Brown-Forman Corporation, Q3 2018, Earnings Call 2018-03-07

Presentation

Operator

Good morning. My name is Dorothy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Brown-Forman Third Quarter Fiscal 2018 Conference Call. **— *Operator Instructions* —**

I would now like to turn the conference over to Jay Koval, Vice President and Director of Investor Relations. Sir, you may begin your conference.

Jason Koval

Thanks Dorothy, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's Third Quarter 2018 Earnings Call. Joining me today are Paul Varga, our Chairman and Chief Executive Officer; Jane Morreau, Executive Vice President and Chief Financial Officer; and Brian Fitzgerald, Chief Accounting Officer.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict. You should not place undue reliance on any forward-looking statements, and the company undertakes no obligation to update any of these statements whether due to new information, future events or otherwise.

This morning we issued a press release containing our results for the third quarter of fiscal 2018, in addition to posting presentation materials that Jane will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other risk – significant risk factors are described in our Form 10-K, Form 8-K and 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures and the reasons management believes they provide useful information to investors regarding the company's financial conditions and results of operations are contained in the press release.

And with that, I'll turn the call over to Jane for her prepared remarks.

Jane Morreau

Thanks Jay, and thanks for joining us for our third quarter earnings call. During my comments today, I will reference the slides we posted to our website this morning to help you walk through our 2 main areas of focus which include: first, a review of our strong year-to-date results; and second, our revised full year outlook for fiscal 2018. After I complete my prepared remarks, I'll turn the call over to Paul for his comments, and then we'll open it up to Q&A.

Let me start with the overall highlights, which are shown on Slide 3. First, our reported net sales grew 9% during the 9 months ended January 31, 2018 and reported operating income increased 15%. Sales and operating income growth were propelled by strong underlying trends and helped by foreign exchange as well as an uptick in year-over-year distributor inventory.

Second, our underlying net sales growth maintained solid momentum in the third quarter, up 6% resulting in year-to-date growth of 7%. Third, we continued to deliver meaningful operating leverage, with reported operating margins up 170 basis points. This expansion was due to tight management of SG&A as well as favorable timing of costs during the fiscal year.

And finally, we reaffirmed our full year outlook for underlying net sales and operating income growth of 6% to 7% and 8% to 9%, respectively. We also updated our fiscal 2018 earnings per share outlook to $1.43 to $1.48. This revised range reflects the impacts from tax reform and the series of stakeholder actions we announced in January, including the anticipated creation of a charitable foundation and fully funding our pension plan, not to mention our recently effected 5 for 4 stock split and additional foreign exchange tailwind. I'll come back to our outlook in a few moments.

Before I run through some additional details on our year-to-date performance, please turn to Slide 4, which helps you reconcile our third quarter EPS of $0.39. The quarter was negatively impacted by $0.05 due to tax reform. Specifically there are 3 items I'd like to point out, 2 onetime and 1 ongoing.

First, the repatriation tax on foreign earnings hurt our third quarter by $0.19. Second, the remeasurement of deferred taxes helped the quarter by $0.10. And third, the net ongoing tax benefit, including the new U.S. corporate tax rate of 21% helped the quarter by $0.04. Additionally, the 5 for 4 stock split, which occurred on February 28 is also reflected in our EPS. All EPS numbers in our earnings release from this morning incorporate new diluted share count of roughly 484 million shares.

Let's now turn to Slides 5 and 6 and review growth rates for several key metrics. Underlying net sales grew a solid 6% in the third quarter, resulting in 7% growth over the first 9 months. As expected, gross profit grew less than sales growth in the quarter due to higher costs flowing through in the back half of the year. Year-to-date, underlying gross profit grew in line with sales growth of 7%, underlying A&P increased 5% and underlying SG&A was flat. This resulted in 11% year-to-date underlying operating income growth.

As highlighted on Slide 7, reported net sales increased 9% year-to-date, helped by 2 points of foreign exchange tailwind as well as 1 point due to year-over-year change in net distributor inventories.

Slides 8 and 9 break down our very well balanced geographic delivery of net sales growth through the first 9 months of the fiscal year.

To summarize, the United States contributed 2 points of the company's 7% underlying net sales growth. Non-U.S. developed markets contributed another 2 points and the emerging markets and travel retail combined contributed the remaining 3 points.

In the United States, year-to-date reported net sales grew 7% and 5% on an underlying basis. This growth was driven by the strength of our American whiskey portfolio, led by the Jack Daniel's family of brands, Woodford Reserve and Old Forester as well as our premium tequila brands, el Jimador and Herradura. As a testament to the strength of the broader Jack Daniel's family of brands in the United States, blended 3- and 12-month takeaway data for the family, excluding Tennessee Whiskey is growing 9%.

In developed markets outside the United States, third quarter trends maintained their high single-digit growth momentum from the second quarter, resulting in 9% reported and 6% net sales growth for the first 9 months of the year. The majority of our developed markets continue to experience solid consumer takeaway trends. Australia, Germany, the United Kingdom, France and Spain are all performing very well. Japan's results were down slightly due to volume declines for our standard bourbon brand, Early Times.

Our emerging markets business has been a standout performer, with reported net sales up 19% and underlying up 15% year-to-date. Mexico and Poland continued their solid trajectory, with underlying net sales up 10%. Emerging markets outside of these 2 countries jumped 21% on a reported basis and 18% on an underlying basis. This strength in the emerging markets was broad based and even more impressive given the comparisons have been getting sequentially more difficult.

While we expect a lower rate of emerging market growth in the fourth quarter, due largely to some items from last year and a change in route-to-market in Russia this year, we believe the improving health for this geographic cluster of markets bodes well as we look ahead to next fiscal year. And over time, we anticipate that emerging markets will become larger contributors to our top line growth. These markets have massive population bases, rapidly growing middle classes and a thirst for premium Western spirits brand. And with our low current market share, we see a long runway for the future development of our American whiskey brands.

