Constellation Brands Inc, Q2 2017, Earnings Call 2016-10-05

Presentation

Operator

Welcome to the Constellation Brands Second Quarter 2017 Earnings Conference Call. — *Operator Instructions* —

I'll now turn the call over to Patty Yahn-Urlaub, Vice President of Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thank you, Jackie. Good morning, everyone, and welcome to Constellation's second quarter fiscal 2017 conference call. I'm here this morning with Rob Sands, our President and Chief Executive Officer; and David Klein, our Chief Financial Officer. This call complements our news release, which has also been furnished to the SEC.

During this call, we may discuss financial information on a GAAP comparable, organic and constant currency basis. However, discussions will generally focus on comparable financial results.

Reconciliations between the most directly comparable GAAP measure and these and other non-GAAP measures are included in the news release or otherwise available on the company's website at www.cbrands.com.

Please also be aware that we may make forward-looking statements during this call. While those statements represent our best estimates and expectation, actual results could differ materially from our estimates and expectations.

For a detailed list of risk factors that may impact the company's estimates, please refer to the news release and Constellation's SEC filings.

— ***Operator Instructions*** — Thanks in advance.

And now, here's Rob

Robert Sands

Thanks, Patty, and good morning, and welcome to our discussion of Constellation's second quarter fiscal 2017 sales and earnings results. Before I begin a review of the quarter, I'd like to focus your attention on the press release issued earlier today reporting that we have an agreement to purchase Utah-based High West Distillery for approximately $160 million. Now this acquisition includes a portfolio of award-winning, high-end American straight whiskeys and other spirit brands at the greater than $30 retail price point.

With the addition of High West to our portfolio, we are entering the profitable, high-end craft whiskey market segment. High West sells approximately 70,000 cases annually and has experienced double-digit volume growth for each of the last 3 years. The portfolio includes 4 core products: American Prairie Bourbon, Double Rye!, Rendezvous Rye and High West Whiskey Campfire. High West will be an excellent addition to our spirits portfolio as we expect it to bolster our position in the dynamic and growing spirits category.

Now let's turn to our discussion of our quarterly results, which reflect excellent performance across our businesses, especially our beer business, which is significantly outperforming the U.S. beer market and our own expectations. As a matter of fact, during the quarter, Constellation beers contributed 60% of the total U.S. beer industry IRI dollar growth, driven by the excellent performance of our top brands, and we remain the #1, #1 share gainer in the high-end segment of the U.S. beer market, with double-digit depletion growth of almost 14% for the second quarter.

These results were driven by excellent execution by the beer team during the peak summer selling season. Our "120 Days of Summer" marketing campaign drove marketing share gains during the 4th of July and continued throughout the heart of the summer and into the Labor Day holiday. This performance was led by Corona Extra and Modelo Especial, both of which held category-leading positions as the #3 and the #2 overall brand share gainers, driven by continued distribution and velocity gains from increased marketing investments and consumer demand.

Corona Extra continued to air TV campaigns in both national English and Spanish language TV while making investments in boxing with the launch of limited-edition boxing bottles at the end of August.

In addition, Corona Extra recently became an official partner of the Los Angeles Rams, as the exclusive import beer sponsor and official Cerveza of the team and kicked off the NFL preseason with in-stadium and retail execution end [ph] market.

During the quarter, we introduced Casa Modelo, a new master brand and portfolio approach for the Modelo family of brands, including Especial, Negra and Chelada. Casa Modelo reestablishes Modelo as an iconic Mexican brewer and allows for more effective cross promotion and awareness building for each Modelo brand, setting the stage for enhanced product innovation and product line extensions.

This new strategy leverages the momentum of Modelo Especial, the fastest-growing major beer in America and the #2 imported beer in the U.S., and directly links it to the leadership of its sister Modelo brand, Negra and Chelada. Negra, which has been renamed Modelo Negra, is the #1 dark Mexican beer, while Modelo Chelada owns nearly 25% share of the Chelada market.

With its entire portfolio under one roof, consumers will begin to see a new thought advertising campaign, unified packaging, including a fully redesigned look for Modelo Negra, and a new point-of-sale at retail inspired by Modelo's heritage, tradition and high-quality standard.

During the second quarter, Casa Modelo continued TV advertising via both national, Spanish language TV and national general market TV for Modelo Especial, including a spot supporting Modelo Chelada.

I'd also like to highlight the Pacifico brand, which launched TV advertising across 11 Western states, a significant expansion of this type of marketing activity. In addition, the recently launched 24-ounce single-serve can continues to gain traction as the #1 new item nationally in IRI channels. Our Pacifico marketing investments are obviously paying off as this brand grew depletions more than 20% for the quarter.

And let's not forget about Ballast Point, which continues to be the fastest-growing major craft brand in the U.S. and achieved solid high double-digit depletion growth during the quarter. We continued to expand distribution of Ballast Point brand throughout the U.S. and recently began the buildout of a new Ballast Point East Coast brewery in Virginia.

Operationally, during the quarter, our recently expanded Nava Brewery and our supply chain performed well in delivering product supply to support our sales growth during our pre-peak sales period. As you are aware, we have been transitioning directly from our recently completed 20-million-hectoliter Nava expansion to our next critical capacity milestone of 25 million hectoliters. This project is progressing extremely well.

