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Molson Coors Beverage Co. (TAP)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Molson Coors Beverage Company Second Quarter Fiscal Year 2023 Earnings Conference Call. You can find related slides on the Investor Relations page of the Molson Coors website. Our speakers today are Gavin Hattersley, President and Chief Executive Officer; and Tracey Joubert, Chief Financial Officer.

With that, I'll hand it over to Greg Tierney, Vice President of FP&A, Commercial Finance and Investor Relations.

Greg Tierney

Vice President of FP&A and Investor Relations, Molson Coors Beverage Co.

Thank you, operator, and hello, everyone. Following prepared remarks today from Gavin and Tracey, we will take your questions. In an effort to address as many questions as possible, we ask that you limit yourself to one question. If you have technical questions on the quarter, please pick them up with our IR team in the days and weeks that follow.

Today's discussion includes forward-looking statements. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in our most recent filings with the SEC. We assume no obligation to update forward-looking statements.

GAAP reconciliations for any non-US GAAP measures are included in our news release. Unless otherwise indicated, all financial results the company discusses are versus the comparable prior year period in US dollars and in constant currency when discussing percentage changes from the prior year period.

Also, US share data references are sourced from Circana. Further, in our remarks today, we will reference underlying pre-tax income, which equates to underlying income before income taxes on the condensed consolidated statements of operations.

With that, over to you, Gavin.

Gavin D. K. Hattersley

President, Chief Executive Officer & Director, Molson Coors Beverage Co.

Thanks, Greg, and thank you all for joining today's call. Molson Coors just finished the single best quarter of reported net sales revenue since the merger of Molson and Coors in 2005.

That achievement is not only a measure of those three months, it's a measure of the past three years. It's about the work we've done to strengthen our business, which puts us in a position to attract consumers when they began looking for alternatives. That's what allowed us to deliver these results today.

Now, to try and remove any skepticism that you may have, I want to show you one chart in our slides that summarizes exactly what I'm talking about. Up until three years ago, our biggest brand in our biggest market was losing dollar share quarter after quarter and year after year. Shortly after we launched our revitalization plan, we changed our marketing approach on Coors Light and launched the Made to Chill campaign. And the brand's results began to improve.

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In the first quarter of this year, Coors Light revenue was up high single digits. In the second quarter, Coors Light grew more industry dollar share than any other beer brand. And it grew industry dollar share faster than Modelo Especial and Corona Extra combined.

If you overlay Miller Lite's performance, it looks remarkably similar. And the reason for that is simple. Three years ago, we generated cost savings and have been reinvesting them back into our brands and back into our business. Three years ago, we completely changed our approach to marketing and media, which unlocked growth for our biggest brands.

Over the past three years, we have improved our supply chain. We've diversified our network of material suppliers and our shipping methods. We've adjusted our brewery and packaging operations. We've streamlined our ordering systems for customers. And we've invested in our facilities. Collectively, we believe this has made us much more nimble and much more prepared to meet elevated demand.

Over the past three years, our strategy has made our brands demonstrably stronger in 2023 than they were in 2019.

So while we didn't plan on our largest competitor's largest brand declining volume by nearly 30% during the quarter, if this had happened in 2019, we would surely not have seen the sales benefit that we did in 2023 or even been able to meet the demand.

Now, a lot has been said about the US beer industry trends over the past few months. But I thought it would be helpful to provide a deeper level of detail than what you've seen in track channel data and give more insights about what we believe the current trends mean for the future.

First, Molson Coors is number one in retail display dollar gains year to date. This is the easiest way for retailers to adjust space on short notice. So we see it as a strong early indicator of shelf reset sentiment. And it's also worth remembering that our largest brands had already experienced a display lift in the first quarter due to (sic) [our Super Bowl] retail execution.

We also know a number of retailers have moved their shelf reset timing from the spring to the fall, which we expect will make some portion of the current trend structural. For the retailers who stayed with spring resets, those conversations are well underway. Currently, nearly 20 of our top retailers are updating their planograms to drive more space for our brands and keep them in stock based on the latest demand.

Continuing with retail, we are seeing particularly strong growth in the convenience channel with both volume sales and dollar sales up double digits in the quarter. In the United States, convenience is the number one channel where we have historically under indexed. So to capitalize on this momentum, we are planning to increase our investment behind C-store shopper marketing in the second half of the year.

In the on-premise, Molson Coors gained over 12,000 new tap handles in the second quarter alone. And we grew sales at double the rate of the category on leading e-commerce platforms. We're proud of this execution. And we're equally proud of the work our supply chain team has done over the past several years to ready us for this quarter, when in May and June, our US breweries had their highest levels of production since 2019.

And lastly, it's important to note that the competitive pricing moves around Memorial Day and the Fourth of July did not appear to have a negative impact on our brands as our share gains continued.

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Given their relative size, Coors Light and Miller Lite in the United States naturally had an outsized impact on our second quarter results. To put the growth of these brands into perspective, Coors Light and Miller Lite combined were 50% bigger than Bud Light by total industry dollars and 30% bigger than Modelo Especial in the second quarter.

And to put that further in perspective, in the second quarter of last year, Bud Light was bigger than Coors Light and Miller Lite combined.

But the momentum we're seeing isn't confined to a specific brand, segment, channel, or geography. Globally, we grew the top line by double digits and the bottom line by more than 50% in the second quarter. We grew volume and share in the United States. We grew volume and share in Canada. We grew volume and share in the United Kingdom. And our top three brands globally – Coors Light, Miller Lite and Miller High Life – are all growing volume globally.

