Brown-Forman Corporation, Q1 2014, Earnings Call 2013-08-28

Presentation

Operator

Good morning. My name is Holly, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Brown-Forman First Quarter Fiscal 2014 Conference Call. — ***Operator Instructions*** — I'd now like to turn today's conference over to Jay Koval, Investor Relations Director. Please go ahead, sir.

Jason Koval

Thanks, Holly, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's first quarter 2014 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 first quarter of fiscal 2014. 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, all 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 Don for his prepared remarks.

Donald Berg

Thanks, Jay, and good morning, everyone. On today's first quarter earnings call, I'd like to cover 3 topics: a review our first quarter results, a quick update on the pricing environment and our current outlook for fiscal 2014.

So let me start with a review of our first quarter results. The first quarter is typically our smallest quarter and is usually fairly quiet compared to the quarters straddling the holiday season. However, at times, the first quarter can also be a bit confusing because it is typically when we have taken a lot of price increases on our brands.

This was certainly the case a year ago when we reported first quarter results for fiscal 2013. If you remember, we had 10% underlying sales growth due in part to the unusually large retail buy-ins in advance of some healthy price increases, the first pricing we had taken in 5 years. That was followed by the second quarter's relatively weak underlying sales growth of 6% as inventory levels came back into balance. When combined, the first half of fiscal 2013 saw an 8% underlying sales growth rate, in line with the full year results.

This year's first quarter is equally confusing. We took more modest price increases this year in the 2% to 3% range, rates more in line with our practice prior to 2009. This resulted in a retail buy-in that was much less dramatic on some pretty tough comps and contributed to our 5% increase in underlying sales in the first quarter. Because we saw a smaller retail buy-in this year, we expect to see a stronger second quarter relative to last year's weak comps. And we believe that again, after the second quarter, our first half results will be more in line with our full year expectations for high single-digit underlying sales growth.

Three things encourage us to believe that we remain on track to deliver this growth outlook. First, if you look at the last 2 years together, the first quarter compounded growth rate would be nearly 8%. Second, when we look at recent syndicated consumer takeaway data for our largest markets, we are seeing stable positive takeaway trends across the majority of them, including the United States, the U.K., Germany, France, Russia, Turkey and Mexico. And finally, our shipments so far in the second quarter are up at a double-digit rate, suggesting we are off to a strong start to the second quarter.

With that as a backdrop, let me provide some more color on our 5% underlying sales growth rate. First, underlying sales results were powered by our price increases, which have driven a strong improvement in our price mix, up 4 points in the quarter. In addition, these top line results continue to be driven by broad-based geographic strength, although in the first quarter, the relative contributions were slightly different.

Starting with our largest market, the United States. Underlying sales grew 5% compared to the year-ago period, which included unusually strong results driven by retail buy-ins as well as roughly 1.5 points of pipeline sale in the state of Washington as it transitioned to an open state. As we look at the combined U.S. Nielsen and NABCA data, we have observed a slight deceleration in the industry growth rate from 4.5% value growth over 12 months to 4% value growth over 3 months, but we believe the industry fundamentals remain sound, particularly in our areas of strength, premium whiskeys. Looking at that same combined syndicated data, we have not yet seen a slowdown for our brands in the U.S., with takeaway trends running at 5.6% on both a 3-month and a 12-month time frame. So while we are closely monitoring the competitive landscape, our brands continue to outperform and deliver strong value growth.

In developed markets outside of the United States, underlying sales increased by 4% but grew double digits if you exclude Australia, where underlying sales declined by 5% despite some market share gains. While Australia's economy remains under pressure, economic trends in parts of Northern Europe appear to be stabilizing, including the United Kingdom, Germany and France. Each of these countries grew underlying sales by a double-digit rate, although the United Kingdom was helped somewhat by easy comparisons. These are large and growing markets for Brown-Forman's brands, but with relatively low market shares compared to our competitors, we continue to see significant opportunities to grow our brands and have continued to invest in these markets while many competitors are allocating resources to other markets, such as China.

The other developed country of note, Japan, grew underlying sales by 17%, as Asahi continues to make solid distribution gains. In the emerging markets, our portfolio of brands grew underlying sales by 5%, as we had some inventory challenges related to price increases in Mexico on Herradura and New Mix and in Poland on Finlandia. Price increases in both countries occurred at the end of fiscal 2013, resulting in some giveback in the first quarter of this year.

Excluding Mexico and Poland, the emerging markets grew 13%. Turkey and Russia, for example, grew at double-digit rates despite going dark on A&P activities earlier this year. And our Jack Daniel's family grew underlying sales by 13% across all the emerging markets, including continued strength in Southeast Asia, Eastern Europe and Latin America.

For our brand results, I'd like to point you to Schedule B in our earnings release, where we have provided additional disclosure to better present the underlying trends by brand, removing some of the quarterly noise due to changes in distributor inventory in addition to foreign exchange movements. Our conclusion after looking at Schedule B is that, while the timing of retail buy-ins clearly impacted year-over-year comparisons, we believe that the brand portfolio delivered strong underlying results.

