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Presentation

Nadine Sarwat

Hopefully, you can all hear me. Thank you, everybody, for joining us today. We got two for the price of one today for Constellation Brands. So we're joined by Bill Newlands, CEO; and Garth Hankinson, CFO today.

Just a little bit on the format, you're able to submit questions through Pigeonhole. I'll integrate them into our conversation. And hopefully, we're going to cover a lot of ground today. So welcome back to both of you.

William Newlands

Great. thank you.

Garth Hankinson

Good to be here.

Question and Answer

Nadine Sarwat

So I suggest we dive in straight to beer. Let's start with the short term, but I will get to the long term, and we'll get a nice balance of that in our discussion.

So the last 12 months have really been unprecedented with what's happened with Bud Light and the market as a whole. So for those in the room maybe who are a little bit less familiar, can you give us an update on how your brands in your beer portfolio are performing today against the backdrop of this incredible last 12 months we've been through.

William Newlands

Our business is doing extremely well. As you know, Modelo took over as #1 by dollars last year, but it's not an overnight success. 10 years ago, it wasn't even a top 10 brand. Today, it's #1 in dollars, and grew double digits again last year. So very strong in that particular brand.

Corona continues to be lower single-digit growth driver, very pleased with what that's doing. And then, of course, Pacifico. Pacifico is, again, looks like a baby Modelo in many respects. It's growing in the high teens, very strong, and it's starting to spread. It originally was on the West Coast, as you know, and we are now extending that franchise in various areas.

Then you wade in our innovation agenda. Again, very strong. Roughly 30% of our growth last year was on products that were on an innovation Our Corona nonalc did extraordinarily well. Our Chelada business crossed 20 million cases last year from literally nothing 15 years ago. Modelo Oro got off to a good start in its first year.

And we have things that are coming out of test market last year, Modelo Aguas Frescas, as an example, and we're just starting test markets on Corona Sunbrew, actually, here in the Northeast. So we're very pleased with how our business is performing. Last year was our single biggest share gaining year. We gained 2 share points in the category and even more in the higher end. So our business is doing very nicely. Anything you want to add?

Garth Hankinson

Yes, just a little bit on the outlook. Per the guidance we provided for FY '25 and consistent with what we laid out at our Investor Day for our beer business, we expect to achieve net sales growth in that 7% to 9% range. That's underpinned by volume growth in the mid- to high single-digit range and then getting 1% to 2% contribution from pricing.

As I mentioned, that's over what we've called the medium term. Just so that everybody knows what that means, it's – that's from FY '24 to FY '28. So when we refer to the medium term, we refer to Investor Day, that's the time period that we're talking about.

But specific to this year, we're just days away from closing on our Q1. So we can't comment on results during this meeting. But for all of you that have a tendency to look at Circana or Nielsen data, the syndicated consumer takeaway data, I think it's important to note that over the last 12 months, there's been a good amount of variability between the gap, between what you'll see in consumer takeaway and what you see from our depletions.

In our last fiscal quarter, that gap was in the low single-digit range, and that was kind of a reversion back to what is more normal. So just keep that in mind as you're looking at results. And then just to augment, again, what Bill is saying. Our outlook for our brands, our biggest brands, Modelo Especial, we're expecting low to high single-digit growth out of that. Corona, we expect to get sort of lower single-digit growth out of that. And then Corona – or Modelo Chelada and Pacifico cross that 20 million case mark, and we're expecting low double-digit growth out of those brands.

Nadine Sarwat

And just to clarify, that Nielsen IRI versus depletions, you're saying that, that low single-digit number that we saw in the last quarter, we're expecting something similar, that's something normal that should we see carrying on now?

Garth Hankinson

I'm saying that some of the anomalies that we saw last year, things have started to revert back to the norm.

Nadine Sarwat

All right. So a key theme that we would have heard at this conference from all consumer companies is a focus in trying to understand where the American consumer is today. We're in a very unique environment at the moment. So from the perspective of your business, how are you seeing the health of the American consumer? Are you seeing any downgrading? Any color on that?

William Newlands

We're very pleased with where the consumer is. When you look at the past 12 months with our buy rate, our buy rate is up. And I think that's one of the best views of how the business is doing and how it's performing. We haven't seen a lot of pressure on our brands.

Now some of that, I would argue, is the great point. I think some of that is unemployment is at a traditionally low rate compared to what we've seen in the last several years. Our consumers are very, very loyal. Almost half of our business is in the Hispanic community, a lot of tailwinds in that community. And the buy rates in that community have remained very, very strong. So we're seeing a lot of things that are very positive about our brands, perhaps a little different than what some people are seeing relative to the category. But our brands have been very, very healthy.

Nadine Sarwat

Okay. And we'll definitely come on to the — ***indiscernible*** — Garth, do you want to add something?

