Brown-Forman Corporation, Q2 2018, Earnings Call 2017-12-06

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 second quarter fiscal 2018 conference call. — ***Operator Instructions*** — Thank you.

I would now like to turn the conference over to Jay Koval, Vice President and Director of Investor Relations. Please go ahead, sir.

Jason Koval

Thanks, Dorothy, and good morning, everyone. I want to thank you for joining us for Brown-Forman's Second 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 second 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 & 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 significant risk factors are described in our Form 10-K, 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

Thank you, Jay, and thanks for joining us for our second quarter earnings call. During my comments today, I will reference the slides we posted to our website this morning to help walk you through our 2 main areas of focus, which include: first, a review of our first half results; and second, our revised 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.

So let me start with the overall highlights, which are shown on Slide 3. First, our reported net sales grew 10% in the first half, driven by strong 7% underlying net sales growth, helped by trade inventories and foreign exchange. Reported operating income jumped 17%, driven largely by the strong underlying growth of 14%.

Second, our underlying net sales accelerated to 8% in the second quarter, marking the fifth consecutive quarter of improving growth trends, as our teams are executing well against our efforts to reignite our top line back towards historic rates of growth. These results lifted our first half underlying net sales growth 7%.

Third, we delivered meaningful operating leverage, primarily due to tight SG&A controls, was helped by inter-year phasing of investments behind our brands.

And finally, we increased our full year outlook for underlying net sales and operating income growth and now expect 6% to 7% and 8% to 9% growth, respectively. We also increased our fiscal 2018 EPS expectations for the second straight quarter to a range of $1.90 to $1.98, representing growth of 11% to 16% compared to fiscal 2017.

Let's now turn to Slide 4, a review of first half growth rates for several of our key metrics. Underlying net sales grew 8% in the second quarter, resulting in 7% year-to-date growth. Although we were looking for a continued acceleration in the first half, we were quite pleased to see our top line growth come in even higher than anticipated. After adjusting for some timing items which helped results, such as significantly higher volumes of used barrels sold in the first half of this year, we estimate that our normalized net sales growth is approximately 5% to 6%, a marked improvement from last year's normalized level of 4%.

As highlighted on Slide 5, reported net sales increased 10% in the first half and helped by 2 points due to year-over change in distributor inventories and a point of foreign exchange.

Slides 6 and 7 break down our net sales growth by geography, which as you can see was very broad-based, with most major markets performing very well. So beginning with the United States, first half reported net sales grew 9% or 6% 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, not to mention continued double-digit gains from our tequilas, el Jimador and Herradura.

In our developed markets outside the United States, second quarter results rebounded as expected, driving 5% reported and underlying net sales growth for the first half. Australia experienced double-digit underlying net sales growth, while developed markets in

Europe grew high single digits. Japan was our outlier, with volume declines due to comparisons against last year's price increase-driven buy-in. Our takeaway trends remain solid in most of our major developed international markets.

Our emerging markets business performed very well, with underlying net sales up 15% and reported up 24%. While Mexico and Poland delivered great underlying results, up roughly 10% in the aggregate, it was the remaining emerging markets outside of these 2 countries that was up most impressive, up 20%. The torrent growth was fueled by improved economies and stabilized foreign exchange and was helped by easy comparison against depressed results a year ago.

Slide 8 highlights the improvement in our emerging market trend over the last 12 months and the more difficult comparisons we expect later this fiscal year, particularly in our fourth quarter. Given the progressively more challenging comparisons, we expect more moderate growth from the emerging markets in the back half of the year.

Our travel retail channel continued its growth trajectory, with underlying net sales up 11% and reported up 18%. The team is focused on growing key accounts and driving better distribution, while our overall results also benefited from higher passenger volumes, particularly in Russia and Turkey.

Slide 9 breaks out our key brands' underlying net sales growth. You can see that the growth was very well balanced across our portfolio. The Jack Daniel's family of brands grew underlying net sales 7% in the first half, with our major brands delivering solid gains, including Jack Daniel's Tennessee Whiskey, Tennessee Honey, Tennessee Fire and Gentleman Jack. Jack Daniel's RTD business grew underlying net sales by 15%, helped by innovation. It's worth noting that the Jack Daniel's RT (sic) [RTD] business is well over 8 million cases annually, equating to over 200 million opportunities to market the brand through the consumption of the product, which we describe as a brand in the hand.

In the United States, we launched the first-ever new grain bill from the Jack Daniel's distillery with our charcoal-mellowed 90 proof Jack Daniel's Tennessee Rye. While Rye is in its early days, the reaction from the trade has been quite positive. And we are focusing on positioning the brand for long-term success, but carefully building awareness in both the on- and off-premise. We realized a slight benefit from the launch of Rye during the second quarter and expect the benefit to continue over the course of the year.

Our premium and super-premium bourbons, including Woodford Reserve and Old Forester, continued to grow net sales on an underlying basis well into the double digits, as did our tequila brands, el Jimador and Herradura. New Mix RTDs underlying net sales were up high single digits.

Finlandia also grew net sales up nicely, up 8%, driven in part by volume gains in key markets in Europe as well as Russia.

