Constellation Brands (STZ)

Updated April 12th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$192	**5 Year CAGR Estimate:**	5.5%	**Volatility Percentile:**	26.6%
Fair Value Price:	$156	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	15.0%
% Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.1%	**Growth Percentile:**	76.0%
Dividend Yield:	1.6%	**5 Year Price Target**	$229	**Valuation Percentile:**	23.8%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	28.3%

Overview & Current Events

Constellation Brands was founded in 1945. The $38 billion market cap company produces and distributes alcoholic beverages including beer, wine, and spirits. With over 100 brands in its portfolio, it is the No. 3 beer company in the U.S. as it imports and sells beer brands such as Corona, Modelo Especial, Modelo Negra, and Pacifico. It also has craft beer brands including Ballast Point and Funky Buddha Brewery. In addition, Constellation has many wine brands including Robert Mondavi, Clos du Bois, Kim Crawford, Mark West, and Black Box, as well as spirits brands including SVEDKA Vodka, Casa Noble Tequila and High West Whiskey. The company also has a stake in cannabis company Canopy Growth.

On April 4th, 2019 Constellation Brands reported Q4 and fiscal year 2019 results for the period ending February 28th, 2019. For the quarter Constellation Brands recorded $1.80 billion in sales, representing a 2% increase compared to Q4 of last year. Comparable earnings-per-share totaled $1.84, which was a 3% decline. For the year Constellation Brands generated $8.11 billion in sales, a 7% year-over-year increase, led by an 11.6% increase in beer. Reported earnings per share equaled $17.57, however, this included a $1.97 billion unrealized gain in fair value of the company's Canopy assets. Comparable earnings-per-share equaled $9.28, which was a 7% year-over-year improvement.

Constellation Brands also provided guidance for fiscal year 2020 (ending February, 28th, 2020). For this year the company anticipates comparable earnings-per-share to come in between $8.50 and $8.80, which assumes solid growth in beer, that is offset by a significant decline in the Wine & Spirits divisions, as Constellation is selling a portion of this business. In addition, the assumptions exclude any equity changes in the company's Canopy investment.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.69	$1.91	$2.35	$2.19	$3.25	$4.44	$5.43	$6.76	$8.72	$9.28	***$8.65***	***$12.71***
DPS	---	---	---	---	---	---	$1.24	$1.60	$2.08	$2.96	***$3.00***	***$4.00***
Shares	222	210	194	190	196	200	199	195	191	196	***196***	***196***

Note: while the company is now in fiscal year 2020, we are displaying earnings closer to the actual calendar year.

Constellation Brands has put together a terrific record in the last decade, growing earnings-per-share by over 19% per year. However, it's important to underscore that this was during a time when the company's revenue more than doubled and its net profit margin went from 9.5% to over 23%. Both of these aspects get more difficult to improve on.

In a highly competitive U.S. beer, wine, and sprits market, Constellation Brands has differentiated itself with a focus on what the company describes as premiumization trends. This means the company is pursuing growth in the high-end of the beer, wine and spirits categories. It is also expanding into new product categories to appeal to changing consumer preferences. An example of this is the August 2017 acquisition of Funky Buddha, which included a portfolio of craft beers to add exposure to the high-growth craft beer segment of the U.S. beer market. In 2018, Constellation Brands acquired Four Corners Brewing, and recently Constellation Brands invested $4 billion in cannabis producer Canopy Growth, giving it a 38% ownership stake. Taking into consideration the strong history and growth avenues available with management's recent guidance, we expect 8% annual earnings growth over the next five years.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	8.5	9.5	8.7	13.6	18.4	20.3	23.6	23.3	22.7	20.7	***22.2***	***18.0***
Avg. Yld.	---	---	---	---	---	---	1.0%	1.0%	1.1%	1.5%	***1.6%***	***1.7%***

Constellation Brands has enjoyed rapid earnings growth in recent years, and shareholders have been rewarded with a rising valuation. The downside of this is that the stock now trades at a significant premium to its historical valuation, with a current price-to-earnings ratio of 22.2 compared to an average closer to 17 times earnings. The 10-year average valuation may be slightly lower than where the stock deserves to trade, given its strong brands and high rate of earnings growth, coupled with the idea that the valuation was severely depressed during the Great Recession. Still, shares trade above our fair value estimation of 18 times earnings, indicating the potential for a valuation headwind in the coming years. However, earnings growth and dividends could offset a declining valuation multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	23%	24%	24%	32%	***35%***	***31%***