Moving to the other line items on the P&L. Reported gross margins increased by 40 basis points in the quarter, leading to 6% underlying growth in gross profits. We continue to invest in our brands, with underlying A&P spend of 12%. Some of that increase was related to timing, driven by the creative costs associated with the new Gentleman Jack campaign, as well as the cost of launching Jack Daniel's Tennessee Honey in several additional international markets such as Germany. SG&A increased 5%, resulting in underlying growth in operating income of 4%.

Turning now to my second topic, a quick update on the pricing environment. Over the last few months, we have been implementing price increases that are more in line with what we've been able to implement on a sustainable basis prior to the 2009 recession. Similar to last year, we expect to realize more pricing in our aged spirits portfolio than in white spirits, as well as more pricing from our super and ultra-premium price points than below. Net-net, we are looking for an increase of 2% to 3% for our portfolio of brands in fiscal 2014.

Industry pricing fundamentals have remained healthy, with price/mix an increasingly larger contributor to industry revenue growth. For example, according to the most recent 3-month Nielsen data in the U.S., price/mix contributed 3.2 points of growth as of July 2013 versus only 1.7 percentage points as of July 2012.

As we've noted in the past, we believe pricing impacts the consumer's perception of a brand's premium-ness and ultimately helps determine the brand's positioning. With a focus on value growth over volume growth, we will continue to look to pricing as a way to keep our brands special on the eyes of global consumers.

In addition, a disciplined approach to pricing and brand building should allow us to offset cost inflation and, over time, grow our gross profits at a faster rate than our sales growth.

Finally, let me move on to my third topic, our current outlook for fiscal 2014. As I mentioned in my introduction, we believe that we are on target to deliver high single-digit underlying sales growth in the year. Regarding the seasonality, as we look back to last year's results, buy-in activity was highest during May and June and shipment growth slowed dramatically as we moved into July and August. So it's not surprising that when we look at our monthly sales figures this year, May and June were down, given the challenging comparisons. These comparisons turned favorable in July, and we have seen the strong sales growth continue so far through August. We expect the adverse seasonality of the first quarter to reverse itself in the second quarter, resulting in first half sales growth that should be more in line with our top line expectations for the year. We anticipate that Tennessee Honey will again be a contributor to our corporate growth rate, albeit not the same rate as what we enjoyed last year.

As a point of reference, Tennessee Honey is on track to be in 90% of Jack Daniel's Tennessee Whiskey markets as measured by sales by the end of fiscal 2014 versus 70% coverage in fiscal 2013. With expectations for a low single-digit contribution from price/mix and cost inflation of 2%, we are anticipating very modest gross margin expansion in the year.

As you saw in the first quarter, we continue to find ways to invest in the long-term global growth of our brands. Notwithstanding some quarterly fluctuations due to timing, we still anticipate that A&P will grow roughly in line with sales growth, and we are focused on leveraging some of the investments we have made in our people over the last few years, which should result in operating income growth of 9% to 11% in fiscal 2014.

In the aggregate, this would lead to anticipated earnings per share of $2.80 to $3, including a $0.03 negative impact from foreign exchange headwinds, as well as an estimated $0.06 negative impact related to our France route-to-market changes. Given the transition should occur on January 1, 2014, we expect most of the inventory buyback to occur in the third quarter. And to help you model the potential impact from changes in foreign exchange, a 10% move in the dollar in either direction would impact EPS for the balance of the year by approximately $0.11.

So in summary, we continue to believe that Brown-Forman is well positioned to outperform the industry. Because of our geographic footprint, as well as a focused portfolio of brands concentrated in faster-growth categories, our results can and often do differ from how the industry performs, as was the case in fiscal 2013. We have a strong presence in the U.S. and Europe, markets where we are driving strong rates of growth, and the economic outlook looks better than the current trajectory for many of the emerging markets. And while markets such as Brazil and China appear to be taking a respite from the torrid pace of growth they have enjoyed over the last decade, our exposure to these markets is relatively limited today compared to our competitors.

We remain bullish about the long-term prospects for our brands in the emerging markets and are investing in brand-building activities that will best position us to realize the future growth potential and deliver industry-leading results for our shareholders.

That concludes my prepared remarks, so I'll now turn the call over the Paul for some brief comments before we open up the call to Q&A.

Paul Varga

Thanks, Don, and they will be brief. I don't really have a lot to add after just 3 months in a quarter that was in line with our expectations.

As you can tell from Don's commentary, there's a lot of noise in the results, as anticipated. And after digesting the results, I think we're very much on track with our FY '14 full year plan. As a result, we confirmed our guidance for the full year this morning.

I just would add, sort of to finish, that a lot of the underlying themes that we've been discussing with you over the last many quarters and years remain virtually unchanged. And a lot of the stories that have been underpinning Brown-Forman over the last many years, particularly the global expansion of Jack Daniel's, continues to be one of the preeminent themes for the company.

With that, Don and I are happy to take any questions that you've got.

Question and Answer

Operator

— ***Operator Instructions*** — And your first question comes from the line of Vivien Azer, Citigroup.