But we also remain bullish on the long-term growth prospects of our business in the developed world outside of the United States. Said another way, our aggregate business and markets outside the U.S., developed and emerging, accounted for over 50% of our total revenue and have grown underlying net sales well into the high single digits during the first 9 months of the year, contributing roughly 2/3 of our total underlying net sales growth to date. We believe this is an impressive rate of growth, particularly when compared to what our competitors and the consumer staples universe had delivered over the same period.

Slide 10 highlights the rebound in our emerging markets trends over the last 2 years, and while comparisons are becoming more difficult as we move into the back half of fiscal 2018, our 2-year stack growth continues to accelerate.

In travel retail, reported net sales jumped 17% and underlying increased 11%. Jack Daniel's Tennessee Whiskey is making solid gains across travel retail and our other brands such as Gentleman Jack and Woodford Reserve are growing quickly as we continue to bring our super-premium American whiskey to new markets through this channel.

Slide 11 breaks out the reported and underlying net sales growth for our brand families and categories, which was broad based and comprehensive across the portfolio.

The Jack Daniel's family of brands experienced strong demand during the first 9 months. Jack Daniel's Tennessee Whiskey enjoyed reported net sales growth of 7% and underlying growth of 5%, helped in part by the steady geographic expansion of the brand in markets around the world. Non-U.S. markets grew underlying net sales high single digits, while growth in the United States was slower given the competitive marketplace, including aggressive pricing and promotion activities by competitors.

The Jack Daniel's family of brands, including Tennessee Honey, Tennessee Fire, Gentleman Jack and RTD grew year-to-date global reported net sales by 10% and underlying net sales 7%. Excluding Tennessee Whiskey, these brands have grown underlying net sales by low double digit. It's worth pointing out that each of these brands has experienced a solid acceleration compared to the same period a year ago, with high single-digit growth for Honey and Gentleman Jack and mid-teens growth from Fire and RTD. While we expect Jack Daniel's Tennessee Rye to initially be a small contributor to our top line growth, the early reaction from trade partners and consumers in the United States has been encouraging.

Our premium and super-premium bourbons, including Woodford Reserve and Old Forester continued to grow reported and underlying net sales well into the double digits, as did Herradura tequila. El Jimador and New Mix RTDs underlying net sales were up high single digits. Finlandia also grew reported net sales by 14%, with underlying growth of 7% helped by volume gains in Russia as we changed our route-to-consumer model there. This growth was offset somewhat by sluggishness in Poland given the competitive environment for premium vodka.

We believe we have a terrific brand portfolio beyond our amazing Jack Daniel's Tennessee

Whiskey. This portfolio is skewed to some of the fastest-growing spirits categories, including bourbon and tequila, and we are pleased to see these brands become more meaningful drivers of our top line performance over the last several years.

Moving now to barrel. Our barrel business maintained this year-over-year momentum through the third quarter. And despite more challenging comparisons against last year's strong fourth quarter, full year barrel sales are expected to come in ahead of fiscal 2017's levels, thanks to the higher volumes of barrels available for sale given the strong volume led growth of our American whiskey portfolio.

Slides 12 and 13 break down our reported gross margins. As expected, underlying gross profit grew at a slightly lower rate than net sales in the third quarter driven by higher content cost. Year-to-date, reported gross margins were up roughly 20 basis points and down slightly on an underlying basis.

Slide 14 summarizes our operating performance for the 3- and 9-month period. Our underlying A&P increased 5% year-to-date, with these investments focused on driving sustained momentum across the portfolio. Year-to-date, underlying SG&A was flat as we remain focused on cap-assuring efficiencies across the organization, while reallocating resources to consumer-facing activities, such as the recent launch of our new distribution company in Spain and the opening of our Slane distillery in homeplace in Ireland. In total, we delivered 15% reported operating income growth and 11% underlying growth through the first 9 months of fiscal 2018.

Year-to-date, reported earnings per share increased 17% to $1.25. EPS growth was driven primarily by the combination of strong top line gains, operating leverage and foreign exchange tailwinds. These gains were offset somewhat by the $0.05 net negative impact in the third quarter related to tax reform. Excluding tax reform-related items, EPS grew over 20%.

Let me now move on to my second and final topic for the call. A summary of our revised full year outlook for fiscal 2018 highlighted on Slide 15. The initiatives that our teams have implemented around the world have helped us accelerate our top line growth back to historic rates. We estimate that our normalized net sales growth is roughly 6% and believe that in the fourth quarter, we'll grow at a similar rate to our full year underlying outlook.

We expect gross margins for the full year to be flat on a reported basis. Cost began to negatively impact underlying margins during the third quarter and this should continue into the fourth quarter, due in part to timing, but also due to some higher cost in wood, agave and freight, not to mention the continued absorption of the roughly $215 million of incremental expense from fiscal 2013 that was above our normal levels of capital investment to expand capacity to meet our anticipated future demand.

We have plans in place to further increase the investment behind our brands during the fourth quarter, which should result in the full year increase in underlying A&P, roughly in line with our full year outlook for underlying growth in net sales.

Full year underlying SG&A will likely be up a couple of points as we are currently anticipating a meaningful pickup in SG&A during the fourth quarter, due in part to compensation-related items, including a special onetime bonus for employees in light of our strong top line performance, the health of our business and the recent tax reform.

In aggregate, underlying operating income will be roughly flat compared to the fourth quarter of last year. This should bring our full year underlying operating income growth into the range of 8% to 9% and in line with our full year prior outlook.

Before I move on to our revised outlook for EPS, let me walk you through a few slides on tax reform and its impact. You can see from Slide 16 that our ongoing annualized cash taxes are expected to drop by $65 million to $75 million. Because we have an April 30 year-end, we expect to capture 1/3 of this cash benefit of roughly $25 million in fiscal 2018 and the remaining $40 million to $50 million in fiscal 2019. We anticipate that our effective tax rate will be in the 21% to 23% range beginning in fiscal 2019.

As an aside, we are carefully evaluating additional opportunities to invest in the long-term growth of our business as we work through our planning process for fiscal 2019. You will notice that our forecasted tax rate for fiscal 2018 is relatively unchanged to 28%.

