Constellation Brands Inc, Q2 2024, Earnings Call 2023-10-05

Presentation

Operator

Greetings. Welcome to the Constellation Brands Fiscal Year 2024 Second Quarter Earnings Call. — ***Operator Instructions*** — As a reminder, this conference is being recorded. At this time, I would like to hand the call over to Joe Suarez, Vice President of Investor Relations. Thank you. You may begin.

Joseph Suarez

Thank you, Darill. Good morning, all, and welcome to Constellation Brands Q2 Fiscal '24 Conference Call. I'm here this morning with Bill Newlands, our CEO; and Garth Hankinson, our CFO. As a reminder, reconciliations between the most directly comparable GAAP measures 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 made on this call. Following the call, we'll also be making available in the Investors section of our company's website, a series of slides, which highlight the prepared remarks shared by Bill and Garth in today's call.

Before turning the call over to Bill, in line with prior quarters, I would like to ask that we limit everyone to 1 question per person, which will help us to end our call on time. Thanks in advance, and now here's Bill.

William Newlands

Thank you, Joe, and good morning, everyone. Welcome to our Q2 Fiscal '24 Call. In terms of key headlines for the second quarter, I'm pleased to report that our team once again delivered solid overall performance. First of all, our beer business led the charge as the #1 share gainer with accelerating shares across the key summer holiday. We continue to invest in growth for this business as our team looks to seize opportunities to gain incremental awareness, shelf space and household penetration for our brands in the back half and beyond.

Secondly, our wine and spirits business continues to progress along its journey to realize the full benefits of its transformation. Prioritized investments in our largest wine and spirits higher-end brands are yielding outperformance in their respective categories while partially offsetting and helping to reduce headwinds from our mainstream brands as they continue to shift the mix profile of our portfolio.

And third, our continued discipline around capital allocation priorities contributing to a strong overall performance in the quarter and sets the stage for fiscal ’24 being another solid year of profitable growth and shareholder returns.

That said, let me provide a little more color around our key performance drivers in the quarter. As noted, our beer team once again delivered remarkable results. Not only did we remain the top share gainer over the entire critical summer season, we also extended our leading position from Cinco de Mayo to become the #1 share gainer in tracked channels during the 4th of July holiday. And although it falls slightly after our second quarter end, I’m also pleased to report that we further accelerated our share gains during Labor Day.

Modelo Especial remained the key driver of our strong performance achieving double-digit volume growth in tracked channels and an 8.6% increase in depletions, ultimately strengthening its position as the top brand across the entire U.S. beer market in dollar sales fiscal year-to-date. The broader Modelo brand family also delivered phenomenal results with Cheladas achieving 50% volume growth in tracked channels and an increase in depletions of over 40%, while Oro continues to build on a solid launch, increasing its share gains in the overall beer category and performing in line with our plans for the fiscal year.

Beyond Modelo, our Corona Extra and Pacifico, core beer brands also continued to perform strongly. Corona Extra delivered solid low single-digit growth in depletions and tracked channel volumes, and was the #6 share gainer in the category, while Pacifico achieved 15% depletion growth, tracked channel volume growth of approximately 27% and was the #11 top share gainer in tracked channels.

Our beer brands continue to resonate strongly with the consumer, driving demand for our brands in the second quarter, which supported double-digit net sales and operating income growth in our beer business. This gives us confidence to shift our fiscal ’24 net sales and operating income guidance for the beer business to the higher end of our initial ranges. That is 8% to 9% and 6% to 7% growth, respectively. That said, it is important to remember that for our beer business, we indicated that only 45% of total volume for the fiscal year will be shipped in the second half, which aligns with the regular seasonality of beer demand in the U.S. and the timing of our brewery maintenance activities.

Beyond fiscal ’24, we continue to see significant opportunities to maintain the growth momentum of our beer business, particularly due to the resilience of key secular trends in the consumer landscape like ongoing consumer-led premiumization across beverage alcohol and the continued outsized growth of the Hispanic population in the U.S. as well as the relentless focus of our beer business on closing the distribution and awareness gaps that still exist across our brands, and on developing and scaling new and exciting products aligned with consumer-led trends. We look forward to sharing more details on this compelling outlook at our upcoming Investor Day on November 2.

