Constellation Brands Inc, Q4 2019, Earnings Call 2019-04-04

Presentation

Operator

Welcome to the Constellation Brands Fiscal Year Fourth Quarter 2019 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

Thanks, Shannon. Good morning, everyone, and welcome to Constellation's year-end fiscal 2019 conference call. I'm here this morning with Bill Newlands, our CEO; and David Klein, 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 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*** — Thanks in advance, and now here's Bill.

William Newlands

Thank you, Patty, and good morning, everyone, and welcome to our fiscal year '19 year-end call. I'm sure you've all seen the announcement we made last evening, indicating that we have signed an agreement with Gallo to sell a portion of our wine and spirit business for $1.7 billion. This strategic action is a result of our ongoing efforts to identify value-enhancing opportunities to better align our portfolio with consumer trade-up trends and to strengthen the financial profile of this business.

Our remaining wine and spirits business will primarily consist of wines at the greater than

$11 price point and will include fast-growing, high-margin power brands like Kim Crawford, the #1 Sauvignon Blanc in the U.S.; Meiomi, the #1 U.S. pinot noir; SVEDKA Vodka, the #1 imported vodka in the U.S.; Meiomi, I already mentioned, The Prisoner; Robert Mondavi; Ruffino; as well as iconic brands like Schrader. With a tighter focus on this powerful collection of consumer-loved brands, we will be able to accelerate growth while increasing brand awareness, consumer demand and household penetration.

I'm confident that this optimized portfolio of wine and spirits brands will enable us to consistently deliver growth, exceeding the trends of the U.S. wine market while migrating to an operating margin profile of 30%, a significant improvement from the 26% margin achieved for this business in fiscal '19.

In a minute, I'll get into some of the exciting marketing initiatives we have planned for this year. But first, I'd like to highlight that several of these key brands achieved significant milestones and accomplishments this past year. We received Impact's 2018 Hot Brand Awards for Kim Crawford, Meiomi, Ruffino Prosecco and Robert Mondavi Private Selection. Our portfolio was also called out in the Beverage Information Group's 2018 awards, where 4 of our brands achieved fast-track status, recognizing their impressive growth, those included Kim, Meiomi and The Prisoner.

In addition, 10 of our brands were named Rising Stars and 7 more received Established Growth brand awards. We also have a strong innovation pipeline planned for the coming year. Some of those keys are: new product launches for Woodridge Rosé and Robert Mondavi Private Selection Rye Barrel Aged Red Blend. We are already having excellent success with some of our recently launched innovations, including SVEDKA Rosé, Robert Mondavi Private Selection Rum Barrel-Aged Merlot and Crafters Union wine in a can.

We will continue to expand our Bourbon Barrel Aged innovation program, which has been a resounding success, selling over 1 million cases of volume in its first 2 years. This initiative has reinvigorated Robert Mondavi Private Selection while also becoming the foundation for some of our other innovations like Cooper & Thief. We're also ramping up our consumer marketing efforts in the coming year. For the first time, we're taking advantage of new sponsorship opportunities with the PGA, the U.S. Tennis Association and several NFL teams for Meiomi, Kim Crawford and Woodbridge brands, respectively.

And our new SVEDKA marketing campaign, Bring Your Own Spirit, has been a resounding success, recently driving double-digit consumer takeaway growth trends in IRI channels. These efforts will help to achieve our goal of accelerating growth for a more premium collection of powerful wine and spirit brands.

Now let's move on to our beer business. Constellation continues to be the cornerstone of growth in the U.S. beer industry, delivering 36 consecutive quarters of growth dating back to the beginning of fiscal 2011. High-end beer is driving virtually all the U.S. beer category growth, and our beer business is the leader in high-end beer.

For fiscal '19, Constellation drove 40% of the U.S. high-end category growth and 100% of the import segment growth. We grew share in every U.S. sales region with accelerating trends on the West Coast, where we already have significant market share.

There are very few industry segments where this level of growth has been sustained over this length of time. Fiscal '19 also saw a monumental shift for the Corona brand family as it expanded its offerings from Extra and Light into a more comprehensive beer family with the launches of Premier nationally, Refresca in test markets and the expansion of Familiar. The Corona brand family generated 7% depletion growth for fiscal '19, selling over 150 million cases, which positions Corona as the #1 brand family in the high-end. It is also expected to surpass Coors as the second largest brand family in the U.S. retail in short order.

Corona Extra remains the engine of the Corona brand family and continues to be the #1, most loved beer among general market and Hispanic consumers. For fiscal '20, incremental media investments are expected to ignite Corona's core growth, including Corona draft and canned formats. As part of these efforts, we are increasing both English and Spanish language media across digital, social and TV, including heavy emphasis on the NFL and the NBA, where Corona is expected to have the #1 share of voice during the NBA playoffs and finals.

Corona Premier was the #1 new brand introduction in both volume and dollars last year and was larger than the #2 and the #3 product innovations combined. We are seeing strong repeat purchases with consumers motivated by the low-cal, low-carb benefits of Corona Premier's premium image. Corona Premier is winning across all demographics, including our core Hispanic consumer base.

To continue the momentum on Premier in year 2, we plan to increase our marketing investment double digits across marketing channels, including the launch of new creative for this brand. We are also significantly increasing support in both English and Spanish language media to reach Corona Premier's diverse drinker base. Corona Premier's national TV advertising focus will air in March through October, with strong presence in sports programming, including sponsorships like the U.S. Open Golf Tournament, where we will be a proud sponsor through at least 2021.