In the US, we were the top dollar share gainer nationally with Coors Light, Simply Spiked, and Miller Lite representing three of the top five franchises in the quarter. Every single one of our top five US brands grew dollar share in the quarter as well. Coors Banquet gained share of the US beer industry for the eighth consecutive quarter, an impressive feat for a 150-year-old brand of its size.

Our economy brands grew dollar share of industry, including volume growth for High Life and Keystone. We also gained the second most dollar and volume share in total Flavor in the second quarter. We now have the number three and number five Hard Seltzer brands in the United States. And Simply [Spiked] Peach was the best-performing new product in the quarter by dollar share.

In energy drinks, ZOA is continuing its upward trajectory. Since the end of the first quarter, more than 11,000 additional retail outlets have placed the brand's new 12-ounce cans. We believe ZOA has a bright future. And just last month, announced a new marketing campaign, featuring some of the country's most prominent college athletes as brand ambassadors.

All of the points I just shared led to our best quarterly US brand volume trends since the MillerCoors joint venture in 2008. It led to revenue growth in every channel, in every segment, and in every region.

And in Canada, the story is similar. We saw double digit brand volume growth in the quarter, led by Coors Light and the Molson brand franchise, which also grew share of the industry. These trends were actually well on their way even before the start of the second quarter. At the end of March, Coors Light became the number one light beer and number two overall beer in the country, surpassing Bud Light.

While the Hard Seltzer segment in Canada was down in the second quarter, Molson Coors was the only large brewer to hold share of the segment. In EMEA and APAC, I'll start with our performance in the UK where we grew volume, share and revenue. And our on-premise share performance hit its highest levels in over a decade.

Madri delivered triple-digit volume growth and is now the fourth largest above premium brand in our global portfolio. Based on tracked data in the UK, Madri is now a top five brand for on-premise value sales. What this brand has achieved in three years is incredible. Backed by Madri and Coors, more than half of our total EMEA and APAC revenue, as of the second quarter, was generated by brand volumes from the above premium segment.

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And Ožujsko, our second largest brand in the region, surpassed the 50% share of segment in the Croatian market and is benefiting from new enhancements we've made to our canning lines in the region. So we had an incredible second quarter, the best in years by many counts. And while our two biggest brands in our biggest market played a large role, you can see that our entire business contributed meaningfully.

We're proving this business can grow the top and bottom line sustainably. We're proving we have the resilience and wherewithal to navigate macro challenges affecting our industry and the world. And we believe we're proving that when we stick to a clear strategy over the long term, results will continue to follow. That's what we've done for the past three years. It's why we are where we are today. It's what we expect will drive sustainable growth for our business moving forward, and it's why we're confident in raising our guidance for the remainder of the year.

Now, before I pass it over to Tracey for more detail, I wanted to share that on October 3rd, we will be hosting a Strategy Day in New York City. More details are to come. But we look forward to providing a longer-term view of our strategy and outlook at that time. Tracey?

Tracey I. Joubert

Chief Financial Officer, Molson Coors Beverage Co.

Thank you, Gavin; and hello, everyone. In the second quarter, on a constant currency basis, we delivered tremendous results. Net sales revenue grew 12.1% and underlying pre-tax income grew 52.6%. We achieved this while continuing to invest in our business, reduce net debt, and return cash to shareholders.

As Gavin discussed, we have built our business to sustainably grow both the top and bottom line. We achieved this in 2022 and in the first quarter of 2023 before this recent period of accelerated demand in the US.

And while we remain mindful of the dynamic global macroeconomic environment and recent beer industry softness, the foundation we have laid, coupled with our strong second quarter performance, provide us confidence to increase our full year 2023 guidance, meaningfully accelerating growth from our prior expectation.

Now, before we get to that, let's talk about some of the drivers of the second quarter performance. Net sales per hectoliter grew 9% in the quarter. This was driven by positive global net pricing due to rollover pricing benefits from higher than typical increases taken in 2022 and favorable sales mix driven by geographic mix and premiumization.

Financial volume increased 2.8%, and consolidated brand volume increased 5%. The volume growth was driven by strength in our Americas business, partially offset by a decline in our EMEA and APAC business.

Turning to costs. Underlying COGS per hectoliter were up 5.9%. As expected, inflationary pressures continued to be a headwind. As you may recall, we bucket COGS into three areas. First is cost inflation other, which includes cost inflation, depreciation, cost savings, and other items; second is mix; and third is volume leverage or deleverage. The cost inflation bucket drove 80% of the increase and was mostly due to higher materials and manufacturing costs, partially offset by cost savings.

Volume leverage had a meaningfully positive impact on COGS per hectoliter in the quarter, providing a 100 basis point benefit. Other COGS per hectoliter drivers included mix, which accounted for the remainder of the increase. This was largely due to the impact of non-owned brands as well as premiumization. And while premiumization is a negative for COGS, it is a positive for gross margin per hectoliter.

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Underlying marketing, general, and administrative expenses increased 4.1%. The increase was driven by higher incentive compensation expense, which is a variable expense tied to our operating performance, as well as higher marketing investment.

Now, let's look at our quarter results by business units. In the Americas, net sales revenue grew 11.5% and underlying pre-tax income grew 40%. Americas net sales per hectoliter increased 6.2%, benefiting from positive net pricing across the region as well as favorable sales mix. The strong net pricing growth included benefits from higher than typical US and Canada pricing in 2022.

