Constellation Brands Inc, Q2 2018, Earnings Call 2017-10-05

Presentation

Operator

Welcome to the Constellation Brands Second 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, Laurie. Good morning, and welcome to our Second 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.

With regard to unregistered security offerings discussed during the call, please note that the securities subject to those offerings have not been registered under the Securities Act of 1933 and may not be offered or sold in the U.S. absent registration or an available exemption from registration requirements. — ***Operator Instructions*** —

Thanks in advance, and now here's Rob.

Robert Sands

Thank you, Patty, and good morning, everyone. Before we get started with our quarterly review, I'd like to convey my sincere sympathy to all who have been affected by the string of recent natural disasters and tragedies. Thankfully, the earthquakes in Mexico did not have an impact on our production operations there, but our sympathies to all of our affected families.

So now let's get started with our discussion of Constellation's second quarter fiscal 2018 sales and earnings results. We delivered exceptional results for the second quarter of our fiscal year. Throughout the business, we gained share overall, improved the margins, continued to generate strong free cash flow and executed exceptionally well both operationally and in market. These results are a testament to the fact that our total beverage alcohol or TBA strategy is paying off. We remain the leader in the high end of the U.S. beer market, and we are reaping the benefits of our wine and spirits premiumization strategy. As a matter of fact, our beer business, which remained the #1, #1 growth driver in the high end of the U.S. beer market, generated more than 60% of the growth of this market segment during the quarter.

Overall, Constellation has been the clear winner during the 120 days of summer for the past 4 years, growing dollar share of the total beer market more than any other leading supplier. Excellent execution during the July 4 holiday, the most important holiday for the U.S. beer industry, drove significant market share gains for the quarter. During this time frame, Constellation had 5 brands in the top $20 share gainers, including Modelo Especial and Corona Extra in the #2 and #3 positions as well as Pacifico, Modelo Negra, Modelo Chelada Tamarindo Picante, for example. Record level distribution gains and increased media activities continued to drive greater than 60% of our overall depletion growth. Across the portfolio, you can see excellent results of these efforts.

Additional TV advertising and digital support propelled Corona Extra, which was recently named by Interbrand as one of the best global brands of 2017 for the eighth year in a row. The Corona canned format grew more than 20% during the quarter with the launch of its limited-edition beach-in-a-can packaging. And Corona Extra was the official beer sponsor of the Mayweather versus McGregor fight, which set the new record for the largest viewing boxing audience.

Modelo Especial increased TV advertising and promotional investments beginning with the NBA finals in early June and was also named the official beer of 2 prominent soccer tournaments, including the Gold Cup, all of which led to the gains in trial and awareness versus a year ago. And Modelo Chelada Especial was recently named a 2017 Nielsen Breakthrough Innovation Award winner. These activities drove depletion growth of almost 20% for the Modelo Especial family of brands for the quarter.

Pacifico continues to capture new consumers by building brand awareness and trial across the brand's priority geographies. During the quarter, Pacifico TV advertising aired across the western U.S., Colorado and Texas. Now this activity was complemented by year-round social media support on both Facebook and Instagram. In addition, the Summer X Games shows Pacifico as their exclusive beer partner for their competition in July.

As we head into the second half of the year, the beer portfolio is well positioned from a marketing and promotional perspective, supporting the professional and college football season as well as key boxing and soccer sponsorships. Our innovation test markets for Corona Premier and Corona Familiar continue to be very successful. As a result, we plan to nationally launch Premier beginning in fiscal 2019, with Familiar rolling out to all major Hispanic markets, a key demographic for this brand, during the same time frame.

I'd like to remind everyone that the benefits of these new product introductions have already been included in the growth goals that we have outlined at our New York City Investor Day last November. During the quarter, we added Funky Buddha Brewery to our newly established craft and specialty beer business. Florida-based Funky Buddha is a regional craft beer player and South Florida's largest craft microbrewery by size and volume. The acquisition of Funky Buddha is a continuation of our beer strategy to be the leader in the high end of the U.S. beer market. This brand has great potential and plenty of runway for future growth, and we plan to leverage that potential to begin building a stronger presence in the high-end craft beer as this market segment continues to be one of the key growth drivers within the U.S. beer market. Our goal is to continue to grow distribution of the brand throughout the state of Florida as well as targeted expansions into key new states.

