Constellation Brands Inc, Q3 2018, Earnings Call 2018-01-05

Presentation

Operator

Welcome to the Constellation Brands Third Quarter 2018 Earnings Conference Call. — ***Operator Instructions*** —

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

Patty Yahn-Urlaub

Thank you, Lori. Good morning, and welcome to our third quarter fiscal 2018 conference call. I'm here this morning with Rob Sands, our President and Chief Executive Officer; and David Klein, our Chief Financial Officer.

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 www.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.

— ***Operator Instructions*** —

And now here's Rob.

Robert Sands

Thank you, Patty, and good morning, and Happy New Year. I hope you enjoyed the holidays and had the opportunity to include some of our fine Constellation products in your celebrations with family and friends. As I reflect on 2017, I am reminded that it has been a dynamic time for our business. We posted another year of exceptional stock price performance, with Constellation stock increasing almost 50% for the calendar year 2017 versus the S&P 500, which grew about 20% for the year. Overall, stars, Constellation was one of the best performers among the S&P 500 Consumer Staples stocks.

I believe our excellent stock price performance continues to be driven by our strong financial results and the ongoing growth prospects for our business. The confidence in our future business prospects compelled us to seek board authorization for a new multi-year $3 billion share repurchase program subsequent to the recent repurchases of more than 200 million of our outstanding shares. I'm also excited about our recent investment in Canopy Growth Corporation, the largest publicly traded cannabis supplier in the world and a leader in the medical cannabis market in Canada. Founded in 2014 and based in Ontario, Canopy Growth is one of the earliest commercial players in Canada's legal cannabis market and has a global presence via numerous joint ventures and partnerships. Canopy is traded on the Toronto Stock Exchange and currently has a market cap in the $5 billion range.

This investment provides Constellation with a first-mover advantage for a potentially significant emerging consumer opportunity and aligns with our long-term strategy to identify, meet and stay ahead of evolving consumer trends and market dynamics while maintaining focus on our core total beverage alcohol business. Our plan is to jointly collaborate with Canopy in a number of areas. Initially, we will be learning the cannabis business and the related consumer space and route-to-market while building and developing a successful cannabis beverage business.

Now recreational cannabis is scheduled to become legal in Canada this coming summer with recreational edibles including beverages expected to become legal in the summer of 2019. We have no current plans to sell cannabis products in the U.S. or any other market, and we will not consider doing so until it is legal at all levels of government.

Our initial investment of approximately $190 million represents an ownership interest of 9.9% of Canopy Growth plus warrants which give Constellation the option to purchase an additional ownership interest in the future. In a few moments, David will review how we are accounting for this investment.

And speaking of growth prospects, we posted another great quarter for our beer business, which generated 80% of the total U.S. beer category growth and claimed 4 of the top 10 share-gainer positions with Modelo Especial, Corona Extra, Modelo Chelada Tamarindo Picante and Pacifico. Overall, Constellation's beer business remains the leader in the high end of the U.S. beer market and was the clear winner for the Labor Day and Thanksgiving holidays, with excellent execution that drove share gains led by Corona Extra and Modelo Especial. These brands continue to drive the growth of the portfolio with ongoing distribution and velocity gains. Throughout the quarter, Corona Extra maintained strong media support and became the official imported beer of 4 NFL teams while also featuring Jon Gruden in football promotions during the season.

Corona Extra also increased relevance with Hispanic consumers through its partnerships with Latin music superstars Enrique Iglesias and Maná. The Modelo Especial fighting spirit campaign continued throughout our third quarter including national TV and promotional activities during the NFL schedule. In addition, national Spanish-language TV support ran through November including a strong presence with live soccer program and top-rated Spanish language TV networks. Social media on Facebook and Instagram also supported NFL, the Mexican Independence Day and the Dia de los Muertos for this brand. Collectively, these initiatives drove depletion growth of almost 17% for the Modelo Especial family of brands for our third quarter.

Pacifico continues to make its mark within our portfolio and recently was named Impact

Beer Brand of the Year by Market Watch. In addition, Pacifico has become the fastest, the fastest-growing beer brand among the top 40 beer brands based on 52-week IRI dollar growth of nearly 24%. Our plans for Corona Premier and Corona Familiar continue to evolve as we finalize our launch strategies for next year. Corona Premier is the first national Corona line extension in more than 25 years, and we plan to make our largest-ever launch investment of more than 35 million to support the effort.

This includes a robust media plan with general market and Spanish language TV advertising beginning in April. Additional support will include print, social media and Hispanic-targeted advertising as well as on-premise sampling and new point-of-sale materials. Corona Familiar will roll out during the same time frame to major Hispanic markets, a key demographic for this brand.

Now turning to the operations side of the beer business. During the quarter, we continued to make progress as we put the finishing touches on our Nava capacity addition to complete the 27.5 million hectoliter expansion while also nearing the finishing line with our fourth glass furnace, both of which are expected to come online in the coming months. Glass furnace #3 is now fully operational and running at peak efficiency levels. The Obregon brewery continues to perform at a very high utilization level, and we remain on track with our brewing and packaging capacity additions, which are expected to be completed before the end of the fiscal year. And construction continues in Mexicali with brewhouse tank fabrication and installation currently under way.

