

Constellation Brands Inc, Q2 2020, Earnings Call

2019-10-03

Presentation

Operator

Welcome to the Constellation Brands Q2 Fiscal Year '20 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, Joele. Good morning, and welcome to Constellation's second quarter 2020 conference call. I'm here this morning with Bill Newlands, our CEO; and David Klein, our CFO.

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

William Newlands

Thank you, Patty, and good morning, everyone. Welcome to our discussion of Constellation's second quarter sales and earnings results. We delivered an excellent quarter, driven by strong performance of our beer business. And while our wine and spirits portfolio continues to be impacted by transition activities related to the Gallo transaction, I am pleased with the pace of progress and the strategic transformation of this business.

Now that we're at the halfway point in the year, I'd like you to focus on 2 key points as the second half of the year unfolds: number one, Constellation and Gallo are working in full cooperation with the FTC, while they continue to review our wine and spirits deal. We are confident in our ability to close the transaction, which we now expect will occur by fiscal year-end 2020.

For now, we have updated our fiscal 2020 EPS guidance to assume that we've closed at the end of the third quarter, but we will adjust accordingly as we get more clarity on exact timing. Meanwhile, we are fully committed to supporting our entire portfolio throughout the transition.

Number two, during the second quarter, Constellation's beer business remained the #1 market share leader in the high end of the U.S. beer market, representing 25% of high-end growth with Constellation growing share in every summer holiday. This is the 38th consecutive quarter of growth for our beer business, and I remain confident in the prospects for this collection of iconic consumer-loved brands well into the future.

Why are David and I so confident? Several reasons: high-end trade-up is a continuing trend for the entire U.S. total beverage alcohol market. Premiumization is becoming more prevalent in U.S. middle-market states, like Ohio and Michigan, where a significant amount of beer consumption occurs. Legal drinking age, Hispanic population growth is expected to continue at a CAGR of roughly 3%. We have ample distribution runway with traction from key initiatives, like "Shopper First Shelf", which is a compelling opportunity for our retail partners.

We have significant opportunities to increase household penetration with key brands and our beer innovation pipeline is strong and will continue to complement the other growth opportunities we have for the portfolio.

As most of you know, the Modelo and Corona brand families are the powerhouse brands that represent the foundation of our business. So let's drill down and discuss some details of the opportunities we have for specific brands within these brand families.

Let's start with Modelo Especial, which generated the most dollar sales growth in the entire U.S. beer category during the quarter. Modelo Especial continues to be en fuego and recently achieved a significant new milestone, becoming the #1 import beer and the #5 overall beer in the U.S. beer market. Modelo Especial alone contributed almost 30% of the total category growth during the second quarter, with double-digit depletion growth in 44 out of 50 states.

Modelo is growing with non-Hispanic, acculturated Hispanic and multicultural consumers, and there remains significant upside to grow both penetration and buy rate with these consumers.

As a matter of fact, in calendar 2018, we estimate that only 5% to 6% of non-Hispanic, beer-consuming households drank Modelo Especial. For reference, that's roughly half the penetration that Corona Extra has in non-Hispanic beer households.

Because Modelo has great growth momentum and excellent velocity, it should command more shelf space at retail compared to other top beer brands. And then the on-premise, Modelo Especial currently has distribution in just over 50% of the accounts that carry Corona Extra. We've already had excellent success this year with the launches of Modelo Especial 32-ounce bottles, Modelo Chelada Limón y Sal and Modelo Negra 24-ounce cans. Bottom line, we have significant runway for growth with this brand well into the future.

Now moving onto Corona, which is the #1 high-end brand family in the U.S. beer market. This spring, the Corona brand family grew shelf space at retail almost 15%. One of the key drivers of this trend was Corona Premier, which experienced accelerating depletion

growth throughout the summer months, while posting double-digit sales and distribution trends in IRI channels during the quarter. With our increased focus on Corona Premier in the on-premise this summer, it has become the fastest-growing beer in this channel, a key channel to drive consumer trial.

Corona Refresca has quickly become a top 5 share gainer in the high end of the U.S. beer category, with the Refresca variety pack becoming the #3 new item in IRI channels during the second quarter based on dollars sales. Interestingly, Corona Refresca has higher velocity trends than one of its key competitors in this space, the Mike's brand family.

