Brown-Forman Corporation, Q2 2020, Earnings Call 2019-12-05

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Brown-Forman Second Quarter Fiscal 2020 Earnings Conference Call. — ***Operator Instructions*** —

I would now like to hand the conference over to your speaker today, Leanne Cunningham, Senior Vice President, Shareholders Relations Officer. Thank you. You may begin.

Leanne Cunningham

Thank you, Dorothy, and good morning, everyone. I would like to thank each of you for joining us for Brown-Forman's Second Quarter and First Half of Fiscal 2020 Earnings Call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Jane Morreau, Executive Vice President and Chief Financial 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 control to predict. You should not place undue reliance on any forward-looking statements, and the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the second quarter and first half of fiscal 2020, in addition to posting presentation materials that Jane will walk you through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations. 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 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 are reconciliation to the most directly comparable GAAP financial 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 investor presentation.

One quick item before I turn the call over to Lawson and Jane. In the interest of time and fairness, we ask that you limit your questions to 1 per analyst. You are welcome to rejoin the queue, and we will take your follow-up questions if time permits.

With that, I would like to turn the call over to Jane.

Jane Morreau

Thank you, Leanne, and thank you, everyone, for joining us for our second quarter earnings call. Today, in our earnings release, we reaffirmed our full year growth outlook for underlying net sales and earnings per share and modestly adjusted our outlook for underlying operating income.

I'm going to walk you through our first half results, which as Leanne just said, are accompanied by the presentation we posted to our website this morning to provide clarity to our performance given there remains some year-over-year noise, particularly related to tariff and timing considerations. After I finish my prepared remarks, I'll turn it over to Lawson for an update on progress against our strategic ambitions and the overall health of the business.

But before I discuss our first half results, I thought it might be helpful to remind you of how the retaliatory tariffs, particularly from Europe, continue to affect our performance. As you know, we've been discussing the tariff effect over the past 6 consecutive quarters beginning with last year's Q1. In fact, in the first half of last year, the tariff-related inventory buy-ins in Q1 and subsequent givebacks in Q2 created noise in our underlying rate of sales growth, both last year and this year. In addition to the buy-in effects, which are essentially behind us now, the cost of tariffs has reduced our margins, which are a result of either, one, lower pricing in certain markets where we sell to our distributors or higher costs in markets where we import and distribute our products directly. While we expect tariffs to remain for the full year and to weigh on our margins, the comparability issues we will improve over the second half of the fiscal year as we cycle the full year impact of tariffs beginning in Q3.

Aside from tariffs and similar to our first quarter, our year-to-date underlying results continue to be affected by timing-related considerations, including customer buying patterns and promotional activities across a number of markets. I will highlight these factors we're expecting are underlying trends as I discuss our first half performance.

So with that, let's dig into our first half performance. As expected, our second quarter underlying net sales accelerated significantly growing 6%, lifting our first half underlying net sales growth to 30%. We estimate the timing-related buying patterns and promotional activities across a number of markets negatively affected our underlying net sales growth during the first half of fiscal year by 2 percentage points.

The key contributors to our top line growth during the first half of the fiscal year were: first, sustain momentum behind our premium bourbon and tequila brands; second, accelerating growth for several of our super-premium brands, including Jim and Jack and our Single Malt Scotches, particularly outside the U.S.; and third, increased contribution from Jack Daniel's RTDs and Jack Daniel's flavors, most notably reflecting the October launch of

Jack Daniel's Tennessee Apple in the United States. While on the Jack Daniel's Tennessee Apple topic, you will probably note in our earnings release this morning that we released that our underlying net sales growth was lower than our reported net sales growth, both on a quarter and a year-to-date basis. That difference is due to the required pipeline and supply chain fill associated with the launch of the Jack Daniel's Tennessee Apple.