Last quarter, I mentioned that we have fired up our second glass furnace at the Nava glass plant. I'm proud to report that in less than 90 days we are producing and packaging quality glass from the furnace at an improved efficiency rate.

And finally, construction at our new brewery in Mexicali is picking up momentum, including an infrastructure investments to support future capacity expansions. Overall, the strong results of the beer business achieved in the second quarter are the primary driver of the upward revision to our EPS guidance for fiscal 2017.

We are now targeting EBIT growth for the beer business in the high teens range, which is expected to drive an operating margin of approximately 35% to 36% for the segment in fiscal 2017 versus our previous margin estimate of about 35%.

And now I would like to discuss the results for our wine and spirits business. During the quarter, our wine and spirits business grew earnings and expanded margins while continuing to drive share gains for our recently acquired premium wine brands, Meiomi and The Prisoner, which posted IRI growth of about 70% and 35%, respectively.

These premium margin accretive wine acquisitions have been excellent additions to our portfolio. As a matter of fact, at current growth rates, we are on track for Meiomi to achieve the 1 million case mark this year. And the Wine Spectator recently awarded the 2014 Prisoner a 91-point score, which marks the 5th consecutive vintage that The Prisoner has scored 90-plus points.

Our higher-margin Focus Brands had an outstanding quarter, posting depletion growth of 9%, driven by Meiomi and Kim Crawford, Black Box, Prisoner, Clos du Bois, The Dreaming Tree and Woodbridge by Robert Mondavi. Several of these brands were also recognized as Blue Chip brands by Impact Databank as they met the criteria for this award in terms of profitability and by posting several consecutive years of volume growth.

As you can see, we are reaping the benefits of our investments in our Focus Brands, which continued to have excellent growth potential and represent the majority of the revenue and profitability for our wine and spirits business. During the quarter, our innovation team rolled out new margin-enhancing offerings like Cooper & Thief, a bourbon-barrel aged red blend at the superluxury price point as well as the Kelly Collection [ph] priced in the superpremium price segment.

We are also gaining traction with Robert Mondavi Private Selection, bourbon barrel-aged Cabernet and Ravage Cabernet, both of which are achieving their goals so for this year.

As we head into the key holiday season – selling season for our wine and spirits business, we will be executing programming designed to ensure that we continue to drive growth, especially for our Focus Brands. As is typical at this point of this year, I would like to provide an update relative to the California grape harvest, which is currently more than 60% complete and expected to be finished by early November.

The current California industry estimate is for our total harvest yield of approximately 4 million tons versus 3.7 million tons last year. The crop is up this year versus last, which is needed to replace inventory levels. The quality looks good to be fantastic with excellent color and flavors.

From a pricing perspective, we continue to expect grain pricing to increase slightly versus last year, depending on the variety, location and demand. So in closing, we are at the halfway point of the year, and I am extremely pleased with our impressive results. Our beer business continues to deliver industry-leading results while our wine business is gaining share and is on track to meet its goals for the year, and I am pleased to welcome High West to our family of brands, and we continue to progress as planned with our brewery and glass plant expansions in Mexico.

With that, I would now like to turn the call over to David, who will review our second quarter financial results.

David Klein

Thank you, Rob, and good morning, everyone. As highlighted by Rob, we're pleased with our impressive results for Q2 and first half of fiscal '17. Strong execution and smart investments continued to fuel our growth and solidify our leadership position in total beverage alcohol.

This is demonstrated by the 17% comparable basis diluted EPS growth we generated during the first half of fiscal '17. As a result of this performance, we are increasing our full year comparable basis diluted EPS target to a range of $6.30 to $6.45 versus our previous guidance of $6.05 to $6.35.

Looking at our Q2 fiscal '17 performance in more detail, where I will generally focus on comparable basis financial results. You can see organic beer net sales increased 15%, primarily due to volume growth of 13% and favorable pricing.

Beer depletion growth for the quarter came in at 14%. Wine and spirits net sales on an organic constant currency basis increased 8%. This primarily reflects 6% volume growth and favorable mix.

Our U.S. depletions grew a little more than 3% in Q2. Our U.S. shipment volume outpaced depletions during the first half of fiscal '17. This is mostly timing related as we expect U.S. shipment volume to generally align with depletion volume for the year.

As a result, we expect wine and spirits net sales and EBIT growth in the second half of the year to be lower than the first half, with Q3 net sales expected to be flattish to down slightly and EBIT down further due to anticipated marketing and SG&A investment during the key holiday selling period.

Beer operating margin increased 200 basis points to 36.9%. This reflects benefits from pricing, volume, freight and foreign currency. These positive factors were partially offset by an increase in depreciation expense, driven by our capacity expansion activities.

Wine and spirits operating margin improved 120 basis points to 25.8%. The increase was primarily related to favorable volume, COGS and mix and benefit from the addition of the Meiomi and Prisoner wine brands, partially offset by higher investment in SG&A and marketing.

Interest expense for the quarter increased $17 million, primarily due to higher average borrowings. Additionally, during Q2, we recorded an adjustment on our balance sheet related to a prior year period for the conversion of $132 million from equity interest into debt for the Nava glass plant JV. As a result, we recognized $7 million of interest expense associated with this debt during Q2. This was offset by an increase in the net loss attributable to noncontrolling interest line of our income statement.