We're very excited to announce that our new seltzer launch planned for next spring, will be the next big innovation for the Corona brand family.

Now admittedly, this has been one of the worst-kept secrets, but as you all know, Corona carries unbelievably strong brand equity as the #1 most-loved brand among both Hispanic and total population drinkers, aged 21 to 54. And that's why we've decided to put the Corona brand name on our new seltzer. And of course, the fresh – the refreshment characteristics of seltzers perfectly matched Corona refreshment DNA.

We believe that seltzers are here to stay and will therefore, accelerate the volume shift into category from the low end to the high end where we are the market share leader.

Corona hard seltzer will be introduced in 4 flavors, including tropical wine, mango, cherry and blackberry lime. The brand will weigh in at 90 calories with a 4.5 ABV with 0 carbs and 0 sugars.

So let's now move onto Corona Extra, which is the #6 beer brand in the U.S. market and boast velocity trends that are 2x the entire category.

There continues to be runway for future Corona Extra growth with the incremental con-

tributions coming from draft and can formats as well as the Coronita product, and we plan to increase our marketing investments throughout the remainder of our fiscal year for this brand.

Last but certainly not least, Pacifico produced double-digit depletion growth this past quarter, driven by the national advertising campaign and retail promotions as we will continue to support the independent spirit of this brand with the Live Life Anchors Up marketing campaign.

As you can see, we have tremendous opportunities to grow the beer business through a combination of enhanced distribution, innovation and executional opportunities across the portfolio for years to come.

Considering these factors, we remain confident in our ability to achieve 7% to 9% net sales and EBIT growth for our beer business in fiscal '20 and beyond.

Moving now to wine and spirits. As I mentioned, we continue to work with the FTC to finalize our wine and spirits transaction with Gallo. Meanwhile, business performance continues to be impacted by transition activities with distributors who have begun to reposition their portfolios for the change in ownership of brands upon the close of the pending transaction.

In addition, we are overlapping a very strong second quarter last year. At that time, we executed select promotional activities for key power brands that we didn't repeat this year as they did not meet the returns and the target returns for the business.

Why, you might ask? The wine and spirits business transformation strategy is evolving under a new set of strategic imperatives that have a higher return target for these types of promotional activities based on a more disciplined revenue modeling tools that we've implemented similar to what we do in beer. While our year-to-date depletion trends for

our power brands are flat, we are confident in our ability to deliver depletion growth for this portfolio of brands in the mid-single-digit range for fiscal '20, and September has reflected that expectation.

We're also pleased with the consumer takeaway trends for the power brands, which grew dollar sales 6% in IRI channels during the quarter, outperforming total U.S. wine growth of 3%. This demonstrates that the brands that will fuel our growth going forward have significant consumer-led momentum, which we believe will continue in the second half, one of the reasons to believe.

As I mentioned, we are experiencing strong consumer takeaway trends for these power brands. In addition, we have an impactful innovation pipeline primed with new products, launching for the key holiday selling season, which begins this month. We're especially excited about our wine in a can launches, which will capitalize on one of the fastest-growing trends in the U.S. wine industry.

We believe that our can format is the most attractive in this segment in terms of both taste and appearance, and we have a successful proof point with Crafters Union, which was our inaugural launch of wine in a can earlier this year. It has since become the #1 growth brand in canned wine and a top-5 share gainer in the super premium price segment.

In addition to launching the #1 Sauvignon Blanc in the U.S., that being Kim Crawford, in a can format, we will also introduce Kim Crawford Rosé cans, that being the fastest-growing SKU in this format. And we will not only plan to launch Woodbridge wine in a can, but in a tetra pack format as well.

In addition to our efforts in cans and tetra, the Robert Mondavi Private Selection Buttery Chardonnay is slotted for release this fall, as well as the Rye Barrel Aged Red Blend, which was recently introduced into the market. As you would expect, we will continue to sup-

port our innovation and brand building efforts throughout the remainder of the year with impactful marketing campaigns to strengthen and build the portfolio.

On the spirits front, SVEDKA Vodka continue to post robust consumer takeaway sales growth, trends of 6% in IRI channels during the quarter, bolstered by our marketing campaign Bring Your Own Spirit.

SVEDKA Rosé continues to outpace our expectations, while the core offerings in the portfolio remained extremely healthy as well.