New incremental distribution opportunities for Corona Premier include the launch of 18-pack bottles to provide trade-up opportunities in larger format channels as well as the national launch of Corona Premier draft to lean into the momentum of the brand and to provide opportunity for consumers to sample in the on-premise.

And last year's regional launch of Corona Familiar, 6 and 12 packs, that brand became the fourth largest growth driver in the category and a top 10 high-end beer brand. The

Corona Familiar 12 pack was the top package innovation in dollars and volume last year, and we believe there's incremental runway for this brand, particularly with unacculturated Hispanic consumers. To fuel additional growth, we recently launched Corona Familiar 24-pack bottles regionally to capture larger social occasions with current Hispanic consumers.

For fiscal '20, Corona Familiar's expansion will be supported through double-digit increase in Spanish-language TV as well as digital, social and in-store merchandising to drive incrementality at retail.

Let's move now to Casa Modelo. Modelo Especial is the leading growth engine in the entire U.S. beer market, posting double-digit depletion growth in 26 of the last 27 fiscal years. It is the fastest-growing major beer in the industry, accounting for almost 40% of total category growth. Across the country, Modelo Especial is now the #1 brand in 3 markets and the entire state of California and the #2 brand in 5 additional major markets, growing double digits in 41 of the 50 states.

From a channel perspective, Modelo Especial continues to be the fastest-growing brand in the on-premise with draft growing more than 25% last year. And in the off-premise, it became the #1 selling beer in 7-Eleven, the biggest retailer and the biggest class of trade in beer.

Modelo Especial has incremental momentum and its superior velocity should command more space at retail when compared with other top 10 brands. The number of Especial drinkers is up versus last year for both Hispanics as well as non-Hispanics as we continue to grow both penetration and loyalty with our core Hispanic base and the general market consumer. We've seen an incredible 60% increase in general market drinkers over the past 2 years, but we still have lots of opportunity as we estimate that less than 5% of the general market currently drinks Modelo. So with this much momentum on Especial and the household penetration that still under indexes major brands, we believe that this brand has a long runway for growth.

For fiscal 2020, we expect to make our biggest-ever investment in marketing support behind Modelo. We plan to continue to engage our core Hispanic consumer by increasing our investment in Spanish-language TV, and we will be a major player in live sports, led by soccer, but rounded out by strong presence in the NFL, Major League Baseball and NBA games.

We'll be upping our game on NFL Sundays and will strengthen our college football presence with the new addition of NCAA Football for the first time. We plan to complement our live sports activity with significant investment in top-rated entertainment programming across Univision and Telemundo, while increasing our digital and social media activities as well. We will also be launching, literally, one of our biggest new items with the rollout of the Modelo 32-ounce bottle as the single-serve segment continues to be on fire. It also offers a trade-up opportunity because almost 75% of the volume in its 32-ounce format is held by domestic, low-end brands that are in decline.

Let's turn to Pacifico, our up-and-comer brand of our portfolio, selling almost 10 million cases this past year. The brand is attracting new drinkers, especially outside its core California market and is seeing double-digit growth in many of these markets through increased awareness with the national expansion of Live Life Anchors Up campaign.

For fiscal '20, we plan to push Pacifico aggressively through increased investment behind national media and sponsorships as well as expansion in digital via Facebook and Instagram. We're increasing our national TV presence for additional engagement with consumers on key entertainment properties like The Daily Show as well as live sports, like the NBA playoffs, the NHL playoffs and Major League Baseball. And with more than 50 million Americans now participating in action sports, Pacifico is continuing its partnership with ESPN as the official beer sponsor of action sports' biggest events, the Summer and Winter X Games. We've added a new Pacifico partnership with the U.S. ski and snowboard team and we will be the official beer sponsor of the Burton US Open of Snowboarding. The growth opportunities though don't end there. Innovation is the second piece of the equation that gives us confidence in our high, single-digit top line growth expectations for fiscal '20. We are building a strong pipeline of new innovative products, leveraging the power of our existing brands to fill gaps in our portfolio and complement our core franchises.

We'll continue to invest in early-stage emerging brands that are both scalable with high growth and high margin potential. Our goal is to drive sustainable high-end share growth through consumer-driven innovation that recruits new drinkers, expands occasions and adds value to the category but we will do it in a very disciplined and focused way.

During fiscal '20, we'll extend the Corona master brand to take advantage of consumer trends with the national launch of Corona Refresca. Corona Refresca brings a completely new drinker to the Corona franchise and allows us to carve out a space within the large and growing FMB category that's anchored in Corona's carefree lifestyle. Beginning this month, we're launching Corona Refresca nationally in guava lime and passionfruit lime 6 packs, plus a new variety 12 pack with the added flavor of coconut lime. This year, we're also testing Wildish, which is to be introduced as a seltzer in the Northeast and as a tea in 1 to 2 additional test markets. It is being positioned as a platform to capture the opportunity driven by the health and wellness trend. And then there's Western Standard, one of my personal favorites. This offers a high-end sessionable full flavored beer that will be available in 5 states this coming year.

Alera and El Grito are products specifically developed to meet the needs of the fast-growing Hispanic consumer. Alera is an FMB that was created for bicultural and acculturated Hispanic and general market women and will be offered in 4 test markets this year while El Grito is a newly created beer that will be part of our planned Four Corners expansion.