Now before I move down the P&L, I wanted to update you on our used barrel business, which enjoyed strong year-over-year volume growth that more than offset the anticipated price declines, driving a positive variance to prior year's first half and contributing less than 0.5 point to the top line. We believe much of the first half strength in used barrel sales has been timing related, as we expect modest declines for the full fiscal year.

Slide 10 breaks down our gross margins for the first half. Reported gross margins was flat relative to the same period a year ago. Foreign exchange hurt margins by about 60 basis points, while the absence of last year's A&D-related activity helped margins by 50 basis points. Our first half gross margins were also helped by higher used barrel sales. The second half gross margin will likely enjoy less favorable comparison.

Slide 11 summarizes our operating performance on both a reported and underlying basis. Our underlying A&P increased 5% year-to-date, 2 points behind our underlying growth in net sales, due in part to the timing of brand investments, as we still expect full year A&P to grow in line with our upwardly revised rate of underlying net sales growth. We plan on continuing to invest in the Jack Daniel's family of brands, including additional investment in new media for Jack – Gentleman Jack as well as the sponsorship with the NBA. We are also investing in other premium brands, including Woodford Reserve Double Oaked, Old Forester Statesman and Herradura, not to mention some of our newer additions to our portfolio, Slane Irish Whiskey and our Single Malt Scotch brands, GlenDronach and BenRiach.

Reported and underlying SG&A during the first half declined 1%, as we maintained our focus on improving efficiency and reallocating towards consumer-facing investments. This decline is even more impressive, given the costs associated with the recent launch of our new distribution company in Spain. The timing of certain costs also helped drive the first half declines in SG&A.

In total, we delivered 14% growth in underlying operating income for the first half. Reported operating income jumped 17%, helped by the year-over-year change in trade inventories. Operating margins expanded 220 basis points to 36%.

Reported earnings per share during the first half increased 24% to $1.08. EPS growth was propelled by the combination of strong top line gains, substantial operating leverage, a lower tax rate and a reduction in our share count compared to the same period last year.

To wrap up our first half review, we delivered outstanding results, due in no small part to the hard work and great execution of our teams around the world.

Now let me move on to our second and final topic for the call, a summary of our revised outlook for fiscal 2018, highlighted on Slide 12. So consistent with our communications to you back in June, our top line results in the first half of the fiscal year were always expected to be stronger than the second half. But given that our first half results were even greater than anticipated, coupled with the current momentum of our business, we have increased our outlook for underlying net sales growth to a range of 6% to 7% for fiscal 2018. As I mentioned earlier, we expect the rate of underlying net sales growth to moderate slightly in the back half, most notably in the fourth quarter, due to more challenging comparisons in emerging markets, travel retail and used barrel sales.

Gross margins in the back half should remain essentially in line with the level of our first half margins, although lower than the same period last year, as we expect modestly higher cost of goods.

We have plans in place to further increase investment behind our brands momentum during the back half of the year, supported in part by the overall improvement in the economic environment. Underlying A&P is still on track to grow in line with our accelerated top line growth, implying an expected pickup in investment spend during the back half.

Underlying SG&A will likely be up slightly for the full year, given the increasingly difficult year-over-year comparison. Given these items, we expect to see the strong leverage we experienced year-to-date reverse – to reverse in the back half and for the rate of underlying operating income growth to slow relative to the blistering 14% increase delivered during the first 6 months.

In total, we now anticipate underlying operating income growth of 8% to 9% in fiscal 2018, 2 points faster than our sales growth. This revised range is also consistent with our prior expectations to deliver a couple of points of leverage due to the reallocation efforts and cost discipline.

Now moving to our earnings per share. We expect EPS to be in the range of $1.90 to $1.98, representing 11% to 16% growth compared to fiscal 2017. This upward revision is due to the combined impacts of improved top line momentum and a slightly lower tax rate of under 28%. This full year EPS range incorporates expectations that trade inventories come down slightly in the back half of our fiscal year.

As to sensitivity, assuming our foreign currency cash flow exposure collectively moves 10% in either direction, EPS over the balance of the year would be impacted by roughly $0.03 per share.

In summary, we are very pleased with our first half results and the improved trajectory of our business. We believe our efforts to accelerate the top line are proving to be successful, due to the combined effects from reprioritized A&P investments, effective reallocation of resources, more analytical revenue management tools, disciplined innovation and a continued focus on geographic expansion for our leading portfolio of premium spirits brands.

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

Paul Varga
Thanks, Jane, and good morning, everyone. Let me just add a few comments to Jane's. We're obviously very pleased with these excellent second quarter and first half results. And while we do not anticipate the second half being quite as strong, we still expect our full year results to represent a noteworthy improvement relative to last year, while also positioning the company for growth beyond this fiscal year.

As most of you likely know, we typically strive to have a strong, balanced, comprehensive performance at Brown-Forman. And as we were planning for this fiscal year back in the spring, this again was the case. However, we also felt at the time that we should sharpen our focus in FY '18 on accelerating the company's growth in underlying net sales above all else. The logic was that our margins and ROIC remained excellent and that we could create significant shareholder value by improving and sustaining our rates of underlying sales growth. And we felt that the best way to do that was with an improved blend of 3 items: investment, price/volume balancing and innovation.