As a reminder, in the US in 2022, we took two price increases: a spring and a fall, each averaging approximately 5%. We lapped last year's spring increase in the first quarter and will begin to lap last year's fall increase this September. Financial volume increased 5%. This was due to a 4.8% increase in US domestic shipments, driven by higher brand volumes due to a shift in consumer purchasing behavior largely within the premium segment in the quarter.

In addition, Canada shipments increased in part due to cycling the impact of the Québec labor strike in the second quarter last year. This was partially offset by lower Latin American and contract brewing volumes. Americas brand volumes were up 8%. US brand volume increased 8.7%, largely due to growth in our core brand with Coors Light, Miller Lite, and Coors Banquet all up double digits. Growth was also driven by strength in our Above Premium portfolio, led by Flavor.

In Canada, brand volume increased 11.3%. While cycling the Québec labor strike was a driver, we also achieved growth in each of our Canadian region. In Latin America, brand volume was down 5.9%, largely due to industry softness in some of our major markets in that region.

On the cost side, Americas underlying COGS per hectoliter increased 2.5%. Inflation remained the leading driver of the increase. But the impact was partially offset by benefits of volume leverage and lower logistics costs. MG&A was up on higher incentive compensation and higher marketing investment, particularly for key innovations like Simply Spiked.

Turning to EMEA and APAC. Net sales revenue increased 14.7% and underlying pre-tax income increased 82.7%. Net sales per hectoliter grew 18.3%. This was driven by positive net pricing largely related to the rollover benefits from increases taken in 2022, favorable sales mix, and continued premiumization in the UK, fueled by the strength of brands like Madri, and positive geographic mix.

Financial volume declined 3%, relatively in line with brand volume, which was down 2.9%. Looking by market, financial volume grew in the UK on strong brand volume due to the resilience of the UK consumer and our strong on-premise performance as well as higher factored brand sales. But this was more than offset by declines in Central and Eastern Europe due to industry softness, including the impact of the continued inflationary pressures on the consumer.

On the cost side, underlying COGS per hectoliter increased 17.7%. This was largely due to inflation related brewing and packaging materials and logistics costs, as well as the mix impact of premiumization and higher factored brands. MG&A was relatively flat.

Underlying free cash flow was $570 million for the first six months of the year. And this was an improvement of $282 million, primarily due to higher net income and lower cash capital expenditures.

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Turning to capital allocation. Capital expenditures paid were $335 million for the first six months of the year. This was down $54 million and was due to the timing of capital projects. Capital expenditures continued to focus on our Golden Brewery modernization and expanding our capabilities in areas that we believe drive efficiencies and savings.

We reduced our net debt by $308 million since December 31, 2022, ending the second quarter with net debt of $5.7 billion. And in July, we repaid our CAD500 million debt in cash upon its maturity on July the 15.

As a reminder, our outstanding debt is essentially all at fixed rate. Our exposure to floating rate debt is limited to our commercial paper and revolving credit facility, both of which had a zero balance outstanding at quarter end.

And we paid a quarterly cash dividend of $0.41 per share and maintain our intention to sustainably increase the dividend.

Given our strong EBITDA performance and lower net debt, our net debt to underlying EBITDA ratio as of quarter end reached our longer term leverage ratio target of 2.5 times. Our capital allocation priorities remain to invest in our business, reduce net debt, as we remain committed to maintaining and, in time, improving our investment-grade rating, and return cash to shareholders.

But our greatly improved financial flexibility does provide us increased optionality among these priorities. And we will utilize our models to determine the best anticipated return for our shareholders.

Now, let's discuss our outlook. But first, please recall that we cite year-over-year growth rates in constant currency.

We are raising our 2023 key financial guidance to reflect the continued strength we are seeing in our core brands in the US, while remaining mindful of the softness in the beer industry and continued caution around the consumer.

We now expect high single digit net sales revenue growth as compared to low single digit growth previously. We now expect 23% to 26% underlying pre-tax income growth, as compared to low single digit growth previously. And we also now expect underlying free cash flow of $1.2 billion, plus or minus 10%, as compared to $1 billion, plus or minus 10%, previously.

Now let me break down some of the guidance assumptions. From a top line perspective, given the strong demand in the US, we now expect growth to be driven not only by rate but also by volume. But we continue to expect a headwind related to the large US contract brewing agreement that has begun to wind down ahead of its termination at the end of 2024.

As discussed on our first quarter call, we expect volume declines under this contract to accelerate in the fourth quarter. For context, the headwind impact of this is expected to be approximately 2% to 3% of America's financial volume in the fourth quarter.

We continue to view the termination of this contract as a positive, because while a headwind from a volume perspective, we believe it is positive for us in terms of freeing up capacity and enhancing margin.

As for distributor inventories, recall that we had both higher US distributor inventory levels at the end of the first quarter this year versus the prior year. However, given the strong demand, distributor inventory levels in the US

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declined following both the Memorial Day and Fourth of July holidays. We expect they will further decline following the Labor Day holiday.

Recall that declines in distributor inventory levels through the summer and particularly post our holidays during this period are typical.

Also, as usual, we anticipate rebuilding inventory in the shoulder quarters, being the first and fourth quarters. So while supply is currently tight, our brewery operations have done an excellent job of meeting the demand.

As for pricing, given the strength of our brands, we continue to anticipate taking a general increase in the US this fall. At this point, we expect our pricing increase to be in line with industry average historical annual level of 1% to 2%.

