Constellation Brands Inc, Q4 2018, Earnings Call 2018-03-29

Presentation

Operator

Welcome to the Constellation Brands' Fourth Quarter and Full Year 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

Thanks, Maria. Good morning, and welcome to Constellation's Year-end Fiscal 2018 Conference Call. I'm here this morning with Rob Sands, our President and Chief Executive Officer; and David Klein, our Chief Financial Officer.

As a reminder, reconciliations between the most directly comparable GAAP measure and any non-GAAP financial measures discussed on this call are included in our news release or otherwise available on the company's website at www.cbrands.com. Please refer to the news release and Constellation's SEC filings for risk factors, which may impact forward-looking statements we make on this call. — ***Operator Instructions*** —

And now here's Rob.

Robert Sands

Thanks, Patty. Good morning, and welcome to our year-end call. Fiscal 2018 marked another year of excellent execution and impressive results for Constellation that generated EPS growth of almost 30%. This is the fifth consecutive year that we've achieved industry-leading EPS growth of more than 20%, an accomplishment of which I am very proud.

I believe it's worth reviewing some of the key accomplishments that drove this result, as they illustrate our commitment to sustaining profitable growth and building shareholder value. I'll follow that up with a review of our business performance along with some of the great initiatives we have underway for fiscal 2019.

Throughout the year, we made value-creating portfolio moves that aligned with our premiumization strategy and enabled us to capitalize on U.S. market trends that favor high-end beverage alcohol brands. This included our acquisition of Schrader Cellars, a highly rated portfolio of fine wines sourced from Napa Valley, Vineyards that sell for $225 to $250 per bottle to customers on its mailing list as well as Funky Buddha, a regional craft brewer in South Florida, where it is the largest craft brewery by size and volume.

Each of these additions boast award-winning, high-end products and excellent growth prospects. These activities were complemented by Constellation Ventures' investments, including The Real McCoy, a high-end rum, Aging American Oak bourbon barrels as well as Copper & Kings, a high-end American-craft brandy that is naturally distilled in copper pot stills and matured in Kentucky bourbon barrels.

I'm also excited about our investment in Canopy Growth, the largest publicly traded cannabis supplier in the world and a leader in the medical cannabis market in Canada. This investment provides Constellation with a first-mover advantage for a potentially significant, emerging consumer opportunity and aligns with our long-term strategy to identify, meet and stay ahead of evolving consumer trends and market dynamics, while maintaining focus on our core total beverage alcohol business.

From an operational perspective, we made planned strategic investments in our beer business and completed the next expansion phases of our Nava and Obregon breweries, which collectively now provide 31.5 million hectoliters of brewing capacity for our fast-growing beer business. We also fired up furnace #4 at our Nava glass plant, which is already showing excellent performance, as we begin to optimize its efficiencies.

We recently launched our fit for growth initiative, which is a multiyear program designed to prioritize resources across the company in support of our most critical growth opportunities. And we promoted Bill Newlands to the position of President and Chief Operating Officer. In this expanded role, Bill has oversight and accountability for all operating aspects of the company. I look forward to working closely with Bill to execute our growth agenda.

Overall, our strong financial results and record operating cash flow generated in fiscal 2018 created flexibility that enabled value-creating investments to support the ongrowing (sic) [ongoing] growth of our business. And we returned more than $1.4 billion to our shareholders through a combination of significant share repurchases and a sizable dividend increase. Collectively, these accomplishments helped STZ remain one of the best-performing stocks in the S&P 500 Index.

Let's move now to the excellent business performance that I just mentioned as a critical component to our success. Our beer business continues to be a powerhouse for growth, with its winning streak of 31 quarters of consecutive growth as the #1 brewer and seller of imported beers in the U.S. market. Constellation also remains the #1 high-end beer company and growth contributor to the U.S. beer category, outperforming the overall U.S. beer industry and all key competitors.

As we look back at the past year's accomplishments and ahead to fiscal 2019, let's begin our discussion with Corona Extra and Modelo Especial brand families, which drove strong execution and sales increases throughout the past year.

Corona Extra achieved record case volumes in fiscal 2018 and has steadily been growing base velocity for 5 consecutive years. It has gained share every month throughout the past year, and it is the only top 5 beer brand that is in growth mode. And with Hispanics, Corona Extra continues to have the highest brand awareness, certainly signs of a very, very healthy brand.

The Corona brand family closed out fiscal 2018 with strong growth momentum supported by strong TV, video and social media marketing and advertising activities.

Corona Familiar gained distribution following its regional expansion of 12-ounce packages in the key states and became the #3 high-end share gainer. And Corona Premier prepared to launch nationwide with the first national Corona line extension in more than 25 years.

We are well positioned in fiscal 2019 with a great lineup of activities to support the growth, momentum of this brand family.

Corona Extra kicks off a new sponsorship as the official cerveza of the San Francisco Giants and will become the official import beer of this year's Kentucky Derby. English and Spanish language national TV campaigns will be launched to support the brand, with this year's increased media investments focused on sports properties.

New TV ads featuring Corona Extra and Corona Light together will begin running in advance of the Cinco de Mayo holiday, and we will begin launching our new TV ad campaigns in support of the Premier and Familiar launches beginning next month.

Now moving to Casa Modelo. This trio of brands, which includes Modelo Especial, Negra and Chelada, has been an amazing growth story, quadrupling to more than 110 million cases in 10 years, making this brand family the #1 source of growth in the entire U.S. beer category for the past decade.

In fiscal 2018, Modelo Especial alone achieved the 100 million case milestone and grew depletions 17%. Modelo Especial was the fastest-growing draft in the on-premise channel and the #2 share gainer in the off-premise last year. It's now a top 5 beer brand in 11 major U.S. markets, including New York, D.C. and Denver. And even more impressive, Modelo Especial is now the #1 beer in the state of California, fueled by its #1 position in L.A. and San Francisco. Last year, Modelo Especial had the highest increase in household penetration in the entire U.S. beer category.

Casa Modelo has plenty of upside from ongoing distribution expansion opportunities in the coming year. Dedicated media spend will increase by more than 20% in fiscal 2019, which will be heavily weighted the high-profile programming on ESPN and other entertainment networks as well as live sports property, such as the NFL and the NBA. And as of January 1, Modelo became the official beer for the UFC, the Ultimate Fighting Championship, which is one of the fastest-growing sports in America. Last year, the Modelo Chelada family grew almost 40%, with the launch of Tamarindo Picante, which became the #1 single-serve item in the U.S. beer market and propelled the Chelada family to greater than 30% market share of the Chelada category.

Modelo Chelada Especial was also awarded the prestigious Nielsen's Breakthrough Innovation Award of 2017, a feat that only 18 brands achieved from a pool of more than 4,500 new CPG items.