At the end of Q2, this debt totaled $159 million with an average interest rate of 5.7%. I would also like to note that at the end of August, we redeemed our $700 million 7 1/4% senior notes that were coming due in September of 2016. This was primarily funded with cash.

When factoring in cash on hand, our net debt at the end of Q2 totaled $7.9 billion, a decrease of $146 million since the end of fiscal '16. Our net debt to comparable basis EBITDA leverage ratio came in at 3.4x at the end of Q2 versus 3.8x at the end of fiscal '16.

Our leverage ratio at the end of Q2 does not yet reflect a full year EBITDA benefit from the Ballast Point and Prisoner acquisitions. Our comparable basis effective tax rate for the quarter came in at 31.8% versus 24.6% for Q2 last year.

Last year's rate reflected the favorable outcome of various tax items that were effectively settled in connection with IRS examinations. We continue to expect our full year fiscal '17 effective tax rate to approximate 29%.

Now let's review free cash flow, which we define as net cash provided by operating activities less CapEx. For first half of fiscal '17, we generated $676 million of free cash flow compared to $508 million for the same period last year.

Operating cash flow was above the $1 billion mark, up 30%, driven by our earnings growth. CapEx for the first half of the year was $369 million compared to $295 million for the prior year period. While our CapEx is up versus last year, it's tracking below our original plan. This primarily reflects some shift in the timing of Nava brewery capital payments into next year.

Primarily as a result of this activity, we've lowered full year CapEx guidance by $125 million to a range of $1.125 billion to $1.225 billion. The lower CapEx is driving an increase in our fiscal '17 free cash flow guidance to a range of $375 million to $475 million.

Moving to our full year fiscal '17 P&L outlook. I shared earlier that we now expect our comparable basis diluted EPS to be in the range of $6.30 to $6.45. This represents mid- to high teen growth versus last year. The increase is being driven by the strong performance of the beer business, which is now targeting net sales growth in the range of 16% to 17% with organic net sales expected to be in the 12% to 13% range. These sales targets represent the high end of our previous guidance ranges and includes 1% to 2% of anticipated pricing benefit for our Mexican portfolio.

Operating income growth for the beer business is now expected to be in the high teens. This new guidance now targets our beer operating margins to be in the 35% to 36% range. The improvement versus our previous guidance is primarily being driven by lower depreciation than we originally anticipated and some additional foreign currency favorability versus our original plan. We are now estimating beer segment depreciation and amortization to be closer to $125 million for fiscal '17, which is approximately $15 million lower than our original estimate.

For the wine and spirits business, we continue to expect net sales growth in the mid-single-digit range and operating income growth in the mid- to high single-digit range. In addition, we continue to project organic net sales and operating income growth to be in the low to mid-single-digit range.

Rob provided highlights of the High West acquisition, and I would just add that from a financial perspective, High West generates approximately $25 million in annual sales, and we expect minimal financial impact from the transaction for fiscal ’17.

I would also note before closing that our comparable basis guidance excludes comparable adjustments, which are detailed in the release.

In closing, our results for the first half of fiscal ’17 have put us on track to achieve another year of strong growth and financial performance and drive growth for the overall total beverage alcohol category.

Our focus on strong execution in the marketplace and making investments to support our business positions us to continue to propel future growth. We expect the addition of the High West Distillery and its portfolio of award-winning, high-end craft whiskeys will provide us an excellent opportunity to strengthen our spirits platform with fast-growing, consumer favorite products in an exciting category.

With that, Rob and I are happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from the line of Nik Modi with RBC Capital Markets.

Nik Modi

So just 2 quick questions for me. On-premise, Rob, maybe you can give us some context on kind of state of the union on-premise generally. And then the second question is just when you think about the overall portfolio, obviously, you have a beverage alcohol play here across all the segments. And when you think about the beer industry and a lot of areas that you're actually not competing in today, some of the new areas like cider or spiked seltzer, what have you, can you just give us your thought process and how you think about some of those verticals as white space over the coming years?

Robert Sands

Sure. First of all, as it relates to the wine – the on-premise, right, I would say that the condition of the on-premise remains fairly poor in that – to the extent that it's measurable, the on-premise I think continues to be sort of on the down-ish, slightly down-ish side. For us, our on-premise business is very strong. So we're clearly gaining share in on-premise. So while the channel is not performing particularly well, we're extremely pleased with our performance in the on-premise. And then to your second question, Nik, there's definitely white space that we think is very good white space that we don't participate in. You mentioned, for instance, the SMB category, that's a very good category in terms of its premium positioning, margins and growth. So that's clearly a subcategory that we'll be looking at in terms of developing our portfolio for the future. And then secondly, there's other areas of white space I think, a good example of our filling white space in our portfolio is our High West acquisition, right. So that has put us in the craft brown spirits, right, American straight whiskey category, and that's a fantastic category in terms of growth and margins, which we see no abatement in that trend in any time in the near future. So we've got a great entrant there and we'll be continuing to look at other areas of white space that would be available to us and make sense in terms of our portfolio and from a synergy perspective, which really anything in beverage alcohol really fits that bill because obviously, we have strong sales organizations across wine, beer and spirits and extremely strong distribution networks in wine and spirits and beer. So we're really in a position to attack anything that meets our criteria in the wine and spirits and beer business, which is pretty simple, right? High growth and high margin are really the 2 things that are critical to us.