Regarding investment, the idea primarily centered around making our investments work harder to produce sales growth. And that in turn entailed some resource reallocation, most notably from SG&A to A&P, and the call for more impactful consumer communication.

Regarding price/volume balancing, the idea was to make FY ’18 a year of volume-led growth. This is not to signal any strategic distaste on our part for seeking pricing in the marketplace, which we will continue to thoughtfully do. It is more a recognition that consumers and retailers do not – do have more choices today due to the influx of competitive offerings and that the advantages that a company like Brown-Forman has relative to many competitors, our investment resources and route-to-consumer strength, while also knowing that what we put in the bottle is of consistently excellent quality. So with our feeling that this was a good year to leverage that and lean a little more heavily on the volume part of the equation. And so far, so good.

And regarding innovation, we felt that we were poised for a stronger FY ’18, and this was reflected in our plans for Jack Daniel’s Tennessee Rye and Jack Daniel’s RTDs and to a lesser extent, our super-premium Irish and Scotch brands. Of course, we would need some cooperation from the environment, and that has occurred in our view, as we’ve seen an improved backdrop in emerging markets and a continuation of the nice momentum in the categories and price segments where we are predominantly focused.

In combination, we believe that these are the contributing factors to the nice accelerating – acceleration we’ve reported this morning and which has led us to increase our guidance for the full year.

In closing, let me congratulate my colleagues across Brown-Forman on these strong first half results.

And now we're available for your questions.

Question and Answer

Operator

— *Operator Instructions* — Your first question comes from the line of Nik Modi with RBC Capital Markets.

Nik Modi

Paul, maybe you can just help us understand. It's – these results are pretty dramatic when you think about the rest of the consumer staples landscape. Everyone's been talking about weakening category growth. So I'm just hoping you can provide some context on was this category driven? Was it market share driven? Can you just help us kind of understand why there's such a big disconnect between your results and basically the rest of the CPG universe?

Paul Varga

Well, I mean…

Nik Modi

And I'm talking more about U.S. – from a U.S. perspective.

Paul Varga

Okay, I was going to say for – one of the things we typically go to on – to just give more color on the type of question you ask is, is how well balanced typically our results are across the globe. Oftentimes, I think the gist to your question indicates that because we're U.S.-based and because this market is the most valuable in distilled spirits, because people have great visibility to it, I mean, I think we're over-indexed in terms of analytics by many audiences when they consider Brown-Forman and in terms of the focus on the United States. But I mean, it's evident in the results we have this morning that a nice part of what's happening with us is the bounce back in emerging markets and also travel retail, which is becoming increasingly important to us. I think that's one element to our results generally that I would highlight. But I also think, I mean, yes, I mean, we don't take for granted that even in the U.S. market that the business is actually growing and has been doing this for many years, consecutive years, at this sort of 3%, 4%, 5% range, depending upon what the quarter or year is, but – and that has 2 elements to it, of course. It means there's great opportunity that we have and then of course within that, keep in mind that our categories where we're focused, American whiskeys, bourbons, increasingly tequilas, Irish, these are categories today that are growing ahead of even the distilled spirits category in the United States. We think we're particularly well-positioned. And then within those categories, the areas that tend to be doing better are at the premium-plus levels, so – and that's where Brown-Forman's concentrated. So I think it adds up to having a strong, well-performing category, and within it, the areas where we're concentrated being those items that are driving the category.

Nik Modi

And then just another quick one from a distributor consolidation standpoint, does that change anything on how you operate, how you go to market? If you can just provide any context on how you see kind of the landscape evolving?

Paul Varga

Well, I think it will change some things market-by-market in a way that if the particular merger you're referring to that occurred, just occurred, I'm sure there will be local adaptations and ways that, that particular instance will cause some local dynamic changes that sometimes causes supplier evolutions, et cetera. But for us, I think we've seen so many of these iterations of change in the U.S. wholesale environment, and they are noteworthy every time they occur. But I think the most important thing is we have a very significant investment to our own people in the U.S. market that I think is a source of stability when you do have these changes, because our people are out there trying to build our brands each and every day as a supplement to the good work that's going on at the wholesale level. So for me, the source of stability during these changes are having very long-term partners in our arsenal in the United States and then the presence of our own RTC in the U.S. to propel the business.

Operator

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

Vivien Azer

And again, I'd echo Nik, congrats, really standout growth against a tough backdrop. As we think about that growth in the investments that you guys have made with – over the last, I guess, 5 years in terms of incremental CapEx investments, can you just remind us where you are in terms of the capacity expansion? Do you have some of those barrels coming out of aging at this point, some of the original capacity expansion that was underway? And what's your outlook for CapEx from here?