In terms of costs, we continue to expect the impact of inflation on COGS to be a headwind for the year. But we expect it to moderate in the second half. While spot rates for a number of commodities have declined, we, like most CPG companies, have a hedging program, which we expect will largely smooth out the impact of swings in commodity pricing.

Further, our business in EMEA and APAC is expected to continue to experience relatively high inflationary pressure.

In addition, we expect favorable volume leverage to partially offset cost increases. This, combined with continued premiumization and lower contract brewing volumes, are expected to drive gross margin expansion for the year.

Underlying MG&A expenses is expected to be approximately $100 million higher in the second half as compared to the first half of this year and up approximately 15% versus the second half of 2022. This is primarily due to higher marketing spend, which is expected to be up approximately $100 million, as well as higher people related costs as compared to the same period last year.

As for our secondary guidance metrics, we continue to expect capital expenditures incurred of $700 million, plus or minus 5%; underlying depreciation and amortization of $690 million, plus or minus 5%; and an underlying effective tax rate in the range of 21% to 23%.

However, we are reducing our net interest expense guidance of $225 million – to $225 million, plus or minus 5%, as compared to $240 million, plus or minus 5%, previously. This decrease is driven by the July payoff of the Canadian debt maturity, higher interest income due to higher cash levels, and higher interest rates on deposits, and lower short-term borrowing than previously anticipated.

In closing, we are extremely pleased with our second quarter performance. While we could not have foreseen the shifts that we have seen in consumer behavior that began in the second quarter, our strategy has positioned us well. With a strong portfolio of brands across all price segment and the financial flexibility that enables us to continue to invest prudently in our business, we are confident in our ability to sustainably deliver top and bottom line growth, not only full year 2023 but also beyond.

We look forward to sharing more details on our strategic initiative, capital allocation, and longer term outlook at our upcoming Strategy Day on October the 3. With that, we look forward to answering your questions. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Bonnie Herzog from Goldman Sachs. Your line is now open. Please go ahead.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

All right. Thank you. Hi, everyone.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Hi, Bonnie.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

I had a question on your guidance. You raised your underlying pre-tax income growth guidance a fair amount. But given the Q2 beat, it does imply a healthy deceleration in the second half.

So I guess I wanted to better understand the drivers of this. And really ultimately, how much of the top line strength you now plan to reinvest versus maybe letting it flow to the bottom line? Also, are there any other headwinds we should be aware of for the second half? Or is there maybe some level of conservatism baked into your updated full year guide? Thanks.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Thanks, Bonnie. Let me start with just a couple of facts. Then I'll pass it over to Tracey. Firstly, I would tell you that the momentum behind our brands in the third quarter has not slowed down. That is maintained.

And then secondly, we intend to invest very strongly behind the momentum that we've got, hence, the $100 million extra in marketing, which Tracey referred to in her remarks.

Our job is to maintain those gains that we've got. We've gained, as I said, 12,000 new tap handles. We're working closely with our retailers to change the shelf sets to meet this new reality. We're the number one share gainer in dollars in the – in displays. And we're going to invest behind the momentum that we've got, mostly in the Americas business unit, but also in our EMEA and APAC business unit behind brands such as Madri.

So I'll make those two points. Tracey, and there's any – I'm sure there's more you want to add to that.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Yeah. Yeah. Bonnie, yeah, the one thing that I would add is the Pabst contract that's winding down. So as I mentioned in the prepared remarks, we will see a headwind in terms of volume and revenue from that contract. We expect on a volume basis for that to have a headwind in Q4 of around 2% to 3% of our American volume.

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And then just also, don't forget the sort of pricing as we lap the larger price increases that we took, so last year, in 2022. So we'll see that impact declining through the back half of the year as well.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Thanks, Bonnie.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Thank you.

Operator: Thanks, Bonnie. Our next question comes from Bill Kirk from Roth MKM. Your line is now open. Please go ahead.

Bill Kirk
Analyst, ROTH Capital Partners LLC
Q

Thank you. I just wanted to follow-up and try to be super clear. So the guidance in the US includes US volume increases and rate. Has that changed just for what you've experienced year to date? Or is your guidance now including those market share shifts that you've seen for them to continue in the back half of the year?

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

All right, Bill, thanks for that question. Look, I don't think we're going to break down the individual components of our guidance. But I'll just – I'll reiterate that we haven't seen any slowdown in momentum for our brands. One big difference is the extra $100 million versus the first half of this year and actually also versus the back half of last year.

To Tracey's point, pricing, we are and have already lapped one of the big price increases we put through last year, and we lapped the other one obviously in the fall. And we've been pretty consistent about the fact that we're expecting pricing to fall back to more historical levels of that sort of 1% to 2% range. And then, of course, there are some employment-related costs which we referred to in our script as well. So, those are sort of big four things which I would point you to.

Next question, operator.

Operator: Thanks, Bill. Our next question comes from Andrea Teixeira from JPMorgan. Your line is now open. Please go ahead.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Thank you. Good morning. Gavin, Tracey, it seems that you're obviously betting on a strong deceleration in the second half. And even accounting for the 2% to 3% headwind that you mentioned in the fourth quarter, in particular.

Can you comment on the underlying assumptions, perhaps for depletions, as you go into the second half? And then, embedding to that, you had this 5% increase in cost per hecto. I understand, Tracey, you mentioned that it's

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going to actually decelerate – the inflation is going to decelerate in the second half which is – it just obviously makes sense.