Garth Hankinson

Just on that point. I mean, while our brands are healthy and while we're performing well, clearly, we're watching the — ***indiscernible*** — always. And particularly, we were watching consumer sentiment, which, admittedly, for the last few readings, has been a bit weaker than I think any of us would have liked.

That being said, we consult with some of our largest banking partners to see what their outlook is for the consumer. And I think, on a positive front, is that if you look at across most financial metrics, the American consumer continues to be pretty resilient and fairly strong across all household incomes. And importantly, in – consumer spending actually increased, again, across all income levels, including lower-income households. So that has us relatively bullish, if you will, on the consumer, but something that we watch very, very closely.

On the positive side, as Bill mentioned, inflation continues to be at historic lows. The outlook is for interest rate cuts at some point in the not-too-distant future, which we think sets the stage well for the consumer to continue to be resilient.

Nadine Sarwat
Well, a follow-on question from that is Constellation has historically been pretty cautious with pricing. I think you've commented on a continuation of Tier 1 to 2 that we've seen historically. Can you talk to us through the rationale of the strategy and how you expect pricing to materialize in your business over the coming quarters given this environment we just discussed?

William Newlands
Well, Nadine, you've probably heard me say this before, but our strategy and my view of it is you don't want to chase your consumer away. We have a very loyal consumer, even at the time when inflation was particularly high over the last 2, 3 years, we were still – even though we were at the top end of our 2%, we still were probably more careful than a lot of other people were. It is much easier to lose your consumer than to lose them and have to go calling them again. It costs you a lot of money to do that. 1% to 2% has worked very well for us. And as you probably heard us say, we do it market by market, SKU by SKU, brand by brand.

So it's not a blanket 1% to 2% across the board. It will vary by market depending on the dynamics that are occurring, but average to that amount. That has worked very well for us, and it's something we plan to continue to do.

Nadine Sarwat

All right. Now let's talk about innovation. You hinted at that in your first answer. So you've had a number of line extensions that – since we sat on the stage last year. So Modelo Oro has been in the market now for, I believe, over a year. You have Aguas Frescas, Corona nonalc, Corona Sunbrew and the Chelada flavor, and I probably — ***indiscernible*** — of others that I haven't mentioned here. But how are all these line expenses performing so far versus your expectations?

William Newlands

They're doing extremely well. I think a lot of the reason they're doing well is our approach to the whole question. We started with everything on a consumer basis. We test outlook concepts that we are going to do with consumers before we even go to test market. Then we go to test market. We do not throw things against the wall and hope they stick.

We consciously go after things that we believe are going to have a place in the consumer repertoire that will be accretive to our overall business. And it's worked very well for us. Chelada is a great example. Across 20 million cases last year, it's high flavor.

One of the things you're seeing today particularly with younger consumers is an interest in higher flavor. That meets that need. Betterment is another thing that we are seeing significantly. Corona nonalc did a great job. That was the single biggest share gainer in the nonalc category last year.

And frankly, we didn't spend a lot against it, but we see a lot of upside to that particular product. Aguas Frescas was the #1 FMB in its test market of Las Vegas last year, and we're now expanding to 20 markets this year, covering roughly 70% of the country.

So all of those things, I think, are working well for us. And our hit rates, with our innovation agenda, has been very strong. And I think it all emanates from our base consumer understanding, our test market approach and then being very intelligent about how we introduce it more broadly to the market.

Garth Hankinson

Just on that point, too. I mean, Bill touched on a bunch of new offerings, if you will. But in addition to that, we also have a very disciplined approach around price pack architecture.

William Newlands

No question.

Garth Hankinson

To ensure that we have an offering at various price points so that we can meet the consumer at a price point at which they're comfortable shopping at. And a couple of examples of that would be that we introduced last year. I think it was last year, we introduced 12-ounce Cheladas. They go alongside the very successful 24-ounce Cheladas, and that's augmented the growth of the Chelada business. We reintroduced 7-ounce glass coming out of some of the glass shortages that we had post the pandemic, which is a great opportunity of entry point for some consumers.

And this disciplined approach allows us to not just accelerate our offerings for our pack size and from a product offering, but it allows us to keep a relatively tight efficient portfolio, which is important to our distributors. One of the stats that Bill loves about our business is that if you look across our 5 brand families, we have about 150 SKUs. And for those 150 SKUs, we generate 5x the revenue per SKU as our competitors.

So it's a very efficient, very enviable portfolio from that perspective and something that is important for us to be able to maintain. And we do feel good about all of that innovation, whether that's price pack architecture or new offerings, but it can contribute 20% to 40% of our go-forward growth because, in the last 5 years, it's provided about 30% of our overall growth.