Our American whiskey, High West, has been growing double digits in IRI for the 3 years that we have owned the brand. Driven by an award-winning taste, brand authenticity and strong distribution gains, we continue to expect High West to remain a solid growth contributor to our portfolio going forward.

During the quarter, we signed an agreement to sell Black Velvet Canadian whiskey to Heaven Hill for \$266 million. This action aligns with our consumer-led premiumization strategy to deliver accelerated growth as we continue to execute the transformation strategy for our business.

Our ventures team was quite active during the quarter as we made 2 new minority investments. The first is Montanya Distillers, a Colorado-based award-winning American craft rum maker. Montanya's rums are currently distributed in more than 40 states and 7 countries overseas and can be purchased online.

The second is Durham Distillery, a craft gin, vodka, liquor and ready-to-drink can cocktail producer, that was recently recognized as the #1 craft gin distillery in the U.S. by USA TODAY.

Additionally, Durham has earned more than 50 national and international awards. Both

these investments are part of our Female Founders initiative, which makes meaningful investments in female-led businesses doing disruptive and innovative work across beverage alcohol.

Overall, we will continue to maintain our focus on premiumization, innovation and brand building as the transformation strategy evolves for our wine and spirit business.

Now a few comments about our investment in Canopy Growth, which continues to be the global leader in total cannabis sales. During the quarter, Canopy Growth and Acreage Holdings received overwhelming shareholder approval for the agreement that grants Canopy the right to acquire Acreage and enter the U.S. cannabis market, once federally permissible.

As you know, this opportunity provides a path for Canopy to have a leading position in the U.S. upon federal cannabis reform.

And speaking of that reform, I was excited to see that the U.S. House of Representatives recently passed the SAFE Act by a wide majority. While this bill also need senate approval, it would deliver access to traditional banking services for thousands of legal cannabis businesses in the U.S. and shows positive momentum in the legalization debate moving forward.

We're also looking forward to the launch of Red 2.0 in Canada, when Canopy will unveil their portfolio of value-added higher-margin products in various form factors, including drinks, edibles and bake.

In the U.S., the Canopy team has been actively developing a range of high-quality CBD products and related marketing plans as well as securing the production resources necessary to bring these products to the U.S. market by the end of their fiscal year.

New CBD product offerings includes skincare and cosmetics, therapeutic creams, beverages, edibles, oils and softgels. Overall, we're pleased with the progress of the Canopy team and what they have done in the last few months.

In closing, I am extremely pleased with the progress of our business at the halfway mark in the year. Our beer business continues to deliver industry-leading results, and our wine and spirits business is successfully executing their transformation strategy. We continue to demonstrate our commitment to returning cash to shareholders with the share repurchases we made during the second quarter, and I am bullish about our prospects across the business for the remainder of this year.

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

David Klein

Thanks, Bill, and good morning, everyone. In Q2, we continue to produce strong beer operating performance, and we delivered superior cash flow results. Our wine business delivered results in line with our expectations as we execute this transition year.

Share repurchases during the quarter reflect confidence in our ability to produce top-tier growth well into the future and our commitment to generate returns for shareholders. We've increased and narrowed our full year comparable basis diluted EPS range to \$9 through \$9.20. This range excludes Canopy equity earnings impact. Our increased guidance now assumes the transaction with Gallo closes at the end of Q3, and the divestiture of Black Velvet Canadian whiskey closes on November 1.

Now let's review Q2 performance and our full year outlook in more detail, where I'll generally focus on comparable basis financial results. Starting with beer. Net sales increased 7% on volume growth of 5%. The reversal of the shipment timing benefit in Q2 was less

than expected. This helped Q2 net sales come in ahead of our mid-single-digit growth guidance, which we provided last quarter.

Depletion growth showed continued strength at more than 6%. When adjusted for 1 less selling day in the quarter, the business generated 7.5% depletion growth, reflecting accelerating trends for some of our key brands during the summer selling season. We expect this acceleration to continue into the second half of the year when we are no longer lapping the Corona Premier and Familiar launches. As a note in Q3, selling days are flat year-over-year.

Beer operating margin increased 50 basis points to a record 41.8%. Benefits from pricing and foreign-currency were partially offset by higher COGS. The higher COGS primarily reflect materials inflation, mostly driven by contractual increases in glass and cartons.

