

COMPANY UPDATE

Constellation Brands (STZ)

Neutral

Equity Research

Analysis points to modest impact from Corona Extra bottle recall

What's changed

We continue to monitor consumer perceptions around the impact of STZ's voluntary recall of select Corona packaging. As a reminder, on 8/15/2014 STZ indicated select packages of Corona Extra "may contain small particles of glass". STZ noted that <1% of the bottles may be impacted, however the company is recalling select packages as a precautionary measure. Recent brand metrics indicate a modest negative impact to the Corona brand. Our baseline assumption is for a limited impact to sales trends given 1) no indications of direct consumer incidents, and 2) the relatively limited scale of impacted bottles.

Implications

Consumer awareness of packaging issue gains momentum – Yougov BrandIndex brand awareness scores have increased to the highest level since the first week of August following the recall announcement. Google search trends have coincidentally increased both on an absolute basis and y/y (indicating the increase might not be seasonal). We note that negative purchase intention scores have also increased, indicating potential causality. We believe the impact will be limited in scope given still modest deterioration in purchase intentions, but warrants further monitoring.

Positive perception still outweighs negative perception - Negative brand quality scores have been moderating (signaling improved quality perception), however the rate of improvement has decelerated since the recall. Notably, positive scores remain well above negative quality perceptions; this is likely due to the fact that Corona benefits from strong brand positioning and a lack of consumer health impact headlines.

Valuation

We retain our 12-month price target of \$97 (based on P/E and EV/EBITDA).

Key risks

Sales trends, cost savings and brewery expansion.

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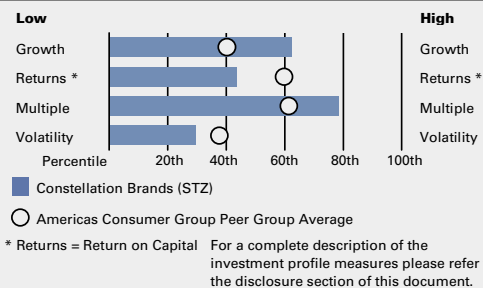
Neutral

Coverage View: Neutral

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Investment Profile

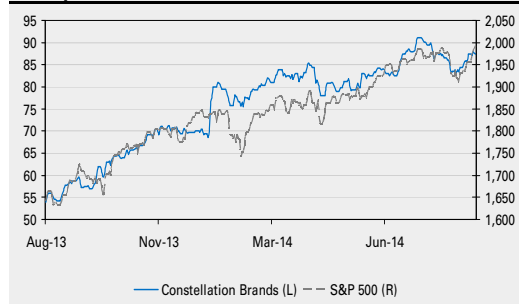


Key data	Current
Price (\$)	87.46
12 month price target (\$)	97.00
Market cap (\$ mn)	16,782.6
Dividend yield (%)	NM
Net margin (%)	14.3
Debt/total capital (%)	54.8

	2/14	2/15E	2/16E	2/17E
Revenue (\$ mn)	4,867.7	6,042.1	6,347.5	6,606.2
EPS (\$)	3.25	4.30	4.84	5.97
P/E (X)	18.3	20.4	18.1	14.6
EV/EBITDA (X)	12.4	13.7	12.3	10.6
ROE (%)	16.4	15.8	15.4	17.4

	5/14	8/14E	11/14E	2/15E
EPS (\$)	1.07	1.10	1.17	0.96

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	5.9	8.8	62.1
Rel. to S&P 500	0.4	0.3	33.7

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 8/21/2014 close.

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Constellation Brands: Summary Financials

