Constellation Brands Inc, Q2 2021, Earnings Call 2020-10-01

Presentation

Operator

Welcome to the Constellation Brands Q2 Fiscal Year 2021 Earnings Conference Call. — ***Operator Instructions*** — I would now like to turn the call over to Patty Yahn-Urlaub, Senior Vice President of Investor Relations. Please go ahead.

Patty Yahn-Urlaub

Thanks, Jonathan. Good morning and welcome to Constellation's Second Quarter '21 Conference Call. I'm here this morning with Bill Newlands, our CEO; and Garth Hankinson, our CFO.

As a reminder, reconciliations between the most directly comparable GAAP measure and any non-GAAP financial measures discussed on this call are included in our news release or otherwise available on the company's website at cbrands.com.

Please refer to the news release and Constellation's SEC filings for risk factors, which may impact forward-looking statements we make on this call.

Before turning the call over to Bill, similar to prior quarters, I would like to ask that we limit everyone to one question per person, which will help us to end our call on time.

Thanks in advance, and now here's Bill.

William Newlands

Thank you, Patty. Good morning and welcome to our second quarter conference call. Before I begin with a discussion of our performance in the quarter, I'd be remiss if I didn't acknowledge the continued and unprecedented challenges of this year marked by the ongoing impacts of the COVID-19 pandemic; ongoing social unrest rooted in a long history of racial injustice in this country; and the most recent string of natural disasters, including wildfires across the western part of the United States.

As it relates to the fires, fortunately, all Constellation employees are safe and accounted for, and there have been no direct impacts to any of our facilities. That said, our hearts go out to those who have been adversely affected by the fires, and we send our sincere thanks to the brave firefighters and other emergency personnel working tirelessly to battle the fires and keep people safe.

I'd also like to thank the members of our Constellation team, who continued to pull together despite adverse circumstances to drive the success of our business, including excellent second quarter results. As Garth and I review these results, we'd like you to focus on 3 key takeaways. First, in what was expected to be our most challenging quarter of the year, our team overcame COVID-related headwinds to deliver solid business performance in Q2. This performance was led by our beer business, which grew depletions by almost 5% as we continue to see incredible consumer demand for our portfolio of brands.

While the COVID-related slowdown of our beer production in Mexico earlier in the year impacted shipments and net sales in Q2 and created some temporary out of stocks at retail, we are quickly recovering and expect inventory to return to normal levels by the end of Q3, and we're beginning to see accelerating consumer takeaway trends in IRI channels as we work to ensure that consumers can find their favorite Constellation products on the shelf at retail.

Second, our wine and spirit premiumization strategy continues to gain traction as our higher-end wine power brands outpace the U.S. high-end wine category in IRI.

Regarding the Gallo transaction, both Constellation and Gallo remain committed to completing this transaction, and we're very encouraged by the progress that we've been making. We continue to receive positive feedback from the FTC staff and addressing the concerns that they raised related to the transaction. Based on our interactions with the FTC, we expect a consent decree will be submitted to the commissioners for review and approval in the coming weeks. We're happy to say that this marks the final stage in this process. Once final approval is received, closing can happen quickly, which allows us to forge ahead with the strategy for our wine and spirits business.

And third, the strong performance delivered by our beer and wine and spirits businesses drove strong cash generation, allowing us to further reduce our debt and progress towards our desired leverage range. As a result, we are well positioned to deliver a solid year of organic growth in fiscal '21.

Let's move to a more fulsome discussion of our beer business performance in the quarter. Despite the challenges posed by COVID-19, including the continued partial closure of the on-premise, which was down 50% in the quarter year-on-year, Constellation's beer business continues to be one of the largest contributors to U.S. beer industry growth.

During the second quarter, our beer business delivered 11% growth in IRI channels overall and more than 15% growth for our priority SKUs. This performance was driven by 12% IRI growth for Modelo Especial as the brand solidified its position as the #3 beer brand in the U.S. beer market, and the brand family is on track to deliver its 35th consecutive year of growth.

The Corona Brand family also grew double digits in IRI channels, with the most significant contributions coming from Corona Hard Seltzer, Corona Premier and Corona Extra. We continue to be thrilled with the performance of Corona Hard Seltzer. Despite launching this new brand in the midst of a pandemic, which presented us with – prevented us from engaging in a number of the activities conducive to introducing a new brand, Corona Hard

Seltzer has become one of the most successful new product launches in our company's history. With the launch of only one SKU to date, the brand continues to exceed our expectations and has already achieved the #4 position in the category.

To put this in perspective, Corona Hard Seltzer is the second fastest moving hard seltzer. Let me repeat that: Corona Hard Seltzer is the second fastest moving hard seltzer for those seltzer brands with significant distribution and velocity and remains strong as we continue to pick up distribution. These ongoing distribution gains have led to IRI ACV distribution approaching 70% since product launched in March. And to date, the brand has maintained incrementality levels at the 90% rate, significantly outcasting our expectations.