Nadine Sarwat

And in terms of those line extensions that you've mentioned, some have – like Chelada has been incredibly successful and others you have had learnings from that may be the first time around didn't work as well as you thought. What are some of those takeaways that you had from those experiences that you try to apply today?

William Newlands

Well, I think any time that we do any kind of new introduction, we were very specific around what need is it going to serve? What is the consumer occasion that it's going to serve? And frankly, once in a while, get it wrong. Nobody hits 100% on those things, and we haven't either.

But I think some of the learning around it – let's use Familiar. We put Familiar into bottles and thought, "Oh, this will be great." It's heavily Hispanic, oftentimes unacculturated. And our distributor network got really excited about it when we were going to put this into 6-pack bottles, hence, therefore, got into stores it probably didn't have the audience for.

That now is one of our real growth drivers. It's been going extraordinarily well because we pulled back to what the appropriate locations were for that product to excel. And it's a great example. We got a little over our skis and went too far with that particular product, until we focused it back where it should have succeeded and where the consumer told us it would succeed.

Nadine Sarwat

And how do you ensure that you're not diluting some other brands, brand equity? Because you obviously have an incredibly concentrated portfolio, every line extension, I would imagine, has incredibly well thought out. How do you get that balance?

William Newlands

I think the biggest thing that we do is we make sure that anything we do that's new is consistent with the brand essence. In other words, let me give you an example. I can never see us doing an [IP&A] in Modelo. It just doesn't fit with what the essence of Modelo is. If you think about Corona, it's all about the feeling of the beach, the beach mentality, the refreshment. So the idea of doing a Sunbrew, as an example, is a perfect extension of that refreshment mentality that you have. So we work really hard to try to have anything that we do be consistent with what the brand is all about so that consumers feel comfortable, and you don't "scare off" the people who are your core consumers going in.

Nadine Sarwat

All right. now let's transition to a long-term focus for beer. Modelo continues to defy gravity. I think it's had over 20 years of share gain, when I looked as far back as my data would go. I feel the question that we ask you every year is how much more room does this brand have? And so perhaps for those in the room that are less familiar, how do you try and quantify the room that Modelo still has to grow in America today?

William Newlands

I think Modelo has got a lot of room to grow. When you look at the share that we have in our 2 biggest markets, Nevada and California, it is more than double what our average share across the country is, more than double. If you look at the household penetration, it is still below what Corona is across the country. .

So – and when you look at what you might consider from Modelo, secondary or tertiary markets, I love to use Alabama. We were laughing about that earlier today. It's one of the big growth markets in the tertiary markets for us. So the opportunity to continue to expand Modelo Especial's presence is really tremendous.

You then look at where we have also extended the mother franchise. Cheladas, Aguas Frescas, all consistent with authentic products that you would find in Mexico. So again, we didn't go off by some tangent. We did things that were authentic to the brands.

So I think Especial has got a long, long runway to go. Remember, we've only really advertised outside of the Hispanic community for about the last 5 years. So we're really in the early stages, in many respects, of getting the breadth that we think is out there and available to us, even though it's already the #1 beer by dollars in the U.S.

Garth Hankinson

And when you think about that runway that Bill just outlined, he didn't even touch on yet the distribution runway that we have there. Because we at our Investor Day, across our largest brands, we're expecting to gain 500,000 points of distribution, again, for our largest brands. 50% of that will come from the Modelo Especial across all regions, except in the West, where we're a bit more mature.

And even in that market, 30% of our growth in points of distribution will come from Modelo Especial. And that's pretty impressive when you think about the fact that Modelo in the Los Angeles market, which is 4x, in other words, it's larger than the next 4 competitors combined, and it's still growing points of display in that market. So good amount of runway left for Modelo from a distribution standpoint alone.

William Newlands

So keep asking the question every year because the answer doesn't change much. It continues to do great.

Nadine Sarwat

Yes. The bullet that never changes, frictionless.

William Newlands

That's right. We can live with that.

Nadine Sarwat

And let me actually dig a little deeper. So we quantified here with distribution. We looked at it on a geographic standpoint. The one thing that really came to the forefront of investors' minds, especially last year, with Bud Light was marketing and brand identity. And so that has been a huge contributor to Modelo's success, although that's very difficult to capture in a — ***indiscernible*** — And so in your best ability, how would you describe your approach to Modelo's brand identity, the marketing approach, how that has been phased over time and how that's contributed to where it is today?

William Newlands

One of the beauties in having had a marketing background, Nadine, I would – might resemble this from – people always say, tell me how – when your new marketing person is coming in and everything changes the minute they do. Like we've had the benefit. Jim Sabia has overseen our beer marketing for over a decade. You get a consistency. The fighting spirit is something that I think has very broad appeal. Yours might be different than Garth's might be different than mine, but we can all relate to it. And I think that consistency of message, the music.