I'm pleased with the success of our first half productivity initiatives. These productivity savings were achieved earlier in the year than originally anticipated and helped us offset other cost inflation headwinds in the business.

Marketing as a percent of net sales increased 20 basis points to 9.1%. Marketing spend came in lower than planned as we revised the cadence and magnitude of marketing spend for the year, which I'll discuss in a minute.

For fiscal '20, we continue to expect net sales and operating income growth of 7% to 9%. This includes a 1 to 2 percentage points of pricing within our Mexican portfolio. We now expect our full year operating margin to be flattish compared to the prior year result of 39.3%, which is an improvement compared to our original guidance of 39%. We continue to expect our gross margin to be flattish for the year as cost inflation headwinds and growth investments are expected to be mostly offset by product pricing and productivity initiatives.

Some of the cost headwinds that we originally projected are not materializing to the levels we anticipated. However, operating margin will be impacted in the back half by the reversal of the remaining shipment timing benefit from fiscal '19 and our implementation of SAP S/4HANA ERP system in Mexico.

In addition, we now expect fiscal '20 marketing as a percent of net sales to be closer to the top of our 9.5% to 10% range. We believe it's prudent to reinvest some of the margin upside from our first half success to support our brands in the second half. Our increased investment will mostly focus on the Corona brand family.

As mentioned earlier, the shipment timing benefit at the end of fiscal '19 partially reversed in Q2. We expect the remaining shipment timing benefit to reverse in Q3.

Over the last 2 years, Q3 has been our lowest-margin quarter, primarily driven by lower seasonal plant throughput and marketing investments. We expect Q3 marketing as a percent of net sales to be greater than 11%. As a result of these factors, we expect Q3 operating margin to be just over 36%.

Moving to wine and spirits. Net sales declined 9% on shipments down 10%. Depletions declined 13%. These trends were largely driven by our lower-end brands and transition activities associated with the transaction.

Wine and spirits operating margin decreased 330 basis points to 22.8%. This decline was primarily driven by higher COGS and marketing investment. Higher COGS primarily reflect great cost headwinds, lower volume throughput and increased transportation costs.

We now expect fiscal '20 wine and spirits net sales to decline 15% to 20%, and operating income to declined approximately 25%. Our revised guidance reflects the transaction close assumptions discussed earlier. As a result of the Q3 closed guidance assumption for the wine and spirits transaction, we now expect our fiscal '20 stranded cost removal to

approximate \$20 million compared to the \$35 million to \$55 million previously disclosed. However, we remain committed to the total stranded cost removal of approximately \$130 million by the end of fiscal '21.

I remain confident that the wine and spirits transformation strategy is working. Power brand performance continues to benefit from our increased focus in marketing investments, which is reflected in the solid consumer takeaway trends for these brands in IRI channels.

In fiscal '20, we continue to target mid-single-digit power brand depletion growth. Longer-term, we expect the business to produce mid-single-digit net sales growth, while migrating to an operating margin of 30%.

As we work through the process to close the transaction with Gallo, the business continues to be impacted by transition activities. Therefore, we expect Q3 wine and spirits net sales and EBIT to decline 15% to 20%.

To finalize this discussion, I have one other point to note. We now believe it's likely that a portion of the wine and spirits transaction purchase price will be in the form of contingent consideration based on future performance of the brands targeted for sale. Accounting rules govern our election to record the contingent's consideration when it's determined to be realizable. Therefore, in the third quarter, we expect to recognize a loss of up to \$300 million on the write-down of the assets held for sale.

Now let's proceed with the rest of the P&L. Fiscal year-to-date corporate expense came in at \$97 million. We expect full year corporate expense to approximate \$215 million, reflecting a second half ramp in IT spends, which includes our SAP S/4HANA implementation.

In Q2, interest expense increased 27%, this reflects interest expense of approximately \$39

million related to the funding for our incremental Canopy Growth investment in November of 2018.

Fiscal '20 interest expense is now expected to be in the range of \$430 million to \$440 million. This reflects incremental interest due to the wine and spirits transaction timing. Our Q2 comparable basis effective tax rate, including Canopy equity earnings, came in at 13.9% versus 18.4% last year. The decrease reflects a lower rate on foreign earnings and higher stock-based compensation benefits.

Our fiscal year-to-date comparable basis tax rate, excluding Canopy equity and earnings, is 16.8%. We continue to forecast our full year fiscal '20 comparable effective tax rate, excluding Canopy equity earnings impact to approximate 17%.

