Constellation Brands Inc, Q4 2022, Earnings Call 2022-04-07

Presentation

Operator

Hello, and welcome to the Constellation Brands Fiscal Year 2022 Q4 Full Year Earnings Call. — ***Operator Instructions*** — As a reminder, this conference is being recorded. It's now my pleasure to turn the call over to Patty Yahn-Urlaub, Senior Vice President, Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thanks, Kevin. Good morning, and welcome to Constellation's Year-end Fiscal '22 Conference Call. I'm here this morning with Bill Newlands, our CEO; and Garth Hankinson, our CFO. As a reminder, reconciliations between the most directly comparable GAAP measure and any non-GAAP financial measures discussed on this call are included in our news release or otherwise available on the company's website at cbrands.com. Please refer to the news release and Constellation's SEC filings for risk factors which may impact forward-looking statements we make on this call. Before turning the call over to Bill, similar to prior quarters, I would like to ask that we limit everyone to 1 question per person, which will help us to end our call on time. Thanks in advance, and now here's Bill.

Bill Newlands

Thank you, Patty. Good morning, and welcome to our fiscal '22 year-end call. Before I get started this morning, I'd like to comment on the announcement made earlier this week relating to the proposal from the Sands family to declassify Constellation's dual share class structure. According to the family's filing, the proposal brings significant benefits that will accrue to the company and its shareholders, including increasing market demand from investors who prefer single-class structures. The proposal is under consideration and will be negotiated explicitly by the Special Committee of our Board of Directors, and any agreement reached with the Sands family will require the approval of that Special Committee as well as our full Board of Directors. . In addition, pursuant to the terms of the proposal, it would require the approval of holders of a majority of our Class A common stock that do not also hold shares of our Class B common stock. I'd like to remind everyone that the Sands family proposal was not made in connection with a corporate transaction. Constellation does not intend to comment further on the proposal unless and until a definitive agreement is reached, the proposal is abandoned or otherwise deemed advisable in connection with any further public disclosure by the Sands family. With that, let's proceed with the discussion of our excellent results and our guidance for fiscal '23. As I reflect on our performance for fiscal '22, I'm extremely proud of how our team pulled together to deliver a year of double-digit organic net sales growth and strong cash flow generation. Our team accomplished this while battling through year 2 of the pandemic, including various supply chain challenges, adverse weather events, rising inflation, rapidly shifting consumer preferences and a host of other issues in the surrounding environment. Through it all, we stayed true to who we are and remain laser focused on our consumers and building brands that people love. We launched our consumer-led innovation while continuing to invest in future capabilities needed to win long term. We continued to deliver on our commitments to return value to shareholders and to serve the interest of all stakeholders by making a positive impact on our communities and the environment. In fact, earlier this morning as part of our ongoing commitment to environmental stewardship, we announced our new targets to reduce greenhouse gas emissions by 15% by fiscal '25 and to restore 1 billion gallons of water withdrawals from critical watersheds and improved water accessibility in disadvantaged communities where we operate in each case by fiscal '25. With that as a backdrop, I'd like to frame up what we believe are key takeaways from our performance in fiscal '22 as we head into our new fiscal year. First, our strong overall performance continues to be headlined by our Beer business, which delivered its 12th consecutive year of volume growth. Our beer portfolio led by our Modelo and Corona brand families posted net sales growth of 11% and added 30 million cases of high-end growth, extending its leadership position as the #1 high-end beer supplier and the #1 share gainer across the U.S. beer market. Second, our Wine & Spirits business delivered strong organic net sales growth of 9% and solid gross margin improvement for the fiscal year. Our enhanced focus on consumer-led premiumization in Wine & Spirits continue to yield benefits as our high-end brands outpaced the overall U.S. Wine & Spirits category primarily driven by Kim Crawford, Meiomi and the Prisoner. Third, we continue to execute against our stated capital allocation strategy, returning nearly $2 billion to shareholders in the form of share repurchases and dividends in fiscal '22. We continue to demonstrate this commitment with this morning's announcement of a $500 million accelerated share repurchase program, which, when completed, will bring us to about 75% of our $5 billion goal. Our continued strong performance in fiscal '22 and the investments we continue to make in our core business provide a nice springboard for another successful year ahead. Now let's dive a little deeper into our business performance in '22 and our outlook for the year ahead. One outlook of our success – one hallmark of our success has been our beer business over the years has been the strength and continuity of leadership. Earlier this year, we announced that Jim Sabia assumed the role of President of our beer business. As many of you know, Jim has played a key role in the success of our beer business for many years, and we look forward to further building on the momentum under his leadership. Jim succeeds Paul Hetterich, who will continue to work with our beer operations team in Mexico to support our ongoing brewery projects in Nava and Obregon as well as the construction of our new brewery in the state of Veracruz. Paul has been a driving force behind the success of our economy, including our beer business for more than 35 years. I look forward to continuing to work with Paul, Jim and the rest of our beer team to accelerate traction of our high-performing beer portfolio in fiscal '23. There are several industry trends that provide a solid platform for our portfolio growth in the year ahead.