And looking at our business from a geographic perspective, starting with the United States, which led our underlying net sales growth through October. Underlying net sales increased 6%, doubling the rate of growth we registered in the first half and full year last year and accelerating since the first quarter of this year. This acceleration was driven largely by the launch of Tennessee Apple, sustained double-digit growth from our premium bourbon brands and tequila portfolio and easy comps caused by our route-to-consumer change in last year's second quarter in one state. We're in the very early days of Jack Daniel's Tennessee Apple launch. But so far, with about 4 weeks of takeaway information that we have available to us, it's comparing favorably to our launch of Fire and Honey. So we're very – certainly cautiously optimistic at this point, but we're really excited to see what the trade and the consumer reactions have been thus far, which have been quite favorable.

Our takeaway trends in this important market, the U.S., continued to increase over the past quarter, growing mid-single digits and largely in line with a healthy growth of total distilled spirits.

So let's turn to our emerging markets. Underlying net sales were up 5% on top of last year's double-digit growth. We estimate timing related to certain customer buying patterns suppressed the top line growth of our emerging markets in the first half by about 2 percentage points. As a result of this timing and incremental activities we have planned for later in this year, we expect emerging markets' underlying net sales to accelerate in the second half of the year.

Despite the second half acceleration, our full year expectation is for slightly slower top line growth than what we've experienced over the last 2 fiscal years. The full year growth rate deceleration in emerging markets is driven by Mexico and Poland, our 2 largest emerging markets, which we expect to grow a bit slower than the last 2 years.

We have a number of emerging markets growing underlying net sales double digits for the first — ***indiscernible*** — including Southeast Asia, Turkey and Colombia and collectively, the BRIC markets. To touch on a few of these markets, Russia's underlying net sales continue to be fueled in part by strong consumer demand of Jack Daniel's Tennessee Whiskey and Finlandia.

In Brazil, consumer demand continues to expand for Jack Daniel's Tennessee Whiskey and Jack Daniel's Tennessee Fire. And we remain very encouraged by China and India's strong double-digit underlying net sales growth, led by the Jack Daniel's family of brands and our Single Malt Scotch portfolio as we believe we have only just begun to reach consumers in these markets where the long-term potential is so significant.

And similar to our first quarter, it was in our developed international markets where tariff-related activity had the largest impact when looking at our Q2 growth rates, a tale of 2 quarters, if you will. Recall the first quarter underlying net sales for developed international markets were hurt, down 3% in comparison to last year, when significant retail and wholesale buy-ins boosted sales in several markets in Europe. Second quarter underlying net sales were up 8% this year, helped by easy comparisons to the same period last year when we experienced the giveback from those buy-ins. The timing noise related to tariffs essentially washes out when we look at our first half underlying net sales growth of 2% in our developed markets. This rate of growth is lower than our historical performance in our developed international markets, due primarily to the timing of certain customer purchases and promotional activities. Considering these factors, we estimate timing-related activity had about a 3-point drag on our overall top line performance in these markets through the first half of our fiscal year.

Just to touch on a handful of our developed international markets. Spain and Taiwan continue to be standout performers, while Australia and France also contributed solid underlying sales growth with takeaway trends in both markets improving significantly for the most recent 6-month period compared to a year ago. And while Germany and the U.K., our largest developed international markets lagged our underlying net sales growth expectations for the first half of the fiscal year, due in part to timing issues, we believe our portfolio is healthy in these markets as the latest 6-month consumer takeaway trends are growing ahead of the distilled spirits category in each of those markets.

And finally, as expected, Travel Retail's underlying net sales remained down for the first half of the fiscal year, declining 8% as recycled against last year's first half very strong 14% growth, which was influenced significantly by the phasing of certain customer purchases. As we look ahead, we expect Travel Retail's underlying net sales trends to improve in the second half of the fiscal year as the timing effects smooth out, resulting in full year underlying net sales growth in the low single digits.