During the quarter, we reached agreement with Owens-Illinois to restructure and expand our contracts for glass supply including our joint venture agreement. As you know, the joint venture operates a glass production plant in Nava, Mexico and provides bottles exclusively for Constellation's adjacent brewery, which is our lowest-cost source of supply for glass. The original joint venture agreement included the expansion of the glass production plant from 1 furnace to 4 furnaces, and initial expansion plans have been progressing as scheduled, as I just mentioned.

The expanded relationships with OI provides for the addition of a fifth furnace, which is expected to come online by the end of calendar 2019 and will be included in our future capital investment plans. Following the installation of the fifth furnace, the Nava plant will be the largest, most modern glass container facility in the world. In recognition of the value-added contributions from both partners, the term of the joint venture agreement has also been extended for an additional 10 years to 2034. David will discuss the high-level details of this new contract in a few moments.

Now turning to the wine and spirits business. It certainly has been an interesting quarter for our wine and spirits division. Early in the quarter, hurricanes hit some of our key markets. And shortly thereafter, we were faced with one of the worst natural disasters in California state history as we dealt with widespread wildfires in Northern California. Overall, we are fortunate that these events are expected to have only a minor impact in our business both near term and in the future. To put things in perspective, about 80% of the harvest was already completed when the wildfires started, and less than 5% of our wine portfolio is Napa or Sonoma appellated. Constellation has a long history in Napa and Sonoma, and we're committed to helping our neighbors and our communities rebuild by driving consumer engagement and continuing to encourage purchase and consumption of Napa and Sonoma wines. Please help us support this effort.

Third quarter wine and spirits depletions were a bit muted following a strong finish to our second quarter. Key Focus Brands drove depletion growth led by double-digit trends for Kim Crawford, Meiomi, Black Box, Ruffino, Robert Mondavi Private Selection and High West Whiskey. Throughout the quarter, our focused investments for some of these brands were visible in the marketplace and drove excellent results, including the firstever national TV advertising campaign for Kim Crawford, which drove accelerating growth trends for this brand during the key holiday selling season.

Now on a year-to-date basis, the business is expanding margins, generating positive mix, driving innovation and seeing excellent results from acquired brands including Meiomi, The Prisoner, Charles Smith and High West. And our innovation efforts are paying off with successes like Cooper & Thief, which has become the #2 super-luxury red blend; and Robert Mondavi Private Selection Bourbon Barrel-Aged Cabernet and Chardonnay, which together are growing more than 120% in IRI channels.

I'm also pleased to report that Constellation Ventures has been busy, recently making 2 minority investments, both of which align with our strategy of investing in emerging unique and distinctive brands. The first is The Real McCoy, a high-end rum aged in American oak bourbon barrels. This line of 3-, 5- and 12-year aged rum is produced by Richard Seale, a legendary fourth-generation master distiller and made at Foursquare Distillery in Barbados. This product has a premium price point of the $20 to $50 range and uses an authentic farm-to-glass production process using high-quality blackstrap molasses with no added sugars, flavors or aromas.

The second is Copper & Kings, a high-end American craft brandy founded in 2014 in Louisville, Kentucky. These brandies are naturally distilled in copper pot stills, and the liquid is matured in Kentucky bourbon barrels and retails for $35 a bottle.

While the U.S. wine industry remains healthy overall with trends that continue to exceed U.S. CPG category growth, we have seen a bit of a slowdown in the market growth rate versus what we anticipated when we set our original guidance estimates earlier this year. In addition, our SKU rationalization efforts are creating a headwind as we continue to carefully rationalize our portfolio of tail brands. Despite these challenges, we are targeting wine and spirits net sales and EBIT growth for fiscal 2018 at the low end of our previous stated guidance ranges of 4% to 6% and 5% to 7%, respectively.

Before I turn the call over to David, I'd like to take a moment to address the topic of tax reform. As a U.S.-based beverage alcohol company, Constellation has been supportive of tax reform that allows U.S. companies to remain competitive globally. While we continue to review the legislation, we are very pleased with the outcome of this historic legislation and believe that it'll be very positive for us going forward. David will provide additional details in a few minutes.

In closing, it is certainly shaping up to be yet another eventful year at Constellation. With the fiscal year quickly drawing to a close, I am very pleased with our progress to date. We established a first-mover advantage in emerging consumer category with our Canopy Growth investment, and we continue to make smart investments including the planned addition of a fifth furnace at our glass plant in Nava. We continue to build shareholder value through ongoing share repurchases and stock appreciation driven by our strong results and future business prospects. And I am pleased with the outcome of tax reform legislation. We look forward to leveraging the opportunities that this will bring for our business and continue to thrive.

With that, I'd now like to turn the call over to David, who will review our financial results for the third quarter.

David Klein

Thanks, Rob, and good morning, everyone. I'm pleased to be here with you today to discuss another quarter of strong execution. On a year-to-date basis, we've grown market share, expanded margins and improved our capital structure while investing in growth initiatives that will benefit us as we go forward.