Total beverage alcohol servings per capita are expected to remain stable with growth of about 1% to 2% annually based on population growth expectations. Premiumization in the beer category is projected to continue with the high-end segment taking share from the mainstream segment. Mexican imports, primarily driven by the Constellation portfolio, are expected to continue to drive traditional beer growth and will continue to be a key driver of gains in the overall beer segment. Significant growth is projected in the flavors category, including seltzers, flavored beer, RTD spirits, wavered malt beverages with all categories exhibiting strong future growth prospects. The on-premise segment has rebounded and is expected to continue to recover to drive incremental category growth. And finally, 3-tier e-commerce and digitally influenced sales have proven sticky for beer with revenue and share growing significantly. In fact, this channel is forecasted to deliver over-indexed growth relative to other channels. Each of these trends, combined with Hispanic demographic tailwinds that work in our favor, either aligns with the core strengths of our beer business, or our areas where we're investing to build capabilities needed to more fully compete and win. We have one of the most focused and highly efficient portfolios in the industry with a long runway for growth ahead. Our inventory position has been rebuilt, and we have plans to invest aggressively behind our brands in fiscal '23. We also got some exciting new consumer-led innovation on the way. Modelo Especial is the #2 beer brand in dollar sales in the country and has significant distribution runway over the medium term to facilitate mid- to high single-digit total annual volume growth in the off-premise. Modelo Especial currently under-indexes with non-Hispanic consumers, but have strong momentum in group household penetration, 7% to 20%. I wish it was 70, but it was 20 with these consumers in the past 2 years, yet there's still significant opportunity to close the awareness gap in order to drive further household penetration. For reference, Modelo Especial currently has only 80% of the household penetration of Corona Extra. We believe increasing total market penetration for Modelo Especial to Corona Extra levels will enable access to more than 2 million incremental consumers. Modelo Especial is the #5 draft brand in the entire category, yet it only has 11% national distribution. This distribution opportunity, along with the velocity the brand delivers, makes Modelo Especial draft our biggest on-premise priority. In the F&B space, our Modelo Chelada brand family has become an important growth contributor to our portfolio as the #1 Chelada in the U.S. beer market. For Modelo Chelada, we're forecasting double-digit CAGRs in the medium term driven by extended channel distribution with new pack sizes, formats and flavors. Current awareness levels from Modelo Chelada are low relative to other flavor categories and large competitors. We expect to improve awareness and accelerate growth of Modelo Chelada through maximizing social and digital media investments to broaden our demographic reach to general market consumers as well as Spanish language TV to stay connected to core Hispanic consumers. Within our Chelada lineup, we're aiming for additional growth for a product line that grew over 30% last year, has tripled in size over the past 5 years and where we own almost 50% of the market nationwide. In fiscal '23, we're introducing a 12-ounce, 12-pack of Limón y Sal and a new Chelada flavor, Naranja Picosa, an orange and chili flavor. We're also extending the Modelo brand into new spaces to bring authentic Mexican flavor to both lighter beer styles and favored cocktail-inspired beer. Modelo Oro is a premium, sessionable light Cerveza with low-calorie and carbs rolling out in 3 test markets, Charlotte, Fresno and Houston. This is a full-flavored beer that fits an active lifestyle. Another product aimed at the low-calorie crowd is Modelo Cantarito-Style Cerveza, a beer with fruit juice that mimics a popular Mexican beverage. It's rolling out in Atlanta, San Diego and Arizona and celebrates the strong Mexican culture and heritage we see throughout the U.S. Shifting gears. We're excited by the resurgence of Corona Extra, which continues to be one of the most loved brands in the U.S. beer market. While modest growth is projected for Corona Extra in fiscal '23, this brand has overindexed brand equity, indicating higher growth potential, both for the master brand and broader brand family, including younger and multicultural consumers, where we see significant opportunity to increase buy rates. Corona Extra also has a fairly high household penetration, yet it still lags behind some large competitors. Distribution opportunities also exist for Corona Premier as there are still significant effective distribution gaps versus Corona Extra. And while buy rates continue to grow for Corona Premier, it still trails behind competing brands, indicating a significant opportunity to increase velocity. Premier is currently underdeveloped in the can format relative to its competitors, as experience indicates that cans are the preferred format for light beer drinkers. And we see a significant unlock with the launch of new packages and format sizes. Finally, consumers have embraced Corona Premier in the on-premise, and our craft focus this year is designed to accelerate that trend. For the Pacifico brand, we're forecasting 10% to 15% total annual volume growth in the medium term from distribution alone. We're prioritizing growth in key DMAs for Pacifico to expand off-premise points of distribution in key cities, particularly in the West and Midwest regions of the country, which will be supported by digital media to reach target legal drinking age Gen Z consumers. We'll also activate consumer and customer-specific national accounts retail programs as well as steel marketing and sponsorship to support targeted investment markets. Pacifico had the hottest draft volume trend in the category during the last 52 weeks, followed closely by Modelo. That trend, along with planned unique activations, positions Pacifico to continue to gain awareness with consumers. We've been increasingly focused on upping our game in the spirits-based RTD space with unique and compelling new brands. Last quarter, we announced a new agreement with the Coca-Cola Company for the U.S. market to create a new to state-of-line of spirit-based ready-to-drink cocktails using the well-loved and fast-growing FRESCA brand. FRESCA mix will debut this fall in bottled strips and tequila Paloma labels. In support of our collective fiscal 3 portfolio initiatives, we will continue to leverage our efficient sponsorship of UFC, the college football playoffs as well as numerous NFL, NBA and MLB teams. You'll see a significant increase and media investments to drive sustained awareness and consumer demand. Overall, we plan to recruit new drinkers through advertising, investments in digital media and localized programming. In addition, our portfolio initiatives will be enabled by increasing adoption of our Shopper-First Shelf approach, which continues to drive results and gain traction. We completed 14,000 shopper-first shelf sets last year, our highest total to date. As you can see, our beer portfolio is well positioned to capitalize on compelling category and consumer trends by leveraging our core brands' competitive advantages for existing and new platforms to deliver our medium-term net sales growth target of 7% to 9%. Now let's move on to our Wine & Spirits business. Despite the confluence of factors impacting this business in fiscal '22, including a major distributor transition, migration to SAP, inflationary headwinds and COVID related to logistics and supply chain challenges, this business delivered strong organic net sales growth of 9% and solid gross margin improvement for the year. Marketplace performance for our higher-end brands continued to outpace the overall U.S. Wine & Spirits category primarily driven by Meiomi, Kim Crawford and the Prisoner Wine Company. And our increased focus on our higher-end price segments yielded benefits as our fine wine and craft spirit portfolio achieved double-digit net sales growth driven by the Prisoner Wine Company and High West. Our innovation efforts also produced excellent results with growth contributions coming from Meiomi Cabernet Sauvignon, Kim Crawford Illuminate Sauvignon Blanch which together both held the top 2 slots among new high-end products introduced over the last 2 years as well as the Prisoner — ***Indiscernible*** — extensions, High West ready-to-serve packed and Woodbridge's buttery chardonnay in 3-liter box. Heading into fiscal '23, our strategic focus includes commitment to continued premiumization, margin expansion, accelerated growth in DTC channels and continued growth in our international business. Our innovation strategy will be focused on prevailing consumer trends of premiumization, digital, betterment, convenience, sustainability and enhanced flavor profiles. We have a strong innovation pipeline planned for the coming year, which includes the launch of SVEDKA Gin, Meiomi Red Blend, Kim Crawford, [T-Wine Spritz], Unshackled Chardonnay and Pinot Noir and — ***Indiscernible*** — combo ready-to-serve cocktails. Today, we announced 2 small additions to our Wine & Spirits portfolio to complement our premiumization efforts in wine with Constellation's ambition to be the #1 player in fine wine and among the top 5 in ultra-luxury and icon wines. We have acquired the highly acclaimed Oregon wine brand, Lingua Franca. This demonstrates our commitment to building a strong omnichannel business that includes category leadership in DTC and 3-tier eCommerce while building our fine wine portfolio with a diverse collection of best wines from top wine regions around the world. We also acquired the remaining portion of Austin Cocktails, which began in 2018 as Constellation Ventures focus on female founders. Austin Cocktails is a leader in the fast-growing premium RTD segment of the U.S. beverage alcohol market. It currently is distributed in 28 states and posted depletion growth of 135% in calendar '21 as RTD trends continue to rise to popularity among consumers. Overall, we expect fiscal '23 to be a dynamic year in our Wine & Spirits business. A tighter focus on higher-end brand strengthens the business and strategically positions it for future success. Before I wrap, I'd like to provide a few thoughts on our investment in Canopy Growth. We continue to believe that the cannabis market represents a significant long-term growth opportunity. and we're encouraged by the work Canopy is doing to further sharpen its strategy, rightsize its operating expense structure and capital investments and achieve profitability in Canada while strengthening its competitive positioning in the U.S. In their most recent quarterly results, Canopy maintained the #1 share position in premium flower products in Canada and drove record performance for its BioSteel and Storz & Bickel product lines. We are encouraged by recent Canadian Government changes to beverage equivalency regulations, allowing consumers to purchase cannabis beverages in greater quantities. And in the U.S., Canopy's THC strategy is anchored by strategic relationships with 2 profitable MSOs, Acreage and TerrAscend, both of which are positioned in high-growth northeastern markets. Canopy continues to progress their U.S. THC strategy by establishing a scalable footprint, best-in-class products and national distribution networks required to unlock the U.S. market upon federal legalization. In closing, I once again want to thank our team as well as our valued distributors and retailers for your efforts in delivering another strong year of performance, and we're just as excited about our prospects for growth in the year ahead. Our Beer business, led by our core iconic brands and consumer-led innovation, is poised to continue extending its leadership position in the high end of the U.S. beer market. Our continued focus on premiumization in the Wine & Spirits business is producing results, and we have plans to further focus our Wine & Spirits portfolio towards the higher end in fiscal '23. We remain committed to our previously stated capital allocation strategy, and we remain on track to deliver our $5 billion commitment by the end of fiscal '23. And finally, I'd like to leave you with this. We operate in a very dynamic and seemingly ever changing environment. But over the years, one thing has remained constant. IRI recently came out with its annual rankings of CPG growth leaders, and Constellation was recognized for being one of the top performers yet again. In fact, Constellation has been recognized as an IRI growth leader more than any other CPG company in our peer set over the last 10 years. That's something we're extremely proud of, and we look forward to continuing to keep this momentum going into our new fiscal year. And with that thought, I would like to turn it over to Garth, who will review our financial results in '22 and our financial focus for '23. Garth?

