Brown-Forman Corporation, Q1 2017, Earnings Call 2016-08-31

Presentation

Operator

Good morning. My name is Calia, and I will be your conference operator today. At this time, I would like to welcome everyone to the first quarter fiscal 2017 conference call. — ***Operator Instructions*** — I would now like to turn the conference over to Jay Koval. Please go ahead.

Jason Koval

Thanks, Calia, and good morning, everyone. I want to thank you for joining us for Brown-Forman's First Quarter 2017 Earnings Call. Joining me today are Paul Varga, our President 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. And you should not place undue reliance on any forward-looking statements, and the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the first quarter of fiscal 2017. The release can be found on our website under the section titled Investor Relations. 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, Form 8-K and Form 10-Q reports filed with the Securities and Exchange Commission.

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

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

Jane Morreau

Thanks, Jay. And thank you for joining us for our first quarter earnings call. I plan on discussing 2 topics on today's call: first, our first quarter results; and second, our latest outlook for 2017. And then Paul and I will address any questions you may have.

But before I jump into our first quarter results, I wanted to discuss a change we have made in how we present our reported and underlying net sales. In the past, we have presented our net sales, including excise taxes. Beginning with this, our first quarter, and going forward, we will present our net sales excluding excise taxes, which is consistent with the presentation used by our competitors. We believe this is a small change in the presentation of net sales and reflects one of several metrics we, as a management team, look at our business. We will continue to present excise taxes in our income statement, so the amount of information we disclose is really unchanged. It's simply the geography in our P&L and the comparability of the net sales metrics that we will discuss and analyze going forward.

So with that housekeeping item taken care of, let me now review our results for the first 3 months of fiscal 2017. Our underlying net sales, using our new presentation of excluding excise taxes, grew 2% in the first quarter. As expected, this rate of growth is less than what we expect to deliver for the full year as the first quarter of last year was our strongest quarter, up 9% on a comparable basis, meaning, excluding the divestiture of Southern Comfort and Tuaca, and up 11% over the 2 years. Remember that last year's first quarter was fueled by the U.S. launch of Jack Daniel's Tennessee Fire as well as a strong start to the year in both our developed markets outside the United States and our emerging markets. And in the first quarter of this year, we stopped distributing some agency brands as we continued to focus on our portfolio. This negatively impacted top line growth, but has little impact on the bottom line.

The trends in our first quarter were similar to those of the second half of fiscal 2016. While our developed markets delivered strong growth, global results were weighed down by disappointing performance in the emerging markets. In the United States, we delivered solid gains with underlying net sales growth of 5% despite cycling against 11% comp in the same prior-year period. Growth was led by the Jack Daniel's Family of Brands, including Tennessee Whiskey, Tennessee Honey and Gentleman Jack. Jack Daniel's Tennessee Honey grew mid-single digits as it entered its sixth year in the U.S. marketplace, while Tennessee Fire experienced double-digit declines. After accounting for last year's pipeline fill and activation behind Tennessee Fire, we estimate that the brand is performing better than those results would indicate, including growth in – strong growth in the on-premise.

Result in the United States were helped by our premium bourbon brands, including Woodford Reserve and Old Forester as well as the summer launch of Coopers' Craft as consumers continue to gravitate toward brands with heritage and authenticity. el Jimador and Herradura also continued to have growth trajectory, with both brands registering double-digit growth in the quarter. In addition, Korbel champagne and Sonoma-Cutrer grew aggregate underlying net sales by 10% in the United States.

Our developed markets outside of the United States also delivered a 5% increase in underlying net sales against last year's first quarter growth of 9%. This growth was broad based, with every developed markets in our top 20 markets growing in the quarter, including the United Kingdom, Australia, France, Germany, Canada, Japan, Spain, New Zealand and Italy. Our teams are doing a great job at growing our value share in these major markets, and they continue to see a long runway ahead.

Let me now move to our emerging markets, where we were disappointed with the results in the quarter. Our business in the emerging markets continued to slow, resulting in a 5% decline in underlying net sales compared to an 8% growth in the same prior year period. Our 2 largest emerging markets, Mexico and Poland, continued to expand in the first quarter, delivering solid rates of growth, while several other emerging markets were down double digits for the quarter. This included declines in Turkey and Brazil, 2 significant contributors to our growth over the last few years. Other soft markets in the emerging world included Russia, China, Thailand, Ukraine and Emerging Africa, but we believe some of this softness was timing related. We believe the majority of the slowdown in the emerging markets has been driven by factors outside of our control, including political instability, challenging economic backdrops and significant foreign exchange volatility, and we are carefully monitoring the trends in our emerging markets.

Travel retail underlying net sales increased 12% in the quarter, driven by easy comparisons against the prior year period, where net sales declined 15%. We are hopeful that the business has stabilized and the distribution gains will help us to begin to grow again from the lower levels. So we aren't expecting a meaningful growth contribution from this channel for the year.

Regarding barrel sales, I mentioned on our last call that we expected moderating prices for our used barrels as global demand has softened significantly over the last 12 months, reflecting weaker demand from blended Scotch industry buyers. This, combined with some lumpiness in order timing, drove a large reduction in barrel revenue in our first quarter.

Moving now to a reconciliation of reported to underlying growth. Reported net sales declined 5%. Reported results were pulled down by 2 points due to a strengthening U.S. dollar as well as a 2-point reduction in distributor inventories, which relates largely to destocking in Russia following some inventory build there in the fourth quarter of 2016. The absence of Southern Comfort and Tuaca, following last year's sale of these brands, resulted in an additional 3-point hit to reported sales. Excluding these effects, underlying net sales grew 2%.