Moving to free cash flow, which we define as net cash provided by operating activities less CapEx. We generated free cash flow of \$1.1 billion for the first half of fiscal '20. This represents an impressive 10% increase. Free cash flow improvement primarily reflects strong operating cash flow and lower CapEx. The lower CapEx is primarily due to timing.

We continue to expect full year CapEx spend of \$800 million to \$900 million. This includes approximately \$600 million of CapEx for our Mexico beer operations expansion, including investments in the Obregon in Mexicali breweries, as well as the fifth glass furnace at the Nava Glass Plant.

We now expect fiscal '20 free cash flow to be in the range of \$1.3 billion to \$1.4 billion, and operating cash flow to be in the range of \$2.1 billion to \$2.3 billion. This increase reflects an additional quarter of EBIT from the wine and spirits brands targeted for sale as well as cash tax benefits.

Shifting to our investment in Canopy Growth. The total pretax net gain recognized since our initial Canopy investment in November of 2017 is \$757 million. In Q2, we recognized

the \$1.2 billion gain on our modified Canopy warrants, partially offset by approximately \$400 million of loss in equity and earnings, which reflects CBI share of additional loss on the modification. This net gain resulted from shareholder approval of the – of Canopy growth's proposed acquisition of Acreage and was more than offset by the decrease in fair value of Canopy investments for the quarter. These impacts were excluded from comparable basis results.

As summarized in the earnings release second quarter fiscal '20 comparable basis diluted EPS, excluding Canopy equity earnings impact, totaled \$2.91 per share. Canopy's business is rapidly evolving and their financial results will likely to be volatile as they continue to focus on their paths to profitability.

I'd like to remind everyone, Canopy equity earnings recognized in our income statement are noncash, and we've not factored Canopy equity earnings into our fiscal '20 comparable basis EPS guidance range of \$9 to \$9.20. This allows us and our investors to focus on the performance of our core business.

In July, we issued \$800 million of senior notes at an attractive fixed-rate and used the proceeds to redeem higher interest rate debt. We're pleased with the progress we are making towards our deleveraging goals, excluding Canopy equity earnings. In fact, we've reduced our net debt level by more than \$650 million since the end of fiscal '19. This allowed us to opportunistically repurchase \$50 million worth of stock during the quarter.

In closing, I'd like to reiterate, we are committed to returning \$4.5 billion to shareholders from fiscal '20 through fiscal '22. The share repurchases we've made during the quarter reflect the confidence we have in our long-term business model. We believe our combination of strong cash flow and future growth prospects creates a best-in-class opportunity within the CPG space.

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

Question and Answer

Operator

— *Operator Instructions* — Our first question comes from Bryan Spillane with Bank of America.

Bryan Spillane

So I guess my question is, given that the pipeline of innovation that you'll have going into next year and kind of the spending levels that you had this year behind the beer businesses to support the innovation and initiatives you had this year, is that 10%-or-so of revenue still a good sort of basis – baseline to use in terms of marketing investments to support the business going forward? Or if innovation is going to step up, will it potentially have to step up more?

William Newlands

Bryan, we're still in the process of finalizing our – all of our spend plans for next year, but we do expect it to be consistent with the range that we've done in this fiscal year, so somewhere in that 9% to 10% range.

Operator

And our next question comes from Kaumil Gajrawala with Crédit Suisse.

Kaumil Gajrawala

Can we talk a little bit about the contribution from some of these innovations over the last couple of years to your depletions at the moment? And then maybe, if you want to give some insight on how you expect it to contribute going forward?

William Newlands

The – certainly, the Premier introduction has been everything we expected. It's appealed to a consumer subsegment, which is those individuals who are looking for a low-carb offering. And as we noted, we continue to see acceleration, particularly in the on-premise during this quarter. So we're very pleased with that. We've seen the addition of the bottle format for Familiar, the smaller bottle format, has been very good for us well.

As David noted, we overlapped all of those early introductions during this quarter, which I think shows that the strength of our overall beer business with our depletion growth on days-adjusted basis of roughly 7.5%, is pretty powerful given the lapping that we had from last year of those 2 introductions. You then add Refresca, which has exceeded our expectations as well. As I noted in my script, the velocity of that is better than one of our key competitors in the FMB space, Mike's. And we expect strong things from that in the future as well. It shows that the strength of the Corona franchise and its refreshment DNA that we are able to extend that brand into other subcategories.