Now turning to the operations side of our beer business. As planned, we have completed the 30-million hectoliter capacity expansion at Nava, which brings our existing capacity, including Obregon, to 34 million hectoliters. This marks a monumental achievement over the past 5 years to provide ample supply to meet the growing demand for our beer portfolio while completing the project on time and on budget. Furnace number 5 is underway at Nava and expected to be producing glass by the end of this calendar year, and we will continue to make progress ahead of schedule with the 5-million hectoliter expansion at Obregon, which I highlighted last quarter.

The Mexicali capacity expansion continues with expected completion by fiscal ’23. As a reminder, upon completion, this planned expansion project will represent roughly 10% of our beer capacity in Mexico.

To sum it up, I am excited about the strong high single-digit growth prospects for our beer business in fiscal ’20. As you can see, we have excellent opportunities to grow our business through a combination of enhanced distribution and consumer innovation across our portfolio.

And now just a few comments about our investment in Canopy Growth, which continues to be a leading share in the Canadian recreational cannabis market, supported by solid product inventories, a national sales force and the rollout of value-added products, including Softgel caps, oral sprays and pre-rolls.

Throughout calendar 2019, we expect Canopy to benefit from favorable changes in the recreational Canadian market as brick-and-mortar retail stores come online and stimulate new growth in larger provinces like Ontario. Canopy is also preparing to deliver incremental value-added recreational products, including vape, beverages and edibles, which are slated to come online in the fall of this year in Canada.

We share Canopy's view that a significant opportunity exists going forward for the inclusion of cannabis as an ingredient in future consumer products and medical therapies. Canopy's current patent portfolio includes more than 35 issued patents and 195 patent applications, including those related to a unique process it has developed to produce cannabis-based beverages, which are expected to be available when Canadian regulations open up this fall.

So in closing, I hope your key takeaways from my comments this morning are as follows: one, I'm confident in the ability of our beer business to generate industry-leading, high single-digit growth trends for fiscal '20 with the initiatives we already have underway for this year. Two, fiscal '20 will be a dynamic year for our wine and spirits business. A tighter focus on high-performing brands strengthens the business and strategically positions it for future growth and success. Three, we are working closely with Canopy Growth on a focused long-term strategy to win markets and form factors that matter, while paving a clear path to profitability. We are confident in their ability to achieve the previously communicated run rate of $1 billion next year.

And with that, I would like to now turn the call over to David, who will review our financial results for fiscal '19 and provide guidance for the coming year. David?

David Klein

Thanks, Bill, and good morning, everyone. In fiscal '19, we grew net sales and comparable basis EPS by 7% and produced a 3-year comparable basis EPS CAGR of 20%. In addition, we generated over $2.2 billion of operating cash flow, returned over $1 billion of cash to shareholders in dividends and share repurchases and completed our incremental investment in Canopy Growth.

Let's look at full year fiscal '19 performance in more detail, where I'll generally focus on comparable basis financial results. Starting with beer. Net sales grew 12%, primarily due to volume growth of 10% and favorable pricing. Depletion growth for the year came in at 9%. Depletion growth was lower than shipment growth, primarily due to year-end timing as poor weather conditions, especially on the West Coast, muted our February depletion result after experiencing strong depletion trends during the winter holiday months of December and January. As a result, distributor inventory levels finished the year higher than expected.

Beer gross margin increased 10 basis points to 54.4% as favorability in pricing was essentially offset by higher COGS, which were primarily related to transportation cost headwinds. Given the challenging cost environment, I'm pleased with this result as our operational cost and efficiency initiatives helped offset the impact of other cost increases like depreciation.

Marketing as a percent of net sales increased 30 basis points to 9.3%, reflecting incremental investment in support of successful innovation activities. This result came in 20 basis points lower than our previous 9.5% target as we tactically balanced our marketing investments. As a result of the above-mentioned factors, operating margin decreased 20 basis points to 39.3%, which is best-in-class amongst North American brewers.

Moving to wine and spirits, shipment volumes were down 1% and net sales were flat, reflecting a slight pricing benefit. Shipment volume ran ahead of depletion volume for the year. Operating margin decreased 70 basis points to 26.5%, primarily due to higher COGS and unfavorable mix, partially offset by favorable pricing. The higher COGS primarily reflect increased grape and transportation costs. Corporate expenses increased $32 million, primarily in support of growth and technology initiatives. Comparable basis interest expense for the year increased 17% to $387 million. This reflects approximately $55 million in interest expense related to the funding for our incremental investment in Canopy Growth in November of 2018.

Our comparable basis effective tax rate for the year moved down a percentage point to 18%, which was in line with our guidance.

Now let's review Q4 results. Beer net sales increased 9%, primarily due to volume growth of 8% and favorable pricing. This net sales result came in ahead of our previous expectation due to the shipment and depletion timing items I mentioned earlier. Beer gross margin increased 50 basis points to 53.8%, primarily due to pricing and FX benefits, partially offset by higher transportation costs.

Marketing as a percent of net sales was 6.4% or 160 basis points lower than Q4 last year. Primarily as a result of these factors, operating margin increased 250 basis points to 40.5%. Wine and spirit shipment volume was down 9% and net sales were down 8%. While Q4 shipments ran below depletions, we finished fiscal '19 with shipments outpacing depletions. Operating margin increased 60 basis points to 27.7%, primarily due to benefits from lower SG&A and favorable pricing, partially offset by higher COGS, driven largely by increased grape and transportation costs.