There are a lot of moving pieces under this number as highlighted on Slide 17. First, is the net ongoing benefit of tax reform, which includes 4 months of lower 21% tax rate. But it also includes the 2 onetime items I discussed earlier related to repatriation tax and the remeasurement of our net U.S. deferred taxes. These 2 items aggregate to a negative $0.09 EPS impact, which pulls the effective tax rate back up in fiscal 2018. We anticipate the full ongoing benefit to our effective tax rate will come through in fiscal 2019.

Slide 18 puts it all together, helping to reconcile from our prior fiscal '18 guidance on December 6 to our new outlook. First, we start by adjusting for the 5 for 4 stock split. Our underlying operating income outlook for 8% to 9% growth is unchanged from what we shared with you on our second quarter call. Foreign exchange has improved by $0.03 for the full year, half of which was realized in the third quarter. And while on this topic as a sensitivity, EPS over the balance of the year would be impacted by roughly $0.02 if our foreign exchange rates move 10% in either direction.

Next we adjusted our outlook for the $0.03 full year impact from tax reform. This is comprised of the $0.05 hit in our third quarter offset by $0.02 of expected ongoing benefits during the fourth quarter. And finally, you will see an adjustment for this establishment of the previously announced $60 million to $70 million charitable foundation, which will appear in our reported results in Q4 in SG&A.

Tax reform created a short window of opportunity for the company to tax-efficiently fund the pension and charitable giving programs that we would have otherwise been funded in future years. While we estimate that establishing this foundation will result in a onetime $0.10 negative impact during our fourth quarter, we expect that this charitable foundation will help reduce the ongoing P&L expenses associated with our philanthropic endeavors in the communities where our employees live and work, such as our corporate headquarters in Louisville, Kentucky.

Taken all together, we now expect fiscal '18 earnings per share of $1.43 to $1.48. Adjusted EPS, excluding the $0.03 related to tax reform and the $0.10 from the foundation establishment would be roughly $1.56 to $1.61 equating to mid-teens year-over-year growth.

In summary, we are quite pleased with our year-to-date performance, delivering strong top line growth and high quality bottom line results. Our teams have embraced our strategic initiative and clearly their hard work is bearing fruit as we have accelerated back toward our historic rate of growth. And we are focused on maintaining this momentum into fiscal 2019. More details to come in June on this topic as we are currently in the midst of our planning cycle for next year.

Equally important, our key financial metrics remain significantly ahead of our competitive set, with industry-leading operating margins well over 30% and returns on invested capital over 20%. The efficiency of our business model allows us to translate this growth into strong free cash flow, which has enabled us to return capital back to our shareholders through our growing dividend stream, share buybacks and special dividends such as the recently announced $1 per share special dividend to be paid in late April of this year.

So with that, let me turn the call over to Paul for his comments.

Paul Varga

Thank you, Jane, and good morning, everyone. With 3 quarters behind us, I believe we remain on track to deliver great full year fiscal year '18 results. With the baseline operating margins and return on invested capital that Brown-Forman enjoys, we can drive exceptional shareholder value if we do 2 things very well. One, grow our top line sales in a healthy and sustainable manner; and two, deploy capital effectively over time. And the evidence of both of these are present in today's earning announcement, so let me briefly highlight them.

A year ago at this time, the company's growth in underlying sales had trailed down to around 3%, which is not a bad top line growth rate at all, but it was below our historical norm. Heading into this fiscal year, we had aimed to essentially double that rate of growth, and I'm pleased that our fiscal year-to-date results reflect an underlying sales growth rate of 7%, aided by an improving environment, but also attributable to effective resource reallocation on our part. I'm very pleased with this progress, particularly the healthy balance of portfolio and geographic growth. I want to thank my colleagues across Brown-Forman for their efforts in producing it.

And on the capital deployment front, Brown-Forman continues to demonstrate, in my view, an excellent balance of reinvesting in our business, returning capital to shareholders and retaining capital flexibility for the future. More specific examples of this capital deployment balance include: our strong capital investment over the last several years behind product expansion, homeplace marketing and hospitality as well as fully funding our pension obligation and establishing a philanthropic foundation.

Another example is the quality of our dividend program, highlighted by 34 consecutive years of dividend increases and supplemented by the occasional special dividend like the one we just announced in January. We also periodically demonstrate this balance when we acquire attractive brands as we did with Casa Herradura tequila more than a decade ago, and more recently, with the purchase of GlenDronach, BenRiach and Glenglassaugh luxury single malt brands. Further evidence is provided by our track record of repurchasing our shares for the benefit of all shareholders by buying back the shares at prices that we deemed at the time to be attractive and to date have proven to be so. Testament to our capital flexibility is our strong continued borrowing capacity and the willing support we observed from lenders when we choose to take on debt.

And finally, I'll point to the metric that measures the effectiveness of our capital deployment over time and as our return on invested capital, which was an excellent 21% over the last 12 months and generally representative of our longer-term trend on this important metric. Taken together, I believe this combination of investment, growth, profit efficiency, capital efficiency, shareholder-friendly capital distributions and conservative balance sheet management are a superb recipe for creating excellent, risk-adjusted rewards for shareholders.

I'm often asked, can we keep it going? And my answer is yes, I believe we can. My logic goes something like this. Globally distilled spirits is growing. Within our industry, whiskey is growing faster than distilled spirit. Within the whiskey category, American whiskeys and bourbons are growing more rapidly than whiskey as a whole. And within American whiskeys and bourbon, the premium price segments are growing the fastest. So against the vast backdrop of global distilled spirits, which is a steadily growing industry in itself, one of the most advantageous positions to occupy today is the leadership of premium American whiskey, and we are fortunate to be the company that occupies that position. And we do so unencumbered by the detrimental effects of a longtail or a big position in a declining category or segment, thereby giving the company and its shareholders a direct and disproportionate exposure to the American whiskey opportunity worldwide. Importantly, and making me most bullish about Brown-Forman's ability to benefit from this opportunity is one that our company will be pursuing it, with an excellent portfolio of trademarks led by Jack Daniel, Woodford Reserve and Old Forester, which I believe is the strongest hand in the category. And two, that we have a track record of thoughtful innovation in the category, and I expect innovation to remain an important driver of the category and our company's ongoing success.