Operator

Our next question comes from the line of Judy Hong with Goldman Sachs.

Judy Hong

So first on, I guess, on High West, I just wanted to get a sense of how we should think about your ability to really scale up the brand kind of similar to what you've done with wine acquisitions like Meiomi and Prisoner's just in terms of supply if you can also give us some color on what the supply situation looks like on High West, that will be great. And then just more broadly, as you think about your spirits portfolio, what is sort of your latest thinking in terms of the scale that you would need to really compete effectively in kind of the high-end spirits segment?

Robert Sands

So to your first question, High West, the way to think about how we can scale that up, is to look at examples like some of the ones that you pointed out, Meiomi, The Prisoner growing, both of those are growing super high single digits. I think Casa Noble is another great example, right? Fastest-growing luxury tequila – of any luxury tequila growing in IRI at 45%. Basically, what we're able to do with these brands, and we will be able to do with High West, is use our sales organization, our expertise and execution in our extremely strong distribution network to take a brand like High West and really grow it into something material in the category that it participates in. So I think that we'll be very successful in scaling that brand. And the brand already has fantastic momentum and it already is of significant size at 70,000 cases. So you apply these kind of high double-digit growth rates and for the next several years, and you can definitely see this being scaled into a material brand, especially when you think about the price point and the high margins that are associated with the brand in the category. And then what was the second question?

Patty Yahn-Urlaub

The supply situation on High West.

Robert Sands

The supply situation, we don't see any issue there. Obviously, part of our due diligence was making sure that, that we have the supply to grow the brand. So we'd wake up and fall off a log on that one. Obviously, we made sure that we would be able to supply the brand growth growing going forward.

Judy Hong

Just in terms of your view on how much scale you think would be needed to compete effectively in the high-end spirits? Do you think that you're kind of there and it's really more…

Robert Sands

Yes, I don't think that that's really a relevant sort of measure. It's not competing in high-end spirits per se, right? It's really a brand by brand kind of thing. We're going to compete and outcompete the competition with the brands that we have. The whole point of sort of our selection process as we make these sort of smaller tuck-in acquisitions is to buy brands that stand on their own and have the momentum to be of a scale to contribute material – materially to Constellation's growth and margins. And I am quite confident that High West will be one of those brands as are the other brands in our spirits portfolio. So just like we bought SVEDKA years ago and have grown that to be the second-largest vodka in the entire United States and the #1 import brand and fundamentally changed the vodka category with that brand. I think that our other spirits additions have a lot of great potential similar to that. So I guess we don't really think about the, how we compete effectively in a whole category. We think about, what's the quality of the brands that we're buying and how can they contribute to Constellation's continued stellar growth in the top line and the bottom line.

Operator

Our next question comes from the line of Mark Swartzberg with Stifel.

Mark Swartzberg

Two questions. One, on wine and spirits, you had about a $28 million SG&A increase and David, you touched on that. But could you give us a little bit more on what was going on there beyond the effect of just factoring in these new businesses? So that's one. And then #2, on Nava, what's the capacity there right now? And where are we in relation to getting to the 20 million by the end of this fiscal year?

David Klein

So I'll start with the second question first, so in terms of 20 million hectoliters at Nava, we're producing at 20 million hectoliters both from a brewing perspective and a packaging perspective. And in fact, we are on our way to our next milestone of 25 million hectoliters. So I would say that Nava expansion work is on track. We revised our capital spend primarily based upon outflows related to Nava for this fiscal year. It's – that's just simply a timing thing as we manage our way through the buildout process and manage our cash flow. So then on the wine and spirits SG&A number, it really is just incremental spend in investment areas within our wine and spirits business like marketing, innovation and having the right talent on board for our wine business.

Mark Swartzberg

Okay. It's a little vague to me. Could you give a little more on that?

Robert Sands

Well, this is Rob. Look, it's a virtuous cycle. Our performance enables us to invest more in our businesses, in particular our wine and spirits business, which is now driving significant growth in that business and enabling us to both leverage the P&L and achieve market growth, market share growth as our Focus Brands are now growing at a rate that more than offsets the decline in our tail brands, which are in categories, which are fundamentally not growing. So we're overinvesting and when I say overinvesting, I mean, we're investing more than we have traditionally specifically in marketing of our wines and spirits brands. And so what you're seeing is advertising campaigns that we've initiated to drive brands like Kim Crawford. We've got tests going on in various states like Texas, for instance, to a really heavy-consumer weight-type advertising for our brand like Kim Crawford to see how that drives the brand, which, by the way, is driving the brand fantastically. And I think that we're proving that our investments in media advertising on wine, on brands like Kim Crawford and Woodbridge is another one that we've really heavy-ed up our advertising on. But these are paying back at a rapid rate, meaning a rate greater than what you traditionally see in consumer products, which is very similar to our beer brands in particular Corona and Modelo Especial, where we see sort of the payback rates on our advertising activities at a much faster rate than what would typically be seen in consumer products. So we're both testing what we can do through marketing, and we're increasing marketing where we know that it already works. So hopefully that's specific as far as market...

David Klein

Mark, I'd also point that...

Mark Swartzberg

Yes, it helps and encouraging. Yes?