Now looking at our business through a brand lens. The Jack Daniel's family of brands underlying net sales for the first half of the fiscal year increased 2%, as growth was propelled by the launch of Jack Daniel's Tennessee Apple in the United States and broad-based geographic growth for both Jack Daniel's RTDs and Jack Daniel's Tennessee Honey. Those gains were partially offset by a 1% decline in underlying net sales growth for the first half of the year for Jack Daniel's Tennessee Whiskey, due in part to timing-related customer buying patterns and promotional activities in the U.S. and across a number of international markets in our Travel Retail channel. We estimate these factors negatively affected

Jack Daniel's Tennessee Whiskey's underlying net sales growth by about 3 percentage points.

Our portfolio of premium brands, including Woodford Reserve and Old Forester continued their strong double-digit underlying net sales growth, up 22% through the first half. We remain very pleased with the continued leadership of Woodford Reserve in the super-premium bourbon category, growing underlying net sales at a double-digit rate each year since its launch in 1996. Old Forester sustained an even faster rate of underlying net sales growth, powered by volumetric gains across the portfolio of expressions, including the brand's most recent innovation Old Forester Rye and favorable mix driven by higher growth from our super-premium expression.

Once again, our tequila portfolio provided double-digit underlying net sales growth on top of essentially the same growth rate in last year's first half. Herradura led the growth with underlying net sales up 19%, driven by higher volumes in pricing in the United States and Mexico. el Jimador's underlying net sales grew 13%, reflecting higher volumes in the United States as consumer takeaway trends remain strong. Additionally, higher prices in Mexico as well as a growing consumer base for the brand and several other international markets contributed to the brand's double-digit increase.

Moving down our P&L. Gross margin declined 270 basis points, resulting in an underlying gross profit drop of 2% through the first half. The margin decline was driven by the same 2 factors we've highlighted in the last 2 earnings calls, tariff-related costs and higher input costs reflecting agave and wood inflation. Underlying A&P increased 4% in the first half of this fiscal year, largely reflecting spending to support the launch of Jack Daniel's Tennessee Apple and higher media investment behind Jack Daniel's Tennessee Whiskey in the United States. We invested incrementally behind the growth momentum of several other brands in the portfolio, including Woodford Reserve, Gentleman Jack and GlenDronach.

Underlying SG&A decreased 1% for the first half of this fiscal year driven by lower compensation-related expenses. In the aggregate, our underlying operating income declined 5% through the first half, driven by an approximate 6-point drag related to tariff-related cost.

Higher distributor inventory levels due largely to the launch of Jack Daniel's Tennessee Apple and an effective tax rate of just over 16%, which included a couple of discrete items recognized in the quarter, drove 5% growth in diluted earnings per share to $0.97.

So turning now to our full year outlook. Our underlying net sales growth through October keeps us on track to deliver another year of solid results. Starting with our top line growth expectations, we've reaffirmed our underlying net sales growth of 5% to 7% for fiscal 2020. As I've discussed throughout my prepared remarks this morning, we had a number of timing-related issues across a number of markets affecting our first half results, that when we consider these factors, we believe our top line trends continue to grow in the mid-single digits. We remain confident in the health of our business as our consumer takeaway trends in most of our major markets remain solid and supportive of our growth ambitions for the year.

We anticipate our underlying net sales in the U.S. will accelerate, particularly for Jack Daniel's Tennessee Whiskey, reflecting our most recent value takeaway performance. We continue to forecast sustained double-digit growth for our premium bourbon and tequila portfolios. And finally, we expect second half results to benefit from incremental contribution from the launch of Jack Daniel's Tennessee Apple in the United States as well as from the focused promotional support in incremental media that we have planned, particularly during the important holiday season that's upon us now across several markets.

We expect gross margins will be down around 200 basis points for the year, split between tariff-related costs and higher input costs. Again, as a reminder, we do not expect further drag on margin from tariffs beginning in the second half of the year. But that being said, we do expect input cost pressures from agave and wood to continue.