Now as you are aware, the bench strength of our beer portfolio goes deeper than our biggest brands. In fiscal 2018, Pacifico was the second-fastest growing major beer brand in the U.S. beer category and a top 15 share gainer, and we believe it has the potential to be the next big national brand in our beer business.

In fiscal 2019, we are executing a national launch of the Pacifico 12-pack can to build on the success of the 24-ounce SKU. The 12-pack can format will be a big part of Pacifico's first-ever National Cinco de Mayo retail program, and we are launching our first ever national TV campaign and our largest retail programs in the history of this brand.

As such, you'll see Pacifico on high-profile programs, like The Walking Dead as well as NBA, NFL, Major League Baseball and college football. And Pacifico will, once again, be the official beer sponsor of the Burton US Open of Snowboarding as well as the Summer X Games, 2 of the largest and best-known action

— Audio Gap —

sports events in this country.

In addition to Corona Premier and Familiar, I'm also very excited about the new product lineup we've planned for 2019. We are introducing [Western Standard], a barrel-finished easy-drinking lager that will be available in 3 test markets this summer at a high-end price point. We are leveraging the equity and authenticity of our high-end, small-batch, high-west whiskey brand and building up trends of craft spirits and barrel-aged beverages, which we're seeing in the wine and spirits space. We believe that this is the trend for the next American beer, sessionability, yet flavorful.

Another segment we are excited about is the ABA space. This is a growing market opportunity, and it's incremental to the beer category. SVEDKA-spiked premium seltzer will be introduced in 3 flavors and is made from natural ingredients and contains no artificial flavors. At 100 calories, it is targeted as the female consumer, who is looking for better-for-you, right options that fit an attractive and active lifestyle. We plan to begin test marketing this summer.

We will also begin test marketing Corona Refresca, a premium spiked refresher in 2 tropical flavors that are very, very refreshing.

Our craft and specialty portfolio continues to stabilize. Last fall, we launched Ballast Point, Fathom IPA and recently began a national rollout of Fathom IPA draft. This new brand is already the third-best selling craft brand in our portfolio.

Now throughout fiscal 2019, we plan to continue our Ballast Point distributor transition to the Gold Network, drive focus around and across our core brands, deliver innovation and leverage our new tasting rooms to build stronger, local brand presence. Funky Buddha will continue to expand distribution in select new markets, and we have a series of new product launches planned throughout the year.

From a beer operations perspective, I've mentioned earlier that our current Nava and Obregon expansion projects have been completed as planned. As we evaluated our plans for fiscal 2019, including the future growth prospects of our beer portfolio, it became clear that we would need to expand capacity beyond what we have already planned due to the industry-leading growth being generated by the business. As such, we plan to increase our Nava footprint to 30 million hectoliters and expand Obregon by an additional 5 million hectoliters, while also continuing the buildout of Mexicali to 5 million hectoliters. Collectively, these projects will provide about 44 million hectoliters of capacity by fiscal 2023.

We are in the enviable position of being the growth leader in the U.S. beer industry, and these investments represent smart usage of our cash. David will discuss the magnitude and timing of these capital investments in just a few minutes.

Overall, I'm excited about the growth prospects for our beer business in fiscal 2019. As you can see, we have tremendous opportunity to grow the business through enhanced distribution, excellent execution opportunities and consumer-driven innovation across the portfolio. As a result, we are targeting beer business net sales and operating income growth in the 9% to 11% range in the coming year.

And now I would like to focus on the operational results for our wine and spirits business, which achieved significant margin improvement for the year, while gaining market share in the U.S. wine category. These results demonstrate that our wine and spirits premiumization strategy is working. Our brand investment strategy is driving positive mix and margin enhancement, and we are winning in the marketplace, as evidenced by our market share gains. These successes combined with our operational initiatives are contributing to operating leverage in the P&L. These results were primarily driven by our fast-growing, higher-margin Focus Brands, which grew depletions almost 7% for the year. Many of these Focus Brands, achieved significant milestones and accomplishments last year. Several of our Focus Brands received impact 2017, Hot Brand Awards, including Meiomi, Black Box, Ruffino, Kim Crawford and Nobilo.

Our products were also called out in the Beverage Information Group 2017 awards, where 5 of our brands achieved fast-track status recognizing their impressive growth, including Black Box, Kim Crawford, Meiomi and Nobilo and the Prisoner. 14 of our brands were named rising stars and 7 listed as established growth brands. Casa Noble took top spot multiple tequila categories in cigar and spirits, the best of 2017, while Whiskey Advocate named High West Campfire, one of the top 20 whiskeys of 2017.

Now from an operational perspective, we have improved our cost of goods sold management capabilities. We are using enhanced consumer insights to ensure that we are spending our COGS dollars on product attributes that are valued by consumers. We were also driving asset utilization to improve ROIC by getting the right fruit of the right vineyards for each brand, including international sourcing.

We have improved yields as a result of process optimization and value engineering throughout the entirety of the production process. And we have engaged in packaging simplification and optimized our production footprint. From a strategic perspective in fiscal 2019, we are focused on delivering against select key objectives.

We will continue to execute a steady evolution to the high end of the U.S. wine and spirits category by capturing growth at higher price points to achieve mix and margin benefits, particularly at the greater-than-$11 price point at retail. This includes driving growth from our Focus Brands, which grew almost 7x the rate of the entire portfolio last year and represents approximately 70% of the profit of the wine and spirits business.

We have plans to accelerate our consumer-led innovation and brand-building efforts. As such, we're focusing on capitalizing on hot-trend opportunities, like Rosé, creating higher price points with cross-category innovation and developing new brands like, Derange, which is a red blend that retails for $100 per bottle. It's actually one of my personal new flavors.

We are excited about the innovation brands we have currently launched and are planning to launch this coming year, including 7 Moons, SVEDKA Blue Raspberry Vodka, Cooper & Thief, especially the Sauvignon Blanc aged in Casa Noble tequila barrels and Black Box spirits, including whiskey, vodka and tequila, will be introduced in a phased rollout beginning this quarter. These collective efforts will be supported by impactful marketing campaigns to strengthen and build new and existing brands.

We will continue to evolve our three-tiered e-commerce TBA strategy as well as our direct-to-consumer initiative, as we clear plans to drive growth from these channels. And we have a long runway to continue to improve our operational capabilities in forecasting, asset utilization, flexibility and throughput. Overall, we will continue to optimize our route-to-market strategy, revenue management, sales enablement and operational processes.

As I mentioned last quarter, while we have seen a slowdown in the U.S. wine industry, it has stabilized and remains healthy overall, with trends that continue to exceed U.S. CPG category growth. In addition, our SKU rationalization efforts are creating a headwind, as we continue to carefully rationalize a subset of our portfolio of tail brands to simplify and premiumize the overall portfolio.