Moving on to Wine & Spirits. Our wine and spirits business continues to make headway on its vision to become a bold and innovative, higher-end market leader. In the second quarter, our largest premium wine brands, Meiomi and Kim Crawford, outperformed their corresponding category segments in U.S. tracked channels. They both increased their respective share in the overall line category. Our largest fine wine and craft spirits brands, the Prisoner Wine Company and our Mi CAMPO tequila brand also outperformed their corresponding luxury wine and higher-end spirits category segments. Notably, all of the individual brands just referenced also delivered solid depletion growth rates in the second quarter.

Our wine and spirits business also continues to advance the renovation of its mainstream brands to address the headwinds to corresponding category segments have faced over several recent quarters. While there is certainly more work to be done here, in U.S. tracked channels, the year-over-year dollar sales decline for Woodbridge improved relative to the first quarter and SVEDKA's overall share remained relatively stable when compared to the first quarter. All of that said, our wine and spirits business continued to face lower demand primarily for our mainstream brands, reflecting continued consumer-led premiumization trends noted in prior occasions, which in turn affected overall performance in the second quarter. Nevertheless, we are reiterating guidance for the full year and continue to expect fiscal '24 organic net sales to remain relatively stable and operating income growth of 2% to 4%.

As we shared when we provided our outlook for fiscal '24, we see the year as a tale of 2 halves for the wine and spirits business, with 55% of planned volumes being delivered in the second half and operating performance projected to accelerate over the rest of the year due to other key factors. We expect to benefit from the more proactive quarterly shipment and depletion rebalancing actions we have undertaken this year versus our single downward shipment adjustment in Q4 of last year. We also anticipate an uplift in our direct-to-consumer channels and improved mix from incremental ASPIRA shipments in line with seasonality and as well as benefits from recent price increases. Ultimately, we also expect to see operating margins meaningfully accelerate due to the improved sales trends just described and the resulting positive operating leverage.

Before I conclude, it would be remiss not to highlight our consistent execution against our capital allocation priorities. We continue to make progress towards our reduced net leverage ratio of approximately 3x with a 400 point reduction since the increase resulting from the financing of our Class B common stock reclassification last November. Importantly, our proactive management of the incremental debt from the reclassification now puts us on track to deliver lower interest expense than initially anticipated for fiscal ’24, and in turn, we now anticipate higher reported and comparable earnings per share, excluding Canopy in the ranges of $9.60 to $9.80 and $12 to $12.20, respectively, for the full year.

In terms of cash returns to our shareholders, our dividend payout ratio for the second quarter remained aligned with our 30% target. And while we did not conduct any additional share repurchases in Q2, we have executed $35 million year-to-date, in line with our goal to at least offset dilution. Lastly, our brewery expansions are progressing as planned, including Veracruz, and we continue to develop and bring these online with the flexibility enabled by our modular approach.

Before I conclude, I also want to again take an opportunity during our second quarter call to highlight the upcoming release of our annual ESG impact report in a few weeks. This report seeks to provide a comprehensive review of our strategy, initiatives, targets and performance to address pressing environmental and societal needs that are important to our business, consumers, communities, employees and broader stakeholders. In particular, as noted in our last 2 calls, we have already surpassed our target of restoring 1.1 billion gallons of withdrawals from local watersheds, and are looking forward to showcasing the initiatives in our beer business that drove most of this achievement and to share more details on our new target in our upcoming ESG impact report. I invite all of you to spend some time reviewing this report when it is released, which will be available through our company website.

In closing, I'd like to leave you with 4 main takeaways for this quarter. First, our beer business continues to outperform the industry and the acceleration of its performance since the beginning of the year has given us confidence to shift our outlook for fiscal '24 to the higher end of our initial net sales and operating income growth expectations. And just as critical, we remain equally confident about the long-term runway for our higher-end brand portfolio.

Number two, the benefits of our Wine & Spirits strategy continue to take hold, and we expect the net sales growth and operating income growth of that business to ramp up through the remainder of fiscal '24, and as we look to the coming years, we anticipate our wine and spirits business to further gain momentum and achieve stronger results.

Number three, we are persistently delivering on our capital allocation priorities, maintaining discipline and balance to yield value and returns, and we remain committed to building on the consistent track record we've established with these priorities over the past few years.

And finally, number four, we are excited to be sharing more of these important topics with you at our upcoming Investor Day in 4 weeks' time. And with that, I'd now like to turn the call over to Garth, who will review our financial results for Q2 in more detail. Garth?

Garth Hankinson

Thank you, Bill, and good morning, everyone. Our second quarter results reflect the ongoing disciplined execution of our strategic initiatives and our relentless focus on continuing to deliver growth while enhancing our performance. As Bill noted, we achieved yet another strong quarter with double-digit net sales and operating income growth in our beer business while our wine and spirits business delivered solid performance across its largest premium, fine wine and craft spirits brands, which partially offset the category headwinds affecting our mainstream brands.