Our fiscal '18 year-to-date comparable basis diluted EPS is up 29% versus last year. Q3 comparable basis diluted EPS increased 2%. The low Q3 EPS growth rate was primarily due to timing as we're increasing our full year comparable basis diluted EPS guidance to a range of $8.40 to $8.50 from $8.25 to $8.40. This improvement is primarily due to anticipated favorability in our full year tax rate and better margin performance in our beer business, which I'll talk about in a moment. We now expect our fiscal '18 comparable effective tax rate to approximate 20% versus our previous 21% guidance. Our EPS and tax rate guidance excludes any impacts from recently enacted tax reform.

Before I move further into our results, let me provide some comments on the new tax legislation. First of all, we're pleased with the bill that was enacted and want to thank our friends in Congress for their work to reform the corporate tax code. Like most companies, we're in the process of evaluating the specific impacts of tax reform, but it is clearly favorable to our previous low to mid-20s long-term effective tax rate guidance. For fiscal '18, we expect to benefit in our U.S. federal statutory tax rate. The new 21% corporate tax rate will apply for the last 2 months of our fiscal year, resulting in a lower blended statutory tax rate versus the historical 35% rate.

We expect the new tax legislation, including the impact of the tax rate deduction – or reduction and the transition to a territorial system of taxation will result in a reduction in our existing net deferred tax liabilities by $300 million to $400 million. This onetime noncash benefit will be reported in our fourth quarter fiscal '18 results and will be excluded from our comparable basis financial results. We expect to provide an update to our long-term effective tax rate guidance as part of our upcoming investor presentation at the CAGNY conference in late February.

Now let's take a closer look at Q3 performance and our full year outlook, where I'll generally focus on comparable basis financial results. For beer, we continued to see strong operational performance and robust marketplace momentum. Depletion growth came in at 9% as we won the Labor Day and Thanksgiving holidays. This result was in line with our depletion growth performance year-to-date and our high-single digit depletion growth target for fiscal ’18.

Net sales increased 8% on volume growth of 6%. Depletion growth ran ahead of shipment growth primarily due to timing. Year-to-date shipments grew more than 8%, putting us on track to meet our net sales target for fiscal ’18 as we continue to expect net sales growth to be in the 9% to 11% range. This includes 1% to 2% of pricing benefit in our Mexican beer portfolio. Beer operating margin increased 290 basis points to 37.7% primarily due to lower COGS and favorable pricing. The lower COGS reflect operational benefits driven by glass and material sourcing along with foreign currency favorability. These benefits were partially offset by a $12 million increase in depreciation expense, which totaled $42 million for Q3. We now expect beer operating margin – or beer operating income growth to be in the range of 18% to 19%. Although we’re increasing our guidance to the upper end of our previous range, our Q4 operating margin is expected to moderate primarily due to lower seasonal production volume combined with the continued ramp-up in depreciation, line commissioning costs and headcount additions. In addition, SG&A leverage is expected to be impacted by the seasonality of the business.

For wine and spirits, organic net sales were flat due primarily to mix benefits being mostly offset by lower volumes. Operating margin decreased 110 basis points to 26.2% as mix benefits from portfolio premiumization efforts were more than offset by higher COGS and marketing investments. The higher COGS primarily reflect higher operational costs including increased transportation costs and the overlap of a supplier cost reimbursement in Q3 last year. We expect to realize benefits from the increased marketing spend on brands like Kim Crawford, Ruffino and Charles Smith over the next several quarters. For the year-to-date period, organic net sales are up 1% and operating margin has expanded 170 basis points.

Excluding the impact of the Canadian wine business divestiture, net sales are up 4% and operating income grew 5% for the first 9 months of fiscal ’18. For fiscal ’18, when excluding Canadian wine business divestiture, we expect net sales and operating income growth rates to be at the low end of our targeted 4% to 6% and 5% to 7% ranges, respectively, for the reasons Rob mentioned. As a reminder, as part of our premiumization efforts, we’ve been rationalizing lower-margin value brand SKUs. These actions are expected to impact wine and spirits revenue growth by almost 100 basis points for fiscal ’18 while improving operating margin and ROIC.

Interest expense increased 5% primarily due to higher average debt balances. We also continue to benefit from our investment-grade status. In October, to improve short-term borrowing costs, we implemented a commercial paper program, which provides for the issuance of up to $1 billion of commercial paper. In November, we issued $2 billion of senior notes at attractive fixed rates and used the proceeds to repay amounts outstanding under our variable-rate European term A loan facility.

Our net debt to comparable basis EBITDA leverage ratio moved down to 3.4x at the end of November from 3.7x at the end of fiscal ’17 while we invested in our Mexican operation, our portfolio and Canopy Growth and returned cash to shareholders with $301 million worth of dividends paid and $239 million of stock repurchases during the first 9 months of the year. The stock repurchases represent a little over 1.1 million shares at an average price of $213 with most of this activity occurring during the third quarter. At the end of Q3, there was $308 million remaining on our existing share repurchase authorization.

As Rob mentioned, we’re pleased that our Board of Directors authorized an additional $3 billion for share repurchases, which we expect to utilize over the next several years. Our significant capital allocation flexibility allows us to continue to invest in our business and return cash to shareholders while remaining committed to our 3.5x leverage target. Our comparable basis effective tax rate came in at 18.9% versus 16.4% last year. This increase reflects the overlap from recording the year-to-date impact of our election of indefinitely reinvested foreign earnings under APB 23 in the third quarter of fiscal '17, partially offset by the fiscal '18 adoption of ASU 2016-09, which requires excess tax benefits from stock-based payment award activity to be recognized in the income statement.