Jane Morreau

Sure. Vivien, we've been at this for, I think we entered our sixth year of investment this year of stepped-up capital. We've done a number of things. Just as a reminder of what we've done over the period of time. Some of our major investments was add another cooperage. It was to add another distillery at Jack Daniel's. Of course, numerous warehouses that have been expanded and put up at both Jack Daniel's and Woodford Reserve. And this is all in light of what we see as the continued long-term viability of this business, the sustainability of the growth that we see. So we're very optimistic and robust about that as we look ahead. This year, we had a forecast or are forecasting somewhere I would say in the $120 million to $130 million of CapEx. I would expect next year to still be another stepped-up year. And we would expect things to then come down a bit from there to get more in line with our historical rate of spending as it relates to revenue, not obviously going back to the dollar amount levels that we had prior to our stepped-up level. So think of it more in the 2.5% to 3% of revenue. We've got a number of investments we are finalizing this year that we're really excited about, one of them being our new distillery over in Ireland for our Slane Irish Whiskey brand. We just opened that distillery at the end of August. We still – opened it to guests. We're still obviously working on everything around it. And we've got the Old Forester distillery and home place that we're looking to open in the spring and early summer next year. So a lot of excitement, a lot of momentum that we see ahead for us, but I think you can see that we'll be closing out and coming down on our CapEx as we look ahead, maybe to about 2020.

Paul Varga

Vivien, additionally, because you mentioned things in the barrel, the most significant development, I think, for this fiscal year and started a little bit last year as well, is after years of waiting, the company has now had available rye product. And we did not go out into the open market and buy rye, we made our own at both – particularly noteworthy, of course, this year is the Jack Daniel's Tennessee Rye introduction. So we have waited several years for that product to become available. It was not necessarily tied to the capital expansions necessarily, but it certainly took some forethought in our part in putting down the inventory. And what's unique about, of course, rye, is it's a different recipe. And so you do have to wait. And we just think that right now, it's a particular unique and special year, not only because Jack Daniel's Rye has been introduced, but also because Woodford Rye has just been out a couple of years, is continuing to perform very strongly and both brands getting excellent recognition for the quality of the product in the bottle. And so it's given us – and in forthcoming years, we will have additional rye inventories to continue to build our presence in that category. So it's another area where we are now well-positioned for growth in the U.S. market, where that category is outpacing the industry.

Jane Morreau

Just building on what Paul said, because it reminded me of – you did ask about barrel whiskey. And you will notice on barrel whiskey has – the investment behind it has continued to increase rather significantly over the past few years. You've got to pull out different things and realize that a big piece of that was just acquiring the Scotch brand. But again, it's important to remember, we've got to be laying down today for what we see in 5 – 4 or 5, 6 years from now. And again, that reflects the robustness and the optimism that we see in the long-term growth trajectory. So you won't – you'll continue to see us increase barrel whiskey because that's going to – part of what our optimism is all about.

Paul Varga

I will add, too, Vivien, that the annual fluctuations you see in our price/volume balancing act not only reflects what's going on in the marketplace, but it also can reflect what we see going on and how we forecasted whiskey demand several years earlier. So I mean, it's all a complex consideration each year, but it does influence how you think about it.

Operator

Your next question comes from the line of Laurent Grandet with Crédit Suisse.

Laurent Grandet

I'd like to focus on the U.S. numbers and more specifically, rye and deflation. You had a great quarter in the U.S., but would like to understand how big Jack Daniel's Rye selling was? And also in terms of deflation, I mean you seem to have a 3% benefit in the quarter and I believe some of this is due to rye. But in addition, you had another 5% benefit in the first quarter. So do you think you are now at the right level of inventory at wholesaler level? Or are you higher than usual? And how we should think about this in the second half of the year?

Jane Morreau

Yes, I mean, to talk about rye, just as a reminder, we did – started shipping our rye in September. So the impact on the U.S. results was very small in the quarter, and for the whole company. So I would not say that that's what's driving the increase in our top line growth rate from 5% to 6%. What we see there is really pretty broad-based growth across the portfolio. The upper end, our premium, super-premium bourbons are doing extremely well. Think of Woodford Reserve in its various expressions, from oak and rye, they're growing quite nicely. You see that in takeaway trends. Most recent trends were up 20%, 30%, 40% depending on what expression you're talking about. Or our Old Forester brands, where we're focusing not only on the Old Forester main brand, but we're seeing an acceleration in the top line of growth on some of our new expressions, which is all contributing to the mix benefit that we're getting from these products, both from the higher-end Woodford Reserve and Old Forester. And importantly, the tequilas are doing quite nicely. In the U.S., they're up well over double digits and the overall category's growing nicely. So I think if you look at the U.S. business, it's really more organically from those parts of our portfolio. Jack Daniel's is of course still growing, maybe not at the rates that it has in the past, but it's still contributing nicely. So in the quarter, what you saw is the growth rate and what you're seeing now is more from the very broad-based and upper-end expressions that we're growing really strongly.

Paul Varga

And as a reminder, we reconcile between – in the charts at the back of the earnings release, the differences between shipments and depletions. And so of course, when you're filling pipeline, the shipments on rye would be ahead of our depletions in the United States. And the depletions, of course, at this stage, because it's still so new, would be ahead of the consumer takeaway. But the one thing that's unique about this is that there is not unlimited supply of rye for FY '18. And so there is a limit to even what we can provide, even in shipment out to the marketplace today, and that's watched, obviously, very closely. But yes, they would – you would fully expect for the shipments to be ahead of the depletions at this stage and the depletions to be ahead of consumer takeaway. But our early read on the consumer takeaway, that even though, as Jane correctly stated, it's not driving the growth rates of Brown-Forman or the U.S., it is having a positive contribution, of course, and it's being, from what we can tell anecdotally more than anything, well received in the market.