Corona Hard Seltzer over indexes to the Hispanic consumer relative to its competitors, which unlocks an untapped opportunity for this category with the fastest-growing demographic in the country. Currently, 15% to 20% of brand volume is estimated to come from Hispanic consumers, while other seltzer brands are closer to 10% to 15%.

Our expectations for the hard seltzer category growth are extremely high, and our intention is to become a top 3 player in the hard seltzer market as we believe there's a natural and compelling connect between what the Corona Brand stands for and what consumers want in a seltzer, refreshing great taste hint the flavor and ours at 0 carbs, 0 sugars and only 90 calories. In the future, you'll see us expand with new flavors, new packages and even new platforms. So stay tuned.

From an operational perspective, we continue to engage in constructive conversations with the Mexican government as it relates to our future plans for production in Mexico. Meanwhile, we're progressing with the 5 million hectoliter expansion of our Obregon facility, which is expected to be completed by the end of this fiscal year. As a reminder, after the completion of the Obregon capacity expansion, we believe we will have ample capacity at the Nava and Obregon breweries to meet consumer demand over the medium term. This includes more than doubling of our seltzer production capacity heading into our next fiscal year.

Let's now move to the quarterly results for our wine and spirits business. I'm pleased that we're nearing the finish line with the Gallo transaction, which paves the way for accelerated growth and margin performance for our wine and spirits business going forward. It also aligns with the vision for our business to be a bold and innovative higher-end wine and spirits company with distinctive brands and products delivering exceptional consumer experiences.

During the quarter, we continued to see the staying power of the consumer-led premiumization trend with premium price point segments continuing to outpace value price segments, further reinforcing the strategy of our business. In fact, our higher-end wine power brands at the greater than $11 retail price point outpaced the U.S. high-end wine category in IRI channels driven by Meiomi, Kim Crawford and the Prisoner portfolio, all of which posted double-digit growth in IRI channels for the quarter. These trends drove excellent margin performance for the business as price and mix benefits for this higher-end stable of brands drove significant margin enhancement. Throughout the remainder of the year, we plan to continue to invest in capabilities that position our wine and spirits business for long-term success.

The wine and spirits innovation pipeline is primed with impactful product introductions as we enter the peak seasonal period for the business. These initiatives are aligned with the key consumer macro trends of betterment, convenience and sustainability that we believe can drive scale going forward.

Key product launches include the Prisoner Cabernet Sauvignon and Chardonnay varietals, SVEDKA and High West ready-to-drink cocktails, Ruffino wine spritzer and Meiomi Cabernet Sauvignon. These initiatives will be supported throughout the remainder of the year with impactful marketing campaigns to strengthen and build the portfolio.

And while we're already a leading player in 3 tier e-commerce, we're excited about our renewed focus on the direct-to-consumer space with our acquisition of Empathy and our minority investment in the Booker Vineyard's business as we believe e-commerce, including DTC, can become a key growth driver for our business.

E-commerce for beverage alcohol has exploded due to the pandemic, increasing 3 to 4x in volume versus prior year. We were focused on e-commerce as a growing channel even before COVID and have further accelerated our strategy with increased resources and focus on digital shelf management and redeploying marketing dollars to support our digital commerce channels.

Now I'd like to take a minute to address the unfortunate wildfire situation in the west in a bit more detail. As mentioned, and thankfully, all of our employees are accounted for and safe, and no Constellation properties have been impacted by the fires. While we're more than 70% through harvest, it is still too early to determine the overall impact the fires and resulting smoke might have on this year's vintage. However, we continue to perform extensive testing and evaluation, and we have considered a number of potential contingencies and options as we progress through harvest based on our perspective at this point. That said, we are committed to providing consumers with the same high-quality wine they've come to expect from our higher-end brands. And despite potential impacts from the fires, we fully expect to be able to meet consumer demand for our excellent portfolio of products. Garth will provide some additional details in a few minutes on that topic.

Now moving to our ventures portfolio. Last year, we announced our commitment to invest $100 million to support African-American black and minority-owned start-ups in the beverage alcohol space as part of our efforts to enhance diversity and access to opportunity within our industry. We're happy to say we've received significant interest in this program to date. We've also made good progress over the past several years with our focus on Female Founders initiative as female-funded and/or female-led businesses now account for more than half of our ventures portfolio. We see an opportunity to make similar progress in supporting African-American black and minority businesses in the coming years and look forward to updating you on our progress.

We've recently acquired a minority stake in the Booker Vineyard's business, a super luxury direct-to-consumer focused wine portfolio to further align our wine and spirits business to changing consumer preferences. We believe this relationship strengthens our fine wine portfolio and our long-term aspiration to build a strong omnichannel business that includes category leadership in DTC and 3 Tier e-commerce.

Additionally, we recently acquired the remaining interest in Copper & Kings American branding company, which marks our first full ventures acquisition. Copper & Kings is a cutting-edge distillery that primarily produces highly-differentiated American brandy with a tasting room and restaurant located in the heart of urban country in Louisville, Kentucky. This acquisition allows us to play in the rapidly emerging craft spirits market, where premiumization trends remain robust.