To the extent that you can comment on the margin, and by the same token, I think it flows through not only the deceleration in top line, but also more conservative assumptions for reinvestment. If you can comment on that. Thank you.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Look, Andrea, as I said, our momentum has not slowed down at all and we're now towards the end of July. And our guidance assumes US brand volume growth in the second half of the year, which implies continued share growth based on current industry trends. It does consider continued caution around the consumer and the competitive environment.

And Tracey referred to the Pabst winding down and price increases; and then of course, there's the extra $100 million that we've got going through from a marketing point of view. So, we factored all of those items into our guidance.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.
A

Yeah. And then just on the cost inflation question. So, as we said, we do expect the impact of cost inflation to continue for this year, but then moderate in the back half of the year. And look we've got good line of sight to our COGS right now, based on hedging our contract prices and the expected cost savings. But we again do expect inflationary pressures to continue, particularly in our EMEA and APAC region, as we've mentioned.

So from a margin expansion point of view, because of some of these factors as well as the benefit from our efficiency project, as we've invested more in our business around efficiencies and cost saving, and really looking at a more normalized cost of goods sold environment, in the medium term we are expecting a margin expansion.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

And when that – that the capacity increases, I also want to make sure that we all stick on that. The 2% to 3% headwind that you spoke about volumes that you're winding this contract, it also gives you more capacity, right? So are you – together with what you mentioned, Gavin, in the beginning of your call, your prepared remarks that you have some of the top 12 retailers in the US taking on, adjusting shelf space for you. Would we see that capacity flipping into your own brand? Or we should wait for that to settle before we can count on that as you go into the balance of the year? Thank you.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Thanks, Andrea. It's our top – it's 20 retailers that are going to make changes in the fall resets. Some of them actually have already made those changes. And frankly, that number grows every week when I talk to our head of sales. So, it's actually somewhat higher than what it was when I made these prepared remarks.

From a supply chain point of view, I think our supply chain team has done an amazing job keeping up at such short notice. We always run close to full capacity in summer. So of course, we're going to be a little tighter than

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normal. And so, there are some distributors in some pockets where they may be out of stocks, particularly where the momentum is really strong. We've got some distributors growing 30%, 40%, 50% at the moment.

We rebuilt inventory coming out of Memorial Day. We're doing the same now as we rebuild heading into Labor Day. And we came into the second quarter with good inventories. So, I think we're doing a great job of keeping up with this unexpected demand. I think we've got the capacity to do that. And of course, when Pabst starts coming out, we will be able to replace that volume with our own brands. And it'll free up a little bit more capacity for us as we head into 2024.

Operator: Thanks, Andrea. Our next question comes from Vivien Azer from TD Cowen. Your line is now open. Please go ahead.

Vivien Azer
Analyst, TD Cowen

Q

Hi. Good morning. Thank you. Gavin and Tracey, I'm hearing some concern from investors that there seems to be perhaps a disconnect in terms of what would have been expected from a depletion standpoint, just using the publicly available data. I have Nielsen; you guys are obviously citing Circana relative to the shipments. I think we've certainly covered the capacity point pretty well at this point.

But were there any other timing factors to consider in terms of understanding why your Americas shipments fell below what we would have seen in Nielsen-tracked channels from a volume growth perspective? Thanks.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Yeah. A couple of points I'd make. One is that we came into the second quarter with very high – well, not very high inventory. We came in with higher inventories than we normally did, because we wanted to make sure we could supply our consumers and distributors through summer.

Now, we obviously weren't planning for the current situation. But we certainly had higher shipments coming into Q2. We always run close to full capacity in summer. So frankly, there isn't a lot of – from a shipments point of view, a significant increase possible as we operate in summer. Notwithstanding that, our breweries had a record May and June since 2019 and are functioning extremely well. So those are the two factors that I would point you to, Vivien.

From a capacity point of view, of course, we don't have unlimited capacity. But we're keeping up I think amazingly well, given the short notice of this demand shift. And we'll rebuild our inventory heading into Labor Day. And we'll build – rebuild inventory post Labor Day as we head toward the back of the year.

Operator: Our next question comes from Nadine Sarwat from Bernstein. Your line is now open. Please go ahead.

Nadine Sarwat
Analyst, Bernstein Autonomous LLP

Q

Hi. Thank you. Good morning, guys. So last time we spoke, I know you mentioned your expectations at the time were that shelf resets could be more modest in the fall than some other brewers were expecting. But it sounds from your prepared remarks that you believe these are going to be bigger than initially expected.

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So could you provide a bit more color based on what you're seeing? I know you touched on it. But the puts and takes of those fall resets. And then how you're thinking of going into the spring next year.

And then one more, if I may ask. In the US, were your on-trade and off-trade trends meaningfully different or broadly in line? And if so, a little color on that as well. Thank you.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Thanks, Nadine. I'll take your second question first. Yes, our on-premise trends were better than our off-premise trends in the US.

As far as your shelf reset question is concerned, yes, we are in a better place now than we were necessarily thinking at the end of the first quarter. A lot more retailers have, A, already moved some of their shelf resets and are planning to move their fall shelf resets than we had initially expected. As I said, nearly 20 of our retailers are updating their planograms right now. That number grows every week. Every time, as I said, I talk to head of sales, that number grows.

We're working really closely with our retailers to recommend space and assortment solutions to just drive a sustained category growth for the retailers.

And given those recent trends, we have seen a number of retailers make interim adjustments to displays and space this summer. And we do expect that to continue into the fall and also next spring.