Jane Morreau

Now Laurent, I thought I would follow up just with one more question that you were asking as it related to our inventory levels, because it did benefit our reported results. You saw our reported results outstripping our underlying results at the top line, and that is U.S.-based on a reported basis that we expect to give back some in the back half of the year. It's not really – a very tiny bit of that is rye. Paul said, yes, shipments are outpacing our depletions, but in terms of the amount of top line benefit that we got from our net inventory levels being up a bit was not due to rye. So I just wanted to clarify that, and just – again, just remind you, as we said in our script today, that we do expect some give back. By the end of year, we'll be back more in balance from what we had said at the beginning of the year, maybe a point of growth, if you will, by the time we get to the end of the year, due to inventory levels.

Operator

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

Judy Hong

So just a quick follow-up on the U.S. market. Just in terms of your view of the underlying category growth that you're seeing in the marketplace, it sounds like you're saying 5% to 6% growth that you're seeing for your business is kind of in line with the broader consumer takeaway trends. So from a category perspective, what do you think that is? And then from a channel perspective, just because, obviously, the Nielsen data seems to really understate that growth rate for both the category as well as your business, so which channels are actually accelerating, from a U.S. perspective?

Paul Varga

Yes, I'll try to address that. I think that – I mean, it's hard, of course, to pinpoint a single point because we don't have a comprehensive metric for the entire U.S. marketplace. But yes, I would agree with you. I think data we are seeing in – at least using Nielsen, would understate what's happening. If you look over at the NABCA markets, which are not comprehensive for the whole market, of course, but I think they're more indicative of what's happening. And the way we're seeing that is that, that business, in my view, continues to grow in the 4% to 5% range. And then consistent with the Nielsen data as well, Brown-Forman continues to perform above the rate of growth for the industry. I think some of the consistent themes that have been there that the largest manufacturers in the – in both data sources are slightly losing share to the rest of the market, which has been a consistent theme, as smaller, more entrepreneurial players in both data sources consistently have shown higher growth rates than the market overall. And I can just say that Brown-Forman is one of the few larger players in both data sources that is performing ahead of the market overall. But I think it is a particularly difficult time to read any one individual data source, simply because they're not comprehensive. And it then forces you to think about what are the dynamics occurring within the marketplace that could be causing certain data sources to be reporting higher or lower, so we're in the same boat as you as you try to figure out all the puts and takes involved there. But we consider to see us ahead of the market. And similar to a prior question, driven in part not only by our own brands and their good performance, but also where we're positioned at the premium ends of the categories that are growing above the market. And just as a reminder, those tend to be American whiskeys and bourbons, Irish category's doing well, cognac's doing very well and tequila is doing very well.

Judy Hong

Got it, okay. And then Jane, just in terms of the tax policy changes, obviously, it's not final yet, but I think we have a better sense today than we did of what potentially could get passed in the next weeks or months. So how should we think about sort of the potential benefit to Brown-Forman? And to the extent that your tax rate comes down, have you given some thought to how that could be used in terms of flowing to the bottom line, investments, et cetera?

Jane Morreau

Yes, so Judy, there are, like you said, there's so many elements of this that are still outstanding, and we're looking forward and we're hopeful this does get passed at some point. For us, I think it will finally level the playing field with many of our competitors that have much lower tax rates. In terms of how, if this comes about and if we have a lower tax rate, it could produce higher cash as you're suggesting. I don't think it changes our approach to capital allocations that we've been so thoughtful doing for a number of years. And so again, we'll look at all the things, levers that we have available to us, make sure we're investing fully behind the business, which we think we are at this point, given our – not only the expected increase in our spending for this year relative to sales growth, but just our CapEx levels extending. But we'll step back and look at it all. As this becomes more clearer, we'll be able to communicate to everyone here more transparently in terms of what this impact may mean to us and how we will potentially use this cash as we go forward.

Operator

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

Robert Ottenstein

A few small items. I think you had said that the barrel – used barrel sales helped the top line by 50 basis points. Can you specify what impact it had on the U.S. business, which I think is running up 6% so far?

Jane Morreau

Robert, this is Jane. So used barrel [revenues] actually had, I think I said a little bit less than 0.5 point impact on our top line results. It's not included in our U.S. business. We separately talk about it as its own line item. So when we go through our various geographic areas and provide you tables, it's not in our U.S. numbers.

Robert Ottenstein

Okay, terrific. That's great. And then a little bit more longer term, Paul, I just wanted to get your thoughts on 2 areas that you're in, relatively small in one case and more important, the other, and that's Scotch and tequila. Tequila's clearly one of the faster-growing categories right now. Just I guess your quick thoughts in terms of your strategy there. Is – do you have the right brands? Do you need more brands? Where you see it going? And then some comments on Scotch and how you see the Scotch market evolving in the U.S. and whether you're happy with your presence or looking to add to it?