Finally, we're pleased with the progress that the Canopy Growth team has made in prioritizing a strategic direction to focus on what's needed to become a world-class CPG company. They've identified goals for their core markets, rightsized their footprint, balanced supply and demand needs, improved execution and made progress in reducing operating expenses and cash burn.

I'm especially excited about the successful launch of the Rec 2.0 cannabis beverage products in the Canadian cannabis market, where Canopy has a 75% market share and the top 4 SKUs in the category, shipping more than 1.6 million cans since launch in March. For comparison, in the calendar year 2019, a total of 4 million cans of cannabis beverages were sold in the entire U.S. market over the course of that year. So great progress to date. We believe that beverages and other Rec 2.0 products will attract new consumers to the market and further drive conversion from the illicit market. And earlier today, Canopy growth announced plans to bring its line of cannabis beverages to the U.S. next summer through its revised agreement with Acreage Holdings. Overall, Canopy remains the best position to win long term in the emerging cannabis space and is well capitalized to face the challenges associated with this current economic environment.

In closing, I want to take you back to the 3 key takeaways mentioned at the top. I'm extremely proud of the results our team has driven in the face of continued adversity. And what was expected to be our most challenging quarter of the year, our team overcame COVID related headwinds to deliver solid business performance in Q2. Our beer business continues to be a top growth driver within the industry, and we're seeing accelerating consumer takeaway trends in IRI channels as we work to rebuild our inventory position.

Our wine and spirit premiumization strategy continues to gain traction, and we are in the final stages of completing our transaction with Gallo, which paves the way for accelerated growth and margin performance for our wine and spirits business going forward. And our performance in the quarter drove strong cash generation, allowing us to further reduce our debt and progress towards our desired leverage range. As a result, we are well positioned to deliver a solid year of organic growth in fiscal '21.

This year also marks our company's 75th anniversary. We have a strong legacy of success that we're extremely proud of. Our continued growth and resilience will help ensure the future of our company remains extremely bright. And as I often like to say to our team, we firmly believe the very best is yet to come.

And with that, I would like to now turn it over to Garth, who will review our financial results for the second quarter.

Garth Hankinson

Thank you, Bill, and hello, everyone.

Despite an uncertain economic environment and headwinds related to COVID-19, Constellation Brands continues to generate strong financial results. During our second quarter, we generated comparable basis EPS, excluding Canopy growth, of $2.91, continued to deliver strong margins in both our beer and wine and spirits segments and increased free cash flow by 10%, resulting in ongoing debt repayment and progress in achieving targeted leverage.

Now let's review Q2 performance in more detail, where I'll generally focus on comparable basis financial results, starting with beer. Despite reduced shipment volume in Q2 related to COVID-19, net sales were flat to prior year. Excluding the impact of the Ballast Point divestiture, organic net sales increased 1% on organic shipment volume down 1%, which was partially offset by favorable pricing.

Depletion volume growth for the quarter came in at nearly 5% driven by Modelo Especial and the successful launch of Corona Hard Seltzer as strong performance continued in the off-premise channel and more than offset the impact of the nearly 50% year-over-year reduction in the on-premise channel due to COVID-19.

In Q2, we benefited from one extra sell day. When adjusted for the extra sell day impact, the beer business generated approximately 4% depletion volume growth. In Q3, depletion selling days are flat year-over-year.

While depletion trends tempered in Q2 versus Q1 due to some out of stocks resulting from the slowdown in production earlier in the fiscal year, we remain confident in the strength of our business as underlying consumer demand remains quite robust. We are making good progress in rebuilding inventory supply across our network, both at our distribution centers and with distributors, following the production slowdown for nearly – for roughly 2/3 of our Q1 and the beginning of Q2 that created out of stocks at retail and negatively impacted depletions during the quarter. We expect distributor inventory levels to return to more normal levels by the end of Q3 as shipment volume is expected to outpace depletion volume during the quarter.

Moving on to beer margins. Beer gross margin of 55.7% was flat to prior year as favorable pricing and the benefit of the Ballast Point divestiture was offset by unfavorable mix and increased operational costs driven primarily by higher material costs and reduced throughput at our breweries, resulting in unfavorable fixed cost absorption.

Marketing as a percent of net sales decreased 70 basis points to 8.4% as marketing spend decreased resulting from COVID-19-related sporting and sponsorship event cancellations and/or postponements. As a result of the above-mentioned factors, beer operating margins increased 70 basis points to 42.5%.

Looking ahead to the balance of the year, a couple of items to touch on from a beer segment perspective. First, we plan on taking selective price increases this fall. For our pricing strategy, we implement price increases annually on a market-by-market and SKU-by-SKU basis depending on the dynamics within a given market. This year, our pricing approach remains intact. However, the timing of the price increases could be more staggered throughout the back half of the fiscal year and in some instances may shift into the beginning of our fiscal year 2020. With that said, for fiscal ’21, we still expect 1% to 2% of pricing within our Mexican portfolio.

Second, our marketing spend in the first half of our fiscal year was significantly muted as a percentage of net sales decreased to 8.6% due to the lack of sporting and sponsorship events. However, during the back half of the fiscal year, we are committed to an increase in spending behind our brands, especially by leveraging the return to sports. As such, we expect marketing spend in the range of 9% to 10% of net sales on a full year basis.

