# Brown-Forman Corporation, Q1 2020, Earnings Call 2019-08-28

## 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 first quarter earnings conference call. — ***Operator Instructions*** —

I would now like to turn the call over to Leanne Cunningham, Senior Vice President, Shareholder Relations Officer. Ma'am, you may begin.

### Leanne Cunningham

Thank you, Dorothy, and good morning, everyone. I would like to thank each of you for joining us for Brown-Forman's First Quarter of Fiscal 2020 Earnings Call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Jane Morreau, Executive Vice President and Chief Financial 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 first quarter of fiscal 2020, in addition to posting presentation materials that Lawson and Jane will walk you through momentarily. Both the release and the presentation can be found on our website under the section titled, Investors, Events & Presentations. In the press release, we have listed a number of risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures are reconciliation to the most directly comparable GAAP financial measures and the reason management believe they provide useful information to investors regarding the company's financial conditions and results of operations are contained in the press release and investor presentation. One quick item before I turn the call over to Lawson and Jane, in the interest of time and fairness, we ask that you limit your questions to 1 per analyst. You are welcome to rejoin the queue and we will take your follow-up questions if time permits.

With that, I'd like to turn the call over to Jane.

**Jane Morreau**

Thank you, Leanne, and good morning, everyone. Today, in our earnings release, we reaffirmed our full year growth outlook for underlying net sales, operating income and earnings per share as our first quarter performance was essentially in line with our expectations. What I'm going to do is walk you through our first quarter results to provide clarity to our performance given the considerable noise that exists. After I finish my prepared remarks, I'm going to turn the call over to Lawson for some additional color and comments.

So before digging into our Q1 results, I thought it might be helpful to remind you how we break down our performance to better understand: first, the significant drivers of our results; and second, the trends that could affect our business. We have consistently isolated both the foreign exchange and distributor inventory shifts to provide an estimate of our underlying performance. When there are other factors that are significantly influencing our underlying performance, we have tried to provide visibility either qualitatively or where possible quantitatively. This quarter was particularly noisy with several factors influencing our underlying performance, most notably, the noise introduced by the trade wars and the effects of the retaliatory tariffs particularly from Europe.

While we've discussed this subject for 5 consecutive quarters, the impact in this year's first quarter is significant and is affecting us in a couple of ways. First, the buy-in from prior year, which led to higher growth in the first quarter of last year. And second, a reduction in margins, which is the result of either lower net pricing to certain markets where we sell to distributors or higher costs in markets where we import and distribute our products directly. Aside from tariffs, other factors can affect comparability, and in this quarter, consumer buying patterns across a number of our markets are notable. With this as a backdrop, I will highlight these factors where appropriate to help cut through the noise.

So now turning to our performance in the first quarter. Our first quarter net sales were essentially flat, in line with our expectations given the tariff and timing issues I just noted. Recall, last year's first quarter underlying net sales grew 9%, favorably impacted by tariff-related buy-ins in anticipation of price increases, particularly in several of our largest markets in Europe. We estimate this factor and price adjustments related to tariffs reduced our underlying net sales growth by approximately 3 points for the quarter. Additionally, we approximate timing-related buying patterns across a number of our international markets and our Global Travel Retail channel negatively affected our underlying net sales growth by nearly 2 percentage points. Thus, after adjusting for these items, we believe underlying net sales grew in the mid-single digits, which is in line with our long-term track record of performance.

And looking at our business from a geographic perspective, I'd like to start with our developed international markets where our performance was most significantly impacted by tariff-related costs and buy-ins. Our underlying net sales declined 3% in the aggregate for the markets there compared to 16% underlying net sales growth in the first quarter of last year. We estimate tariffs had about a 6 percentage point drag on the overall top line performance in these markets combined in the quarter.

Adjusting from the tariff effect and an estimated 2 percentage point reduction related to timing of certain customer purchases, we believe our developed international business grew underlying net sales approximately 5%, in line with our historical performance in these markets.

The U.K. and Germany markets were most significantly affected by the tariff-related buy-ins, and therefore, both reflected underlying net sales decline. We believe our consumer takeaway trends in both of these markets remain healthy. I thought I'd pause for just a moment to mention that U.K., our second largest market, is navigating through multiple changes this year, including, first, the uncertainty around Brexit; and second, the recently announced change in our route-to-consumer. We have mitigation actions in place for Brexit and are executing against our plan to minimize disruptions and to maintain our business momentum during this transition to our own distribution.

France and Spain, both among our largest European businesses and where we have invested in our route-to-consumer models, delivered mid- and high single-digit underlying net sales growth, respectively. France's growth was fueled by the launch of Jack Daniel's RTDs and sustained strong momentum behind Jack Daniel's Tennessee Honey. Spain continues to benefit from the focus that has resulted from our route-to-consumer change as growth we're seeing across nearly every brand in the portfolio.