That concludes our prepared remarks this morning. And we're now happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Lauren Lieberman with Barclays.

Lauren Lieberman

I was hoping you could talk a little bit first about Russia, mentioning the route-to-consumer change. I think there was also something in the 10-Q about last quarter, but last quarter was called out as being a benefit to pricing and then I think this quarter, there was some pull-forward of volume ahead of that change. So just detail on what the change is and how we should think about just if there was some timing issue benefiting Russia in the quarter and if you are expecting that slows down as we go forward?

Jane Morreau

Yes. Sure, I can take that. We did have a route-to-consumer change last year's fourth quarter, where we changed our importation to us partly and then has continued to do with our other player as well. What we're talking about this quarter is that we're actually changing who actually distributes our product in Russia and there was a buy-in as normally happens when you change out distributors. We're going to this new distributor because we believe they've got very strong on-premise reach, if you will, and can help build our brands even more. So there were some onetime in the quarter and there were some onetime in last year's fourth quarter and that's what we were referring to as one of the reasons why emerging market growth is still going to be strong, but perhaps not as strong as what you've seen year-to-date. Now with that being said, as I look ahead to next year, I think that the emerging markets have stabilized and are growing nicely, and I'm very optimistic about the growth overall as we look at even for the market Russia with all the noise that's in it.

Paul Varga

Yes. Our Q4 numbers, we would expect to have very tough comps for Russia overall, so when we report in the summer related to Russia, you'll see that, that changed from highlighted because of the difficult comps we've got in Q4.

Lauren Lieberman

Okay. And then also on Mexico, which was notably strong again this quarter, a lot of other consumer product companies have talked about the environment in Mexico getting a bit tougher from a macro standpoint. And I was just curious about premium spirits right, so not just the growth for your brands, but is the sort of premium end of the market feeling okay? Do you feel like is it – this is going to be kind of high end versus everyday CPG products? Then were there some difference in terms of what's the impact in a consumer environment?

Paul Varga

I think the thing for us down there is that the whiskey category continues from – relatively, it's still small by comparison to the size of the distilled spirits market down there. But has been – over the many years, it's been growing well. And then I think one callout I'd give for our particular portfolio down there has been the continued performance of our Herradura ultra brand, which is at the high end of the local tequila market and knows that particular small subsegment, I might call it, Crystal — ***indiscernible*** — are continuing to do very well and Herradura Ultra has had a – I mean, a very strong and now multi-year strong performance. So that's one item that would be influencing us relative to the broader macro step that you cite.

Lauren Lieberman

Okay, great. And then if I could – I mean, I just was curious a little about Old Forester and just a little a longer-term question. If you could just kind of talk a little bit about some of the efforts behind Old Forester, thinking of bringing that brand – premiumizing the image a bit perhaps in advance of the homeplace opening this spring and just kind of give us an update on kind of what you've done proactively maybe over the last 12-plus months to generate the kind of performance you're seeing now and heading into that homeplace opening?

Paul Varga

Sure. I mean it's a blend of activities now over several years that includes a lot of the tried and true stuff, everything from portfolio management to homeplace marketing investment as you just cited. Repackaging is another element of it. And then also managing price volume I think effectively. But I mean, the combination of them have not only increased the consumers' acceptance of the Old Forester trademark, but also improved our profitability considerably. The examples I cite are that – if you went back 10 years ago, we would not have had as expansive a portfolio on Old Forester in terms of the super-premium expression. We would have just been beginning to sell birthday bourbon around that time and then more recently distillery [RO] series, which is doing exceptionally well at higher price points. I mean, the brand continues to also have, it's really amazing, a bit of a retro appeal. While it's new in terms of basic awareness to many people, the fact that it's been around for so long and once was larger and then, of course, became quite a bit smaller, than its peak years ago. We were experiencing I think some benefit from retro appeal. And you see this across a few categories. I've seen some of it in beer as well and so all of these are contributing to this recent resurgence in Old Forester. And I think it's still, I mean, on the scale of what's possible for particularly in the United States, but also outside the United States and we still have quite a bit of geographic expansion to do. It's been doing well and it's in major metro market and some of that bourbon heartland. But as the American whiskey category and bourbon continues to surge across the United States, I think Old Forester should be able to ride that momentum quite effectively.

Operator

Your next question comes from the line of Brett Cooper with Consumer Edge.

Brett Cooper

In the release and in the prepared comments, you had talked about the benefit of tax and carefully evaluating additional opportunities to invest in long-term growth. And while I appreciate we're not going to get fiscal '19 spending plans now, look, I was just hoping you talk maybe a little more generally about where you see the best opportunities for incremental investment.

Jane Morreau

Brett, I mean…

Paul Varga

Jane, why don't you start that?

Jane Morreau

Yes, what I would say is we're in the midst of our fiscal '19 planning process. And so we will share all this with you in June. I do say that we just finished a pretty thorough look at our – just our opportunities behind American whiskey. And so if I were to say where there's more opportunities – potential opportunities to invest, I would say in some of our super-premium plus American whiskey. Further, we've got new brands in our portfolio within the last 2 years, the acquisitions of the scotches and then, of course, our Slane Irish whiskey that just launched this – about a year ago at this time. And so both of those portfolios, I guess scotch and Irish, they have opportunities I think to have further investments behind them. We'll definitely share more with you in June.