Question and Answer

Garth Hankinson

Thank you, Bill, and good morning, everyone. Fiscal 2022 marked another year of solid financial performance and shareholder value creation despite a myriad of headwinds forming our fortitude and resiliency. Our strong operating results and powerful cash flow generation allowed us to return almost $2 billion in capital to shareholders for the year. Additionally, as Bill mentioned, this morning, we announced that we are entering into an accelerated share repurchase, or ASR agreement to repurchase $500 million of shares during Q1 of fiscal 2023. Please note that the ASR agreement constitutes the $500 million share repurchase referenced in this morning's earnings release. Once we complete the ASR in Q1, we will be approximately 75% of the way toward achieving our goal of returning $5 billion to shareholders by the end of fiscal 2023. More on fiscal 2023 in a minute, but first I want to review full year fiscal 2022 performance in more detail, where I'll generally focus on comparable basis financial results. Starting with beer. Net sales increased 11%, landing in the upper end of our previous guided range driven by shipment growth of approximately 9% and favorable price, which, as expected, landed slightly above our typical 1% to 2% range. These tailwinds were partially offset by unfavorable sales mix primarily driven by a shift in package types and the return of on-premise draft SKUs. Depletion growth for the year came in at nearly 9% driven by the continued strength of Modelo Especial and Corona Extra as well as the strong return to growth in the on-premise channel. On-premise volume accounted for approximately 11% of the total beer depletions during the fiscal year and grew strong double digits versus last year. As a reminder, the on-premise accounted for approximately 15% of our beer depletion volume pre COVID and was only 6% of our depletion volume in fiscal 2021 as a result of on-premise shutdowns and restrictions due to COVID-19. When adjusting for 2 extra selling days in the year, the beer business generated approximately 8% depletion growth. As previously guided, cases shift continue to exceed cases depleted during the fourth quarter, which resulted in distributor inventories returning to normal levels at fiscal year-end. Moving on to beer margins. As expected, beer operating margin decreased 110 basis points versus prior year to 40%. Benefits from favorable pricing, marketing as a percent of net sales and mix were more than offset by unfavorable costs. The increase in COGS was driven by several headwinds that included the following: first, the previously announced obsolescence charge of approximately $80 million due to excess inventory of our hard seltzer SKUs resulting from a slowdown in the overall category; second, increased brewery costs driven by incremental head count, labor inflation in Mexico and increased spend related to capacity expansion; third, increased material costs due to rising commodity prices and inflationary headwinds that, on average, landed in the mid- to high single-digit increase range, predominantly driven by wood pallets, cartons, steel, corn and aluminum. Please note that this range includes the impact of hedging where possible. And lastly, step-up in depreciation expense, largely due to the incremental 5 main hectoliters at Obregon completed in early fiscal 2022. These comp headwinds were partially offset by favorable fixed cost absorption driven by increased production levels in fiscal 2022 versus last year. On an absolute dollar basis, marketing investments increased versus prior year. However, due to favorable top line leverage, marketing as a percent of net sales decreased 40 basis points to 9.2% versus prior year. Moving to Wine & Spirits. Net sales declined 19% as shipments declined approximately 34%. Excluding the impact of the Wine & Spirits divestitures, organic net sales increased 9% mainly driven by shipment growth of nearly 3%, favorable mix, increased pricing and small tainted bulk wine sales related to the 2020 wildfires. Organic shipment growth was largely driven by Meiomi, Kim Crawford and the Prisoner partially offset by a decline for some of our key mainstream brands. Depletions declined approximately 6%, mainly driven by SVEDKA, Robert Mondavi Private Selection and Woodbridge. These declines were partially offset by the robust growth of our higher-end brands, led by the Prisoner Wine Company of 16%; Meiomi and High West, up 13%; and Kim Crawford, up 9%. Shipment growth was ahead of depletion growth for the year, mostly reflecting impacts from our distributor transition. During the coming year, we expect to rightsize inventory levels in the business. Operating margin decreased 180 basis points to 22.7% as mix benefited from the divestiture and favorable price were more than offset by increased marketing and SG&A spend as a percent of net sales and increased costs. Higher costs were driven by increased freight and warehousing costs partially offset by net favorable fixed cost absorption, lower break raw materials and cost savings initiatives. Marketing and SG&A as a percent of net sales increased versus the prior year largely due to a loss of top line leverage resulting from the divestitures. Now let's proceed with the rest of the P&L. Fiscal 2022 corporate expense came in slightly higher than our previous guidance, finishing at approximately $238 million, up 4% versus last fiscal year. This increase was primarily driven by higher consulting, T&E spend and increased depreciation. These headwinds were partially offset by a decrease in compensation and benefits and a favorable foreign currency impact. Interest expense for the year decreased 8% to approximately $356 million primarily due to lower average borrowings partially offset by higher weighted average interest rates. Our full year comparable basis effective tax rate, excluding Canopy equity and earnings came in at 17.5% versus 18.2% last year primarily driven by a higher level of stock-based compensation benefits. Effective tax rates on our 4 businesses came in lower than expected during Q4, driving tax rate favorability versus our previous guidance. Moving to fiscal 2022 free cash flow, which we define as net cash provided by operating activities less CapEx. We generated $1.7 billion of free cash flow, which reflects strong operating cash. CapEx totaled approximately $1 billion and was in line with our most recent guidance. This included approximately $850 million of CapEx for our Mexico beer operations expansion. Pivoting to our full year fiscal 2023 P&L and cash flow targets. For fiscal 2023, we expect comparable basis diluted EPS to be in the range of $11.20 to $11.50, which excludes Canopy equity and earnings. For fiscal 2023, the beer business is targeting net sales growth of 7% to 9%, reflecting 1 to 2 points of pricing benefit within our Mexican product portfolio, which is in line with our typical pricing strategy and operating income growth of 2% to 4%. This implies operating margin to approximately 38%. As previously discussed, the implied decline in operating margin is predominantly driven by