Vivien Azer

In terms of Mexico and Poland, I hear you on the distributor inventory movements. Could you maybe speak to what the underlying business did, potentially brands that weren't impacted or the health of the category, to give everyone a little bit of reassurance? Because some of the numbers around el Jimador were a little bit surprising to me.

Donald Berg

Sure. I'll start with Poland and then move to Mexico. I mean, when you look at Poland, obviously, it's a really large vodka market, and it's a large vodka market for Finlandia, as we've seen, like we do in most of our markets. As consumers are getting higher per capita incomes, they're looking to trade up to more premium brands, and we've benefited from that. One of the things that you've seen there over the last couple of years are a number of major competitors kind of in the popular pricing area for vodka that have been in a lot of financial trouble that has really kind of impacted some of their approach into that market. And so it's been a bit disruptive. Finlandia has continued to do pretty well within that environment, but I would say that when you look at the market fundamentals, not a lot has changed there from what we've been competing against kind of over the recent time and the recent quarters. One of the things that we've also benefited from in Poland is – and again, you see this in a lot of markets too – you have very heavy vodka market that are looking to other areas of interest, and whiskey is one of those areas where we've been seeing some trading out of vodka generally and into the whiskey category. As a consequence of that, Jack Daniel's has performed very well in Poland. And so in spite of some of the things that we've seen in that market around Finlandia, we've continued to see Jack do really well there. Let me turn to Mexico for a second. In a way, it's a little bit of a similar story. As you know from what we've talked about and others have talked about for quite a while, there was quite a glut of agave that took the prices down pretty low, which brought a lot of competitive brands kind of in the low pricing arena. And so the tequila market within Mexico has been pretty competitive for a while. And while we've seen agave prices starting to go up, we still haven't seen any kind of a knock-on effect of that in terms of reducing the level of competition there. And so overall, when you look at the tequila market in Mexico, I don't think that you see a lot of fundamental changes there. And again, similar to Poland, you've been seeing a lot of interest in consumers moving into whiskey, and Jack Daniel's has been a big benefactor of that consumer interest move, and it has continued to do well in Mexico while we've seen a more competitive landscape on the tequila side. The one area in Mexico that I would say has changed a little bit is in the RTD arena, where we've got our el Jimador New Mix product, which has had a substantial share of that overall business. There are a number of new entrants that are going into that category. And so that really precipitated us to take some actions down there to kind of take in – try to take advantage of the current situation. We did a few tactical things to make sure, as we saw new launches coming into that arena, we were doing some things to kind of protect our distribution. And so that's an area where I think there is a little bit of a change, and there was probably some particular issues that affected the quarter around New Mix. But generally speaking, when you think about that in terms of the corporation overall, it's a relative – it's an important part of our business in Mexico but a relatively small part of our business for overall Brown-Forman.

Paul Varga

Yes, I wouldn't read the Schedule B data as consumer related on New Mix. It's very, very much related to changes in trading patterns between the spring and the summer and Q4 of last year and Q1 of this year. One thing, though, that I think that Don touched on, I think you all can – I mean, it's not a 100% global observation, but places like Mexico and Poland where Brown-Forman made acquisitions into categories that we might call local categories, where there was always a sizable standard price category, I mean, it's been our experience over many, many years that in these particular instances, where those local categories – in this case, in Poland, vodka; and Mexico, tequila – that we are benefiting, and it shows up in the Jack Daniel's business, not only from the distribution platforms that came from that, but also the consumer shifting from the local category toward whiskey and also, in many cases, from lower price points to higher price points. So we benefit from that. And there's a number of other countries where I think that, that has occurred as well. It's not a – you can't make that statement about every country around the world, but it certainly is a theme that we think we benefit from, particularly in our premium whiskey brands. So that's one thing. We have to take the hit for it, though, with a struggling standard price category in Poland that Finlandia certainly pays attention to and, similarly, el Jimador pays attention to in Mexico with tequila. But for the country overall, we think we've, net-net, benefited.

Vivien Azer

Understood. My next question has to do with Australia. I understand that the first quarter largely came in line with your expectations on a total company basis. Does that hold true for Australia? And what are your expectations for that market for the remainder of the year?

Donald Berg

Yes. I mean, I think when you look at Australia overall, a lot of what you're seeing is around the – what's happening on a macroeconomic basis and the impact that, that's having on consumers and consumer spending and alcohol consumption. I think within that, there's a couple of unique characteristics around Australia that we think about. Australia is one of these markets where, by law, they take excise tax increases every 6 months, basically around the rate of inflation. And because of the different taxing environment on spirits being higher than what they tax beer and wine, they've been doing this for several years, there's really a price disproportionality in that market that really puts spirits in a bit of a disadvantage. And so when you find yourself kind of coming under some of these recessionary squeezes and what have you, I do think that spirits ends up getting hit a little bit disproportionate to the rest of the alcohol industry. And within spirits, it's not surprising to see bourbon, because it's such a – it's the largest category in Australia, kind of seeing that hit probably sooner or bigger than others. And so I don't know that I would say that it is out of our expectations in terms of what you kind of see when you go into these kinds of economic downturns. Within the market, for the most part, we've been gaining share as it relates to several of our brands and several of our introductions there. And so we've continued to perform pretty well in spite of all of that, but there's a lot of pressure on that market. And I think as you look forward – I mean, anybody – it's anybody's guess as to what will happen in the Australian economy. But there's nothing that I think we see that indicates that it's going to improve in the near term.