Moving on to our emerging markets. In the quarter, our emerging markets collectively grew underlying net sales 3% on top of last year's double-digit growth. We estimate the tariff-related buy-ins in last year's first quarter for a number of emerging markets, including Turkey and Poland, negatively affected growth by approximately 3 percentage points. Timing related to certain customer buying patterns further suppressed the growth of our emerging markets in the quarter. We expect our emerging markets underlying net sales to accelerate over the balance of the year and approximate the growth we've experienced over the last 2 fiscal years.

Now with that being said, in Mexico, our largest emerging market, underlying net sales grew 3%, a bit slower than recent trends reflecting the difficult macroeconomic and political environment in that country. Though we often don't discuss BRIC markets as a unit, this quarter, these markets collectively grew underlying net sales in the high single digits.

To touch on each market briefly, Brazil continues to focus and execute a strategy as consumer demand expands for Jack Daniel's Tennessee Fire and Tennessee Whiskey. Russia's underlying net sales growth was fueled in part by strong consumer demand of Jack Daniel's Tennessee Whiskey as well as Finlandia. China and India's strong growth was led by what we believe are early days of introducing Jack Daniel's Tennessee Whiskey to consumers in these markets where we believe represent significant long-term potential.

Quarterly sales on our Travel Retail can be inconsistent. And this quarter was no exception, as underlying net sales declined as expected, cycling against the very strong 22% underlying net sales growth in the same quarter last year, which was influenced significantly by the timing of certain customer purchases. Looking ahead, we expect Travel Retail's underlying net sales growth rate to improve as the large timing effects move out. As a result, we expect full year underlying net sales growth in the mid-single digits for the year.

Now turning to the U.S., our largest market representing a little less than half of our net sales, grew underlying net sales 4% for the quarter, representing an acceleration over the

3% underlying net sales growth delivered in fiscal 2019. We believe this positive momentum is reflective of the continued strong and sustained performance of both our super-premium bourbons led by Woodford Reserve and our tequila portfolio led by Herradura as well as improving trends for the Jack Daniel's family of brands led by Jack Daniel's Tennessee Whiskey. We believe our trends for Jack Daniel's Tennessee Whiskey are just beginning to reflect the benefits of our incremental broad reach media in digital investments we have made in the first quarter, and we attempt to continue to make over the balance of the year, enabled in part by our significant reallocations within advertising and a year-over-year increase in activations and promotional activities.

The improving trends in our U.S. business are also evident by the fact that we have closed the gap versus TDS on a blended basis to less than 1 point over the past 6 months. Further, the latest 3 months Nielsen's reflect that we are growing in line with the industry, which remains very healthy growing mid-single digits.

Now looking at our business from a brand perspective. Jack Daniel's family of brands underlying net sales declined 1% globally as tariff-related cost and buy-ins for Jack Daniel's Tennessee Whiskey largely in Europe negatively affected our growth by 3 percentage points. These declines were partially offset by broad-based growth of Jack Daniel's RTDs, international gains for Tennessee Honey, sustained advances for Gentleman Jack as well as the increasing volumes of Jack Daniel's Tennessee Whiskey in the United States.

Our premium bourbon portfolio grew underlying net sales 16% for the quarter, led by over 20% consumer takeaway trends for Woodford Reserve in the U.S., the leader in the super-premium bourbon category. Old Forester delivered strong double-digit growth in underlying net sales, driven by the launch of our new innovation, Old Forester Rye, which has been very well received by the trade and our consumers as well as broad-based double-digit growth across the portfolio of expression. The brand's new home place and distillery, which opened last summer in Louisville has also boosted the brand's growth with nearly 100,000 visitors since that time.

Once again, our tequila portfolio showed strong sustained momentum, growing underlying net sales at a double-digit rate, building on the double-digit growth in fiscal 2019. Herradura led the growth with underlying net sales of 22%, driven by higher prices and volumes in both Mexico and the United States. el Jimador shared in the double-digit underlying net sales growth, driven by higher volumes and prices in the United States as takeaway trends remain strong.

Moving down our P&L. Gross margins were in line with our expectations, declining 330 basis points for the quarter, resulting in underlying gross profit drop of 5%. The margin decline was driven by 2 factors that we discussed during our year-end earnings call. First, the tariff-related costs, which accounted for roughly 2/3 of the decline. And second, higher input costs primarily related to agave as well as ongoing wood inflation.

Underlying A&P was down for the quarter as our increased investments behind Jack Daniel's Tennessee Whiskey in the United States, primarily media related, was more than offset by the timing of investments on our tequilas and the rest of the Jack Daniel's family of brands. Underlying SG&A was down in the quarter, driven by lower incentive compensation-related expenses considered to be timing only.

Turning now to the full year outlook. As I said earlier, Q1 was essentially in line with our expectations and that's why we believe we remain on track to deliver another year of solid results. Starting with our top line growth expectations, we expect underlying net sales growth of 5% to 7% in fiscal 2020, unchanged from our earnings call in June.