We now expect the fiscal '18 effective tax rate to approximate 20% versus our previous guidance of 21%. The lower projected rate is primarily due to an increased benefit from lower taxes on foreign earnings. As noted earlier, our updated guidance doesn't include any impact from tax reform. I'd also like to note for fiscal '18, we continue to expect weighted average diluted shares outstanding to approximate 201 million shares and net income attributable to noncontrolling interest to approximate $10 million to $15 million.

As mentioned earlier, we're now projecting our full year comparable basis diluted EPS to be in the range of $8.40 to $8.50. The midpoint of this guidance has us targeting 25% year-over-year growth. Our comparable basis guidance excludes comparable adjustments, which are detailed in the release.

I'd like to highlight 2 significant comparable adjustments that occurred in Q3. The first is the $217 million pretax gain from the change in fair value of the Canopy investment and Canopy warrants. This gain is primarily based upon a CAD 18.43 share price for Canopy at the end of our third quarter as compared to a CAD 12.98 share price at the time of our initial investment. The Canopy share price has moved significantly higher since the end of the third quarter as well.

Going forward on a quarterly basis, we will continue to record a comparable adjustment for the change in fair value of this investment and warrants and update reported EPS guidance accordingly. Our current reported guidance assumes that the Canopy share price at the end of our fourth quarter will equal the share price at the end of our third quarter. The second is related to glass sourcing initiative highlighted by Rob, where we reached an agreement with Owens-Illinois to restructure supply contracts and expand our joint venture agreements for the operation of the Nava glass plant by 10 years to 2034. The expanded relationship provides for a fifth furnace to be added at an estimated cost of $140 million. This will be financed by equal contributions from both partners and will be included in Constellation's future capital investment plans. The fifth furnace is targeted to come online at the end of calendar 2019.

During Q3, we recorded a $59 million pretax charge associated with the restructuring of our agreement with OI. This initiative will result in more glass being efficiently provided to the Nava Brewery from our lowest-cost source of glass supply, providing Constellation additional opportunities for margin enhancement and a higher return on our investment.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. For the first 9 months of FY '18, we generated $763 million of free cash flow versus $824 million for the same period last year as operating cash flow growth was more than offset by an increase in CapEx. We continue to expect fiscal '18 free cash flow to be in the range of $725 million to $825 million. Our free cash flow guidance reflects operating cash flow in the range of $1.9 billion to $2.1 billion and CapEx of $1.175 billion to $1.275 billion including approximately $1 billion of CapEx targeted for our Mexican beer operations.

At this point, I'd like to highlight ASU 2014-09, the new revenue recognition accounting standard, which will be effective for Constellation at the beginning of fiscal '19. Upon adoption, certain sales incentives will be recognized earlier than they are currently, and we'll make an adjustment to increase accrued expenses with an offset to retained earnings as of the end of fiscal '16. We will recast the full year of fiscal '17 and fiscal '18 along with fiscal '18 quarters. We're in the process of quantifying the changes, but we don't expect there to be a material impact to net sales. We expect to provide recast information when we file our fiscal ’18 10-K.

In closing, we’re well positioned to deliver another year of top-tier financial performance as we close out fiscal ’18, and we’re excited about our financial prospects heading into fiscal ’19.

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

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Mohsenian

My question is on the beer division. First, David, you mentioned a number of reasons behind the expected large year-over-year decline in beer operating margins in Q4. Are those more discrete factors in Q4 causing the year-over-year compression? Are you comfortable those factors don’t linger and you get back to expansion beyond Q4? And then also on the top line front in beer, can you help frame the magnitude of contribution you expect from Premier next fiscal year based on what you’re seeing in test markets so far and in light of the heavy investment of more than $35 million that you mentioned earlier in the call?

David Klein

Yes. Dara, so in terms of Q4 margins for beer, the real issue for us is that we haven’t seen a full seasonality picture of our business really until this year because of being under the interim supply agreement prior to this. And so in Q4, it’s our lowest net sales quarter of the year, so we get a bit of a delevering effect at the fixed cost line in the plant as well as on the SG&A line. And then on top of that, we’re bringing in employees. So we're adding headcount in Q4 that we will be able to deploy when we get into the peak production season, and we have some line commissioning cost. So I think there's just a bit of a seasonality built in, but we're pretty confident in the margins and being able to deliver strong margins going forward. I'd also say, Dara, that we had concerns both for Q3 and Q4 about some headwinds from FX within our beer margins, but with the peso sitting around 19, we're just not seeing those headwinds this year. And then from a top line perspective, we expect the majority of the benefit from the Premier launch will be seen in Q1 of next year versus Q4 of this year, and so we simply expect to have our distributor inventory kind of at our normal 30-ish days at the end of the quarter when we get to the end of the fiscal year, which is why we expect our net sales to be in that 9% to 11% range for the year.

Operator

Your next question comes from the line of Nik Modi of RBC Capital Markets.

Nik Modi

Just as we kind of approach the February shelf set – resets and obviously you're launching some new products into the marketplace, I'm just curious on what the retailers and distributors are saying in terms of incremental space because I know that's been a big initiative that you guys have been pushing for a number of years now. Can you just provide some context on kind of how it looks now and how it's changed from where you were a year ago?