Paul Varga

Yes, I think one perspective I've got on the timing of our evaluation of this and the arrival of the tax reform is that, in part, it was intended to spur investment, right? And at our company, of course, if you go back 4 or 5 years ago, we started to really ramp up our investment behind capacity expansion and homeplace marketing, some of the things I mentioned in my prepared remarks. And so we sort of preceded tax reform, and it's interesting, I mean, the timing actually may come to be kind of nice for us because the benefits we'll be seeing down at the net income line can help to offset some of the costs that are associated with those expansions as they make their way – depreciate their way into our costs. So that's another reference point for us as we evaluate how to invest and how to think about what to do with tax reform. So we're putting it all in the mix, and we've got another couple of months here to figure that out. But it – I couldn't agree more with Jane, I mean, the premium aspects of our portfolio, the single malts, the Irish whiskey, the tequilas, they're also very much coming into focus for us to these premium plus American whiskey opportunities around the world.

Brett Cooper

And if I can just follow up on a different topic, the – I mean, you guys made the – I think Jane made the comment about promotional intensity in the U.S., and I was just wondering kind of what you guys are seeing? Do you think we're sort of at a trough of that? Or are we going to continue to see relatively high levels of promotion and price aggressiveness in this home U.S. market?

Paul Varga

That's a hard thing to forecast. I think some of it is associated simply with competitive intensity right now. I mean, it's such an attractive market, the United States. And it has a growing distilled spirits industry, which is taking share within beverage alcohol overall. And then you just have such a large influx of new competitors over these last few years. It's just mathematically more difficult when there's that many alternatives to be able to push price. I do think that an offset to that is – very timely is the appeal of the premium plus segments where one of the ways you can effectively get pricing is to have your portfolio at those higher price points grow more rapidly, bringing in very valuable benefits of mix. And so I think that, that has come into focus I think more for us over the last couple of years. But I do think just because of the large number of competitors in this particular country, you will continue to see it be less robust than it had been previously. There are still opportunities market-by-market and channel-by-channel and size-by-size to look for – opportunities to grow. And of course, some of it could be reflective of if things such as the U.S. economy continues to grow and show momentum, if inflation comes in and you start seeing input costs go up, and I think those could be things that compel higher pricing. But right now I think we were pleased with the fact that a lot of our growth has been – has really come from more volume related in this particular competitive time. And so I don't see that easing here in the next – it's certainly not one of our planning assumptions for FY '19.

Jane Morreau

One thing I would add onto what Paul said is, one category that may have an opportunity for pricing is tequilas, simply because of the supply-demand dynamics. We talked a little bit about this in our second quarter. In terms of agave prices being at all-time high, we've heard several of our competitors indicate that they're going to take pricing. And so I do believe because of that dynamic, there could possibly be an opportunity to take some pricing in that category.

Paul Varga

It is. And we don't manage the local market on this basis, but certainly the stuff that's happened over the last year in terms of favorable FX environment is net beneficial to our reported net sales.

Operator

Your next question comes from the line of Vivien Azer with Cowen.

Vivien Azer

So I wanted to stick with the pricing topic, but pivot to the EU, all this tariff talk continues to mount, it seems like the White House is saying this morning they're going to announce by the end of the week and while I know there's a lot of uncertainty around the potential response from the EU, can you just offer some color on how you think about your price elasticities in developed Europe, just so we can have a framework in the back of our minds?

Paul Varga

Yes, I mean, I don't know that – I mean, over in Europe I mean, the thing that, of course, influenced our pricing posture more than anything over the last decade has been the shift of our business, driven by Jack Daniel's in a conscious and very favorable way for Brown-Forman, which at the beginning of that period years ago, it would have been had a different mix of on-premise and off-premise. And as we move to much more prominent off-premise brands and thereby making the brand more affordable to broader number of consumers, you also expose yourself then to, I mean, the realities of very large customers and we have lots of options for promoting brands. And so it's just we found over the years this is navigating that kind of pricing environment to be – certainly, I think we've done pretty well, but just more challenging than advancing your price, for example, on the on-premise. So that has been the largest influence. And I think you have to look market-by-market. I mean, we have found it equally difficult in Europe as well to just, I'd say, with consistently raised prices year-on-year. So I think we have to be thoughtful about that going all the way back to really like 2013 and '14, when we were – probably felt the environment was more conducive to raising prices in Europe. So it kind of, again, like in the United States, it's state-by-state, it's country-by-country over there. I mean more generally on this topic, I mean, it's obviously developing as we sit here and speak, and we're going to monitor the potential for retaliatory tariffs closely as you will. And of course, we are sharing our point of view in Washington as well. And just some background for people, I mean, as most of you know, the overwhelming majority of our products are made here in America. And over the last few years, as I just cited, we've been investing heavily in our American manufacturing expansion. And then of course, when we complete the production, we sell our American whiskey brands in something like 165 countries worldwide. I mean, if all of this were to come to fruition, the irony I feel is that a company like Brown-Forman could be an unfortunate and unintended victim of the policy which in part is aimed at promoting something, which Brown-Forman is a stellar example of, committed long-term American manufacturing company. I mean, this point is being made by us and we certainly hope it will be compelling enough to influence us and may be alternative courses of action. But right now, we're monitoring and observing it closely like you all are, and we'll see how things go. Just another perspective on it, that I think is important because it's occupied so much of the media's time the last week or so, just don't miss the point that out there is the improving global economy. Which is also not getting as much of a headline today of the favorable FX environment for Brown-Forman over the last year or so. And then of course, these comments that we've been citing in the morning about the attractiveness of the category, which we are concentrated in. So all of these things I hope also come into focus, while people digest the possibilities of these retaliatory tariffs. And just also know we – it's not new to Brown-Forman to periodically have things in the macro environment arise that we have to deal with. A few years ago, when the U.S. and

Russia were having some spats back and forth, I remember our Jack Daniel's Tennessee Honey brand got caught up for a short period of time in Russia over that topic, and so we are fairly well skilled at knowing how to deal with this stuff, but net if this were to come to fruition, it would, obviously, be kind of a negative thing for our particular company.

Operator

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

Freda Zhuo

This is actually Freda Zhuo on for Judy. So I wanted to get more clarity on what we were seeing in terms of the latest, in terms of the U.S. spirits category. I understood on the increasing divergence between Nielsen and NABCA may be what people are actually seeing on the ground, but it also sounds like some of your peers have mentioned that they have seen a fundamental slowdown. So I'd love to hear your take in terms of whether or not that squares with what you're seeing currently is a slowdown? If any, is that mostly on price? Or is there a volume component? And any other color in terms of drivers.