When the music comes on, on any sporting event or a TV event or a digital event, everybody knows it. It's very consistent. So we have a consistency of message that I think is really important in that it carries through, it has broad appeal, and I think that's a key factor. Don't, of course, underestimate the quality and the value of the can. I think it all starts there. If the product is best in class, and we believe it is, that also is a very important factor.

Nadine Sarwat

Yes. I almost started humming the tune from the past.

William Newlands

Don't ask Garth to hum. He's not so hard as that.

Nadine Sarwat

So Garth – no, I'll ask you a margin question, though. So obviously, you reiterated your medium-term beer operating margin target of 39 to 40 at the Investor Day. So I'm going to ask maybe a past question here, but when do you think that we're going to get back to that? Where are we comfortably within that range? It's something clearly that's important for investors since that is the best in cost margin. So levers and time lines.

William Newlands

Do you want to add anything?

Garth Hankinson

So first of all, as you know, as it relates to the margin, I mean, the guidance that we provided this year, which is approximately 39% operating margin, which is fairly consistent with the target that we laid out. Obviously, we've seen improvement in our margin as we said we would. We saw that starting in the back half of last year. We said that you could expect to see in Q3 and Q4 on a year-over-year basis increasing margins, and that's absolutely true in Q3. Would have been true in Q4, but for a write-down we did due to some debt recoverability. So we've already seen some good progress on margin, and again, as we laid out our guidance for this year to be about 39%.

Now keep in mind, when we said 39% for fiscal, we meant on a full year basis, right? So that doesn't mean that every quarter, we're going to hit 39% precisely, right? There will be puts and takes.

As a reminder, what some of those puts and takes will be in our fiscal – in the first half of our fiscal 2024, we benefited from wraparound pricing actions that we took in the fall of FY '23. You won't see that same thing here in the first half of FY '23 because we didn't take those pricing actions in the fall of last year. And in fact, the pricing actions that we have for fiscal '25 are more second half oriented.

Secondly, as I mentioned a second ago, we had that debt write-down in Q4 last year. We won't be lapping that this year. So again, there will be variability as we move throughout the year.

Looking beyond this year, again, we did guide to 39% or approximately 39%. We feel good again about being in that 39% to 40%. We think that's the right range to think about our margins. As we've said in any given year, we might have more headwinds or tailwinds. And in those years that we have more tailwinds, we can be above 40%. And if we have more headwinds, we will drop below 39%. That's the right range long term.

Nadine Sarwat

Right. I'm thinking of, again, this year, coming back to that 39% you mentioned in terms of input costs. Anything changed on that front? Or what are the key levers that we should take into consideration?

Garth Hankinson

Well, as we laid out in a pretty good detail as we provided guidance, we feel good about the input costs and the progress we've made from a procurement standpoint in not just getting lower costs on a year-over-year basis, but scaling back some of the outsized increases we saw as a result of disruptions in the supply chain. So we've done a very nice job on a cost and efficiency standpoint.

We're doing a really nice job. You've heard us talk about this migration from being builders to operators and finding inefficiencies in our footprint to take – not only take – to add capacity and need less CapEx, but just to find ways to be more efficient on a day-to-day basis.

Commodity costs have come down, so inflation has abated, hasn't gotten back to where it was pre these elevated inflationary times, but that's trending in the right direction. So we feel really good about all of that. I mean, for us, the biggest question mark that we have right now as it relates to margins for this year, maybe for the next 1 or 2 years, is the strength of the peso. That's – the peso has been a bit more resilient than we've expected. Obviously, we have a pretty robust hedging policy, so we're able to manage that. But beyond the next couple of years, we'll be watching that closely.

Nadine Sarwat

Then you mentioned capacity going from builders to operators. Well, you are building something, which is Veracruz. So can you give us a status update? How is that progressing? And when can we expect that facility to come online?

William Newlands

That's progressing very well. The development of the project is really going according to plan. We're very pleased with the water supply, the labor supply that we have in Veracruz. So all is going very, very well.

We'd expect that to open probably late next fiscal year, give or take. There's always some variability in the last little bit of time. But we would expect that to be roughly when we would open, and that's pretty much on schedule. So all going well. We're very pleased with the development there.

Nadine Sarwat

And I remember you mentioning in terms of sorting out transport logistics, you were laying out different plans and scenarios. Where are you at with that? I remember, I think you had mentioned barges and having it for a certain proportion of the U.S. on the East Coast. How have those plans developed now?

William Newlands

They're still ongoing in their development. But – as you point out, there's a port that's very close to the Veracruz facility that would feed right up to the East Coast. It probably will mean different mode of transportation, which will be different for us. We've mainly used rail out of our other 2 facilities.