Robert Sands

Yes. So I think that in general, we're making good progress on our efforts to increase our space commensurate with how we're growing at retail and our contribution from a profitability point of view at retail. So we continue to see good distribution growth. And so I'd say, everything is on track. We've also made some significant organizational additions to bolster our category management activities and have brought in some really great people to continue to drive those efforts. So in general, we're pleased with the progress that we're making. But we start from a position, as I've stated a number of times, of not being where we think we should be or would like to be from a space allocation point of view at retail.

David Klein

Nik, I'd also add that on a year-to-date basis, our effective points of distribution are up double digits, so we continue to do really well in gaining distribution.

Operator

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

Vivien Azer

So I was hoping to get your thoughts on the outlook for the beer category. The results from a category perspective despite your very good depletion growth continue to look increasingly sluggish in Nielsen. That's also mirrored in the deceleration we're seeing in PCE growth. And so with your largest market, California, transitioning to legal cannabis, how are you thinking about the overall beer category for calendar '18 and any impact from cannabis?

Robert Sands

Yes. So number one, I think that we think that the beer category is fundamentally going to continue to perform as the beer category in general has been performing. It's a flat to slightly down volumetrically market with all of the growth in the market being in the high end and then the premium end, in particular, giving up shares. So I don't think we'd see anything different there as we move into calendar year 2018 or our next fiscal. And then on cannabis in California, we don't really expect to see any impact from that. I think that one of the things that people don't necessarily appreciate is that cannabis has been generally available as medical marijuana and pretty accessible to almost everybody for 16 years. And therefore, the, I'd say, official legalization on a state level of it for recreational purposes is probably a nonevent is the truth of the matter. And then also, as we track what everybody else is tracking and we look at the numbers, we really can't see any real impact in terms of how it's affecting beverage alcohol in general even in the states – the 6 states – or now 6 states, including California where it's been legalized. So as, I guess, I've said in the past, it's probably not worth getting into a big debate right now about whether it's cannibalistic or complementary. There's just not enough information, I think, to really say how that's going to affect beverage alcohol in general going forward. What we do know is it's going to be a big market, however, worldwide.

Operator

Your next question comes from the line of Robert Ottenstein of Evercore ISI.

Robert Ottenstein

Just following on the last question. I'm wondering if you could give us any details or further details on your plans in Canada in terms of building out a sales team there, the sort of products you will be looking to develop or codevelop and kind of the general strategy. And I understand this is very early days and it's still very much a learning process, but would just love to get a sense of how you're thinking about it and what sort of investments on the ground that you'd be looking to put in place and thoughts on route-to-market.

Robert Sands

Yes. So we are making investments. We have started building an organization in Canada. I'd characterize it more as a marketing organization than a sales organization because our partner, Canopy, has a sales organization and will continue to build their sales organization as well, and we expect to partner with them. But we have put a team in place to work with Canopy generally in evolving a lot of what they do in terms of consumer research, marketing, a lot of the standard sort of CPG stuff that we have a fairly deep knowledge and expertise in. And they, as a newer company, really focused on a totally emerging category and anticipated extremely high growth, haven't become fully developed in yet. So we've got our team working with their team, and we expect to attack that market together really when, in our case, beverages become legal, which is either going to be with the initial recreational legalization in 2018 or in 2019. I think the sort of the – right now, the official government stance is that edibles will come in 2019, but it's kind of unclear whether they're lumping beverages into that or what they might do in 2018. So the best guess we have right now or the official word is probably beverages in 2019. And then in terms of what we're developing with Canopy, it is, as it relates to Constellation, beverages, nonalcoholic beverages which would include cannabis, so – or be infused with cannabis. So we're working on the development of those products and things like branding, et cetera, at this time. But given sort of the time frame, we don't have everything fully baked nor should we or would we at this point in time as to exactly what the product is in terms of flavors, in terms of packaging, in terms of branding. Canopy's got a strong brand of its own even currently, which uses in the medical marijuana side of the business called Tweed, T-W-E-E-D, and I think that brand has a lot of potential as well.

Robert Ottenstein

Great. And just following up on that, any – what sort of organization would you need in Québec?

Robert Sands

Well, we haven't really, I'd say, gotten that far that we're thinking about organizations by province. But as I said, in terms of like a larger sales organization, that will really be done through Canopy as it specifically relates to Canada. So I wouldn't see us building a huge sales organization necessarily, but we will build some significant capabilities and make some investments next year.

David Klein

Yes. So Robert, when we provide guidance for the year on our next call, we'll talk about investments in cannabis. But clearly, there will be some.

Operator

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

Bryan Spillane

Just had a couple of follow-up questions, David, I guess, on the comments on tax. One was just I wanted to clarify the benefit that you're expecting. Is that relative to the fiscal '18 20% rate? Or is it benefit relative to your long-term guidance on tax rate?

David Klein

Well, Bryan, what we said in the script was that it would be beneficial to the low to mid-20s kind of long-term guidance rate. But we'll have a lot more specifics when we get to CAGNY because, as you can imagine, it's complicated even to understand what's in the regs as well as working through how to apply it to our business. But I can say that we're pretty confident that it's going to be below the long-term guidance and likely in line with the 20% rate that we threw out for the remainder of this year or for this year.