Paul Varga

Okay, yes, I mean, I continue on a blended view between the sources we have, feel the category of TDS continues to grow at something in the 3.5% to 4% range. Maybe modestly off versus the higher part of that range towards the lower part of that range over the last 12 months. It's really hard to know because these sources aren't that accurate in capturing everything. But my view – and of that, we would certainly be observing that over – particularly over the last couple of years, it's becoming more volume driven than pure price driven, although it continues to benefit from mix as the premium categories continue to outpace the lower price categories. I mean, for our company, I mean, of course, we focus first and foremost on the Jack Daniel's brand, and we continue to think over the last 12 months, it's holding up reasonably well. My estimate of what it grew over the last 12 months was around 2%, something in that range, down a little bit from where it would have been 12 months ago, but continuing to perform well relative to the other larger, very large distilled spirits brands, with which it also compete. I think there's some – the pricing and competitive pricing can be a contributing factor and that's been I think observed by many people. I think another thing that could be influencing the Jack Daniel's Black Label trends here in the last 12 months is actually something potentially of our own doing, but it was also kind of positive, which is a year ago we were experiencing lower growth rates on Jack Daniel's Tennessee Fire, Jack Daniel's Tennessee Honey and Gentleman Jack, and they have accelerated and then of course, we've introduced Jack Daniel's Tennessee Rye this fall. And if you just look at the numbers for that collection of non-Jack Daniel's Black Label expressions from the Jack Daniel's family, that growth rate in the last 12 months has essentially tripled up toward a very – it's now high single digit. And that has enabled the family to remain quite sort of steady in the 3.5% to 4% growth rate. So I think you would expect if you have all 4 of those expressions growing nicely at the same time, you increase some of the potential for intra-family switching and a little bit of cannibalization. And I think that could be a bit of a contributing factor to the more recent Jack Daniel's Tennessee Whiskey trends in the U.S. So those are a few of the views we've got. I mean, as I've said, these – there are things to take away, it does remain very competitive. I'm very pleased that our company when you add in, not only what's happening within the Jack Daniel's family, but also beyond that with Old Forester and Woodford Reserve and Herradura, et cetera, that we are one of the few large suppliers who are continuing to gain share in the U.S. market. So all told, we feel pretty good about where we are.

Freda Zhuo

Okay, great. And then I also wanted to clarify a little bit in terms of the foundation contribution impact, so it sounds like $60 million, $70 million 4Q, but that it would also be a positive to profit growth for next year, like on easier comps and maybe lower ongoing contribution versus maybe what you had before. Could you help us give some context as to what that phasing could look like just in terms of the difference in the contributions now versus what you had been doing before?

Jane Morreau

Certainly, I'll take that. So just to remind you why we did this, really had this opportunity to tax-efficiently prefund a portion of something we believe in and we believe in strongly, which is charitable giving in the communities where our employees work and live. And so you're right we're going to see a onetime hit, it's going to hit SG&A. We pull-forward it. We pulled out for underlining for around $60 million to $70 million. The way you should think about it as it goes forward. So this is only a portion of what we give annually. So think about our return on assets, our investments of about 5%. If you use something in that ballpark, you could assume that about half of our annual charitable giving would not be therefore within our P&L going forward. So we delinked it to the performance of our business. Does that help?

Operator

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

Mark Swartzberg

Two questions. One is an upside, if you will, question. The other one might be called a risk question, also pertaining to the U.S. And I do want to say those prepared remarks were extremely helpful and the results speak for themselves. But we do need to look at risks. On the upside side of things, you seem to be managing this A&P very well and I appreciate that it will go up in the fourth quarter, but how much opportunity do you see for added marketing efficiency there? And then on the SG&A side, it makes a ton of sense to share the wealth, great year and I understand the discretionary bonuses, but as you think about going forward, the constraint you're seeing there and demonstrating there in SG&A, how much opportunity do you see for that to continue, Jane? And then I can, if I kick the U.S. question over to you, Paul.

Jane Morreau

Yes. So I would say it goes back to our initiatives that we announced earlier. Back in June, we announced a $100 million initiative. That wasn't just for the SG&A line item. It was for every line item of the P&L, every cost line item of the P&L. And you're right, if you look at this year combined with last year, we have had held our SG&As quite nicely in terms of year-over-year growth. We believe there is still opportunity. We continue to manage it the way we've been looking at it. We've made significant investments in our SG&A and route-to-consumers. We were able to actually do that this year, with funding Spain and really not having a significant increase in SG&A other than the decisions we've recently made that are going to cause the SG&A to go up. And so we continue to believe there is additional opportunity around discretionary spending, continued opportunities to leverage investments we've made in the past, and so I don't anticipate SG&A to increase to high single digits or something like that in the future. Do I think that there might be possibilities to increase behind new opportunities? Certainly, that we haven't identified yet and that will come through our planning process.