David Klein

Yes. And I would add to that, Kaumil, that in our algorithm, we say that we're going to grow net sales in our beer business, high single digits over the next few years, and 25% of that growth is really made up of innovation. And clearly, that includes Premier and the new Corona seltzer that we're talked about.

The other thing that I just want to point out too as it relates to our overall growth in the business, we called out the lost sell day in Q2, which really drives our depletion growth to that 7.5% range. That has us continuing to grow significant share in the beer business and a big driver of that is the innovation work within the beer business.

Operator

And our next question comes from Kevin Grundy with Jefferies.

Kevin Grundy

Question, Bill, on the spiked seltzer rollout for next year. So a handful questions, all related to that. Based on your internal models, how big do you think the category can become, over, say, the next 3 to 5 years? How are you defining success for the Corona Spiked Seltzer to rollout?

And then how do you think this product is differentiated in what is a fairly undifferentiated product category at this point? The ABV, calories and sugar content, all sounded pretty similar to the existing brands. Of course, taste will be paramount but any comments you have there would be helpful.

William Newlands

Sure. I think that's an evolving answer. And I think everyone has been somewhat surprised by the aggressive growth that we've seen in the seltzer business, particularly over the course of this selling season.

What I would say is this, I think Corona brings a unique refreshment profile to this particular category. We would expect to gain a significant amount of share in the high end as we have with anything else that we introduced amongst our franchises.

Relative to the product, I would look very carefully at what we said. This is 0-carb, 0-sugar product. I don't think you will find that with any of the other products that have been introduced into the market.

And I'd add one more point. We said on our prior quarter discussions that we would not be entering this category unless we felt we could do it with a superior product, with superior margin and profitability structure. I can assure you that this will be a superior product with superior margin and profitability structure versus other competitors in the marketplace.

Operator

And our next question comes from Bill Kirk with MKM Partners.

William Kirk

So just one for me on the transition of the divested wine brands. It seems you're saying the loss cases of that negative growth is the result of distributors, maybe not giving those brands as much attention since they may be leaving their houses. One, is that fair? And two, is there an additional aspect of maybe you're not putting as many trade dollars or putting as much spending into those brands since they're leaving your system?

David Klein

Yes. So Bill, look, we continue to support the brands. But when distributors understand that brand won't be in their house, as you said, it's difficult to get them to continue to drive the brands that way we would like them to.

In general, to switch back to our portfolio, we've called out full year depletions for our power brands of mid-single digits. Year-to-date, we're below that, but we remain confident that we'll get to that number over the course of the year as a result of the more disciplined execution strategy that Bill talked about in his comments.

Operator

And our next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira

So I was just hoping to be able to kind of reconcile. I know there is definitely a difference between the track channel and, obviously, what you deplete. But obviously, when you still look at – so I was just hoping to see if you can reconcile some of the comments on the on-premise and off-premise and granted that you've been making a lot of Os on the on-premise on cans and also on draft. So I was hoping to see if you were saying, obviously, as

the track channels skew more into California, where you are? And then it's always going to trail your numbers. But if you can clarify, I think it will be helpful for investors.

David Klein

Yes. So Andrea, that – thank you for that question because we normally operate with a 200 to 300 basis point disconnect between depletions – our depletions and IRI, meaning our depletions run lower than IRI. When you adjust for the sell day, and remember the market day or the IRI day is just 12-rolling weeks, we're back within that 200 to 300 basis point delta, right? So there's not really a disconnect that's anymore unusual than we normally experience.

So then when you look at individual channels, when we look at on-premise, in aggregate, we continue to grow share in the on-premise being up. We were up in the quarter low single digits. I think the industry was down low single digits or somewhere in that area. So we continue to perform well across all channels for our beer business.

Operator

And our next question comes from Amit Sharma with BMO.

Amit Sharma

Just 2 clarifications. One, Bill, you talked about seltzer having a superior margin to competitors, is it also superior to your beer margins as you think about it?

And then the second for Dave. Dave, so if there's 200 to 300 basis point delta to IRI, is the right metric? I mean IRI trend show a pretty meaningful acceleration in August and September. So what does it say about Q3 depletions? It's certainly going to be, at least, looking back at the data, much stronger than what you did in Q2?

