be careful on how you interpret it. Its velocity spiked up quite a bit about a year ago, maybe a year and change ago because when they rolled out grapefruit, it really was a little bit of lightning in a bottle. The velocity in that particular SKU was extremely strong, albeit on a very small base. And then part of their strategy or the strategy there was sort of putting the menu out as they rolled out to other states, meaning take whatever product they want off the list as we expand versus us being fairly directive in terms of this comes first, this comes second and then you can take whatever you want off the menu. So a lot of our new distribution has, I'll say, a scattered array of what specific SKUs are in distribution. So the big opportunity there is we've got to drive more distribution on Ballast in – at the moment with what's going on in craft with a lot of shifting around there at the moment, that's getting a little more difficult to aggressively drive the distribution. But that's what we're going to need to do, and that's the opportunity there for that brand.

William Newlands

— ***indiscernible*** — Can I add one thing, Nik, to your question around innovation. We're also doing innovation very differently than what we had done. So historically, new products often were done by "stealing" grape supply from something else. So Sam Glaetzer, who is our new partial Head of Operations we put to in place to replace the gentleman who retired, he is now funding all our innovations. So what that does is that gives us the chance for something that takes off like Cooper & Thief or like the Bourbon Barrel Cabernet in RMPS. We have the chance to fund that and be able to increase the growth rate more so than historically how we have funded the grape supply to support innovation.

So I think the desire is not only on the pipeline, but our approach to it, I think, will give us a chance to have that be an increasingly important part of our overall delivery.

Patty Yahn-Urlaub

I don't mind if — ***indiscernible*** — room. So Robert, — ***indiscernible*** —?

Robert Ottenstein

Robert Ottenstein, Evercore ISI. A couple of related questions on the beer side and then one more on wine and cash flow. So on the beer side, you laid out a lot of very tantalizing goals, new products, looking to be, in a sense, a high-end category captain. To get there, do you have to increase the size of your sales force from where it is today? And if so, could you give us some metrics around that in terms of how many salespeople you have now, how many do you need 5 years from now? And then perhaps somewhat related, could you talk about the evolution of your relationship with the ABI distributors? Are you getting more share of mind now, particularly outside of Southern California? Are the changes that the DOJ has imposed on them having a meaningful effect, can they – so if you could kind of circle those 2, please.

Robert Sands

Sure. What was the question again? Well, maybe I'll just talk about the ABI distributors briefly, which is, number one, we don't have any ABI branches in our distribution network anymore. We eliminated and had the right as part of the deal to terminate the branches, which we did. And we transferred those – the brands to other distributors. Then as it relates to other ABI, traditionally ABI houses, for argument's sake, it's an interesting question because I think in ABI house, in many cases, it's almost a misnomer, just like a MillerCoors house these days is almost a misnomer. Take Southern California, take L.A., Beverly Hills, Anderson, right, big – it used to be big Bud distributor, okay. Well, probably today, our portfolio is the #1 profit provider in the house. So while it may be characterized as an AB house, I think that that's a bit of a misnomer because it's actually a Gold Network house or a Constellation house, and that we're the largest profit provider in that particular house. There are MillerCoors house examples of that as well, again, in Southern California is probably the best example where we're the highest share there; a place like San Diego where we have Ballast Point and the imported portfolio, the Mexican portfolio in Reyes, actually, joint venture MillerCoors operation where we're probably, by far, the largest profit contributor to that house. So I think the bottom line is that there's nothing particularly onerous for us being in an AB-type house. And fundamentally, I think that it just so happens as our network has developed over time, the majority of our distribution is through the historical either MillerCoors or Millers and/or Coors versus AB. What's the percentage now of...

William Newlands

It's about 24% AB.

Robert Sands

24% AB, of which 0% of that is AB branches. And then of that 24%, I'd say there's a pretty good number of them where it could be a push as to whether we're the biggest guy in the house or whether they're the biggest guy in the house from a profit-provision point of view to the distributors. So I don't really think that for us we get too caught up in sort of that whole is it an AB house or a MillerCoors house or whatever. I mean, we tend to focus on our Gold Network strategy and our strategy with our distributors. It's a lot more important to these littler guys who are getting shoved around, right, by AB as some of the – as that little shell game gets played, and AB has the right to redirect where they're going to go and this and that. It really – I would say that doesn't have very much impact on us today in general.