From an operations perspective, our capital expansion projects in Mexico continues to be on track on all fronts. The Nava Brewery achieved record production volumes during the second quarter, and we look forward to completing the next phase of expansion, taking the brewery to 27.5 million hectoliters of capacity by calendar year-end. Glass furnace #3 is now fully operational and ramping to peak efficiency levels.

The Obregon brewery continues to perform at very high utilization levels, and we are currently optimizing existing capacity as we plan to increase capacity in both brewing and packaging before the end of the fiscal year.

Construction continues in Mexicali, and we are making solid progress. Brewhouse tank fabrication and installation are currently in process, and building structures for brewing, packaging and utilities are well underway.

Overall, the strong results that the beer business achieved in second quarter are driving the upward revision in our EPS guidance for the year. David will have more to say in this regard in a few moments.

Now turning to our wine and spirits business. During the second quarter, we gained momentum for our wine business, gaining market share and delivering strong depletion growth of 5%. And while we continue to improve margins for this business, the significant margin enhancement that we saw in the first quarter from positive mix and the divestiture of the Canadian business were somewhat offset by planned investments in marketing, primarily for our Focus Brands, as well as promotional activity as shipments and depletions became aligned through the first half of the year. These investments are obviously paying off as we posted depletion growth of more than 12%; for our Focus Brands during the quarter, driven by Black Box, Robert Mondavi Private Selection, Kim Crawford, Meiomi, Woodbridge by Robert Mondavi and SVEDKA Vodka. And within our Focus Brand portfolio, our top 5 profit contributors are collectively growing volume 10%, with profits also growing double digits year-to-date.

As we head into our key selling season for the wine and spirits business, we have solid programming in place and are well positioned to develop our goals for the year. Planned investment, including Black Box digital advertising, the launch of a new TV campaign for Kim Crawford beginning this fall as well as the continuation of Woodbridge TV and digital advertising to increase awareness and fuel momentum for this brand. In addition, the new first-ever national digital advertising program for Meiomi will continue leading up to the holidays.

Now from an innovation perspective, the 7 Moons Red Blend wine brand is gaining momentum and has already become a top 10 premium red blend. And our recent rosé line extensions have taken off, including Meiomi, Kim Crawford and Black Box rosé brands. Our acquired wine and spirits brands are performing exceptionally well, including High West Whiskey and Casa Noble Tequila as well as The Prisoner, Meiomi and Charles Smith wine brands. On a year-to-date basis, through the first half, these brands collectively delivered depletion growth of 23% with a gross margin in the 60% range. And following the recent Schrader acquisition, Constellation has become a top $100-plus Cabernet Sauvignon wine producer. Our spirits portfolio posted net sales growth of 2% for the quarter, driven primarily by High West Whiskey. In addition, SVEDKA Vodka gained market share of the vodka category due in part to the successful launch of the new SVEDKA blue raspberry flavor.

Now in closing, I am pleased with our second quarter results and what we have accomplished in the first half of the year. The total beverage alcohol portfolio remains strong as many of our high-end beer and premium wine and spirits brands gained share. It is these products that remain growth drivers within the TBA category, which is expected to continue in the future.

In addition, our portfolio performance and execution by our commercial and operational teams continues to drive margin benefits, giving us the confidence to raise our guidance for the year.

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

David Klein

Thanks, Rob, and good morning, everyone. I hope everyone saw our new press release format and found it helpful. We decided to provide the financial press, analysts and investors with our financial results, accomplishments and strategic initiatives in a more concise and easy-to-use format.

Our Q2 results demonstrated continued strong financial performance as we generated 8% organic net sales growth, expanded our consolidated comparable basis operating margin by 340 basis points and increased comparable basis EBIT by 14%. These results include particularly strong operational performance by our beer business, which, along with anticipated favorability in our tax rate, is driving an increase in our full year comparable basis diluted EPS goal to a range of $8.25 to $8.40 a share.

We believe the recent natural disasters had a minor impact on our Q2 results and may have some minimal impact on Q3 results, which we factored into our new guidance. However, we continue to monitor the situation in these affected areas.

Let's look at Q2 performance and our full year outlook in more detail, where I'll generally focus on comparable basis financial results. For beer, net sales increased 13% on volume growth of 12%. Depletion growth came in at 8% as we won the 4th of July holiday and the rest of the key summer selling season. We overlapped a difficult 14% depletion growth comparison for Q2 fiscal '17. Shipment growth ran ahead of depletion growth after we saw the opposite trend in Q1.