Sales growth was split evenly between volume and price/mix and resulted in a 2% increase in underlying gross profit, as underlying gross margins were flattish. Reported gross margins were hit by combined effects of last year's divestiture and adverse foreign exchange.

Underlying A&P spend in the quarter declined 1% due, in part, to the comparison of last year's launch of Jack Daniel's Tennessee Fire in the United States. And underlying SG&A declined 2% as we remained focused on controlling costs and leveraging prior route-to-market investments.

In the aggregate, underlying operating income grew 6%. On a reported basis, operating income declined 6% and earnings per share decreased 2% to a split-adjusted $0.36.

This leads me to my second topic, our outlook for fiscal 2017. Our results in the first quarter was a tale of two cities, with growth in the developed markets offset by disappointing performance in the emerging markets. Our developed markets business today represents over 80% of total revenues and has been sustainably growing underlying net sales by a mid-single-digit rate of growth for several years. As you know, the first quarter is our seasonally smallest of the year and can be disproportionately impacted by timing issues, such as: barrel revenues, as they were this quarter; volatility in emerging markets, such as Turkey's unforeseen coup attempt and terror attacks, not to mention foreign exchange swings. But net-net, we delivered 11% underlying net sales growth on a 2-year stack, and we believe we remain on track to deliver 4% to 6% underlying net sales growth in fiscal 2017.

Takeaway trends in our non-U.S. developed markets remain strong, including high single-digit growth in Western Europe. In the United States, takeaway trends remain solid and the Jack Daniel's 150th birthday execution is well under way, which, when combined with incremental media investments and a commemorative gift, should drive a moderate acceleration in the United States. And while we are carefully monitoring the challenging off-premise trends for Jack Daniel's Tennessee Fire in the United States, we are encouraged to see Tennessee Honey growing again as we move past last year's new flavored whiskey launches.

On the margin front, we expect cost increases to slightly increase more and offset the improvement to our price/mix in the year, but SG&A cost-containment efforts should allow us to deliver solid leverage to the operating income line in the year, resulting in 7% to 9% in underlying operating income.

After accounting for our recent 2-for-1 stock split, we still anticipate earnings per share of $1.71 to $1.81, including a $0.03 headwind from adverse foreign exchange. Full year tax rate is expected to be between 29% and 30%. And as a reminder, a 10% move in the dollar in either direction would impact EPS over the balance of the year by approximately $0.05.

In summary, we continue to deliver solid rates of underlying growth year-after-year. This growth is being led by the Jack Daniel's Family of Brands as well as our other premium bourbon and tequila brands. We have and will continue to take a measured approach to innovation that allows us to maximize our brand equity over the long term.

In addition to delivering solid underlying rates of growth today, we are continuing to invest in our long-term business prospects, such as the build-out of the Slane Irish whiskey distillery, which is on track to launch in spring as well as the integration of BenRiach.

In the quarter, we issued our first non-U.S. tranches of debt at very favorable rates, thanks to our balance sheet strength and track record of growth. We also returned over $0.25 billion in cash to shareholders through the combination of a growing dividend and ongoing share repurchase program which, in effect, allows us to invest in ourselves. We believe that our success at balancing the short term and long term is a major reason we have been able to deliver leading TSRs over long periods of time, and we are focused on continuing that legacy for all of our stakeholders.

So with that, unless Paul has any comments, we'll turn it over to the operator. You okay?

Paul Varga

Yes, let's just go straight to… Yes.

Jane Morreau

Okay, we'll go straight to the operator and address any questions you all may have.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question will come from the line of Vivien Azer of Cowen.

Vivien Azer

So just in terms of your outlook, Jane, I think you were real clear about kind of the puts and takes, but you did indicate that some of the EM softness was timing related. And clearly, you're going to need that to stabilize, I would think, a little bit in order to hit the full year guidance. So a 2-part question, number one, can you quantify how much of the drag to EM was timing related? And number two, just help give us a little bit more confidence on any kind of stabilization that you're looking for from emerging markets, please.

Jane Morreau

Certainly, I'll take – let me – if we just talk about emerging markets in general. So while we were down for the quarter, as we noted, we were down 5%, and it was a little bit more than we expected, it should be noted that we had very tough comps versus last year. And I'd like to step back and remind everybody how much our emerging markets makes up of our total business. So it's around 20% of our total revenues. And so to really understand it, there's a lot of moving parts within it, and you got to peel back the onion, so to speak, to understand it. As I said in my script, our 2 largest markets are Poland and Mexico. They represent well in excess of 40% of our emerging markets, and they're growing quite nicely at 8% and 17%, respectively. And that – and we expect them to continue to grow, so we do not expect them to be a drag on our results. Then we talked about our – 2 of our larger contributors of growth over the past couple of years, being Brazil and Turkey, being a drag on the quarter. And they very much were a drag on the quarter. And that's not surprising, given the political instability, the economic woes, the terrorism, the huge excise tax increases in both countries, but primarily in Brazil last year. And so these really did have a significant drag on our results. We have other parts of emerging markets that are continuing to grow. And then we have some emerging markets that have what I would call, I think they are stabilizing. They're not necessarily getting better. And so as we look on to the rest of the year, I think we don't expect, as you said and you're right, it's one of our key drivers, not the most important, but one of our key drivers to get to our full year forecast is that we won't have as big of a drag as we did in the quarter. You mentioned the timing issue. And you're right, timing is – was an issue. I would say it was about 1 point of timing issues. And I would say the rest of it was that we also expect significantly easier comps as we go throughout the year, particularly if you look at the last half of the year. And most notably, the fourth quarter of the year, where emerging markets were down. And that's where you'll start to also see some of the things that we're talking about, where I believe we could – a bottom, if you will, so to speak, in some of these markets that have been down for a while. Russia would be an example of that, where I think we're close to getting to the bottom on that. So I hope I've answered all your questions there.