Ultimately, we are committed to growing our wine and spirits business – businesses ahead of the U.S. wine and spirits industry, while targeting margin expansion from ongoing price/mix benefits and cost of goods activities.

In closing, it has certainly been another exciting year at Constellation. Our achievements are many and have driven a year of strong, strong financial, commercial and operational performance.

In 2018, we delivered industry-leading market results from our beer business while continuing to enhance our operational platform in Mexico to support the growth of our iconic Mexican beer brands.

Within our wine and spirits businesses, we maintained our focus on premiumization, innovation and brand building, which drove enhanced margins and wine market share gains.

We are very, very proud to have delivered another rewarding year of value to our shareholders, and I'm pleased that our results can support a significant dividend increase and an enhancement to our dividend payout ratio in the coming year.

With all of that, I would now like to turn the call over to David, who will review our financial results for fiscal 2018 and provide our outlook for fiscal 2019.

David Klein

Thanks, Rob, and good morning, everyone. Fiscal '18 was another tremendous year, as we continue to generate top-tier growth in the CPG space. We generated over $7.5 billion of net sales and 7% organic net sales growth. We expanded operating margins in both businesses and improved our consolidated comparable basis operating margin by 270 basis points. We increased comparable basis EBIT by 13%. We increased comparable basis diluted EPS by 29%, which follows the 24% EPS growth we generated in fiscal '17. And we produced over $1.9 billion of operating cash flow, which is an increase of 14%.

The strong earnings and operating cash flow growth provided us with significant financial flexibility, as we continued to make capital investments in our Mexican beer operations; return cash to shareholders with more than $1 billion in stock repurchases and $400 million of dividend payments; while making investments in Canopy growth and brands like Schrader and Funky Buddha.

The stock repurchases represent 4.8 million shares at an average price of $216. Approximately, 75% of the repurchases occurred during the fourth quarter, as we believed the benefits of U.S. Tax Reform and our top line growth prospects were not appropriately being appreciated by the market.

Our net debt to comparable basis EBITDA ratio finished at 3.6x versus 3.7x at the end of fiscal '17.

We expect fiscal '19 to be another year of strong financial performance, as we're targeting healthy net sales, EBIT, comparable basis diluted EPS and operating cash flow growth, while we continue to invest in our Mexican beer operations, our brands and in other areas in order to capture future growth opportunities.

In addition, we're increasing our dividend by more than 40% and our dividend payout ratio to 30%, while we remain committed to our 3.5x leverage ratio target.

Let's look at fiscal '18 performance in more detail where I'll generally focus on comparable basis financial results.

Starting with beer. Net sales grew 10%, primarily due to volume growth of 9% and favorable pricing. Depletion growth for the year came in at 10%.

Beer operating margin increased 320 basis points to 39.5%. We're extremely pleased with this operating margin performance, which we believe is best-in-class for North American brewing. The margin increase was driven primarily by lower COGS and favorable pricing. The lower COGS reflect strong operational performance, driven by glass and material-sourcing benefits, foreign currency favorability and supply independence from ABI. These benefits were partially offset by a $54 million increase in depreciation expense, which totaled $168 million for fiscal '18.

For wine and spirits, excluding the impact of the Canadian wine business divestiture, net sales increased by 5%. This includes 3% organic growth, driven primarily by favorable product mix, partially offset by lower volumes, along with the acquisition benefits from the Charles Smith, High West and Prisoner brands.

Total U.S. depletions grew 1% for the year, while our Focus Brand portfolio posted 7% depletion growth.

Wine and spirits operating margin increased 160 basis points to 27.4%. This improvement primarily reflects mix benefits from the portfolio premiumization efforts, including the Canadian wine business divestiture, partially offset by marketing investments and higher COGS.

As a reminder, as part of our premiumization efforts, we've been rationalizing lower-margin value-brand SKUs. These actions impacted wine and spirits revenue growth by almost 100 basis points for fiscal '18 while improving operating margin and ROIC.

Interest expense for the year decreased slightly to $332 million as the benefit of lower average interest rates was mostly offset by higher average borrowings. Our comparable basis effective tax rate for the year came in at 19% versus 26.8% last year. This reflects an increased benefit from lower taxes on foreign earnings in the adoption of ASU 2016-09, which requires excess tax benefits from stock-based payment awards to be recognized in the income statement.

The fiscal ’18 rate also benefited from the new 21% U.S. federal statutory rate for the last 2 months of the fiscal year.

Now let’s review Q4 results. Comparable basis diluted EPS came in at $1.90, up 28%. Beer net sales increased 12%, primarily due to volume growth of 10% in favorable pricing. Beer operating margin remains steady at 38%, as pricing, along with operational and foreign currency benefits, were mostly offset by higher SG&A, including increased marketing spend for the quarter.

Wine and spirits organic net sales increased 8%. This primarily reflects mix benefits, driven largely by strong sales of the Meiomi wine brand, which experienced tight supply in Q4 last year, as strong consumer demand outpaced expectations.

Wine and spirits operating margin increased 80 basis points to 27.4%, as benefits of favorable mix were partially offset by higher COGS and marketing investments. The higher COGS primarily reflect the impact of lower volumes for the quarter and the overlap of certain inventory cost benefits in Q4 of fiscal ’17.

In Q4, we recognized an additional $236 million pretax gain from the change in fair value of the Canopy investment and warrants, bringing the total pretax gain on this investment to $453 million. We recorded a net tax benefit of $363 million as a result of U.S. Tax Reform, which is comprised of a benefit from a reduction of our net deferred tax liabilities, partially offset by a onetime transition tax related to unremitted earnings of foreign subsidiaries. And we also wrote down $19 million of bulk inventory – bulk wine inventory due to smoke damage sustained form the California wildfires. We are pursuing insurance reimbursements for this loss. These items were excluded from our comparable basis financial results.

Moving to fiscal ’18 free cash flow, which we define as net cash provided by operating activities less CapEx, we generated $874 million compared to $789 million last year.

Operating cash flow totaled $1.9 billion, up 14%, primarily driven by our earnings growth; and CapEx totaled $1.1 billion, which was 17% above last year’s spend. The CapEx in below our previous expectations due to timing.

Moving to our full year fiscal ’19 P&L and free cash flow outlook. For fiscal ’19, we expect to leverage our ongoing portfolio premiumization efforts and execute the marketplace initiatives, outlined by Rob, to deliver another year of strong financial performance, as we’re projecting our comparable basis diluted EPS to be in the range of $9.40 to $9.70 per share. The midpoint of this guidance has us growing EPS by approximately 10%.

Our beer business is targeting net sales and operating income growth in the range of 9% to 11%. Our projections include 1% to 2% of anticipated pricing benefit for our Mexican portfolio.