Regarding our operating costs for fiscal 2020, we continue to plan for solid reinvestment behind our brands, with underlying advertising growth only a bit lower than our rate of underlying net sales growth. We are anticipating incremental investments to continue to support the launch of Jack Daniel's Tennessee Apple as well as incremental spend to fuel the momentum of several of our brands in our portfolio. We are thoughtfully continuing to reallocate certain investments from less efficient areas to broad reach media, digital and scalable consumer-facing activities, which we expect to drive an effective increase well above our actual increase in spend. We are expecting modest growth in SG&A for the year, implying an acceleration in the back half, but still driving some leverage to operating income.

So in summary, we are reaffirming our full year outlook for underlying net sales growth of 5% to 7% and earnings per share of $1.75 to $1.85 for fiscal 2020. We've modestly reduced our underlying operating income outlook by 1 point to a range of 2% to 4%, reflecting the pull-through of continued input cost pressures and macroeconomic and geopolitical uncertainty, notably, in a handful of emerging markets and our Travel Retail channel. It's worth noting that in the absence of tariff-related costs, we are on track to deliver mid- to high single-digit underlying growth in operating income for the year.

In closing, despite the short-term headwinds from tariff and input cost pressures, we continue to manage the business as we always have for the long term. This includes our multiyear period of stepped-up investment, including this fiscal year in maturing whiskey inventory and CapEx to support the organic growth of our business in the years ahead. We expect this will drive additional free cash flow in the coming years and provide opportunities to return cash to our shareholders as we always have, thoughtfully, disciplined and consistently, including our recently announced cash dividend increase of 5%. We believe we have some of the best brands and assets in the world, along with a talented team of people across the globe, positioning us well for a long run rate of growth ahead and continued value creation for our shareholders. Brown-Forman remains strong and resilient as we look toward our 150th anniversary in 2020.

And with that, let me turn the call over to Lawson for his comments.

Lawson Whiting
Okay. Well, thank you, Jane, and good morning, everyone. Now that we've completed the first half of our fiscal year, I thought it'd be helpful if I focus my comments really on the progress that we are making against our strategic ambitions and then the overall health of our business. For those of you who are able to join us about a year ago at our investor conference in New York, you may recall we introduced our – a strategic framework and ambitions. This framework included our portfolio development efforts, geographic expansion, investment philosophy. And then most importantly, our people and our culture.

I'll start first with our first portfolio ambition, which is to lead in premium American whiskey. This is largely driven by the Jack Daniel's trademark, but increasingly by Woodford Reserve and then also by Old Forester. First, the Jack Daniel's family of brands, led by Jack Daniel's Tennessee Whiskey, remains strong, healthy and relevant to our consumers worldwide. We see solid consumer takeaway trends in many of our major markets, including the U.S., where we've seen consumer takeaway accelerating in both volume and value. Jack Daniel's super-premium portfolio, the biggest of which would be Gentleman Jack, is approaching 900,000 cases worldwide and serves as a way to really premiumize the trademark.

Our Jack Daniel's flavors continue to bring new consumers into the franchise, as evidenced by our eighth consecutive year of growth for Jack Daniel's Tennessee Honey, our fifth consecutive year of growth for Jack Daniel's Tennessee Fire, and we anticipate similar success with the launch of our new flavor introduction – innovation, Jack Daniel's Tennessee Apple. Though it's very early, certainly the consumer excitement for this product seems to be very high.

Woodford Reserve, continues to enjoy its leadership position as the #1 super-premium bourbon in the world, it's grown underlying net sales 20% during the first half of this fiscal year on a global basis and remains one of the companies most important growth drivers. And then we've also got Old Forester growing faster even than Woodford driven by high – or volume growth on its core brands and then also by its premium line extensions.

I'm pleased with the progress against our second portfolio, which is to increase our focus against the super-premium portfolio brands. One example of this increased focus was the creation of the emerging brands team in the United States last year. The results have been excellent, with meaningful acceleration across the portfolio. And I know we've talked about that quite a bit over the last couple of quarters. So it's worth highlighting again that GlenDronach, Slane Irish whiskey, Old Forester, now there's a lot of excitement around Fords Gin and all are doing very, very well.