Vivien Azer

Yes, that's perfect.

Paul Varga

Yes, I mean, Vivien, I'll just add, too, there are – I mean, in any 3-month period, you always have, I'll call it, these fluctuations. I'll give an example of one, which is like these discontinued agency brands that Jane mentioned. Once you cycle against not having them, in this instance, it would be – that would – I think those affected Mexico and Czech Republic. So as an example, you won't have the detriment of that going forward. There's several examples like that.

Vivien Azer

That's helpful. If we could just turn to the U.S., clearly, for you guys, the plus side was good. It does feel, though, that at least in the syndicated data, the ACNielsen data, that the category does seem to be softening a little bit. Are you guys seeing that as well? And if so, what do you think is driving that?

Jane Morreau

I mean, it's a good question. Paul, I'll probably take this again. I think we might say it's hard to look at any 3-month trend to draw a lot of conclusions from it. We were talking earlier, if we had seen increases in other industries as the alcohol industries and beer or wine, which we haven't necessarily seen – or we haven't seen, so we don't see beer growing. So I think it's just – I wouldn't over-read the trend at this point in time. We're definitely looking at it and watching it, but **— *indiscernible* —**..

Paul Varga

Yes, I mean, I think the hardest part is because it doesn't measure the whole market, you're always trying to estimate what's going on in the on-premise or in the geographies not covered. But I think as a general thing, I've seen some speculation that it's going to potentially be lower than it historically has. But I think we're still estimating in the mid-single digit something – in the U.S…

Jane Morreau

Value.

Paul Varga

Yes, value growth, something in the 5% range, which I think isn't too far off what – and – but again, the most important thing for us is that it's been driven, in good part, by the American whiskey business. So I mean, I think I'd need a little bit more time to see, in either softness in trends or something, to start to forecast it forward in a way different than history.

Operator

Your next question will come from the line of Judy Hong of Goldman Sachs.

Judy Hong

So just maybe a couple of follow-ups on the U.S. If I kind of look at your 5% underlying sales growth, can you give us some color just in terms of volume versus price/mix within that figure? And then, just on Tennessee Fire, obviously, you're lapping the launches there, and some of the – I guess the syndicated data does show some weakness as you're lapping it. So maybe just a little bit more color just what you're doing to maintain some of the momentum you've seen in maybe the other channels. And then it also looks like your pricing has come down on that brand, and so just curious to kind of what the rationale was there.

Paul Varga

Well, I'll take – tackle at least a piece of this. I think going back to much of the interest in this category literally over the last – as we received interesting questions about it, I mean, I feel like we're pretty much sticking to our plan as it relates to knowing first that we're cycling last year's launch, which of course had pipeline in it but also a lot of investment, that of course generated quite a bit of trial. And with any of these pent-up demand launches we've had over the years with Jack Daniel's, we experienced that there's – particularly at premium prices, like Jack Daniel's is, that there are triers who sometimes don't convert that to full monthly usage. So I suspect we're going against some of that. As I think you inferred, the on-premise is doing much, much better. It didn't ramp up as rapidly. So it, of course, doesn't have the pipeline build that the off-premise channel does. And then I think very importantly, as we said, is that versus introducing an additional flavored whiskey from Jack Daniel's or 2 or some of our competition has done, our main focus was on geographic expansion, so trying to take out in a thoughtful way into other countries. And of course, the combination of the on-premise and the few markets we've introduced this fiscal year outside the United States is having a nice and positive offsetting factor to that pipeline that we're working against in the United States. And Jane, do you want to address the pricing thing?

Jane Morreau

Yes, I can talk a little bit in the U.S. I mean, there's not a lot of pricing coming from there.

I would say, if you were to just look at the U.S. numbers story, up of course; the volume numbers will be down a bit because of brands like Canadian Mist. But I think more importantly is to look at a brand like Jack Daniel's. And the volumes were up a couple percent and we had about 1 point of pricing.

Paul Varga

Yes, and I think, Judy, too, the other thing on – just if we could go back to the earlier statement I made about how you sometimes will have triers who won't convert. I mean, oftentimes, one of the barriers for people converting to regular weekly or monthly usage is pricing. And as I think you'd know this, that like for example, the drink price difference in the on-premise is much less than the bottle price in the off-premise for Fire and its main competitors. And so we think that might be one of the contributing factors, that the hurdle for an individual drink price in the on-premise isn't as great as the shelf price difference in the off-premise. So I think our people are appropriately always dabbling with the right price-volume mix within our range in order to try to find the best way to create sales value.

Jane Morreau

Yes. Well, if I can just fill in on Paul's, I think we said earlier this year, even in the U.S. market, that as we look around the world in terms of pricing opportunities, or Paul alluded to just a moment ago, we're looking at all these smart ways to do it. But the environment right now is not – in some markets, they're deflationary markets, so it's not necessarily conducive to it. And as we look at the full year, as we discussed in our fourth quarter, we're expecting very little from pricing, whether it's in the U.S. or globally. But some – we'll get some mix in there, as we expect, as we have higher volumes coming from our faster-growing premium and premium plus brands.

Paul Varga

Yes. The lone exception to that for us – and those comments are absolutely relevant to the Jack Daniel's line. But the Woodford Reserve and Old Forester brands – Old Forester has been able to get some price in recent years; and Woodford, which had been doing modest pricing, is probably doing a little bit more this year than in past years. So we're hopeful that, that can help in the United States.

Judy Hong

Okay. So maybe just looking at the consolidated price/mix in the quarter, though. It came in up 1%, a little bit softer than the trends that we've seen in the last several quarters. I would imagine the divestiture would have had a more positive price/mix impact. So is there any sort of timing issue? Do you expect that 1% to improve as you get out to the balance of the year?

Jane Morreau

Gosh, I don't remember that. I don't think so. But I think, first of all, the SoCo piece of it, we pulled all that out when we do – did this analysis. So it's not yanking – it's not helping or hurting. So the analysis you're seeing is excluding that. I think maybe if you're focusing on reported gross margins, that's where you see the hurt or the absence of Southern Comfort and Tuaca, which had nice, high gross margins. And so the 180 basis points on reported decline year-over-year in margin, about 130 basis points of that decline was due to the exiting and the divestiture of those 2 brands. But just [ph] 1% is – we're expecting somewhere in that range, Paul?

Paul Varga

Yes.

Jane Morreau

I mean, I think as we look at the year, it's unlike the past couple of years. Some of it because we've got lower innovation …

Paul Varga

We were getting such a big benefit last year from particularly Fire as we introduced it. And in past years also, these barrel sales have been helpful. So in this particular quarter, I think both of those things would have worked against us.

Operator

Your next question will come from the line of Bill Chappell of SunTrust.

William Chappell

Just first question, and maybe I missed something, but I think the original gross margin guidance was kind of flattish. Now it's down 200 basis points. Just trying to understand exactly how you get back to your original EPS guidance. I mean, what the areas – major areas of improvement are. And maybe correlated, it seemed like – I thought you had said in the past that advertising would be up this year or at least for the first – this quarter, and it was down year-over-year on a dollar basis. So maybe you could kind of help us understand the pacing of that.

Jane Morreau

Okay, let me see if I can start. So if you look at our full year, our guidance is unchanged. And what we need, what we're looking at, as we – and the confidence we have in achieving that for the full year versus where we are today, is we do expect to continue to have leverage, operating expense leverage via SG&A. You will recall last year, we had very low growth levels of SG&A. We expect some more continued low growth this year, too. It was 2% underlying last year. And so we still expect that to happen. You're right, on an underlying basis, we had very small – I guess, not – we didn't have a gross margin help, if you will, on an underlying basis. It's about what we expect for the year, give or take a little bit. So no help there. It's really coming from operating expenses, particularly SG&A. But let's talk more about what's going to drive this. It's really your top line growth. And we already talked about the emerging markets and why we feel confident that the emerging markets will improve from both a comp perspective and a timing perspective. But also, as we look out, we won't have the drag on our results from our first quarter Fire and the U.S. launch last year that drove us down this year, in other words, the pipeline. And we continue to expand internationally, so we're going to continue to get benefits there. And then Jack Daniel's 150 activation is just under way. And so we've talked – Paul talked a lot about this in our Shareholders' Meeting in July as well as – he introduced this in June during our call. And so there's a lot of activation really going on now. And then when I think about the United States, we are actually increasing our media spend as well. And so you'll start to see that coming through in the second and third quarter. We've got a lot of incremental gift coming through to – and our whole sales force and our trade partners are all focused on that. So we'll see some modest improvement, as I said, in Jack Daniel's as well. So those things combined give us that confidence. If you look at advertising, it's probably worthwhile to step back and think about advertising a bit. What we said was we expected advertising to grow in line with our full year forecast top line. I think at this point, we would still say that. What was happening in the quarter, there were some comparability issues. I mentioned one of them being that we had the launch of Fire last year. In effect, in the U.S., we had a lot of promotional activities and so forth that we were doing. We had the absence of that level. We're still – of course, we're advertising behind it this year, but not at the levels we were doing last year. There are some timing things going on, too. And then I think it's also worthwhile to just pull out Southern Comfort and take back and look at what kind of investments we've actually been doing behind our business over the last couple of years. And so if you look at the F '15 and F '16 combined, pulling out Southern Comfort, on a 2-year stack basis, it's up 13%. First quarter of last year, just to illustrate, the comp in advertisement last year that had the Tennessee Fire in it, it was up 6%. So we also have all that going on. So I hope I've given you some color. I know I said a whole lot in there. So I'll stop and see if Paul wants to add anything, or you can ask us further clarifying questions.

Paul Varga

No, I think that covers it well. And again, I think – again, it's 3 months and we – I find typically, on this particular earnings release, you end up having a lot of quarterly noise because it's only been 3 months. And so I think it's an emphasis that we've placed on some of this, this morning particularly, is it hit a few of our emerging market businesses. And – but as it relates to the expenses, I feel like we're continuing to – we'll continue to invest behind the brands as we go forward. And most of that leverage, as planned, is at the SG&A line.

William Chappell

And Paul, just to follow up on that, I mean, just to be clear – I mean, what you're saying is there's really no surprise internally from this quarter, and maybe the surprise is more the stock reaction. Because it sounds like you knew the comps were going to be tough. The new – but it seems like the gross margin was a surprise, or at least the outlook, and so that's why I'm trying to couple all these things together. It does seem like something's changed in the past 3 months.

Paul Varga

Totally, I understand. I think what happened is like, for example, I'll give you the – like, for example, the full year impact of these lower barrel sales is really the brunt of it's hitting us in the first quarter. I mean, it'll still be not as – I mean, it'll still be negative to us as we go through the year, but not to the level that it was in the first quarter. I know that sounds odd, but – and that was something that we were not experiencing through the course of FY '16, for example. So – and again, that's why I make an example of that one. It's just 3 months. It does hit you pretty good. And so on a 3-month basis, it really will be impactful. I know you are looking for signs and signals that the business is moving in some direction that's either the same or different. And you always have surprises in a quarter. I mean, there's no doubt that I would have hoped for and helped – hoped for emerging market business was better than it ended up being, simply because of just the unsettled nature of a lot of these markets. I think we – those reflected somewhat in our results. Having said that, there are some onetime, seasonal, more short-term things that we think will abate as we go through the remainder of the year. So it's probably a tale of both. As you'd say, I wouldn't say that – we're surprised every quarter by something.

Operator

Your next question will come from the line of Tim Ramey of Total (sic) [Pivotal] Research Group.

Timothy Ramey

On the barrel sales, I assume that you just re-marked them to market in the 1Q, and that's why the brunt of the impact for the full year is in the 1Q. Am I thinking about that correctly?

Jane Morreau

Let me take you through barrel sales, how this all comes about. Of course, we're fully integrated, if you will, through the supply chain, so we make everything from start to finish, essentially. We don't grow our own corn, but we're making our barrels all the way to distilling them, and then out the door. So remember that we're one of the largest barrel-making operations in the world. And so just to give a little background, I think it's worthwhile to think about the background of just barrel sales in general, and then we'll talk about how it flows through our P&L. Just the background. Because we've been doing this – we've been making our own barrels for a number of years. And what we do, as you know, is each bourbon and Jack Daniel's whiskey require a new barrel to put the whiskey in to age. When we get finished with those barrels, we sell them. And the market, generally, for the sale of these barrels, has been the Scotch industry. So if you look at it over a long period of time, we'll just say 50 years, it's a very cyclical business. So we can see when the production and sales of Scotch go up and down. So it impacts the sale of barrels. It impacts supply and demand and it impacts pricing. And so as you know, there's been some softening in the demand of blended Scotch. So we started seeing some pricing pressures, and we noticed that and we said that in our – at our fourth quarter conference call. What that did is, in the first quarter, we had a couple of things happen. We saw those pricing pressures. So each barrel that we were selling on the outside market, once liquid got dumped, those used barrel, we were making less on it than we were a year ago. We also had some lumpiness, as I was alluding to, to orders which would have been one of our surprises in the quarter, if you will. But it's going to abate over the course of the year, because it's not gone. That's a little background, but how it flows through our P&L is it's simply we got less revenues from those sales of barrels this year than we got last year. It comes through our revenue line and it hits you all the way through your P&L. It's just basically revenue. It's a very high-margin business, and so there's no brand expense, if you will. There's some people that sell it, but it largely drops to the bottom line, whatever you have in your revenues, all the way to operating income.

Paul Varga

Yes, and remember, too, that while we – while the demand end has been influenced, remember, just each year that's been going by as bourbon has been doing well. Not only have we been emptying more barrels to meet the bourbon supply – or demand out there, there have been other bourbon barrels out there. So that influences the supply of those against the Scotch demand. So some of that is hitting us in this first quarter. And as Jane said, it is a nice margin business.

Jane Morreau

And we do expect throughout the year the pricing pressures, didn't we? Because of what

Paul said and what I was saying, too. So yes.

Timothy Ramey

Just – not to belabor it, but in wine, trough to peak, used barrels pretty much doubled. I assume that something similar happened on your end, and so this is softness relative to recent, but not softness relative to, say, 3 years ago. Would that be a fair statement?

Jane Morreau

I think our – I would say softness relative to, let's see, 3 years ago, I'm trying to remember what our price – the prices of barrels – the prices of barrels have gone up because, actually, they were in short supply a couple of years ago. So I'm trying to think relative to 3 years ago…

Paul Varga

I think… a lot of it…

Jane Morreau

I think it would be a little bit higher today than it was…

Paul Varga

It would be. I think a lot of that growth over the 3 years, Tim, was driven by us selling more barrels in addition to the prices at which they were sold. And so now you've got to – were sold at.

Jane Morreau

And just to let you know, Tim, I don't want to belabor this either, but there's obviously other things that you can do with barrels. And so that influences your mix. So if you can't – if you don't have a – someone to sell it to, so a person in need of it, a Scotch buyer or an Irish whiskey producer, you can sell it as planters and other things like that. They generally are less profitable, too, which would also hurt your mix.

Timothy Ramey

Yes, just the same as in wine. And on the tequila side, I mean, those numbers were really good. Should we think about those – you mentioned Mexico was quite strong as well. Should we think about that as primarily a Mexico impact? Or is there something else we should be focusing on relative to el Jimador and Herradura?

Jane Morreau

They're both growing nicely in the U.S. and Mexico, I know that. So you should see both those trends. I think in the quarter in Mexico, there were a little bit of price increases, so they probably were a little bit stronger. But they both have been …

Paul Varga

In Mexico, yes.

Jane Morreau

In Mexico, not in the U.S. And – but I think both brands are doing quite well. They're both growing, I think, in the double-digit range, thereabouts, in both countries.

Paul Varga

Particularly el Jimador in the United States continued to go, from month-to-month, rolling very, very well.

Jane Morreau

Sorry, I should correct myself on el Jimador in Mexico, because that's the one where we've been repositioning the price. And I'm looking at the profitability from a pricing perspective.

Paul Varga

Yes.

Jane Morreau

So we do have less volumes there, so yes. But they're still both doing well.

Operator

Your next question will come from the line of Bill Schmitz of Deutsche Bank.

William Schmitz

Can you guys just clarify a couple of things for me? First of all, what exactly – maybe I missed it, but what was the impact from the barrel softness in the quarter? And how big is that business? And maybe where it shows up? You have that schedule in the last page of the press release, like, where do we see the trends in the barrel business?

Jane Morreau

The trends are in your revenue. It had about 1 point of an impact on the quarter.

Paul Varga

A point drag, yes.

Jane Morreau

A point drag that was made up of both the pricing, which we expected. So it was about half – half of that was point and the other half is timing.

William Schmitz

Okay. These are reflected in that schedule on, like, Page 10 of the release or not.

Jane Morreau

It's on – it's not separately – okay, I'm sorry, you're on Page 10 of the release.

William Schmitz

Yes, I'm sorry to get down to the minutia.

Jane Morreau

Yes, it's all right. Actually, I guess it would just be in your bottom line numbers, because this is all – the first things are volumes and we don't…

Paul Varga

In our brand and…

Jane Morreau

Yes, and we don't track it there. So it would just be in your very bottom line 2%, I guess. So it's not, per se, in there.

William Schmitz

Okay, that's helpful.

Jane Morreau

In terms of our total business, it's not a major – a meaningful business itself.

William Schmitz

Okay. No, that's helpful. And then can you just kind of give us like a more detailed gross margin bridge, and how you think that sort of plays out over the year? I know you talked about it qualitatively, but I mean do you see gross margin up this year? And maybe some of the moving pieces that could drive it one way or the other.

Jane Morreau

Okay, so I think in my – in the fourth quarter, I was talking about our gross margin, at that time, I think it's really relatively unchanged from that. So I said it was, at that time, we expect it to be flattish. Bill referred a little bit earlier to 2/10 down – 200 – 20 basis point difference, so I'm talking, give or take, 20 basis points or so. So nothing's really changed in that perspective. So in that time, I talked about it being largely a volume and a mix versus any pricing.

William Schmitz

Okay. No, that's helpful. And then, just it sounds like the SG&A costs are going to be up a little bit this year. Is that – so should we expect that ratio to expand and – as percentage of sales? And then, what's driving the higher SG&A costs?

Jane Morreau

Actually, are you looking at the same thing I'm looking? I think SG&A costs are actually down on the — ***indiscernible*** —..

William Schmitz

But I thought you were talking about the outlook. Did you say that the SG&A costs would be up, offset by some pricing? Or I didn't – did I mishear you during the…

Jane Morreau

Okay. I'm sorry. I was talking about underlying SG&A growth. If you were to look at where we are today, underlying SG&A is down 2%. I would say that was largely influenced by timing or onetime – the absence of onetime items we expect going forward. And so we do expect some modest increase in SG&A. Recall last year, our SG&A grew about 2%. Recall our sales grew, what I said earlier, 5%. So we – if you look at the metric, we actually improved, on an underlying basis, our SG&A as a percentage of revenue. I would expect a similar type of thing this year, low single-digit growth in SG&A at this point, and then of course, higher growth at the revenue line. So improving trends on an underlying basis.

Paul Varga

Hopefully, there'll be similar leverage to last year.

Jane Morreau

Yes.

William Schmitz

Okay. No, super helpful also. And then just lastly, do you think for the full year that depletions and underlying will kind of be aligned? Or is there still more inventory to come out in emerging markets?

Jane Morreau

Depletions…

Paul Varga

Actually, in some markets and emerging markets, I hope inventories will come back versus – because I think any time you have – some of the circumstances we've got, you'll find some inventory tightness in some of these markets. But I mean, I think as a general – you're talking about depletions, I was trying to convert it over to sales, which is – but…

Jane Morreau

It's there. I mean, we did have some timing issues with some markets…

Paul Varga

Russia, particularly.

Jane Morreau

Yes, and some – yes, that's right. We over – we had shipments last year ahead of depletions. So we expect depletions to get ahead of shipments this year there. We had some timing issues – seasonality or timing issues in the first quarter of this year with a shipper.

Paul Varga

And distributor changes and things like that, yes.

Jane Morreau

Some of that shift is in depletion, so that will work itself out.

Paul Varga

And we have been accommodating – we have been – now the 2 offsetting things on Tennessee Fire, remember, is in the new markets we will be – internationally, we will be probably building some inventories out there as we go along the pipeline, particularly retail. And then, offsetting it in the United States has been some of those reductions, so.

Operator

Your next question will come from the line of Bryan Spillane of Bank of America.

Bryan Spillane

Just a couple of questions, first, just some clarifying points. Jane, I think you talked earlier about the prior year comparison on underlying sales, excluding the divestitures, was 9% in the first quarter. Is that right?

Jane Morreau

Yes. I think I excluded foreign exchange from that as well.

Bryan Spillane

Yes, excluding. So underlying, ex foreign exchange and ex acquisition and divestitures. Have you given what that comp is for the full year, just trying – because I know, at least in terms of where we were modeling it, we were looking at just what was reported last year, and the organic sales comp, I think, it was 7%. So I just want to make sure, if you've got it, if you provide…

Jane Morreau

Last year – excluding SoCo, it was 5%. So I – we talked about $20 million of operating – sorry, $0.20; now it's $0.10 split adjusted was the bottom line impact of that. I'm trying to think what else I get – what else I have on it.

Paul Varga

Are you trying to – Bryan, get to the seasonal 2-year stack? Yes, are you…

Bryan Spillane

Right, we've got a 4% to 6% underlying sales growth expectation. And I just don't know what it's comping against. What does 4% to 6% comp against if we're going to be apples-to-apples pulling out the divestitures?

Paul Varga

The last year's quarters were 9%, as she said, right? And then as they came down, what – it was 5%?

Jason Koval

Roughly 4% over the balance.

Paul Varga

4% over the balance. And so you need 5 to 6s on a 2-year stack to equal out to the double digit that you would have accomplished with a 9% and a 2%. I think that's where you were going, right, Bryan?

Bryan Spillane

Yes, yes, yes. That's helpful.

Paul Varga

— *indiscernible* —, yes. And so I think, yes, we need mid-single digits off on a 2-year basis. And that – I think that the reason that Jane was illustrating that is just to show you how good the first quarter was last year and how the 2-year – or the 2% this year can be explained against that.

Bryan Spillane

Yes, and that's what I was getting at. It was even a more difficult comparison, I think, than we all thought because we weren't – we didn't have the comp excluding the divestitures.

Paul Varga

Right, got it, which – you're looking for more specifics on mostly the Fire launch, to be honest with you, which wasn't there for Q1.

Bryan Spillane

Okay. All right, that's helpful. And then just a second question, just on Finlandia, it's – the decline is getting less steep, I guess. And in Poland, you grew this quarter. So could you just give us – are we at a point where the drag there from Finlandia maybe is going to be less of a drag than it had been in the last year or 2?

Paul Varga

We hope so, yes.

Jane Morreau

Yes.

Paul Varga

Yes, you – I mean, you look at – I mean, you're looking at the correct numbers. So mathematically, yes, it has been. And I think the other thing, too, it's off a slightly smaller base and profitability. It's less impactful when you get down to the bottom line. So our teams are working hard, particularly out there in its core geographies in Eastern Europe. And so we were pleased to actually see the quarter on Poland.

Bryan Spillane

I guess what I'm after is just, is there anything that's changed either in the sort of the approach that Brown-Forman is taking to it? Or anything that's changed in the market that has stabilized it? Or is it – have we just – is it just sort of evolving on its own?

Jane Morreau

Yes, I mean, I think some of it was what I was alluding to earlier. As some of these –

whether its brand markets are getting to a point where they got a new low, and so you're going to start cycling against that. We're not seeing that in Poland. Poland actually had recovered some, but Russia would be one place that's still declining there. But again, I think it's getting to a place where it's not where it was a year ago. It wasn't much of a drag. In terms of our own sales force and what they're doing differently, they're always trying new things. And then, we're looking at a new package later this year and probably next year.

Paul Varga

Which we won't get the … yes, and get benefit until '18. I wish we could get that faster, but it's just the nature of packaging change.

Jane Morreau

Yes, and so there's work always being done on it to help improve it. So…

Paul Varga

But I'd have to look at it by country to see, but one of the influences I always feel in the vodka business particularly, in a lot of these markets, is the pricing activity of competitors. And your question makes me want to go look at a few of the key countries to see if that's stabilized. Because sometimes, that can have a very nice impact on Finlandia's performance.

Operator

Your next question will come from the line of Rob Ottenstein of Evercore.

Robert Ottenstein

A couple of questions. Number one, Coopers' Craft, haven't heard much about that on the call today. Can you just remind us when that launched? If there was any impact in the quarter? And how you see that reception in the marketplace and with your distributors?

Paul Varga

I don't think it had virtually any impact on the quarter. I think it launched July 1 in a very…

Jane Morreau

8 — ***indiscernible*** —

Paul Varga

Select number of states, just 8. Yes, I think it's 7 or 8. And our read, so far, has been – which is mostly just trade. And then any reviews about the product has been very, very encouraging. So I mean, so far, so good on it.

Robert Ottenstein

Terrific. And then on Jack Daniel's, you mentioned that you had about 1% pricing. I just wanted to clarify, is that 1% pricing for No. 7? Or 1% price/mix for the Jack Daniel's family in the U.S.?

Jane Morreau

That was in the U.S. and that was only for No. 7. Again, as I said earlier, I think that was – as we look at the full year, I don't expect that – I think I expect minimal pricing for the full year in the U.S. from the brands. So that was…

Robert Ottenstein

Okay. Okay, so you've got maybe an easier comp in Q1 and then less pricing for No. 7 the rest of the year.

Jane Morreau

Easier comp in Q1 in the U.S…

Robert Ottenstein

On pricing.

Jane Morreau

Pricing. Yes, I don't think – no, — ***indiscernible*** — Paul...

Robert Ottenstein

So you expect 1% – roughly 1% pricing for the rest of the year for No. 7?

Jane Morreau

No, I'm sorry, I said we had 1% in the quarter in the – and I don't expect as much for the balance of the year. So the full year will be minimum pricing.

Robert Ottenstein

Got it. Okay, that – okay. And then, just a final question. Going back to Finlandia, is this – and I know these are delicate questions, but is this a strategically important brand for you? Or is it something kind of it's nice to have, but not need to have?

Paul Varga

Well, I think it's been an important brand for us, particularly in key markets. You heard Jane emphasize that Poland's one of our top 2 emerging markets. And Finlandia was actually really, really helpful, particularly in its early years, to helping launch Jack Daniel's in a lot of these markets. So it definitely had some strategic benefit and roles, even beyond its own trademark contribution. So I mean, as you all know, the vodka category is an enormously competitive one. And particularly at the prices where, even though they're what we would consider to be premium for the vodka category, there's a lot of competition in them. So – and I – like I mentioned early on, I think it's an encouraging sign that we've had a good quarter in Poland, but it's been a tough couple of years. And they have, I mean – this – in the markets where Finlandia has been strongest, it's just there's been, between excise taxes and competitive activity – I remember a lot of these markets were what we considered dark markets, our ability to sort of advertise our way out of it is difficult. So it's had some challenging times, but I wouldn't go so far as to say that it's not strategic to us in maybe the way that you were implying.

Robert Ottenstein

But maybe a little bit less than in the past?

Paul Varga

Oh, yes, mathematically, sure. I mean, yes, mathematically. It – because – just because of the innovation success we've had with – particularly within the Jack Daniel's family and then the growth of the American whiskeys. And if you're – just mathematically, Finlandia hasn't kept up with those. So as a percentage of Brown-Forman, it's down.

Robert Ottenstein

Well, no, I understand that, but just in terms of your ability to thrive in the Russian and the Polish markets, which are the 2 key markets, do you need to have Finlandia to give you critical mass in Poland and Russia?

Paul Varga

I mean, it was certainly – before Jack Daniel's have had any scale in those markets, Finlandia would have been – proportionately been more important. But I would – I'd still think it's important.

Operator

And your last question will come from the line of Brett Cooper of Consumer Edge Research.

Brett Cooper

Can you talk about your relative performance in emerging markets? So I guess, more on a trailing 6- or 12-month basis versus a couple of years ago. And then on a separate topic, when you're thinking about the go forward, what do you expect from blended Scotch competition, given the devaluation of the pound?

Paul Varga

Jane, you want to – which one – do you want to tackle either one of those?

Jane Morreau

The relative performance, relative to the competition? Again, I think, ourselves, I would point to some of the things that we already talked about in the quarter in terms of the numbers being down, and some of it being timing. And I think that you have to peel back the onion and, again, similar to what I was doing with our own numbers, and look at the footprint of each of your geographic competitors to do any kind of comparison. Most of them have a lot larger percentage of their business in emerging markets than we do and actually were hurt earlier, a couple of years ago, by the emerging markets actions, whether it was in China, than we were, just because we didn't have a big footprint there. And so I think relative performance to that, again, is you have to look at each country and I think where the – our competitors of note are doing well, places like Mexico, we're doing very well there. So I think our performance is holding in those places where it should be, and if not better.

Paul Varga

Yes, I think the big delineation between us and the competition is that – in some of the instances, not all of them. But in some of them, we aren't in the, what I'll call, the lower-price local business, whereas, several of our competitors are influenced. They're business is influenced quite a bit by that. We tend to be at the more premium end. Even where we're in a category that's indigenous to the country, like tequila to Mexico or in the example of the very sizable vodka market in Poland, we tend to be at a little bit higher price points. So you'll see some observations on performance between, say, us and some of our competitors that skew because of the portfolio. But I'd have to look – I mean, I agree with Jane, it's a mixed picture and you'd have to look at it market-by-market. We group it into emerging markets a little bit for just convenience, so aggregating what is for – particularly for us, Jack Daniel’s global business. And then Jane, the other question?

Jane Morreau

The second part of the question, I think, perhaps you were alluding to was the impact of Brexit. Is that what you were really referring to?

Paul Varga

Your expectation of what the blended Scotches might do.

Jane Morreau

Do as a result of that? Since they actually got a nice, favorable FX or pricing impact to them, I think that’s what he was referring to.

Paul Varga

Yes, I mean, I think it remains to be seen. I haven’t seen, and personally I haven’t heard of any reports or seen any data that tells me that they’re using it to lower prices. Just so you’ll know, even though you can be impacted by lower prices of competitive whiskeys, for some time, that was not the basis on which Jack Daniel’s particularly competed with the standard blended Scotch brands. I mean, oftentimes in most of these markets, almost virtually all of them, we’re a meaningful trade-up to those brands. So it remains to be seen what they do with them. But I like Jack Daniel’s price position where it is today for the very long term.

Jason Koval

Thank you, Paul, and thank you, Jane. And thanks to all of you for joining us today for our first quarter earnings call. Before you jump off, though, we wanted to make sure you knew we do plan on holding an Investor Day in New York on the afternoon of December 14. So be sure to mark your calendars. And in the meantime, if you have any other questions, please feel free to reach out to any of us. And we hope you all have a great Labor Day weekend and that you enjoy some of our fine products. Take care.

Jane Morreau

Drink responsibly.

Operator

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