Profit model (\$ mn)	2/14	2/15E	2/16E	2/17E	Balance sheet (\$ mn)	2/14	2/15E	2/16E	2/17E
Total revenue	4,867.7	6,042.1	6,347.5	6,606.2	Cash & equivalents	63.9	203.6	291.0	521.6
Cost of goods sold	(2,860.0)	(3,448.0)	(3,558.0)	(3,502.1)	Accounts receivable	626.2	651.3	651.3	651.3
SG&A	(839.4)	(1,030.4)	(1,077.3)	(1,143.6)	Inventory	1,743.8	1,781.5	1,781.5	1,781.5
R&D	--	--	--	--	Other current assets	313.3	326.4	326.4	326.4
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	2,747.2	2,962.8	3,050.2	3,280.8
ESO expense	--	--	--	--	Net PP&E	2,014.3	2,488.0	2,779.1	2,908.9
EBITDA	1,423.1	1,767.0	1,930.2	2,193.8	Net intangibles	9,377.9	9,920.2	9,893.1	9,866.0
Depreciation & amortization	(166.9)	(185.9)	(200.7)	(215.9)	Total investments	0.0	0.0	0.0	0.0
EBIT	1,168.3	1,563.7	1,712.2	1,960.6	Other long-term assets	162.7	148.7	66.4	2.2
Net interest income/(expense)	(323.2)	(348.5)	(303.2)	(289.2)	Total assets	14,302.1	15,519.7	15,788.8	16,057.9
Income/(loss) from associates	87.9	17.4	17.4	17.4	Accounts payable	295.2	345.7	345.7	345.7
Others	0.0	0.0	0.0	0.0	Short-term debt	647.2	849.6	849.6	849.6
Pretax profits	933.0	1,232.6	1,426.4	1,688.7	Other current liabilities	1,083.3	1,059.4	1,059.4	1,059.4
Provision for taxes	(291.3)	(371.3)	(456.5)	(506.6)	Total current liabilities	2,025.7	2,254.7	2,254.7	2,254.7
Minority interest	0.0	0.0	0.0	0.0	Long-term debt	6,373.3	6,345.6	5,845.6	5,845.6
Net income pre-preferred dividends	641.7	861.3	970.0	1,182.1	Other long-term liabilities	921.8	986.3	1,027.9	1,069.5
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	7,295.1	7,331.9	6,873.5	6,915.1
Net income (pre-exceptionals)	641.7	861.3	970.0	1,182.1	Total liabilities	9,320.8	9,586.6	9,128.2	9,169.8
Post tax exceptionals	1,309.2	(8.0)	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income (post-exceptionals)	1,950.9	853.3	970.0	1,182.1	Total common equity	4,981.3	5,933.1	6,660.6	6,888.1
EPS (basic, pre-exception) (\$)	3.25	4.30	4.84	5.97	Minority interest	0.0	0.0	0.0	0.0
EPS (diluted, pre-exception) (\$)	3.25	4.30	4.84	5.97	Total liabilities & equity	14,302.1	15,519.7	15,788.8	16,057.9
EPS (basic, post-exception) (\$)	9.89	4.26	4.84	5.97	Additional financials	2/14	2/15E	2/16E	2/17E
EPS (diluted, post-exception) (\$)	9.89	4.26	4.84	5.97	Net debt/equity (%)	139.7	117.8	96.2	89.6
Common dividends paid	--	--	--	--	Interest cover (X)	3.6	4.5	5.6	6.8
DPS (\$)	0.00	0.00	0.00	0.00	Inventory days	205.8	186.6	182.8	185.7
Dividend payout ratio (%)	0.0	0.0	0.0	0.0	Receivable days	41.2	38.6	37.5	36.0
Growth & margins (%)	2/14	2/15E	2/16E	2/17E	BVPS (\$)	26.22	31.48	35.34	37.43
Sales growth	74.1	24.1	5.1	4.1	ROA (%)	5.8	5.8	6.2	7.4
EBITDA growth	56.2	24.2	9.2	13.7	CROCI (%)	10.0	9.6	10.2	11.5
EBIT growth	109.9	33.8	9.5	14.5	Dupont ROE (%)	12.9	14.5	14.6	17.2
Net income (pre-exception) growth	54.3	34.2	12.6	21.9	Margin (%)	13.2	14.3	15.3	17.9
EPS growth	48.0	32.1	12.6	23.4	Turnover (X)	0.3	0.4	0.4	0.4
Gross margin	41.2	42.9	43.9	47.0	Leverage (X)	2.9	2.6	2.4	2.3
EBITDA margin	29.2	29.2	30.4	33.2	Free cash flow per share (\$)	3.06	2.51	4.14	5.99
EBIT margin	24.0	25.9	27.0	29.7	Free cash flow yield (%)	5.1	2.9	4.7	6.8
Cash flow statement (\$ mn)	2/14	2/15E	2/16E	2/17E	Note: Last actual year may include reported and estimated data. Source: Company data, Goldman Sachs Research estimates.				
Net income	1,943.1	853.3	970.0	1,182.1					
D&A add-back (incl. ESO)	166.9	185.9	200.7	215.9					
Minority interest add-back	0.0	0.0	0.0	0.0					
Net (inc)/dec working capital	9.1	0.0	0.0	0.0					
Other operating cash flow	(1,292.9)	64.1	123.9	105.8					
Cash flow from operations	826.2	1,103.3	1,294.5	1,503.8					
Capital expenditures	(223.5)	(600.0)	(464.7)	(318.6)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	(4,681.3)	(558.0)	0.0	0.0					
Others	41.0	0.0	0.0	0.0					
Cash flow from investing	(4,863.8)	(1,158.0)	(464.7)	(318.6)					
Dividends paid (common & pref)	0.0	0.0	(242.5)	(354.6)					
Inc/(dec) in debt	3,628.6	173.3	(500.0)	0.0					
Other financing cash flows	166.3	0.0	0.0	(600.0)					
Cash flow from financing	3,777.0	173.3	(742.5)	(954.6)					
Total cash flow	(267.6)	139.7	87.3	230.6					