gross margin compression as benefits from price and our cost savings agenda are expected to be more than offset by the following COGS headwinds. First, we are expecting elevated inflationary pressures to continue throughout fiscal 2023 and estimating inflation on the commodity spend component of raw and packaging materials to land, on average, in the high single-digit to low double-digit range, including the impact of hedging where allowed. These significant inflationary pressures are expected across numerous cost components but largely driven by aluminum, cartons, wood pallets and steel. Second, similar to fiscal 2022, we are expecting incremental brewery costs driven by labor inflation in Mexico is estimated to range between 5% and 6% as well as incremental head count and training expenses to support our continued capacity expansion initiatives. Third, as a result of these brewery expansion plans, we are estimating a step-up in depreciation expense as additional capacity is planned to come online throughout the fiscal year. For fiscal 2023, we are targeting total beer segment depreciation expense to approximate $295 million or an increase of approximately $45 million. And finally, we expect margin headwinds related to incremental logistics costs in fuel and freight rates for both rail and truck, which is expected to drive an increase in the low to high single-digit range. As previously stated, we expect to execute against our aggressive cost savings agenda to help partially offset these headwinds, along with expected favorable fixed cost absorption driven by increased production models. As it relates to beer marketing spend for fiscal 2023, we expect marketing as a percent of net sales to land in the 9% to 10% range. Shifting to Wine & Spirits. For fiscal 2023, the Wine & Spirits business is targeting net sales to decline 1% to 3%. While this range is outside our medium-term growth goal for the business, it is an anomaly driven by the significant overlap we have from our distributor transition as well as revenues associated with sales of smoke-tainted bulk wine. Both are anticipated to be onetime in nature, and thus, we do not expect them to be repeated in fiscal year 2023. Excluding these impacts, we expect an underlying Wine & Spirits business to return to its targeted goal of 2% to 4% net sales growth next fiscal year. On the bottom line, we expect operating income to increase in the 4% to 6% range. This implies operating margin to approximate 24.5%, which represents almost 200 basis points of margin expansion. This margin expansion reflects benefits from price, mix and cost saving initiatives to help more than offset significant COGS inflation headwinds mostly related to freight and packaging. Cost saving initiatives include optimizing the Appalachian mix across our portfolio and decreasing the weight of our glass bottles, which also has positive environmental impacts. This is a good spot to update everyone on our Wine & Spirits operating margin expectations in the medium term. Since we provided original targets back in 2019, the operational environment has changed considerably. Inflationary pressures have got significantly worse, driving increased freight and warehousing costs in fiscal 2022 and are expected to continue well into fiscal 2023. Additionally, while we continue to remove stranded costs from the business, we strategically decided to reinvest more of these savings back into the areas of businesses that are driving growth. Specifically, in DTC, e-commerce, our fine wine and craft spirits portfolio and consumer-led products that are fueled by category tailwinds. As such, we've updated our operating margin goal to reflect these impacts and now expect medium-term operating margins to migrate to a range of 28% to 29% and EBIT margins at approximately 30%, reflecting a leading margin structure for our industry. Before we move on to guidance for the rest of the P&L, I'd like to highlight the new additions to our wine spirit portfolio that Bill mentioned earlier. As part of the evolution to the high end, we acquired Lingua Franca as well as the remaining interest in Austin Cocktails from our ventures portfolio, 2 businesses positioning categories with significant growth tailwinds behind it. From a finance perspective, these transactions collectively, along with My Favorite Neighbor, which was fully acquired in fiscal 2022, were almost entirely self-funded through the sale of one of our successful venture investments, which generated a significant return on investment. Other fiscal 2023 guidance assumptions include the following: corporate expenses to approximate $230 million, interest expense to be in the range of $350 million to $360 million and a comparable tax rate, excluding Canopy equity earnings of approximately 20%. The increase in our tax rate is mainly driven by a lower level of anticipated stock-based compensation benefits versus fiscal 2022. Rounding up the P&L, noncontrolling interest is expected to approximate $40 million and weighted average diluted shares outstanding are targeted at approximately $198 million. This share count assumes we execute a $500 million of share repurchases in Q1. We plan to repurchase additional shares throughout the remainder of the fiscal year. However, we do not know the timing of cadence, and as such, these expected share repurchases have been excluded from our guidance assumptions. We will continue to update our outstanding shares accordingly when we report quarterly earnings throughout the fiscal year. Additionally, this EPS guidance range does not reflect a prolonged impact from the volatility associated with the ongoing headwinds we've been experiencing on fuel prices and other commodities as the sustained impact of the recent geopolitical events remains unclear. Thankfully, we have no employees who live or work in Russia or Ukraine, and we have minimal commercial disclosure to this part of the world. That said, our thoughts and prayers are with those being impacted by this growing humanitarian crisis, and we wish for a quick resolution to this conflict and return to peace in the region. Turning to cash flow. We expect fiscal 2023 free cash flow to be in the range of $1.3 billion to $1.4 billion, which reflects operating cash flow in the range of $2.6 billion to $2.8 billion and CapEx of $1.3 billion to $1.4 billion, including approximately $1.2 billion targeted for Mexico beer operations expansion. To wrap up, I'd like to reiterate that our capital allocation strategy remains unchanged. In fiscal 2022 alone, our strong operating results and powerful cash flow generation capabilities enabled us to return almost $2 billion in capital to shareholders as part of our overall goal of returning $5 billion by the end of our fiscal 2023. Our capital allocation priorities augment our organic growth strategy to enable strategic reinvestment where we see category tailwinds. We believe this strategy, combined with excellent execution and returns to shareholders, positions us to be a top-tier shareholder return generator for many years to come. With that, Bill and I are happy to take your questions.