And as I said in – I think in my prepared remarks or maybe in Q&A, I can't remember. But Molson Coors is the number one in retail dollar display gains year to date. So we're working hard at making sure that shelf resets reflect the current reality in the marketplace, which shows that there is a strong momentum behind all of our core brands.

Operator: Thanks, Nadine. Our next question comes from Filippo Falorni from Citi. Your line is now open, please go ahead.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Looks like we may have lost Filippo from Citi, Nadine – not Nadine, operator.

Operator: Filippo, if you want to – your line is now open. Please ask your question.

Okay. Moving on to the next question. Our next question is from Eric Serotta from Morgan Stanley. Your line is now open, please go ahead.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.
A

Doesn't sound like Eric's there either, operator.

Eric A. Serotta
Analyst, Morgan Stanley & Co. LLC
Q

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Hello. Can you hear me?

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Yeah, now, we can hear you, Eric.

Operator: Eric, we can hear you. Go ahead.

Eric A. Serotta
Analyst, Morgan Stanley & Co. LLC

Q

Great. Sorry about that. Just wanted to circle back on the shipments versus depletion. Not to beat a dead horse here, but is the implication correct that shipments will – are expected to again lag depletions for the third quarter? And that inventory rebuild would happen largely in the fourth quarter?

And do you expect shipments and depletions to still be broadly in line for the full year? Or do you think it'll take until first quarter or early next year in order for the two to converge?

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Yeah. Hi, Eric, it's Tracey here. So look, we're going to monitor this very closely. Obviously, our distributor inventory levels, as Gavin mentioned, over the sort of holiday period will fall. And then we'll grow it again. Typically, we grow on the shoulder quarters, the first quarter and the fourth quarter. But we're monitoring it very carefully.

I mean right now, we focus on making sure that we have enough inventory to meet the demand. And that our distributors have enough inventory to meet their demand. So as we get further into the year, we'll continue to balance that. And again, just really focused on making sure we've got beer on the floor.

Eric A. Serotta
Analyst, Morgan Stanley & Co. LLC

Q

Great. And then a bigger quick – bigger picture question for you, Gavin. You referenced several times the weaker US beer industry trend. Hoping you could unpack what you see as the key drivers there. Do you think that the situation at your competitor is having a spillover effect in terms of overall industry?

We've seen the beer industry from a volume perspective weaken this year at a time when spirits volume growth has certainly slowed quite dramatically. So any color as to your take on what's driving the industry weakness would be helpful.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Sure. Thanks, Eric. Yeah, look, I mean the US industry in 2023 has been softer than expected. There are obviously a number of drivers behind that. You know, there on the West Coast, particularly California, big beer drinking market, we had some really difficult weather conditions in the first part of the year. And so that challenged the overall industry.

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And then I think it's true to say that we've had higher-than-expected declines in the overall seltzer segment. Our data would – from Circana would suggest that there's actually been a slight improvement in Q2 when you compare it with Q1. And an improvement from an overall industry point of view versus the second half of last year.

We do think that some of the bigger drivers of these trends are lifestyle choices. Some buyers shifting to other categories. However, core beer drinkers are incredibly loyal and have maintained their share of dollars and volume in beer.

So we obviously have seen some pretty seismic shifts across the industry, fueled by the continued growth in Mexican imports and fabs. And obviously, the disruption in the ABI portfolio, our brands, Coors Light, Miller Lite, growing industry share.

So what really matters here for us is that more consumers are reaching for our beers versus our competitors' beers, regardless of the segment that they are purchasing from. Those are the comments I would have from an overall industry point of view, Eric.

Operator: Thanks, Eric. Our next question comes from Peter Grom from UBS. Your line is now open. Please go ahead.

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator. Good morning, everyone. So, Gavin, this may be a hard question to answer, as we're still really only halfway through this year. But I would love to get your perspective on how you see the company's growth algorithm evolving in light of the share shifts we're seeing. Obviously, great to see the share gains, but you're also kind of increasing your exposure to an area of industry where growth has been challenged for some time.

And I know you had previously communicated that you expect to exit this year with stronger bottom-line growth versus the low single digits originally targeted for this year. So I would just be curious, how do you think about the ability to kind of grow off of this elevated base, especially if some of these share gains prove to be less durable? Thanks.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Yeah. Thanks, Peter. Look, obviously, we'll share a lot more detail when we have our Strategy Day in October, but I'll make a few points ahead of that.

When we started down the journey of our revitalization plan, we wanted to deliver top and bottom line growth on a sustainable basis, not just once every now and then. So that's the first thing I would say to you. That's how we measure ourselves.

Secondly, we're seeing share and brand improvement in every single one of the markets that we operate in. So this is not just the United States. We're seeing it in Canada. We're seeing it in the United Kingdom.

In the US, we're the number one dollar share gainer in the second quarter. Canada is up 1.5 points from a volume perspective. That's through May because we don't have more recent data than that. We grew premium light's dollar share almost 11%. Canada premium beer is up 2.4%. In the FAB segment, we grew industry and the

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segment. We grew all of our core brands in the United States and Canada. Grew industry share, and we continue to grow our economy segment performance from an improvement point of view.

Now, our job is to make sure that we maintain and retain as many and, frankly, more of these consumers that are moving to our brands. It's one of the reasons we're investing $100 million more in the back half of the year. That's a significant investment and commitment to the momentum that we're experiencing. And we're seeing that in the data.