Paul Varga

The other thing that I would set – cite that is unique to us down there is that Australia has been one of our most active countries on the innovation front. And when you're active on the innovation front down there, it's been both – very much so in RTDs, historically. Last year, they had to launch Tennessee Honey that they're cycling against that pipeline that went in there, as well as even standard price tests we're doing down there. So there's always comparables against introductory periods in markets that are very active with innovation. And so I think that can be a contributing factor as well, particularly the 90-day results.

Vivien Azer

Terrific. And my last question is a quick one. Can you just comment on inventory levels with distributors, given that your shipments are up double digits so far in the second quarter?

Paul Varga

Oh. You were thinking about forward-looking?

Vivien Azer

Just kind of where are you kind of restocking inventory with distributors? How are your shipments and depletions running?

Paul Varga

I think Don's comment on that was just to describe the seasonality of the shipping patterns. And what we – they, for month-to-month, of course, vary based on these fluctuations. But no, I think that was more a reflection of things coming back into balance with our historical rates for whatever season we're entering. I mean, they fluctuate within the year even a normal basis, based on whether it's the holiday season or what other months might be unfolding based on our programming. But no, I think that reference was just to let you know that some of the seasonality that was working against us in the first 2 months of the year seems to be – we seem to be benefiting from in the ensuing 2 months.

Donald Berg

Yes. So just to kind of reinforce that point, Vivien, think what – we have seen buy-ins in advance for our price increases this year, just not to anywhere near the extent that we saw them a year ago. And so our expectation is that there will be some kind of "giveback" in the second quarter, but nowhere near the amount of giveback that we would have seen a year ago so that net-net, by the end of the 6 months, we would anticipate kind of being back in kind of a normal balance at that juncture.

Operator

Your next question comes from the line of John Faucher, JPMorgan.

John Faucher

Just 2 quick questions here. First off, can you talk about the gross margin performance in the quarter? The top line was probably heavily weighted towards pricing. So do you think you see relatively consistent gross margin performance like this over the balance of the year, or was there something interesting in the comp, given the buy-in before the price increase? And then the second question is about your Europe commentary. Can you talk a little bit, particularly the Western Europe piece, how optimistic you are that it'll get better from here? Or is it something where you see it sort of skimming along at the bottom?

Donald Berg

Yes. So a couple of things. I mean, I think, as we have talked about kind of the full year, we're anticipating at the cost line somewhere around about 2% inflationary cost. So when you think about a 2% to 3% increase overall on pricing, that's where you end up – where we talk about some modest, very modest improvements kind of at the gross profit line. I think the first quarter was somewhat in line with that. I think one of the things that you saw a little bit in the first quarter was still getting a little bit of the advantage of last year's higher price increases kind of in the May-June time frame when we were taking July 1 price increases. So I wouldn't read too much into that. I'd really kind of focus more on kind of how we've talked about the full year overall.

Paul Varga

As long as the portfolio and geography mix holds up about like it was last year or planned. And that, that...

Donald Berg

And then there's allocations for inflation.

Paul Varga

Yes. And that always has an influence on it if they're higher or lower gross margin countries or brands in the portfolio in terms of the mix. But – I mean, after 90 days, we don't right now have any new position on that. And then on Europe, there was – Don can make some comments about that. I mean, I think any of the short-term news on Europe – one encouraging thing was much better performance from Southern Comfort over in Europe. I don't know if that was necessarily directly related to the economy or the environment as much as it was to our own efforts and the competition that exists for the brand, and we were really encouraged by some of the things we've transferred from learning from the United States and other places to see, particularly, the U.K. and Germany get off to a nice start there. And I think Jack Daniel's, and Don cited statistics, is just off to a nice start in – which is encouraging, given what we just talked about as it related to other large countries like Mexico, Poland and Australia, that in France, Germany and the U.K., countries that a lot of people in our space are not talking about, they were very important to the first quarter and continued to grow nicely. We've been gaining share there even when the market was declining and sluggish. I mean, Jack Daniel's, particularly, not only gained share but continued to grow in Western Europe. So notwithstanding the Southern European difficulties, we don't have any news story as it relates to perspectives on Western Europe. I think, like a lot of places around the world, it will depend somewhat on how any of our innovation, whether it's in the Jack Daniel's family or otherwise, unfolds over the next balance of the year to see what kind of impact that could have on Europe.

Operator

The next question comes from the line of Judy Hong, Goldman Sachs.

Judy Hong

Just a couple of questions. First, in terms of the U.S. category, the slight deceleration that you've cited. Can you just talk about what you think is causing a bit of a deceleration and whether you think that there's any risk to pricing, as the category has been a little bit slower?