Operator

— ***Operator Instructions*** — Our first question today is coming from Lauren Lieberman from Barclays.

Lauren Lieberman

Great. I wanted to talk just a little bit about Corona. I was actually surprised that in your prepared remarks, you talked about expecting more modest growth in Corona Extra in ’23. But the momentum on that brand has been strong this year, my understanding of anecdotes around performance during the Super Bowl period has been tremendous. So just curious why expecting things to slow down a bit in ’23.

Bill Newlands

Well, Lauren, we’re actually very optimistic that we’ll continue to see strong Corona Extra performance. Obviously, as you point out, it was a very pleasant situation for us this past fiscal year, and it significantly outperformed than we expected. But we also have a lot of other priorities in the Corona brand family, as you know. As I stated in my remarks, we expect Premier to be a heavy focus both in the on-premise as well as building out our distribution capabilities in the off-premise. So we’re just trying to be sort of aware that we’re going to have a lot of overall work across the family, but we expect to continue to see Corona Extra be a continuing growth driver in our overall business.

Operator

Our next question is coming from Dan Mohsenian from Morgan Stanley.

Dara Mohsenian

So I wanted to focus on beer margins First, just how much visibility do you think you have on the fiscal 2023 beer margin guidance given there’s a number of moving pieces? There’s also tremendous external volatility including how hedged or locked in on contracts you are on some of your key commodities and might. And what might be some of the bigger risk points in terms of margins? And then second, just on the pricing front, playing devil’s advocate, why not be more aggressive than the long-term 1% to 2% algorithm? I’m just having a hard time believing that $1 incremental per case cost on beer is going to be that much of a factor in a trade down decision relative to consumers seeing much, much higher dollar pressure from other areas, whether it’s grocery, gas or electricity costs. So just your thoughts around why not being more aggressive on pricing, particularly given the market share volatility and if you're seeing any signs of trade down so far?