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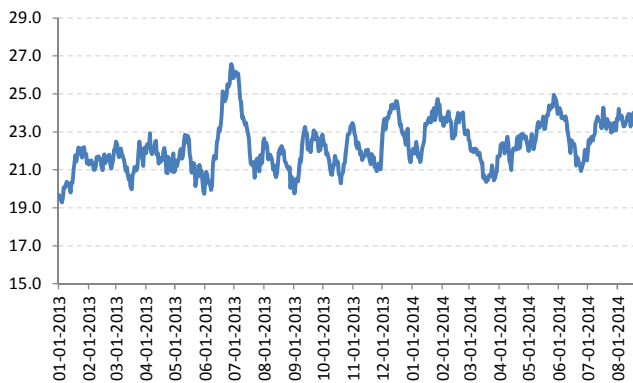
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Corona impact still appears limited in scope

- Follow up on Corona indicates increased consumer interest** – Following STZ’s 8/15/2014 recall of Corona bottles, Yougov brand awareness scores (index of consumers indicating they are aware of brand) have increased to near August monthly highs. YouGov’s Brand Index tracks the real time evolution of consumer brand perception via its proprietary survey platform. As a reminder, Constellation Brands (STZ, Neutral) announced that its Beer Division is voluntarily recalling select packages of Corona Extra bottles that “may contain small particles of glass”. Notably, the bottles came from a part of their Nava brewery that is 20% of that brewery’s production, which is around 60% of total production. The company noted that less than 1% of the bottles may be impacted.

Exhibit 1: Brand awareness is gradually increasing for the Corona brand...

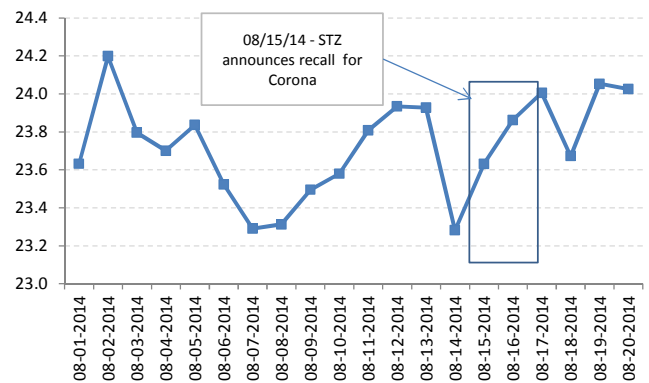
Yougov Brandindex, Corona brand awareness score



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 2: ...Moving higher following the 8/15/2014 recall of Corona bottles

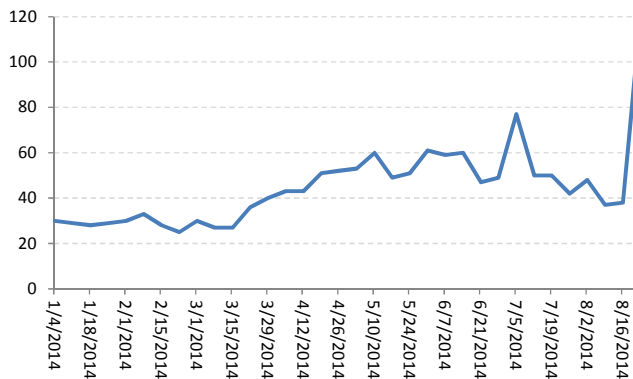
Yougov Brandindex, Corona brand awareness score



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 3: This data point is corroborated by a significant increase in Google trend searches in the same time period