In fiscal ’19, we expect to see gross margin improvement, primarily from product pricing as benefits from glass sourcing initiatives and operational efficiencies are expected to be offset by increased depreciation.

Looking closer at depreciation expense for the beer segment, it totaled $168 million in fiscal ’18. We expect that to increase by approximately 30% in fiscal ’19.

We expect gross margin benefits to be mostly offset by incremental marketing investments in support of our innovation and other growth initiatives. These investments include: $35 million for the national launch of Corona Premier as well as a regional expansion of the 12-ounce format of Corona Familiar; we're also rolling out our first-ever national advertising for Pacifico to drive awareness across the U.S. and supporting other programs like the Modelo Especial UFC sponsorship. The additional marketing spend in fiscal '19 is expected to be weighted towards the first half of the year, as we prepare for the upcoming Cinco de Mayo holiday and the summer selling season.

Beer marketing as a percent of revenue finished fiscal '18 at approximately 9%, and the additional marketing spend that I outlined for fiscal '19 could move that percentage up by 50 to 100 basis points.

For the wine and spirits business. For fiscal '19, we expect net sales and operating income growth of 2% to 4%. For sales, we're targeting low single-digit volume growth and continued mix benefits from our premiumization efforts. We expect mix benefits and COGS productivity enhancements to be mostly offset by some cost increases, including higher grade and transportation cost and technology-focused SG&A investments, which will create operating efficiencies as we go forward.

I'd like to remind everyone, from a first quarter standpoint, that in Q1 fiscal '18, wine and spirits EBIT grew 22% and U.S. shipment volumes significantly outpaced depletions. This was driven by replenishment of Meiomi supply, which was constrained coming out of Q4 fiscal '17. As a result, our Q1 fiscal '19 wine and spirits EBIT could be down 10% to 15%, with sales down low to mid-single digits. This first quarter was contemplated when we set our guidance of 2% to 4% growth on the top line and bottom line in our wine and spirits business.

Shifting back to the full year fiscal '19. To be clear, we are planning to expand operating margins in both business segments. However, we expect the deltas between sales and operating income growth to be contained within the range as provided. As I mentioned at the recent CAGNY Investor Conference, we've begun a multiyear program to make us fit for growth, whereby we will reengineer our business processes and implement a company-wide ERP platform to create better digital connectivity with our consumers and our customers.

For fiscal '19, in our corporate segment, we're planning approximately $20 million of incremental spend related to digital-enablement activities, like the ERP platform I just mentioned and e-commerce initiatives as well as investments in personnel and resources to build brands and open new markets in support of our cannabis investment. These initiatives should help us stay ahead of trends to meet the needs of the perpetually evolving consumer.

Let's transition to our tax rate where we are pleased with the overall net benefit resulting from U.S. Tax Reform, which will primarily be reinvested to support the long-term growth of our business. We expect our tax rate to approximate 19%, which is in line with our new 18% to 20% medium-term effective tax rate. As a reminder, we were targeting a low to mid-20% tax rate prior to tax reform.

While the year-over-year tax rate is expected to be flat, fiscal '19 reflects the anticipated benefit from the new 21% U.S. federal statutory rate, primarily offset by an increased in our effective rate on foreign earnings, which will occur due to the adoption of ASU 2016-16. Under this accounting change, we will record a deferred tax asset at the beginning of fiscal '19 for the future tax amortization of certain intangible assets. As a result of this amortization, we expect our cash tax rate to run at least 700 basis points lower than our effective tax rate for the foreseeable future.

For fiscal '19, our tax payments are also expected to be reduced by prior year refunds. As a result, we expect our fiscal '19 cash tax rate to be almost 10 percentage points below our effective tax rate. Interest expense is expected to be in the range of $355 million to $365 million, and weighted average diluted shares outstanding are targeted at 197 million. For clarity, our guidance assumes no share repurchases during fiscal ’19.

I would also note that our comparable basis guidance excludes comparable adjustments, which are detailed in the release.

We expect fiscal ’19 free cash flow to be in the range of $1.2 billion to $1.3 billion, which reflects operating cash flow in the range of $2.35 billion to $2.55 billion and CapEx of $1.15 billion to $1.25 billion. This includes approximately $900 million of CapEx for our Mexican beer operation expansion, including investments in Obregon, Mexicali, Nava and a fifth glass furnace. We expect to finish fiscal ’19 with approximately 34 million hectoliters of brewing capacity.

At this point, I’d like to highlight ASU 2014-09, the new revenue recognition accounting standard, which was effective for Constellation at the beginning of fiscal ’19. Under the new guidance, we’ll recognize certain sales incentives earlier than we have historically. This change will shift net sales recognition between our fiscal quarters but is not expected to have a material impact on full year net sales. We’ll recast full year fiscal ’17 and fiscal ’18, along with fiscal ’18 quarters and provide this information in connection with our first quarter fiscal ’19 earnings release.

In closing, we believe we’re well positioned to continue to deliver best-in-class top line growth over the long term. Our fiscal ’18 results, along with the growth-focused investments we are making while we project strong fiscal performance for FY ’19, demonstrates our commitment to create shareholder value through sustainable and profitable net sales growth.

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

Question and Answer

Operator

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

Dara Mohsenian

On the beer top line front, your beer portfolio market share accelerated in Q4 within a weaker category. So any highlights on what drove the market share momentum, and does that give you visibility, as you look at to fiscal '19, that you can hit your volume goals, even if the industry softens further? And also, can you just tease out specifically the net impact you're expecting from innovation on beer volume in fiscal 2019 guidance and a review of how the Familiar expansion and Premier launch are trending in the market so far in March?

Robert Sands

Yes, Dara. I'll comment on it all. I mean, first of all, yes, the fundamental answer to your question is yes. I think that our performance in the fourth quarter gives us a significant amount of confidence going into the first quarter and the fiscal year, regardless of what's happening in the beer category in general. In fact, I don't really think that the two are connected to the extent that we're looking at the beer category ex Constellation's beer business. So I don't think that there's that kind of interaction in that – the beer category exclusive of Constellation really has much to do with how Constellation's beer brands are performing or will perform in the future. So we feel pretty good about where we're going. And if the beer category softens further, it just probably means that we're going to have larger market share gains as we go into this year. And then new products, they are contributing to our growth this year. Our new products are performing, I would say, extremely well. I'm talking about the Premier and Familiar. And when I say performing well, reorder rates are very strong. And by all indications, it's looking like it's going to be an extreme – they're going to be extremely good introductions and therefore, we're real optimistic. It's probably providing 200 to 300 basis points of our growth in fiscal 2019.