But we're still getting our feet wet, if you will, no pun intended, about how we will take product out of that port. What we probably will do, given it will be a little bit more logistically [challenging] to what we've had is we do very efficient SKUs in that plant. Large long run SKUs to be much more conducive to that mode of logistics and shipping them to have a wide array of products, even though it's very efficient. A wider array of products that we have at the other 2 facilities.

Nadine Sarwat

All right. And then maybe a final question here on the beer portion of the business. There was one resounding question I've had year-to-date, time and time again, probably for many people in the room, which is what is going on with U.S. alcohol consumption? So U.S. beer, in particular, I mean, has been especially weak over the last 18 months. It's been an exceptional time. So what do you believe, let's just stick first with the overall industry or the fundamental factors driving the sweetness?

William Newlands

I think there are a lot of factors involved. First of all, we don't see too much of that with our brands. I think the consumer is a bit more brand-specific, and brand loyalty is as important as it's ever been. And fortunately, we have a lot of brand loyalty within our brands, so that's very positive. I do think there's some evolution of what some consumers are looking for. Some consumers, they're looking for things like more flavor for Betterment. It's a great example of why Corona nonalcohol is helpful in its inception year.

But I think we need to be careful and not look at too small and discrete periods of time. It's been a little [squirly] this year with the weather at times, and there's direct correlation with our beer business and how is the weather? Is it cold, rainy or is it nice, hot and sunny?

So you can see some of those characteristics. I wouldn't be overly concerned about long-term trends at this point in time. But as Garth pointed out earlier, it's certainly something we're keeping our eye on.

Nadine Sarwat

So if I just push that a little bit further. If we look back at history, U.S. beer has historically been a plus or minus 1 volume. From your answer, it sounds like you think we will revert back to that on a medium to long-term basis, and you're not overly concerned about structural factors. Would that be a fair way to put it?

William Newlands

Yes, I'm not overly concerned about structural factors. I mean, we've spent most of our time worrying about ourselves rather than the broader category. Although, obviously, it's in everybody's interest if the broader category is helping.

As you've seen, we tend to do very well, and we continue to take share. We took 2 share points last year of the category. It was the biggest we've ever done in our history, and we're compounding that this year with 1.2 to 1.4 period after period. If the category was a little healthier, those numbers would be a little bigger, and that would be nice.

But I think some of the things that we need to do as a category, we're doing the nonalcoholic, higher flavor, the Sunbrew as the example, making sure your brands have authenticity. All of those things are, at least, as important as they've ever been.

Nadine Sarwat

So anything that ties back to brand health?

William Newlands

Yes, I think that's really important.

Nadine Sarwat

Now if I play devil's advocate, which is probably what many people in the room are thinking, brand health is fantastic, but there are 3 sort of factors I have been hearing over the last 6 to 9 months. This GOP one, I saw an ad for it in my cab here on the way to the airport, the rise of legal cannabis and also the potential for younger consumers to be drinking less.

Now I fully appreciate your view here that brand health is paramount, and that's the first and most important thing to focus on. But how do you consider these potential long-term headwinds to the industry?

William Newlands

Well, let's take the GOP diet scenario first. And we said this at Investor Day, Garth, if you remember, we have seen almost no evidence that, that has any impact on our business. And we've listened to millions of conversations with consumers, and it literally comes up about 2% of the time. It's just not a factor.

Similarly, when you think about cannabis, we've studied many of the markets where cannabis has been legal for a longer period of time and have seen, again, very little to no impact across it. My guess is you've seen some people that have actually consumed more who are cannabis users, meaning more alcohol beverages, and then you've seen probably some who have done less. It washes out. So that has been a relatively unimportant factor.

And we've been fortunate that we continue to bring legal drinking age, newer consumers into our marketplace. Again, we're somewhat [debited] by that because of our heavy SKU to Hispanic consumers. The Hispanic consumer and the Hispanic culture tends to be more beer-oriented, and we are way overdeveloped with that particular marketplace. So some of those factors just don't seem to be big issues as far as it relates to us.

Garth Hankinson

Just since you mentioned the cannabis, I think because it was 1.5 years in the making, it's worth noting that in Q1, we did move from common shares to exchangeable shares in Canopy Growth. I think that's important for the audience because that now means that beyond Q1, you will not see any impact from Canopy Growth in our EIE numbers. So as we move forward, reported — ***indiscernible*** — results will be more in line with the — ***indiscernible*** —

Importantly, while we moved to exchangeable shares, and this won't be a factor from us from a reporting perspective anymore, we still do have exposure to what is an interesting and dynamic category that's unfolding here, and we'll have to see what happens from a regulatory environment for certain. But – so not only do – not only do we benefit from being an exchangeable shares, but Canopy does as well, because it allows them to be maybe a little bit more aggressive in how they attack the all-important U.S. market.