Garth Hankinson

Thanks, Dara. I'll take the first part of that question on margin and then Bill will comment on pricing. So as we started selling in the second half of last year. The inflationary environment, obviously, have gotten a little bit deeper and more protracted than anyone expected. And so that's why we were focused in January as to the facts we're going to be facing some additional headwinds this coming year. . Typically, we're seeing inflationary increases on a year-over-year basis in that kind of low to mid-single-digit range. And this year, we're expecting them in the high single digit to low to mid-double-digit range. You're seeing that across things like glass, which is our biggest component in beer, which is up 6%. Cartons are up 17%. Crowns were up 26%. Wood pallets are up 35%. So costs are definitely under pressure for sure. That being said, we think that we're fairly well positioned as we enter into the year. To be very proactive around this, we've gotten more aggressive with our hedging policy or our hedging practices, I should say. We typically enter a year somewhere hedged in the neighborhood of sort of 50% to 60% on any given line. But this year, we've taken a more defensive posture to make sure that we're really protecting the P&L. As we enter the year this year, we're hedged at about 75% on aluminum, 70% on natural gas, 6% on the core and 90% of diesel. So we're in a pretty good spot. That being said, as you articulated, there's a lot of volatility around commodities, and that's where we're watching as we go through the year, and we're being opportunistic to layer and even been further hedges as we see weaknesses on a day-to-day basis. So we think we're in pretty good shape. But certainly, there's still some exposure just given the depth and the duration of the inflationary environment we're currently in.

Bill Newlands

So relative to your question on price, we certainly understand the question, a lot behind it. So let me remind you how we price. We price on a SKU-by-SKU basis, market-by-market basis, and we're going to continue to do it that way. We also are probably a bit more judicious on price, and perhaps we could be. The reality is we need to be sensitive to our consumers. It's a challenging time for consumers across many, many industries. And it's our view that this is not the time to try to put extra burden out on one of the critical things that many people have in their basket, which happens to be our beers. So we're a bit probably more judicious than we might be able to be, but we think this is in the long-term interest. We always say it's a whole lot easier to keep your consumer than to lose them and have to reacquire them. And that's part of what drives our thinking.

Operator

Your next question is coming from Bonnie Herzog from Goldman Sachs.

Bonnie Herzog

Maybe just a little bit of a follow-on question to Bill, what you were just mentioning. I was just hoping to get some color from you on the consumer and sort of the spending behavior so far this year. I certainly know your products are premium, but curious, are you seeing any signs of down-trading pressure? And then could you talk about how well you think your portfolio will hold up if or when we enter a recession? I know Bill, in the past, you kind of mentioned your portfolio is pretty defensive. So I'd just be curious to kind of hear you revisit that for us.

Bill Newlands

You bet, Bonnie. Fortunately, so far, things are holding up very well. One of the things that I've seen over the course of my career in the alcoholic beverage business, is many, many times, when there is recessionary environments, consumers are still interested in our category and almost view it as a small luxury that they can still experience where they might pass on buying a new refrigerator or something that's a bigger purchase. If they're having personal challenges, they still want to engage in some things that they enjoy in their life. And fortunately, our category is one of those. So so far, this continues to hold. And I think it speaks directly to my answer to Dara a minute ago, which is trying to be sensitive to our consumer and to make sure that that we continue to provide our great products to them at pricing that's reasonable given a tough environment.

Operator

Our next question is coming from Chris Carey from Wells Fargo.

ChrisCarey

Just one follow-up on the pricing and then related question. Are you planning on pricing on Corona? Or is that all going in Modelo and the other SKUs? Can you just maybe comment on where the pricing is going to be going in? And then just specifically on Modelo, I think you said mid-single digit to high single digit in the off-premise. Can you maybe review expectations for on-premise penetration for this fiscal year? And just in general, where you see that as far as kind of innings of developing the on-premise for that specific offering?

Bill Newlands

Yes, you bet. So I'll just remind you what I said earlier, which is we look at pricing on a SKU-by-SKU basis and a market-by-market basis. So it's not any individual brand, let's say, where we focus on pricing. It's really on a SKU by SKU, brand by brand. And so there's not in generality, as to your question, on a particular brand. Relative to Modelo, as I also stated earlier, one of our biggest arteritis is really on-premise draft. We're the #5 player in on-premise draft. We're only 11% penetration nationally in that particular format. That's a great opportunity for us to expand our reach, particularly on Modelo Especial. And interestingly enough, it was only beaten out of its growth last year by Pacifico, which I guess is not the worst thing. But certainly, Modelo, we think, has a great opportunity to continue to expand its reach, particularly as we continue to see much greater penetration in non-Hispanic households that's going to be both the on-premise and the off-premise numbers that both you and I quoted earlier.

Operator

Thank your next question today is coming from Kaumil Gajrawala from Credit Suisse.

Kaumil Gajrawala

Garth, can you maybe talk about the logic behind doing an ASR versus just buying in the open market over the course of the first quarter?

Garth Hankinson

Sure. Thanks, Kaumil. Look, we're going to use the same approach this year that we used last year, which is we're going to use all sort of the tools that are available to us to buy back the shares that we need to buy back in order to meet our obligations. So last year, we used an ASR in the second quarter. We also took advantage of a 10b5 and 10b18 program. So we're going to do that for the – we can optimize the timing of the – of our repurchases as well as appropriately dollar cost averaging, dollar cost average out here to make sure we get the best value for this. And we opted to use the ASR in the first quarter because we're going to get the benefits earlier in the year. And also, I think that it's a good time for us to buy it.

Operator

Thank your next question today is coming from Vivien Azer from Cowen and Company.

Vivien Azer

I just wanted to offer, I think it's really reassuring to investors how consistent you guys have been in terms of the commentary on capital allocation today. So thank you for that. In terms of my question, I also wanted to focus on pricing in the health of the consumer but perhaps pivoting to the Wine & Spirits business. Clearly, you guys have done a ton of work to premiumize your portfolio. So given the portfolio evolution in Wine & Spirits, how does that change your thinking around your ability to take price there?