The key message is that we remain confident in the health of our business, while Q1 was noisy, it was expected. After considering these factors, we believe our top line trends remain solid, growing mid-single digits and supporting our outlook. Our confidence is further supported by our brands, consumer takeaway trends, which have improved in many of our major markets.

Further, we expect our underlying net sales in the U.S. to continue to accelerate, reflecting our more recent blended value takeaway performance and sustained double-digit growth for our premium bourbon brands and tequilas. We also expect Jack Daniel's Tennessee Whiskey to add to our improving trends throughout the year as we continue to invest in incremental advertising and promotional activities. In addition, we continue to expect the launch of Jack Daniel's Tennessee Apple in the United States, which is anticipated to begin shipping in September or plans to be on the shelves in October will provide incremental contribution to the year. We are encouraged by our trade partner's response, enthusiasm toward this innovation thus far.

We still expect gross margins to be down around 200 basis points for the year, split between cost of sales impact related to tariffs and higher input costs. Now I thought it might be helpful to remind you that we expect the cost of tariff to continue to be a drag on our margin in bottom line through Q2. In Q3, we will begin to cycle these costs from last year.

And regarding our operating cost in fiscal 2020, we are planning solid reinvestments behind our brands with underlying advertising growth slightly lagging our grade of net sales growth. As a reminder, our planned advertising investment for the year includes a significant reallocation of certain investments from less-efficient areas to broad reach media, digital and scalable consumer facing activations, which we expect to drive an effective increase well above our actual increase in spends. We expect SG&A to grow modestly as we remain diligent and focus on efficiency and productivity, driving some leverage to operating income.

So in summary, we reaffirmed our full year outlook for underlying operating income growth of 3% to 5% and earnings per share of $1.75 to $1.85. We continue to believe we have a long runway of potential growth ahead and that our business remains quite attractive with higher margins and industry-leading return on invested capital. In addition, we believe our long-term highly engaged shareholders led by the Brown family allow us to endure volatile times, such as what we are currently experiencing with tariffs and to continue to thoughtfully build our brands to endure for generations to come.

We believe that regardless of the tariff-related drag that significantly affected our results last year and that we expect to continue this year that Brown-Forman remains healthy with a demonstrated track record of resilience over the last 149 years and with high anticipation of celebrating our 150th year, which is just a few short months away.

And with that, let me turn the call over now to Lawson for his comments.

**Lawson Whiting**
All right. Thank you, Jane, and good morning, everyone. As Jane said and I'll just acknowledge it, again, the significant amount of noise in our first quarter results in both sales – that hit the sales and the cost line make it a difficult quarter to understand. So hopefully, her comments provided a lot of clarity and the slides that you have, I'll provide some more clarity in why we remain confident in our outlook for the full fiscal year.

So let me reiterate a couple of the key points that we talked about this morning already. The tariffs are the biggest single thing affecting us both as a result of the buy-ins from last year or comparing against the buy-ins from last year and then also the costs that are flowing through this year. In addition, on the timing of certain customer buying patterns largely in our Travel Retail channel, but also in a number of emerging markets are also compounding some of the volatility. But if you cut through all of that, as Jane has said a couple of times, we really do believe that we're still delivering that mid-single digit sales growth, and importantly, maintaining our consumer momentum.

Although – another reason I believe that the overall business remains healthy – healthier may be than the headlines might read is simply that our takeaway trends have improved in most of our major markets. So if you take a look at the U.S. and the U.K. and Germany and Poland and some of the other real big markets around the world, our consumer takeaway, which is really the leading indicator is moving in the right direction. So it gives us some confidence that those markets will continue to pull through.

Third, we do believe that the top line results will start to look better over the balance of the fiscal year, partially because we're going to cycle past the tariff-related buy-ins that happened last year, but the launch of Jack Daniel's Apple have a meaningful impact and then just the overall momentum that we want to continue to see in the U.S. business from our planned investments and focused execution. We anticipate our bottom line results will continue to be negatively affected through Q2. So this is going to be tough for another quarter, but then we get into Q3 and we get to cycle more like-for-like comparisons and it ought to be a little bit clear and easier to understand.

But last key point. When you cut through all this noise, we do feel like our business is still on track, therefore, we reaffirmed our outlook for underlying growth in the full year net sales and operating income this morning. So enough for the quarter, I want to talk a little bit about – a little bit more of the strategies that we're pursuing that give us some good confidence for the long term. I want to spend a little time this morning talking about the U.S. results and why we feel that they're moving in the right direction and providing confidence in the long-term growth outlook for us.

As you heard from Jane, the U.S. underlying net sales trends in the first quarter reflected an improvement from our fiscal 2019 performance, the stronger trends across much of the portfolio. As a reminder, the U.S. market has by far and away the most developed portfolio of brands in many of our markets and that diversification of the portfolio is a big benefit to us right now. Our growth is not reliant on a single trademark. For example, we saw a very strong performance from Woodford Reserve and that's been going on for a number of years. The brand is about to top the million case mark globally. And so that is becoming a very meaningful brand for us.