Bryan Spillane

And then do you think that it will have a positive effect on free cash flow? So as you kind of look at cash taxes, cash tax rates, any sense yet as to – in terms of whether there's a real tangible cash benefit that you'd expect to receive?

David Klein

So there – again, we're still working through this. But before we said – we provided guidance on an effective tax rate and we said that the cash tax rate would be somewhere around 500 basis points less than that while we're continuing to amortize some of our intellectual property over time. We suspect that, that will actually expand a little bit from 500 basis points, but we haven't – we don't have final answers. We'll have those in several weeks at CAGNY.

Bryan Spillane

But there's a chance that, that relationship between your cash tax rate and your new lower effective tax rate would be maintained?

David Klein

Correct.

Operator

Your next question comes from the line of Mark Swartzberg of Stifel Financial.

Mark Swartzberg

A question on wine and spirits, Rob, but just as a point of information, this group called Smart Approaches to Marijuana points out that alcohol consumption has risen in Colorado post legalization. There's a lot of just really useful data there, I found. But wine and spirits, your year-to-date organic revenue was like plus 1%. Your fiscal '18 through fiscal '20 target is mid-single digits annually, and I hear you on the SKU rationalization. But how are you thinking about what's necessary to deliver that mid-single digits? Or do you think the mid-single digits is too high?

Robert Sands

Well, what we expect is mid-single net sales growth for the year. That was our initial guidance range, and we feel pretty confident given sort of where we are right now, and how fourth quarter will go that we will be in that range. Year-to-date, we're about 4% growth on net sales, excluding the impact of Canada, so – the Canada sales, so we feel pretty good. The market has slowed down a little bit, probably 100 basis points to 200 basis points versus where we thought the market would be for the year. That's probably the biggest factor that's impacting us relative to where we are in our range. We said that we think that we're more towards the low end than the high end of the range. It's probably the market that's impacting that. Lower end wines below premium seem to be being impacted, which actually could turn out to be good news. Because I think we continue to see an acceleration of premiumization, and we're seeing all of the growth really in the wine business starts to coalesce around price points which are substantially higher than they have been in the past. It used to be sort of the $8 to $12 range, and now we're seeing very strong growth, which is I'm sure hurting the lower end, between the $15 and $20 price points, which is still well within the commercial segments of the business. And we are particularly well positioned in some of those price points, and we'll continue to focus on those price points. And so over the last several years, we've become much more focused not in so much on that $8 to $12, but now in the $15 to even plus $20 range, where we think all of the growth is going to be in the future. We expect the wine category in general, there's a little bit of a slowdown in the second half of this year. As I said, could be a couple of 100 basis points. We think that the category will continue to be one of the faster or fastest-growing consumer products categories, outperforming consumer products in general. Year – the whole – the growth rate's been mid-single digits, almost 4%. We were at 4%. So we prefer to be at the high end of the range than the low end of the range, but we don't see anything happening here that is unusual or should constitute any kind of a warning sign. And in fact, as I said, the kind of growth we're seeing at the higher end of the commercial premium range, $15 to $20, I'd say is extremely encouraging for a lot of brands in our portfolio in particular.

Mark Swartzberg

I could have been clearer. I was thinking about your fiscal '18 through fiscal '20 objective of mid-single digits. And in the current fiscal year, you're getting about 300 basis points from acquisitions, so the underlying business is doing a 1%. So I was really thinking about, is it just keeping up the pace of acquisitions because, mid-single digits is not how your business is growing on an organic basis?

Robert Sands

Yes. I would say that the – excluding acquisitions, the underlying business has been a bit softer than we'd like to see it. And the numbers that you quoted are essentially correct, but I don't think that we see the short term or the quarter really being indicative of anything. And in fact, it's probably just timing, whether we're talking about the market or whether we're talking about our business overall, which we expect to be in line with those numbers that you quoted, mid-single digits.

David Klein

Yes, we don't think we need to continue to add to the portfolio to hit those numbers. We expect that our portfolio can hold or grow share as it stands.

Mark Swartzberg

And so do you think you can get margin expansion next year if you want that lift in organic growth?

Robert Sands

Yes.

Operator

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

Judy Hong

So on the $3 billion share buyback announcement, it's a multiyear program. So it seems to leave you still with plenty of room for additional cash usage, especially with your free cash flow stepping up in fiscal '19 and with some other tax benefits also accruing. So I guess I'm just wondering why the board came up with this number. And to the extent that you don't have a big M&A opportunity, do you think that you can complete the program earlier than you expected? Just kind of thoughts around that program.

David Klein

Yes. So Judy, we asked the board for the authorization so that we can be opportunistic, and we didn't want a necessarily a time horizon on it. And so they gave us a multiyear authorization, which is consistent with the way that we've always done it in the past. As we said before, after we've invested in our – for our expansion needs, in particular in beer, it's our intent to keep the business somewhere in that 3.5x leverage ratio range, and we'll do that through returning cash to shareholders through dividends and share repurchases and then some M&A activity that's probably looks a lot like the M&A activity we've done over the past few years. So I would say that we were looking for flexibility in the multiyear repurchase and will be opportunistic.