Paul Varga

Sure. Thanks for those questions. I mean, our tequila strategy, I think, remains unchanged. We feel we have the assets and trademarks from our acquisition of Casa Herradura more than a decade ago. And this year's performance is really just building on last year's. I mean, it's comprehensive. It's a nice performance from Herradura, el Jimador and New Mix and both in the United States and Mexico. And one of the things that's something – and there's always hidden nice performance in this, even if we don't report out to you all in a table or chart. One has been building over the last couple of years down in Mexico is Herradura Ultra, which is a – and the reason I bring that up is that versus adding trademarks, innovating within the existing trademarks, we think, is a critical piece of the growing – growth of the category and the success. And in that instance, it's been rapidly growing. It's really only available in Mexico. And in some ways, remember the tequila category down in that market is much more established and well-known than it is anywhere else in the world. So the relevance of innovation is even more impactful. So that's a project that we're looking at and continuing to be excited about in that one country, but also we'll, in passing quarters and years, consider its applicability for introduction into other markets. But that's one such example of how innovation can be important to the tequila category. But again, we're really, I mean, excited with this last sort of 2 years or so of momentum that's been building on, and we're investing more behind it. We had consistently been investing well ahead of the last 2 years, and so we just think things line up particularly well for our premium-plus tequila business. And of course, even the ready-to-drink business we've got down in Mexico continues to perform well. Again, grounded in innovation, but it's an – sometimes an underappreciated aspect of our tequila business. On the Scotch front, I mean, I continue to think it's still very, very early days for our single malt. I mean, we are such a tiny percentage volumetrically, or even on a sales basis, of the single malt category and the Scotch category overall. But we think we are learning some things about, in the first year-plus of owning these brands. The first part of it was the integration was heavily focused on just their company into ours and on the manufacturing side. The second year, we're actually making more transitions on the route-to-market side, and there's natural hiccups that go with that, that always take longer. So yes, I would say our first half of the year, the single malts aren't performing up to what we might have planned for them. But we think they're more timing related, and we continue to have very high hopes for them, as we get them positioned with our sales forces and the right partners in the marketplace and as we get them priced the way we'd like. The thing we're most encouraged about with those brands in the first, really, 2 years here is the reception to the product in the bottle. I mean, the accolades that are coming out on all 3 of the brands have been excellent. And so it's now in our hands to go do some of the things we do with some of our other brands, which is to build their awareness and distribution. And they do require, because their entire price point is sold in more unique ways than, say, taking Jack Daniel's Tennessee Whiskey to the marketplace. So we do have to refine our selling approaches, and that takes a little bit of time as well.

Robert Ottenstein

And how do you see just the Scotch market in the U.S. in general developing? And maybe if you kind of go back in time when bourbon has been strong, has Scotch followed along? I'm just trying to get a sense of how you see the 2 of them relating with each other going forward and how you want to play in that.

Paul Varga

Well, I think they actually have a lot of similarities, Robert. I mean, the single malt category in the United States has been growing very nicely for a really long time, even back – I mean, I'll just use the days when we were introducing Woodford Reserve and had started developing Gentleman Jack and Jack Daniel's Single Barrel. Around that same time, Brown-Forman actually started to represent and then ultimately took an ownership position in Glenmorangie. So our memory of the growth of single malts in the United States goes way back, and that has continued pretty much interrupted for a generation. So some of what we've seen, and because there's so much attention on the bourbon aspect, particularly the super-premium bourbons today, people – it's kind of overshadowing how strong and significant the American single malt market is. And of course, because the huge amount of volume that historically existed at the standard price of Scotch overwhelms even the growth sometimes of the single malt, it doesn't come into focus so much. Whereas if you look at other categories like tequila and Irish and then increasingly, American whiskey, where a lot of the development is at the premium end, when that premium growth is coming in, it's not being offset by sluggishness in the standard part of this category. So I think the single malt aspect has been – single malt category in the United States has been attractive for a very long time. It's one of the reasons we were so interested in the acquisition and continuing to try to find a way to participate in it.

Operator

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

Timothy Ramey

It's fun to think back 10 years ago, you were doing the – I think it was just over 10 years ago, the Herradura acquisition, and that had some sacrifices at the time, but what a payoff that's been for you. So congrats on the long-term strategy there.

Paul Varga

Thank you.

Timothy Ramey

Jane, just to ask the tax rate question a slightly different way, can you tell us what your cash tax rate might be expected to be this year?

Jane Morreau

I don't have that in front of me right now, Tim, but I'll be happy to follow up with you after the call. We said our overall effective tax rate for the year was going to be a little bit under 28%. I think we just – if you'll go back and look at last year's each of our Qs, our 10-Qs, 10-Ks, you'll see our cash tax rate at the bottom of that. So I would utilize that information and get yourself in it, too, but we can walk you through that aspect to help you. Take it offline, is that okay?

Timothy Ramey

Yes, it sounds good. I can circle back on that.

Operator

Your next question comes from the line of Bill Chappell with SunTrust.

Grant O'Brien

This is actually Grant on for Bill. We just had a question on the travel retail segment. That continues to kind of outperform, and you said it's becoming a more important part of your portfolio. Maybe kind of what stage are we in, in the growth of that segment and kind of how sustainable is that going forward?