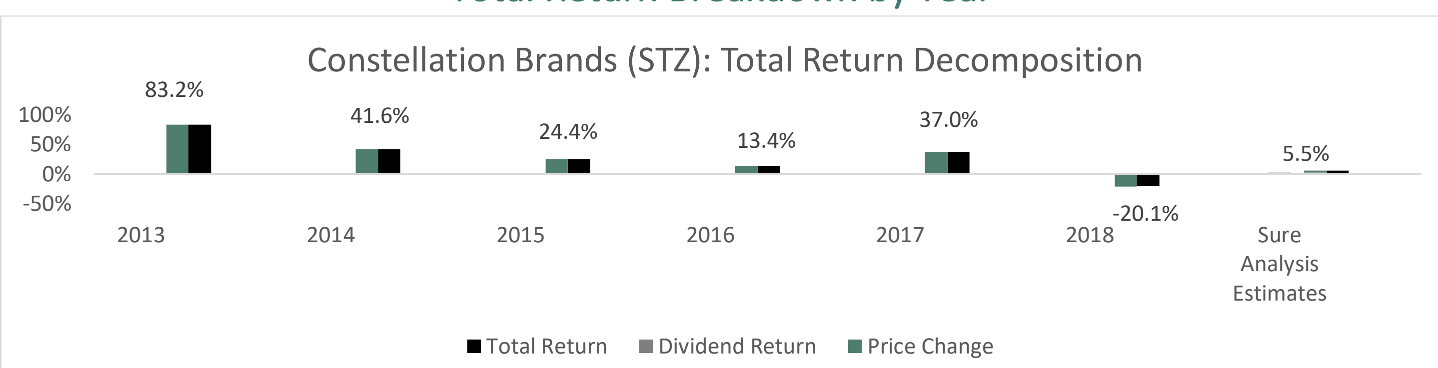
Constellation Brands also has a number of competitive advantages. Its long list of strong brands gives the company pricing power. It has six of the top 15 imported U.S. beer brands, and 19 of the 100 top-selling wine brands. Its strong distributor network provides an effective route-to-market for the company's strategy in premium categories. Another benefit of Constellation Brands' business is that it can withstand downturns very well. Alcoholic beverages are generally resistant to recessions. During the last recession, Constellation Brands reported earnings-per-share of $1.68, $1.44, $1.60 and $1.91 during the 2006 through 2009 stretch.

As of the most recent report, Constellation Brands held $94 million in cash, $3.68 billion in current assets (58% of which was inventory) and $29.23 billion in total assets (39% of which was goodwill and intangible assets) against $3.16 billion in current liabilities and $16.39 billion in total liabilities. Long-term debt stood at $11.76 billion, requiring $367 billion in interest expense last year, against underlying annual earnings power of roughly $1.7 billion.

Final Thoughts & Recommendation

Shares are down about 12% since our last report, but so too are earnings expectations for this year. Constellation Brands has generated incredible returns for shareholders since 2011. Much of the returns were fueled by an expanding valuation and earnings growth. While we expect the company will continue growing earnings at a high rate going forward, the valuation has become elevated and the dividend yield is unimpressive. We rate shares as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	3365	3332	2654	2796	4868	6028	6548	7332	7585	8116
Gross Profit	1145	1190	1062	1108	1992	2579	2942	3529	3817	4080
Gross Margin	34.0%	35.7%	40.0%	39.6%	40.9%	42.8%	44.9%	48.1%	50.3%	50.3%
SG&A Exp.	683	641	538	585	895	1078	1177	1392	1533	1668
D&A Exp.	156	125	104	115	155	162	180	238	294	333
Operating Profit	462	549	525	523	1097	1500	1765	2137	2285	2412
Operating Margin	13.7%	16.5%	19.8%	18.7%	22.5%	24.9%	27.0%	29.1%	30.1%	29.7%
Net Profit	99	560	445	388	1943	839	1055	1535	2319	3436
Net Margin	3.0%	16.8%	16.8%	13.9%	39.9%	13.9%	16.1%	20.9%	30.6%	42.3%
Free Cash Flow	295	531	716	494	603	362	522	789	874	1360
Income Tax	160	-9	89	129	259	343	441	554	12	686

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	8094	7168	7110	7638	14302	15093	16965	18602	20539	29232
Cash & Equivalents	44	9	86	332	64	110	83	177	90	94
Accounts Receivable	515	417	438	472	626	599	733	737	776	847
Inventories	1880	1369	1375	1481	1744	1827	1852	1955	2084	2130
Goodwill & Int. Ass.	3496	3506	3499	3594	9378	9389	10542	11298	11388	11287
Total Liabilities	5518	4616	4434	4778	9321	9212	10273	11718	12476	16394
Accounts Payable	269	129	131	209	295	286	429	560	592	617
Long-Term Debt	3836	3236	3130	3305	7021	7297	8081	9238	10187	13617
Shareholder's Equity	2576	2552	2676	2860	4981	5771	6560	6891	8046	12551
D/E Ratio	1.49	1.27	1.17	1.16	1.41	1.26	1.23	1.34	1.27	1.08

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	1.2%	7.3%	6.2%	5.3%	17.7%	5.7%	6.6%	8.6%	11.8%	13.8%
Return on Equity	4.4%	21.8%	17.0%	14.0%	49.6%	15.6%	17.1%	22.8%	31.0%	33.4%
ROIC	1.6%	9.2%	7.7%	6.5%	21.4%	6.7%	7.5%	9.9%	13.5%	15.4%
Shares Out.	222	210	194	190	196	200	199	195	191	196
Revenue/Share	15.21	15.59	12.72	14.69	24.64	29.96	32.13	35.92	37.78	41.51
FCF/Share	1.33	2.48	3.43	2.60	3.05	1.80	2.56	3.86	4.35	6.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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