Bill Newlands

I think it largely depends on the sector of the wine business in which we're discussing. As you know, mainstream is actually down, although we're gaining share in a down market. And that's the way we think about it. Let's gain share in the mainstream of the business. On the other hand, as you move up the price ladder, you're seeing significant acceleration, and many of our brands are performing extremely well, and it does give us some opportunity to increase our pricing and doing probably even a better job of covering some of the inflationary increases that we see in the beer business. So I think you should expect them to see a bifurcated answer where we need to be sensitive to what the marketplace is giving us in the mainstream but there's probably some opportunity as you look at the premium and up sections to be a little bit more aggressive in the pricing arena.

Operator

Our next question today is coming from Nik Modi from RBC Capital Markets.

Nik Modi

So just a quick housekeeping item, and then I have just a real question. Just, Bill, if you can just comment, given the rules around ASRs and material nonpublic information, can I presume that Constellation is not sitting on some news regarding a large M&A transaction? So that was just a clarification. And the real question is any update on how March depletions look. Some of the channel work that we did suggested some very strong results that look to be an acceleration sequentially from what you guys showed this February quarter. So any thoughts on that would be helpful.

Garth Hankinson

Nik, this is Garth. I'll take the first part, and then I'll turn it over to Bill. I think it speaks for itself that Constellation is fully aware of and comprise all of our obligations under state and federal securities laws. And relative to your question of how March was, Nik, we're pleased that it's at least consistent with our annual algorithm despite huge comps that we faced in March of last year. So we're pretty pleased that we got off to a good start.

Operator

Your next question is coming from Bryan Spillane from Bank of America.

Bryan Spillane

So Garth, I had a question about just the Wine & Spirits margin outlook medium term. And one thing just in terms of, I think you gave kind of 2 sets of numbers. One was 28% to 29% operating margin and then the other was approximating a 30% EBIT margin over time. And just are those different? Or are we just saying that we still think we can get back to the 30% margin? I was a little just confused about the language there.

Garth Hankinson

Yes, sure. So on the operating profit margin question, yes, so we are coming in at 28% to 29%. The difference between operating margin and EBIT is the addition of our – what we take in from equity earnings and Opus One.

Operator

Your next question is coming from Nadine Sarwat from Bernstein.

Nadine Sarwat

I want to touch on Corona Hard Seltzer for a little bit. So that brand continues to underperform the broader seltzer market. So what's your strategy going forward with the brand? And then maybe taking a step back, a broader question related to this. What lessons have you learned from launching Corona Hard Seltzer? And how is this going to influence your approach to rolling out innovation in the future? I think you called out a number of those in your prepared remarks.

Bill Newlands

Obviously, the seltzer market has developed very differently than what we had anticipated. And frankly, it's been more of a challenge than what we had anticipated as well. As you know, this year, we're doing a number of things. We're repackaging, as we said, in prior quarters. We are getting much more focused on where we bring differentiated products rather than me-too products into that particular sector. But we still feel that, that's going to be a growth segment of the overall beer business, and we're going to participate in it. So relative to lessons learned, I think a couple of things are always important. It's important to test. We're obviously doing tests as it relates to our Modelo franchises to make sure that we have consumer propositions that are best of class and that are going to win with consumers. And we're going to continue to operate under that approach going forward.

Operator

Our next question is coming from Rob Ottenstein from Evercore.

RobOttenstein

Terrific. Just kind of swinging back to the question on seltzers and taking it a little bit broader. Clearly, a lot of the excitement on that segment is gone. From your perspective, is there actually a silver lining in that such that retailers and distributors will spend more time, energy on your brands, and that should be something that you should benefit from going forward? And then connected to that, are you starting to get a little bit more of the shelf space that you guys have earned given the tremendous brands and velocity that you've had and the fact that you've been undershelved in the past?

Bill Newlands

Robert, you definitely put your finger on a benefit of the scenario that the seltzer business has not been quite what we expected, which is – it's very mix-accretive. So the more beer we sell, the better the mix. So that's the flip side of the seltzer business for us is not developed quite the way we had anticipated, as you point out. I think you make a very good point relative to shelf space. One of the things that occurred during the pandemic is many retailers just didn't redo their shelves to the degree that we would have expected or that you would see on a typical annual basis. And there's no question that the growth profile of our overall portfolio not only demands but really should have more shelf space. So this is going to be a critical part of what our sales organization is driving for this year, is to broaden our reach and package sizes and depth within stores. I mentioned the Shopper-First Shelf initiative, which we actually had a pretty good year on last year. We expect to extend that this year. It's good for the category, it's good for us. So a lot of work will be done on that very topic this year, as you point out. And we think it will be in everyone's interest, ours plus the retailer, to give our brands more shelf space. They've earned it.

Operator

Our next question is coming from Kevin Grundy from Jefferies.

Kevin Grundy

Great. First, a housekeeping question on the Sands proposal, which Bill, I think you can't comment on, when do you expect the Board to vote on that proposal before potentially putting it out to the Class A shareholders? And then the broader question, Bill, just your perspective on the slow start to the year for the U.S. beer industry. So your data looks good. The results were obviously very good today. The Nielsen data continues to look good in the month of March for Constellation and probably even is a bit better, given some of the noise we understand in the Nielsen data in the last week of March. But I just wanted to get your perspective, more broadly, on what you think is driving that. I think there's some year-over-year comps at play, the seltzer slowdown, as you commented. But anything you're seeing that's potentially sort of concerning that you're watchful of, particularly around the consumer that may sort of play out here as it pertains to your portfolio? So your thoughts there would be helpful.