Paul Varga

Well, it's benefiting from, I think, just the return of travel, generally. And then if you think about that channel compared to our universe at large, it is – it really is an environment for premium brand building, which is an area where we tend to be focused. So it really helps a company like Brown-Forman when you have a channel that is premium-skewed return like it is. And then within that, historically, the categories that were so strongly developed in global travel retail, it was always led by whiskey, but also alongside were categories like cognac and other very high-end categories. So the – we're still, I believe, at the very early days of the American whiskey and bourbon and tequila and Irish presence in that channel. It – so my view is, yes, it's accelerating for our company, but from a – a still relatively early stage of development in the channel.

Grant O'Brien

Okay, great. And then actually, our second question, just on the guidance raise for the back half of the year, just kind of why didn't you pass through kind of the full quarter beat? Is that just conservative on your part at this point in the year? Are you looking to maybe invest more in the brand building going forward? And maybe is that going to drive more growth into '19?

Paul Varga

Yes, I mean the whole idea was just – as Jane, I think, articulated in her – the primary reason were some tougher comps in the second half, but also the desire to invest more. So the mix of spending first half versus second is going to change in a way that has the effect that you referenced. And so we'll – we, of course, will be making those investments for the benefit of the second half, but also hopefully to position the company for continued growth beyond this fiscal year.

Operator

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

Brett Cooper

I was wondering if you guys could break down geographically where the 2 points of better top line growth are coming from? And then as you increase ad spend, I'm wondering if it's safe to make the assumption that some of the higher ad spend is going into emerging markets, given sort of the better backdrop that you've been talking about.

Jane Morreau

I heard the first part of your question. So you saw we went through all the various growth rates, but essentially, the acceleration in our growth rate, and this is why we're referring to the second half of being a little bit more difficult, came from emerging markets largely, a little bit from barrels, but primarily, that acceleration came from emerging markets. Some of that was timing. Some of it was just improving momentum in the business, and that's why we gave you some insight into the visibility of our normalized trend.

Paul Varga

And then the second half – the second part of the question was, would that then dictate or suggest a higher investment rate in the second half related to emerging markets, so…

Jane Morreau

Yes, so it may or may not in terms of emerging markets. I think where we're looking at putting the incremental investments in the back half of the year, we're starting talking about some of that. Some of that is just seeding the new brands that we have out there, Slane and the Scotch brands. Some of it is to continue to fuel the momentum that we've seen on our tequilas as well as our premium bourbons. We've seen nice growth in our – we've accelerated our investment behind both Woodford Reserve and Gentleman Jack, and we've seen results accelerate correspondingly. And then, of course, we'll put it behind Jack Daniel's. And Jack Daniel's emerging markets would benefit from that piece of it.

Paul Varga

Yes, there's no – and in terms of our approach just more strategically, we always – well, we're always looking to, as we said in our remarks, make the investments we make work harder for us at any given time. I mean, we still prefer a balanced approach geographically, because we continue to think there's growth opportunity globally for the company. And you will see pockets from time to time of investments. Like one such as this year on the SG&A front, for example, is the investment in the Spanish route to consumer, which of course in the second half we'll have higher investment levels in SG&A versus last year because we didn't have it last year. And so there's examples like that, that will be in every quarter almost or every half year. And so – but as a general theme, we would certainly feel like now is the better time to invest in the emerging markets versus 2 years ago. Same thing with, say, travel retail in some of these areas, but also, we typically are putting in incremental investments that will show up in a particular quarter behind whatever's new on the innovation front. That's the other thing to keep in mind. So if you're investing behind Jack Daniel's Rye, that will incrementally hit a particular quarter or segment of the year. So – and I think that continues to be the right mix for us. And – but we're always looking at that to see if there's not some timing-based thing to try to propel growth during a particular 1- to 3-year segment for the company.

Brett Cooper

Great. And if I could follow up with one more, I was wondering if you guys have a reasonable read on industry inventories for U.S. whiskey and sort of the implications of what that means from a competitive standpoint, obviously, 3, 4 years out.

Paul Varga

That's a hard – I mean, obviously, a difficult – we have some visibility. Obviously, Jane, the leader of it, we have significant influence on it ourselves, because of the inventories we've placed. But there's ways to estimate it. And I mean, I think that because of – I mean, how does it impact our business would be the natural question that comes from having visibility to those inventories. And I would say probably the most significant one in this year, it doesn't mean it will be this way every year, but because there are an increased number of competitors and people in the industry are leaning more onto the volume part of the volume price equation, you see Brown-Forman in some ways adopting the same philosophy. I think it has, at least for this fiscal year, and I think it's actually served us very, very well this year. It's one of the contributing factors, as I've stated. So I mean, you're constantly looking at, first and foremost, to your own historical forecasts, because remember, we had to make these forecasts a few years ago as well, and are regularly been trying to extrapolate those out into the future. And it will have – the most significant impact it will have is on how you manage your volume and pricing. There's not much we can do, if for some reason we thought that the consumer was going to walk away from the category. I do, I said this many times before, that I think the boom-bust aspect of this category will be moderated in part by the fact that aging is required. It at least will lengthen the ride up, and I think it will have the impact of lengthening any kind of bust that people might forecast. So I consider that to be a mitigating effect to the fashionability of the category right now.