Francis Hetterich

Then on your category management question. In terms of additional resource in total, it wouldn't be anything that you would really notice in terms of the total financial metrics on the business because we've been adding and we'll continue to add commercial SG&A. As we continue to grow the business, we'll start to redirect more of that toward category development and category management, and we'll actually do some shifting of current resources towards that. But the trick to win in that initially isn't necessarily going to be that we need an army of people to write all the sets. It's we need to develop and bring the insights to the head buyers and their bosses so that the people that are actually writing the sets are simply adhering to certain principles, and certain principles can just be things like brand-blocking and flow, even – notwithstanding whether we get more space or not in that equation. If we just got flow and brand-blocking fixed, that's big opportunity for us. Then eventually, there's going to have to be a whole space allocation issue that's going to come up for all these retailers anyway.

Patty Yahn-Urlaub

— indiscernible —

Analyst

For you Patty or for you David, the earnings algorithm, the greater than 10% is a pretty wide swath. I think I understand the logic. You've got high single-digit EBIT. You've got deleverage. You've got the tax rate benefit. I think the logic is we're all going to get there because you're being clear about free cash flow. You've got the volatility from the tax rate. Is that the reasoning for not being more specific on this – on the EPS line?

David Klein

Yes, also, I think that it's – we've had really good return – results recently, but it's a pretty – I think, it's a pretty lofty goal for any company to stand here and look out 3 years with all the volatility that you can experience and talk about greater than 10% growth at the

EPS line. And so I think that's just the number that we felt comfortable with given the other components of the business.

Patty Yahn-Urlaub

There, one over there. — ***indiscernible*** —

Bryan Spillane

Brian Spillane from Bank of America Merrill Lynch. Just one clarification and a question. David, on the tax rate guidance, the adoption of the stock compensation component, was that there just to introduce that there'd be volatility in the tax rate? Or is that part of actually going from 30% to 25% in the expected tax rate?

David Klein

That actually has been one of the – if you bridged out from our cash tax rate over the last couple of years to our effective tax rate, that's actually been one of the biggest components of the delta because of the amount of stock option exercises that we've had over the past several years as our company's gone from $17 a share to $160 a share. So that's been a lot of the volatility, but it sat outside of the ETR. And so going forward, it will be included in the ETR, which will cause it to bounce around.

Bryan Spillane

And if I can just – in the wine algorithm with the EBIT growth, just how should we think about input cost volatility over the next year, in the next – over the next 2 years to the extent that you have some? Is there anything different about the business today in terms of maybe the way you source wine, the way your ability to maybe priced differently than you had before, anything that helps to sort of absorb input cost volatility? And as you…

David Klein

I'll take a shot at that. And then, Bill, you can – Bill, fill in. But what I would say is that, first of all, I think it's all of those things, right? So first of all, we have pricing expertise being applied to the wine business in a way that we haven't done so before. It's nowhere near where we are in our beer business, but we're trying to get closer in terms of always getting our fair share. Bill also talked about our ability to source wine from around the world for some brands when it's not a consumer requirement, right. And so that gives the team in the wine business the ability to try to optimize their costs that go into a particular blend. And so – and then on top of it, I think it's introducing margin-accretive brands and putting resources behind growing the mix, the favorable mix shift that we can effect in our portfolio, right. So it's all of those things that give us comfort that says we expect to get some leverage out of our wine business from the net sales line to the EBIT line.

Patty Yahn-Urlaub

Tom, could you give the mic over there, right there? Thank you.

Dara Mohsenian

Dara Mohsenian, Morgan Stanley. So David, when you laid out your beer financial algorithm over the next few years, you're not assuming much beer margin expansion. You mentioned investment behind marketing, R&D, sales force, et cetera. So can you give us a sense of how much incremental investment you're expecting and what the underlying margin improvement will be x at since you have a number of productivity initiatives in place?

David Klein

Yes, so the thing that we really want to focus on internally, and we think that you guys should be focusing on, is our ability to grow our EBIT. And if you look at the range we gave for beer, we said that we'd grow sales high single digits, and then we admittedly gave a pretty wide range in terms of where we would get to with EBIT. But if you look at that and you say you take the midpoint of both ranges and you said 8% net sales growth and

10% EBIT growth, well, that implies some margin expansion, right. But if Paul's team can get us more toward 9% net sales growth, and we have to invest more in marketing or more in the sales execution area, we'd be happy to do that because we think it gives us the best NPV value of our business in the long run, especially given the fact that in our beer business, we don't burn up a lot of working capital in terms of funding incremental growth. So I guess, again, I'm sure I'm not providing as much in the way of specifics as you like to put in your model, but we really want to concentrate on growing our EBIT high single digits, low double digits. And there is some implied margin expansion. We just think that we want to focus more on growing the business. And then one further point on that, when we get into the opportunities we have around margin expansion, a lot of the activity is going to be in value-engineering work and optimization work that takes place at Obregon, Mexicali and Nava. And right now, most of our resources are really running around just trying to get beer into the market, and so it's going to be a couple of years before we can really turn on that tap and try to squeeze more GP out of the business itself. So long-winded answer, but we're committed to growing our beer EBIT in the high single-digit, low double-digit range however we can do that.

Patty Yahn-Urlaub

Over here.

Hale Holden

Hale Holden from Barclays. David, the new leverage target that's half a turn lower, is one of the outputs of that going to be investment-grade rating do you think or hope for?

David Klein

So you'll note I didn't say that because we chose that target really because it gives us – in most economic environments, it gives us our lowest cost of capital. And when it's wrong, it's not very wrong, right. So it's the right target for our business. I think we have a pretty diversified business in terms of our cash streams. I think we generate a lot of cash. I think there are competitors out there in our space that have higher leverage ratios than us and are investment-grade and

— Audio Gap —

But I'd leave that whole investment-grade thing up to the experts in that area because I think that's a decision other people have to make about us. We want to operate at 3.5x because it's the right place to operate. If that gets us to investment grade, we'd be very excited about that

Patty Yahn-Urlaub
Tom, can you give the microphone to Caroline, please? And then Caroline, if you could pass it next to you when you're done.

Caroline Levy
This is a question for Bill. There was quite a lot of discussion in beer about the benefit of your distributors knowing you're the #1 profit contributor and even for the retailers to understand the move up to high end. What is going on in wine and spirits distribution? Can you talk to us about what your opportunities are to leverage your scale and your portfolio to get more distribution and more attention?

William Newlands
Sure. There's a number of things that we're doing, a couple of which I talked about. We're doing our account segmentation. I spoke only about Ruffino just in the interests of time. But our ability to be able to pinpoint exactly where we see high-velocity opportunities, I think is going to be game-changing for what we do. That allows us to manage our own people as well as manage distributor much more aggressively than we have in the past. Secondly, we are actively working to build up our capabilities in 3 areas: wine, core wine;

high-end wine; and spirits. That's the way most of our distributors go to market. They don't go to market with just one big plush. They go to market in those 3 ways. So we are actively – in fact, we're going to talk to Rob about that next week, about our expectation for how we are going to, in the future, align our business against what the distributor does. I think what that will do is that will allow us to be much more focused. It'll match what our distributors do and should allow us to improve our throughput in each of those areas in conjunction with the account segmentation. I think there's no one that puts more profit through the distributor network in wine and spirits than we do, and we expect to continue to get a disproportionate amount of their time and attention, and there's a number of other things that are happening that our Head of Sales, Kevin Cooke, is working on to make sure that we get a disproportionate amount of time and attention, much like Paul does through his beer network.

Stephen Powers

Steve Powers from UBS. So a couple of questions for David actually. The first one as being – just to clarify on the tax rate changes. Maybe you said this, but I don't think there's any change in the cash tax to this point versus going forward, if there is, just to clarify that.

David Klein

Yes. So I'll take that one first because then I'll forget all the rest. I get so excited about this tax topic, right.

Stephen Powers

Very excited.

David Klein

So a couple of things going on. So the benefit of stock-based comp, the adoption of ACB23 [ph] right back that gets to the mid-20s. And then 500 basis points lower than this cash tax rate. So in the past, I think we said low 20s is guidance for cash tax rate. So we're probably a smidge below that now.