Bill Newlands

You bet. So just relative to your question about the Sands proposal, we've been advised that transactions of this nature typically takes 60 to 90 days. Beyond that, it's really out of our hands. The management is not involved in the discussion, the discussions between the Sands family and the special committee of the independent directors of the Board. So I don't have the exact answer to that question, believe that by 60 to 90 days is very typical. So we shall see. Relative to the start of the year, I think everybody recognized January was a bit of a tough month. It was for every – I think everybody in the industry. A little bit of that was where New Year's fell, there were weather events, Super Bowl got pushed out an extra week versus what it was the year before. But I think the exciting part for us is it was a very, very strong February, and as I responded to Nik 2 questions ago, March has been very strong as well in the start of our fiscal year. So I don't think there's anything that's overarching as an issue within the category but certainly not as it relates to our business. We continue to be very pleased with how our brands are performing. And as Garth pointed out in his prepared remarks, we've gotten our inventories back in the right position. So brands like Pacifico, which we were a little challenged for a while on brown glass, we have gotten through that. Some of those kinds of things, which were sort of detrimental to an otherwise very strong performance here, we've now fixed. So we're in a much better position heading into this fiscal year than we were last year where there were just a lot of extraneous things that were not helpful to us.

Operator

Our next question today is coming from Andrea Texeira from JPMorgan.

Andrea Teixeira

I just wanted to double-click on the opportunity to improve mix with the shift to on-premise. You had, I think, 3.8% price/mix expansion in the quarter. Can you still have around – my calculation's around the 100 basis points tailwind? And do you expect this to be – price/mix to be embedded in your guide around 400 basis points? I just want to double check that. And on Wine & Spirits, I think Bryan, Vivien asked good questions regarding the outlook. Is there any reason why it was a bit disappointing? I know you're making a lot of investments to premiumize the portfolio. But anything to kind of give us more comfort that besides the Opus One impact, what is impacting there and if there is a better outlook towards the long term?

Bill Newlands

Sure. Let me touch on the second piece first. We're still very pleased with the development, particularly at the higher end of our Wine business. As Garth pointed out, we had 2 or 3 one-off items that were a bit challenging based around the distributor transition that occurred last year and some sale of smoke tainted wine from prior years. If you would exclude those things, we're in a growth profile for our wine business, and that's being driven by the higher end. The work that Robert Hanson and the rest of the team have done to refocus our attention towards the high end in the growth sector of the wine business I think is exactly what we expected to do. It's the strategy we began and undertook a couple of years ago, and we're continuing to execute against it. So despite the significant headwinds, as I said earlier, in the mainstream sector of the business, we're very pleased with how things are developing at the higher end. And we're comfortable that our longer-term algorithm of 2% to 4% in the wine business will be achieved sooner rather than later.

Garth Hankinson

And relative to your first – the first part of your question, if I understood it correctly, you're pointing out that, in Q4, we had sort of a 4% points of pricing and whether or not that's going to continue. Our outlook for next year assumes that we're going to get our – more in line with our typical 1% to 2% pricing. So that's sticking in line with our normal outlook.

Operator

Our next question is coming from Steve Powers from Deutsche Bank.

Steve Powers

Great. I actually wanted to follow up on both those those 2 questions and your answers there. So on the beer side of things, the 1% to 2% pricing outlook, you're saying that that's inclusive of any mix impacts. I want to clarify that. And then on the wine, Bill, given the decision to reinvest stranded overheads towards additional growth, as you think about that 2% to 4% objective, are you biased, over time, higher within that range because of accelerated reinvestments? Or is the takeaway that the – just sort of the cost of achieving that top line has just gone up a tick because of – probably because of mainstream dynamics, but just your perspective there.

Bill Newlands

I think relative to the second piece of that, there's no question that there's obviously been an inflation, which is making a bit of that more challenging than what it had been prior. But I would like to point out something related to what Garth said in his prepared remarks, which is we've been very judicious, and thank you, Vivien, for your comment about our careful capital allocation. But I think this is a great example of it, we made 3 small purchases in the Wine & Spirits business almost entirely funded by the sale of one of our venture businesses, which was sold at a significant increase versus what we paid. So again, I think this begins to reflect a very judicious view of how we think about capital allocation and it's very consistent with what we've promised externally. We do believe that we are going to see significant success going forward, particularly at the higher end of the business. I think the only thing that's going to potentially challenge that or be a challenge to it is where the mainstream business goes. As I said earlier, that's in the category that's been declining, and we're gaining share. So we're still winning in that category, but it's a tougher segment of the category. Certainly, we expect high single digits growth profile or even better at the higher end portion of our business. And you're seeing that in brands like Kim Crawford, Meiomi and the Prisoner and High West. So I think, over time, you're going to be pleased with what you see in the profile of our wine business. And this year will be a continued step in that direction.

Operator

We've reached the end of our question-and-answer session. I'd like to turn the floor back over to Mr. Newlands for any further or closing comments. .

Bill Newlands

Well, thank you, everyone, for joining our call today. In closing, I want to reiterate that I'm extremely proud of what our team accomplished in fiscal '22. We delivered strong financial results, continued to launch consumer-led innovation and reinforced our efforts to making a positive impact on our communities and the environment. Our beer business extended its leadership position with its 12th consecutive year of volume growth, and we are confident in our ability to maintain this momentum in fiscal '23. Over the medium term, we continue to see a strong runway for growth, supported by favorable industry trends for our portfolio and our ongoing investments in brewery capacity expansions. Our Wine & Spirits business also delivered solid performance in fiscal '22 with organic net sales growth and gross margin improvement. We are enhanced – focused on consumer-led premiumization continued to yield benefits as our high-end brands outpaced the overall U.S. Wine & Spirits category. Overall, we remain bullish on the future performance of our business, in our ability to deliver value for our shareholders, as reflected in our announcement of a $500 million accelerated share repurchase program.

Again, I thank you all for joining today. We look forward to speaking with you in late June during our next quarterly call. And before then, we hope you will certainly choose some of our fine products for your Cinco de Mayo and Memorial Day celebrations. Thank you very much again. Have a great day, everybody.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.

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