Donald Berg

Sure. I mean, to be honest – I mean, you see such fluctuations in these NABCA and Nielsen data from month-to-month that I wouldn't read too much into it, to be honest. I mean, we have seen what we identify as a slight deceleration when you look at it more recently. It's hard to say if it's going to stay there or not. I think the one thing that we have seen is that while – when you look at the NABCA data and you break out the off-premise from the on-premise, the off-premise has continued to stay very healthy in terms of growth rates. The on-premise has continued to get a little bit more sluggish over time. And NABCA – the NABCA markets tend to be more about the central part of the United States. It doesn't really do a very good job of capturing what's going on, on the East Coast. But even anecdotally, we are hearing a little bit of softness in the on-premise that might be showing up in the overall numbers.

Paul Varga

I agree. I think that – one thing to remember, too, I think, this was – and there was a lot of news over the last, I don't know, maybe 6 weeks, about U.S. retail environment generally. And so there was a lot of reports of softness. I mean, unlike that environment that was reported as discrete, we actually do benefit. We don't have good data to tell us what these rates of transfer would be, but when people don't go to restaurants and bars, and that might have a softening effect on the on-premise, we do think they continue to consume products from our category and industry at home. We don't know enough about that, but anecdotally, that is different from many retail environments. And so I would reiterate that we watch that on-premise number very closely. And whether that has an impact on pricing, whether it's economic or just some other factor that might – could be explaining it, we don't have a lot of deep or interesting perspectives on that, but it's certainly something we monitor.

Judy Hong

Okay. And then just on pricing. So you've talked about taking 2% to 3% pricing for the portfolio as a whole, more on the premium whiskey versus the other part of your portfolio. But I was just curious if you can actually give us a little bit more granularity in terms of the magnitude of the pricing you're taking on the premium whiskey? Are you taking any pricing on the white spirits at all? And just maybe a little bit more color, either by brand or by category?

Donald Berg

Sure.

Paul Varga

Just a little bit. Sure.

Donald Berg

Yes. We can give you some. I mean, if you look at Jack Daniel's Black Label and you look at it across the board, it's – it will be somewhere in the range of 3% to 3.5% over the course of the year. We're also taking somewhat similar increases on Honey in various markets because we're – to a large extent, we're trying to keep a pricing comparison between those 2 fairly close. We're seeing similar things, a little bit higher rate, kind of 3% to 4% or 3% to 5% on Gentleman Jack and Jack Daniel's. Finlandia, I mentioned that we had the price increase in Poland. That would – that's certainly the largest market for Finlandia, and that's the one where we were to focus kind of our pricing actions around. And then we're doing a little bit on Southern Comfort in the United States, and we're doing a little bit on el Jimador in Mexico.

Paul Varga

And Woodford, I think, spotted too. And actually, remember, we're also going to benefit some this year from price increases taken last year, and that's the other thing, the carryover for full year. So there's a little impact from that too.

Judy Hong

Got it. Okay. And so all of these price increases have been announced. And in terms of flow-through to consumers, I guess, similar to last year, it'll take a little bit of time to sort of see the impact all the way up to the consumers?

Paul Varga

That's correct.

Operator

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

Timothy Ramey

Just – so it's interesting to see the increase in Canadian Mist. I know that's not sort of core to the portfolio, but there's such a great halo effect there. Can you talk at all about availability there and what that does to that brand? Or is it just enjoy the ride kind of thing?

Paul Varga

Yes. I mean – so of course, it's only important to our North American business, and so it's – yes, I mean, it's encouraging that – they've actually been a bit more innovative now thinking about our North American group. First, with a non-Canadian Mist trademark – it was actually Collingwood going in to test a couple of years ago to look at leveraging the trend towards super-premium and then just observing the trends that are in flavors, introducing a few flavors here more recently. And then also, just seeing interest, I think, more broadly in whiskeys generally. And this is a more unique one. This category sometimes gets referred to as lighter whiskeys, lighter-tasting whiskeys. So it's a different segment than some of the more full-strength bourbons but has shown some growth as actually, it's quite a bit of innovation going on right there by a bunch of our competitors. And I think, yes, Canadian Mist is in the game, I would say, versus 2 or 3 years ago, where it was not as innovative and not bringing things out. And I think there is probably some – we can't quantify it, but I think there probably is some halo effect there.

Timothy Ramey

Great. And then on Europe, would you attribute the recent strength to innovation or just finally bouncing along the bottom and seeing some improvement in the macro?

Paul Varga

I just don't think that – maybe a little improvement in the macro. We really never hit the bottom. I would say, on Southern Comfort, we felt it at times, but I never felt on Jack Daniel's that we got as discouraged as many of our competitive brands and companies did about it. I think the big factors for us, just using the example of Germany where a combination of an investment in route-to-consumer and starting our own company there would have had a dramatic impact on Brown-Forman's differential performance in Europe, certainly in Germany. And then I think, paired with things like innovation – when you have your own company, you can be a bit more innovative, and they've had – particularly in the ready-to-pour, that was where the Winter Jack expression came a couple of years ago. And so I think there are a number of influences. Do we hope for an improving European economy? You bet. But I think route-to-market investments and improvement there, along with spotted innovation, not the least of which here, more recently, is Tennessee Honey, are contributing factors for us.