Moving to wine and spirits. Our wine and spirits power brand strategy continues to gain momentum as marketplace performance for our higher-end power brands continues to outpace the higher-end segment. However, as expected, power brand depletion volume decelerated during the quarter resulting in a 1% decline, while overall depletion volume for Q2 declined 3%, reflecting the brands to be divested.

To better align with our strategy for the business going forward, we did not replicate some lower return incentive programs and pricing initiatives that ran during our Q2 fiscal '20. During the quarter, we also worked to rightsize inventory on hand at several chain retailers in key states. While this drove a negative impact to depletion trends in the quarter, this will allow us to better manage inventories on a go-forward basis.

Wine and spirits net sales declined 11% on shipment volume, down 19%. Excluding the impact of the Black Velvet divestiture, organic net sales declined 9%, reflecting shipment volume decline of approximately 17%, partially offset by robust price and mix benefits in the quarter. Q2 net sales results outperformed our previously communicated expectations, primarily due to incremental shipments from the brands to be divested driven by the timing of the Gallo transaction.

Operating margin increased 310 basis points to 25.9% as benefits from price and mix, along with lower marketing spend, were partially offset by higher COGS and SG&A as a percentage of net sales. Higher COGS mostly reflect increased packaging costs, including glass and labels, partially offset by lower rate costs.

In Q2, we experienced continued margin expansion driven by shipment volume mix resulting from some of our fast-moving power brands, such as Kim Crawford, Meiomi and the Prisoner brand family, and favorable pricing for Woodbridge and SVEDKA. In addition, we saw lower promotions as some incentive programming activities did not occur due to the current operating environment and COVID-19-related closures for the on-premise.

The marketing benefit to margin in the quarter is mostly related to timing as we plan to shift marketing dollars from the first half into the second half of the fiscal year to support key marketing and advertising initiatives for our power brands and innovation launches as we enter our peak selling season. Let me point out that a majority of the shift will occur in Q3, resulting in an increase in year-over-year spend for the quarter.

As Bill discussed, during August, significant wildfires broke out in California, Oregon and Washington State. We are currently monitoring and assessing the impact of the smoke damage from these wildfires as we progress through the August to October harvest season. At this time, we do not expect a material impact to our ability to meet consumer demand. However, we expect our margins to be impacted as we recognize costs in the remainder of the fiscal year due to decreased production levels, driving unfavorable fixed cost absorption. Currently, we are estimating these costs of about $25 million to $35 million in Q3 and $10 million to 50 – $15 million in Q4 fiscal '21.

As Bill mentioned, we expect a consent decree will be submitted to the commissioners for review and approval in the coming weeks and, therefore, expect the Gallo and other ancillary deals to close by the end of Q3. Therefore, we are expecting reported net sales for wine and spirits to be flattish to prior year in Q3 while expecting a decline of 20% to 25% in reported wine and spirits operating income, reflecting the negative impact of the wildfires and increased marketing expense during the quarter.

Now let's proceed with the rest of the P&L. Fiscal year-to-date corporate expenses came in at approximately $110 million, up 13% versus fiscal – versus last fiscal year. The increase was primarily driven by increased compensation and benefits, unfavorable foreign currency losses and an increase in charitable contributions primarily driven by COVID-19 support efforts, partially offset by reduced T&E spend. Comparable basis interest expense for the quarter decreased 10% to approximately $100 million primarily due to lower average borrowings as we continue to decrease our leverage ratio.

Our Q2 comparable basis effective tax rate, excluding Canopy equity earnings impact, came in at 16.9% versus 15.2% in Q2 last year primarily driven by higher effective tax rates on our foreign businesses, partially offset by an increased benefit from stock-based compensation. While our pre-COVID estimated full year FY ’21 comparable basis effective tax rate, excluding Canopy equity earnings impact, was 18%, we now expect the rate to approximate 19%. The 1 percentage point rate increase versus our pre-COVID estimate primarily reflects an estimated higher marginal rate on foreign earnings.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. We generated free cash flow of $1.2 billion for the first half of fiscal ’21. This represents an impressive 10% increase. Free cash flow improvement reflects strong operating cash flow and lower CapEx.

Fiscal year-to-date CapEx totaled $278 million or approximately 22% below last year’s spend. This included approximately $200 million of beer CapEx primarily driven by the 5 million hectoliter expansion project at our Obregon brewery, which we expect to be completed by the end of fiscal 2021.

Moving to Canopy. In Q2, we recognized a $48 million decrease in the fair value of Canopy investments. These impacts were excluded from comparable basis results. The total pre-tax net gain recognized since our initial Canopy investment in November of 2017 is $64 million. In August, Canopy reported first quarter fiscal ’21 results. We are pleased with the progress that has been made since David Klein took over as CEO in rightsizing the business, reducing the company’s cash burn and improving free cash flow. We are bullish on the growth prospects for Canopy growth as they continue to execute against their strategic plan.

Now let’s shift the discussion to outlook and guidance. Given the unprecedented COVID-19 events that began to abruptly and dramatically impact consumers and the marketplace almost concurrently with the start of our fiscal year and given the related uncertainty, volatility and fast-moving developments that have evolved during the first half of our fiscal year, we still do not believe it is prudent or appropriate to provide formal financial guidance for fiscal ’21 at this time. However, let me reiterate that in a normalized environment, our medium-term growth algorithm remains unchanged for both our beer and wine and spirits segments.

In closing, I’d like to reiterate our capital allocation priorities. While we remain focused on our goal of returning $5 billion to shareholders in the form of dividends and share repurchases through fiscal ’23, in the short term given the volatile environment, we remain focused on paying down debt and further reducing our leverage ratio. In fact, we’ve reduced our net debt by nearly $600 million since the end of fiscal ’20, resulting from our strong cash flow generation while continuing to maintain our quarterly dividend rate.

And with that, Bill and I are happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from the line of Bonnie Herzog from Goldman Sachs.

Bonnie Herzog

I wanted to ask a little bit about the spending that, Garth, you just kind of touched on.

A key driver of your strong operating margins in the quarter really has been a result of lower marketing spend. And now you've talked about your outlook for spending for the full year being between 9% and 10% as a percentage of sales, which is about 50 bps lower than your previous guidance. So I kind of wanted to better understand that this is mainly a function of the ongoing pressures from COVID. Or do you see this maybe more as a realistic run rate going forward in terms of what you're seeing with your depletions and demand for your brands? I guess I'm trying to get a sense of how you guys are balancing things and really how important it is for you to drive continued margin expansion.

William Newlands

Sure, Bonnie. Let me take the first part of that, Garth. Our expected run rate is no different going forward than it's ever been. At the same point, because so much of our live events and sports were delayed in the year, I mean think about the NBA Finals, hockey, baseball playoffs, many – football, many of the things that we advertised on were pushed back later in the year, and therefore, into our third quarter. Some of our spend was also pushed back into those time frames as well. So our intention is to have a consistent run rate of spend in that 9% to 10% range as we always have, and you will expect to see a little bit more in the third quarter because many of those pre-bought scenarios will take place during that quarter rather than in the second quarter when we had originally anticipated they would occur.

Garth Hankinson

Yes, and the only thing that I would add to that, Bonnie, is from a margin perspective, right, we continue to think that the right range to think about in terms of our beer margins are at 39% to 40%. Obviously, in any given year, we're going to face headwinds or tailwinds that are going to fluctuate a little bit. But those are best-in-class margins, and that's the right way to think about the business on a go-forward basis.

Operator

Our next question comes from the line of Nik Modi from RBC.

Nik Modi

So Bill, I just wanted to have a chat on shelf space, right? So you guys have obviously been very active with the shopper first initiative, ran into a bit of a hiccup with supply/demand. So maybe you can just kind of give us a state of the union on are – have you lost any spacing as a result of the out of stocks? Because that has happened in a few categories. So if you could just give us an update there.

And number two, how do you think the retail psychology is evolving as the last 6 months has gone on? Clearly, Constellation has been under space for a very long time. So I'm just curious like where the retail universe is right now in terms of your actual slot in the core.

William Newlands

Sure. The – certainly, the space issue has been somewhat challenging over the very most recent past, simply because of the reduction in production that we had around COVID-19. With that said, we have seen very little reduction of our overall space as we have spread out our product mix and our product offering into the existing space that we already had. We're also fortunate that many retailers have moved their resets and their timing back in the year for the same reason as because of the COVID-19 pandemic, which now matches up with the time when we're expecting to have our inventory levels back in a more normalized fashion during this quarter.

So we don't see any long-term issue around that. We've been very straightforward with our retail partners about where we are. And as you well state, our business, if anything, demands more space given the great acceleration that our brands have in the marketplace. And we expect that over time, we will continue to gain in the distribution area much as we have over the last several years.

Operator

Our next question comes from the line of Kaumil Gajrawala from Credit Suisse.

Kaumil Gajrawala

As it relates to inventories, it looks like kind of year-to-date, you're running with shipments down about 4%, depletions up about 5%, and that's during a seasonal peak period. To get inventories back to where you want them by the end of Q3, what should we be thinking about in terms of the spread between shipments and depletions?

Garth Hankinson

Yes. So Kaumil, thanks for the question. I'd say that the spread between depletions and shipments is going to top to gauge as we move through the quarter because it'll largely be dependent upon what depletions look like. And we've actually seen – as Bill noted, we've actually seen very strong continued consumer takeaway in IRI, and depletion growth remains very robust.

Suffice that to say, we do know that there will be a dislocation – not really dislocation, but a difference in between shipments and depletions for the quarter. How much remains to be seen will be driven by consumer takeaway.

William Newlands

Let me just add to that. I'm sure that you have seen in the most recent 4-week share data that our brands are accelerating as we bring more and more of them back to the table. I think as Garth points out, that's going to be a big factor in terms of what the balance is of that. Depletions are certainly accelerating, we're very pleased with that, but it's very tough to give you an exact answer without knowing how that will land during the course of the quarter.

Operator

Our next question comes from the line of Vivien Azer from Cowen.

Vivien Azer

So I'm curious, Bill, it sounds like you're very constructive on the momentum that you've established early days on the Corona Hard Seltzer offering. Curious to hear how you're thinking about positioning a new hard seltzer offering and taking a portfolio approach to the category.

William Newlands

Well, we've shipped about 5.5 million cases year-to-date, which is ahead of what we had expected, and we're very excited about it. As I already said, our velocity against literally one SKU is second in the category. So everything that's occurring around Corona Hard Seltzer has been sort of positive to what our initial expectations are.

As we already also stated, we're going to be in a position to put additional SKUs into the marketplace next year. We would – we've already said also that our capacity would more than double next year. And keep in mind, we have a minority investment in PRESS, which we're very excited about. PRESS has performed exceedingly well. And as we've said in prior calls, we do expect some price stratification to occur over time in the seltzer category. So PRESS is very positive.

We've also done some very limited regional things like Funky Buddha in Florida. In Florida, that particular brand is in the top 5 of all seltzers in the state of Florida. So we've got our toes in the water on a number of areas. Corona Hard Seltzer will continue to be our lead, but we certainly have other opportunities to continue to gain share in what is becoming a very important subsegment of the beer business.

Operator

Our next question comes from the line of Bryan Spillane from Bank of America.

Bryan Spillane

Garth, I just wanted to follow up on the incremental costs in the wine segment. So I guess 2 questions related to it. First are the costs that you highlighted, are they relevant to the – or related to the ongoing business, so separate from the piece that's going off in the divestiture to Gallo?

And then second, I guess trying to understand if this at all impacts kind of the timing or the cadence of supply chain for the wine business going into next year. And I guess what I'm trying – I'm thinking of it is, are you – is there a delay in terms of pressing grapes and putting juice in the tanks? Is there a delay in pulling product out of the tank and bottling? I'm just really just trying to understand if there's going to be any kind of disruption in the flow of the supply chain in wine that might lead into next year.

Garth Hankinson

Yes. Bryan, thanks for the question. So the costs, as I outlined them, are for the remaining business, for the business that we are retaining, not for what we're divesting to Gallo. And as it relates to the question on supply chain, we don't expect there to be any material impact on our ability to meet consumer demand as we go forward. We have lots of flexibility in how we source grapes and fruit, whether that's through the bulk line market, the bulk line that we have on hand, our own vineyards, relationships we have with other growers. We don't see any impact on our ability to meet consumer takeaway.

Operator

Our next question comes from the line of Dara Mohsenian from Morgan Stanley.

Dara Mohsenian

So Bill, you mentioned your aspiration to be a top 3 player in the seltzer category – hard seltzer category longer term. Obviously, you just touched on some of the new SKUs that you have planned. But can you also give us a sense for how important new platforms will be in that aspiration long term in terms of becoming a top 3 player? And is that more of a longer-term focus? Or could we see a big push behind new entries of brands in the hard seltzer more near term?

William Newlands

Well, certainly, Corona Hard Seltzer will be our primary approach to this category. As we stated, given our roughly $10 million capability for this year, we've relied on one – literally one SKU. So as we go forward and we expand and finish the Obregon expansion that I discussed earlier, that gives us the opportunity to extend our reach within the Corona Hard Seltzer franchise.

We're a big believer that Corona is the perfect brand to maintain our lead focus for seltzer because it meets up exactly with the whole brand essence of refreshment, relaxation and finding your beach. So it – that will continue to be the lead play for us, but we're always exploring what consumers are interested in going forward. And yes, we do have some additional things that we'll be talking to you about in future conference calls as to what we expect to do during the next fiscal year.

Operator

Our next question comes from the line of Sean King from UBS.

Sean King

Yes, I wanted to dig a little bit more into what you're seeing in the month of September. I know you mentioned like based on the IRI data that we're seeing a gradual acceleration as you're getting more on the shelves, but in terms of the on-premise that you're seeing there would be helpful. And what I've been hearing is that there's fewer taps at most of the outlets that are open, if that's a potential headwind or a benefit for your portfolio.

William Newlands

Sure. As you know, we are somewhat less susceptible to the on-premise versus much of the competition with our brands. With that said, there's – we had 50% closure in the second quarter. We had 75% in the first, and it's looking more and more like that will also reduce another 15% to 20% during the third quarter if things continue as they're going.

With that said, admittedly, the quarter – I mean, excuse me, the month literally ended yesterday, so we're still adding it up. But it certainly looks like we're going to have a significantly better depletion month in September than we have year-to-date. In fact, it could quite well be our best month of the year so far. That matches up entirely with the acceleration that you've seen in IRI data over the last 4 weeks, which has been accelerating and returned us to a gaining share position, which is something we've normally seen in our business over the course of time.

Operator

Our next question comes from the line of Kevin Grundy from Jefferies.

Kevin Grundy

Great. This is building on Nik's question earlier. This is for you, Bill. Just the outlook for the Modelo brand looking out over the next few years and kind of pass some of the near-term volatility related to COVID comes up frequently with investors, understandably given the importance of the brands to your outlook. So could you comment on your ability to grow volumes in that business double digits over the next few years? As we look at the Nielsen channels, ACV is less of an opportunity. But as was pointed out, shelf space is an opportunity. So maybe comment on that a bit, talk a little bit about the interplay and your ability to drive that kind of growth, the interplay between Modelo with the Corona brand. And then just lastly, perhaps touch on, is it in the consideration sector that you would extend the Modelo brand into seltzers as well?

William Newlands

Sure. As we've said, Modelo is one of the chief growth drivers of our beer business. Modelo Especial has become the #3 beer brand in the U.S. market, and it continues to accelerate, part of – it does that for a number of reasons. One is it continues to have a disproportionate SKU in the Hispanic community, which is a growing demographic in the United States, but we've also radically extended that into the non-Hispanic community. Jim Sabia has been advertising to the non-Hispanic community only for the last few years. So this is relatively new that we've been expanding the reach, particularly in Modelo Especial.

As you know, our Chelada introductions have gone extremely well, one after the next. And certainly, it's continued to see growth in Negra as well. So the overall family is very healthy. As I said in my prepared remarks, we're looking at the 35th consecutive year of growth for that brand. And quite honestly, I don't know how high is up. I think there's – there remains tremendous opportunity to extend that franchise, both with its core Hispanic community as well as the non-Hispanic marketplace into which we've started to advertise.

I highly doubt that we will do a seltzer under that brand. We believe that the core essence of that brand focuses much more on full flavored beer. And any innovation that we might approach on that particular brand will follow more of the brand essence of the Modelo brand rather than what we have done with Corona, where we feel the whole refreshment platform matches up perfectly with the hard seltzer subsegment.

Operator

Our next question comes from the line of Andrea Teixeira from JPMorgan.

Andrea Teixeira

So I wanted to go back to the depletions commentary. I understand there are obviously a lot of puts and takes, but you sounded optimistic. So Bill, are you running in the midsingle digits as you alluded to before or even at the high single digits for beer depletions in September?

William Newlands

Well, as I said earlier, and I'll maintain that thought given we have not even gotten all the numbers in yet, and therefore, Garth has not added them all up. But it appears that September will be significantly better than what our year-to-date has been. And as I said, it very likely will be our single best month of the year.

So we continue to be optimistic that what we've seen on takeout and IRI trends that have occurred over the last 4 weeks is currently being reflected in our increased depletion trend that we're seeing in September, which again matches up with our expectation given we have been back operating at normal levels within the plant now for a significant period of time.

So again, it's a little difficult to put an exact number on it right at this point, but it certainly looks like September was a very, very positive month.

Andrea Teixeira

And if I can squeeze – that's helpful, Bill. If I can squeeze just a margin question. I know it's like you just quoted some of the expenses that are – I mean, obviously, the COVID expenses. Other than those, like which may or may not recur as we lap next year, are we looking at obviously a better outlook now that production is when – it's where it should be and you're reaching back to the production and you're getting obviously economies of scale and you're getting your seltzer volumes like as you quoted better than anticipated? Should we see a progression in like long-term outlook for margins to continue to build or you're going to have to invest more into the pricing? The pricing commentary obviously is going to last, but you're going to increase the pricing through the beginning of fiscal – we could go into fiscal, but I'm just thinking of the puts and takes of FX and volumes coming back, how we should be thinking about margins going forward.

Garth Hankinson

Yes. So margins for our beer business going forward, as we said earlier, the right range to think about them is, as we said previously, which is that 39% to 40% range, right, again, best-in-class margins. In any given year, we're going to have puts and takes as it relates to margins. We're going to get the benefits of our pricing, but we're also going to face headwinds around things like incremental depreciation that flows through cost of goods as well as we build and add capacity, we'll have periods where we have lower utilization rates, which can – which will have a drag. And so as we say, there's always going to be these puts and takes in any given year, but 39% to 40% is the right way to think about our margin profile over the medium term.

And on the seltzer point that you raised, seltzer currently is a drag given the additional flavors and some of the co-packing that needs to be done there. As we progress and as we get to be – have more scale in seltzer, there'll definitely be margin improvement there, and we'll start to get closer in line with Corona Extra glass. But again, even as margins improve on seltzer, that there will be other puts and takes. So 39% to 40% is the right way to think about it.

Operator

Our next question comes from the line of Robert Ottenstein from Evercore.

Robert Ottenstein

Bill, I just want to kind of step back and ask you a big picture question that you're probably in a better position to answer than anybody else. And that is at least based on the data we get, and for spirits, it's not that good, but even with the tremendous boost that the beer industry has gotten from hard seltzers, it looks like spirits are gaining share of throat and that maybe even have accelerated this year. And based on what you see, is that, in fact, true? And what do you account for that? Is it the out of stocks for beer? Or is there something – due to the COVID environment that favors spirits? And if these trends look like they're going to continue, are you thinking just in terms of your long-term capital allocation to pivot more towards spirits? I know you just made a spirits acquisition. But just how are you thinking about that dynamic?

William Newlands

Sure, Rob. It's very difficult in a COVID year to make lots of predictions about what will be sustainable and what will maintain itself once we come out of the COVID scenario and what won't. I do think it's very fair to say there will be some fundamental change. Some of that fundamental change will be about 3 tier e-commerce and direct-to-consumer, things that we're investing a lot of our energy and focus on going forward. So I wouldn't make a lot of prediction as to what the adjustments that could occur between spirits or beer or wine.

What I would say is we have worked aggressively, as you've seen, to make sure that our portfolio is positioned for where the consumer is going, not where the consumer has been. We've invested in craft spirits, which we think has tremendous upside. Our beer business plays in the high end, which is where the growth in the category is. We're extending our capabilities in seltzer to more than double what we have done in this fiscal year going forward. And our wine business is tremendously positioned to continue to leverage the premiumization trend that's going on. In addition to that, we're doing the kinds of innovations that the consumer is looking for in things like betterment and convenience. You're seeing that in some of the new products that we've talked about this year.

That's where our focus really lies, and I think there's tremendous opportunity within our portfolio no matter how it shakes out post-COVID. As I said, I do think there will be some fundamental change about how the consumer buys. And to some degree, there almost has to be because there has been a significant shift from the on-premise to the off-premise. And I think that the long-term trend of that, I still think, is too early to predict.

Operator

Our next question comes from the line of Bill Chappell from Truist Securities.

Grant O'Brien

This is Grant on for Bill. Just had one on the wine and spirits power brand's depletion growth this quarter. I was just hoping, Garth, you give a bridge on some of those impacts you walked through the inventory changes at the distributor level and the promotional changes. Just trying to get an underlying growth number for that business.

Garth Hankinson

Yes. The – I think the question is that you want to understand sort of like why the power brand growth wasn't higher than you were expecting, and that really is because we did do – we didn't repeat some non-return generating promotional activity or take some non-enhancing – non-value-enhancing pricing actions. And we also cleaned up or reduced the number of days outstanding with some key retailers. So the underlying brands are strong as you see in the IRI takeaway, and the reduction or a slowdown in depletions really is just – is doing a little bit of house cleaning, so to speak.

William Newlands

Yes. Keep in mind, Bill, if I could add – just to add to Garth's comment, our high-end over $11 power brands continue to outpace their competition, and that's led by Meiomi and the Prisoner family, Kim Crawford. These brands are accelerating in the minds of consumer.

Keep in mind, going back to sort of Robert's question from a minute ago, one of the things that we continue to see is people are attracted to try and true brands. And we are very fortunate when you talk about our beer business or our wine business or our spirit business to have a lot of those brands that are inherently trusted, and that has been extremely helpful for us during the pandemic.

Operator

Our next question comes from the line of Laurent Grandet from Guggenheim.

Laurent Grandet

Another question on seltzer. With the launch of Topo Chico seltzer next year, there will be more competition to attract Hispanic consumers into the seltzer category potentially from beer. So first, I mean do you see Topo Chico seltzer as a risk for your core Mexican beer business? And second, what are your plan with Corona seltzer to increase Hispanic penetration that seems to be low by your account?

William Newlands

Well, as I said earlier, we have been very pleased by the development of our Corona Hard Seltzer business with the Hispanic community. It's indexing somewhere between 5 and 10 points greater than the overall category, and we think that speaks very well to broadening the reach of the seltzer subsegment with consumers. So we're very positive about that.

As I'm sure you've seen, there's been a lot of introductions in the seltzer category, but consumers have a tendency to go with tried and true, trusted brands. And there is really no stronger brand that's trusted in the minds of consumers than Corona. And certainly, Corona Hard Seltzer will fall into that ZIP code as well. So we always wish well for our competition, but we'll be quite happy to do our bit, and we'll see how it all falls out.

Operator

Thank you. And this does conclude the question-and-answer session of today's program.

I’d like to hand the program back to Bill Newlands for any further remarks.

William Newlands

Thanks, Jonathan. So thank you, everyone, for joining our call today. Despite the continued and unprecedented challenges that have occurred since the beginning of our fiscal year, our team continues to remain agile and have overcome massive headwinds to deliver strong business performance in the first half of our fiscal year. We remain confident in the resiliency of our business.

Our beer business, as we’ve discussed today, continues to be a top growth driver within the industry, while our wine and spirit premiumization strategy continues to gain momentum, especially as we enter the final stages of completing our transaction with Gallo. We remain bullish on the future performance of our powerful collection of consumer connected brands, and we are well positioned to deliver a solid year of organic growth in fiscal ’21.

Our next quarterly call is scheduled for early January. So I’m wishing everyone at this point a safe and happy holiday season, and I’m also reminding you to enjoy some of our great products during your socially-distant celebrations with your family and friends.

So thanks again for joining the call today, and have a great day.

Operator

Thank you, ladies and gentlemen, for your participation in today’s conference. This does conclude the program. You may now disconnect. Good day.