We also continued to generate strong cash flow results and execute against our consistent and balanced capital allocation priorities.

Now let's review our Q2 fiscal '24 results in more detail where I will mainly focus on comparable basis financial results. To begin, our beer business increased net sales by 12%, representing an uplift of $253 million. This was driven primarily by volume growth of 8.7% as demand for our beer brands accelerated through the first half of the fiscal year. This growth also benefited from favorable pricing which contributed $59 million of the overall net sales increase. As a reminder, we continue to expect pricing to account for 1% to 2% of our net sales increase this fiscal year from the combination of the wraparound impact from the significant pricing actions taken in Q3 of fiscal '23 and targeted pricing actions we are taking in fiscal '24.

For the second quarter of fiscal '24, beer shipment volume and depletions were generally in line with one another, and I'm pleased to report that our inventories are at healthy levels to support the ongoing growth of our brands. Beer depletion growth for the quarter came in at 7.9%, reflecting a successful summer selling season, driven by ongoing consumer demand across our industry-leading beer portfolio as evidenced by our share gain acceleration. Execution of our distribution and marketing strategies, including extending our category leadership across the key summer season and continued positive results from our Shopper-First Shelf initiative.

And lastly, the accelerated growth in share gains across our core and emerging markets.

Before moving to on-premise performance, I'd like to take a moment to explain a notable recent development in off-premise channel observation. As many of you are aware, Circana tracked channel volume growth has historically been above depletion growth by a low single-digit variance. However, more recently, that variance has expanded to the mid-single-digit range as independent retailers not captured by Circana data have lagged in reversing the additional pricing they took beyond our October fiscal '23 pricing actions. We believe this has led certain consumers to ship from these independent retailers to chain retailers offering more competitive consumer pricing. While the shift in these variances has no impact on the overall demand of our brands, we continue to monitor channel performance and plan to provide further updates or insights needed to reconcile, track channel data with our overall as warranted. As a reminder, Circana captures approximately 50% of our total beer buyers.

Shifting back to the on-premise channel. Depletions were essentially flat year-over-year and accounted for approximately 10.3% of our total beer volume. Please note that while we did have some minor disruptions in our supply of kegs during the second quarter, this Q1 to Q2 step down largely reflects a normal seasonal pattern that we have seen in previous years. Importantly, while there is some disruption in the near term, we are currently producing and shipping kegs and fully expect to offset the impact of the disruptions as swiftly as possible.

Looking forward to the second half of the year, as Bill noted, approximately 45% of our volumes will ship in the second half of the year as a result of it being our lower volume period. In addition, our Q3 shipment volumes are also normally more subdued due to routine maintenance activities. Lastly, from a pricing perspective, we will start to overlap the uplift we saw from significant incremental pricing actions taken in October of fiscal

’23. Nonetheless, as we have previously stated, we fully expect our full year shipments and depletions to be largely in line, both on an absolute and a year-over-year growth basis by fiscal year-end.

In regards to selling days, they were flat year-over-year for the quarter. Please note, for the remainder of fiscal ’24, Q3 sales days will be flat year-over-year, and there will be 1 more selling day in Q4.

Now let me review beer margins. For Q2, operating margin decreased by 60 basis points to 39.9%. This decrease was driven mostly by the ongoing inflationary pressures in our COGS as we faced an overall cost increase of approximately 17%. The largest drivers of these cost increases came from packaging and raw materials, incremental costs related to a voluntary product recall of selected kegs for quality assurance, and higher depreciation that amounted to $12 million or a 24% increase.

To mitigate the inflationary and depreciation pressures, we continue to work across the business on cost efficiency and operational productivity programs that yielded meaningful and sustainable benefits. Building on the $30 million of net savings delivered by these initiatives in the first quarter, we realized an approximately $20 million in incremental net savings in the second quarter.

In addition to our cost-saving initiatives, we incurred margin benefits from the following: a $4 million or 2% decrease in marketing expense, primarily driven by the divestiture of our craft beer business; marketing as a percent of sales came in at 7.1% for the quarter; and a $3 million or 3% decrease in SG&A expense, which was primarily the result of favorable foreign currency impacts.