Robert Sands

It is encouraging. It’s super encouraging as a matter of fact.

David Klein

I would also want to point you, Mark, to, we still believe in and its implied in our guidance that we’re going to get leverage from net sales to EBIT in our wine and spirits business despite a spending increase.

Robert Sands

And share gains.

Mark Swartzberg

It’s helpful and just quite encouraging.

Operator

Our next question comes from the line of Tim Ramey with Pivotal Research.

Timothy Ramey

David, you mentioned that the tax rate would come in at 29% I think, you said for the full year, which implies a pretty low rate for the 3Q and 4Q. Is there anything lumpy about the split between those quarters so that we don’t get our estimates too confounded here?

David Klein

No, I think, as is always with tax planning, I am sure, anything I say will be wrong. But I would suspect that the way we have our initiatives planned over the rest of the year you can expect it will be roughly flat to bring you around to that – between the quarters to bring you to that 29% guidance.

Timothy Ramey

Got it, okay. And Rob, as you pointed out quite rightly, your wine business has been pretty dramatically outperforming, but the category has been pretty good too. How would you describe the category outlook? Are we still in kind of an acceleration mode or just sort of growth is stable but okay?

Robert Sands

Well, I think, the category is performing very well. I think that we'll continue to see sort of mid-single-digit volume type growth in the category, right? And I think that we'll see the spread between volume and sales and therefore, premiumization and trading up, I think, we'll continue to see that grow. I think, we're seeing a real shift, whereas, 5 years ago, we were sort of talking about what they used to call the superpremium category, which was the $8 to $12 range, as really being the hot and premium segment of the industry. We're seeing a definitive shift up in that regard and now you're sort of seeing this $15 to $25 segment really coming on strong as well as segments above that. So this is what's driving the growth of brands like Meiomi, which are about $20 a bottle or even Prisoner closer to $40 a bottle as this premiumization trend, which we think is going to continue unabated in certainly the midterm. So I'd say that the outlook for the category continues to be extremely positive.

Timothy Ramey

And just relative to the crop, generally when we get a bigger crop, as it looks like we might this year, that does put some pressure on bulk wine prices, which I would think might have good impacts on brands like Mark West not right away but perhaps for fiscal '18. Any thoughts on just the state of the bulk wine market and some of the brands that are sourced from bulk wine?

Robert Sands

Yes, I mean, look, a bigger crop, it definitely bodes well for lower prices and supply, especially like you mentioned Mark West, for pinot, it can't be tight. So larger crop is going to be better all the way around. Could there still be a little price – a little cost inflation associated with that? Yes. But we're not – as typical, I mean, we just don't see cost inflation on the wine side of the business as being a big material factor in driving anything. I mean, we're expecting I'd say very normalized, pretty low cost inflation that we'll be able to pass on one way or another. So we don't see it impacting margins. And as I said, the bigger crop is a positive thing, yes, that will even help that. So it's a good thing for supply and cost.

Operator

Our next question comes from the line of Caroline Levy with CLSA.

Caroline Levy

I was just wondering, David, if you could walk us through, again, the moving parts for margins in beer and also in wine in the back half. Because you did throw out a lot of different things that were favorable in the first half and then some higher spending but it would be really helpful as the peso, the depreciation, all those things if you could just run through that?

David Klein

Yes, so as we said, the real change in our guidance was driven by a move in the peso and slower ramp-up of the depreciation charge into the business, right? So that explains why we slid our guidance up a little bit, so that's the first bit. I would say in the second half, we really would expect that gross margins would be flattish to the first half. We would expect that our marketing spend, which we say is between 8.5% to 9% of net sales, that will be flattish in the second half, however, a big chunk of that will be spent in Q3 versus in Q4. So there will be a little bit of volatility in that. And then when you get to the remainder of SG&A, if you think about that as SG&A in a growing business, you start out, and you say well, if you're not going to grow it at all over the course of the year, it's going to be straight line throughout the year. And in our business, SG&A is actually growing a little bit because the business is growing and it's really that SG&A drag, which you're going to see affecting the beer margins in the second half. And then …

Caroline Levy

Is that depreciation a bit of a catch-up versus the first half not being up?

David Klein

Yes. See when we get into the second half, you start to have more depreciation come online, you get a little bit more noise on line commissioning, you have less throughput at the plant. So there are a lot of puts and takes, I would say, in the second half. But as I said, I would still expect that our margin – our gross margins in beer will remain somewhat consistent. And then our wine, for the most part, our wine expansion in the U.S. has been driven by mix. And mix in the form of nonorganic, such as Meiomi and The Prisoner, but also mix within our base portfolio has improved as well, or our organic portfolio has improved as well. In addition to that, we have had some benefits from freight savings in the U.S. on wine. But I would say that we would expect wine margin trends to remain somewhat consistent in the second half. Although as I called out in my script, we can expect that since over the course of the year, shipments will roughly equal depletions that will have a slowdown on the shipments line in the second half. Even though consumer pull continues to be very strong and depletions will continue to be healthy.

Operator

Our next question comes from the line of Bill Chappell with SunTrust.

William Chappell

I may have missed it. Can you give us maybe some update on the Canadian wine business in terms of decisions to IPO versus for divesture? And the reason I ask that is I would have thought if we were in a process for sale that you would have may be separated the revenue out as available for sale and not be part of the numbers. So I'm just trying to –

any update and kind of thought process or where that process stands?