Herradura continues to grow well into the double digits and this is a very another strong performer. And then we continue to get good performance in el Jimador and Old Forester, which is actually the fastest-growing brand in our U.S. business these days. So all these together are meaningful and moving the top line growth of this market.

In order to accelerate – but in order to accelerate our portfolio development in the U.S. market, we did – we established something called the emerging brands group about a year ago, and we talked about this a couple of times I know on these calls. But as a reminder, it's a group of about 40-plus dedicated individuals that really focus just on building some of our smaller, very premium brand, brands like Old Forester, Coopers' Craft, now we've inserted Chambord in there, and they focus on our 3 Single Malt Scotches, but particularly emphasizing GlenDronach in the U.S., Slane Irish whiskey, and now our most recent addition, Fords Gin.

Consistent with the message that we had just a few weeks ago at our Annual Shareholder Meeting, these brands continue to thrive and one of the points that I think that we're all proud of is that they're growing – each one of those, at least the major ones are all growing faster today than they were 12 months ago, when we first put this group together. I couldn't be more proud of the team and the accomplishments and believe that they've really done a good job in setting us up for the next generation of growth for the company. But it also points to another factor that we think we can use and export to the rest of the world and that's really the benefit of focus.

Focus is what really builds brands in our industry, and I think we're showing this focus can have a meaningful impact on our growth rates. These lessons we've learned here in the U.S. business at least in the early days, we're not declaring victory yet, but certainly the early days are moving in the right direction that does – this focused effort really can be used around the world.

So our portfolio outside of the U.S., as you all know, is much smaller and largely focused on Jack Daniel's Tennessee Whiskey. We know that we need to have a both end here. We need the Jack Daniel's family to continue to grow around the world and it is, but we also know the importance of building a super-premium portfolio of brands. So we want to now replicate the success we've had in portfolio development in the U.S. and make that work in our largest particularly developed international markets. So we've invested incremental resources in Europe, places like Poland, Germany, France and the U.K. And as a result, we've started to see a meaningful acceleration in the growth of some of these brands, particularly Gentleman Jack and Woodford Reserve.

So although these brands today are relatively small outside of the U.S., I mean, order of magnitude, Gentleman Jack is about 250,000 cases, Woodford is about 150,000, but we believe we've only just begun this long-term growth journey. It was – simply over the history or over the last couple of decades, it was not happening fast enough. Portfolio development was not happening fast enough when we're using third parties as our RTC partners. Now we've taken control in most of the largest markets in the world, giving us at least the ability or better chance to win in the world of portfolio development. So despite the current drag from tariffs and a very noisy quarter, we do believe we've got the right long-term growth ambitions and that we can continue to deliver.

Before I conclude, I do want to say a few words on Fords Gin. Since I did not get the opportunity to talk about it last call, we missed – we actually announced the acquisition of Fords Gin a couple of days after the call. While this brand is small today, it's little over

30,000 cases, we believe it has the potential to be a powerhouse in the upcoming years. It's just a beautiful liquid paired with an intriguing package and rich brand stories. It's a combination of all that. It's a formula that works well for Brown-Forman and something we think we can build upon. Furthermore, Fords Gin we have put into that emerging brands group that I was describing earlier, but Simon Ford, the Founder and his team will help us up our game I think in the on-premise. They've done a beautiful job in some of the most prestigious bars and restaurants around the world in seeding the brand in a way that very few entrepreneurs actually can achieve. With a very large percentage of the business in the on-premise right now, we think we can take the Brown-Forman system, the Brown-Forman emerging brands team and use the size and scale of our system to really find new and exceptional ways to grow. So I'm really looking forward to many success stories on Fords Gin as we talk about that in the coming years.

So look, my last point, just want to thank our employees who've been putting in the extra time and effort through these volatile times, continue to deliver the growth we're seeing is only possible because of our super-talented teams around the world and I just want to thank you again. So that wraps up our prepared remarks.

Dorothy, can you please open up the line for questions?

**Question and Answer**

**Operator**

— ***Operator Instructions*** — Our first question comes from the line of Amit Sharma with BMO Capital.

**Drew Levine**

This is Drew Levine on for Amit. I just wanted to touch on the top line. Just trying to think about the cadence through the rest of the year. Obviously, you have some easier comps in the next quarter, but you also mentioned some timing-related issues with customer ordering patterns. So maybe you could kind of give us some help on when those should reverse and kind of how we should think about the cadence through the rest of the year?

**Jane Morreau**

Sure. I'll take that. As you said, one of the things that we know is going to happen in our second quarter, which should help our top line quite a bit, is that we'll recycle in against last year's get back of tariff. So that top data – with what you saw in this first quarter will be the opposite the time we get to our second quarter and will further we'll pass the – any impact to the sales line from price reductions with tariffs in the handful of markets where we reduced our price to compensate for tariff. So that will all be behind us in the second quarter. Further, we'll get a benefit from the introduction of Jack Daniel's Tennessee Apple.