And as Jane mentioned, we remain very excited about the continued double-digit underlying net sales growth for our tequila brands. The growth opportunities for Herradura and el Jimador are exciting, not only in an established market like the U.S., but also the potential for these brands to lead tequila category growth internationally.

Finally, and is really as part of our efforts to grow our portfolio around the world and ensuring that Jack Daniel's Woodford Reserve, Old Forester, Herradura and el Jimador are properly supported in their global expansion. We recently announced the selection of Energy BBDO as our new global creative agency of record. This is the first time that Brown-Forman has consolidated the majority of our brands under one creative partner and the first time that Jack Daniel's has changed agencies in more than 50 years. The teams are all excited to work with Energy BBDO to find new and interesting ways to communicate with our consumers around the world.

So moving from portfolio to geography, our ambition is to deliver balanced geographic growth with competitive routes to consumer. Our first half results reflect growth across all of our major geographic aggregations. The United States is our largest market, as you would know, and representing nearly half of the company's net sales. TDS remains fairly strong in the U.S., this is the most important spirits market in the world. And Brown-Forman, and really the industry overall continue to show relatively healthy growth. We're optimistic that our current portfolio can continue to grow at or above TDS for the foreseeable future.

Our emerging markets remain our least developed geographic sector. However, we believe that we also have enormous opportunity there. We continue to see these markets with a very focused portfolio, really led by Jack Daniel's Tennessee Whiskey. And while our first half top line growth in emerging markets was a bit slower than we expected, this really was due to the 2 largest markets in that bucket, Mexico and Poland. But it's worth commenting that Asia, in general, remains very strong, most notably China, Southeast Asia and India have all been performing nicely for us lately, and all have a lot of long-term potential.

And as Jane mentioned, the other half of BRIC, Brazil and Russia is also performing very well this year. Our long-term ambition to grow emerging markets at a faster rate than the overall company and becoming a larger and larger source of our – piece of our business, that remains unchanged.

Our developed international markets, which includes most of the EU, has been the geography most affected by tariffs, and as a result, this region has been volatile and challenging over the last 12 months. Despite the geopolitical headwinds, we have continued to invest in the consumer momentum and absorb the majority of these tariff costs. But I think from a more strategic perspective in these markets, we're also focused on building a broader-based portfolio of brands that mirrors the portfolio development we have seen in the United States. So although early days, Gentleman Jack, Woodford Reserve and the single malts are all getting incremental investments and focus in building a nice base of business that we expect will improve our growth rates in the coming years. Collectively, our entire super-premium whiskey portfolio is growing underlying net sales double digits this fiscal year outside of the U.S., so we're encouraged by the initial results of this source of incremental investment.

Finally, we're always looking for ways to increase our competitiveness through improved routes to consumer. Our most recent example of these efforts is the change in the distribution model in the U.K. that we announced earlier this year, which is anticipated to be effective May 1, 2020. We believe this kind of change will provide us with the opportunity to increase the level of focus on all the brands in our portfolio and believe it positions us well for the next generation of growth.

Our third strategic ambition relates to our investment philosophy as we look to deliver shareholder-friendly capital allocation and top-tier total shareholder returns. For nearly 150 years, the company and the Brown family, have been committed to preserving Brown-Forman as a thriving family-controlled independent company with the ability to create long-term value for all shareholders. We recently increased our quarterly cash dividend by 5%, marking the 74th consecutive year of paying regular quarterly dividends, the 36th consecutive year of increased dividends, and we continue our membership in the S&P 500 Dividend Aristocrats Index.

Brown-Forman has and will continue to be very purposeful with our capital allocation decisions. We're always looking for smart investment opportunities whether that be investments to grow our brands, make acquisitions or initiate share buybacks. We balance these capital deployment decisions with our desire to return cash to our shareholders. This has served us well for many generations, and we will continue that into the future.