Operator

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

Caroline Levy

As we move forward, you're adding a lot more capacity than you'd originally planned for very good reasons. Do you think that that's the way this is going to continue, that each year, where initially, we thought there might be a falloff in CapEx in the outer years. If you keep up, a sort of close to double-digit top line growth rate, will you continue to add capacity at a similar rate?

Robert Sands

Well, we're planning out quite a number of years. So I think the answer to your question is no. We're not going to continue to simply add capacity like this every year. But as we get out 4, 5 years, if the growth continued to be, I'd say, outsized, we will have to add capacity at some point in the future. But I think that what we've – what we're doing now pretty much covers us for a significant period of time. So I don't think that you should be expecting more capacity projects in the near future. I think this takes us up to about 44 million hectoliters of capacity, okay, which should clearly get us to where we need to be through 2023. So no. We're not going to be adding capacity at this rate in the near future.

Operator

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

Lauren Lieberman

I was curious if you could talk a little bit more, actually, about fit for growth. So you mentioned it in the context of ERP systems, but I guess, other investments that are necessary to, kind of, go after the cost savings and any kind of quantification you could give and time line for what you're expecting to be able to get out of fit for growth, and if that's – where are those dollars are expected to go. And then just one follow-up was Rob, you said 200 to 300 basis points of growth coming from Premium and Familiar. I'm just assuming that's a growth number. That's not net of assumed cannibalization.

David Klein

So I'll take the fit for growth and then also cover up on a – on the cannibalization point. But – so from a fit for growth standpoint, Lauren, we're doing this program because we think that there are ways for us to get more efficient as a company over – by reengineering our business processes. We expect that the savings, which at this point, we're not ready to quantify publicly, the savings, we would expect that reinvest in growth initiatives like the initiatives that we talked about this year. Like building a better digital connectivity with our consumers, with our customers, with our retailers; investing in creating and marketing brands and capabilities in the cannabis space; as well as looking at different ways to get our products to market from a DTC standpoint. These sorts of investments we want to make in our business, and we feel that we can mine our current P&L to fund them. And that's really the point of the fit for growth program. We're really in the early stages of scoping out the ERP program and the process redesign work, and so you'll hear more about that over the coming months. And then in terms of overall growth in the portfolio, I think the way to think about it, there are 2 ways to look at it, I suppose. One is, we expect our base business net sales in beer to grow high single digits. And so any difference between that base growth and the NPD, so Premier and Familiar, is – so the difference between the growth in our base business and our guidance is explained by Premier and Familiar. And so I would say that the 200 to 300 basis points is probably exclusive of cannibalization.

Operator

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

Vivien Azer

So I wanted to double back on the beer category dynamics. Clearly, you guys are floating above the fray in terms of the competitive activity that mainstream price points. But we are hearing from the trade press, about heightened competitively at the high end as well, given some of the capacity issues that are happening in craft. So a 2-part question, please. Number one, I'd love your thoughts on what you're seeing in the craft category; and then number two, how does that inform you're thinking around price realization?

Robert Sands

So Vivian, I'd say a couple of things. Number one, I think that unfortunately, we talk about these categories generically, and I think that even within these categories, there are sub-categories, and there's things that are going on that have really no impact whatsoever on other elements of what you're referring to as a category like the high end. So first of all, if you looked at various definitions of the craft category, what you'll see is, on a total category basis, that pricing in craft is pretty much consistent with the whole high end or everything else for that matter. But within craft, what you have seen is anecdotal reports of various craft beer companies reducing prices and introducing cheaper, larger pack sizes, basically to do anything to try to stem their declines. These are specific companies. But it's not really across the whole category affecting pricing in the craft category. That's really more a function of the fragmentation of craft and the competition in craft with the hugely expanding number of craft breweries and the trend towards hyper localization and fragmentation for that matter. But in general, craft pricing is pretty stable at about plus-1.5%. Probably, more importantly, the anecdotal pricing you're talking about has – no, 0 interaction with us. It does not affect us whatsoever. If a particular craft brand, because they're falling out of bed, drops their price to $9.99 or introduces a 15-pack at some cheap price, it matters not to us whatsoever and really doesn't affect the parts of the business that we play in. So most importantly, I guess, to get directly to the point, we don't see anything that's going on across the beer industry or any category for that matter that would cause us to do anything differently than our normal 1% to 2% price increase to cover typical inflation in the business. So we feel good about that. We don't see anything that's occurring that we think would jeopardize that.

Operator

Our next question comes from line of Bonnie Herzog of Wells Fargo.

Bonnie Herzog

So I was hoping you guys could drill down a little bit more on your Q4 beer margins, which ended up better than, I think, you guys had been expecting, based on some comments you made few months ago. So just wanted to understand the key drivers of that. And then, David, you mentioned you expect beer margin expansion in FY '19. But your guidance really doesn't call for much. So touch on that, please, and the factors you expect that could limit beer margin upside? And then I'd just love some thoughts on long-term expectations for beer margins, what's realistic?

David Klein

Yes. So in terms of Q4, the things that were really a little different from may be where we expected it to land was, performance in particular continued, really strong operating performance at Obregon from a cost perspective. We also sad some FX benefits that are – that we got in the fourth quarter, that's may be more of a timing benefit than anything else, because some of the peso strengthening that we were seeing coming into the quarter that we were concerned about actually ended up getting captured in inventory at year-end. So it's just a timing difference. In terms of the margin guidance, we are – we expect that, depending on upon where you pick net sales number and where you pick your operating margin number in that 9 to 11 range you can see that there's some amount, although, as you say, limited amounts of margin expansion planned in our numbers. But that's inclusive of the investment that we're making in the launch of Premier and Familiar, which, as we said, would take our marketing spend as a percent of net sales up by between 50 and 100 basis points for the fiscal year. I would say that over time, Bonnie, I probably would say that we – we'll continue to drive as much operating margin as we can out of the business. We like the trends we're seeing in the – in gross margin. We think we can get a little sharper over time from an SG&A standpoint. But we'll continue to invest in our brands from a marketing standpoint. So I would say that we think that there's some amount of margin expansion to be had over the next couple of years, but I would put it in a reasonably small bucket, as we are really going to try to continue to drive the top line of the business. And for me, that's the thing, I think, that's missed a little bit by our story is, the power of the top line growth of our beer business, where last year, we grew 10%. This year, we have a range to grow 9% to 11%. We're setting ourselves up to continue to grow at that rate for the foreseeable future. And so I guess, we would be – we want to make sure we're appropriately investing in our brands as opposed to just dropping dollars to the bottom line.