We recorded $17 million of equity loss on a comparable basis or $0.06 per share related to our Canopy investment. As a reminder, we're recognizing our share of Canopy's earnings on a 2-month lag. As such, we recognized our share of Canopy earnings for only 2 months, November and December, which is included in Canopy's third quarter fiscal '19 results.

In our Q4 reported basis financial results, we recognized an additional $1.2 billion pretax net gain from the change in fair value of the Canopy warrants and convertible notes, bringing the total pretax net gain on our Canopy fair value investments to almost $2 billion for fiscal ’19. We also recorded a $108 million impairment charge related to the trademark value of Ballast Point. While this investment has not met expectations as the craft marketplace has slowed since our acquisition, it has increased our leadership position in the high-end of U.S. beer and provided us an innovation and operating platform in the craft and specialty category to contribute to future growth. These items were excluded from our comparable basis financial results.

Moving to fiscal ’19 free cash flow, which we define as net cash provided by operating activities less CapEx, we generated $1.4 billion compared to $874 million last year. Operating cash flow totaled $2.2 billion, up 16%, primarily driven by beer earnings growth. Operating cash flow came in below our expectation, primarily due to cash flow underperformance in the wine and spirits business. CapEx totaled $886 million, which was 16% below last year’s spend. CapEx spending was favorable versus our previous expectation, primarily due to timing.

Given the accelerated pace of the 5-million hectoliter expansion at the Obregon facility, we’ve been able to shift out the timing of some of the spend related to our Mexicali brewery build.

Moving to our fiscal ’20 P&L and free cash flow outlook. For fiscal ’20, we expect comparable basis diluted EPS to be in the range of $8.50 to $8.80. This excludes Canopy equity earnings and assumes the transaction to sell a portion of our wine and spirits business for $1.7 billion will close at the end of Q1. Primarily as a result of this transaction, we expect fiscal ’20 wine and spirits net sales to decrease 25% to 30% and operating income to decrease 30% to 35%.

During fiscal ’19, for the businesses sold, shipment volume was 28 million cases, net sales was $1.1 billion and gross profit after marketing was $389 million.

We've also identified approximately $130 million of stranded costs resulting from the transaction. The company is developing plans to eliminate these costs during the fiscal '20 to fiscal '21 time frame. We currently expect to realize $35 million to $55 million of these cost reductions during fiscal '20 and have factored them into our fiscal '20 guidance. For Q2 through Q4 of fiscal '20 – or fiscal '19, the shipment volume, net sales and gross profit after marketing cost for the businesses being sold totaled 21 million cases, $852 million and $303 million, respectively. When you exclude these Q2 through Q4 amounts from our fiscal '19 wine and spirits results, our remaining wine and spirits business is targeting net sales growth of low to mid-single digits and operating income growth of high single digits for fiscal '20.

We expect to occur a – incur a restructuring charge in the first quarter of fiscal '20 in connection with the cost reduction plan that's being developed. We've not reflected this change in our fiscal '20 reported basis guidance. In addition, we've not included any potential net gain or loss in our fiscal '20 reported basis guidance. Both items will be excluded from our fiscal '20 comparable basis guidance.

We expect most of the wine and spirits shipment timing benefit for fiscal '19, that I mentioned earlier, to reverse in Q1 fiscal '20. As a result, Q1 fiscal '20 wine and spirits net sales and EBIT is expected to decrease 10% and 20%, respectively. For fiscal '20, our beer business is targeting net sales and operating income growth in the range of 7% to 9% and our full year operating margin to approximate 39%. Our projections include 1% to 2% of anticipated pricing benefit for our import portfolio. We expect gross margin to be flattish as cost inflation headwinds, primarily related to glass, raw materials, transportation and labor cost in Mexico are expected to be mostly offset from product pricing and productivity initiatives.

As mentioned earlier, beer marketing expense as a percent of net sales finished fiscal '19 at 9.3%. For fiscal ’20, we expect marketing as a percent of net sales to increase slightly, around 20 basis points, to 9.5% to support the innovation and brand growth initiatives outlined earlier by Bill.

We expect some of the beer shipment timing benefit that we recognized at the end of fiscal ’19 to reverse in Q1 fiscal ’20. As a result, Q1 fiscal ’20 beer net sales and operating income growth is expected to increase mid-single digits. Interest expense is expected to be in the range of $420 million to $430 million. This includes approximately $105 million of incremental interest expense associated with the financing of our November 2018 Canopy investment. This brings the total Canopy-related interest expense to $160 million.

Net proceeds from the wine and spirits transaction will be used to pay down debt and an interest expense reduction of approximately $40 million has been factored into our fiscal ’20 guidance for this item.

Our tax rate is expected to approximate 17%. Weighted average diluted shares outstanding are targeted at 195 million. This guidance assumes no share repurchases for fiscal ’20. Net income attributable to noncontrolling interest is expected to be in the range of $30 million to $40 million. I would also note that our comparable basis guidance excludes comparable adjustments, which are detailed in the release.

We expect fiscal ’20 free cash flow to be in the range of $1.1 billion to $1.2 billion, which reflects operating cash flow in the range of $1.9 billion to $2.1 billion and CapEx of $800 million to $900 million. This includes approximately $600 million of CapEx for our Mexico beer operations expansion, including investments in the Obregon and Mexicali breweries and a fifth glass furnace at the Nava glass plant. This expansion CapEx spend is below our previous fiscal ’20 guidance as we’ve shifted out the timing of spend for Mexicali.

For fiscal ’21 and ’22, we expect total company CapEx to be in the range of $700 million to $900 million per year. This includes $200 million to $400 million of maintenance CapEx across the total Constellation business. In fiscal ’21 and ’22, we expect beer expansion project CapEx to moderate from the $600 million level in fiscal ’20 as we work to complete the buildouts of Obregon and Mexicali. While our fiscal ’20 comparable basis EPS is moving down due to the wine and spirits divestiture, we remain committed to growing our dividend and have increased our quarterly dividend slightly.

As summarized in the earnings release, fiscal ’19 comparable basis diluted EPS, excluding Canopy equity earnings, totaled $9.34 per share. As mentioned earlier, we expect comparable basis diluted EPS, excluding Canopy equity earnings, to be in the range of $8.50 to $8.80 per share. Canopy’s business is rapidly evolving and their financial results will likely be volatile as they invest behind their growth opportunities. Additionally, as Canopy’s planning process for the next fiscal year is ongoing and the Canopy equity earnings we recorded in our income statements are noncash, we’ve not factored Canopy equity earnings into our fiscal ’20 guidance. This will allow us and our investors to focus on the underlying performance of our core business.

In closing, the actions we are taking in fiscal ’20 will provide us a more premium portfolio of wine and spirits with a stronger growth in financial profile. This, along with the opportunities we plan to capture to increase our leadership position in high-end beer, has us very excited about the future.

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

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from Dara Mohsenian with Morgan

Stanley.

Dara Mohsenian

So clearly, a lot of variance in the beer depletion growth within fiscal Q4 with the great start that you mentioned and then the weaker end of the quarter dampened, I guess, literally by weather. So I'd love to get more detail on if you think the softness in February was just weather related or if there are any other factors that may linger? And any update on March if you're expecting – sort of if you're back to that full year trajectory that you're expecting? And then just second on Premier on the beer depletion front, I guess what level of growth are you expecting out of that brand in fiscal 2020? And what gives you confidence that it can build and grow in year 2?

William Newlands

Sure. Yes, the entire scenario around the slight weakening at the end of the fourth quarter was driven by weather. The last 2 weeks in the State of California, which, as we all know, is our biggest market, was literally wet, soaking wet. In fact, only 1% of the State of California today is in drought conditions and just a few years ago, that number was in 90-plus range. So we literally saw everything dampen in the last couple of weeks. You combine that with the polar vortex that we had in the northern tier of states and it was a literal weather mess for the last couple of weeks of our fiscal. We are, though, very pleased with the start of our March, and we feel that it's consistent with the guidance that we just provided. Relative to your question on Premier, we expect Premier growth to be in the 30% to 45% range this coming year. So we see significant upside in that brand beyond the results that we saw this past year. As most of you know, Premier virtually doubled what our expectations were in its first year and we expect that acceleration to continue.

Operator

Our next question comes from Lauren Lieberman with Barclays.

Lauren Lieberman

I wanted to keep talking a little bit about innovation. So a lot of activity in the ABA space broadly. So first, could you talk a little bit Refresca, my understanding from test markets is it's largely incremental. But how big – with FMBs, I mean when they launch, if they hit, they can hit really big but the sort of trajectory generally speaking for a lot of these brands has been year 2 or year 3 is a real struggle. So as you look for planning out the future of Refresca, how do you manage that kind of boom/bust scenario? And what are your general expectations for year 1? Then secondarily, you mentioned Alera. So how does that in respect with Corona Refresca in terms of positioning and marketing, knowing that's still just in test markets?

William Newlands

Sure. Let me cover those. Refresca, in our test markets, had tremendous incrementality. In fact, it was even better than Premier was. So we are very excited about the opportunity to put a strong recognized brand like Corona packaged as Refresca into a separate area of the store, both on the retail shelf and in the cold box. It appeals to a much broader demographic than what our core beer business does, and we think it opens up a wonderful vehicle with the strength of the carefree lifestyle that Corona represents for our business. Alera on the other hand, is much more focused to Hispanic women, also multicultural women, but Hispanic women specifically. And that will be somewhat different than what we see as the demographic profile around Refresca. As you know, Alera will only be in test market. We have a very defined approach to innovation where we test and learn in year 1. And as we see success, we expand, much like we did with Premier, we're doing the same thing with Refresca and we will do that assessment with Alera and El Grito and things of that nature as well so that we have a focused approach and disciplined approach to our innovation agenda.

Operator

Our next question comes from Vivien Azer with Cowen.

Gerald Pascarelli MR

This is Gerald Pascarelli on for Vivien. So just kind of building on Refresca, the national rollout, obviously, encouraging and bringing a seltzer to market. As you guys look to build out your portfolio, are there any gaps that you see that you might want to invest in and kind of enter, not just across beer, but across spirits as well?

William Newlands

Sure. We obviously do a lot in our – through our Chief Growth Officer in – as assessing what consumer opportunities and segments are available to us. That's frankly how we got to Premier, that's frankly how we got to Refresca and how we've gotten to Alera and other things that we are testing. We certainly see an opportunity in higher-end sessionable domestic beer. That's why Western Standard is being tested in 5 Western states this year. I personally am very excited about the opportunity around that and it's a bit of one of those what I would describe as category blurring. It is a lager that's then – has time in high west barrels. So it has the benefits and it's really what we're calling a saloon lager. It's a great opportunity to leverage existing capabilities that we have, but also put us into a new area as consumers continue to trade up. We are also evaluating, and we'll continue to evaluate new things. I use the example of our Bourbon Barrel Aged wine programs, which, as I mentioned in my remarks, have generated over 1 million cases from 0 in under 2 years. So we will continue to find those niche opportunities that we believe are big, impactful and sustainable, whether it be in our beer business or in our wine and spirits business.

Operator

Our next question comes from Bonnie Herzog with Wells Fargo.

Bonnie Herzog

I actually had a question on your update – or your FY '20 EPS guidance. It excludes the expected dilution from Canopy and I think it appears a bit low so possibly conservative. So I guess I was hoping you could touch on that and your level of conviction? Then I was hoping to get a sense of your level of visibility with Canopy and if you have any sense of when equity earnings from Canopy will inflect positive? And then, I think earlier you had mentioned that you are expecting that to happen by the end of this year so I just wanted to confirm that. And I also wanted to understand, you mentioned that you're not going to include Canopy in your FY guidance, so just want to confirm that's going to continue through this year. And curious how you think about it in the out-years, especially when Canopy is no longer a drag on earnings, will you possibly start to include it then?

David Klein

Yes, so let me take it kind of in 2 parts. So on our base-level guidance, Bonnie, we're – we – our guidance is really out there for beer, in line with our medium-term growth algorithm in the 7% to 9% range, kind of centering on that 39% operating margin, which we think is aggressive but achievable, and again, in line with our medium-term expectations. For wine and spirits, once we have closed on our transaction, we have a base underlying business that we think as a result of more focus from ourselves internally, where we can apply our ability to drive connectivity with our consumers, better performance in our operations, maybe some pricing along the way, that we'll be able to deliver, over time, mid-single-digit growth and achieve the 30% operating margins that Bill talked about. The headwind there, really, for FY '20 for us is the stranded cost removal. And so we've baked into our guidance between $35 million and $55 million of cost takeout of the total of $130 million. Maybe the reason why we couldn't be more aggressive with that number is related to timing in the year of when the costs come out for some of the costs and the fact that some of the costs will be coming out of COGS and COGS overhead, which will take time to come through our P&L and won't likely show up until next year. So we think the story stays completely on our medium-term guidance. We just have to work through some of the near-term work. Shifting to Canopy, we still are confident, as Bill called out, that the Canopy business will be generating over $1 billion in run rate. Net sales at the end of their upcoming fiscal year, we expect to be able to see profitability out of the markets that they were in when we did the transaction, so meaning Canada medical and rec as well as some international medical markets. We would still expect to be able to see that come through our numbers in FY '21. So our view on Canopy hasn't changed. But let me just touch on guidance or lack thereof. I'm personally disappointed that we weren't able to get – to be able to provide guidance for the fiscal year on Canopy, but there are a couple of factors that played into that. The first is the planning process at Canopy isn't completed. In fact, the board and the management team will be going through their plans over the next couple of weeks. Secondly, we're seeing changes literally as we speak because this week, brick-and-mortar sales started to take place in the province of Ontario. We still don't have clarity on CBD products, how they'll be regulated in the U.S. And of course, we expect different form factors to come online in Canada later in the year, but that timing could move around a little bit. So we looked at all of these factors, and we felt that we would probably just make things less clear to our investors if we tried to provide some very broad guidance range that would take into account all of these factors. And in any event, we're going to show Constellation ex-Canopy equity and earnings in our results and so that's what we've provided to you today. We do expect at some point to be able to provide at least a broad range of guidance for Canopy, we were just unable to do it today. And since I've already missed on that commitment, I'm not going to commit on when we'll be able to do that, but we'll get there as soon as we can.

Operator

Our next question comes from Judy Hong with Goldman Sachs.

Judy Hong

So I guess, my first question is just 1 clarification. David, your comment about the mid-single-digit sales growth in beer in Q1, can you just quantify how much under shipment you're expecting in Q1 specifically? And then my broader question is really on your marketing investments. So throughout fiscal '19, it seems like that number has come down a little bit. You talked about tactically balancing the investments. I guess, I just want to get a little bit more color on what you meant by that? And then when you look at fiscal '20, obviously, a lot of innovations and lot of activities even on the core. So I guess I'm just wondering if you're looking for more efficiencies in term of marketing. Are you looking at that in sort of a different ways? Or is sort of the return you're getting, perhaps sort of influencing how much you're spending on some of these brands at this point?

David Klein

Okay. So in terms of Q1, Judy, well, let me just kind of step back a little bit and talk about the ships and depletions growth rate and balances over the last couple of years. So in FY '18, depletes grew faster than ships, in FY '19, ships grew faster than depletes. We would expect in FY '20 that we'll end up with a year where depletes grow a little bit faster than ships, just as a general comment. And by the way, the actual volume deltas between these really is in a – there's a small number of cases, call it 1 million or 2 million cases a year. And so we just have different growth rates as a result of different numerators between ships and depletes. So in the first quarter, we have an imbalance to unwind, that gets us to the mid-single digits, even while we're on target – mid-single-digit growth in ships in the first quarter, even while we're on target for our full year depletion growth rate. So again, just timing. And as Bill mentioned, that imbalance really happened because of our – the way we plan out our shipments versus our depletions, happens within a 10-day to 2-week sort of window and the last couple of weeks of February depletions just slowed down for reasons Bill described. Talking – shifting to the marketing question, our philosophy really hasn't changed. I would say that our marketing team, headed by Jim Sabia, does an outstanding job of both getting really good returns on our marketing investments, while they're squeezing as hard as they can on the dollars that are applied to nonworking marketing. Our returns haven't diminished. And so we remain committed to driving that real value-add marketing spend. What really happened is, we believe that we should be spending about 9.5% on marketing and just as a result of timing of ad placements and that sort of thing, we ended up a little bit light in FY '19, but we expect to be in that 9.5% range in FY '20.