It's expected to ship in the middle of September, and therefore, hit the shelves plan is in sometime in October. So we'll get a benefit from that as well in the quarter. So I expect the Q2 to have a nice top line growth. I think our back half of the year will continue to benefit from the acceleration in the U.S. business as well as the Tennessee Apple introduction. So all in all, again, we walked through why we believe the top line of 5% to 7% is still achievable because we're essentially still online with what we – in line with what we were expecting in the quarter. And so nothing has changed that outlook for us.

**Operator**

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

**Judy Hong**

Just following up on the last question. Jane, you talked about the benefit from Apple launch in the second quarter. Just wondering if you have any kind of quantification that you could give us on what you think the impact could be? And then I think, more broadly, if you think about the U.S. market, clearly, we've seen some improvement. I think your promotional activities went up in the quarter. So I guess, I'm just wondering how you see sort of your strategy to accelerate the U.S. growth both from kind of the promotional activity whether we should see that continuing as we go into the holidays. Or we should start to see more of an innovation-driven growth in the U.S. market going forward?

**Jane Morreau**

Let me try that out. Again, as we get to impact – I'm not going to get down to the tens of points here. I think we communicated at year-end that we expected Apple to contribute incrementally to our business this year about a 0.5 point of growth. Because we're getting it out in the shelves in the month of October, you'll start to see some of that come through. It won't be material, but it will help our second quarter.

As it relates to your questions in terms of why we believe the U.S. business will continue to accelerate, this is really similar to what we discussed in the – in our year-end call. You'll recall that our takeaway trends there, which have been improving even at the end of April, were not reflected in our financial results. We grew last year in the U.S. 3%. So we said takeaway the leading indicator. Lawson just mentioned and reminded us of that again. Our takeaway trends are well in the mid-single digits now 5%, 5.5% already.

Our financial results don't reflect that. So as the year goes on that will be coming through our financials. So that acceleration will continue to see the year-over-year financial. Further, the – we do plan – as you noted, we do plan to continue the incremental spend behind Jack Daniel's Tennessee Whiskey. We believe that the incremental monies that we're putting behind Apple, which actually are beginning in our second quarter, will also benefit the whole Jack Daniel's family of brand and the parent company – the parent brand. That combined with incremental promotional activities will continue to accelerate that brand, and we do plan that all throughout the year.

**Lawson Whiting**

Yes. I mean, a couple of things I'd add on top of it too to in terms of confidence for the U.S. business as a whole. Some it is the brands themselves, the Woodford is there, there is the Old Forester that we keep talking about have simply gotten bigger. And so – and they're maintaining the growth rates that they've had for the last couple of years or in some cases even getting better. And so you get a more meaningful impact from those brands and you combine that with really not much in the way of a drag from our tail. I mean, we have a couple of brands obviously that are not growing, but it's not a very meaningful impact from those brands.

And so I think that helps the overall Brown-Forman portfolio. I mean, I think there are some time to reset for the U.S. market – for the U.S. distribution system itself, which has been through a bit of turmoil over the last few years seems to be settling down now, and everybody is getting their job done. So that, I think, is a bit of a benefit too. And then we continue to have what I console as a strong discipline around revenue growth management trying to manage the business and what we think is the smartest way possible. I think that message has gotten through and people are executing on it. So things just feel a little bit better.

**Operator**

Your next question comes from the line of Peter Grom with JPMorgan.

**Peter Grom**

I just wanted to get a bit more color on the U.K. distributor change. I know the company has done a good job of developing in-house distribution over the years, but the U.K. is a large and important international market that is kind of dealing with a number of its own challenges. So first, it will be helpful to get more background as to why the agreement wasn't renewed? And then second, realizing the company is taking mitigation efforts, will there be a point in the future where you have greater clarity on whether or not these issues could have a financial impact on FY ’20 or beyond?

**Lawson Whiting**

Okay. Yes, let me – I’ll start with it a little bit and Jane can finish on some of the impacts on fiscal ’20, but let me back up a little bit just for those that haven’t been closer to us over the years. We have entered – we with Bacardi entered into and we called it a cost sharing arrangement back in 2002. So this is a 19 – a 17-year partnership that we’ve been in there. And we’ve – basically, what it was, we’re sharing the sales team between the 2 of us and then also sharing some back-office support. So we have always held responsibility for our own brands – on the marketing of our own brands unless the shared sales force do their job. And it’s been a long successful relationship. It’s – but both companies agreed that it was just time. It was time to take control of our own business and develop our own portfolio.

So as being the second largest marketer in the world for Brown-Forman, one of the comments I made in my prepared remarks was about how we now have a better chance at developing the rest of the portfolio, which is what we want to do. We really – when we started the agreement 17 years ago, there were only 13 brands in the – between both companies, 13 brands in the portfolio and it was largely complementary as they were focused on rum and we’re focused on really on Jack Daniel’s. We now have something like 110 brands in that structure. I mean, both companies have grown tremendously over the 17 years and it’s everything from Scotch to Irish whiskey to tequilas.