Regarding Q2, our marketing spend as a percent of sales was outside of our previously stated algorithm of 9% to 10%. As usual, part of this relatively lower percentage in Q2 is a reflection of the strong volume and therefore, net sales performance of the business due to category seasonality. However, the impact of the reduction in marketing due to the previously noted exit from craft beer has further lowered that percentage. For the full year, we now expect to be closer to the lower end of our stated range of 9% to 10% of net sales due to the craft beer divestitures and our continued focus on ensuring our large marketing investments are prioritized to the highest return areas in our portfolio.

As a result of the acceleration in the growth of beer business since the beginning of the year, we are shifting our expectations for fiscal '24 to the higher end of our initial ranges, resulting in an 8% to 9% expected increase in net sales growth and a 6% to 7% expected increase in operating income growth.

Now moving on to our wine and spirits business. In line with the reshaping of our wine and spirits business to a higher-end portfolio of offerings, we continue to benefit from the solid performance of our largest premium wine, fine wine and craft spirits brands. Meiomi, Kim Crawford, the Prisoner Wine Company and Mi CAMPO, which as Bill noted, outperformed the corresponding categories in tracked channels and delivered solid depletion growth. While we are pleased with the results with these leading higher-end brands, our overall wine and spirits organic sales were down 11%, driven primarily by the category headwinds we continue to face from the performance of our biometrically larger mainstream brands, Woodbridge and SVEDKA.

Our plans to renovate Woodbridge and SVEDKA are underway, and our wine and spirits leadership team is looking forward to sharing updates on this progress at our upcoming Investor Day. Shipments on an organic basis decreased by 15% and depletions decreased by approximately 8%. As a reminder, approximately 55% of the wine and spirits sales are anticipated to occur in the second half of the year, where we also expect to see consumer-led premiumization mixed shift towards the higher end to continue, supporting what we believe will be a notable acceleration in the growth trajectory of the business for the remainder of the year.

Wine & Spirits operating income, excluding the gross profit less marketing of the brands that are no longer part of the business following their divestiture, was down 12%, and operating margin decreased 10 basis points to 18.2%, also reflecting the same exclusion. The margin decline was primarily driven by the volume declines of our mainstream brands and partially offset by lower material costs, primarily from sustainable packaging projects, supply chain savings and lower marketing spend as we continue to focus on higher return areas of our portfolio.

As we look forward, we continue to expect the wine and spirits business to significantly improve its net sales growth trajectory for the remainder of the fiscal year through a combination of increased contributions from our higher-end portfolio as well as incremental pricing actions. We expect this acceleration in net sales growth combined with our continued cost reductions and marketing efficiency initiatives to also support our operating income growth targets. As a result, we remain confident in the outlook for wine and spirits for the year and our guidance for that business for fiscal '24 remains unchanged.

Now let's proceed with the rest of the P&L. Corporate expense was approximately $67 million, an overall reduction of 19% when compared to the prior year, primarily driven by reduced spend in the second wave of our digital business acceleration program, lower headcount-related costs and lower compensation and benefits post our reclassification transaction. Interest expense for the quarter was approximately $111 million, a 17% increase from the prior year, driven by higher weighted average interest rates on the portion of our debt with adjustable rates, which is approximately 5% of our debt obligations, and higher average borrowings due to the financing of the share reclassification.

However, we now expect interest expense for the full year to be approximately $460 million, roughly $40 million lower than our prior guidance due to refinancing actions for some of our higher interest debt and faster-than-expected deleveraging throughout the year. We ended the quarter with a net leverage ratio of approximately 3.2x excluding Canopy equity earnings, and expect to continue to make progress towards our 3x ratio target over the coming quarters.

Our comparable effective tax rate, excluding Canopy equity earnings for the quarter, was 17.8% versus 20.3% last year. For fiscal '24, we continue to expect the comparable effective tax rate, excluding Canopy equity earnings to be approximately 19%.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. For the second quarter, year-to-date of fiscal '24, we generated free cash flow of $1 billion, a 15% decrease versus prior year, driven by a 34% increase in CapEx investments, attributable to the capacity expansions at our Nava and Obregon facilities and the construction of our new brewery located in Veracruz. As of Q2, we have fully commissioned our latest additional brewing capacity project at our Obregon facility and now have approximately 47 million hectoliters of capacity across our 2 breweries.

Looking ahead, we remain on track to bring our ABA facility online at Nava towards the end of this fiscal year. And the development of our additional expansion at Obregon and our third brewery site at Veracruz are advancing as planned. We continue to expect fiscal '24 free cash flow to be in the range of $1.2 billion to $1.3 billion, reflective of operating cash flow between $2.4 billion and $2.6 billion and CapEx of $1.2 billion to $1.3 billion.

Our comparable EPS for the quarter, excluding Canopy equity and earnings, was $3.80 as a result of the continued profitable and disciplined growth we have seen this year. We are raising fiscal '24 reported EPS guidance to between $9.60 and $9.80 and comparable EPS guidance, excluding Canopy equity and earnings to be between $12 and $12.20.

And finally, our announced dividend of $0.89 a share will result in approximately $163 million returned to shareholders for the quarter.

In closing, I'd like to say that our entire team continues to execute and deliver against our strategic priorities. We demonstrated solid execution in the first half of fiscal '24, and as we enter the back half of the year, we plan to remain disciplined as we seek to drive long-term profitable growth and enhanced shareholder value.

Our management team is excited to meet with many of you this coming November as we lay out our medium- and long-term ambitions and vision for Constellation Brands at our Investor Day.

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

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from the line of Vivien Azer with Cowen & Company.

Vivien Azer

So obviously, very strong one half results in the year. I've been getting a lot of questions on why the positive revision to guidance wasn't a little bit more robust. And obviously, Bill, you laid out some of the factors to contemplate from a shipment perspective as well as from the lapping of pricing that Garth called out as well. But is there anything incremental that you can offer in terms of your outlook for the category in the back half that might have informed a little bit more caution as well?

William Newlands

No. We remain very positive about the back half of the year. The critical things that are important and relative to our back half is normal seasonality. We only do 45% in the back half. We do our maintenance in Q3, which always limits Q3 somewhat. And we're going against pricing from last year that won't largely be repeated combined with the normal sales buildup ahead of price increases that occurred again in Q3 last year. But let's just keep in mind, when you look at the takeout data you see in tracked channels, our 4-week numbers are very consistent with the 52-week numbers. This is an ongoing growth story that we have a lot of confidence in, which is why we raised our expectations for the year in beer. We expect to have a very strong second half.

Operator

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

Andrea Teixeira

I was hoping to see if you can comment a bit on the shelf resets in the category at large, how you're seeing consumers? I understand the CAG situation and the on-premise consumption. Just hearing obviously, the shift in market share and you were a beneficiary and you have been doing a lot of work for a long, long time in the shelf resets. And so if you can comment on that, how you're looking at as you go into the spring resets in the large boxes as well as what's happening in the on-premise?

William Newlands

Certainly. We certainly expect to see a strong reset period. There's some limited resets that occur here in the fall. Most of those occur in the spring. Our confidence around that drives primarily from the sheer velocities that we have within our key brands. No, we – our portfolio is second to none in terms of delivering against velocities, and those have been consistent year-on-year, which gives us a lot of confidence in our ability to continue to see shelves that gain. Retailers are very smart about this and they recognize where the growth and velocity is coming from, and that will work strongly to our advantage as those resets occur.

Operator

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

Nik Modi

Bill, I was hoping you can just comment on systems and supply chain and volume? And I asked this question because a lot of your growth is coming in areas that were not really driving your growth, let's call it, 5 to 10 years ago. Getting the right volume in the right place at the right time, require some adjustment and probably some systems overhaul. So I just – I was wondering if, a, if that is a valid point to be making; and b, if it is, what you're doing internally to make sure that you can actually have the most optimized supply chain?

William Newlands

Certainly. A couple of things stand out, Nik, around this. As you know, a few years ago, we literally had no redundancy in the system. We now do. And that certainly provides much greater flexibility in terms of our operations footprint to do a number of things. One is to make sure we're able to keep up with our increasing demand that we consistently see in our business. And in a scenario where something is accelerating at a greater pace than what we had anticipated, we can react to that. I think, a, that's very strong. Secondly, as you know, we made some significant investments in our digital business efforts. And those are really paying dividends in terms of our supply chain capability as well. That has significantly refined our ability to make sure we have the right supply chain capabilities all the way through the supply chain.

So I'd say both of those things have been critically important. In fact, and I know you'll be there, you'll get a chance to hear about this in some depth during our investor meeting on November 2. We think this is a critical factor that's been important to our continuing ability to maintain and meet the significant increase in demand that we've seen. And we'll go into that in a fair amount of detail on November 2.

Operator

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

Dara Mohsenian

So just two quick clarity questions. The mid-single digit gap versus Circana data that you saw in this quarter in terms of depletions. Do you think that lingers? Might that close back towards the low single-digit gap going forward? Just conceptually, how do you think about that? And in your answer to Andreas' question around shelf space, is there more opportunity this year than a typical year, just given ABI's business has obviously fallen off unexpectedly after the spring reset. So do you think about the shelf space opportunity is greater than typical just given those dynamics and there may be greater shifts even if your business doesn't compete as much directly head-to-head versus them?

William Newlands

Yes. Sure, Dara. On your first point, the question of whether or not the sort of mid-single digit continues, I think, remains to be seen. Certainly, as Garth noted at Barclays, and we said during our prepared remarks, it's more than it has usually been. So whether or not it reverts to the norm of what we usually see, which is sort of lower single digit remains to be seen, and obviously, one that we watch carefully. Relative to the shelf sets, yes, we think this is going to be a great opportunity for us for all the reasons that I answered earlier, which is our velocities are second to none. And we fully expect that we're going to be able to expand our presence. That also impacts some of our new product development. If you think about Oro, I mean, Oro is off to an excellent start, much in line with what our expectations were. And that also gives us a chance to expand our shelf presence because we expect that, that particular brand using that example is going to get more shelf space.

The last thing I would say, and I got to call out Cheladas because Cheladas has just been absolutely on fire. And our additional sizes and variety pack in those – in that particular category, again, gives us a chance outside of the core beer set to also gain more shelf space. So we need to think about this very broadly because we expect to gain both in what I would call the core beer shelf as well as the ancillary beer shelf as well with things like Cheladas.

Operator

Our next question comes from the line of Gerald Pascarelli with Wedbush Securities.

Gerald Pascarelli

It's a macro-related question. Bill, one of the questions we get a lot is on student loan repayments. They're going to resume this month after a 3-year pause. So just how are you thinking about the impact from that, maybe the potential for down trading, just obviously given some of the premium price points on your beer products? Any color there would be great.

William Newlands

Yes. That, again, is one of those things that I think remains to be seen. One of the important things that we see with our brands is the consumer loyalty that is attached to those brands. Taking Modelo as an example, we over-index with the Hispanic community, and the Hispanic community has tremendous brand loyalty to Modelo. Also with Corona. Corona is a much broader-based demographic, but we continue to say it's the most loved beer because it is. I think that's critically important. People make choices all the time about where they're going to spend their discretionary income. And brand strength is critically important about how people make those judgments. So specifically to your question, it remains to be seen, but we feel very confident in our ability to see our brands continue to gain traction simply because there's so much brand loyalty attached to them.

Operator

Our next question comes from the line of Nadine Sarwat with Bernstein.

Nadine Sarwat

Two questions for me, please. Coming back to Modelo Oro. Could you share some – any updated data points that you have especially when it comes to cannibalization? And how would you characterize that incremental consumer? And then just one final question on that voluntary keg product recall. Can you quantify the impact that this has had in the quarter, both on top line and on the margins?

William Newlands

Sure. As I noted earlier, we only had a couple of SKUs in Oro, but it's off to a really good start. And the cannibalization rates were less than we had anticipated, and frankly, less than they were in the 3 test markets that we had originally run. So we're very positive about that. One place where we're seeing disproportionate pickup on that particular sub-brand of Oro is in the Hispanic community. We've been very pleased by the takeaway in critical large Hispanic markets how Oro has done. And as we continue to build that out, you'll see additional SKUs coming next year, which we believe will help to continue to accelerate that brand's growth. And if the cannibalization rates stay where they have been, it's going to be better than we had initially anticipated.

Garth, do you want to handle the second one?

Garth Hankinson

Yes. Just on the CAG recall, the impact was entirely in the cost of goods as related to shipping and destruction of products as well as the initial cost to produce the product. It's – it wasn't a material movement for us for the quarter. There'll be a little bit more detail in the 10-Q on that, and you can find it there.

Operator

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

Bryan Spillane

So I guess a little bit of perspective maybe on – and this may be a little bit of a follow-up from one of the earlier questions, but just we're getting a lot of questions about demand elasticity, consumer tolerance of inflation. So can you just give us a little bit of perspective for both your beer business and also in wine and spirits, just what kind of economizing behavior might you be seeing? Again, is it like buying more in chain convenience versus independents or choices people are making on packaging. Just as you're kind of looking forward, just kind of where we are on economizing behavior and how you might have to adapt or adjust to that.

William Newlands

Yes. So I think this points out to where our judicious approach to pricing has been spot on. We've said consistently – in fact, we got questions about that on prior calls at times about why we weren't taking more price. Our view has consistently been 1% to 2% annually. We were a little more than that the last couple of years, but 1% to 2% is the consistent way that we look at it, and we look at it market by market, SKU by SKU. The rationale for that is quite simple. It's much easier to keep your consumer than to have to go get them again if you have lost them. I think in this particular instance, as you point out, people are careful. We're seeing less – more trips, but somewhat less purchasing per trip than we used to see, which simply means people are being a little more careful about what they do given the inflationary environment that exists.

I think the important part for us is the fact that even though there are more trips, they are making more trips to purchase more of our brands, even if they might spend a little less on any particular trip, again, that speaks to what I just replied to on the prior question, which is about our brand loyalty and about the consistent consumer dynamics that really works to our advantage over the long run. So again, I think the critical element to that is our judicious pricing approach over time is one that's going to do us very well when you're in a consumer environment that people are a little bit more concerned or a little bit more nervous about the inflationary environment, and I think that's going to work to our advantage as we go forward.

Operator

Our next question comes from the line of Chris Carey with Wells Fargo Securities.

Christopher Carey

Garth, can you just comment on how inflation is coming in relative to your expectations entering the year, puts and takes? I asked this in the context of your comments around marketing coming in at the low end of the historical range for the full year. And I would just be curious on how you view gross margin delivery in the quarter relative to expectations with any context on the back half of the year. But – so anyway, high level, just trying to get some context around how costs are running relative to what you were thinking going? And maybe you could frame how this delivery is coming in, again, relative to your going expectations?

Garth Hankinson

Yes, Yes. Thanks, Chris. Look, as a reminder, we expect our beer operating margin for this fiscal year to be around 38%. That remains unchanged as it relates specifically to Q2. Q2 is historically traditionally our higher – our highest margin quarter given the volume associated with Q2. And so in the second half of the year, obviously, we're going to continue to face inflationary pressures that we've had all year long. We are seeing some easing in inflation as expected as we've gone through the year. Unfortunately, while we've seen some improvement in inflation, we've also seen a strengthening peso kind of hold up. And so any improvement that we had due to inflation has been really offset by the strength of the peso.

And then again in the second half of the year, because of the historically lower volume that we have in that half, there will be an impact, obviously, to fixed cost absorption as well as COGS and marketing. And additionally, incremental depreciation as we brought on over gone partway through the year. And then as Bill noted in his remarks, scheduled maintenance in – that we traditionally do in the second half of the year as well as the overlapping and the pricing benefits last year. So all in, I mean, those are the sort of the factors that will contribute to the 38% margin for the full year.

Operator

Our next question comes from the line of Lauren Lieberman with Barclays. Lauren, we can't hear you. Are you muted.

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

Robert Ottenstein

Great. I was wondering if you could give us a little bit more detail on your productivity programs, the specific buckets that you've addressed that you're targeting? And is this something that is potentially a multiyear process of system optimization?

Garth Hankinson

Thanks, Robert. Yes, I would say that our cost savings and efficiency initiatives certainly are multiyear in nature. Obviously, we communicated earlier this year in Q1, we had taken $30 million out and then this year, an incremental $20 million for this quarter, I should say, an incremental $20 million. We're always looking at ways to sort of prove productivity, create efficiencies in the business, whether that's through supply chain and procurement or operations.

Examples of that over time have been things like double-stacking railcars and the use of plastic pallets, optimizing the location of inventory, as Bill referenced in response to a question earlier, improved purchasing in terms of raw materials through better contract management and negotiations as well as more effective and efficient use of our marketing spend. So it's absolutely something that the organization is focused on, on a year-on-year basis. And certainly, we will share a lot more detail on our cost savings initiatives for both our beer and our wine and spirits businesses at our upcoming Investor Day.

Operator

Our next question comes from the line of Filippo Falorni with Citi.

Filippo Falorni

Bill, you mentioned that the last 4-week trends has been very strong and consistent with the last 52 weeks. Can you give a little bit maybe more color on the performance of your business in September? And then at the industry level, one of your competitor at the Investor Day mentioned that September for the industry is particularly sluggish, particularly the last couple of weeks as you cycle the shipments ahead of the price increases in the last year. So maybe some color on the timing of shipments into September into Q3 would be helpful.

William Newlands

Sure. When I look at the most recent Circana data for 4 weeks, our total beer business is up 13.7%, which is very consistent with what the 52 weeks. That's what I was alluding to in my prior comments around that. Certainly, as we also noted, we expected that we would see some element of tightness during the course of the beginning of this quarter that we are in purely because we are lapping the October price increases that occurred last year and some of the prebill that people do – the retailers do ahead of any price increases that existed. All of that consistent with what we've expected. And we expect, as we've said, the reason we raised the – our guidance expectation around beer is because we expect to have a very strong back half of the year despite a couple of these headwinds that certainly exist.

Operator

Our next question comes from the line of Andrew Strelzik with BMO Capital Markets.

Andrew Strelzik

My question is on capital allocation and in particular, around buybacks. And I think you noted no buybacks during the quarter, but being on track for your target to offset dilution year-to-date. I guess my question though is what's the appetite for buybacks in excess of that, particularly given the momentum in the business, the strong cash flow generation? How are you thinking about that now versus where you were at the beginning part of the year and moving forward?

Garth Hankinson

Yes. So capital allocation is obviously something that we're going to discuss in greater detail at our upcoming Investor Day. But just broadly speaking, I would say, for this fiscal year, as we noted when we entered this year, we were going to at least buy back the dilution that occurred throughout the year. But this year, we're also prioritizing, getting our leverage ratio back to our target of 3.0 versus where it was at an elevated state as a result of the reclassification. That said, we're always looking to be flexible and agile as conditions allow for it. So something we continue to look at. And just as a reminder, we do have $800 million remaining under our current Board authorization. So in the event that we decide we want to be a bit more active, we have the ability to do so.

Operator

Our next question comes from the line of Lauren Lieberman with Barclays.

Lauren Lieberman

But just quickly, I was going to ask about wine industry growth. And just against the backdrop of your comments on Woodbridge/SVEDKA, obviously [not one], and then the higher-end brand performance. But just as you think about the fast forward, not just second half but into next year and so on, how do you think about wine industry growth, wine versus beer versus spirits? I'm guessing we'll get into this a bit more at the Investor Day, but I was just curious if you could preview a bit your view on kind of that long-term growth in wine?

William Newlands

Yes, certainly, Lauren. It's really the tale of 2 cities. The lower end piece of the business, what we refer to as mainstream has been very challenged. It's down mid- to high single digits, which obviously is somewhat challenging for us because we do have significant involvement with that category still even though we have divested a number of brands that played in that category. So that certainly is a very different answer than what I would say to you about the higher-end portion of the business where brands like Meiomi and Kim Crawford and High West and Booker and things of that nature are all significantly outperforming our plans and expectations and gaining share. You're right. We'll talk about that at Investor Day.

The other thing I'd keep in mind, unlike beer, which is about 45% in the second half, it's directly the flip when it comes to wine. That's 55% in the second half. And as we do in a distant portion of the amount of our business comes from ASPIRA, which much more relates to vintage releases, those all tend to occur in the second half, which, again, [weights] our business toward the back half of the year versus the first half of the year. And the other one I would just point out, which I think is important to recognize. We made the choice, as we said earlier this year that we were going to balance our ships and depletes all year long as opposed to doing it once in the fourth quarter, which is what we did last year. That creates a bit of a challenge in the early part of our fiscal year, but gives us a significant improvement proposition in the back half of the year as that won't occur as it did last year, creating a disproportionate shipment number in the fourth quarter last year, which won't be the case and we will be going against a much better proposition this year.

So all in, I think the wine business certainly has seen some challenges, but much like we see in the higher end of the beer business, the higher end portion of the category is much stronger. And certainly, our business in that sector is performing very nicely against category norms. And you're right, we will go into all of that in much more depth during our investor discussion on November 2.

Operator

Thank you. We have reached the end of our question-and-answer session. I would now like to turn the floor back over to Bill Newlands for any closing comments.

William Newlands

Thank you, and thank you all again for joining our call today. We're very pleased with our performance in the first half of fiscal '24. As anticipated, our beer business further accelerated during its seasonally strongest period of the year to deliver excellent results. In our wine and spirits portfolio, our higher-end brands continued to outperform and track channels, and we're looking forward to an acceleration in the growth of that business over the second half.

All told, we remain confident in our outlook for the full year and have tightened the expectations for growth in our beer business at the higher end of the initial range, while increasing our overall EPS outlook as we drove interest expense lower due to our proactive debt management.

In closing, I would like to encourage you to tune in for our upcoming Investor Day on November 2, where we will be sharing our latest perspective on the medium-term outlook for our business, you will find further details on how to access this event through our Investor Relations website at ir.cbrands.com.

Thank you again for joining us today, and we look forward to seeing most of you, if not all of you, November 2.

Operator

Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect at this time. Enjoy the rest of your day.