Stephen Powers

And then the second thing is just to help me think about the return profile on the investments in beer because on the one hand, I think the story that Paul laid out is very compelling from a growth standpoint. On the other thing – on the other hand, as he says, it costs lots of cash investment, right. And so when I think about the $1 billion of cash in 2019, that's a good bogey, but that's $5 in cash earnings per share 3 years from now. And on the one hand, if you exceed that, we see the growth rates, that's great, but then there's probably more CapEx that follows, right, which constrains the returns going forward. On the other hand, if you fall short of the growth, I'm not sure you can claw that CapEx back, right. So then you – so I'm just trying to figure out how you think about the risk around that cash outlook.

David Klein

So we think we have really good – we have a really good return profile on our CapEx spend in Mexico, just because these brands are really profitable and the production – there are a lot of opportunities in the production environment to continue to enhance that. In terms of overbuilding capacity, you saw a lot of the innovation that Paul talked about today, and some of those items, we'd already have in the market if we had capacity, right. We simply can't get there because we don't have capacity, which is one of the reasons why we all liked the Obregon transaction because it immediately gives us capacity that we can use for these sorts of things. And then in terms of – if we quickly run out of capacity, again because it has a really good return, we wouldn't feel bad about spending incremental cash in Mexico to build out production capacity. But the good thing about the Obregon transaction is we now get a couple of years to assess that as opposed to having to make that decision right now while we're kind of under duress.

Francis Hetterich

The other thing to add, too, is if you remember in the Nava, the way we modeled Nava increments in Mexicali was sort of – let's say, it takes between 3 and 4 to build, and then we were using about a 5 to fill that capacity, 5 years, which is about as optimal as you can get. But then we looked at all different increments of what if it took 3x that, 15 years to fill it up, meaning if we were only growing into it 1% a year or 2% a year, it still was a very attractive return.

Patty Yahn-Urlaub

Okay. So we have time for one last question. Tom, can you give the microphone to Bonnie here, please? Thank you.

Bonnie Herzog

Bonnie Herzog from Wells Fargo. Rob, I want to go back to something that you mentioned just how great the demand for your brands is right now, and it's never been greater you said. So I'm curious if you guys could talk about then your ability and willingness to take pricing on your brands going forward and sort of triangulate that with your top line and then trying to think through, frame that for us in light of the current competitive environment, please.

Robert Sands

Yes. So the algorithms that you've seen, the sort of numbers that we put up there, I think contemplates pricing occurring pretty much in the same manner that it has been for the last several years. So I think we've been taking sort of inflationary price increases in the 1.5% to 2% range. I think that we expect that the environment will remain friendly to continue to take that kind of pricing in the future, which is baked into pretty much all the numbers that you've seen. So we think that – we don't see any change in the competitive environment, for instance, as it relates to how our competitors are taking pricing or how they're operating relative to one another that would suggest to us that the environment is going to change very dramatically. I mean, obviously, there's a lot going on with MillerCoors and ABI and that would suggest to me that getting into a price war is probably not high on their radar screen at the current moment. So as I said, I think the pricing environment is going to be conducive to us having the same – just pretty much the same kind of thing that we've been doing in the past. Do you have anything to add to that?

David Klein

No, I think that's right because – particularly on the domestic end, I'd say that there's only – there's a couple of segments in the high end that are playing out a little different, specifically ABA and craft. They are not good at taking prices in those 2 categories. So it acts a little bit more like premium wine. You see it growing each year, but it's more mix than it really is to a specific price point of a 6-pack going up, but that's only…

Robert Sands

But they're higher priced, anyway.

David Klein

And they're only – it's only 12% of cash.

Robert Sands

Even the lowest end of craft is more like what, $9.99?

David Klein

Yes.

Robert Sands

A 6-pack versus Corona at $6.99 a 6-pack or $12.99 a 12-pack. So there's already a pretty big price gap there. So…

Patty Yahn-Urlaub

Okay. I think that concludes our Q&A session. Thank you, everyone, for attending. Please don't forget to join us for cocktails right outside, and thanks again.

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