Our final strategic ambition relates to our people and culture. We're focused on continuing to build a strong and agile workforce and everything I've shared with you so far this morning could not have been accomplished without our talented and dedicated team of employees and partners around the world. Our thriving culture is committed to living our values and delivering on our commitments to diversity and inclusion, alcohol responsibility, environmental responsibility and caring for the communities in which our employees live and work.

We've accomplished much in this space in the first 6 months of this fiscal year, but I'll take a moment just to highlight a couple of the recent accolades. We were named one of the Disability equality Index Best Places to Work, receiving a top score of 100. Our offices in Spain and Mexico were just recognized as Best Places to Work within their countries. And Forbes recently published the World's Best Employers list with Brown-Forman ranking in the top 15% of the 2,000 largest public companies in the U.S.

In summary, for the first half of fiscal '20, I believe we've made meaningful progress towards our strategic ambitions and have delivered solid broad-based growth. With that, I'd just like to say thank you to all of our employees around the world for their talents, their dedication and wishing them all a wonderful holiday season.

So Dorothy, I'll turn the call back over to you and open the line up for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Peter Grom with

JPMorgan.

Peter Grom

So my question is just kind of more on the phasing implied in your guidance for the back half of the year, I mean, both from a profit and sales point, but I'm just going to kind of focus on sales right now. So to kind of get from the 3% in the first half to at least the low end of 5%, you kind of would need to accelerate underlying sales to the high single-digit range to kind of get to the low end. So can you provide any commentary as kind of what you're seeing that gives you confidence that the trends can accelerate that meaningfully from here, particularly against tougher comps? And then just kind of – is it just the benefit of Tennessee Apple? And then if these timing-related issues that you kind of mentioned throughout the call, I mean, have you already started to see a reversal of these issues in Q3?

Jane Morreau

Sure. So let me take the question as it relates to the top line. And you're right, we're expecting high single-digit growth in our underlying net sales in the second half of the year, and this is why we're confident and that we will do that. First of all, you saw the acceleration, and we expected that acceleration in the second quarter, where we grew 6%. As we look to the rest of the year, and then if you recall in my prepared remarks, I talked about several timing-related items, customer buying patterns and promotional activities, in particular, and we said our first half results will pull down about 2 percentage points because of that. So with that we would be in the mid-single digit. We expect that to reverse in the second half of the year, as you were just asking about, and we are starting to see some of those activities in certain markets in November and more in December.

So that and we look at the Jack Daniel's Tennessee Apple launch, which was just launched in October, so we expect incremental contribution over the balance of the year. When we guided earlier in the year, back in June, we thought it would have about 0.5 point impact to the year. We're now saying about 1 point impact to the year. I believe that addresses your question, too.

And then finally, our takeaway trends is just to remain healthy and really in many markets of what we're seeing in the P&L today. And therefore, that also indicates the timing-related activities that we expect to reverse. I would say one more thing. There's nothing in our trends that we've seen today that would lead us to believe that our premium bourbon and tequila portfolios won't sustain their growth, which we're assuming in the back half of the year, too. So think of timing, think of sustained growth on bourbon and tequila, think about incremental contribution from Jack Daniel's Tennessee Apple and you got there.

Peter Grom

Okay. That's helpful. I mean, just – if I could just, is it fair to assume that the kind of the high end of the range in the context of 3% year-to-date is kind of – would be a challenge to get to?

Jane Morreau

To get to what? 5?

Peter Grom

To get to [6% to 7%].

Jane Morreau

Again, a lot of this depends on our – we're still trying to forgot early days of Jack Daniel's Tennessee Apple. And then we've got so much of our spend that we've been talking about earlier in my call or in my script that were taken and reallocated to broad reach media. You've got a lot of that happening now. And so we're hopeful that, that impacts our momentum even more, which is not built in. It's in that range, but we don't know how far that will go. So it could get you there.