David Klein

Yes, so I'll start out and then Rob can add some color. So where we are from an internal standpoint is we're still evaluating the IPO route. And I would say that in the last quarter, we finished our carve-out statements, which I will admit took longer than we had expected, I think, when we first started the process. And then beyond that, I would say that as we do with every decision the company has to make, we consider all of our alternatives. But as of this moment, we're still doing the work to prepare for an IPO.

Robert Sands

Yes, I guess I would only add that as we have sort of gone down the IPO right, the myriad of opportunities relative to the Canadian business are numerous. So we are in the process of evaluating all of the opportunities that are available to us, and I would venture to say that we'll have something to say about all of that in the relatively near future when I would say our decisioning and the opportunity is crystallized. So as I said, more to come on that in a relatively near future. All very positive though.

William Chappell

Good to hear. Good to hear. And a follow-up on the whiskey side just kind of future plans that whiskey can be segmented with a lot of different brands, stand for a lot of different things, including, I am sure, old [ph] West. Do you look to add a variety of brands to build up the portfolio? Or do you really want to just get behind old [ph] West for the near term?

Robert Sands

We'll look at other brands as they become available. We're really kind of attacking I'll say whiskey from a couple of different perspectives, right? So #1, we bought High West in its entirety. In essence, we'll be integrating that into the Constellation wine and spirits platform, albeit, we will be keeping and utilizing the resources that High West already has, which is one of the attractive things about that particular acquisition. And then on the ventures side of the business, we've made an investment – we've made an investment in another bourbon brand.

David Klein

Greenbrier.

Robert Sands

Yes, the Greenbrier company, which currently has released its Belle Meade brand of American straight whiskey, right, bourbon. And we'll be introducing other brands as they continue to distill and age the whiskey. So that was a minority investment on the Greenbrier side. We think that's got some real attractiveness as well. So we're able to help them out more as a minority partner and on a consultation perspective. And then on the High West side, as I said, we've taken full ownership of that, and we'll be in essence integrating that into our wine and spirits platform. So we'll continue to look at that category and look at it both through our Constellation ventures lens as well as our normal sort of M&A lens.

Operator

Our next question comes from the line of Rob Ottenstein with Evercore ISI.

Robert Ottenstein

So in terms of the High West, can you talk to us a little bit about the products' brand, proposition? What makes the brand attractive and why you think it has a national appeal? And then separate or related to that, just kind of thinking about actually buying the brand and the business in total as opposed to having a distribution agreement in which you distribute the product for them and take a nice payment for the ability to use your system as opposed to buying it straight out?

Robert Sands

Yes, so in terms of the brand and the proposition, we think that the brand, #1, has a great image. The proposition is all about the founders of the company going into the business before bourbon and rye had really reached the level craft bourbon and rye in particular reached the level of popularity that it has to today. They took a view that much like the Scotch whiskey category that sort of a combination of distilling and aging their own whiskey and then combining that with blending could create a product that was really superior so that they did create those products. And I'll say through the expertise of master blenders that they brought in created a product that really appeals to the luxury American straight whiskey and bourbon and rye consumer and was able therefore to take advantage of the whole sort of craft trend in that area. So we think it's a relatively unique proposition and that certainly is reflecting itself in the way that the company has been able to grow the brand. And we think that we're going to be able to really take that platform and accelerate that. Distribution agreements, we have no interest in whatsoever, okay? Number one, you don't own the brand. Number two, distribution agreements are short term, nobody is going to sign up and give you the distribution rights for life. Number three, distribution margins are small relative to the kind of margins that we at Constellation generate through our owned brand portfolio and certainly the type of margins that we're talking about on luxury spirits. So we don't have really any interest at all in distribution, low margin, short-term distribution agreements that would utilize probably one of our most valuable assets, which is our sales and marketing organization. So we don't see that – we don't see distribution arrangements as an add-on for the future. As I said, way, way, way too low margin and no brand equity related there too.

Robert Ottenstein

Terrific, very clear. And then just on the beer side, could you please give us an update in terms of where things stands on the beer's draft initiatives? There's a lot of talk about that a year ago. And maybe where you are in terms of rolling out, I think, it was mostly Corona

Light in terms of how you're doing with tap handles penetration with sort of growth and size of that business today versus a year or 2 ago?

Robert Sands

Yes, draft is going fantastically. I mean, the bottom line there, our total draft volume increased 30%, for example, in the second quarter. So it's a significant contributor to our growth. Most of that growth was driven by Modelo Especial draft for instance, which was up almost 50% year-on-year, and we're seeing these kinds of positive trends across our whole draft portfolio. So draft, which was something that we almost didn't participate in at all and, nevertheless, a significant segment of the beer industry, is another area that we're sort of infantile in but will contribute significant growth to the business going forward. So we're very excited about the draft proposition. We've been running tests with Corona draft, obviously, Corona Light draft is an area that is also providing growth for the company. So just nothing but up there.

Robert Ottenstein

That's great. And just what percentage of your business now is draft and where do you think it could go?

Robert Sands

It's small, and I think that it could start eventually to reflect industry – the industry amount. So for us, less than 5%. And for the industry, I think, it's closer to 15% to 20%, something like that. 10% to 15%.