We're seeing the 12 – the handles, the new tap handles we're getting. We're seeing the shelf set changes. We're seeing the display dollar share gains. And we're going to push hard to maintain that and more, Peter.

So I think I'll stop there ahead of our Strategy Day. But we'll share more with you in early October.

Operator: Thanks, Peter. Our next question comes from Lauren Lieberman from Barclays. Your line is now open. Please go ahead.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. I was curious if you could talk a little bit about operating leverage. Because I know a couple times, Gavin and Tracey, you both referenced that 2Q is normally a time when you're producing pretty close to full capacity.

So as we think about the balance of the year and starting to see these structural share shifts in market share persist, if the higher volume growth – if we start to see more operating leverage kind of on a year-over-year basis because the delta is bigger in the so-called shoulder quarters than would have been, for example, in 2Q, meaning the upside in your production volume is actually higher later in the year versus 2Q, because this is already a seasonally very strong volume production period.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Yeah. So maybe let me help maybe give a little bit of color and maybe a little bit more detail around our leverage and operating leverage.

So on an enterprise basis, our fixed costs comprise about 20% of our enterprise underlying COGS. So now that does differ by geography. And the composition – as the composition of our year-over-year volume changes, that can influence that. But on average, for enterprise, COGS makeup is about 20% fixed.

And then obviously, as we look at operating leverage, our marketing strategy also supports flexibility, which does allow us to put the right commercial pressure behind our brands. And so as Gavin mentioned, we're going to be spending $100 million more in marketing in the back half of the year.

And then just from a overall sort of margin driver as well, we've mentioned the Pabst contract coming to an end. That's certainly going to help our margin, even though it is a revenue loss. But overall, a margin expansion, as well as a lot of these efficiency projects that we've been working on and our ongoing cost savings, that's all going to help drive that margin expansion over the medium term and this year.

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Operator: Our next question comes from Rob Ottenstein from Evercore. Your line is now open. Please go ahead.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much. Just a couple of follow-ups, Gavin.

First, you mentioned that on-premise was stronger than off. But I'm not sure I heard by how much – how much the on-premise was up? And you mentioned that you won 12,000 tap handles I think in Q2. Can you give us a sense of what that is as a percentage of total tap handles?

And then second, we're seeing and hearing about some weakness in the market overall in the below premium side. Is that something that you're also seeing in your – not just in your business, but in the market overall? Thank you.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Thanks, Rob. Lots of questions there. I'll take your last one first. No, we're not seeing any slowdown in our economy portfolio. As far as on versus off-premise, you didn't hear it because I didn't say it. And we're not going to get into that level of detail. But suffice it to say that on-premise grew, I would say, maybe low single digits better than the off-premise.

What was your second question? Oh, the tap handles. It's a meaningful number, Rob, and that's only Miller Lite, Coors Light, and Blue Moon which I referenced. And let's say – I'm not sure we've given this before, but let's say, around 10% higher. Meaningful for us.

Operator: Thanks, Rob. The next question comes from Chris Carey from Wells Fargo Securities. Your line is now open. Please go ahead.

Christopher Carey
Analyst, Wells Fargo Securities LLC

Q

Hey, everyone. One quick question just on the investment plan for the back half of the year. Just given the year-to-date strength, makes total sense. I'm trying to understand the tight capacity relative to the investment. It sounds like you're keeping up with demand. But just, have you contemplated a dynamic where this accelerated investment into the back half of the year accelerates demand, but you're not able to keep up with the demand?

I totally understand the brand building for the medium- to longer-term, which makes complete sense. But it does sound like this is going to be supportive of perhaps even higher demand. I'm just trying to frame how much excess capacity you might see in the system if indeed you do see a step-up in line with this increased investment activity in the back half? So, thanks so much for that.

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Thanks, Chris. Look, our tightest period obviously is always during the summer. And we always see a fall off after major holidays, just like we did in July 4th. And we're currently rebuilding the inventory as we speak, and we'll continue to rebuild it in August. And then we'll have a fall off coming out of September. And then, overall

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consumer takeoff traditionally does fall off in the fourth quarter. So it provides us a good opportunity to get inventories back to where we would like to have them going into next year.

Our marketing activities, as I said, is not just limited to the United States. We are putting more money into our other markets as well behind the momentum of a brand like Madri, behind the Coors Light and Molson trademark brands up in Canada, behind some strength in certain territories in our Latin America business. But it's also true to say the lion's share is in the United States.

And frankly, at a very, very high level, there's two kinds of marketing, right, and selling expenses. Some drive shorter term behavior, which we're investing behind; and some drives longer-term brand health, and we're going to be doing both. So as I said, we don't have unlimited capacity. But certainly, Pabst coming out of our system and then the shoulder quarters, as I think Lauren referenced, in the fourth quarter and the first quarter, give us ample opportunity to maintain inventory and supplies where we want them to be.

Operator: Thanks, Chris. Our next question comes from Bryan Spillane from Bank of America. Your line is now open. Please go ahead.

Bryan D. Spillane
Analyst, BofA Global Research

Q

Hi. Thanks, operator. Good morning, Gavin. Good morning, Tracey.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Morning.

Bryan D. Spillane
Analyst, BofA Global Research

Q

I just had two sort of related questions about free cash flow. One, Tracey, if you could just talk about the 2.5 times leverage target and just why that's kind of a desirable target, just given how much cash flow TAP – the company throws off? And it just seems a little bit conservative. So just kind of what the thinking was there in terms of getting to the 2.5 times? And then I just had one other related follow up.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Yeah. So look, we did a lot of analysis, what was the desirable leverage target for us to have? And we got to the 2.5 times. And remember, we've been very vocal and made sure that we maintain our investment-grade rating. And over time, we want to improve our investment-grade rating.