So there was a lot of overlap that became a – starts to become a problem in terms of how you’re going to get priorities – how you’re going to set priorities for your team. So we made the decision, the time was just right and we’ll see how trends going. Every time that we have made a distribution change in our past, I think we’ve had a nice uplift from it. So we have confidence that we've done this enough times, that we won't see a tremendous amount of disruption and life goes on. So yes, it's going to take us few months to get through all this stuff, but we put a lot of plans in place and – to make sure that it's not a lot of disruption this year, and we hope to be in a better place starting at the beginning of next fiscal.

**Jane Morreau**

Yes. So just to add on to Lawson's and answer your question as it relates to any financial impact to this year, yes, I would like to step back and say, this is really unlike a lot of other changes to own distribution companies, such as Spain and France, where we actually did take a financial hit in those years where we've moved to and that was because of the inventory reductions that resulted from the third-party relationship to – well, on this case, we felt that impact 17 years ago when we moved from our third-party partner at that time to this cost sharing arrangement and the inventories owned by us today. So there will not be a big financial impact as a result of that.

Now we will start to see some start-up expenses. So think of them more as onetime in nature incurred later this fiscal year for putting in systems and hiring and training people. This has all been factored in our outlook. What's interesting about this particular distribution arrangement is, again, 17 years ago, when we moved to this cost sharing, we would have not only had the hit from the inventory reduction, we would have also gotten the benefit at that time from the increased margin from the – margin going away that we used to pay our distributor. So this cost sharing arrangement we share in SG&A that's already in our P&L today. So you're not going to see incremental costs really going forward once you get past these start-up expenses. They aren't material in nature and they are in our full year outlook. So hopefully that answered your question.

**Operator**

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

**Vivien Azer**

So it sounds like things are very much getting back on track in the U.S., but there are certainly from a macro perspective a lot of noise in developed Europe just in terms of kind of the economic health of the region and then some country-specific uncertainties, namely with Brexit. So Lawson, given your long tenure at the organization, can you just remind us like how this business performed, in particular, in developed Europe against more challenged macro backdrop?

**Lawson Whiting**

Well, look, I mean, the – some of our largest markets in the world are obviously in developed Europe. This has been a place where we've been able to grow kind of mid-single digit now for, I don't know, many years. And as we look at the true underlying, I mentioned that the consumer takeaway numbers are in there, I mean, it's why we think we've got confidence that we'll continue to be able to grow at those kind of rates. Now one of the – I don't know if you're implying this or not, I mean the – is the world of macro political issues and all that kind of stuff starting to hurt our brand as being sort of Americana, something we at least ask ourselves. But this is not the first time that we've been through. I mean, it's a little bit different this time, but certainly there've been some anti-American sentiments that have leaked through various markets around the world.

But for whatever reason, the Jack Daniel's brand seems to be a bit insulated from that. We just haven't seen any negative backlash against some political issue impair the brand. And in fact, if you rely on the takeaway figures, it's not happening now either. So we'll continue to fight through. It is a difficult environment. It's a difficult pricing environment over there, too. But I think our strategy of maintaining consumer momentum, which you heard us now saying multiple times, is still the right thing to do for the long-term good of the company. It's to maintain that momentum. And so I'm happy as long as we continue to get that top line growth. That answered your question?

**Vivien Azer**

Yes. That was perfect.

**Operator**

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

**Timothy Ramey**

I know there was tremendous noise relative to Travel Retail, but that segment sometimes is a canary in the coal mine for overall economic activity and potential slowdown of markets. It sounds like you didn't really see any slowdown that would be attributable to the base business, but I just wanted to ask that. And number two, if Jane could comment on the tax rate outlook for the year?

**Jane Morreau**

Sure. I'll talk about the tax rate first. Our – we had guided to a tax rate of around 21% for the full year. We now think it's going to be somewhere between 20% and 20.5%. So slightly better than what we had provided at year-end.

As it relates to Global Travel Retail, in terms of anything that we're seeing there, again, we have guided to, we think we're going to continue to grow mid-single digit. Are there things happening in various airports and channels? That happens all the time, ebbs and flows, I don't know if I've seen.

**Lawson Whiting**

Yes. I mean, our growth last year in the first quarter in that channel was enormous.

**Jane Morreau**

Was 22%, yes.

**Lawson Whiting**

22%. So I mean it – and I think it gets a little more exaggerated overtime as we got bigger in that channel and we do more business with Woodford Reserve, with Single Malt Scotches, it can be – I mean, you can see some volatility in the way that they order those. So it's just a – it's part of the game playing in there as you're going to live with the choppy order patterns. But I still – I don't think there's really a change on the outlook. What we have not seen is a decline in travelers and all those kinds of macro things, but that stuff all seems to be pretty solid so.