Timothy Ramey

Yes. And just finally, on Southern Comfort, still sort of seeing modest declines there despite the amount of A&P and the controversial approach of the advertising. Have you thought more about that approach? Or do you continue to feel confident there, or are we taking a second look?

Paul Varga

Well, we're looking at everything on Southern Comfort. I mean, if you go back a few years, we were seeing more like mid- to high single-digit declines that, through this work, we've had the brand's performance moderate down more toward low single digits. So I feel pretty good about it despite the – what you called the controversial presentation of the brand. We felt so comfortable with the reaction to that, that we've actually extended it into our European markets that we were citing. And so far, pretty good reaction to it, as you can tell from these early results. So with Southern Comfort, I think the news, the biggest news about it versus when we were – I mean, we – any brand we take into the market, we want to do the best we can with it. It is less impactful today as a drag on Brown-Forman in the way that it was 3 or 4 years ago, I think, because of the work that has been going on and getting it stabilized, particularly in the United States, where – just going back, all that's going on today with this flavored brown spirit or flavored whiskey, you might call it the shot occasion, you might call it the young adult segment. However you frame it, Southern Comfort had far less competition 5 or 6 years ago in that arena in the United States. And today, just to see the back bars on the shelves and see the size of some of these new competitors, including our own Jack Daniel's Tennessee Honey, all our new competition for a brand that had this space very much – not all to itself, but played a very dominant role in this arena. And so my expectations now looking back on it is that it's held up pretty well, given what's been happening. We've still wanted to do better, and so efforts like the communications you referred to are our attempts to try to make it stand out in a really exciting segment of the U.S. business right now.

Operator

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

Ian Shackleton

Love to get a bit more color on how you see Tennessee Honey and the international rollout continuing and which of the key markets that's still to move into?

Donald Berg

So, yes. So when you look at it, I think Tennessee Honey, overall, has continued to do extremely well. U.S., as – when you look at the syndicated data, it's still kind of growing in the 30% to 40% range. It's in its third year in the U.S. When you look at the international expansion, there's a number of markets that it's going into this year. Germany is the biggest one that we'll be going into, but we're also – we'll also see introductions in France and Russia and in a whole host of smaller markets kind of throughout the world. We're seeing kind of second-year results in the U.K., Australia, Poland and South Africa that we went into last year. And I would say, with maybe one exception, pretty much, they've all been going similarly to what we saw in the U.S. in terms of consumer interest in – and one of the metrics we use is what percentage of Jack Daniel's Black Label business is being represented by Tennessee Honey. And as we've kind of continued to roll these out, we've been seeing pretty much, within a fairly tight range, pretty much similar performance across all the markets.

Paul Varga

Ian, I might add on it too. You can imagine, this is a conversation we're having inside the company about what is the mid- to longer-range potential for a very successful line extension, and how much of it is a line extension and where is it almost, from a mindset standpoint, its own brand that begins to take on far more life of its own. I mean, it certainly will always have its core equities associated with Jack Daniel's, but the thing that's most encouraging that we found, not – starting first in the United States, but everywhere else, is the new consumers and new occasions that it is giving the Jack Daniel's trademark access to, which is resulting in very low levels of cannibalization thus far. So all of this, feeling incremental. And as Don was saying, sometimes, you can measure these things as a percentage of the parent. Well, if the parent brand's – if it's a highly cannibalized effort, the parent brand's coming down as the new brand's going up, those are irrelevant. But this is a really interesting one and is – with the low levels of cannibalization, this is all new consumers, new occasions, new business. And that's the thing that is encouraging us to maybe dream a little bit bigger about what might be down the road for a brand like Jack Daniel's Tennessee Honey and how might we think about it. And we're still at the early days of that because, quite frankly, we've just been trying to get it launched into the marketplace. The U.S. would be ahead of that thinking because it was the introductory market, but those are questions that, of course, we're asking ourselves. But we see nothing but encouraging news so far from the global rollout of Jack Daniel's Tennessee Honey to make us think in bigger ways about innovation at Brown-Forman.

Ian Shackleton

And so Don referred there to one exception. Which market was that? And were you slightly surprised? Did that teach you something else about the brand? Or…

Brian Fitzgerald

Yes. So the exception would be Australia. And to be honest, the – it started out very similar to what we were seeing pretty much across all the international markets. We've seen softness across the category recently. I mean, it's really hitting all the flavored whiskeys that were introduced into that market. And to a certain extent, we think that part of that is because it is such a strong bourbon and cola market, it's just got so much dominance around that kind of a flavor profile. And when you think about it in terms of consumption occasions, how big of an RTD market it is down there and what have you, it just may well be that there's not as much interest in new flavor profiles than what that market already has. And then to a certain extent, I'm sure there's some impact from what we were talking about earlier from a macroeconomic standpoint.

Paul Varga

Yes.

Ian Shackleton

Just one quick follow-up. SG&A expenditure went up quite a bit in the quarter. From what you were saying earlier, it sounds like nothing of that has to do with France. France, any cost comes later. Is that just a comment of additional spend in existing markets?

Donald Berg

There may be a little preparatory – very tiny amount related to France as we sort of gear up, but I think most of it is just sort of the regular reinvestment in the business. I don't think there's anything major or noteworthy there.