Nadine Sarwat

Got it. And then just coming on to that legal drinking age consumer point you mentioned, about how that is still a very dynamic consumer for you, is what you're saying that the rate at which 21-year-olds today are drinking more product is the same, at or greater as what they were drinking than previously? Or is it that…

William Newlands

Yes, our [bottle] rates have been very strong with that consumer.

Nadine Sarwat

So let's move on to Wine and Spirits. So last time you were here on the stage, I asked you if you would consider divesting your wine business. And your response was very honest, and I quote, "There are no sacred cows in our business. There might have been at one point, but there are no longer." And so here, 1 year on, what is your view on the role of the wine business in your portfolio today?

William Newlands

Well, certainly, Nadine, we expect all of our businesses to perform. And frankly, we've had some challenges with our wine business. So we have put a fair amount of work into it. What I would say is the business is very different. We – from – if you think about what it was, say, 5 years ago, we've got 1/10 of the amount of mainstream brands that we had 5 years ago. So we've pretty radically addressed what our portfolio looks like, moving a disproportionate amount of our business to the higher end, where there's better growth, better margins and certainly a more strategic play.

With that said, we still have a fair amount of presence in the mainstream segment because of Woodbridge and SVEDKA in particular. So that – I would say, my comment from a year ago hasn't changed any. But what I would say is look at our track record. This company has historically always challenged itself to make sure that we are doing what is in the best interest of our shareholders, and we're going to continue to do that.

Nadine Sarwat

So still no — ***indiscernible*** — I'll ask again next year.

William Newlands

Okay.

Nadine Sarwat

Now let's stick to wine here. I think everybody appreciates the efforts to turn around brands, investing in brand building for the core brands in the business. But this is all against a wine business that is, for the industry as a whole, a very challenging time. So if we cast our minds beyond just this year, which you provided guidance for, and we look out over the next couple of years, how do you see the potential for that business sort of a normalized run rate, if you will, considering the challenges the industry faces today?

William Newlands

Well, as you've seen, and we said at Investor Day, we believe that, that category can be sort of a low single-digit growth category, driven by the higher end of the business, not by the lower end of the business, which has been very challenged, as you point out. Here's what I'd say. We went in – and as you know, we had a change of management in January. We went in and looked very carefully at everything we were doing. And there were a few things that we felt were critically important.

One is we had peanut buttered our spend a bit too broadly. We've got 10 or 11 brands that really matter, including the 2 at the low end of the mainstream segment, which we needed to shore up. So that's one. So we focus much more attention on the brands that matter.

Secondly, some of that business is tactical. We had probably gotten away from some of the key tactical work that needed to be done. So we put more focus on tactical work with some of our brands, particularly those that play in the lower price points.

Third, we think the cost structure had gotten a bit out of whack. And a bit of what we've done this year is put some very aggressive cost approaches in that business.

For instance, Garth mentioned earlier about the procurement and logistics capabilities that we brought into our beer business. The gentleman that has overseen that is now working with our Wine and Spirits business as well, and we think that's going to provide some strength on the cost side of that business.

We continue, though, to think about it on a consumer basis. Consumers, 9 out of 10 alcohol beverage consumers, drink beer, wine and spirits. And those who do spend 6x as much as somebody that just drinks one category. So by playing in all those categories, it allows us to reach more consumers and more consumer occasions. And we think that's important over the longer run. Anything you want to add?

Garth Hankinson

Yes, maybe to [practice piling]on a little bit. I mean, so obviously, the guidance provided for FY '25 is not in line with what we laid out at Investor Day. That being said, we are still committed to the longer – to the midterm algorithm that we did lay out at Investor Day, meaning we do believe we can achieve 1% to 3% top line growth and 25% to 26% operating margins over the medium term.

The deep dive that Bill and I have been performing with the team really has given us greater conviction that the strategy that we have in place is still the right strategy. Continuing to lean into the premiumization trends that have been ongoing for a long period of time and show every sign that they will continue, that's the right strategy. Diversifying our business away a little bit from the U.S. wholesale into DTC and to the international – select international markets is the right approach. And so we think we'll see improvement.

Again, the guidance for this year is not where we would have I liked it to have been. That being said, we are expecting to see sequential improvement as we move through the year. Similar to our beer business, not every quarter is going to look the same. We would expect to see improvements in both the top and bottom line sequentially as we move through a number of the initiatives that we reviewed with the team and have been put in place.

We'll start to show dividends, if you will, through most of the year and keep that business a little bit different than our beer business, which, in beer, we do about 55% in the first half and 45% in the second half versus Wine and Spirits. So we do expect to see, as we move through the year, that, that business will improve.