Judy Hong

Okay, and then just a quick follow-up on beer depletion. Can you comment at all on the December trend? Just because obviously, last year, we had a pretty weak December, and just wanted to see if you get – you have any color just in terms of what you saw this December.

Robert Sands

You're talking beer, right?

Judy Hong

Yes, beer.

Robert Sands

Yes, we're expecting a pretty strong fourth quarter on beer depletions is the bottom line.

David Klein

And December is performing in line with us getting to that strong quarter, so we're comfortable.

Robert Sands

I would say in general, our beer depletions are pretty much right where we expected them to be and right where they should be, sort of around that 10% number. So it's good. It's good. The quarter – this quarter, it was 9.1%. We're expecting a strong fourth quarter in beer.

Operator

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

Bonnie Herzog

I just I want to stay on this topic, just in terms of depletions versus shipments. And certainly recognize, there's usually some seasonality, timing differences, but there's still a decent delta between the 2 during this quarter, and even the last quarter or 2. So could you help us better understand the dynamic? And are these 2 then tracking more closely right now? Or is there still a pretty big delta? And then curious if you could comment on the end or consumer demand, and how you expect this to progress throughout the year given the planned marketing campaigns that you mentioned as well as your new innovation.

Robert Sands

So in the quarter, shipments were below depletions quite considerably, I think around 6% versus 9%. That would be entirely a timing-of-shipment matter, and we don't expect that delta to be anything like that as we approach the year-end. Year-to-date ships are up 8.4%, and depletions are up 9.5%. So on the year-to-date, we're seeing it a lot closer. But definitely third quarter, there was a timing-of-shipment matter that – and I say matter, there's nothing unusual. It's just that shipments lagged a little bit more than usual behind depletions in third quarter, but we don't expect that to be a trend or that there'd be anything – or that there's anything unusual. I mean, it could be how we ship in the last day. I mean, so it's not – there's nothing going on there. And then your other question, Bonnie?

Bonnie Herzog

Just trying to get a sense of the current consumer demand right now. You have touched on that with the previous question, but I'm more curious how you expect that to progress throughout the year.

Robert Sands

If you're talking about — ***indiscernible*** — business, we think that it's very strong. And that would be evidenced by the very strong measured consumer takeaway with IRI, for instance, which is – was more like at 16.5% for the quarter. So we don't see any issue with the consumer whatsoever. In fact, consumer takeaway is very strong right now especially in the measured channels.

Operator

Your next question comes from the line of Tim Ramey of Pivotal Research group.

Timothy Ramey

I kind of wanted to press on the tax issue, not from the perspective on what it will do to your rate. But particularly in the wine industry, there's a lot of goodies there for the industry. And since many of your competitors or most of your competitors are privately held, do you expect this will sort of fall to the bottom line in perhaps accelerated promotion or maybe leaving prices alone when – because you'll have a margin benefit? How do you think this will play through the market, is kind of the thrust of my question.

Robert Sands

Well, for us, I would say that we would plan on letting sort of the…

Operator

Ladies and gentlemen, I apologize. There will be a slight delay in today's conference. Please hold. The conference will resume momentarily.

— Technical Difficulty —

Patty Yahn-Urlaub

We're back online.

Operator

Yes, you may resume the call.

Robert Sands

I got cut off in mid sentence, but I was answering Tim's question, and he was asking about the effect of tax reform in general on the industry. And what I was saying was that it was going to be – we believe it's going to be positive. People are going to have more money in their pocket. And we think that certainly, as it relates to premium products, that's going to be very healthy for the industry. So all good news. No bad news on that front.

Operator

Your next question comes from the line of Stephen Powers of Deutsche Bank.

Stephen Robert Powers

David, if I could, I want to come back to – I think it was Dara's original question on beer margins for Q4 and just reframe it in sequential terms versus Q3. I think your comments on seasonality implies some lessening P&L leverage in Q4. But by my math, your Q4 – your implied Q4 guidance really doesn't show any falloff in sales versus Q3. So could you just maybe bridge the difference between Q3 and Q4 as you see it? I know you mentioned some hiring ahead of kind of first half ’19 demand. But was there anything else going on? Because I guess depreciation comes at – continues to ramp, so I get that. But on the other side, the peso seems cooperative. Glass benefit should continue to build, I would assume, and so on. So is it really just the incremental hiring that forms the delta between Q3 and Q4? Or is there something else?

David Klein

So it’s all of the above. So it’s incremental depreciation as we bring more assets online. It’s continued line commissioning costs, again, as we bring assets online. And remember, once we put something into production, the incremental costs go through the P&L as opposed to getting capitalized. We’re hiring employees. I think we have like 100 employees that we’re bringing in, production employees in Q4 to be prepared for the ramped up production season. And then there is historically in this year, there is seasonality at the net sales level in the beer business. So again, we’re not expecting – we’re not – I don’t want to sit here and really apologize for the margins in the fourth quarter. I’m just suggesting that the margins will be a little bit lighter than they were in say, Q2 when we hit an all-time high. But understanding where we’re going to end up with the margins is actually why we took up our guidance in – or at least tightened the guidance to the top end of the EBIT growth range year-over-year.