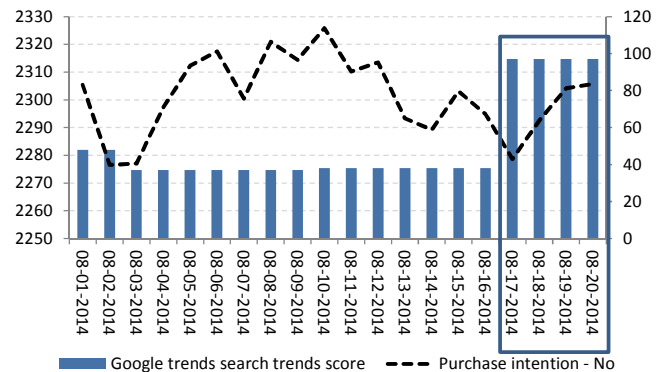
Google search trends score, “Corona Beer” YTD 2014



Source: Goldman Sachs Global Investment Research, Google Trends

Exhibit 4: More consumers are indicating they do not intend to purchase Corona, in tandem with increased Google searches

Google search trends score (Right), “Corona Beer” 08/2014 vs. Yougov Brandindex, Corona negative brand purchase intention score (Left)

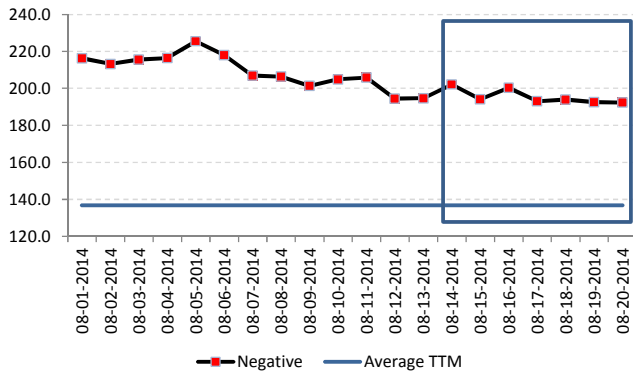


Source: Goldman Sachs Global Investment Research, Yougov, Google Trends

- Google search trends reveal increased searches for Corona** – Notably this data is corroborated by a significant increase in Google searches (Exhibit 3). In tandem with the increase in google searches, daily Yougov negative purchase intention scores increased (Exhibit 4). We believe the impact will be limited in scope, but warrants further monitoring.
- Rate of improvement in Negative quality scores stalling** – Digging deeper, we observe that negative brand quality scores have been improving (declining, indicating a lower number of negative responses), however the rate of improvement has decelerated since the recall announcement (Exhibit 5). Positive scores remain well above negative quality perceptions (Exhibit 6), we believe this is likely due to the fact that Corona benefits from strong brand positioning and a lack of consumer health impact headlines.

Exhibit 5: Negative perception scores are improving vs. TTM levels, however the second derivative change in improvement has stalled

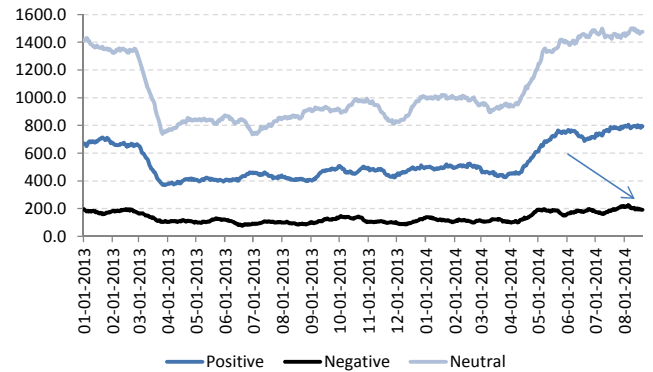
Yougov Brandindex, Corona brand negative quality perception score vs. TTM average



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 6: Positive quality scores remain above negative scores, likely given there have been no reported consumer health incidents

Yougov Brandindex, Corona brand negative vs. positive vs. neutral quality perception score



Source: Goldman Sachs Global Investment Research, Yougov



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Reg AC

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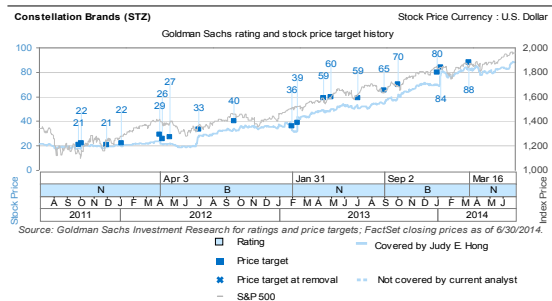
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