David Klein

Yes. So I think to take the first question, we expect all up – all-in to be over time when

we are fully at scale production in seltzer that we'll deliver kind of a similar margin case to the one that we have for the rest of our beer business.

And we, without really commenting on September depletions, we expect our depletions, as I said in my comments, to continue to accelerate as we go through the year, and we are past the launch of last year of Corona Premier and Corona Familiar.

Operator

And our next question comes from Nik Modi with RBC.

Nik Modi

So I had 2 quick questions. Bill, have guys tested the seltzer concept yet? I mean I know it's – you've guys have been just pretty fast in terms of the turnaround here, but just curious if you have any – things you can share with us on the test market.

And then like the bigger-picture question is on the wine and spirits transactions of Gallo, I mean, is – can this deal be revised? Is there potential to realize more value from some of the brands or may be the FTC is looking out with other buyers? I mean any context around that would be helpful.

William Newlands

Sure. Relative to the question of testing, we obviously have not done a market test. But we, as we always do, when we introduce any new product, we do a battery of consumer testing around it to make sure that we both have the right look, and by that I mean packaging, that we have the right flavor profiles that will perform at or better than the competition.

As I said in my prepared remarks, we think this product is going to be a demonstrable winner in the category or we wouldn't have launched it.

David, do you want to answer the other one?

David Klein

Yes. So Nik, we remain confident that the Gallo transaction will get done. We need to work our way through the process to see kind of the final form that it takes. As I called out in my script and you'll see in the queue, we will recognize, in the third quarter, a \$300 million loss on part of the disposition set, right? And what I mean by that is we have a set of brands, including the Gallo brands that we listed out and the Black Velvet brand that we've also talked about that. We are disposing off as a result of the wine transformation that we are going through, and we are pretty confident that when we are done with all of the work that's required around that portfolio that we are dealing with, that we'll end up with neither a loss nor a gain, we'll end up with about a push in that regard, and then we'll have our business really well-positioned to focus on the high end of the industry and a portfolio that can grow mid-single digits and deliver 30% operating margins.

Operator

Our next question comes from Rob Ottenstein with Evercore.

Robert Ottenstein

And my apologies but some – a few more questions on Corona seltzer. I've tried the product in Atlanta yesterday, it's a great product, very exciting. What are your thoughts on cannibalization, both in terms of your beers and then also in terms of the category, how accretive is it to the beer category? In your view, is it kind of 50-50 cannibalizing beer, 50 wine and spirits? Or are you thinking about it differently?

And then finally, do you – are you set up for automated lines for the variety pack?

William Newlands

Sure. Well, I'm glad you liked it. We'll add you to our consumer panel next time, Robert.

So we like it as well.

Here is what I would say. We expect that this to be heavily accretive to our overall beer franchise. Obviously, the growth that we've all seen in seltzers has had some impact on our franchise and many other beer franchises during the summer months. But if – I will take you back to what we have done most recently, which is Premier and Familiar, both of which had more than 50% accretion to our overall brand portfolio, with Premier being closer to 75%. So we would certainly expect that this is going to be very additive to our overall portfolio for the Corona brand franchise going forward, and a big factor is going to be just what you said, these are delicious tasting products.

Operator

Our next question comes from Lauren Lieberman of Barclays.

Lauren Lieberman

Bill, you went through like a bunch of stuff in all of the major brand franchises and trends. So when I was thinking about the depletion number in total with Modelo growing as strongly as it is, I feel like it's medium size the rest the portfolio in aggregate, it's sort of flattish. I guess is that reasonable? And if so, like what are the pieces we didn't really talk about today? Is Corona Extra – we know – I mean, Corona Light, expect you to be cannibalized by Premier? But what are you seeing from Corona Extra? And as you think about stepping up spending from here outside the seltzer launch, what are the areas in particular that you're targeting on Corona to accelerate performance? What do you think you can do differently?