Operator

Our next question comes from Steve Powers of Deutsche Bank.

Stephen Robert Powers

So I guess, first, just – I wanted to just confirm that you're still holding to your CAGNY comments of roughly 10% EPS CAGR off the reported $9.28 base that you just finished in '19. Just a clarification there. And then my real question is on the wine sales and how – just a question around how you're thinking about the valuation. On a trailing basis, it looks like the transaction was done at about 6x EBITDA, which is more or less in line with some of your prior comments. But I guess I was a little surprised in that context with the magnitude of the stranded overheads, because, on a contribution margin basis, it looks like Gallo is paying closer to 4x. So just a little bit more color around how you thought about that? And just one last – just clarification, the restructuring charge is not in your outlook, but I'm assuming that any cash outlays related to that effort are in your free cash flow outlook, I'm just hoping you can confirm that.

David Klein

Yes, so I'll start with that one because that's easy. Yes, any anticipated restructuring cash cost we have included in our cash outlook and – however, as you highlighted, we excluded that from our numbers from a P&L standpoint. So now I'll go back to your first question. Yes, we are still on track for 10% EPS growth. Remember that, that guidance was really on a 3- to 5-year basis. But our models, even as we roll our plan into it and have final FY

’19 numbers, we continue to support 10% EPS growth using FY ’19 as a base. So now let’s talk about the transaction value itself. So I think we called out in our release some of the details about contribution after marketing spend. If you look at the brands on a trailing basis, yes, you’re in the 6-ish range, between 6% and 7% on a trailing basis. These brands are declining mid-to high-single digits. So on a forward basis, you’re more in line with 7% or slightly above 7%. We also have a fair amount – most of the CAM that we sold was – is branded CAM. We also have a couple of ancillary businesses such as our concentrate business and our Polyphenolics business that were included in the sale as well because they actually reside at the Mission Bell facility. So when we look at the transaction on a multiple basis, we’re comfortable with it. When we look at the transaction on a DCF basis, we’re comfortable with it, and on an accounting basis, we’re comfortable as well. So I think the important thing though to take away from the transaction is the strategic merit for Constellation in being able to direct their attention to these higher-margin brands that remain in our portfolio. We believe that if we put the sort of thinking and maybe discipline that we’ve applied to our very focused portfolio in beer to this portfolio and wine and spirits, we can have some pretty impressive results. And that’s really the point of the transaction. It’s more of the strategic merits than the economic merits, but we think it was a fair deal all around.

Operator

Our next question comes from Robert Ottenstein with Evercore ISI.

Robert Ottenstein

Just one quick point of clarification. Have you finished the sales in the wine and spirits business? Is this what you had intended, is it done? And then my real question, can you talk a little more about the potential for Pacifico? How you’re sizing? How big that brand could be? And what you’re seeing in terms of incrementality on that brand?

William Newlands

Sure. Yes. We view this as the optimization effort in its entirety, for your first question. The second question about Pacifico. We were very excited around Pacifico. It has grown double – grew double digits this past year, outside of the core California base, as the advertising campaign that we had associated with it kicked in and worked very well. I think we're going to continue to see this brand be a double-digit growth driver for us going forward as it extends itself. As I said in my prepared remarks, we have extended some of our sponsorship opportunities with this brand, and we'll continue to do sort of the edgy X Game type of approaches that we think Pacifico has become known for and we think it's got some continued success to come.

Operator

Our next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira

So my question is on beer. So Bill mentioned – Bill, you mentioned that you expect Premiere to have about 35% growth embedded in fiscal '20 guide. So what is the total assumption for the Corona family as a whole and for Modelo in that guidance?

William Newlands

Sure. Our expectations is that the Corona family, after growing 7% during this past year, will probably be in the mid-single-digit range for this coming year. Premier, we do expect, as I said earlier, to be a significant growth driver as part of that, and we expect the overall brand family to be in the mid-single-digit range.

Operator

Our next question comes from Kevin Grundy with Jefferies.

Kevin Grundy

Quick housekeeping question for Dave and then one for Bill. So David, the housekeeping, after-tax proceeds on the $1.7 billion sale of wine assets and then whether you had any flexibility to buy back the stock as opposed to paying down debt? And then, Bill, for you, on pricing, just given the protracted volume declines in the industry over a long period of time, do you see any potential that the big domestic brewers become less rational at some point? How do you sort of handicap the possibility of that and potential implications for your portfolio?

David Klein

So Kevin, we are not prepared to really talk about the after-tax proceeds, but it will be a fairly efficient transaction for us from that perspective. We do intend to repurchase stock, as we've said before, as soon as we are comfortably within our targeted leverage ratio range of 3x to 4x. We haven't built anything into our guidance, we'll see how the year unfolds, but we would very much like to be buying our stock at this point, and we'll do so as quickly as we can.

William Newlands

Relative to your question on pricing, I mean, we continue to feel, as we have, that there is 1% to 2% pricing within our beer business on an ongoing basis. As you know, our brands have strong consumer demand attached to those, and we continue to feel that, that opportunity is going to be there for us as we continue into the foreseeable future. Relative to – and I don't know if that was uniquely to beer, I would say, we are putting some of the same capabilities on our remaining wine and spirit business that we have put on our beer through revenue management, and we expect to see both mix and pricing benefits coming out of our wine and spirit business, which, quite frankly, we had been relatively unable to get in the recent past with our remaining portfolio, which we think is much more conducive to pricing and mix benefits.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan Spillane

Just two quick ones. David, do you have any sense on what depreciation and amortization is sort of ongoing after divestitures?

David Klein

I don't have that off the top of my head, but clearly, that's something that we can provide at some point. So I think – so, Bryan, sorry about that, we didn't give you a chance for your second question.

Patty Yahn-Urlaub

Shannon, can you let Bryan back on the line, please?

Bryan Spillane

And just a question on beer margins, David. Can you just walk through a little bit color on some of the pressure points on cost, on headwinds and cost of goods, I guess like glass and labor inflation and that type of thing? And just how fixed that is as you're kind of – through the course of this year, meaning is there op chance or how much volatility could there be in that cost basket?

David Klein

So Bryan, if I knew you were going to ask a beer margin question, we wouldn't have gone through letting you back on the line. So yes, I think I said this before that we're seeing labor inflation in Mexico in the 4% to 6% range. We're seeing cost – the contractual cost of glass increasing in the 4% to 6% range, in particular, coming out of our joint venture, which is producing about 55% to 60% of the glass that we use. We expect to see transportation headwinds in likely the high single-digit range. We do expect to have some benefit, clearly, from pricing, but in order to hold our gross margins, not only do we have to get benefits from pricing and possibly FX, we have to also deliver on productivity improvements, which the team is diligently working towards. So I think all in all, given the sorts of headwinds that we're seeing and the pricing environment that we're anticipating with this 1% to 2% price increase activity, we feel pretty good about being able to have flattish gross margins during the year.

Operator

Our next question comes from Tim Ramey with Pivotal Research Group.

Timothy Ramey

Thinking about the wine portfolio in 2021, kind of skip ahead and take this transaction year out. Have you modeled what net revenue per case might look like versus the current portfolio as you talked about the – understand where that was and where that's going?

William Newlands

We are, obviously, running models as we speak about what we expect our RemainCo portfolio. As you would expect in a transaction of this size, the final dimension of what was going to be sold has just been recently completed. So a lot of work is now being done on our forward-looking wine piece. What I would say is this, I think you should expect it to be significantly higher than what it has been because, as you know, the vast weighting of the portfolio that has been sold is that reflecting under $11 on a retail price basis. So the overall average out-the-door price point for our RemainCo brands will be significantly higher than it was, and we'll be able to give you a more concrete answer to that as we get the work done.

Operator

Our next question comes from Sean King with UBS.

Sean King

That $0.75 dividend came in lower than at least our expectation. Are you thinking any differently about, the, I guess, the cadence or composition of the $4.5 billion return to shareholders over the next 3 years?

David Klein

No, not at all. We feel really bullish about that, Sean. What – we've been targeting a 30% payout rate at our business and the – as a result of the disposition of some of the wine brands, as our net income came down, our actual – at that 30% number, our payout would have come down. We wanted to keep it in line with where it was last year, and quite honestly, show a slight increase so that's what we offered up. It really is more in keeping on track at that 30% target more than it is any kind of indication around comfort level with being able to return the $4.5 billion. We remain absolutely committed to that.

Operator

And our last question is from Brett Cooper with Consumer Edge.

Brett Cooper

Beer question, what do you guys expect to get in terms of incremental placements as you go into the spring with the new products that you're rolling out? And then as you're putting more products, more packages in there, how do you guys think about driving velocity growth for the total beer business and the importance of doing that?

William Newlands

Sure. As we've shared at prior discussions, we believe that as our algorithm for growth, roughly 50% of our growth profile will come out of increased distribution with an increase of the innovation agenda to 30% and then various other miscellaneous things. So we continue to feel that there remains a lot of opportunity in distribution as well as in formats like cans and draft and so forth that we alluded to earlier on the call. Relative to velocity, as you know, a lot of work has been done by our – and our space management approach that we have definitively proven, improves the overall results in a beer section when our Shopper First approach is undertaken. We are radically increasing the number of retailers that are engaged with this particular program, which we expect to have a significant and helpful velocity improvement based on improving the overall space in the beer section. So we believe with that particular element, it will be helpful not only for us, but for the overall category, and we're excited about the opportunity around it.

Operator

This concludes the question-and-answer session. I'd like to turn the call back over to Bill Newlands for closing remarks.

William Newlands

Great, thanks very much. Much appreciate all of you joining Patty, David and me today. Obviously, we're excited about our organic growth prospects for the coming year, and we're already hard at work, as you would expect, to deliver these opportunities while continuing to invest in our brands and in our operations. We look forward to speaking with all of you again in late June when we share the results of our first quarter for our new fiscal year. Before then, we certainly hope that you'll choose some of our fine products for your spring celebrations, including Cinco and Memorial Day weekend. Speaking of Cinco, look for us at the New York Stock Exchange as we will officially kick off the summer selling season by ringing that closing bell. So thanks, again, everyone, much appreciate your time and have a good day.

Operator

Ladies and gentlemen, this concludes today's conference. Thanks for your participation and have a wonderful day.