**Operator**

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

**Lauren Lieberman**

Hey, I thought I'll ask a little bit about tequila. So first was, I guess, a follow-on on some of the comments that you had made last quarter around pricing receptivity of the market in the competitive environment. So just kind of how that developed, what you've seen in more recent months and the outlook as we move forward? And then also just, it feels at least from my seat in Times Square, like there's been a major acceleration in your efforts to market both Herradura and el Jimador in the U.S. or maybe it's just in New York, but if you could just talk about if that's the case and sort of a bit of why now? Why not 2 or 3 years ago? Why not 2 or 3 years looking forward, why is this right moment to really step-up efforts on those 2 brands domestically?

**Jane Morreau**

Let me take the pricing part of it.

**Lawson Whiting**

Yes.

**Jane Morreau**

Yes. So the tequila category remain amazingly healthy, particularly in the United States. I think if you looked at last year's IWSR, the overall category grew 16% so quite nice. But as it relates to the pricing environment, both in Mexico and in the U.S. that's one category where you're seeing pricing. You're seeing fairly significant pricing in Mexico, and we've taken fairly significant increases as well on our brand. The overall category down there is actually – volume has actually slow value. Some categories of the Mexican market is actually down a bit from a volume perspective, but the overall value improved year-over-year.

So – and if you move to the U.S., as I said a moment ago, we're actually starting to see pricing across all price points in tequilas. We took some pricing last year on Herradura and el Jimador. We took some significant pricing on our low value in tequila this year, Pepe Lopez, and we continue to expect to take some more surgical increases across a number of markets on Herradura and el Jimador this year. We'll continue to monitor what's going on in the environment. People are taking as we talked about like you said at year-end more related to that incredible increase in the cost of the agave, which is a cyclical pattern that we discussed and expect that to come back in the next couple of years, but people are past trying to offset these increases as we are by passing down pricing.

**Lawson Whiting**

I mean I think to head on the why now a little bit, I mean, obviously, we bought these brands 12 years ago, and it took us a while to sort of get our feet underneath us with tequila and it was a sort of a slow start. We have changed the model for tequila quite a bit on el Jimador in terms of premiumizing in Mexico and continuing to really grow in the United States. I mean, it's gone from, I get this a little around 150,000 cases to 600,000 over that period of time. So really good growth there. But Herradura, at the higher price point, is the brand where we're going to put the most sort of consumer-facing activities out there and really the category – the ultra-premium tequila category in the U.S., which was always led by some of the big brands like Patrón, but is a very healthy place to be. The consumer demand is very healthy. I think the consumers love the mixability, the authenticity, the – it's just a hot category. And so I think it's really taking off and it's some of the things that we would have put down in the rationale for interest back in 2007 coming out…

**Jane Morreau**

When the recession hit.

**Lawson Whiting**

Yes, when the recession hit soon thereafter. But a lot of those consumer dynamics are coming through today. And so yes, it's just a hot place to be and somewhere we want to continue to invest.

**Jane Morreau**

And beyond the U.S. and Mexico, it's so early in this infancy as it relates to the rest of the world, but we're very excited about the opportunities to introduce consumers to tequilas around the rest of the world. That's also in line with Lawson and what he was talking about in our investments and focus and people to premiumize our portfolio beyond Jack Daniel's in those markets outside of the U.S. where we think there are such tremendous opportunity. That brands – those brands are support of it.

**Operator**

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

**Bryan Spillane**

Got a couple of – Jane, just couple of cleanup questions and then just 1 broader question for Lawson. So it's just first on the model, I might have missed this earlier, but I think on the last call you talked about gross margins for the year being down 200 basis points. So is that still a good figure to work with?

**Jane Morreau**

Yes, about that is perfect, yes.

**Bryan Spillane**

Okay. And then I think last year that the tariffs were about 100 basis point drag on price mix for the – annualized for the full year. So if this is really the last quarter, I guess, where we'll have that sort of drag year-over-year comparisons, we should see a little bit of a pickup in price mix as we're modeling out the balance of the year because we'll have kind of lapped all that noise?

**Jane Morreau**

The latter part of your question is correct. I want to say that the impact last year was maybe a bit more, 160 basis points is kind of what I had in mind. So – but yes, as we – once we get past Q2, we have – we'll have lapped the cost of the tariffs.

**Bryan Spillane**

Okay. And then Lawson, with, I guess, the emergence of hard seltzers here in the U.S., and it's sort of a slash, right? I think – is it a beer or is it a spirit, I think, people – consumers have a lot of kind of varying viewpoints of kind of what it is. Can you kind of just maybe talk about how you're observing it and whether there are some opportunities that might present themselves for some of your brands, not necessarily a hard seltzer, but was it maybe the format, right, having things in more convenient, portable ready to go format, maybe consumers more sort of open to that now than may be they had been before at least in the U.S.?

**Lawson Whiting**

Yes, I mean, I think you're right. One of the – we did this at year-end. We talked about the categories to be in whiskey, tequila and gin and how we feel good about that and then the IWSR now puts a lot into the format of the next 10 years is going to RTDs. And we've got about 16 million case RTD business around the world, 7 million new mix and 9 million cases of Jack Daniel's. So – but as – the vast majority are outside of the United States. So how are we playing in inside the United States? I mean, as we're sure everyone knows, it's from a tax perspective very punitive against spirits relative to beer or malt.