Nadine Sarwat

Okay. And then in terms of CapEx, longer term, how should we be thinking about CapEx for that wine business, in particular, especially when we place that in context of overall Constellation?

Garth Hankinson

Well, let me just start with overall Constellation and then we can go specifically. I don't want to spare us, but overall constellation, we've been investing a lot in CapEx, mostly in our beer business. And this is actually going to be our high watermark for CapEx as an enterprise.

This year, we're going to spend about 13%, 13.5% of net sales on CapEx. Again, the vast majority of that in Mexico. And we see over this medium-term period that coming down in our fiscal 2028 to be in the 4% to 6% range. So that's a real inflection for us as [advised].

There hasn't been as much variability in Wine and Spirits as there has been in beer. That being said, we're a little bit of a high watermark right now in Wine and Spirits as well. Now a lot of that, I would tell you, is sort of catch-up CapEx because we probably underinvested in the last 5 to 7 years, and so we've had to spend a couple of years [over], I think. But the target rate for CapEx for that business, on a more normalized basis, is right in that 4% to 5% of net sales range.

Nadine Sarwat

Perfect. And then finally, just a question on spirits, in particular, to round out our conversation for this segment. So the spirits category, as a whole, in the U.S. has been the biggest share, sort of, gainer over the last 15 years. Is Constellation interested in growing its presence more meaningfully in spirits? I know you've spoken about your string of pearls approach to M&A. Is that an area of focus for you?

William Newlands

Yes. But the reality is there's probably limited amounts of what we can do. We bought High West. That has performed extremely well and outperformed its acquisition case. We built Mi Campo from scratch, and that has done extraordinarily well for us. We also have, in our venture arm, a couple of investments in the spirit arena. I don't know that we're going to substantially change the profile and the size of that section of the business.

But I'll give you an example. We've done ready-to-serves now that are doing extraordinarily well from High West, which puts us in a different sort of piece of the business and a piece of the spirits business that's performing very well, utilizing the brand that we already own, High West. So would we like to continue to see that be an important part? Yes. I don't think you're going to see it be substantially different than where it is today.

Garth Hankinson

I mean the only thing I would add to that is, to the extent that there is something that we want to take a look at, we'll use this team's, sort of, rigorous strategic assessments that we always do. We'll apply the same rigorous financial discipline. There's a whole sort of list of criteria that has to be met in order for us to consider an M&A transaction, whether that's in the spirits or the wine space, for that matter, even in the beer space.

Some of those are the fact that they have to be accretive to both our top and bottom line, they have to have the ability to scale. And importantly, they have to be accretive to our enterprise-wide ROIC. So we'll apply that same discipline, regardless of the opportunity.

Nadine Sarwat

Now with the time we have left, I'd like to shift back to the overall strategic focus of Constellation as a whole. So capital allocation is something that's got a lot of air time when it comes to you guys. Could you just remind us what are the priorities today? And I'm going to preempt the question that will come from the audience, probably, which is, many investors ask, when we can expect very fruitful share buybacks again?

William Newlands

Well, I'll let Garth give the big answer to that. But I think you should keep in mind, we said we were going to do $5 billion of returns between dividends and share buybacks, and we far exceeded it. In fact, Joe Suarez, who's sitting here often, says it's the one place where we've gone beyond what we said we were going to do on a capital basis is on that.

You should also keep in mind, we have almost $2.5 billion authorized by our Board for share buybacks that's still existing. So share buybacks and returning dollars to shareholders has been a critical part of the overall capital allocation approach that Garth and I have been doing for the last several years. And I think our capital allocation hasn't changed in years.

Garth Hankinson

Yes. I mean, look, I think that's an important point for the last 5 years. We've been very consistent with what our capital allocation priorities are, and we've done what we said we were going to do.

As a reminder, our capital allocation priorities are, first, to maintain our investment-grade rating. This is something that when Bill and I took over, Bill took over a little bit before me, but the leverage ratio was about 4.5x. We got that down to near 3x, 3.1x before the share collapse transaction, and that took it back up to 3.5x. We ended fiscal 2024 at 3.2x, and we expect to be back at 3x in this fiscal year.

Second priority is to maintain our 30% payout, dividend payout. Clearly, that's important for our shareholders. We think it's an important element of our capital allocation strategy.

Third is we're going to continue to invest in the growth of our business, most notably production expansion, capacity expansion in Mexico.

Fourth is we'll continue to provide our return capital to shareholders for share repurchases. As Bill said, we significantly overdelivered on our commitment over a couple of years ago, and we've continued to be opportunistic when we've seen dislocations in the marketplace.

And then fifth and finally, we'll do some select bolt-on M&A transactions, again, using that rigorous financial discipline that we outlined a little bit a few minutes ago.