And so, it makes sense for us to continue to look at that leverage ratio, reduce our net debt. That drives us towards that upgrade in terms of investment grade. So yeah, it's just really important to us. And so, we'll continue to look at that, Bryan.

Bryan D. Spillane
Analyst, BofA Global Research

Q

Okay. And then the $1.2 billion or plus or minus 10%, the free cash flow guidance increase for the year. I think one of the questions we're getting today is just, if you were to hold on to the benefits that accrued to the company

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this year, would that be a normal cash flow? Or were there other things like capital spending coming down or just other things that the free cash flow conversion, if we sort of rebase the company from here, could be higher? Put another way, would free cash flow necessarily be higher even for this year, if there weren't some other sort of unusual things pulling on cash?

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

No. I mean, look, obviously, capital expenditure is one of the things that we look at. But I think we've been quite consistent with our capital expenditure. And we've also said that any investments we make is not going to drive our capital expenditure up significantly. And even the investments that we've made in new breweries in Canada. We built those two new modern breweries in Canada. We're busy modernizing our G150 Brewery in Colorado.

We built capabilities in our breweries, whether that's new Flavor capabilities or variety packing capabilities. All of that was in that range of around $700 million, which is the guidance that we've given for this year as well.

So don't see a significant uptick in anything CapEx related or anything unusual. I mean the one thing is at the end of the year, obviously, working capital will be a driver of our free cash flow. But yeah, nothing out of the ordinary.

Operator: Thanks, Bryan. Our next question comes from Steve Powers from Deutsche Bank. Your line is now open. Please go ahead.

Stephen Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Hey. Thanks and good morning. I wanted to just revisit the capacity question in the US, maybe from a different perspective.

I think both in the quarter and year to date, the financial volumes you shipped in the Americas lagged what you were able to ship in the first half of both 2020 and 2021. And I guess I'm just – is that – is there a reason for that? Is that reflective of capacity that you've taken out of the system at that point?

And I'm thinking about it – as I look to the back half and just trying to think about a theoretical max on what you might be able to ship. And using that same logic, I think in the back half of 2020 and 2021, you shipped 32 million, 33 million hectoliters. I just -- is that feasible in 2023? Or is the capacity just not there?

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Yeah, Steve, look, we don't have unlimited capacity, as I said. But obviously, we had strong May and June shipments, well above anything that you would have seen in 2020, 2021, 2022.

Just obviously, I think I've made the point, we had higher inventories coming into the second quarter at the end of March, and that might have affected some of our shipments in the sort of first part of April. So there is that as well.

We have long had a very robust program of seasonal workers, and some are temporary workers, which, frankly, if we needed to, we could continue even into the shoulder quarters. We traditionally haven't found that to be necessary.

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But in the event that it did, we could extend our summer brewery performance into the shoulder quarters. I'd also think, Steve, just to remind you that we are seeing Pabst come out, and that will free up a lot of capacity for us. And it'll free up and simplify our brewery. There won't be so many changeovers. There will be longer runs. Much more effective and efficient.

And as Tracey said, we start to see the benefit of that coming through at a faster rate in the second half of this year and the fourth quarter than we did in the first half. And then obviously, that'll accelerate even further into 2024. So based on what we know now, we've got the capacity to supply the market demand.

Operator: Thanks, Steve. Our next question comes from Filippo Falorni from Citi. Your line is now open. Please go ahead.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Can you guys hear me okay now?

Gavin D. K. Hattersley
President, Chief Executive Officer & Director, Molson Coors Beverage Co.

A

Yes. We can Filippo.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Great. Thank you. So just want to go back to your guidance for net sales growth on a constant currency basis of high single digits.

It seems like, Gavin, you mentioned the momentum continue in Q3 in terms of Coors Light, Miller Lite at the consumer level. You should have a little bit of financial volume kind of recovery as you ship ahead of depletions to recover the inventory.

So what – can you help me square like what are the other headwinds, other than the Pabst volume coming out in Q4, that you're assuming that kind of slow the momentum as you're expecting the second half. Any other things that we should be aware of? Thank you.

Tracey I. Joubert
Chief Financial Officer, Molson Coors Beverage Co.

A

Yeah. Filippo, let me – maybe I'll take that. So the other thing also just to note is the pricing.

So recall, the impact of our pricing increases steps down in the second half of this year as compared to the first half because of the pricing that we took in 2022. And then as we mentioned, we expect the pricing for this year to be more in the historical average of around 1% to 2% in the US.

We also are a little bit cautious around the consumer, particularly in Central and Eastern Europe, as Gavin mentioned in his remarks as well, looking at the competitive environment. And then you mentioned the contract brewing volume coming out as well. So I would say those are the big things to consider.

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Operator: We have no further questions at this time. So with that, I will hand back to Greg Tierney for final remarks.

Greg Tierney

Vice President of FP&A and Investor Relations, Molson Coors Beverage Co.

Okay. Thank you, operator, and thanks, everybody, for joining us today. I know if you do have additional questions or may have additional questions that we weren't able to answer today, please follow up with our IR team. We look forward to talking with you, many of you as the year progresses and certainly looking forward to seeing you at our Strategy Day in October. So with that, thank you all for participating in today's call. Have a great day.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect your line.

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