So certainly, that is a disadvantage that the spirits players have relative to these malt brands. But I do think when we were – in fact, there was a commercial on television last night for Truly where the guy took – it was a bottle of whiskey and it was a generic bottle, just that whiskey across the top of it and he actually poured it out and went over to his cooler and grabbed his Truly out of a cooler, I don't know if anyone has seen that yet. So obviously Truly is coming at us a little bit. I'm not – but I would argue that the whiskey category is a little bit more insulated from this sort of spike in hard seltzer demand. They're – it's closer in on beer and then likely closer in, I think, on some of the lighter drinks given it skews female and it skews younger, so you're going to get a lot of – you're going to start ticking from vodka.

So I don't worry too much about our whiskey portfolio and the impact that it might have on there, but we spent a lot of time thinking about how can we play in that there and we're running some tests in California right now with Jack Daniel's under a spirit-based model. But it's a – given the tax thing that I mentioned they're expensive. So we feel pretty good about it. It is an interesting phenomenon to watch and see how many people are going after these seltzer drinks, but God, I'm not going to predict the category direction, but we've seen this before in the RTD world. A lot of brands go up fast and go down. So we're trying to do it in our own way, mostly with the Jack Daniel's brand.

**Operator**

Your next question comes from the line of Chris Pitcher with Redburn.

**Chris Pitcher**

A couple of follow up questions really. On the U.K. business, just to get a little bit more understanding on where you're sourcing the resources for your own business. If we look at the development of that joint venture and you've become a much more significant player than your partner was sort of back when you first set it up. Are you able to just basically carve out your respective costs and those sales people will be enough to support the business, hence you're saying, there isn't going to be a significant increase in costs or can – does your existing partner still require the headcount they currently have in Bacardi MARTINI?

And then just secondly following on from tequila, one of the other distillers recently have been saying that the agave costs aren't falling off as perhaps as quick as they thought. Can you comment on when you expect your higher agave cost to start to run off or are you seeing some of that being pushed out a bit further?

**Lawson Whiting**

I can do the U.K. Well, we both can. I mean…

**Jane Morreau**

Talk about it, yes.

**Lawson Whiting**

There is a contract in place that goes through a process of how we're going to – what the team's up for the most part. So – that, so yes, we're working through that right now, but on the cost side of things, I think, Jane already said this, we expect it essentially be neutral to where we are today. So…

**Jane Morreau**

We already have marketing folks there, our own marketing folks we have. So this is really the sales force, and so, yes, we'll…

**Lawson Whiting**

We're going to split the teams, yes.

**Jane Morreau**

So we already have those. Yes. And then in terms of the agave, really we haven't got – haven't really changed what we believe will happen. Again, we can go back in terms of when we will start seeing that cycle of pricing of the cost of agave to go down. As we talked at year-end, we had some visibility into the number of plantings by year, by calendar year and that points to really probably late '20 – '21, calendar '21 before you start to see that. But there's a lot of dynamics going on. I'll just say that now in terms of the market with people – our competitors, ourselves, actively taking pricing particularly in Mexico where the margins aren't as attractive as the U.S. So they can take that agave and move it towards the United States and support the great growth that has been happening in the category in the U.S. So there's a lot of dynamics that could impact that, but that really nothing has changed those right now, but it could perhaps come a little bit earlier, meaning start to see, start to come down a little bit earlier, should some of the volume in the Mexico market where it's low margin, it's being suppressed really not been needed as quite as high as what is expected in the U.S. So it could be some little things like that can move it up a little sooner. But we've said that again, towards the end of calendar '21.

**Chris Pitcher**

And then just one final clarification because you've reiterated your earnings per share range, you've got a lower tax rate. Is that helping compensate for some of the adverse currency movements that will be running through particularly in say the U.K. market. Is that the way to think why earnings hasn't changed despite the tax?

**Jane Morreau**

Yes. I mean, if you're looking at – yes, so foreign exchange for us, I think, we have a couple of cents maybe in our full year forecast, which is fairly consistent I think with what we started off in the year. But what you're probably asking is, "Hey, I've seen a lot of movement in the currency just themselves," but we have a hedging program in place and have for a number of years. It's a 36-month hedging program. So what you're seeing is some of the underlying results really being offset by our hedges, that's what you're seeing right now. So that's why it's not expected to be a big deal this year because we would have hedged these currencies before hedging offsetting the fluctuations you're seeing in the market. Hopefully that makes sense because these were laid down some time ago, but better rates.

**Operator**

And there are no further questions at this time. I will turn the call back over to Leanne.

**Leanne Cunningham**

Thank you, Lawson and Jane, and thanks all of you for joining us today for Brown-Forman's First Quarter Fiscal 2020 Earnings Call. If there any additional questions, please feel free to reach out and connect with us. Thank you.

**Operator**

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