Brown-Forman Corporation, Q1 2011, Earnings Call 2010-09-01

Presentation

Operator

Good morning, my name is Kimberly, and I will be your conference operator today. At this time, I would like to welcome everyone to the first quarter fiscal 2011 conference call. — ***Operator Instructions*** — Thank you, Mr. Ben Marmor, you may begin your conference.

Ben Marmor

Thank you. Good morning, everyone, and thank you for joining us for Brown-Forman's Fiscal 2011 First Quarter Earnings Call. This is Ben Marmor, the Director of Investor Relations at Brown-Forman. Joining me today are Paul Varga, our President and Chief Executive Officer; Don Berg, Executive Vice President Chief Financial Officer; and Jane Morreau, Senior Vice President of Finance. John will begin our call this morning with a few remarks about our quarter, our guidance and our recent trends. Paul will provide additional commentary on the quarter and our guidance.

As always, this morning's 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 fiscal 2011 first quarter. The release can be found on our website under the section titled Investor Relations.

We have listed in the press release 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, Form 8-K, and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we also will be discussing certain non-GAAP financial measures. These measures and the reasons management believe they provide useful information to investors regarding the company's financial conditions and result of operations are contained in the press release. And with that, I will turn the call over to Don.

Donald Berg

Thanks, Ben. Good morning, everyone. This morning, we issued our fiscal 2011 first quarter earnings release and reaffirmed our expectations for the fiscal year. In many ways, our first quarter is a continuation of the story we've been seeing over the previous six months or so.

Looking at the first quarter, we believe the key takeaways are the following: First, we believe the year is off to a good start, particularly as it relates to our net sales performance. Once again, our geographic diversification played an important role in our results. Our international sales performed quite well with underlying sales up 8%, while our U.S. business was a little softer than expected. That netted to a 3% organic growth rate, again not dissimilar to our recent trends. If you look at the last four quarters, including this last one, on an underlying basis, our quarterly sales results showed a 1% decline, then 2% growth, then 3% growth, followed by this quarter's 3% growth. So in total, considering this environment, we continue to be pleased with the direction in our sales trends.

A second key takeaway is that our operating expenses were about where we expect it. On an underlying basis, advertising expenses were up about 2%, underlying SG&A was up 12%, primarily due to planned strategic investments concentrated in the first part of the year and incremental pension expense that we noted in June and that we will see throughout this fiscal year.

Our third take away is that foreign exchange hurt us during the quarter. But having said that, exchange rates improved throughout the three-month period. So looking forward, based on recent rates, assuming they hold throughout the rest of the year, the overall impact is not as large as we originally expected. If you remember, during our conference call in June, we said at that time that we expected our 2011 earnings per share to be negatively affected by $0.15 based on the exchange rates at that time and that this effect is included in our guidance. At recent rates, that impact to full year EPS compared to a year ago is now projected at about a nickel.

The last key take away, while we continue to be cautious with all the uncertainty in the marketplace, we confirmed our full year guidance of $2.98 to $3.38 per share. This recognizes no change in our underlying operating income guidance of mid-single digits. And so adjusting for the change in our foreign exchange assumption noted above, that puts us towards the upper half of the range at this early stage of the game.

Let me spend a few minutes talking a little bit about the economic climate and the competitive environment and talk in a little more detail about our SG&A expenses in the first quarter. In June, when we did our year-end call and spoke about expectations for fiscal '11, we said at that time that we are hoping for an improved economic and consumer climate, that we are beginning to see some stabilization in the on-premise, the trading down was abating some and that we are hopeful the environment will become conducive to increased pricing. So far, we have not seen the improvement we were looking for, and much uncertainty remains. The economy continues to have a clear impact on the consumer environment. Particularly in developed markets, consumer confidence is low, savings rates have increased and unemployment remains high. The on-premise channel continues to be a challenge in many markets.

Looking more closely at the U.S., Spirits continues to grow at low-single digit rate. Using NABCA data, some trends we are seeing on the quarter include: a weakening in both the on- and off-premise channels; popular price brands, those priced between $10 and $15 gained share, as did brands priced higher than $25. Innovation or new products contributed about half of the market's growth. This innovation seems to be broad-based and a good part of this innovation is coming from some of the smaller private companies.

And finally, performance seem to swing with changes in consumer sentiment. Outside the U.S., the performance of the spirits market is mixed. Emerging markets, particularly in Latin America and the Asia Pacific region, are the healthiest. Europe had some relatively healthy markets while other European countries continue to struggle.

Within this difficult global environment, we are pleased with our net sales growth of 1% on a reported basis and 3% on an underlying basis. As we said in our earnings release, our sales growth was broad-based. We made gains in several international markets, more than offsetting sales declines in the U.S. These gains were in both developed and emerging markets, from Australia, Germany, the U.K., Canada and the travel retail channel, to Mexico, Turkey, Russia and India. We continue to watch the consumer closely and work to keep our brands top in mind in this uncertain environment.

Moving on to the competitive environment, in June, when we provided our earnings guidance for fiscal 2011, we said, we are planning for fiscal 2011 to remain competitive in terms of increasing prices but are hopeful that discounting in the industry will be less pervasive. We had also heard a lot of public commentary from some of our competitors about how they were going to start raising prices even at the expense of volume.

During our first quarter, from the syndicated data we reviewed, it appeared that the pricing environment to remain competitive. Still, we maintained a flat price mix overall during the quarter as higher volumes drove our underlying net sales growth. As we look forward, we'll continue to seek opportunities to raise our prices, but we expect the pricing environment will remain very competitive.