Operator

Our next question comes from the line of Bonnie Herzog from Wells Fargo.

Bonnie Herzog

I guess I wanted to follow-up a bit on wine pricing opportunities, which you touched on.

Clearly, you're driving a premiumization of your portfolio with your recent acquisition. But I guess I was hoping you could talk a little bit more about potential pricing opportunities you have with some of your larger brands, such as Mondavi, which has generally seen price deflation over the last several years.

Robert Sands

Go ahead.

David Klein

So we're beginning – we're maybe 3 years into a pricing journey in our wine business where we're trying to apply the same sort of pricing discipline that we apply to our beer business on a year-in and year-out basis. And I would say that so far, our wins have really been at the low end of the portfolio and at the luxury end of the portfolio. But we do believe that over time, that we will continue to get pricing opportunities across the portfolio, right? So this will be the third year we've taken price in various brands in our wine portfolio and this will be the year where we have the biggest effect of those price increases but I would say that we're just beginning that journey. And I would also say that we're also seeing some ability to take price in certain segments of the wine category that haven't taken price in the past. So we remain cautiously optimistic but we need to get some wins behind us before we want to talk about that much more.

Robert Sands

Yes, And I would just point out just a couple of interesting statistics, which we track, which is, if you look at IRI and year-to-date pricing for the top 20, we call premium SKUs, the percent change now this is excluding Constellation, the top – the percent change versus a year ago is about 1.3%, okay. And then if you looked at year-to-date pricing for our top 10 SKUs in the premium category, meaning Woodbridge and above, we're at plus 3.5%. So I think that the sort of journey that David was talking about is reflecting itself and working relatively well at the current time.

Bonnie Herzog

Okay, that makes sense. And then just one final question on Corona cans. Could you just update us on the progress you've made with your cans and then maybe touch on your penetration or ACV and consumer acceptance?

David Klein

Yes, so we continue to see cans growth. So as a percentage of Corona Extra sales, there is still around 6%. But we saw – from a depletion standpoint, we saw high teens growth in cans for depletions in the quarter. So we continue to see increasing consumer uptake of the brand. And I would say that from an ACV perspective, our cans are not distributed anywhere near the level of kind of the total 80 ACV that, that brand Corona has distributed at. So we think there's still a lot more runway for that.

Operator

Our next question comes from the line of Steve Powers with UBS.

Stephen Powers

Maybe first, David, just any color on what drove the CapEx shifts into '18? And then back to the DNA topic in beer. Should we expect that too to kind of ramp and catch-up in fiscal '18 commensurate with the CapEx moving?

David Klein

Yes, so as we indicated earlier, I just want to reiterate, we're on track with all of our build-out activity. I would say that it just – we have a multibillion-dollar activity going on in Mexico and it's really difficult to forecast, to get the actual dollar amounts of cash payments nailed down to a specific quarter. So I think we're seeing a little bit of that going on. And so anything that slips out of this year, we can expect will end up coming through our cash flow statement in FY ’18. And in terms of depreciation and amortization, in my comments earlier, I said that we would be at $125 million of depreciation and amortization for the beer business. That does – that will just by definition, the growth from about $65 million last year to $125 million this year, that will be somewhat back-end loaded just given the fact that we are behind a little bit on a year-to-date basis.

The other thing I think to keep in mind though is that, as I also indicated, we would expect that our margins, our gross margins in beer will remain roughly flat first half to second half so there’s just a whole bunch of moving pieces there, depreciation just being one of them.

Stephen Powers

Okay, fair enough. And then separately, I was wondering if you could just comment a bit more on the response to the recent marketing, especially in Modelo. You’d mentioned earlier, it’s a great payback on that and obviously, we see the business results. But just I wondered, is there any ways that you can get underneath that and measure the ROI on these marketing investments whether in terms of real-time or relatively real-time, increases in brand equity or other indicators that give you confidence about the longevity of the ROI related to this investment?

David Klein

Yes, so this is something that we spend a fair amount of time on, and I would say that our team is outstanding at understanding the returns they are getting from their marketing investments. And we continue to see payback from our investment in Modelo Especial. Let me give you an example. When we were talking about our thoughts for the second quarter at the end of the first quarter, we actually thought that we would see a spike in marketing spend in Q2. We did spend more in marketing, but as a percentage of sales, it ended up being in line with our projections, simply because we got a significant short-term payback from that investment. So we continue to monitor that on an ongoing basis and that's our work on the beer side. And, as Rob had talked about the marketing investment on the wine piece of our business, we're bringing that same rigor to marketing spend in wine.

Operator

Our next question comes from the line of Brett Cooper with Consumer Edge Research.

Brett Cooper

I just wanted to ask you on shelf placement, retailer acceptance as we get into fall shelf resets, what you guys have seen, have heard kind of rumblings that craft has lost some space and you guys and F&B picked up. Just wondering if you can give any color?