Operator

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

Andrea Teixeira

Just wanted to follow up on your guidance for the funding for growth, if you will, this new program. For the expenditures that you're hoping for this ERP, are they included in your guidance within the range of margins that you have on the ongoing – on the [growing] margin guidance? And also, if you can comment a little bit on wine. If you, kind of normalize after you cycle this impact on the first quarter, what is the kind of growth that you're seeing on depletions? I mean, I understand, obviously, the Focus Brands, but if you look at it like excluding this effect, we are looking at, obviously, a much bigger – if you can do the math, a much better improvement after this effect in the first quarter.

David Klein

Yes. So on the fit for growth in ERP question, that's included in our guidance. Again, that's part of why you see costs – our corporate costs going up. In terms of wine growth, we – Rob mentioned that we had seen a bit of a slowdown from where we were over, say, the last 5 to 10 years in the wine business. We saw a bit of a slowdown in calendar year '17. We, however, are also seeing a bit of a bifurcation within the wine business, where – and Bill talked about this at the CAGNY conference, where above the – that $11 price point, which is somewhat arbitrary, but above that $11 price point, we're seeing market growth that are in the range of 13% versus 1% growth rate for the brands below the $11 price point. And we believe that you see this capability in our portfolio when you see the growth that we have in our Focus Brands versus the growth in the rest of the market. And so we remain quite bullish on our Focus Brands, while we continue to work the SKU rationalization sorts of activities that we've talked about in the past, which, as Rob mentioned, is creating a drag on the business of about 100 basis points in FY '18, and we'll have included in our guidance, some amount of drag, maybe in the 50 basis points range during FY '19.

Andrea Teixeira

Just a follow-up on FX. What is embedded in your guidance, in terms of, you always hedged part of your COGS? Can you update us on the range of FX that you disclosed before?

David Klein

Yes. I think, from an FX standpoint, at this point in the year, we're probably around 60% hedged. Our biggest exposure, as you know, is to the peso, and the peso has been fairly stable recently, although, we expect there could be some volatility in the peso, as we go through the public discussions around NAFTA and the elections in Mexico.

Andrea Teixeira

And you're ready to disclose the amounts that you're hedged at or...

David Klein

Yes. I just – again, I think, we're roughly in that 60% hedged range as we go into the year.

Operator

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

Stephen Robert Powers

Great. I guess, just given how important increased distribution is to the beer-growth algorithm, can you talk about your line of sight to incremental points of distribution entering fiscal '19 across all the brand families inclusive of Premier, Familiar but also, what you expect on Modelo, Pacifico and craft? And I guess, as you think about that, I'm curious about 2 things. First, what portion of the gains embedded in the outlook you feel at this point is more or less locked in versus what you need to go out incrementally win over the course of the year? And then second, just for context, as your conversations with distributors and retailers have taken shape, if there's any way to frame how this year's setup compares to what you might have saw entering fiscal '18? That would be great context.

Robert Sands

So our line of sight to getting more distribution is very good, in that we have definitive distribution gaps in big – parts of our portfolio. And therefore, we have a lot of upside, especially when you look at the Modelo Especial family and when you look at brands like Pacifico, there continue to be huge upsize to be gained in distribution, and our organizations are all tasked and incentivized against getting that distribution. So I'd say, we have very good line of sight into getting the distribution. And therefore, it's just another factor that goes into the confidence that we have in the business of continuing along the same lines that it has and in the guidance that we've given. So there's really no magic to any of that. It's all about sales execution and where we are in terms of what the gaps are, and our people are acutely aware of where the gaps are, and they will be continuing to drive against closing those gaps. So I'd say, a high line of sight.

David Klein

And I would also say, Stephen, that we believe that we've said before 50% of our growth is sourced from distribution. We think that we can continue that for the next several years, meaning that we have, as Rob said, line of sight into distribution opportunities that allow us to continue on that growth trajectory for the next few years.

Operator

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

Bryan Spillane

Just that – I wanted a follow-up, I guess, on Caroline's question earlier around CapEx. And forgive me if might've missed this. But David, could you just kind of give us some sense of beyond '19, how CapEx sort of phases with the capacity expansion, and maybe just remind us of, kind of, where you sit now in terms of what maintenance CapEx levels are? And then sort of what the growth CapEx is going to be over the next several years?

David Klein

So Bryan, the way I think about it, and when we get out a couple of years in capital, we're all kind of making the numbers up. But when I think about it, we know that we've committed to – after FY '19, capital expenditures in Mexico that are in the $1.1 billion to $1.3 billion range. And we know that, that all needs to be completed by FY '23. That's likely to be front-end loaded in that time period, because we're building out capacity. In addition to that, in the rest of our business, just broadly speaking, we spend about $200 million in CapEx, that's the corporate initiatives, wine and spirits. And then just as a placeholder, we've been thinking, it's $100 million to $200 million of spend in our beer business from an – on an ongoing business for maintenance as well as for value engineering and return-generating investments in our production assets outside of simple capacity expansion. So I think that kind of frames up where we see CapEx beyond FY '19.

Bryan Spillane

So – that would mean, I guess, that like 2020 CapEx might look similar to fiscal '19, and then it begins to kind of taper from there. Would that be a good way to, kind of, think about modeling it?

David Klein

Yes. I think that's fair.

Operator

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

Timothy Ramey

Was interested in your comment on the $19 million write-down of smoke damage to bulk wine. Are you seeing that more broadly in the industry, and does that firm up the bulk wine market? Does that wine that's written down still exist for the bulk wine market? Or is it essentially condemned?

Robert Sands

So we're – I'd say, interestingly enough, we're probably the first company to talk about this. I believe that there's probably a significant amount of smoke tainted or damaged bulk wine or wine out there in the tanks and in the valley. I think that it's not something that everybody's necessarily telegraphing. I don't know how it's going to affect the bulk wine market other than I don't believe that is – will have any effect on us, whatsoever. And we're certainly not going to use any of the tainted – smoke-tainted bulk wine or buy any. And I think that from what I hear, a few others, some of the most premium guys who are now realizing that there's some smoke-tainted wine out there, I've heard of a couple that are going to skip the vintage. But I don't – this isn't going to have any impact on us or our ability to meet our guidance.

Our wine business is very strong. We've got some fantastic brands that are just really blowing the socks off a lot of the industry. Things like Meiomi and Kim Crawford and Prisoner. We've got some unbelievable innovation out there, like Derange, which is our new high-end wine blend out of the Prisoner Wine Company, part of our business. We've really been leaders in driving the new, sort of, barrel-aged spirits or Bourbon Barrel-Aged wines with our Robert Mondavi Private Selection, which is in significant growth and Cooper & Thief, which is – I think, it'll turn out to be a significant phenomenon where we've extended that to tequila, Barrel-Aged Sauvignon Blanc, which I'd say try it. It's very unusual wine. So the smoke taint issue is a small one. We don't expect it to be a recurring matter. It's relatively immaterial to us. And we don't expect it to have any impact on us going forward. But yes, I think that there's some smoke-tainted wine out there in the Valley.