William Newlands

Sure. We obviously are increasing our support for Corona Extra for the remainder of this fiscal year. And you are correct, year-to-date, Corona Extra itself is roughly flattish. There's some obvious interaction between Modelo, which is, as I noted, on fire and Corona. So

we would expect a little bit of that movement within our own franchise. But overall, the Corona brand family continues to grow and a lot of that growth remains in things like Premier, Refresca with continued strong performance with Corona Extra, given there is a lot of other family members now than there was not so long ago. Pacifico, as I noted on the call, was up double digits in depletions during the quarter, and we continue to be happy with the acceleration in that area. I realize, Robert – going back to Robert for just a second, I apologize, I did not answer your second question about automation. We have an approach that we think is ready to go to create efficiencies within how you pack for a variety pack, which is I'm sure the real answer to your question, or the real question that you have in your mind. So we are set up to do that within our current operation structure.

Operator

Our next question comes from Vivien Azer with Cowen.

Gerald Pascarelli MR

This is Gerald Pascarelli on for Vivien.

William Newlands

Yes. You don't sound like Vivien.

Gerald Pascarelli MR

So Bill, mine is on Corona Refresca. Just based on some of the share again commentary that you offered, can you just provide some color on where you believe you're sourcing share and then maybe some color on specific consumer demographic trends around the brand?

William Newlands

Sure. We are still developing some of those answers, as you can imagine, we're still in the early stage. One of the things that we have noted is that the Hispanic demographic

had been generally less aggressive in their adoption of FMBs. But because of their strong affiliation with the Corona franchise, we have noted a strong uptick with our strong demographic base in the Hispanic community around Refresca. However, we are also seeing, as you can imagine, this product is largely shelved and largely placed in the coal box in a different place and competes much more with the FMB categories rather than competing with our core Corona offering. So we are very pleased that we are broadening our audience and broadening our appeal to new use occasions with Refresca and are very bullish on the future for that sub-brand as well.

Operator

And our next question comes from Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

So a follow-up question on Corona seltzer. I guess can you help us understand why an existing beer brand, albeit one with an incredible equity in Corona, is the right choice for brand in the seltzer category, given it looks like hard seltzer is more of a distinct segment versus traditional beer, and a lot of the companies who have launched brands there have used new brand names instead of the traditional beer brands, so maybe you're zigging when others are zagging but help me understand why that's the right decision in your minds and what your consumer research is telling you?

And then second, any concerns over longer-term brand equity to the traditional Corona beer business from a hard seltzer launch, and how do you guys think through that?

William Newlands

You bet. As you can imagine, we tested that question very, very deeply. The whole essence and the whole DNA of Corona is all around refreshment. I mean when you discuss that across any of the sub-brands, that's the first thing that comes back in the consumer's mind is this, is a refreshing beer, it's a refreshing product no matter in which category it

falls. It falls similarly as a response to Refresca. One of the key elements that the consumers are looking for in seltzer is refreshment. Therefore, the match with that DNA is perfect to go along with Corona's core DNA, and why we felt that if we were going to enter this category, we would do it with a brand that had deep trust with the consumer. As we noted earlier, is the #1 trusted brand with Hispanics and non-Hispanics, 21 to 54. Therefore, we believe this will be a very strong entry in the seltzer space.

Operator

Our next question comes from Bill Chappell with SunTrust.

William Chappell

Just a follow-up on the wine business. Can you just give us a little more color on the distribution changes? How that – it sounds like there's some collateral damage, at least in the near term, to your existing brands from the divestiture? And so trying to understand if – more color on that and then how you then, going forward, reduce the dissynergies? It would seem like you would need to continue to have a fair amount spending behind there – personnel behind there to kind of keep their presence the same?

William Newlands

We have focused our attention on continuing to deliver results against the entire business. There is no question that the transition that is occurring has been distracting to our distributors and to our internal population. With that said, we continue to remain excited by the power brand results of up 6% in IRI during the most recent quarter and SVEDKA falls into the exact same number, 6% growth during the most recent quarter as well. So we remain very bullish that as we get this transaction completed that what will remain will be high-margin, high-growth potential businesses and franchises and brands that are going to be a very strong consumer products play for a long time to come.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Bill Newlands for any further remarks.

William Newlands

Well, thank you, everyone. Appreciate your joining the call. And let me say, as we close out the discussion of our quarterly results, David and I are both pleased with the strong start to the first half of this year, and we remain very bullish on the future performance of our powerful collection of consumer-connected brands. Our next quarterly call is scheduled for early January. Please be sure to have a safe and happy holiday season and remember to enjoy some of our great products during your celebrations with family and friends. Thanks, again, for coming on the call, and have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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