Robert Sands

Yes, I think that there's some truth to that. We're certainly trying to drive that trend through our category management efforts. I would say that as a general proposition, we probably think that craft is over-SKU-ed and over spaced and imports given the importance and the growth of high-end imports are under-SKU-ed and under spaced. And premium domestics are way over-SKU-ed and over space. So that's something that we spent a lot of time sort of thinking about, which is assortment in the high-end, especially, and I think we're in a very strong position to advise our retail customers through our category management initiatives as to ways that they can improve their velocity as well as their profit per unit space that they're devoting to beer. So that's a big part of what we're doing, and I think that the trend that you're alluding to is definitely occurring. And I think that, that bodes really well for us in a couple of ways. Craft, even though you're going to see some shakeout there, I think that what will also occur there simultaneously is that the bigger, stronger, faster growing brands like Ballast Point will and should be given more space, more SKUs sort of for the obvious reasons because it's moving and it's highly,

highly profitable. And I think that you can say the same thing about imports because it's going to become obvious to the retailer that that's the best way to maximize, as I say, their velocity and profitability for the unit space that they're devoting to the category. So the trend that you mentioned is occurring and it bodes extremely well for our entire beer business because we only play in craft and the high-end.

Brett Cooper

And if I could follow-up on pricing. I mean, from the data that we see that your pricing is going up much – or going up more than we're seeing from others. As you head into I guess calendar '17, thoughts on expanding price caps given that you guys continue to drive some meaningful share gains?

Robert Sands

I'm not sure our price is really going up more than others. It's going up to the extent that we're taking pricing where we're right in line with sort of the typical I'd say inflationary increase that occurs every year, and we continue to look at it on a market-by-market basis. We're probably under 2% when we combine everything sort of between 1% and 2%, and I would say that, that's normal just to keep up with the pace of – with cost of goods inflation and so on and so forth. So nothing different, I would say, is occurring on the pricing front period industry-wide from what we can see.

Operator

Our final question comes from the line of Laurent Grandet with Crédit Suisse.

Laurent Grandet

I've got a question regarding Ballast Point. You previously stated that a goal to have Ballast in 50 states by the calendar year-end. Where are you on this progress? And also on Ballast Point, I mean, it seems like the growth is coming from ACV – it's coming from, sorry, distribution and ACV. What about the velocity and in terms of sales? It seems to be flat to us. So what are you doing to increase the repeat purchase here, which would be critical for that brand?

David Klein

So first of all, on distribution, the brand is in 43 states plus D.C., and we continue to plan to expand that for the remainder of the year. And as it relates to what sort of runway we have on distribution, it's a brand that has an ACV of say in the low 20s versus some other major crafts that are more in the mid – low to mid-60s, right? So we think that there's a lot of opportunity on the distribution front. And I would say, as it relates to just overall velocity, I think, we have a little bit of an effect as we grow points of distribution that we're driving down our own brands' velocity. But we continue to be pleased with the brand. As Rob mentioned, we've got depletions that are up 40% on a year-to-date basis. We have – we're very pleased with where we are from a profitability standpoint as we've continued to get leverage in the production environment at Ballast Point. So we're just generally very happy with where we are with Ballast Point.

Laurent Grandet

And last, one final on Ballast, if I may. What would you say to those who said that with Ballast Point management team leaving, you lost some kind of know-how and craft credentials?

Robert Sands

Yes, I guess, I'd say I think, it's the opposite. I think that, that team certainly had some knowledge and credentials, but I don't think that they have anywhere near the level of sophistication and knowledge, okay, that the team that we supplanted them with has. First of all, as far as that team goes, okay, we replaced the CEO with Marty Birkel, who is the guy who ran national sales for our beer business for 8 years and probably the fastest growth period in our entire beer business and therefore, is really one of the stars in the beer business period. And also was our sales president for our wine and spirits business as well for many years. And he brings a level of knowledge and expertise in growing brands and in wholesale and distributor relations and sales execution that far exceeds with the previous management team had. And then if you look at the sales side of the business, we replaced the sales guy with the #2 sales guy that was heading California already at Ballast Point, and California presented a very large proportion of the business. And this is the guy that was driving that portion of the business. And then the other changes aren't going to have any real commercial effect on the business. So I would say if anything, we're really excited about the changes that have been made and we think that it's going to lead to even stronger results on Ballast Point as it grows into a much larger business and needs a degree of professionalism that I don't think that the old management team could bring. And then as it relates to the product itself, we have the same production team, the same expertise in the making of what really is the highest quality and most award-winning craft beer brand of any size in the country. And they're just – they're going about their business and doing what they've done in the past and they're probably doing it better than they've ever done it before. So there's a lot of really exciting stuff. And then sort of culturally, everybody is acutely aware of the type of culture that needs to be maintained in sort of that fast-moving craft-type business, where it's important to continue to proliferate new products and new types that the consumer is really interested in, that particular craft consumer. So I don't think that we're going to see anything lost there. So we're very optimistic and very pleased with the changes that we've made.

Operator

That was our final question. Now I'd like to turn the floor back over to Rob Sands for any additional or closing remarks.

Robert Sands

All right. Well, thanks everybody for joining our call today. And as we close out the discussion of our second quarter results, I want to reiterate that I am extremely pleased with our performance and our accomplishments for the first half of the year. Though the year is far from complete, our new guidance reflects the confidence that we have in our ability to execute in the second half. Now we look forward to seeing many of you in our upcoming New York City investor meeting scheduled for November 9. At that time, we plan to outline Constellation's strategic business initiatives and outlook for the future. So thanks, again, and have a great rest of your day.

Operator

Thank you. This concludes today's conference call. You may now disconnect.