Timothy Ramey

Actually I was thinking of it from a positive perspective, given that, as you put it, skipping of vintage and making an insurance claim is one of the best ways to enhance margins and perhaps pricing and [sectoring]. Would you – do you think that's overstating it?

Robert Sands

For some companies, I'd say that, that's possibly the case. We're not going to have to skip a vintage in any of our wines as a consequence of this. But it may be the case with some others, and it could work to their advantage or disadvantage. I'm not actually really sure, one way or the other. So…

Operator

Our next question comes from the line of Amit Sharma of BMO Capital Markets.

Amit Sharma

Rob, a quick clarification and then a bigger question on the Premier. The 50 basis point SKU rationalization impact on the wine business in this year, should we assume that's the end of it? And going forward that is no longer a headwind? And then I have a Premier question.

Robert Sands

So, no. I'd say that in general, SKU rat is going to be the case. I think it's just generally good business practice to call the portfolio every year of smaller and slow-moving SKUs that are nonstrategic to the company. It helps to make sure that, fundamentally, the whole supply chain isn't mucked up and that you're managing the balance sheet, in particular, working capital, efficiently by not – by getting rid of, as I said, small and slow-moving SKUs that can tend to drive inventories up and basically gum up your operations. So we'll have SKU rat every year, which is a big portfolio like our wine portfolio, would not be unusual at all and is probably best practice in terms of managing the business and the balance sheet and working capital and efficiencies.

Amit Sharma

Got it. And then on Premier, look our conversation with some of the distributors has been really positive. There is clearly a lot of enthusiasm for how the brand has performed initially. Just as you look maybe 2, 3 years down the road, and you think about the targeted audience and segment, I mean, close to 150 million cases segment, what is the realistic scenario for Premier as a percent of share for that segment?

Robert Sands

Well, I mean, that's a little bit hard to predict. But I said something a little earlier about not getting too focused on categories, and it's really about brands. It's interesting to talk about like the super-premium category doing well, because it's not a category, it's one brand. It's Mich Ultra.

And then Premier is a new brand or a new sub-brand of Corona, that is designed to appeal to that consumer and has some additional attributes of being more premium than what's out there and successful at the moment. So we expected – the introduction's been extremely strong. You've talked to distributors. Distributors are very enthusiastic, retailers are enthusiastic, the consumer seems to like the product. So we think it's going to be a very highly successful SKU in the Corona brand family. So we're very optimistic, but I don't think that we can sit here necessarily and predict exactly what share it's going to take of what. As I said, there's no category anyway. It's a brand. So we think it's going to compete extremely well against the competition, let's put it that way. And it may be by the way that the competition – hopefully, the competition does well and Premier does well

Operator

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

Freda Zhuo

This is actually Freda on for Judy. I wanted to follow up on CapEx a little bit and get a sense of what drove the decision-making between expanding incrementally at Obregon versus, maybe, a little bit more Mexicali or building even further within Nava. And then if you look at like the $900 million guide for Obregon, like 5 million hectoliter expansion, it would imply that the cost per hectoliter is maybe a little bit higher versus what we've seen in some of the other CapEx rounds that you've done. So if you could provide detail as to what the drivers to the difference may be for this expansion that would be great.

Robert Sands

I'll let David answer part of the question. But I'd say a couple of things. First of all, with the kind of growth that we are having and that we're now predicting in the short term, it's basically resulted in our deciding that it's prudent, given the lead time – the lead times to put more – to start putting in place more capacity, okay? Why Obregon? We think that geographic diversification in Mexico is also a good idea. These states Baja California, Sonora, Coahuila all have different politics, and we think it's only prudent to make sure that we have capacity in a number of different places in Mexico rather than overly concentrating our capacity in one particular place, even though we don't see any problem or major problem, let me put it that way, in any one of our geographic locations. And then you also have to remember when we're – when you're talking capacity, capacity is not – we tend to talk about it in gross terms, right? 44 million hectoliters, which is, I don't know, about 500 million cases. And when I say that you've got to be careful, it's not just sort of the gross – what we have to have is the capacity to meet our demand in our peak production months. That's how capacity is planned, because it's not even throughout the years. There's certain months leading up into the summer where we have our largest production runs. And therefore, our capacity is determined off of those peak months. So it's just a process of us continuously reviewing where we are against our long, long-term plans, how we're doing in the near future, we – and what we expect in the near future, and what the lead times are in putting in place capacity. And so we make these decisions to stay ahead of the game, because – and it's actually a fairly easy decision. I think I've said this probably in the past in that probably the worst thing that we could do is run out of capacity. So if you start from that premise, given the growth in the business and the fact that the immediate-term prospects remain consistent with that, it makes sense to be putting in place this capacity, given the lead times, so that we don't run out of capacity sometime in the future, which, as I said, a whole bunch of perspectives, financially, customer service, that would be the worst thing that we could possibly do. So it's really not a very hard decision.

David Klein

Yes. And then just on the build-out costs. Just to be clear about what we're doing at Obregon is, we're building a brewery that's literally across the road from our brewery. So it's effectively a Greenfield inclusive of infrastructure, land acquisition costs and so forth. So from that perspective, it's in line with what we've paid elsewhere.

Operator

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

Robert Ottenstein

This, Corona, 6% growth for the family. Wondering if you could unpack that a little bit in terms of how much is Corona Extra, how are cans doing, draft? Any sense, so that we can get a better sense of how that number builds up. And then looking out on the next 12 months, can you give us your expectations or rank between Pacifico, Premier and Familiar, which – how those will rank in terms of adding incremental volume to the company?

David Klein

So in terms of growth within the family, I think about half of the growth rate came from the base Corona Extra, and that includes all packaged formats, Robert. But then the other half of the growth came from the rest of the family but primarily driven by Familiar, the success of Familiar during the year.

Robert Ottenstein

And how was that – how much growth did cans give?

David Klein

I don't have that. We can get that to you, Robert. I don't have that at the – of the off the top of my head.

Robert Ottenstein

Terrific. And I'm hearing great things about Familiar. How would you rank, again, Familiar, Premier and Pacifico, in terms of likely incremental contribution over the next 12 months?

Robert Sands

Well, it's a little hard to do, because it's all a little bit different in that – Premier's sort of a full-blown national rollout. Familiar's more concentrated against the larger Hispanic markets. And Pacifico is really only in the West and has its core business in the – in Southern California but is expanding rapidly. So I think it's good to be some and some. I may not – I guess, I can't tie up at the top of my head exactly what the ranking is going to be other than we expect them all to make a significant contribution to that, roughly, 200 to 300 basis points that we were talking about in NPD. So for the moment and you can talk to Patty or whomever more about this, after we looked at it a little bit more closely, I'd say that they're all making a roughly equivalent contribution to the 200 to 300 basis points.