For the first half of the year, shipment and depletion growth rates are both in the 9% to 10% range. This has us on track to meet our net sales goal 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 targeted for our Mexican portfolio.

Beer operating margin increased 420 basis points to 41.1% primarily due to lower COGS, favorable pricing and foreign currency benefits. The lower COGS reflects benefits from supply independence from ABI and glass sourcing as we saw strong operational performance at our breweries and glass plant during the peak summer production period. Our Nava Brewery generated record production volume and performed ahead of our expectations for the quarter. These benefits were partially offset by a $13 million increase in depreciation expense, which totaled $40 million for Q2.

Given the strong operational performance, we now expect beer operating income growth to be in the range of 17% to 19%. The expected moderation in beer operating income growth and margin for the back half of the year versus the first half of the year is being primarily driven by lower production volume due to normal seasonality combined with the continued ramp-up in depreciation and line commissioning costs, including headcount additions to support our expanding operating platform. In addition, SG&A leverage is impacted by the lower volumes that occur in the second half of the year as a result of the seasonality of the business.

Last quarter, we indicated that we expected an unfavorable foreign currency impact due to tougher peso comparisons in the back half of fiscal ’18. However, this headwind has been mitigated through our hedging program, and we currently expect an unfavorable currency impact to be fairly minimal.

For wine and spirits, we saw strong Q2 U.S. depletion growth of 5%, which outpaced U.S. shipment volume primarily due to timing as we reported shipments ahead of depletions in Q1. This contributed to Q2 organic net sales being down 1% as favorable mix was more than offset by lower volume. Promotional expense was higher in Q2 than Q1 due in part to the increase in depletions we saw in Q2 versus Q1. At the halfway mark of fiscal ’18, organic net sales are up 2% and U.S. depletions are also up 2%, while operating margin increased 330 basis points, driving operating income growth of 5%.

For the quarter, wine and spirits operating margin increased 40 basis points to 26.2%. This improvement primarily reflects the divestiture of the lower-margin Canadian wine business and favorable mix, partially offset by higher marketing investments. For fiscal ’18, we continue to expect wine and spirits reported net sales to decrease in the range of 4% to 6% and operating income to be flat. These projections include the negative impact of the Canadian wine business divestiture and the estimated incremental benefits from the High West, Charles Smith and Prisoner acquisitions.

When excluding the impact of the Canadian wine business divestiture from our fiscal ’17 wine and spirits results, we continue to expect net sales growth of 4% to 6% and operating income growth of 5% to 7%. The moderation of our wine and spirits operating growth in the back half of fiscal ’18 implied by our guidance is being driven primarily by Q3 activities, including planned marketing and SG&A investments during the key holiday season and loss of $17 million of operating income from the Canadian wine business, which was recognized in Q3 last year. As a result of these factors, we are targeting wine and spirits operating income to be down in the low to mid-teens range for Q3 fiscal '18 on a reported basis.

I'd also like to note that 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 decreased 14% as the benefit of lower average interest rates was partially offset by higher average debt balances. We now expect fiscal year '18 interest expense to be in the range of $330 million to $340 million. The improvement is primarily related to short-term interest rates trending more favorable than our earlier projections.

We recently announced plans to launch a commercial paper program to improve short-term borrowing costs, which is typical for investment-grade companies. The program is expected to be an unregistered private placement and provide for the issuance of up to $1 billion of commercial paper. The program is expected to be supported with available commitments under our revolving credit facility, so it will not result in an increase in the total amount of our authorized debt.

When factoring in cash on hand, our net debt at the end of August totaled $8.8 billion, a $230 million decrease from our net debt balance at the end of fiscal '17. Our net debt to comparable basis EBITDA leverage ratio moved down to 3.3x at the end of August from 3.7x at the end of fiscal '17, while we continue to invest in our Mexican operations, build our portfolio and return cash to shareholders, with $201 million worth of dividends paid and $14 million of stock repurchases during the first half of the year.

Our comparable basis effective tax rate came in at 20.5% versus 31.8% last year. This improvement reflects the benefit of reinvesting foreign earnings under APB 23 and the adoption of ASU 2016-09, which requires excess tax benefits from stock-based payment awards to be recognized in the income statement.

For fiscal ’18, we now expect the effective tax rate to approximate 21% versus our previous guidance of 22%. The lower projected rate is primarily due to an increase in forecasted excess tax benefits from stock-based payment awards and lower effective tax rates on the foreign earnings of our beer business. We expect our Q3 tax rate to be higher than our full year tax rate and then Q4 to be in line with that full year rate.

I would 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 is now expected to approximate $10 million to $15 million versus our prior estimate of about $10 million.

As mentioned earlier, we’re now projecting our full year comparable basis diluted EPS to be in the range of $8.25 to $8.40. The midpoint of this guidance has us targeting 23% growth. Our comparable basis guidance excludes comparable adjustments, which are detailed in the release.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. We generated $598 million of free cash flow for the first half of fiscal ’18 versus $676 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. We did not revise our free cash flow guidance as the benefit from our projected earnings increase is expected to be offset by unfavorable timing of recoverable value-added taxes. 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 Mexico beer operations expansion.

In closing, our beer business continues to deliver impressive operational and marketplace execution while generating top-tier sales and profit growth. And our portfolio premiumization efforts continue to enhance the financial profile of our wine and spirits business.

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

So first, just a detail question. David, you indicated hedging offsets a lot of the peso FX margin impact in beer this fiscal year. I'm just wondering if you can quantify if we stayed at current spot rates. Can you give us a sense for how much of a drag FX will be to beer margins in fiscal '19? And then the real question is, Rob, I was hoping you could flesh out a bit more detail on Corona Premier success in test markets. It looks pretty solid at around 3% of sales in the test markets and tracked channels. So just any details around the magnitude of traction for the brand in test markets, the cannibalization you're seeing on the rest of the portfolio and then any expectations around the national launch next fiscal year.

David Klein

So Dara, on the first part, the current effective FX rate, so kind of net of our hedges, on a year-to-date basis is probably in that mid-18s range. So to the extent that current spot's a little lower than that, it would be a bit of a drag next year, but not much.

Robert Sands

Yes. So as it relates to Premier, the test markets have been very successful. What do we mean by successful? What we're looking at is pretty much things like velocity per point of distribution, which, for a new product, Premier's velocity per point of distribution was high. And the other thing that we are looking at, which is, in actuality, a relatively minor concern, is cannibalization, which actually turned out to be significantly lower than we expected. Now I'd say that cannibalization is a relatively minor concern, and that's cannibalization of our own products, because there's no margin difference between Corona Premier and the other products. So cannibalization isn't really an issue as long as 1 plus 1 equals 3. And right now, I would say that it's looking definitively like 1 plus 1 will equal 3 because, given our market shares versus the rest of the market, if cannibalization is the right term, we're really taking share from competitors, not to a large degree from ourselves, which makes logical sense. So looks good.

Operator

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

Bryan Spillane

My question was around advertising. Can you give us a sense, David, sort of specifically in beer, what type of increase you've had in advertising and promotion this year and then, I guess, some color on, still, are you getting the immediate lift when you're adding more marketing and advertising in the market? And I think that was the case last year. So just trying to get a sense if you're putting more into the market and if you're still getting that good sort of immediate lift off your advertising.

David Klein

Yes. So we're still running, in general, in that 8.5% to 9% range. Clearly, that means the dollars are up because of the growth of our business. And just kind of as a note, we'll see, as a percentage of net sales, higher marketing spend in Q3 simply because of the lower sales quarter and we spend money with the NFL properties. So again, we're spending about the same percentage as we have in the past. And yet we continue to see really impressive returns on our marketing spend in our beer business, which, I think, is a tribute to the quality of the advertising that our marketing team puts in place as well as the power of the brands. But we monitor that return on an ongoing basis, and we're going to continue to invest in our brands in our beer business. And you're going to see us begin to invest more in our brands in our wine business, which will also see a fairly large increase on a percentage of net sales basis in Q3 versus where we've been in the past.

Operator

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

Adam Scott

It's actually Adam Scott on line for Bonnie. A question on the wine and spirits business. Obviously, really great performance in Focus Brands with depletions up 12%, but the implied growth of non-Focus Brands was almost down 6%. So I was hoping you could talk a little bit about the strategy behind these brands and maybe whether, at some point, it might make sense to divest them or, perhaps, to reinvigorate them since they're such a drag. So if you could just touch on that, that'd be great.

Robert Sands

Yes. So what you just suggested is not at all unusual in that our Focus Brands constitutes the vast majority of our sales and profit. It's almost like a perfect Pareto principle-type situation, which almost every company exhibits, in that a relatively small number of our brands, i.e. our Focus Brands, which are about 17 or so brands, constitutes about 70%, 80% of our profit. And yes, so therefore, the rest of the portfolio does represent what we might call tail brands or, perhaps, more euphemistically, technical brands. The interesting thing in the wine and spirits business is regardless of the growth rate, every brand is profitable and a contributor, therefore, to our overall profits. And therefore, it makes economic sense to keep them when you look at what the potential value would be to a third party from a discounted cash flow basis versus the value to ourselves. So that's why we don't divest the tail. We also don't spend a lot of time on it from an operational, marketing or activity point of view. Now that said, we have divested lower-margin, lower-growth tail businesses and brands in the past where it makes economic sense to do so in the manner that I just described, meaning taking a look at what the NPV of the future cash flows of those businesses are compared to what we think that we could sell that for. Canada's a good example of that. A number of years ago, we sold off our value wine business, Almaden and Inglenook. We sold off our value spirits business, as an example, brands like Barton and Crystal Palace and Mr. Boston and so on and so forth. So we're always evaluating that, but I've given you basically the method under which we evaluate that. And generally speaking, the brands that are in our portfolio now are worth more to us than they would be to a third party, and that's why we keep them. And they are profitable, and therefore, they help fuel the investments that we make in the Focus Brands.

David Klein

Then just one other thing to add to that, Adam, as I said in my script, that we have been doing some SKU rationalization, which creates about – or create about 100 basis points drag on growth. But that's just good business, where we can discontinue a SKU that has say, like, low 30% margins and replace it with a SKU that has 50% or 60% margins using the same assets.

Operator

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

Robert Ottenstein

Terrific quarter and very nice press release. Well done. I like the new format. I was wondering if you could talk a little bit – I understand, for the year, your shipments and depletions are in line. I'm wondering if you could talk a little bit about the quarter, specifically why there was such a large difference. Our sense was that they were going to come in closer. Did that have to do with some year-end slowdown in business or a lot of extra shelf space? Just trying to get a sense, specifically for the quarter, why the big difference, please.

David Klein

You're talking about beer, Robert?

Robert Ottenstein

Yes, yes, beer shipments and depletions, please.

David Klein

Yes. So from – so when we look at it from a growth rate perspective, what – I guess we – so we – in the first quarter of the year, sorry, I'm just backing up here, so in the first quarter of the year, we – you're referencing the fact that we depleted more than we shipped, right? So we were able to recover in the second quarter, and I would say that we probably did a little bit better job in the recovery than we may have expected. Thanks to some amazing performance by our operations, we're able to ship a little bit more beer than we would have expected, bringing our distributor inventory days back in line with where we would like them to be.

Robert Ottenstein

Okay. So your brewery operations ran more efficiently than you thought they would, so you were able to ship more. Is that the answer?

David Klein

That's a majority of the answer, and it's not even the efficiency. The level of utilization at our breweries was quite high and, again, some amazing work by our teams in Mexico.

Operator

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

Mark Swartzberg

Rob and David, too, I'm confused why you haven't committed to repo. And the reason I say that is we heard you in November say we've clarified our leverage objective. It's now 3.5. And we're now sitting at kind of 3.2, 3.3 levels, and there's no comment on repo, and the cash flow is going to continue to come. So what's going on? And as far as your priorities from an M&A perspective, is it fair to think spirits is your highest priority if you have to consider the comparative share you have there versus your other 2 businesses?

David Klein

So I'll comment on the repurchase component, and I'll let Rob comment on M&A. Our capital allocation philosophy, Mark, hasn't changed at all. So we said, when we were below 3.5x, we would look to buy back our dilution on a systematic basis and more than our dilution, say, opportunistically. And remember, we purchased – repurchased $1.2 billion worth of stock toward the tail end of last fiscal year. So we waited in Q2 until we got below 3.5x, and then we started with our systematic repurchase of our dilution. Granted it only amounted to $14 million in the quarter, but that's more of a timing issue than anything else. So we remain committed to our capital allocation principles.

Mark Swartzberg

And then maybe there's a nuance I missed, but is 3.5 the objective? Or are you willing to go lower than that?

David Klein

So we're going to continue to operate the business kind of targeting 3.5. Now that said, I'm not sure we'll be dogmatic to stay exactly at 3.5, but we will stay in that 3.5x range over a medium-term period of time.

Robert Sands

And what was your question on M&A, Mark?

Mark Swartzberg

Well, is spirits comparatively high priority versus beer in terms of the size of the assets you might purchase? Is spirits comparatively higher priority than the other 2 alcohol businesses?

Robert Sands

Not necessarily. We continue to look across all 3 categories. So fundamentally, you could see tuck-in acquisitions across beer, wine and spirits, and I'd say we're fairly agnostic relative to the 3 categories. It's more a question of growth and margins and what is – what we think is opportunistic. So there's good examples across all 3 categories of tuck-in acquisitions, if they were available, that would meet the growth and margin and economic criterion that we have. So I wouldn't, in any way, shape or form, expect to see from us either just spirits or just beer or just wine. I think you're going to see more of the same kind of thing that you've seen in the past, right? So we bought High West. We bought Casa Noble. We bought Charles Smith. We bought Funky Buddha. I mean – so it's been a mix. It will continue to be a mix.

David Klein

By the way, Mark, if the question also relates to, by not staying at 3.5x, are we in some way loading up for something, the answer is no. It's just we're going to be around that 3.5x range, and we do intend to buy our stock back as well as invest in our business as well as do M&A.

Mark Swartzberg

Super. I'm glad you said that. That's exactly what I was trying to get clarity on.

Operator

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

Caroline Levy

Again, my congratulations, and I think you just set the gold standard in press releases. In terms of the – I was just wondering if you could help us understand this growth in beer. If you took your biggest brands, Corona and Modelo, could you quantify how much of the growth is distribution gains and how much – I mean, how happy are you with the trends in velocity at existing points of distribution?

David Klein

Yes. So from a distribution standpoint, we've said that about 60% of our growth has come from distribution gains. And in fact, the beer sales team has done an outstanding job of executing against their distribution objectives for the year and that we're seeing a bit of an acceleration of our distribution growth across the portfolio. So yes, so a majority of it is based upon the growth in distribution in the business.

Robert Sands

And then to the second part of your question, we're entirely unhappy and disappointed with our distribution growth because we don't have the distribution that we ought to have as a company, meaning in beer and given the growth and margins to the retailer of our portfolio. So the good news in that is we're making progress, but there's a lot of room left to go in distribution, which basically means there's a big growth runway ahead of us.

Caroline Levy

Just on the velocity, is Corona significantly higher than Modelo or vice versa?

Robert Sands

Yes. Velocity?

Caroline Levy

Yes.

Robert Sands

Yes. Corona would have higher velocity than Modelo, I believe. We'll double check that.

David Klein

Yes. I don't have the individual brand velocities with me.

Robert Sands

I don't, either.

Operator

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

Judy Hong

So just, I guess, a couple of quick questions related to your guidance. So when I kind of think about your depletion outlook for the balance of the year, I think it implies sort of stable growth versus what you've seen the first half of the year. The comparisons are a little bit easier. You have talked about maybe a minor impact from the hurricane. You've got the Premier launch in kind of the, let's say, beginning of next year. So just trying to get a little bit more of an understanding where the upside versus kind of the downside case in terms of depletion guidance. And then, David, just in terms of the margin for the back half for beer, obviously, it does imply, I think, something like a 36% EBIT margin. So kind of the delta between first half versus the second half, is it mostly attributable to, really, the lower volume related to the seasonality of the business?

David Klein

Yes. So I'll take the second one first. So yes, if you looked at the seasonality of the business and used the last couple of years as an example, we sell about 55% to 60% of our total U.S. beer in the first half of the year. And I think if you look at our fixed costs in our business plus, from an operations standpoint, plus thinking of SG&A as roughly fixed across the year and you kind of apply the seasonality against that, you get a pretty reasonable drag in the back half of the year. And we think that's going to be the normal seasonal cycle going forward. In addition to that, this year, we do have work going on at Nava and at Obregon that will result in line commissioning costs and incremental labor coming on to support the expansion. And then, of course, we have the continued addition of depreciation as we put assets into service. So I think when we get through this year, we'll be able to outline a better seasonality model, but that's what we're expecting. And then in terms of depletions, we're – I would say that we're pretty balanced in terms of where our guidance is because we have a – we do have an easier overlap, in particular, in Q4 from a depletion standpoint with beer. At the same time, we're sitting here at just over 8% depletions in Q2. So we think that we're pretty balanced in terms of the deplete forecast, if you will.

Operator

Your next question comes from the line of Laurent Grandet of Crédit Suisse.

Laurent Grandet

I've got one follow-up from — ***indiscernible*** — question from Caroline about the beer segment. So could you please update us on the commercial approach to gain shelf space from slow-moving competitive brands, specifically craft beer and national light beer. How, I mean, are you assessing your progress on these? And then the second one, as you are one of the best, if not the best, beer commercial organization in the U.S., besides M&A, could we motivate you to import or to distributing beer from Europe or Japan to leverage better your assets in the U.S.?

Robert Sands

Yes. So first, on shelf space, our increases in distribution are specifically coming from the kind of thing that you mentioned, either shelf space coming from slower-moving craft SKUs or slower-moving domestic as we increase our shelf space because the overall beer shelf space I wouldn't say, at this stage, is growing. I mean, that is precisely the thrust and the concept. And our discussion with retailers is that they can improve their growth rates and their profitability per unit shelf space by devoting more shelf space to our growth portfolio and high-margin portfolio than either low-margin domestic beer or craft that is not moving. And then on your second question, imports other than our own, I would say, at the moment, don't – are not very exciting to us for a couple of – number one, if you look at imports as a category in the United States, I would say the vast majority, if not almost all of the growth in imports, with a small exception of a couple of small brands, is coming from our portfolio. So it's a little bit of a misnomer to think that the growth in the beer category, to the extent that there is any, is coming from imports. It is not. It is coming from Constellation's portfolio of Mexican beers, and then there is also growth coming from the craft segment, and that's about it. And then, number two, we're uninterested, completely uninterested in taking on imports of other companies on an agency basis. In fact, we gave up those imports. So we used to have brands like Tsingtao in the portfolio and St. Pauli Girl, and those were agency brands. Now the margins on that kind of business are not consistent with the kind of business that we're interested in, point number one. And then point number two, there isn't really much growth in imports from any country except Mexico, and that's all coming from our portfolio. And of course, there's like 1 or 2 small exceptions to what I'm saying, but they literally are 1 or 2 small exceptions. So hopefully, that answers your question.

Operator

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

Timothy Ramey

Rob, you've made a great case for incremental distribution and facings in the beer segment. And it's a couple of years back that we did the big distributor realignment in wine, and I think the 5% depletion growth in wine in this quarter and particularly these strong growth rates in the Focus Brands leads me to ask the question: Do you have the ability to kind of ask – under this total beverage alcohol discussion, do you have the ability to go to retailers and say, we're not getting fair share facings in wine or make that case to your distribution? How do you think about that?

Robert Sands

Well, I mean, the answer to that is yes, especially in – when you look at our Focus Brands and some of our most key brands. I mean, the – what you're describing, and I know you know this, is sort of the essence of what we call sales execution. But okay, in wine and spirits, it's slightly different than beer, although very slightly, because what I'm about to say really applies to all 3 categories. But in wine and spirits, in particular, because of the – and really, wine, in particular, because of the very, very, very high degree of fragmentation versus beer, for argument's sake, the total key is merchandising. And when we talk about merchandising, it's all about getting the product on the floor and advertised by the retailer with some kind of a deal. That's really the key to execution in, really, wine and spirits, a little less so in beer, where it's about getting more of that shelf, which continues to be dominated by, really, just a couple of companies that represent the vast majority of the market share in beer in the country but have declining portfolios. That said, merchandising in beer is important, too. Getting the floor is also important but not – in wine, a wine bottle on a shelf is 1 wine bottle and 1 label amongst 1,000. And so if you really want to have your product in danger of being purchased, right, there's no better way than having a display of your product on the floor, in front of the cash register and in the store's ad with the discount so that consumers can easily pick up a bottle of it as they check out at the cash register. So as I said, that is – it's the essence of sales execution.

Timothy Ramey

So would you argue that the point of leverage is with the retailer with the discussion on total beverage alcohols? Or is it I need to go back to blocking and tackling with the distributor?

Robert Sands

I would say that it's both. But as far as TBA goes, total beverage alcohol, I think it's a retail story. And what I mean by that is that there's a number of facts that are extremely important that the retailer needs to understand and really probably doesn't understand, and there's 2 facts, okay? And I think that if you were at back-to-school, Bill Newlands, our COO, and David talked about this, all right? A very large percentage of consumers right now are shopping across all 3 categories at once, so they're buying wine, beer and spirits. I think the number is something like 55% of consumers are shopping and drinking across all 3 categories, which is far different than it used to be years ago. And so we need to address those consumers' desires, and we do that at retail by offering our TBA portfolio of premium and growing brands. That's point number one to the retailer. Point number two to the retailer is almost even a more important point. And that is that if a retail basket, okay, contains all 3 beverage alcohol products, meaning beer, wine and spirits, the total value of the ring will be larger by several hundred percent than a basket that only has 1 category in it of the 3 or even 2 categories in it of the 3. So that's what retail is all about. And the most successful retailers in the country are all about how do we increase the average size of the ring, i.e. the basket, as the shopper leaves the store. And there probably is no better way to do that than to get the consumer to purchase all 3 categories because if they do that, that consumer's going to be a very big purchaser in that store. That's the story.

Operator

Your next question comes from the line of Bill Chapelle of SunTrust.

William Chappell

I wanted to follow up on Funky Buddha and just kind of the decision on that. And based on kind of the learnings from Ballast Point, how might that be different? How does that lead to maybe looking at other-type acquisitions? I mean, you'd kind of taken a break from Ballast Point to this. And so just trying to understand how this might be different in terms of your thought process after having Ballast Point for a couple of years.

Robert Sands

Yes. That's an interesting question. And there is some very significant learnings relative to that, and what we're doing with Ballast Point relates to that, and how we're treating Funky Buddha also relates to that. So I would say that when the craft beer business as a general proposition was growing at a much faster rate, the modus operandi that most craft businesses had, including Ballast Point before we bought it and for a period of time after we bought it, was create a whole bunch of products, throw them out there – try to throw them out there everywhere and anywhere you can and see what happens and let the consumer decide. As the business has slowed down, as there's a SKU contraction going on, that modus operandi really doesn't work anymore because what you found is that just putting the product out everywhere and anywhere around the country in stores that may not have a very high, what we call, CDI, category development index, doesn't make a lot of sense because the stuff just sits on the shelf. It gets old. And now consumers are sort of realizing that. So what we've done with Ballast Point is, number one, we're consolidating the distribution network into our Gold Network. That's a very important learning and very important to us. Funky Buddha, if and when we expand it outside of Florida, that'll be a key tenet, number one. Number two, focusing on key SKUs that are really driving the growth as opposed to overly fragmenting the portfolio and then driving or – your marketing against those key SKUs, marketing and promotion, where we know that there's velocity and consumer interest, that's another key learning as opposed to just putting out 50 different things. So driving the usually 2 or 3 or 4 key SKUs that are important. And then the third element, which is really important, is not expanding geographically too quick and, therefore, into markets where there's no consumer awareness of the brand, there's really no marketing, just throwing the product out there to retailers because it will just sit there and won't be reordered. And that's where you sort of see a bit of the slowdown. And a lot of these companies is that – they're cycling through, having thrown a lot out there and then finding out that it's not repeat business. So number one, with Funky Buddha, we get the beauty of being able to apply those tenets right off the bat and, therefore, I would say, building a stronger, more consistent and more measured growth story. With Ballast Point, we're retreating to that approach in philosophy a bit, and hence, that's why you see some of the shorter-term negative impact at Ballast Point, which – I would say that as we move into our next fiscal, you'll see us cycle that, and we're pretty hopeful that our activities there will take hold because we've moved it to our Gold Network. They're extremely highly motivated to drive the brand. The liquids are award-winning and fantastic. So there's nothing fundamentally wrong with it other than the approach that was previously taken was not, I'd say, the kind of professional approach that we, as a major company, could really bring to it. So we're in that process right now. And those are new learnings from our Ballast Point experience, so more to come.

Operator

Your final question comes from the line of Tom Coleman of Kensico.

Thomas Coleman

I got a question. No one's asked it, very important question. How did you guys know to stick with the New York Jets Corona Red Zone promotion? Who figured that out, that they were going to be 2 on 2 after 4 weeks?

Robert Sands

It's pure prescience, which – we're not going to go into gambling because we'd probably all be arrested, Tom, because of the foreknowledge that we have of these matters.

Operator

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

Robert Sands

Okay. As we close out the discussion for our second quarter results, I want to thank everyone, everyone who contributed to the strong performance of our business for the first half of the year. Though the year is far from complete, our new guidance reflects the confidence we have in our ability to sustain our growth momentum in the second half. Now our next quarterly call is scheduled for early January, when we will share the results of our third quarter. Until then, we wish you all a safe and happy holiday season. Certainly, in our business, this time of the year is great. And it's a great opportunity to responsibly share Constellation's fine beer, wine and spirits products with friends and family. So thanks again, everybody, for joining our call, and have a great day.

Operator

Thank you for participating in the Constellation Brands Second Quarter 2018 Earnings Conference Call. You may now disconnect.