Paul Varga

One of the things I thought about, just if you take – to go back multiyear here and think about it, we always are sensitive. We never internally or even with our external communications want to imply that in the mix of operating investments, A&P is always preferred over SG&A, or that A&P is good and SG&A is bad, it's easy for people to take that away in an environment where so many companies are doing zero-based budgeting, I think. The circumstances at Brown-Forman were such that after we had been doing such work on portfolio reshaping and we brought in these brands that – or started these brands that were reasonably small and needed, we felt in the instances of brands that were more premium, say, near the Jack Daniel's price point, they kind of needed A&P, I mean, to launch Jack Daniel's Rye or to go give support to Jack Daniel's Tennessee Fire and Tennessee Honey brands like that, which have become prominent in our result, they needed some A&P. Some of these other brands will actually require people and not that they would also need A&P. So it will be the different blend of A&P and SG&A and I think what you've seen from us, if you just went back like the last couple fiscal years particularly, that will probably carry into next fiscal year as well, thus reallocating resources from SG&A toward A&P in order to reflect the portfolio reshaping we had done and what the needs of the business were at that time. I'm not 100% sure where we'll land on that as we go F '19, FY '20, et cetera, because, I mean, some of the markets where we may go, they may not be conducive to A&P investing. For example, they may have laws where you can't advertise things like that. And we have found that investing in people in particularly, some of these emerging markets, has been at the start particularly a very smart investment to get us off the ground and then later come in and phase more as you start to scale up the need for awareness with A&P and in that, I wish I could give you all the examples market by market because it does vary. But one of the great case studies we've got across time is down in Brazil where we've tried to expand within the country, and we pick off particular cities versus trying to tackle the whole country and the blend over time of resource allocation within the operating investment has shifted because you absolutely need both of them and then as you can imagine, those are the types of conversations that we're regularly having, and we'll conclude on all that here in the next 8 to 10 weeks on what it looks like for F '19, but I think Jane and I continue to believe that F '19 will continue to have A&P outpacing SG&A as a general theme.

Mark Swartzberg

Really helpful. If I could ask one A&P question, which is simply – a lot of companies draw the distinction between working and nonworking dollars, maybe that's not the way you all think about it. But when you think about marketing efficiency, do you see a lot of opportunity for gains there to mitigate the pace of increase?

Paul Varga

Yes, a little. I think one of the things we cited a year ago was trying to favor even within our A&P our dollars more toward consumer-facing or marketplace-facing and looking for ways to, if you could, if you're going to reallocate even say within the marketing budget, maybe spend a little bit less on the research and making the ads and spending a little bit more on actually – the spending behind them. So I do think those are things that we remain sensitive to. I think there's always opportunity. When you get to be a company the size of Brown-Forman, there's always opportunities in both A&P and SG&A to just strive to be more efficient, and I think that is the general callout. When a year ago we started to emphasize that $100 million, it was not to say that there are no opportunities to continue to invest in route to market or reinvest behind our people, but the business needs and the competitiveness that we were experiencing a year ago. We really felt like if we needed to pause a little, just temporarily on things like training, for a year, while we went and really spent against the consumer, it was a worthwhile trade-off. And I think some of that is actually in the lift that we've seen this year.

Mark Swartzberg

Really helpful. And on the U.S., can you speak, Paul, to what you think is a sustainable rate of revenue growth for your business here? And that's in the context of, and I know it's only a quarter, you had a 3 on 3, and of course, you had some inventory build in the second quarter. So it seems like your business really has consistently trended in the 4s and 5s. But you think about some of the things that have come up in this call and it seems like it might be more reasonable to start thinking about 3s and 4s. With this component of your business, obviously, your global opportunities are huge, so could you just speak to what you think sustainable growth here is in the U.S?

Paul Varga

You said it really well. I mean, we expect the international piece to outpace and lift the overall company. But I would – I mean, my view and I'll put one asterisk against this is that I would start with the base assumption that we would grow at the distilled spirits level. We certainly start with that assumption. And that has the balance of American whiskey category that's growing faster, but of course, us having one of the leading brands in all of distilled spirits, Jack Daniel's, which is more than 150-years old, but we continue with that ambitions to grow it. The thing that could alter the view I think just a little bit is depends on our innovation. If you go back and look the influence of innovation in the trends over many years could be one of the determining factors as to whether we perform sort of at or slightly above it. And during those – I remember during those years where Tennessee Honey came in or Tennessee Fire or if Woodford has an offshoot and all of our plan – remember the one thing about when you're led by American whiskey, we make the volume well in advance. So I mean, our assumptions have to be pretty good. And so we look at the marketplace and base our production plans on what we think we – is reasonable, but also we try to be a little bit on the ambitious side because we want to be more net winners than losers in this game. But I think your assumptions related to where the general industry growth rate is, the good one, with the only caveat that the way we flex in innovation could be a net benefit.

Jane Morreau

I'll just add on to Paul's and I agree 100%. The other thing that I think is very optimistic about our businesses is where our growth is coming from and it is at the higher end. And so from that, these are getting to be meaningful numbers now from Woodford Reserves, from the Herraduras and they have – are growing faster than TDS. And so they effectively can have, as we talked about several times in prior calls, an effective mix increase so can take your amount above your typical 4%, what value, if you will, depending on how fast they are growing and the meaningfulness of these brands as they get bigger and bigger and they are doing that.

Paul Varga

Yes, I mean, over the years, our portfolio reshaping has enabled us to get that kind of benefit, but if you are – like they were most notably cited a few years back, the sales of Southern Comfort, which is really dragging the overall growth rate down. And then with that, out of the portfolio and then, the available attention and investments we put behind the brands that Jane was citing there, you really do get some nice portfolio lift.

Operator

Your final question comes from the line of Robert Ottenstein with Evercore.

Robert Ottenstein

Great. A couple of things that we haven't really touched on for a while, and I know it's very small for you, it's challenging. But China, potentially a large market, you guys generally look to invest way ahead of the curve. I'm just wondering if – just kind of love to hear your thoughts in terms of what you may be doing now so that China could be an interesting market for you, 5, 10, 15 years from now.

Paul Varga

Thanks. I mean, it's something we'll be talking about here over the next few weeks as well. I think we have regularly, I mean, almost feels like every 3 years, flexed with the marketplace there and altered in some ways, might be a little bit of our portfolio approach or our route-to-market approach, which has been the most significant thing we've done here in the last 10 to 15 months. And but we've also been learning in that marketplace related to ways to be more effective with – led by Jack Daniel's, of course. And the things that I think have piqued our interest more recently are things like e-commerce and adding back much more significantly to the mix of how we serve our consumers over there, and so far, we've had some very promising results over the last 6 months to a year that have encouraged us. We'll probably be making more investments in that arena in the future. And that topic, even beyond China, will be a very interesting one as it unfolds in the years ahead. And my view is that, that's an important topic and if you might – whether you think about it from a marketing standpoint or a route-to-consumer, it's continuing to evolve fast and it's something that has our attention, and we feel like China can be for the company one of the great learning places for us and beneficial while learning through the channel of e-commerce. Jane, do you want to add anything to it?