Operator

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

William Chappell

Just for fun, I'll ask the 43rd question on pricing. But wanted to get a little clarification, just so I understand, on this past quarter, why the pre-buy didn't match kind of the pre-buy of last year? Is it because – mainly just because the depth of – or the size of the price increases wasn't as big as last year? Or was it the timing, where pricing is going to be kind of rolled out over multiple quarters versus all the kind of – early on in the year?

Donald Berg

Yes. I mean, to a certain extent, there's a little speculation here. But I think there's a couple of things at least that we're thinking about from that standpoint. I think one of the – one of them, you could argue, is psychological. I mean, we have gone 5 years without taking any kind of a price increase, and we went out with – when we went out a year ago, it was at a relatively high level compared to what people were accustomed to, kind of in the 3% to 5% range. I think in a period of low interest rates and people not knowing what the impact was going to be, I think what you saw was a little bit, perhaps, of an overreaction at kind of the retail level in terms of using it as an opportunity to buy in, in order either to make more money or to do things competitively. And I think as we came back this year and it became sounding like it was going to be a more routine thing, the price increases were at a lower level, we just saw a lot less interest on the buy-in side. I also think that there was a little bit – a lot of these price increases come in July 1, some come in June 30th. I think you saw a little bit more competitive activity in the marketplace around that time frame this year than what we would have seen last year. And so in terms of kind of having that period a little bit more to ourselves in terms of how retailers were thinking about their own purchase patterns, I think there were some other factors that might have been out there where they were kind of taking that mindset and that approach across a bigger portfolio of brands.

Paul Varga

I also think – one other factor is just the scale of a couple of the excise tax increases around which we went ahead and took those first price increases created, in some instances, I'll just cite the U.K., a far higher price increase versus this year. And then I just – I think – I would have to go look at – just my recollection is that this time last year, far larger number of markets, a more pervasive global increase, particularly for Jack Daniel's Black Label relative to this year. So people taking price increases, letting them set. In some cases, people said, "If we're going to go up this amount, we might as well go to the next price point. So we'll take 2 years of price increases in 1." So – and you look at those types of things market-by-market, but they will have an impact on the number of markets and the overall amount that we end up taking.

William Chappell

Paul, that just kind of leads to the question – I mean, as you look back now a year, and maybe especially over the past few months, are you pleased with kind of the competitive matching on your price increases? And I know we're not just talking about bourbon. I'm talking about all spirits in general. Or have you seen

them – some use it as an opportunity to be more competitive?

Paul Varga

For Jack Daniel's, and particularly excluding either 2 major factors – one would be the presence of excise taxes that accompanies it, which has a profound impact on the market-place, as you well know. The things that we initiated on our own, I feel very good about. I think that we did a very nice job of implementing those, and the ultimate positions of the prices were an improvement and did something we were trying to accomplish, which is improve the premium-ness and specialness and some of the things that we've referenced in the past. So I think for Jack Daniel's Black Label, the answer to your question would be yes. There are some other things that, last year, we talked about, things like the reduction of value-added packs and some other things that ended up hitting cost of sales. You have to smooth some of those things out to look at your price up and what's the impact on volume in order to understand it. And when we get through that analysis, actually feel comfortable that we did the right things with our pricing last year, particularly on Jack Daniel's in terms of price positioning, and that the consumers' response was acceptable to us.

William Chappell

That helps. And last question for me. Just with LIFO accounting and grain prices looking more favorable, are you expecting any relief this fiscal year? Or are you just waiting to see what happens?

Donald Berg

Yes. Any benefit from corn prices would definitely come through LIFO. I think the – and we've talked about this as much as when we saw corn prices going up, and we'll talk about it as corn prices come down. And when you think about the relative impact that corn has on our overall cost of sales, it's not that large. It's very manageable. I mean, when you look at the component of our cost of goods, it's far more impacted, quite honestly, in terms of what's happening with glass prices, what's happening with wood prices. I mean, the cost of the barrel and the cost of the bottle actually is more impactful than what you would see with corn.

Operator

Your next question comes from the line of Mark Swartzberg, Stifel, Nicolaus.

Mark Swartzberg

I guess the 44th question on pricing. Could you speak a little bit more on the white spirits dynamics here in the US? To what extent is the lack of planned pricing a symptom simply of the non-aged nature of the category, and to what extent do you think there are other elements here in terms of consumer behavior and the way young adults are treating white versus brown these days?

Paul Varga

Well, I mean, if you're talking about the U.S. market, I think the white spirits market, and I'll cite – let's just use the term vodka, primarily, which is the dominant category there, remains amazingly competitive. Their mix of volume and pricing as contributors to net sales growth is dramatically different from the data I've looked at relative to whiskeys. So it's – so their recipe for getting that sales growth has historically been around innovation, particularly directed at flavor. And so a big question as you sit and think about that business would be, where is all the flavor growth of the category going to end up? I mean, people have been predicting its demise for many, many years and quarters here, and actually, the flavors continue to be very – a very exciting part of the overall vodka categories, from what I can tell. And some of the fastest growers and highest-flying trademarks in the syndicated data happen to be flavored expressions from relatively new trademarks, too. And then the other influence there is the fact that the lack of barriers to entry, I think, will continue permit lots of competition, I think, regularly there. So I think the churn that exists in vodka in the United States – I don't see any reason to forecast it – any diminishment in that. The supply/demand dynamics of global whiskey and the barriers to entry are always influences to the ability to take price, and I would contend that the size of the premium-plus or the ultra-premium category in the whiskey segment, not only in the United States, but globally, is just – dwarfs the same segment in vodka. So consumers show a willingness to pay up for the heritage and authenticity and quality that comes from those expressions in our category. We think we have a number of expressions that compete very well in that, and I think it – that continues to be an area where there's a lot of innovation. And all this micro-distilling that's going on, I'd – you also take note, in vodka, there's actually one player in the United States who, I would contend, was a forerunner of micro-distilling that's doing well. It isn't winning with flavors. It's primarily winning with selling vodka the way – oftentimes, the way whiskey is sold. And so that's – maybe that's an example of somebody standing out, going against the grain. But we're encouraged. We're certainly encouraged that the growth trends have been holding up and continuing for whiskey in the American market relative to vodka, even though we want to see vodka growth rates continue as well because we think it's good for the industry.

Mark Swartzberg

And it sounds like, on the vodka dynamic, it doesn't – to your point about churn, it's been there for a while. It doesn't sound like you feel like that dynamic is getting more competitively challenging or the comparative, like, pricing there is a symptom of an increase in competitive pressure there. Is that – in terms of picking out the risks of the story, so to speak, it doesn't sound like that is a particularly large risk versus your larger objectives.

Paul Varga

Not for us, certainly. But I think for the category, if you were trying to assess the category – I think that one of the differences is, in vodka, you see a tremendous amount of innovation at lower price points. You see a – you continue to see a lot of new entrants into standard and even lower than that price point in the United States, and then tons of innovation, usually around flavor, for those entrants. And a lot of the growth, going back before the Cîroc success, which has been out there for a while, and some of the other ones that have been newer entrants, some of those were down at relatively standard price points or below for vodka. Whereas in bourbon, you're seeing most of the innovation up at the premium-plus level. And I think that's some of the economics of the category. I'm talking about in terms of new trademarks. I think that some of the economics of the business, that vodka is an easier category to get into with less risk, whereas if you're going to enter into bourbon or American whiskey and have the capital exposure that you do, you're going to want to try to complete at higher price points to get your returns. And so I think those dynamics play out. So a lot of vodka competitors, instead of raising price where it's difficult to do it, they introduce a – or lowering price, even, they introduce a new brand under, sometimes, a different trademark. We've seen that from some suppliers. Whereas I just think, based on the momentum of the category and the attractiveness of the individual brands, it's been easier for the premium trademarks and bourbon to get pricing.

Mark Swartzberg

That's great, and that actually feeds into my other question on Jack Daniel's. You've made a big decision, you're going to be expanding in Lynchburg. Can you speak to how you came to that decision? The growth has clearly been there, and there's a lot of reasons to believe that it will be there going forward. But historically, you've not had this – you haven't put as much emphasis on expansion of actual distilling. Can you just speak to how you came to that decision? Was it sort of inevitable, so to speak, given the anticipated growth? Can you just give us a little bit of color on that decision?

Paul Varga

I think you cited it. I mean, eventually, you run out of distilling capacity for the expectations you've got for the business. We have been making expansion investments all along. They just – they're more in the area of, say, warehouses. We've been expanding our cooperage-making – the barrel-making capacity here, in the last year we announced it, I think. And this one was just a larger investment and so we gave, certainly, more prominence to it. But it's all in line with trying to ensure we've got sufficient distilling, warehousing, cooperage capacity to meet the forecasted growth that we see for the Jack Daniel's trademark.

Donald Berg

Yes. And the other thing I'd just add to that, just so that it's kind of understood, I mean, for – I mean, if you go back many years – I mean, at various times, we've had to add stills within the current structure that we had, and we're just running out of room to continue to add stills. And so it was time for us to really kind of think about it from a broader basis and where it's all going and how to think about it going forward and came to the conclusion that, at this juncture, we – to be able to continue to expand, to be consistent with our growth, we needed to go invest in a new distillery.

Paul Varga

We – compared to a lot of – our single-point production is so unique for such a large business. And I just would cite breweries who are building their breweries all over the world because they have shelf life concerns and things like that, that we don't have. And so it's unusual for us to be making these very, very large investments because, I mean, we are so efficient in producing this global brand. And so I think it probably stands out as unique news for us, but it is all about our forecast for the future and that Jack Daniel's has this great opportunity as a trademark out there, and we want to make sure we have all the manufacturing capacity that can support that.

Operator

At this time, there are no further questions.

Jason Koval

Thank you, Holly. And I want to thank all of you for joining us today for our first quarter earnings call. Please feel free to reach out to us if you have any additional questions. And we hope you have a good long weekend. Take care.

Operator

Thank you for your participation on today's conference call. You may now disconnect.