Jane Morreau

And just to build on what Paul said, obviously, the boom-bust type thing, when we look at our opportunity in emerging markets with American whiskey and things like that, just the knowledge of what's out there, the social economic place that the consumers are there, the demographics, all those things, even if you're thinking boom-bust U.S., there's itself tremendous opportunities outside of the U.S. as it relates to whiskey. And that's supply we need to be laying down today.

Paul Varga

Yes, I would remind everybody the company had excellent results and growth for many, many, many years, when the category was not growing, and so it goes back to some of the basic elements, whether there's excess supply in the industry or not, critical items like investing behind your brands, having your innovation pipeline thoughtfully planned are, I think, continue to be critical elements no matter what the supply situation is.

Operator

And your final question comes from the line of Mark Swartzberg with Stifel Financial.

Mark Swartzberg

Also a U.S. question focusing on the Jack Daniel's family. Paul, if we presume you do have an appetite for getting better price realization, whether it's fiscal '19 or sometime not long after the current fiscal year, do you have confidence that there's an environment support of that, from both from a competitive and consumer standpoint? No one has a crystal ball for what Christmas next year will be like, for example. But just wondering how you're thinking about the opportunity as you at least have the early preparations for next fiscal year. Because the dynamic between you and the Beam family, for example, is obviously rather price competitive right now. And your tactics are working very well. I'm just wondering how much opportunity you see for a change in tactics, given the competitive environment.

Paul Varga

Yes, I mean, I think the thing is being responsive and also thinking beyond just the 12-week period when we make these determinations. I mean, the things that I look for, the basic old list that I would look for, are what are the – what is the category strength generally? So just you're trying to see if you have general momentum in your category. And that category, of course, when you're a brand like Jack Daniel's, is both the distilled spirits industry and the bourbon/American whiskey category, you will be looking at what we've referenced here on the call, which is the supply-demand dynamics. And then as a result, you're looking at your competitors. I think an underappreciated piece of how we sometimes look at this that actually, in my view, is starting to show a little bit of encouragement versus prior years, is the strength of the on-premise environment. I've always considered the strong and growing on-premise environment to be one of the helpful considerations when companies or brands go to raise price in our industry. And in the U.S., I mean, it would suggest to me, just looking at some of the anecdotal elements and seeing actually some of the differences between some of the data sources, it might suggest that the on-premise is beginning to improve a little bit. So that can be a factor as well. And I think the other thing comes down to how we are spending money and what our consumer communications are actually communicating, and that can be – a consumer communication can be a packaging change. A consumer communication can be an improved representation of the brand in advertising. It can be a number of things. And so there can be conscious efforts generated by the brand owner to help their cause as well. I mean, really, for us, it really is just a preference to run the business the way we're doing it right now and in terms of the price-volume mix. I mean, we just know – we know mathematically that from a financial standpoint, the more it's skews toward – and at least in the short term, the more it skews toward for pricing, the more efficient it produces profit. However, I've always used this example, but what I'd call consumption-based brand equity in a business that is inherently social, I feel it's always important to make sure that consumers get to enjoy the products in our bottle. And oftentimes, they do that with other people, whether it's in their home or in a bar or restaurant, and there's nothing like losing the momentum. We've seen it before. We saw it a little bit on Southern Comfort, when you lose the momentum that it comes from people just consuming your product. And so volumetric market share is – has to be looked at with great priority, not exclusively, but it has to be looked at great priority. And this is one of those times where we feel like it really is important, particularly given what we've got in the bottle. I just feel like reinforcing the quality of our products right now through consumption is – and trial, is really important for the company. And I think it's one of the nice contributing factors to our performance right now. And in these results, too, I just have sort of really enjoyed the positive performances we don't talk as much about these days, because of just fewer questions, but of our Jack Daniel's Tennessee Fire and Jack Daniel's Tennessee Honey brands, where we could have – and it was a conscious choice to treat those more like brands from the Jack Daniel's trademark and family and not come out with a flavor every quarter, every year. And because our people have been focused on developing them, both through geographic expansion, but also reinforcing their product attributes and why they exist in consumer communications, I think it's having an impact, of developing them more along the lines of brands than flavors. So those are some of the things that I think can help, and I – Jane's mentioned it a couple of times. I think this is – we are very fortunate to be able to lean on volume at a time when you might not be getting as much benefit from price. But to have the higher-end segments of our categories growing at exceptional rates, that gives us the equivalent of some pricing through portfolio mix. So right now, it's all working well for us, but it is subject to change, I agree. And over the last 10 years, I can probably identify a bit of a roller coaster ride for the company as we emphasize volume over price at one point and price over volume at another. And then we try – so we try to measure it over the span of maybe 10 years.

Jason Koval

And thank you, Jane and Paul. And thanks to all of you for joining us today for Brown-Forman's second quarter call, and we hope you all enjoy your holiday season. Please feel free to reach out to us if you have any additional questions. Take care.

Paul Varga

Thanks, everyone.

Jane Morreau

Thank you.

Operator

That concludes today's conference call. You may now disconnect.