Jane Morreau

You got it.

Robert Ottenstein

Great, and then I guess it's been about a year or so on Slane. Just wondering to what extent that's meeting your expectations, and how you see the Irish category developing?

Paul Varga

It's continuing to do – the category is continuing to do very well. I mean, the influx of an announcement regarding new brands would be evidence of that. I mean, though it's so early with the brand still, I mean, but the reaction we're getting to the range of things that we've done thus far, which are establish the production in homeplace operation, package the product, name it and put excellent product in the bottle, all of those are going extremely well. But I'll go back to the earlier comments that Jane made and I made, that they also – you always are tweaking your sort of brand building model to build at this stage for that brand comes under 2 basic things, getting it into the right distribution and making people aware of it. Because what we have in the bottle and the way people are receiving it is probably beyond our expectations even. And so a very important set of conversations along the lines of where will you invest incrementally and how are you thinking about these small brands? I mean, this is a ripe area. And back to my earlier blend of A&P relative to investing in people, this is one of the primary brand opportunities where we're going to have to figure that out. What is the optimal mix? And we're not just – as you know from this one, just from the upfront costs associated with the operation in Ireland, I mean, we really believe in this opportunity. And so it doesn't bother us at all to invest way ahead of what we see in that opportunity. And but we're just getting the mix right and getting our organization who is out there, we're asking them to simultaneously drive Jack Daniel's, which is in and of itself, could captivate an entire organization while also developing this. And so trying to figure out how to best accomplish that is a lively conversation at Brown-Forman right now.

Robert Ottenstein

Great, great, and if just…

Jane Morreau

I was going to say, Robert, just a reminder on this brand. We – in terms of just overall impact to our earnings and our sales this year, it's not – it wasn't intended to be a big deal. We are constrained by our liquid that we bought because we're actually not producing that ourselves until now. We just started that process. And so we've been finishing whiskey we bought on the market. We're only in about 18 states and at global travel retail in a few areas. So it's – as Paul said, we're very, very excited and the comments we're getting back is if you can get that liquid to people's mouth, so working with – getting people to become aware of this will pay dividends for us in the future when we have more and more whiskey down the road.

Paul Varga

It so closely reminds me of Woodford Reserve in 1996, 1997. I mean, it's just – it absolutely reminds me of that. With one benefit to this that Woodford at that time probably didn't have which was that the Irish whiskey category, which is already booming. Back then, the

American whiskey was not. And so that's why we've got such excitement about this.

Robert Ottenstein

Great. Very exciting. And then just one final question, Jane. Going back to tax reform, pretty significant material difference for the Brown-Forman company. And understand kind of what you're doing now and I know that you're talking also internally about what you may do, perhaps differently on the investment front. I'm just wondering if the tax reform has any impact on your thinking in terms of capital allocation, balance sheet, dividend, share buyback on an ongoing basis kind of going forward, should we expect your behavior on those fronts to be any different than it was in the past?

Jane Morreau

What I would say, and actually Paul talked about, our really balanced view in terms of our capital deployment over the past decade, past number of years now. So if we could repeat that recipe again in the next 10 years, we'd be very happy. What I would say with that is one overarching thing we will continue to do is keep our flexibility as we have over the past decade in terms of where we want to invest, what comes available to us. Our priorities will not change, first and foremost. Our capital priorities have been investing fully behind the business, which we have been doing quite a bit of that as Paul mentioned earlier with our capital investment, taking another look at opportunities today with this, which will be going into our – I always call this a stew, if you will, that we do during our planning process and looking at everything that's available to us. And then of course, we're going to continue to increase dividends, but as it relates to our prioritization, it will continue to be – it doesn't change my idea on the prioritization of our capital needs.

Paul Varga

Robert, the most significant swing factor oftentimes that changes the mix in a given year, I don't know it might – it would change it if you did a sort of a 10-year view. But in a given year, it's usually around things like acquisitions, which you just – you can't – they are hard to plan for at least – the way Brown-Forman approaches it. And if you look at the multiples that are out there today and what's available, it's just my view is that across the industry it's slim picking. And so we've done a lot of capital here recently. So my view is taking a pause and generating great cash flows is just fine. But you had another add-on. What was the supplementary comments you were going to make?

Robert Ottenstein

I was just wondering, given as you said the multiples are high and they have always been high for high quality products, I'm just wondering given your lower tax rate, does it make sense to perhaps set a higher dividend payout than you've historically had? Or more share buybacks? I'm just – is your thinking on any of those topics changing?

Paul Varga

I think it's the same, circumstantial in terms of timing. But as I highlighted, I mean, we believe, particularly because we have such a long-term shareholder base that providing cash back to shareholders has always been a priority, but done I think really thoughtfully and in balance mixed way the way we've done it, and we've obviously just returned a bunch here – or announced returning a bunch with a special dividend, and we've done a few of those now over the past few years. We just prior to that had more aggressively than recently bought back in consecutive years a bunch of our stock at what we thought were attractive prices. And so I will continue to see us approach the mix like that going forward, really continuing to be very shareholder oriented in our approach to it. And then we'll just have to wait and see what happens with acquisitions. I will tell you strategically, if I look out to 2025 and like, I mean, I feel like we've done a lot of the hard work on portfolio reshaping and to position us and our particular portfolio right now happens to be in categories that have wonderful favor. I mean, there is just great momentum where we're positioned. And we cross our fingers that, that continues. And if it does, I mean, we've got a lot of work to do just to go drive the business against these opportunities. So my view is wait and see a little bit on it, but don't expect a ton of change unless there's some dramatic change in the environment out there that would create great opportunities for us.

Jason Koval

Thank you, Paul and Jane. And thanks to all of you for joining us today for Brown-Forman's Third Quarter Earnings Call, and please feel free to reach out to us if you have any additional questions. Goodbye.

Operator

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