Let me speak for a moment about innovation, a key theme in the competitive environment, particularly in the United States. NABCA data reveals that new products are playing a key role in incremental volumes to the Spirits category, particularly over the most recent three- and six-month period. In fact, new products contributed more than half of the U.S. Spirit category growth during our last quarter.

Interestingly, over half of these new products are premium priced or above. The NABCA data shows that most suppliers benefited from new products boosting their sales trend, we expect this to continue. We are also participating in the innovation trends as we have introduced a number of new package changes in the quarter, as well as new line extensions, most notably Southern Comfort Lime and Chambord Vodka. However, while we expect this innovation to contribute to our sales growth, the bulk of our first quarter growth is from our core portfolio.

Moving on to adding a little more color around our SG&A expenses in the quarter. As I mentioned, our first quarter SG&A increased 12% on an underlying basis. On a reported basis, SG&A grew 13% when compared to the prior year. There were several factors that contributed to these increases. First, the year-ago comparable period was unusually low following our reduction in force, our early retirement program and extremely tight management of discretionary spending.

Second, this year's SG&A was affected by some front-loaded expenses. These expenses range from market and consumer research studies to set up costs for our own route-to-market operations in Germany and Brazil. Also affecting the growth rate of our SG&A

was an incremental $5 million pension expense, which will be with us for each of the next three quarters.

Our full year plan anticipates that the SG&A growth rate will moderate particularly in the back half of the year. So net-net, I would not read too much into the quarterly figures and estimating our full year SG&A expense. I believe this barely summarizes our first quarter results.

In closing, based on an underlying sales results and our expectations for total spending over the balance of the year, we are reiterating our expectations for fiscal 2011 and affirm our guidance of $2.98 to $3.38 in earnings per share for the year. Now let me turn the call over to Paul for some additional comments.

Paul Varga

Thanks, Don. I'll talk just briefly here, supplementing what Don said, and I want to reiterate that since that we think we're off to a good start overall, as Don mentioned, and I'm particularly pleased with the start in our international markets, let me mention just a few company-wide highlights, I think, that caught my attention.

First was the Jack Daniel's family, overall, was off to a nice start with plus 4% constant currency net sales. As you might recall from either our June call or if you tuned into our annual shareholder meeting, the continued expansion of the Jack Daniel's family and our International business overall are important pillars in our 10-year strategy for the company. We're also pleased with the performance of our leading tequila brands, most notably el Jimador and Herradura, building nice momentum in recent quarters both of these brands. And el Jimador continues to do very well in the United States.

Also super premium brands continue to do well, pretty much across the Board as the company with Gentleman Jack, Jack Daniel's Single Barrel, Woodford Reserve, Herradura, Chambord, Sonoma-Cutrer and Bonterra, all showing positive trends in the quarter. The development of our tequila brands and these super premium brands are an example of another one of the important pillars in our 10-year strategy, which is our ambition to grow the rest of our portfolio faster than Jack Daniel's.

Now largely due to softness in Southern Comfort's recent performance, we're not currently achieving this ambition. However, the development of these brands over the long term is important to Brown-Forman's long-range strategic conditions.

I'd also like to cite the performance of our ready-to-drink brands in the quarter, which continue to do well and were off to just a super start. And they, of course, are helping the growth rates of the Jack Daniel's and el Jimador families overall.

Our soft spots for the quarter is Southern Comfort and the U.S. in general and we'll obviously be focusing on improving performance for the balance of the year.

Just to reiterate something Don said, it's still very early in our fiscal year. And while we remain concerned about, just like everybody else, about the global economic conditions and some of the heightened competitiveness that's in the marketplace, we're really pleased with a good start to our fiscal year. With that, we're happy to take any questions that you might have.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line Judy Hong with Goldman Sachs.

Judy Hong

I guess my first question is just in terms of the U.S. market and the softness that you've alluded to, maybe just get a little bit more perspective on that. First, from an industry perspective, it sounds like you guys sound a little bit more cautious than some of your competitors. You referred anecdotes of on-premise actually getting a little bit better even in the recent months, so I'm just wondering if there's a little bit of a disconnect in terms of what you're seeing from an industry perspective versus some of your competitors. And then secondly from your share-performance perspective, I wanted to just get a little bit more granularity on how much your share was up or down in the second quarter in the U.S. and what you're doing to improve that share trends going forward.

Donald Berg

Yes, Judy, this is Don. And in terms of the on-premise environment, I think we said in June that we were starting to see some signs of stabilization. And we did start to see some early signs of that in the May and June, July kind of went the other direction and I think it just kind of shows a lot of how quickly consumers are reacting to the environment that they're living in today. And the quote that I referenced was coming out of the NABCA data for July where you can actually get a read on some of what's happening between the on-premise and off-premise environment. So what all maybe going on there, it's hard to tell at this stage. I mean, it just seems like it continues to see some of the volatility we've seen in the past. It's hard to tell how weather might have impacted on how much consumers were going out or if it's just more a matter of reaction to the economic climate that they're seeing. But we do remain a little bit tentative about what we're seeing in that arena.

Paul Varga

I might supplement it just a little bit. Some of the ways that tend to organize that are things that we've been seeing all along, which I think the consumer continuing to seek out value, however they define that. It's not always about trading down, but there are, I think, all sorts of different expressions of that whether it's people seeking larger-sized purchases for lower-cost per ounce, for example, but it can also reflect in pricing as everyone would naturally expect. But I think the environment where consumers are consistently re-evaluating and retailers in the on-premise environment constantly trying to find ways to create value. So it's hard to go on to one thing, which would be typical to say how's it's pricing. But certainly, trading down would be a component of it. Actually, noticed also in the more recent months something that I think is maybe more unique to a company like Brown-Forman, which is that we saw particularly in July, but also maybe a little to the summer months and a bit of an acceleration in the difference in performance between brown goods and light goods. When we use that phrase, it's sort of a summary phrase. But clearly, vodka continues to perform very, very well and that the trends as you move toward the more current months have – you can just notice that the Whiskey categories, liqueur category, are struggling a little bit more. And that's where I think Don made reference potentially, who knows whether May can be a contributing factor after July, we just don't know. But it's one hypothesis that might be out there. And I think the other thing Don mentioned is a couple of times, which is just as a whole bunch of new activity in the U.S. market around line expansions, new products, the way people are promoting the products. And we're particularly in tune to that because we have Jack Daniel's versus but also Southern Comfort. And particularly on Jack Daniel's, it's such a big brand that you have many, many occasions from which you derive your business. So you can get competition for all those occasions. So we're really trying to pay attention to whether it's super premiums sipping occasion or an on-premise mixed drink or shooting occasion or any wide variety of sorts of business for Jack Daniel's to have. And I think when you have innovation, lot of these items mentioned you can get even at the small in the grand scheme of things, it can have an impact in a particular month or a quarter. So we're looking at closely and actually I'm sure as we go through the course of the year be trying to understand it better and promote our brands and accordance of one we're seeing some of that competitive activity.

Judy Hong

Just in terms of your share performance of a suspect that first quarter, your share was down and maybe just go through what drove that softness in terms of the share performance and what you have in place to drive better share performance for your brand?

Paul Varga

I mean, I think it depends on where we think – it's that last comment I think, it is where I was tried to reference…

Judy Hong

More just the U.S. market.

Paul Varga

Yes, I think that, that's the point. I think if your comments are on the U.S., I mean, I think it varies by bringing that from corporate-wide standpoint.

Judy Hong

You've talked about Southern Comfort seeing softness. Was Jack Daniel's up from a share perspective?

Paul Varga

It depends on which Jack Daniel's probably has from which Jack Daniel's probably has from our – the way we look at the Jack Daniel's business, as many as a half a dozen competitive set.

Judy Hong

Whatever you think is maybe the most appropriate way of looking at it…

Paul Varga

Well, I think probably the best way for you maybe to make sense of it is the reference I was just making, Jack Daniel's and Southern Comfort relative in the first quarter relative to the performance of this distilled spirits overall would have seen share erosion. And that actually – a lot of the leading brands over the last two years during this tough economy than losing share to either a wide variety of brands that can be higher-priced brands from small basis, but also the value-conscious consumer trading down. We've talked about that a number of times. I mean, one of the biggest influences for our corporation, though, I think, is we are skewed as a company more toward the Whiskey and Liqueur side of the business and if you just look at the figures closely, a lot of the activity in spirits, particularly over the last year or so has been very much concentrated in vodka and light goods. And so it's a question that we're continually working on. It's one of the things we mentioned in our last call as to why our work on Finlandia and the tequilas and some of the areas where the actual – there's better wins at the back of the categories are really important to the company.

Jane Morreau

Judy, I wanted to add one thing. And you're focusing primarily in the U.S., but as Paul alluded to, one of our strategic pillars is to grow internationally faster than the U.S. and that continues to be one of our biggest focus, and more than half of our business comes from outside the U.S. And our international market share has grown in nearly all of our markets overseas, so we don't want to lose sight of that very important factor as you think about our performance in our business, how big our International business is to us.

Paul Varga

Yes. I would venture to guess, Judy, that if we were doing a global market share for the quarter, we won't have data – we don't typically don't get it on a quarterly basis that would venture to guess that Jack Daniel's, it has been its history on a 12-month basis to grow share of the Whiskey segment, globally. And we would anticipate that unless we see data that shows the change in the trajectory of some of the other leading global brands that on a global basis we would continue to see share gains.

Judy Hong

Don, just in terms of the operating expenses, is there a way to quantify how much some of these upfront kind of temporary investment really impacted the first quarter, just so that we have a better gauge in how the operating expenses really flows through for the balance of the year? And from a timing perspective, if I look at your quarterly progression last year, is really the fourth quarter where you saw a big jump in terms of the SG&A expenses so there's a lot of the year-over-year comparisons getting more favorable mostly in the fourth quarter that we'll end up finding.

Paul Varga

Yes, and that's what's driving a lot of the comment I made earlier. And if you remember, towards the end of last year, we ended up having some compensation-related items that really increased over the course of the last half of the year that at this juncture, we wouldn't expect to see this year. And so the comps get a lot easier as we go forward. There were, as I mentioned, there were some certain things like some market research studies that we've been doing on a strategic basis that ended up in the first quarter. There's a host of things that have kind of ended up being in the first quarter this year. We didn't have last year in terms of some meetings that we're having, and these other kinds of things was related to travel and entertainment that are all kind of front-end loaded. And so between the abatement of those kinds of expenses and going against the kind of comps that you're talking about, that's where we feel pretty comfortable where we are right now and in terms of the overall operating income guidance that we gave, why we feel we can stay there because right now, pretty much everything is where we expected it to be.

Operator

Your next question comes from the line of Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

Paul, advertising as a percent of sales has come down pretty significantly in the last couple of years during the downturn and even in the few years before that. So I'm just wondering, do you view this new level as the right base going forward or do you anticipate a need to reduce marketing spending as you look out over the next couple of years?

Paul Varga

I don't see the need to boost marketing spending as defined by the ratio that you're using. I think that the brand building models we have brand by brand tap into everything from packaging to cost of sales to discount line all the way through to SG&A. So we really redefined over the last – this goes back several years now how we really view investments. And so I think it's not something we focus on with great precision trying to manage to an advertising as a percentage of sales ratio. And as we sit right now in the environment we're in, I don't think any of – I mean, we're really sort of pleased with the progression of our underlying sales growth rate that Don mentioned over the last four quarters or so. So a lot of what we're doing we think is working at the top line. We want to just to try to continue it. I don't think that there's any competitive disadvantage we've heard for our company around the world right now that deals with the level of advertising spending.

Dara Mohsenian

And just in terms of the mix of investment behind your business, I guess as the consumer recovers over the next couple of years once you think you'd see a shift back to the marketing line from some of these other areas that have been a focus over the last couple of years?

Paul Varga

It just depends. I mean, it depends on how much of the growth story for a particular brand, other growth plan to deal with things such as packaging or product formulation or I mean, the hottest brand we've got in the United States right now. I mean, the primary impetus for us is acceleration and growth was a product formulation coincided with a packaging. It's really a modest packaging change and that's el Jimador, which created momentum from which we then have continued to put some resources behind it. Because if we thought that particular brand was very much under invested we were under investing behind it because it's base of distribution was small, et cetera. So I think it varies by brand so it's just a hard one to give you a blanket answer that says, yes, as the consumer returns, you should expect to see big media budgets. I mean, it depends on what we're trying to accomplish with each brand and each market around the world.

Dara Mohsenian

And then Don, can you give us an update on your agriculture costs and your grain strategy if you have hedging in place, what level of pressure you're expecting this fiscal year, and if you expect incremental pressure next fiscal year also?

Donald Berg

Most of the lion's share in terms of when you look at the value in terms of where our cost of goods when it comes to grains, it's mostly around corn. We do have a hedging program in place. I believe we're about somewhere at a little bit over 60% hedged at this juncture. And so we aren't as exposed to variability of the corn prices. And relatively speaking, it's not a large component when you think about the overall magnitude of our cost of goods and if you went back a couple of years ago, when corn prices just really spiked up to like $6 and $7 a bushel, I think the overall impact to us was somewhere around $10 million in that year. And so as much corn as we buy, it's a relatively small component in our overall cost of goods sold.

Operator

Your next question comes from the line of Lauren Torres of HSBC.

Lauren Torres

My question is relating to your inventory levels. If you could talk about what you're seeing with respect to distributors and retailers. I know there's been reductions historically, I'm not sure if we're at comfortable levels now or if the environment's getting softer, if you're seeing some changes there?

Jane Morreau

Lauren, this is Jane. We continue to see volatility really around distributor inventory levels that we saw on the quarter, largely in this particular quarter was in Southern Europe that we saw some fluctuations in inventory levels. But we continue to see fluctuations in different pockets of the world. I think we said that at the end of last year, we thought we were back in line with what was expected to be. But again, I think you're going to see from quarter-to-quarter that fluctuations happening.

Paul Varga

I would say compared to what had us all concerned that maybe 15 to 16 months ago in terms of some of those more dramatic reductions that were occurring post the fall of 2008, we haven't seen anything like that kind of – particularly, as you go beyond the quarter, we think that some of those inventories were rebuilt through the course of that flat '10 and so we think we are probably a little more stable overall inventory levels, but it's going to jump overall inventory levels but it's going to jump around based on everything from price increases and the timing of those to distributor changes to a wide variety of things, but I think those are different. You kind of expect those versus things where people are just ratcheting down their inventories, and so we haven't seen as much of that, just conscious reductions of inventories.

Lauren Torres

I can also ask on pricing. You keep mentioning that you'll remain competitive and just curious versus some of your larger competitors here in the States, what you're seeing –

I know you're not going to reveal your pricing strategy at this point but just kind of your reaction to what they're doing, how you're going to manage that as you think about this year.

Donald Berg

Lauren, it's Don. Certainly, the competitive activity that we feel like we're seeing at the field level continues to be very competitive. We've talked about this quite a bit. I mean the way that we think about pricing is really more along the lines of keeping our consumers and our franchise and really being very specific and targeted around our pricing strategies. And so it will vary from state to state in the United States depending upon what's happening in the individual markets and what kind of competition that we're seeing and kind of the environment within that state and how much we need to be doing in order to keep our consumers, at least, in our franchise. The way we've had talked about in the past is particularly in those states, with particularly hurt in the downturn and for those in our franchise that continue to be hurt, giving them an opportunity to be able to stay and then to buy in various times. As much as we talk about how the economic recovery has been very inconsistent outside the United States, there's some inconsistencies within the U.S. too. And so keeping this focused on, I'm looking at a market-by-market basis has served as well. And when you look back at last year's holiday timeframe, I don't think we went as deep as some of our competitors went. And when you ended up looking at the syndicated data at that time, it pretty much bore out that we stayed pretty strong in the kind of price mix category and ended up being one of the best performers in terms of net sales. And we're going to continue – we were very happy with the performance during that time and we're going to continue looking at pricing kind of along the same lines as we have historically.

Paul Varga

Lauren, I might just add one thing. I think one of the ongoing influences we should all – I mean, if you were going to pay attention to something, it would be to this on versus off proportion of business that's occurring in the on-premise relative to the off-premise. And one of the things in our industry I think that has a big influence on how pricing unfolds in the entire industry is when you have a softer on-premise environment, I mean, I think you generally see as an industry less pricing capabilities because – I mean, just the one thing we know as consumers move from on-premise to off-premise, they just generally become more price sensitive. And so I think that distribution of business actually has a big of an impact on our industry as it does relative to other packaged goods, which don't have that heavy on-premise component. And so they've got 100% of their pricing considerations concentrated in the retail environment. And for us, I think subtle shifts as we've had in this on- and off-premise environment has played a major role in the ability to get pricing. I mean, my take on looking at it over more of a two or three-Year level is the people are still getting moderate price increases is the degree to which they have to maybe give it back in terms of promotional pricing is the open question. And the strongest brands you'd think should be able to hold in there the best, and we certainly have a few of those. So in any event, I don't think it means the end of pricing. I mean it's just how you treat the combination of front-line pricing with promotional pricing. And I think some of that, at a corporate level, gets influenced by the ability to get higher-priced items typically through the on-premise.

Lauren Torres

I know it's really hard to gauge this but do you think that the competitive activity heading into this holiday season could potentially be worse than last year? I mean, any sense of comparing this year versus last year?

Paul Varga

I'd be guessing. I would say probably an increase in component of competing for retail, merchandising, attention and space, and priorities is going to be not only dealing with pricing but a lot of this innovation as well. I think there's so much that a lot of the companies are attempting to do in terms of line expansion, et cetera. That will be another form of competitiveness at retail beyond just the normal pricing.

Operator

Your next question comes from the line of Tim Ramey with D.A. Davidson.

Madeline Miller

This is Madeline Miller stepping in for Tim today. I was just wondering, so the Ready-to-drink segment, it's relatively new especially the good growth you guys have seen. One of the questions I had is what do you guys expect out of that for the holiday season?

Paul Varga

Well, I think for us, the Ready-to-drink is really a global category so it goes well beyond the perceptions of a lot of people who cover our company from a U.S. perspective would have. So it may be a wide variety of comments. Actually, our largest, one of our largest, I guess it is our largest RTD market is Australia, so that is actually lots of holiday seasons also, the beginning of their summer selling season. So their influences are quite different than the kind of holiday season we would have in this hemisphere. All I can really say about it is it'd be hard to forecast any sort of competitive dynamics there. All I can say is that we've been benefiting over recent quarters from the development of ready-to-drink expressions under the Jack Daniel's, el Jimador, Southern Comfort trademarks. And we're really pleased with those brands. And those forms contribute not only economically to the company but also from a consumer standpoint and our ability for people to try and mix drinks from our trademarks and also some of the branding that comes from a single-serve expression of Jack Daniel's, Southern Comfort or el Jimador. So the numbers are in our release are actually very, very good start as I mentioned to the fiscal year related to the ready-to-drinks. We think they're an important marketing component, and we're pleased with the way that they've been actually contributing to the financial performance as well the last couple of years.

Madeline Miller

So you reiterated the guidance even though the EPS this quarter was a little bit low than the street expectations. In terms of timing or growth or cost reductions or FX, what's going to change this year in order to reach your guidance?

Paul Varga

To be honest about it, I think that we don't give quarterly guidance. And so part of it is that, as we said, both Don's and mine, we think we're off to a good start and performing within the expectations we had for ourselves at this stage. We talked earlier in response to one of the questions about the seasonality of our spending. Some of the changes that we saw just in the first 90 days related to foreign exchange rates. So a couple of those things, if I'm trying to read your question, is to how do you make up from where you all have – I think part of it deals with our expectation of a continuing nice top line progress and then a moderation of the expenses that we saw in the first quarter, which we would fully expect and we sort of explained a little while ago. And then also then you start to bring in, when you do an EPS range, of course the things such as foreign exchange and other factors. So we reiterated our guidance this morning.

Operator

Your next question comes from the line of Thomas Russo, Gardner Russo.

Thomas Russo

India, where you mentioned you saw good growth, what's your route-to-market there now and sort of partner, and I mean products in the market? Just some color on India.

Donald Berg

In India, we have a sales force on the ground there. Their primary role is to create demand, and so they're more like brand ambassadors and market promoters and calling on accounts, and particularly the on-premise arena in order to continue to introduce Jack Daniel's in particular to the consumer base there. Outside of that, the route-to-market basically and we've got some wholesalers there that we do business with it. We import the product into, and it just kind of makes its way through the traditional channels.

Paul Varga

And Tom, in end market it's very Jack Daniel's-focused at this stage. There's a lot of our competition that are in the local Indian whiskey market, they have JDs. And as you well know, it's a very good brown spirit market with the Indian Whiskey category. And so far, we're playing mostly an imported stab with the Jack Daniel's brand.

Thomas Russo

Don, you also mentioned the investment setup cost for the route-to-market in Germany and in Brazil, can you give some color on that and then what type of benefit do you think you get from that current investment spending burdening income?

Donald Berg

Starting with Germany, you might remember in Germany, we had a commissioner arrangement with Bacardi. And so through that, we still – at the time we went to commissioner about five years ago is when we first had basically all the sales coming into our sales line but still paying some form of a commission for their sales expenses. So we have taken the sales side across to us now as well, along with all of the logistics and distribution of the products there. We're in the process of hiring a number of folks, a lot of that happened in kind of the May, June timeframe. We are gearing up for kind of a early October start. We're shooting for October 1, but certainly some time early October to have the thing up and running and we'll have the thing fully transitioned over to us, so that at that juncture we'll be like any traditional spirits company that has their own distribution in that market. In terms of the benefits we expect to have, there's a couple. One, we definitely believe that Jack Daniel's in Germany is a must-stock-type brand. And that status gives you a lot of opportunity to have access to the trade and to kind of use that access to your benefit as opposed to allowing your agency partners to use it to his benefit. And so we see benefits coming that way. The other benefit, Tom, in that particular market is is that it will allow us to put even greater focus on the rest of our portfolio beyond Jack Daniel's. And one of the things that we have found traditionally in these agency relationships is that everybody is excited about Jack. It's a very easy sale, it's something that you can get your own sales force very efficiently excited about. Southern Comfort, to a certain extent, but when you go beyond Jack and Southern Comfort, and you get into a lot of the missionary work that's required in terms of building brands from scratch, it gets a little bit more difficult to get an agency partner to be willing to put that kind of sweat equity into something they don't own. And so as Paul mentioned and kind of BF-150 [ph], where one of the things that we're looking at is both expanding our international presence, as well as growing the rest of our portfolio faster than Jack Daniel's. It's going to be moves like this that's going to help us to accomplish that objective. Brazil is similar. There's really not much more to add when you compare it to Germany, and we've been in a traditional agency arrangement down there for quite some time. Brazil's a very difficult complicated market, and we just come to the conclusion that if we're going to make some strong inroads in that market going forward in the future, it's going to take the focus of a Brown-Forman group down there in order to get that job done.

Donald Berg

Tom, I know you assume this, but I just want to reiterate so people don't miss it. While we're having some of those upfront cost now, one of the ways you pay for those is you come along off those. When we make a shift such as we do in Germany, we see the margins go up in the gross margins in order to help pay for those cost of having your own route-to-market. So that's one of the ways we typically been able to afford it. You don't actually go in and just start having upfront cost without any kind of benefit. SO we do recoup these costs as the year goes on by having a higher selling price or higher profits for Brown-Forman because those were shared with Bacardi in the past.

Thomas Russo

Then the same theme one more in the country, Russia and the proposal that you go to market with the soft drink bottler. How does that stand?

Donald Berg

Are you talking about in terms of...

Thomas Russo

I think there's a measure with Coca-Cola possibly partnering with you in Russia.

Donald Berg

There is. I'm not just sure. We've have that relationship with them in a number of markets. We started that relationship a couple of years ago in a couple of smaller markets. I think we started in Croatia and we've added the Ukraine and couple of other places that went very well. And so we made the decision to make the change over to Coca-Cola in Russia this year. I know there was something in the press earlier that talked about some difficulties that Coke had in getting a license there to do business. They've got that license. All of that is beyond an issue at this stage. We're in the process of finalizing our discussions and conversations with them, and we're looking to have that also up and running sometime in the October timeframe. And just to clarify that, Tom, it's the Coca-Cola Hellenic Bottling Company as opposed to Coca-Cola Atlanta.

Operator

Your next question comes from the line of Kaumil Gajrawala with UBS.

Kaumil Gajrawala

Can you talk a little bit about on-premise trends? It seemed like sequentially they had stabilized and maybe we're getting better. And my sense from the commentary is that maybe they're not trending negative or sequentially maybe just looking like they're getting worse.

Paul Varga

My view is there's some data in the more recent months in the United States market, for which we had some data, that showed while we thought there was some stabilization maybe occurring in the prior quarter to that it actually showed more shift toward the off-premise versus the on in terms of the distribution of the business overall in the latest data. But my advice on it is not to try to forecast what will happen over the next 12 months and what happened in the latest 60 days, because the data itself can vary wildly on a one-month or even three-month basis. So we're trying not to read too much into it. I think the issue with it is there continues to be a consumer out there that is looking for value. And that one part of course I think take them to the off-premise and when they do go out, I mean, we were speculating earlier on the call, then maybe some of this could be weather-related, particularly in parts of the world where it was very hot during the more recent weeks. But it's all speculation. So if that was part of the contributing factor, you'd expect us that, that reverse when things weren't so hot. So we really don't have a definitive view on the direction of what's going to happen with on-premise and off-premise as it relates to the next quarter or particularly the next eight weeks or 12 weeks.

Kaumil Gajrawala

And then on the promotional activity that we've been seeing, especially what we saw during the holiday period, would you say that yourselves and the competitors in the industry in general attained a lift that they had hoped for whether it stepped up to similar activity or the volumes come in a bit below despite how heavy the promos were?

Paul Varga

I just wouldn't know how to even answer that question exactly. I didn't have a lot of expectations around competitive promos. So I think you'd have to look at each individual brand and the region where they were giving the promotion. So I really wouldn't be able to comment on it in a broad way. I just don't feel comfortable doing that. There might be some data you're looking at that would illuminate it better but I don't have a real view on that.

Donald Berg

It's hard to know how the competitors are building up their own promotion. But I know, I mean kind of what I said earlier. As we came out of last year's holiday period, we were pretty happy with the effect that the promotions that we had out there had and our ability to kind of find a sweet spot between giving the consumer value and how to translate it into volume and value for us at the end of the day.

Paul Varga

I think that just, again, there'll be a temptation to look at the latest data and then forecast it out. I think you're going to see, whether it's syndicated data in Spain or Mexico or the U.S. I think you're going to see many of the players in the industry regularly dabbling with their price volume mix in order to try to find the right recipe for value in an environment where it's not perfectly clear. And so I think it's going to be really hard for anybody to make blanket statements about an era of this type of behavior, that type of behavior. I find it personally really difficult so I think it requires a review of the data at a much more granular level than we're able to make with sort of an overwhelming observation, particularly as it relates to doing business all over the world.

Kaumil Gajrawala

— ***indiscernible*** — talked about there is, looks like there's going to be quite a bit of innovation in the back half of this year. Is it almost all focused on – is it primarily value-based innovation or are we seeing some launches of premium products and some things that couldn't be net revenue case numbers up from a mix perspective?

Paul Varga

I'll take some and then, Don, you can chime in. Don actually cited, at least in the U.S. innovation arena, that a lot of the innovation was at the premium price level and above. I think there is some value-based innovation. I thought you have seen quite a bit introductions in a popular-priced arena, particularly for unaged products. But I think it's all over the place. And in fact, what I think people are – I think if it's good innovation, really genuine innovation, and it comes from consumer insight, it may be dealing some of the trends that we've been talking about, such as the shift that's been going on the last couple of years from on- to off-premise. So RTDs or ready-to-pours end up being expressions for a period of time where people are consuming more in the off-premise that are seeking the same convenience that they get by having a bartender in the on-premise. So I think some of the innovation is actually directed at some of the behavior that people are observing. I know that that's part of it in our case, and I think some of the things that I see going on from our competition are trying to capitalize on the same trends. So I'm sure when you get innovation going, there's always going to be just some instances of steps just thrown out there. But I suspect the stuff that makes it will actually be directed at true consumer or trade needs and help the consumer and meet the consumers' needs as well through the period of time it has changed from the way it was three or four years ago.

Operator

Your next question comes from the line of Ian Shackleton with Nomura.

Ian Shackleton

Two questions really, when we talked a little bit around the holiday season coming up in the U.S., and obviously you're giving a reasonably cautious message into that. I mean I just wondered if there's anything more substantive you're seeing in terms of wholesaler ordering patterns that's causing to be a little bit cautious. So is it really just a worry that the industry pricing dynamic may not renew and consumer meant weak? That's the first question.

Paul Varga

I think it's the latter. I mean in terms of the consumer environment that you referenced there to – just using the U.S. data as an example, you've got a 12-month and a three-month trend at the consumer takeaway level. I saw at least the NABCA data that's about the same, it's about 1.5 point, something like that, at the volumetric level. So we haven't seen any big uptick that would cause us to say that there's some acceleration on the way. I think it's really more looking at that kind of data than it is something to deal with orders or shipments or anything like that.

Donald Berg

I would just comment, too. The holding around wholesaler inventories and what have you, we have been – when we do this going from reported sales to underlying sales, one of the factors that we take into consideration on that is the distributor-wholesaler inventories that we see. And we've been doing it for a very long time. And when you look at it prior to when we had the economic crisis, it was not unusual to see that varying up or down a point or two on a quarter-by-quarter basis. And so in anything sometimes it could be the U.S., sometimes could be outside the U.S. There could be different factors at different times that would be driving it. And so as I've seen that number now kind of slowly come back into kind of a 1% to 2% range every quarter, to me it feels like we're getting closer to a normalcy situation than anything else. And so I don't think there's anything that we're necessary seeing in kind of wholesale partners that's affecting everything about the holiday season at this juncture.

Ian Shackleton

On the same question, really around there was a comment about some further destocking in southern Europe. I'm just keen to know whether that was mainly focused on Greece and where clearly there was a real downturn, or is it more common to quite a few of the Southern European markets.

Jane Morreau

It was actually just a handful of markets, largely there were some in Greece, there were some in France and Spain. So just a handful of markets in southern Europe.

Ian Shackleton

It sounds, what you said early on, you see this as probably a small worn-off adjustment rather than ongoing trend that we should see in the next few quarters as well in southern Europe.

Jane Morreau

Absolutely. As we talked about, I think it's just fluctuations that are going to continue to happen. I don't think it's sustainable or ongoing. You're going to see fluctuations come quarter-to-quarter.

Operator

Your next question comes from the line of Graeme Eadie with UniCredit.

Graeme Eadie

Just really following up on the high levels for promotional activity in the States. It's just quite difficult for us in the outside route to get our heads around this to understand to some extent why this is happening, given what we've seen historically that all that has done is to destroy brand equity and to delay the sort of recovery in the industry. So

I've been interested in your thought that given the consolidation seen in the industry, one would've thought the response might have been different this time around. Why do you think the industry has become a lot more aggressive on pricing? I'm saying only who's driving that? Is it the retailer, is it the distributor, or is it within the manufacturers themselves?

Paul Varga

The first thing I'd have to conclude is that people are being ultra-aggressive in the first place and I think it all depends upon your view of it. If I look at – if we had a situation where volumes were up 5% of sales dollars were down 10%. That's a very different story than percentages and shifts in price mix that are far more subtle than that. And I mean, as we said, I think we have been pretty comfortable with the types of adjustments we're making so I can really only comment on our own company's behavior. And that has been evolving over the last really several years. I mean it goes all the way back to when the U.S. market, the gasoline prices started to rise so much. So we've seen, all the way back to that period, subtle adjustments that have been made in terms of frontline pricing and then the ability to promote it at varying levels, and you try to be very targeted. I think one of the keys is to be very targeted versus making a sweeping change to pricing. You will notice periodic patterns in certain companies or certain brands, whether it happens to be around a heavy promotional period or certain time of the year the people get a little more aggressive. But I mean I'd really like, based on what your question was, to go back and look at the last sort of two to three years to see how dramatic. Because implied in your comments is a deterioration of price position by main brands in the United States and I really just – I know of some activity. Several of it I think is probably a contreble [ph] to the ones I know of or combinations of probably manufacturer, distributor and retailer participating. You always have to – it's just the way pricing is set in this environment. It's a collective exercise because you have a three-tier network, so there's a lot of parties that get involved in setting pricing. But I don't maybe share the same observation that we've had this dramatic romantic erosion of pricing in the United States as much as maybe everyone's expectations were that during the difficult economy, prices were going to continue to rise up 4% a year or something like that. And when you look at the aggregate data, remember that you're looking at a lot of mix, too, so you really have to get in and look at where specific price points are in the marketplace. It is hard to read from afar, I agree with you. That's why it's best done, I think, market by market or brand by brand.

Operator

Your next question comes from the line of Ann Gurkin with Davenport.

Ann Gurkin

Two questions. One, if you can just review use of cash flow, if there were there any changes. And two, as you look out to the second half of your fiscal year, are you moderating expectations for consumer behavior or have you made any changes to kind of the consumer outlook portion of your fiscal year results?

Donald Berg

I'll take the cash flow part, Ann. There really isn't any significant change for cash flow. The only item that's kind of new for us this year is we are having to make some contributions to the pension fund. And in the first quarter, it was around $20 million, $21 million that we ended up and that's about the biggest of that. Otherwise, everything is pretty much in line with what we've said in the past in terms of what our cash flow plans have been.

Paul Varga

And related to maybe the consumer environment, I think the only subtlety as we entered this fiscal year, and just as you all noted, you probably seen this in commentary from the market as a whole, people I think, based on trends the whole world was seeing back in sort of January through April or May period, we would've had a hope for a slightly improving consumer environment into the course of fiscal year '11. And I'd say what we've seen in the first quarter is sort of a mixed signal at best, so I don't that we'd say it's rapidly deteriorated or anything. We think it's still a sluggish environment now out there, it's tough, it's causing a lot of I think competitiveness. And so versus our original expectations, maybe a little softer environment than we were hoping for. Nonetheless, we think we're off to a good start. We're going to adjust accordingly as we go through the year based on what we see and observe. But I don't think it's a dramatic difference, I mean, we still thought we were very cautious going into the year. We thought it was going to be difficult and competitive, but we were hoping, I'd say, just like a lot of people who are in business back in March or April who would've been forecasting the next six or 12 months, we're hopeful that trends we were seeing in those winter and spring months may continue on. And of course there's been a lot of difficult economic news out there in the media over the last 60 or 90 days.

Operator

Your next question comes from the line of Andrew Keydo (sic) [Kieley] with Deutsche Bank.

Andrew Kieley

The first question, I just want to go back to the promotional pressure. I know you talked about the channel impact, but was there any major difference in the competitive impact either by product category or any specific geographies that stood out?

Paul Varga

No, not really. I mean, I think it's just one thing we observe from time to time and have conversations but I don't have a lot of data in front of me. It's a real value-oriented consumer, again using the U.S. example. But I suspect it would be true that I think this is probably more over the last couple of years versus anything I can cite in the last 60 days or anything, is we're seeing a pickup in some of the club store, the large club store businesses because they tend to offer some of the lowest prices in the marketplace. So again, that might be marketplace trend for the consumer that can have an impact on the dynamics in the marketplace, but what it means is that the consumers continues to shop for the best value they can find on maybe the brands they like. And so that might be one thing that we've observed over the last couple of years and of course I'm not sure, I wouldn't validate this with Don and Jane. That data doesn't get picked up and a lot of syndicated data, does it or is it picked up? Yes it's not picked up in a lot of the U.S.-syndicated data. So whatever that impact is can have an influence on overall performance. But versus everything else that we've sort of cited here, unless you have something a little more specific, it's hard for me to answer that.

Andrew Kieley

Just in terms of the price mix in the margins, is there much impact from the faster growth of the ready-to-drink products and the faster growth of international versus U.S.? Does that exert much pressure on the margins?

Jane Morreau

Actually on the margin, Andrew, I would like to point out that while margins on a reported basis were down 60 basis points, they actually were up once you pull out FX. So that's the way we look at our results. And so it's not having pressure at this point in time.

Paul Varga

And we also, there's one of the tables we put in our release that gives you the ready-to-drinks on an equivalent basis, that's why we give it in sort of two formats, nine liter and equivalent, so people can actually see in different forms. And so on an equivalent basis, we find that the ready-to-drinks actually can help on the higher gross profits per case because you converted it down to an equivalent and you're selling it by the drinks. So those actually can have a positive contribution.

Donald Berg

The other thing too, I'd just add on the whole margin question. When you look at the size of our RTD business today, there's also a big mix effect now that is included in there. Between the margin that you get on Jack Daniel's versus the margin that you get on something like New Mix, it's different. And you also will end up with different margins on a country-by-country basis. And so it's hard to answer that question directly because there's just such a mixed component in RTDs as well as when you look at it on the Full-strength Spirits side.

Andrew Kieley

And then Don, just finally, could you talk about any other further route-to-market realignment cost for the balance of the year? Would that be material or is basically – was this quarter the bulk of it?

Jane Morreau

We may have just a little bit more, Andrew, in the months of August and September as we get ready and get started for these rough markets that Don was referring to in Germany and Brazil. But in the grand scheme of things, they will be more in line with what you saw in the first quarter, which was fairly immaterial to the grand scheme of SG&A spending.

Paul Varga

And at this stage, in terms of – I think of it as if there weren't any different markets or new markets. So nothing that we wouldn't have already forecasted.

Operator

Your last question comes from the line of Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

Can you give us a sense of if you saw any changes in consumer demand either in the U.S.

or in Western Europe as you move sequentially through the quarter?

Paul Varga

Meaning sort of like month by month?

Dara Mohsenian

Correct.

Paul Varga

I don't know if there'd be any overall – gosh, it varies so much from month to month and I think maybe the best thing, if you're trying to look at that as you could probably – if you're looking at U.S. syndicated data, and you could probably spread the months out, we just haven't done that. We look at it more – we have a hard time sometimes even looking at it on a short-term basis like three months. So you can imagine we don't focus that much on one month. But if I was going to look at it and analyze it, what I'd do is just I'd look at how you can get four-week data from Nielsen, stuff like that. But we just don't tend to focus on a shorter timeframe.

Dara Mohsenian

And the organic sales number in the U.S. in the quarter, do you guys have that and can you give us a sense of depletions in the U.S. versus price mix?

Jane Morreau

Organic sales number. We're down in the low-single-digits just modestly. The depletion numbers were about the same.

Operator

And there are no further questions.

Ben Marmor

Thank you, Kimberly. We do not have any closing remarks today. And thanks everyone for joining us.

Paul Varga

Thank you, all.

Operator

Thank you. That does conclude today’s conference call. You may now disconnect.