Operator

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

Andrea Teixeira

I’d like to follow up on the beer volumes commentary. I just wanted to clarify. Did you mean that the fourth quarter shipment will be more in line with depletions or just for the year as you do the year-to-date? As you correctly pointed out, the difference year-to-date is definitely narrower. But you’re talking about fourth quarter coming up to be obviously, catching up with depletions and with shipments against depletions accelerating above shipments, accelerating above depletions to match the year-to-date. And then I'd also would like to follow up on the capital structure. Is your new buyback plan an indication that the uses of capital will be more heavily weighted on towards cash return to shareholders or compared to strategic M&A?

David Klein

So on the billings and depletions kind of alignment, first of all, in terms of – at the end of the year, we'll deplete and ship about the same number of cases. The percentages will be off a little bit just because of the starting point from last year. But we – I think the best way to do your math is to come back in line with the 9% to 11% net sales growth and the 1% to 2% pricing algorithm, kind of putting you in the very high-single digits in net sales. And again, that's kind of where we are year-to-date on the depletions basis. In terms of capital structure, Andrea, I would say that what the authorization represents is that we're getting closer to the time where we have more and more free cash flow to deploy, and we're saying that we're going to use that in all the ways we have before. But clearly, we're going to buy back a lot of our stock because we continue to believe that the company is undervalued.

Operator

Your next question comes from the line of Caroline Levy of Macquarie.

Caroline Levy

My question's around Corona, the – your flagship brand. If you could talk about what the trends were like in the last quarter, in the third quarter, and how you're thinking about potential cannibalization with Corona Premier or with Familiar on your existing brand. Is that something you're going to be watching very closely, where you don't want to see your flagship Corona dip, even if it is a positive margin trade? So just to talk a little bit about how should we be thinking about that April launch.

Robert Sands

Yes. So we think Corona remains healthy, very healthy in fact, given its maturity. It was up about 3% in the quarter.

David Klein

— ***indiscernible*** — depletions, right?

Robert Sands

Yes, on depletions. And that's pretty consistent with where it's tracking, so we see good growth there and good continued growth. Now Corona is the most – Corona Extra per se is the most mature of the brands in the portfolio. But given its state of maturity and the large market shares it has in particular places, we think it's doing very well, and we think that it will continue to do well. And then you asked about Premier, and I think that your question was on cannibalization. And yes, I mean, we're looking at that. We tested it. The cannibalization was probably less than we thought that it would be in fact, which was encouraging. The cannibalization is not a problem per se because it's not a lower-margin product. But we, nevertheless, wanted everything to be more at – we want 1 plus 1 to add up to 3, which is what all indications were in our test market. So yes, we'll be looking at the cannibalization, but you can imagine that it's 2 different consumers to a certain degree, meaning the people that are going to be attracted to a Premier are going to be people who are already drinking some version of a light and low-carbohydrate beer, like a Mich Ultra, okay. And people that are drinking Corona are obviously doing so without regard to it being not a light or low-carbohydrate beer. So just logically, we don't expect there to be a lot of cannibalization there.

Operator

Your final question will come from the line of Bill Chappell with SunTrust.

William Chappell

I'll try to do 2 quick ones. One, just follow up on tax. I understand you're still trying to figure out the final benefit. But has there been any discussion from the board of the company of kind of how much of that will be spent back or reinvested? Or how you would spend the extra money in your pocket? And then my other question, just on the business. Any kind of update on on-premise and kind of how that's trending? We heard from different sources that there've been a lot of taps added for craft and all types of brands on-premise. And it seems maybe, you're not getting the volume terms, and so maybe there's some reversal there. So if you could you give us some update there, that would be great.

David Klein

So in terms of tax, unlike a lot of companies that had – that are sitting on piles on cash overseas and they're looking for something to do with it in the next several months, our situation's a little different in that we've already heavily invested the cash that we generated overseas into things like our breweries in Mexico as well as our Canopy investment in Canada. And so for us, I think the cash flow benefits that we think accrue over time get deployed along the lines of the rest of our – or our previously stated capital allocation strategy, which is continue to invest in the business, return cash to shareholders through dividends and share repurchases, and occasionally where we can get in a growth accretive and ROIC accretive sort of M&A transaction, we'll look at that as well. So I would say that, that piece doesn't change. And then in terms of on-premise, our beer business continues to do really well, I think for the last – this quarter, we're up high single digits. I think that's been a consistent trend over the last several quarters. And so we're just seeing continued strong performance of our brands and the brands in the on-premise, even while during the same time, overall trends in the on-premise have been down, call it low single digits.

Operator

I'll now return the call to Rob Sands for any additional or closing remarks.

Robert Sands

Okay. Well, thank you, everybody, for joining our call today. We certainly – we apologize for the line going dead for a few minutes, but we rectified that. I would say that our business has performed exceptionally well for the first 9 months of fiscal '18, and we are very confident that we'll continue to sustain our profitable growth by executing on our TBA premiumization strategy.

Just as a reminder, during our next quarterly call, we will be providing guidance for the upcoming fiscal year. Prior to that, we look forward to seeing many of you at the Beer Industry Summit conference in a couple of weeks and at the CAGNY conference in late February, where we'll be providing updates on our strategic business initiatives. So thanks again, everybody, for joining the call, and have a great day.

Operator

Thank you. That does conclude the Constellation Brands Third Quarter 2018 Earnings Conference Call. You may now disconnect.