Nadine Sarwat

And something else that we've seen a lot of change when it comes to completion is corporate governance. I know we've spoken about this a number of times. There have been a number of changes over the last couple of months and years. I think it would be helpful maybe for those in the audience to hear some practical ways that that's changed the day-to-day of the business. And maybe some examples of how the corporate governance changes have led to some actually more tangible changes that we could imagine. Is there anything else that you could add on corporate governance?

William Newlands

Well, I think we've done a lot of things. Obviously, Garth mentioned the collapse of the B shares, so that we're now single-class shares. I think a lot of investors were anxious to see that happen. And while it was an expensive transaction, it certainly is one that I think everybody is pleased it exists today.

Second, we've added multiple directors to our Board with stronger financial acumen, which we thought is an important thing that we need to do. And we've just had a new chair of the Board this past, what, like 2 months ago, 3 months ago at this point, who we're very pleased with. Strong outside perspective, strong consumer perspective, I think that's been a real positive addition to what we're doing as well. We operate much more consistently now, as you would expect, a normal publicly traded company to be. And I think a lot of our investors were looking for that sort of — ***indiscernible*** — approach.

Nadine Sarwat

And one of the most frequently asked questions I get on Constellation, it's the level of concentration in your portfolio. Now obviously, given that your core beer brands were growing so strongly, that concentration is a very good thing at the moment. That will translate both at the group level as well. But obviously, some people will push back on this concentration geographically especially. So to those investors who are in the audience today or listening and who have those concerns at the back of their minds, what would you tell them?

William Newlands

I'd say, if I was – wanted to be invested in one market in the world, the highest profit market in the world is in the United States. So if you wanted to be in a position where you're overskewed to a particular place, this is by far is best place to be overskewed.

I would also say, you often see more risk in international markets than you do in the United States on an ongoing and long-term basis. I mean you've seen many competitors have pros and cons that go on as markets around the world changes or governments around the world change, lots of things can be variable. So while certainly, there's a concentration in this market, and that's a statement, I can't think of a better place to be overinvested than in the United States.

Nadine Sarwat

And I'll ask you the same question, but at a concentration level in terms of category exposure, what would you say to that investor?

William Newlands

Well, I think beer business is a huge business, and it represents 85-plus percent of our total profit today. So it is a category that has – it is huge. There's still tremendous opportunity for us to take share as well as grow in usage occasions and consumer occasions, which is what we're doing with many of the things that we've added into our portfolio, the Cheladas and the Sunbrews and Aguas Frescas and those types of things. So I think we're in a position where we are actually broadening our consumer reach as we go forward, and I think that's going to be good for investors.

Nadine Sarwat

All right. Well, with the 1 or 2 minutes that we have left, I'd like to end with a question that I ask all our management team, which is what is the one thing that you believe is underappreciated or misunderstood about Constellation by the capital markets today?

William Newlands

Shall I?

Garth Hankinson

You go first, and I'll follow up.

William Newlands

Look, I am always perplexed by why our – we don't get a better valuation on our stock. We have said year after year after year what we're going to do. We've been judicious in our capital allocation approach the entire time that I've been in the seat. We've said what our growth profile is going to be, and we've hit it consistently, and with additional ups and downs that periodically occur in any business.

So 5 of the last 7 years, we have been the #1 large-scale growth company in Circana, 5 of the 7. Meanwhile, everybody asked every year when Modelo is going to slow down. So – and acknowledging, I didn't bring it up, but – and acknowledging the last year or 2, we've had some challenges in our wine business, to be fair. So I would argue, we are very undervalued, frankly, an opportunity and a nuance at the management level.

Garth Hankinson

Yes. I mean, just to follow on some of that. I mean, I'm not concerned that everyone appreciates or digested what we shared at [Investor Day]. I mean from an enterprise-wide basis, right, we're going to grow the top line 6% to 8% over the medium-term period. We're going to deliver 35 – 33% to 35% operating margins. We're going to deliver low double-digit EPS growth. That's all going to then result from FY '24 to FY '28, in aggregate, about $15 billion to $17 billion worth of operating cash flow. And I already touched upon the big inflection point from a CapEx perspective. So that's going to result in much improved free cash flow generation.

So we took those metrics, and we looked at a host of companies that are really similar-facing, if you will. And across the universe of consumer-facing companies, if we – if you look for companies that have at least the growth rate in the top line growth rate that we have, the earnings growth rate that we have and the dividend payout that we have, there's like 7 companies that follow within our universe, 6 of which have a higher multiple than we do. So clearly, we believe we're undervalued. And we think with our track record of result delivery and the future growth that we have ahead of us, the outlook we have ahead of us, we certainly deserve a higher valuation than we have today.

Nadine Sarwat

Well, I think that's a great place to end. Bill, Garth, thank you for joining us. Thank you, everybody.

William Newlands

Thanks for having us.