Robert Ottenstein

Okay. And just to be clear, you're including Pacifico in that number as well?

Robert Sands

Yes. I'm – Pacifico – you know what? Yes, yes. Absolutely, we're – Pacifico's not a new product introduction. Obviously, we're just driving that brand. But interestingly enough, right, Victoria is also growing at high double digits now, right? It isn't one of our focused brands. Meaning, we're not really putting the same effort right now behind Victoria that we are behind Pacifico, because that's really the – one of the smaller brands that we think is first in line to really start driving to be the next major growth brand. But interestingly enough, Victoria's looking particularly strong as well. But Victoria is a little bit more like Familiar, in that it's got its main strength in the really concentrated Hispanic communities with large populations of unacculturated Hispanics, because Victoria is a very large brand in Mexico and very well known in Mexico but is not very well known in the United States and therefore, to the general market and the more acculturated or longer-term Hispanic population. So that's got a lot of promise too, is all I would tell you.

Robert Ottenstein

Great. And on Pacifico, I've noticed, at least in California, that it seems to be priced somewhat less than Corona and Modelo. Is that correct? And do you plan to have, if that is correct, somewhat lower pricing on Pacifico, nationally? Or do you look to line price it?

Robert Sands

So the answer is no. I mean, I don't know exactly what you're seeing. I think in general terms, it's pretty much priced with everything else. So – and there would be no – we would not be interested in a strategy to price it below Corona or Modelo Especial. So...

Robert Ottenstein

Good to hear.

Robert Sands

That's a resounding no.

Robert Ottenstein

Okay. It must've been a retailer's decision and...

Robert Sands

Yes. That can always happen. We always see antidotes – retailers control their own pricing. So if they want to really blow something out, they'll do it. But there's – I think if you even look at pricing and IRI across the Pacifico versus the other families, you're not going to see anything different. And there's – as I said, resoundingly no on The Street that there's no strategy to do that.

Operator

Our next question comes from the line of Bill Chappell of SunTrust.

William Chappell

It's Bill. Two quick questions. One, just any thoughts update on aluminum and tariffs? I understand that you're probably largely hedged, and it's still a small part of your, kind of, input cost. But any kind of initial thoughts of how it could affect you or the industry? And then second, just on a modeling standpoint. On depreciation, I think you said it's up 30% in '19. Is that a straight line across the year? Or are there any things that come on where it, kind of, build as we go through the year?

David Klein

Yes. So on the depreciation point, yes, it will build a bit as we put assets into service. But the total will be – it's that 30%. Not dissimilar to year's number. It'll be that $50-some million additional depreciation for the full year. But it'll build over time. And from an – from a tariff perspective, as you mentioned, we have a strong hedging program, and so we're protected from a price standpoint. But even from a specific imposition of the tariff on aluminum, it's going to have a de minimis effect on Constellation. And you've asked about the industry. I can't really comment on that. But it's not really going to have an effect on us as a result of our hedging program and our source of supply.

Operator

Our last question comes from the line of Mark Swartzberg of Stifel Financial.

Mark Swartzberg

I like that phrase Robs, SKU rat, I haven't heard it, abbreviated that way, and that's my question…

Robert Sands

We really usually like to talk about rats on a conference call.

Mark Swartzberg

That's fair enough. But you took down your outlook for your wine and spirits business at CAGNY, and SKU rat seems to be – the rat seem to be the factor here. Two questions really. Is that the only factor? And then secondly, if you say that you've set the targets back in November of '16, and then you've decided to be more aggressive with SKU rationalization, what changed? Are you seeing just higher rates of decline in those SKUs that you want to – reduced? So that – those 2 questions.

David Klein

Yes. I'll let Rob kind of finish up with the answer. But I'll just start up, Mark, by saying, we're seeing – we saw in calendar year '17, a bit of a slowdown in the overall wine market. We still believe that the wine market is the 4% to 5% grower over time. We just saw a bit of a pullback. But we also are seeing this bifurcation in the market, where it looks a little bit like beer, where you're seeing the higher end of the market, and we – for CAGNY, arbitrarily drew a line at $11 a bottle of retail. We're seeing that part of the market growing at 13% and below that, growing at 1%. And so yes, we're probably being a little more aggressive than we have been in the past to cull our portfolio below $11, so that we have capacity to produce the brands like Meiomi and Kim Crawford and the Prisoner and other brands in our focus portfolio that are growing high margin brands. And so we're making a bit of an ROIC trade-off, that's causing us to have a bit of a drag on the net sales line.

Robert Sands

Yes. I don't have anything really to add other than the bifurcation that David is talking about, is becoming more pronounced in that the growth is moving up the chain from a premiumization point of view, meaning the fastest-growing categories are higher priced now than they even were a couple of years ago. And the lower end of the market is less healthy, even more so than it was a few years ago. Overall, we think the market – in actuality, that's – that the positive trend and it's a positive trend for us in particular because I'd say, we predicted this happening. And we've been generally organizing our portfolio and tweaking our portfolio to keep it moving up the price spectrum from an average price point perspective. So I think we're particularly well positioned at the current time to take advantage of the fact that these higher priced categories are now where the real outsized growth is. And I think a good example of that is a brand like Meiomi, which is a $20 bottle of wine and a very large brand. Much larger than – 5 years ago, there was no brand at $20 a bottle that sold anywhere near or had the growth of what Meiomi has. So these are very positive trends for us going forward. And it's not – I don't think that's what one really should be looking at necessarily, is our overall growth rate, because of precisely this fact. There will be continued SKU rat at the lower end and we will be – and we will continue to focus more and more on the higher price points. And therefore, as sort of looking at our focus brand portfolio, which constitutes the – of the large bulk of our sales and profits is really where you should look, because – and there the growth is extremely healthy. I mean, that could be a business all in it of itself, right? A multi-billion dollar business, with growth in high single digits in consumer products, which – that would make it probably in the top 10 percentile of all consumer products companies in terms of growth in CPG. So that's what I would look at if I were you guys.

Operator

And that was our final question. I will now turn the floor back over to Rob Sands for any additional or closing remarks.

Robert Sands

Well, thank you all very much for the call today, and your great questions. I'd like to reiterate how proud I am of our many achievements in fiscal '18. And our fiscal 2019 guidance reflects the confidence that we have in our business to sustain our top-tier CPG growth profile. And we look forward to speaking with you in late June, when we report our first quarter results. And until then, of course, we'll be celebrating Cinco de Mayo by ringing the closing bell of the New York Stock Exchange and as always, we hope you choose our fine products to enjoy responsibly as part of your spring celebrations. So thanks again, everyone, and have a great day.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect.