

# Brown-Forman Corporation, Q4 2013, Earnings Call

## 2013-06-05

### Presentation

#### Operator

Good morning. My name is Holly, and I will be your conference operator today. At this time, we'd like to welcome everyone to Brown-Forman Fourth Quarter Fiscal 2013 Year-End Conference Call. — **Operator Instructions** — I would now like to turn the today's conference to Jay Koval, Director of Investor Relations. Please go ahead, sir.

#### Jason Koval

Thanks, Holly, and good morning, everyone. I want thank all of you for joining us today for Brown-Forman's year-end 2013 earnings call. Joining me today are Paul Varga, our President and Chief Executive Officer; Don Berg, Executive Vice President and Chief Financial Officer; and Brian Fitzgerald, Chief Accounting Officer.

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

This morning, we issued a press release containing our results for the fiscal 2013 fourth quarter and year-end. The release can be found on our website under the section titled, Investor Relations. In the press release we have listed a number of risk factors that you should consider in conjunction with our forward-looking statements. Other significant

risk factors are described in our Form 10-K, 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 reason 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 Don for his prepared remarks

**Donald Berg**

Thanks, Jay, and good morning, everyone. On today's 2013 year-end earnings call, I'd like to cover 3 main topics, including a review of our full year 2013 results, our preliminary outlook for fiscal 2014 and a quick update on our balance sheet and capital allocation.

So let me start with my first topic, a review of our full year results. In a nutshell, 2013 was a stellar year at Brown-Forman. We achieved record levels of sales, gross profit and operating income. Here are some of the highlights from the earnings release: Underlying sales grew 8%, or 5% on a reported basis, and price mix contribute over 3 points of the growth. Gross margins jumped 200 basis points, half of which was driven by the absence of the Hopland-based wine business, with the other half from improving price mix and a lower utilization of value-added packs, particularly during the holiday period. This led to underlying gross profit growth of 10%. Underlying SG&A grew by 8% driven partly by increased hiring in non-U.S. markets and the realignment of our business organization in Europe, EMEA and China to better pursue our long-term growth objectives. Underlying A&P increased 6% as we continue to find opportunities to invest behind our brand-building activities. This drove some additional leverage to the bottom line resulting in underlying operating income growth of 13% or 14% on a reported basis. Finally, earnings-per-share of \$2.75 came in 16% ahead of last year's reported results.

As you recall, in 2012, Hopland-based wines contributed \$0.03 to our EPS. If you exclude

that from the base, fiscal 2013's EPS growth would be 17%. In addition to the Hopland-based wine sales, other reconciling items between reported and underlying results included an appreciating U.S. dollar, which caused foreign exchange to be a modest headwind to our reported results, and distributor inventories, which ended the year slightly higher than a year ago. So all in all, another great year of what we believe to be top-tier industry results.

Before I move onto some country and brand highlights, I'd like to call out 2 items that helped contribute \$0.07 to our fourth quarter earnings per share relative to what we were expecting 3 months ago during our third quarter earnings call. The first item relates to the slight uptick we saw in distributor inventories for the full year. In the fourth quarter, shipments ran ahead of depletions by \$17 million or \$0.05 per share, with Japan and the U.S. accounting for the majority of this difference. Japan's inventory build was driven by our new distribution relationship with Asahi, and we may see some of this increase reverse itself over the coming quarters. We also saw a modest increase in inventories in the quarter in the U.S., but we don't anticipate any give back there as distributor inventory days remain below historic levels. The second item had to do with discrete tax items which helped deliver better-than-expected tax rate in the fourth quarter contributing \$0.02 of outperformance. If you adjusted for these 2 items, full year 2013 EPS would have been closer to \$2.68, representing strong 12% year-over-year growth and in the range that we shared with you on our third quarter call. And looking forward to fiscal 2014, we shared a chart in the earnings release detailing these items to help you better understand what we view to be the baseline EPS in 2013.

So with that, let me walk through some of the geographic drivers of our broad-based revenue delivery in fiscal 2013. First, constant currency net sales grew in each of our 10 largest countries. We included a table in our first quarter earnings release to help you better understand the relative size and growth rates for each of these countries in 2013.

Looking at the emerging markets, where we believe we remain in the early stages of realizing our long-term growth potential, we grew net sales by over 12% and are approaching \$1 billion in sales. With over 1/4 of our business now generated in these rapidly growing markets, this diverse and sizable base of business is an increasingly important driver of our company's growth. For example, in Eastern Europe, Poland grew 5% on strong demand for Jack Daniel's and solid results from Finlandia in a very competitive premium vodka market. Russia and Turkey continue to grow rapidly up 36% and 38% respectively, although it's too early to ascertain the impact from recently implemented rules that restrict spirits advertising in both of these markets. Our CIS markets, which include Kazakhstan, Georgia and the Ukraine grew net sales by 29% and depleted 300,000 cases, a substantial pocket of business for our company with strong contributions from both Finlandia and Jack Daniel's. In Asia, India's net sales jumped 26%, making Jack Daniel's the third-largest imported whiskey to that market.

Net sales growth continued in Thailand, up 19%, as well as Indonesia, up 29%, helping deliver 15% growth for Southeast Asia which, as a region, depleted 300,000 cases. Japan growth of 18% was partly inflated by the previously mentioned shipments but we are still seeing solid growth adjust for this pipeline build that resulted from our new agent's relationship with Asahi which is off to a great start.

In emerging Africa which includes Nigeria, our net sales grew 12% to 100,000 cases. And in Latin America, Mexico delivered solid growth of 8% despite intense competition in the standard tequila market, and Brazil jumped 23% as our own Distribution business made progress in this enormous premium whiskey market.

So in the aggregate, the emerging markets continued to grow at very healthy double-digit rates in the year, and we believe that the breadth of our emerging markets business positions us well to continue our legacy of delivering top-tier rates of growth while carefully

managing our risk profile.

Net sales growth was also quite healthy in the developed world in fiscal 2013, up over 6%. We believe that this balanced revenue delivery confirms our strategy to focus on driving the long-term growth potential for our brands across all markets, emerging and developed. Within the developed markets, United States net sales grew 8% after adjusting for the \$79 million in sales that the Hopland-based wines contributed in the previous fiscal year.

U.S. remains the most attractive and competitive spirits market in the world, and contributed 41% of our sales in 2013. After enduring years of market share declines, the bourbon category is in the midst of a strong resurgence and demand, driven by strong consumer interest in authentic, genuine and flavorful brands in super-premium and higher-price points. With almost 60% of our portfolio in North American whiskeys and with our premium portfolio SKU, we believe we are very well-positioned to capitalize on these trends, leading to market share gains compared to the industry.

In Western Europe, we also delivered outstanding results, considering the challenging macroeconomic backdrop and sizable excise tax increases in some markets. Germany was a standout, with net sales growth at 13% as the route-to-market investments we made in 2010 continued to pay dividends. The United Kingdom grew 4% despite a weak trading environment, particularly in the on-premise. France also delivered excellent results with net sales of 14%, and we are excited about its future as we transition to an own distribution model next January 1, 2014, and I'll share more on France in a few minutes when we get to our 2014 outlook.

Australia grew net sales by 6% where strength in the Jack Daniel's trademark, including the successful launches of Tennessee Honey and Gentleman Jack RTDs, more than offset weakness in Southern Comfort.

Our global travel retail team delivered 12% net sales growth and crossed the 1 million case milestone for the Jack Daniel's family of brands globally. Results in this channel were bolstered by premiumization trends which drove over 20% growth for Collingwood and Woodford Reserve, as well as the rollout of several new products, including Tennessee Honey, Jack Daniel's Sinatra Select and Finlandia Platinum.

Now, let me turn to some brand highlights in the year. The Jack Daniel's trademark grew 11% globally, with 10% growth in the U.S. and 12% growth outside of the U.S. Net sales for Jack Daniel's Tennessee Whiskey increased a strong 7% powered by a healthy balance of volume growth and price increases. Tennessee Honey almost doubled its net sales in its second year in the marketplace, driven by both the brand's roll out to some of Jack Daniel's largest non-U.S. markets and 30% growth in the United States. We continue to believe that there has been relatively little cannibalization and that the launch of Tennessee Honey has helped rather than hurt the parent brand sales.

Despite this tremendous success, we believe substantial global growth remains, from a penetration standpoint, with Tennessee Honey only 7% the size of Tennessee Whiskey, in terms of its global sales. In addition to Honey, our Jack Daniel's ready-to-serve pre-mixed business grew 7% globally, including 23% growth in the United States where we made some route-to-market enhancements that allowed us to better penetrate the convenience store channel.

Finlandia's Family of Brands grew net sales 6%, with 30% growth in Russia, 9% growth in the U.S. and 3% growth in Poland. Southern Comfort's brand family showed signs of relative improvement, moving from a 7% net sales decline in fiscal 2012 to a 4% decline in fiscal 2013. Results in the U.S. have stabilized on the heels of our new Whatever's Comfortable media plan and deliver the first year of growth since 2008, with net sales up 1%. While we continue to experience declining sales outside the U.S., we believe that

fiscal 2013 marked the first step towards returning the brand to profitable global growth.

In tequilas, our Herradura brand continue to deliver exceptional results, outgrowing the premium plus tequila category globally with net sales growth at 20% in the U.S. and 13% in Mexico. El Jimador's family of brands grew 7%, with U.S. sales for the parent up 11%. In ready-to-drink, el Jimador's New Mix grew over 13%, as our leading position allowed us to capitalize on a growing Mexican market. And despite a very competitive market for popular priced tequilas in Mexico, el Jimador still grew 2% globally.

In our super and ultra-premium whiskey brands, which include Woodford Reserve, Gentleman Jack, Jack Daniel's Single Barrel and Collingwood, net sales jumped almost 20% and depletions totaled 825,000 cases. It is worth noting that Woodford sales grew 28% globally and we saw a nice progress on Gentleman Jack internationally as it grew 30% in markets outside of the United States. We are launching our Order of the Gentleman campaign in fiscal 2014, as well as our first TV advertisement for Woodford Reserve to help build brand awareness and to capitalize on the momentum of these brands globally. We believe our entire portfolio of high-end whiskeys is well-positioned to leverage the company's global distribution strength and build on Jack Daniels' prominence and retail strength.

Now, let me turn to my second topic, our outlook for fiscal 2014. We expect 2014 to look very similar to 2013. For starters, this means we expect that a strong consumer interest in bourbon, both in the U.S. and many markets outside of the U.S., will continue. We anticipate that the environment will remain acceptable to price increases, albeit at a more moderate level. We expect interest in flavors in the whiskey category will also continue and that opportunities will expand both in the U.S. and abroad. And we believe that our broad-based geographic reach will continue to serve us well as interest in our brands grow in both the developed and emerging markets. We would expect to see

continued economic difficulties in some markets, particularly Europe and Australia, and some regulatory challenges in markets such as China, Russia, Turkey and South Africa.

On the subject of China, which has been in the industry news a lot lately, less than 1% of sales are currently derived from China, so our business is significantly less impacted over the near term by the recent slowdown in that market. Having said that, we have been making a number of changes to our China team and our strategy there that will hopefully position China to become a more meaningful driver of our future growth.

Let me talk a little bit more about the price environment. In 2013, we were pleased with the way the marketplace responded to the first large-scale price increases for our brands in over 5 years. As we had hoped, the loss and profit growth due to slower volumes was more than made up for by the increase in prices. A good trade off, given we still experience strong volume growth for the company as whole, and we're able to grow value share.

In 2014, we plan on implementing additional price increases at a low single-digit rate and in a market-by-market basis. As we proceed through 2014, it is worth remembering that, because the price increases in 2013 were the first in several years, we experienced some volatility in our reported underlying rates of growth in the first half of fiscal 2013. Price increases drove unusually strong results in the first quarter with underlying sales growth of 10%, due to retail trade buying activity, and then we saw softer results in the second quarter due to the natural give back, with underlying sales growth of only 6%. As such, we would expect the first quarter of 2014 to be up against much more challenging comparisons than the second quarter.

So all in all, we believe we are well-positioned for strong additional growth in fiscal 2014 and expect another year of high-single digit reported in underlying sales growth. We also expect cost inflation of roughly 2%, a little less than what we hoped to deliver in price

mix improvement for the full year, resulting in a slight improvement to our gross margins. Foreign exchange will likely drag down our reported results as the euro, the pound and the Aussie dollar have all depreciated against the dollar over the last 12 months and especially over the last few weeks. We also plan on growing our A&P roughly in line with sales growth and we expect the operating leverage in fiscal 2014 to be driven mainly through the SG&A line.

Our EPS outlook incorporates the cost associated with the route-to-market changes we plan to make in France in fiscal 2014. The majority of the onetime cost to implement this route-to-market change are related to the buyback of inventory previously sold under our agency relationship. We expect this to impact our reported EPS by \$0.06 per share in fiscal 2014, primarily in the third quarter. But the buyback is not included in our calculation of underlying operating income growth. In the aggregate, we expect the onetime cost associated with France and adverse foreign exchange moves to negatively impact our reported earnings per share by \$0.08 in fiscal 2014. These items, along with expectations for a tax rate in the 32% to 33% range, have been incorporated into our EPS guidance of \$2.80 to \$3. As noted in the chart in the earnings release, the midpoint of this range adjusted for France and FX would be roughly \$2.98, which would represent 10% growth from fiscal 2013 adjusted results of \$2.71 per share.

Finally, to provide you with some sensitivity in currency movements, a 10% move in the dollar, in either direction, across all currencies, would impact full year EPS by approximately \$0.14.

Let me now move on to my final topic, a brief discussion of our balance sheet and capital allocation, our balance sheet is in great shape, with net debt of \$793 million at year end, and our strong and growing free cash flow has allowed us to invest in our growth initiatives, as well as return cash to shareholders through our dividend. As previously dis-

cussed, we are making substantial investments to support future growth, including the Lynchburg distillery expansion and the new cooperage in Alabama. We spent about \$100 million in total in 2013 and fiscal 2014 spending calls for \$130 million to \$150 million to continue with these expansion plans. We then expect our capital needs to return to their historically efficient levels beginning in fiscal 2016.

Beyond investing in our organic growth opportunities, our ample balance sheet capacity positions us well to evaluate potential acquisition candidates. But we remain disciplined in our approach and will only pursue if we believe the brands or assets would do well in our hands and create long-term value for our shareholders. To the extent that attractive and advisable acquisitions are not available at the right price, Brown-Forman has a long track record of returning excess cash to shareholders through a combination of dividends, share buybacks and special dividends.

In fiscal 2013, we returned a lot of cash to shareholders, a record \$1.1 billion through our growing quarterly dividend and with a special dividend of \$4 per share. Strategically, we balance this return of cash with our goal to remain a solid, investment grade company that is positioned to endure and thrive for future generations.

Returning cash to our shareholders has helped augment the total shareholder return beyond our long-term earnings growth. In fact, we delivered what we believe to be an industry best TSR of 31% in fiscal 2013 and are focused on delivering industry-leading results for all of our stakeholders in the future by successfully executing against our B-F150 goals. This includes our aspirations to consistently outperform the industry, as we did in fiscal 2013 and as we expect to do again in fiscal 2014.

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

**Paul Varga**

Thank you, Don, and good morning to everybody. To supplement Don's nice summary of the year, I'll simply add that I, too, was we're really pleased with our performance in FY '13. Our underlying sales momentum continued, pricing played a more important role, we saw improved cost efficiencies, we continued to invest strongly while also achieving some operating leverage. It all added up to a 13% growth in underlying operating income and operating margin of 23.7%, a return on invested capital of 22%, and a 1 year total shareholder return of 31%. Just great results in our view.

We sometimes refer to our results as top tier within our industry competitive set with, for example, our 13% underlying operating income growth rate over the last 12 months, comparing quite favorably to our estimate of the industry's very solid 8% on the same measure. And a similar theme emerges when we look beyond just the last year and study our relative performance over the last 5 years, covering the period from fiscal year 2008 to 2013.

A simple averaging of our estimate of the industry's underlying operating income growth rate for each of the last 5 years yields a 4% average growth rate. Now keep in mind that this 5-year period included the very difficult fiscal years of 2009 and 2010, when global economic and financial turmoil reigned and our industry, not unlike many, struggled to show growth at the bottom line. By comparison, Brown-Forman's average on the same measure, over the same time period, was 8% or twice the average rate for the industry. It's also noteworthy, in my view, that in each one of those 5 years, our growth rate exceeded our estimate for the industry.

In a highly competitive and well-performing industry, not to mention unpredictable world, we are pleased to have been able to report to you such strong and consistent results. Looking beyond the purely quantitative results, I was also very encouraged by the quality of our FY '13 performance. As you could probably ascertain from Don's summary, Brown-

Forman's results were very well-balanced across several different dimensions. First, there was geographic balance. The breadth of our geographic performance continued to be impressive, spanning countries in both the emerging and more developed world. There are only a few brands in our industry that span the entire world, and Jack Daniel's is one of them. The brand's global presence is a primary source of our company's excellent geographic diversification. Don correctly mentioned so many of the countries that contributed to FY '13's results, and I want to reiterate how important the improved sales and share growth in the United States has been to Brown-Forman over the last couple of years. It's the most important distilled spirit market in the world and continues to represent greater than 40% of our sales, so seeing our U.S. underlying sales grow by 6% is really encouraging.

In addition to geographic balance, there was P&L balance. We experienced contributions up and down the P&L as the nice mix of volume, price, cost efficiencies and operating leverage produced a very healthy growth in underlying operating income. There was improved portfolio balance. While we strong led – while we were still strongly led by the wonderful Jack Daniel's trademark, we did see improved sales performance from the balance of our portfolio, with notable performance being Woodford Reserve, Herradura, the el Jimador family and Finlandia.

And there was particularly nice investment balance, in my view. We spent behind both operating and capital priorities with the aim of motivating consumers to call for our brands today while preparing our production operations for the drink orders of tomorrow. We also altered the marketing mix for some brands, most notably Southern Comfort in the United States where we more heavily weighted and consistently advertised the brand and this contributed to improved results in that country.

Looking ahead to next year, we are forecasting a continuation of our nice momentum and

it shouldn't surprise you that we are planning for many of FY '13's themes to continue to drive the company's FY '14 results. The development of the Jack Daniel's brand around the world, including the continued global rollout of Jack Daniel's Tennessee Honey, continuing to improve Southern Comfort's performance, the growth of super and ultra-premium brands, most notably Woodford Reserve and Herradura, and further developing Finlandia in the world's primary vodka-consuming markets.

A nice mix of investments will support the business and, once again, a balanced sales growth coming from both volume and pricing, while planning for moderate levels of price increases compared to FY '13. This is primarily due to the fact that some of our FY '13 price increases were pretty healthy since we had not taken any widespread increases for a few years and, accordingly, we felt there was an opportunity to be slightly more aggressive. And in some instances, our increases coincided, last year, with rises in excise taxes. So we want to be appropriately sensitive to the cumulative impact of all of this. Even though we'll be a bit more moderate this year, I'm still generally encouraged by the pricing environment for premium distilled spirits, particularly the super and ultra-premium whiskeys.

In closing, let me thank and recognize my Brown-Forman colleagues worldwide for a superb FY '13 and for positioning our company so well for the success we continue to see ahead of us. We're now happy to take any questions you might have.

## **Question and Answer**

### **Operator**

— ***Operator Instructions*** — Our first question will come from the line the Vivien Azer with Citi.

### **Vivien Azer**

The first question has to do with the bourbon category growth outlook. Where do you guys see the category growing either next year or over the next 3 years?

**Paul Varga**

Well, we don't, Vivian, generally have – do category forecasts as much as we do our brand forecast, of course, because of the need to produce in advance. But right now, as we look out, we continue to see, I mean, just using – I'm just using the U.S. data for bourbon for the last sort of 12 months, I mean, that category is growing at a sales level at sort of close to high-single digits. I mean, it was about 7% sales growth a year ago. It looks more like 8% this year. So that's a nice continuation of that momentum. And I think, of course, it's a different story outside of the United States where bourbon is less-developed but from a small base, you would expect that the category would continue to develop around the world. I mean, the largest contributor to American whiskey's growth for the last, of course, decade-plus has been the expansion of the Jack Daniel's brand. And with all of the excitement around flavors and the excitement around – it was really nice expressions like the Woodford Double Oak and things like that and the ability to innovate, we would expect the momentum we're seeing today to continue.

**Vivien Azer**

That's great. My second question has to do with potential acquisitions. Just – can you just frame out how you think about the need for potentially additional whiskey brands or exposure to other categories? Or is it kind of more of a geographic focus where you want more distribution footprint?

**Donald Berg**

Actually, it's both. We actually do look at it along both those lines. When you think about the expertise that we have in whiskey, looking at whiskey opportunities is a natural for us. Now, that kind of comes into play really when you think about anything along aged

spirits where that kind of capability is required. We also like the whiskey arena because it's such a great global category. When you look at how much breadth that has and how far reaching it is in all the different geographies and it tends to be very premium in nature, there just seems to be a very high consumer interest in those types of genuine, authentic, higher end brands. And so, given kind of where the consumer is at, given where we think our capabilities lie, it's really natural for us to look at all the different areas of whiskey that are kind of growing in that premium, super-premium arena. We still tend to, like vodka in terms of looking at it as a category in terms of global growth, but it does tend to be more of a regional play than a global play. And so you have to take more of a regional lens to that and see where you think those bigger opportunities might lie. And then we continue, for a lot of the markets where we own our own distribution, if we think that there is some local opportunity that would help us in developing the rest of our owned portfolio, we'll certainly take a look at those as kind of unique opportunities. But in looking at them, we'll also look at them to see, if we think there are some opportunities even go beyond that one individual market.

### **Paul Varga**

And if I – I think you had referenced in your question, if they'd help us with the distribution platform or anything else strategic. For example, our acquisitions in Mexico and previously what Finlandia did. The only thing I'd add is, I mean, we just – if you just look at our company's history and our track record and where we tend to play, we have a fairly limited portfolio relative to a number of other – of our competitors around the world and we tend to favor higher-margin brands that are sort of positioned at higher price points, we think that have long runways for growth. And so the type of characteristics Don just described point us toward things like higher-end whiskey brands, whether it's through innovation or acquisition. So we think those gives us opportunities not only to expand geographically but also as we proved this past year, to be able to get price more readily.

**Vivien Azer**

And my last question is for Don. For A&P, can you just give a little color in terms of the cadence of the spend, just for our modeling purposes for FY '14?

**Donald Berg**

In terms of like quarter-to-quarter?

**Vivien Azer**

Yes, it seems to me like it might be a little bit lumpy so if there's anything you want to call out there.

**Donald Berg**

No, we've actually kind of spread it over the last couple of years, we've actually tried to take some of that lumpiness out of it and kind of spread it out a little bit more. So I mean, I would probably look at it in terms of how you kind of view our shipments coming through as being a nice barometer around how our A&P spend would go.

**Operator**

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

**Judy Hong**

First, just on the pricing side, so I know you've talked about this year being a little bit more moderate level of pricing. Just competitively, is there anything on the horizon that points to that more modest pricing? And then when you think about your low single-digit pricing outlook for the year, how does that sort of break down between Brown versus other parts of your portfolio?

**Donald Berg**

We, of course, look at our competition, but I wouldn't say there's some individual or specific competitive reference that is driving our point of view on this. I mean, that's in the

mix, of course, you try to look at that. It's probably more us looking at the circumstances market by market and very much with a focus on Jack Daniels because of its importance to us. And I would say we are, I think, feel – we certainly feel stronger about the possibilities for pricing in our whiskeys relative to, say, vodkas, and a lot of that is we're really, primarily, our largest vodka brand is Finlandia, and it, of course, is in a competitive vodka category and price segment. I mean, it's not that we don't look for opportunities to price it, but I just think that compared to brands like Woodford Reserve or Jack Daniels or Gentleman Jack, we just foresee stronger and more readily available pricing opportunities for the whiskeys.

### **Judy Hong**

Okay. And then just going back to the A&P spending question, so I think in the last – in the earnings call, you said your A&P spending was going to be up in the mid-teens in the fourth quarter and it looks like maybe in the fourth quarter, it wasn't up as much, at least on the advertising side. So can you just give us a little bit more clarity on whether the spending actually did happen on a total A&P side as you expected or whether there was some type of a timing issue?

### **Donald Berg**

Yes, there were, in the fourth quarter, there did end up being some timing issues on some of the spend that we had intended to make. A couple of examples, we had intended on getting the campaign on Gentleman Jack launched before the end of fiscal 2013, but it took a little bit longer than we anticipated to get everything in the can and to get it out there. And so you'll be seeing that in 2014 rather than 2013. So there's a little bit of timing there. We had some investments that we were looking to try to make in Russia, but then when the regulatory environment changed there in terms of the regulations on advertising in that market, it turned out that we weren't able to make that spend in that quarter. And so, it was a myriad of things, to be honest, across a lot of brands and in a lot

of countries. But for the most part, they were those types of different activities that we were facing.

### **Judy Hong**

Okay. And then just lastly, on Russia and Turkey, just what is your expectation in terms of how the advertising restriction would impact the category in your brands in those markets?

### **Donald Berg**

It's really – it's pretty early to tell yet given how recent those changes are. So we're not really sure. We can tell you that when you look at markets where we have experienced this before and you can look at examples like Poland or France, a lot of times what you find is that brands have already gotten in there and done their advertising and created awareness with consumers, and our well-established brands end up not getting hurt that much in a way it helps them a bit in terms of creating a little bit of a barrier of entry to other brands that weren't as early going in. The other thing that I would just mention that we've also seen is that there are a lot of ways to get to the consumer. And in many of these markets, the best way in the early stages of brand building is the work that you're doing in the on-premise channel. And so, so long as you continue to be able to find ways to get directly to the consumer and tell your story and get them to sample your product and what have you, there are still a lot of ways that can go about building your brands even in spite of some of these restrictions around how you go about communicating to the consumer.

### **Paul Varga**

I'll add to that too. Just for reference to those 2 particular countries. What you think about before and after the regulation, we were not massive advertisers in those 2 countries going in anyway. I mean, when we think about our stage of development in those countries

and we still think we're relatively early stages where a lot of the good work that's been going on has been either in-store, in-account, on-premise using the benefits of our, sort of sales and promotional efforts. We actually don't like when these regulations come down. Particularly a company like us, who prides itself on being very responsible marketers and promoters. And so it is a limitation. But we think, as Don said, that it just forces us to be more creative about how we get our messaging out to the consumer.

### **Operator**

And your next question will come from the line of Ian Shackleton, Nomura.

### **Ian Shackleton**

I think Don talked about Europe and Australia being tough. Now, I just wondered how you see that going as we go into FY '14 and specifically in Australia, there seems to be some sign of the beer industry getting its act together a little bit more and does that represent some new competition?

### **Donald Berg**

Why don't I start out. At this juncture, if we look at Europe first, I mean I think our expectations there is along the lines of what you hear from just about anybody is that economically, we expect those markets to continue to be tough as we go forward. As we've experienced that over the last couple of years, in some of those markets, we've been able to outperform what's been going on in terms of actually having growth in our portfolio. In other areas where we have seen some struggles, we've still been able to manage to continue to grow market share. And so I think it's a testament to a large extent of just kind of where Jack Daniels is in its development when you look at Europe. When you look at Australia, we are seeing some slowdown in the market and it is getting more competitive. There are certain areas, though, that we continue to see some really nice growth and we saw some nice growth around the launch with Tennessee Honey. And some of the

consumer reactions there, which I would say were pretty close to being similar to what we saw in a lot of the markets around the world in terms of kind of at the end of kind of a first year, the percentage of the business that you're seeing, Honey representing of the total brand. We also saw some really nice consumer interest in the launch of Gentleman Jack RTD. It's the first market we've actually taken Gentleman Jack into in an RTD form. And it was nice to see the acceptance level in terms of premiumization at the RTD level. And so like anything, when you start to see some of these issues are having in some of these markets, you can't generalize it across every brand in your portfolio. They're still where you'll find pockets of opportunity and pockets of growth.

### **Paul Varga**

Ian, I might just add to Don's comments particularly on Europe, as we think about Europe, it's almost like 3 sections that we might consider for evaluation. Eastern Europe for the company remains pretty much on fire. I mean, and the Jack Daniels and Finlandia business out there are the primary drivers. Of course, just like a lot of businesses, when you consider the combination of markets like Spain, Italy, Greece, I think that's where Don's comments relate to the struggles of Europe, we would say that we've experienced similar difficulties there. But our largest markets and ones that also had some actually – actually, it's real challenges as it related to excise taxes in F '13, of France and the U.K. We were pretty pleased with how we ultimately performed in France and the U.K. given those circumstances, and I think Don highlighted I think really well in his comments the performance that continued in Germany. So it's a mixed perspective from our companies as it relates to Europe. But net-net, I haven't added all those up when compared it to our competitors. I feel just qualitatively that we continue to perform better than in the industry in Europe overall. In Australia, the only thing I'd add is like France and the U.K., one of the challenges the whole industry has is in those markets they've been deploying these excise tax increases and for companies like ourselves and many of our competitors who are at the premium end, it has the impact of making the price to the consumer higher.

And I consider that to continue to be an issue that we have to confront.

### **Ian Shackleton**

And just a quick follow-up, going back on the pricing situation, there seems, to be some specific issues with the U.S. — *indiscernible* — brand at the moment. I mean, is that part of that slightly more cautious pricing outlook or do you think that's a rather short-term issue which we'll walk through in the next few months?

### **Paul Varga**

No, I haven't studied that particular one real closely. I mean, we do watch vodka pricing and as a general statement, I'd say in the U.S. Market particularly, we would say that their price mix improved over the last 12 months relative to prior years but certainly not as strong as the whiskeys and the bourbons. As you, I think, probably well know, the Vodka category generally is very price competitive and one of the things when you look at the statistics around price mix that influences that, is that I would just draw the contrast between bourbon trademarks and vodka trademarks. A lot of the line extension activity that occurs in vodkas typically is what we call horizontal, which means a lot of flavoring. And oftentimes, they don't get a lot of improved pricing with that. It tends to be more land priced. There's examples where they can a little bit out of it. In bourbon, what you see is the ability of trademarks and it's actually one of the things that I think is driving a lot of the interest in this category in the United States these days, is you do see many, many, many examples of what we call vertical and premium laddering on the bourbon trademarks. And so I think for particularly trademark families and brand families, you see that, that will contribute to more profitable mix for the trademark. And of course, we've been excited to actually have the ability to do some of these horizontal stuff in more recent years as well. It's one of the reasons we think that bourbon is still attractive, it's ability to line extended both horizontally and vertically.

**Operator**

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

**Timothy Ramey**

Just wondering when we're thinking about the 11% growth of the Jack Daniels family, was the mix between volume and price mix similar to the company overall, sort of an 8%, 3%? Or did you have a little bit more price mix due to Honey?

**Donald Berg**

Let me just try to interpret your question. Did Jack mirror the company basically? Is that – I mean, as it relates, I'm trying to look at it.

**Timothy Ramey**

Exactly. Should we think about that 11% being comprised of 8% volume, 3% price mix or something like that?

**Donald Berg**

The Jack family, we've actually been a little bit higher than the Corporation overall.

**Timothy Ramey**

In terms of price mix?

**Paul Varga**

Actually, a way you might look at it in the aggregate is actually on Schedule B of the earnings release this morning. Just using constant currency for the Jack family, it was 11% and on equivalent conversion depletions, it was 6% for the Jack family. So at least 5% for sort of mix, portfolio mix price, et cetera. Does that give you a good feel for it?.

**Timothy Ramey**

Very good, yes. And then also, just is there any thought on what interest expense might

look like in 2014?

**Donald Berg**

It will be a little bit higher year-over-year. But then we have roughly \$1 billion of long-term debt outstanding and the average interest rate is roughly 2.5%.

**Operator**

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

**Mark Swartzberg**

A question about the revenue build in the quarter and if my math is right, there was a bit of a volume slowdown, a couple of points, a bit of a price mix pickup, also a couple of points versus the full year rates. And if that math is right, can you speak really at any way that would be illustrative to what you think that's reflective of? If it's in North America, what brands are benefiting, so to speak, in getting that better mix? Is it really just a JD phenomenon we're seeing where the higher end JD is growing faster than perhaps the mainstream JD? I'm just trying to better understand what's driving that move to greater price mix in the quarter.

**Donald Berg**

Well, I think a lot of it was still – last year, at the end of the year, we were actually starting to take some of our price increases. So you saw price increases in the U.K., you saw price increases in France, but the majority of them did not start taking place until after the May 1 beginning of our fiscal year. And so this would've been the quarter that you would've seen probably the full brunt of the whole pricing side of the equation because we would have had all the pricing in there that ended up getting kind of graduated in there throughout the year. Most of it came in the first and second quarter, but you would've seen the full brunt in the fourth quarter. On the volume side, there is no doubt we have seen a little bit of softening in the U.S. But that would be about the only thing that I can

think of that would have been a big driver in terms of the results that you saw in the fourth quarter.

**Paul Varga**

And what's true generally of total distilled spirits in the bourbon category in the, I think, the 13 weeks ended April. And we mostly theorized that the impact of things in America, like the post-January 1 high-payroll impact. Just some of the malaise that people were describing generally in retail could have had an influence. But I think you're at a broader, even going broader than the quarter. I think you're correct that the company's price mix sort of a value equation for the fiscal '13 overall, the balance between volume and pricing and mix did change. And one of the contributing things at the corporate level to that is that these higher-margin brands do continue to grow at faster rates than our lower margin brands, and such the Woodfords and Herraduras. So there is some portfolio mix within Brown-Forman that's contributing to that too.

**Mark Swartzberg**

And as you look at your elasticity models and you look at vodka, for example, Finlandia versus JD or even some of your higher-end North American whiskeys, and then you take what seems to have been kind of an industrywide slowdown from a kind of a volume growth perspective, any tweaks there? You're saying greater level of price realization going forward in North American whiskey than in white spirits, but what sort of new discoveries, if any, are you kind of seeing given the patterns both from a broad consumer perspective and then the different behaviors within white and brown spirits?

**Paul Varga**

I mean, I don't know that I have something that's earth-shattering as much, and I do think your word tweak is correct and we try to take license to tweak not only from year-to-year but within the year as we see either opportunities or concerns. So I think we'll

be making some sort of regular adjustments. As a general thing, I refer back to, I think, some comments that we've discussed at the end of our Q3. The primary driver, even though there are influences from other brands in the portfolio, the primary driver of the corporate financials is the Jack Daniels trademark. And so if you think about the balancing act that we're undertaking as it relates to starting with price and volume, and I think I went into quite some detail back in the third quarter talking about just going to get this huge volumetric brand that you constantly desire to have be pervasive and popular and desired but also be correctly perceived as of enormous quality and specialness. And so as the owner of that kind of trademark, you really want to do that balancing act well and you at times are willing to sacrifice some volumes for the enduring positive perceptions of the brand and have it be held in aspirational regard. I really do think that's a very subjective and qualitative call that we are – — **indiscernible** — our people around the world are regularly trying to make. I mean, we could probably devote an entire investor conference on that topic alone. But you add to the mix a very successful introduction like Jack Daniels Tennessee Honey and the continued expansion of Gentleman Jack and Single Barrel within the trademark and the expansion of Woodford Reserve above the Jack Daniels price point. So as owners and purveyors within the whiskey category and innovators within flavor, we're also trying to do that in the best way where we can have our cake and eat it too, which means just limited cannibalization. And so we'd look at a lot of factors in this, and I can't tell you how pleased we are with – particularly on Tennessee Honey piece of it, these first 2 years of that balancing act. And then we added another dimension to it here in '13, which was the pricing aspect where we, a year ago, just felt like there was a greater pricing opportunity than we were realizing and a need to continue to push Jack Daniels aspirationally up. And I think we accomplished a lot of that. And as we report to you today, we think there are still continuing opportunity but we just don't think we need to be or should be as aggressive as we were in F '13 with our F '14 assumptions.

**Donald Berg**

The other thing. I would add to that a little bit just in terms of – I think one of the things that we've seen, and this isn't anything necessarily new, but we've certainly continued to see it throughout the last fiscal year. As you get down to popular price brands or more of the standard price brands, it really is far more competitive. And that's more than just the United States. I mean, we see that with the tequila market in Mexico, we see it in the vodka market in Poland and in many, many markets. And so when you're dealing in those categories, it has a much tougher pricing environment for you. But as you get more premium, there are a lot greater opportunities in order to take price. And so it's part of what you're hearing from us in terms of as we think about next fiscal year being a little bit more targeted brand by brand and market by market, continuing to see a lot of opportunities in the premium and above part of our product portfolio.

### **Mark Swartzberg**

Final one for you, just on the U.S. market. Anything you'd call out of note from a depletion versus shipment or maybe a different way, and you made this comment, you had the benefit in the quarter which you called out, which I think was more non-U.S. But just trying to get a feel for where you think your customers' inventories are versus either a year ago or target levels? Just give us a flavor for how you feel that situated as you undertake incremental pricing here.

### **Paul Varga**

Well, our distributor customers, as we reported, were a bit higher than anticipated, and that's the sort of adjustments we make between our reported and organic. But in terms of my own views of their customers, so the retail inventories, I haven't qualitatively or quantitatively observed anything that would tell me that they were out of line with a year ago.

### **Donald Berg**

At this point, at the end of April, it's usually a pretty calm point, if you will, in the calendar because a lot of the price increases don't start kicking in until June or July. So I haven't seen anything that would suggest at the retail level that there's any kind of anomalies that are going on right there in terms of as of April 30. On the distributor side, we don't manage the distributor level in terms of what they keep in their inventories. And so you can see some anomalies that can happen year-over-year. Usually, it's a day one way or the other, maybe 2 days one way or the other. If you look at the range, as I've been here 20 years, we're kind of at the lower end of that range right now than where we've been. We're still within the range, but where we would be at the lower end of the range of what I've seen in the terms of the U.S. distribution inventory levels, we may end up seeing it move around a day or 2 during the course of 2014. It just wouldn't be unusual.

**Paul Varga**

It certainly is seasonal. With these price increases we take, they float up and then come back down. But nothing unusual, I don't think, from our view.

**Operator**

And your next question will come from the line of Bill Chappell at SunTrust.

**William Chappell**

I wonder, I know you don't give quarterly guidance but can you maybe give us a little bit of color in kind of what we're looking at in the first quarter? And then talking about that, just in terms of the comps with the pre-buy in front of price increase last year? And then also, as you talked about an A&P spend being pushed, didn't know if we should expect all of that to be pushed from fourth quarter to first quarter or if that's kind of will be blended throughout the year?

**Donald Berg**

I'll start with the A&P one first. I mean, in terms of looking at how we would anticipate

the A&P spend and total flowing on a quarter by quarter basis, I think of the best I can tell you is what I said earlier in terms of just kind of take a look at where you think our shipments and how our business flows and we're getting it to be pretty close to following how the business nets out.

### **Paul Varga**

But there are seasonal fluctuations. I mean, just the example that Don gave of the Gentleman Jack launch that we wouldn't have had a year ago, where we would have had heavier media schedule expected the first part of F '14. So there is an example where you can get seasonal fluctuations. But I mean, I think generally, as it relates, I think, we just think it's smart to call out as we did a year ago where we had expected a lot of pre-buying in advance of those price increases that were of a far more widespread in nature a year ago that they had been in previous years. And I think that served you guys well and served us well to be able to upfront let you know that it could be a bumpy first half between the first quarter and second quarter. And I think the same thing because what we're trying to do here is illuminate that with the price increases not being as aggressive and being year 2, you could get some comps between first quarter and second quarter. Remember, these things always have a buy-in and a give-back that we want you all to be alert to as it related to the seasonal earnings of Brown-Forman, which we try not to focus too much on that, as you can imagine. And generally, we tried to direct you to the sort of full year guidance we're giving you.

### **William Chappell**

Okay. And then just kind of switching, I know it's a small kind of test but on the RTD side, going to Gentleman Jack, I mean, are you seeing around the world RTD is getting to where you can test more superpremium? Is this something we'll see more in the next 2, 3 years versus kind of being more of the low-end convenient value-priced type option?

## **Paul Varga**

Well, Jack Daniels being the – I think just being the indiscernible] and pretty much exclusive, this I think about the competitive set premium brand in that arena worldwide. If you think about having a brand with a Jack Daniels price position in ready-to-drink format in a multitude of countries. If you go down into a great sample, you can always look at it as in Australia there are other brands that are at the premium level. Gentleman Jack would certainly be at the high end within the Australian market. But look, the more people are drinking in single-serve format, I'll use the example of the U.S. craft beer business, there is a very high end single-serve expression that has gained enormous popularity. And so we keep a very open mind to the possibility that people want to enjoy their drinks when they want to enjoy them and they're willing to pay for very high premium quality. And whether that happens in beer or spirits or even single-serve wine as it's available in some countries around the world. So that is a test, honestly, that we're doing, but as Don said, we've been pretty much encouraged by the initial reception to it.

## **William Chappell**

And then the last one. On gross margin, it was a little bit better in the quarter and just trying to understand kind of where you're seeing the commodity inflation for 2014 with? It seems like grain prices are starting to be more favorable.

## **Donald Berg**

Yes, I think the best way to think about that is really in terms of a comment I made as part of my beginning comments. As we look at across all of the different components of our cost of goods, we're kind of looking at inflationary type increases for next year that are kind of at a 2% level. There's a lot of things that in terms of moving parts there where we're seeing some benefits in terms of glass costs. We should see a little bit of benefit in terms of grain. But on the other hand, we're seeing quite a bit of price increasing coming through from agave and the whole tequila market. And so when you kind of get through

all the puts and takes, we're generally looking at something around 2%.

**Operator**

And that does conclude the question-and-answer session of today's call. I'd like to turn the conference call back over to you for closing remarks.

**Paul Varga**

Thank you, Holly, thanks to all of you for joining us today for our year-end 2013 earnings call. Please feel free to reach out to any of us if you have any additional questions, and have a great week.

**Paul Varga**

Thank you, all.

**Donald Berg**

Thank you.

**Operator**

Thank you for participating in today's conference call. You may now disconnect.

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