Lawson Whiting

I mean I do – just to add a point on there. I mean our – the U.S. business for us is as strong as it's been in a number of years right now. And TDS remains strong, but we've seen improvements as we talked about in Tennessee Whiskey itself with the rest of the portfolio is all really supporting our growth rates right now. And so one of the reasons we've got, I think, pretty decent confidence in the outlook is that this U.S. market continues to pull forward. And yes, I mean, I think the fact that Woodford Reserve itself, Herradura, el Jimador have gotten much bigger in recent years, and so they're more meaningful to the overall mix. And they're all growing very, very quickly these days. So yes, we feel very good about it.

Jane Morreau

I do.

Operator

And your next question comes from the line of Steve Powers with Deutsche Bank.

Stephen Robert Powers

Another question on the outlook, pivoting to the operating income growth outlook. Just to clarify, the lower outlook that you're calling for now, where is that going to show up in the P&L in terms of COGS versus SG&A? Because you mentioned incrementally higher input costs, but you also, if I heard you right, seem to reiterate the 200 basis point outlook from before as well. So a little confused as to where the incrementality is on that front?

And then you also made some comments on geopolitical risk as a driver for the lower profit outlook. And I guess I'm just somewhat surprised that those are showing up in the cost structure rather as an impact to the top line, which you're not guiding to. So just what are those? And where are they going to show up?

Jane Morreau

Okay. Sure. Again, I think that you pointed out a couple of fair questions for sure. What I guided to this morning is the reason why we took our bottom line down about 1 point, which is very modest, was because of the cost pressures, as you said. I've guided it from the beginning of the year to now to about 200 basis points, you got to realize it a couple – a few million, give or take, either way is – you're talking – still rounding to 200 basis points. I'm only pointing this out because as I get into this, this is more meaning – hopefully, you'll follow this.

Our second piece does relate to the top line, and it does relate to a little uncertainty with our emerging markets in Travel Retail because of the economic and geopolitical uncertainties. I'm talking 0.1 there. So given our structure of our P&L, very small changes in our net sales growth, very small, 0.1, very small changes in our cost of sales related to input costs, 0.1. These changes are well within our range, can flow through at somewhat larger impacts on our OI.

So just realize our intention at this point in time is we want to continue to invest behind the business. We're not talking of or we want to reduce our A&P or anything like that because we want to sustain what we believe is already healthy top line growth and continue to sustain and propel the launch of Tennessee Apple as we look ahead. So I hope that helps a bit. You're talking – it doesn't – if you go and do a little math, it's very small.

Stephen Robert Powers

Yes. Okay. So just to play it back. Yes, it's all within the prior outlook on the – within the ranges, but a little bit more pressure on gross margin, a little bit more pressure on the top line versus what you had guided to 3 months ago?

Jane Morreau

And I'm talking 0.1.

Operator

Our next question comes from the line of Nik Modi with RBC.

Nik Modi

I guess the question I – they're kind of interrelated. But maybe we can get a quick update on just what you're seeing in the competitive landscape as it relates to craft distillers? What you're seeing from some of the bigger players?

And then just kind of dovetailing into that discussion about pricing in the U.S. market, in particular, and kind of what you're seeing? Because we're seeing some deceleration over the last several quarters on an underlying basis on pricing. And so just wanted to get a sense of what's going on there?

Lawson Whiting

All right. I'll take just the last one…

Jane Morreau

You can start.

Lawson Whiting

I'll take the craft one a little bit. I mean I – and I've said this on a couple of the previous calls. I mean the market share growth of, what we would call, the craft distillers has been a little bit less than what was predicted a couple of years ago, and I haven't seen anything that's really changed that in recent quarters, where the big brands continues to hold their share pretty well and the big players continue to hold their share pretty well.

So I've said this before and I got a little bit of criticism for it from the craft industry, but they haven't pulled through to the extent that maybe others thought as a competitive threat a few years ago. So that's mostly a U.S. comment, but we will see how it plays going forward. The brands that are really growing the fastest in the market these days are sort of the mid – like ours, the Woodford, which has gotten actually quite big, but there's other competitive brands out there, too, that are 100,000, 200,000 and 300,000 cases that are growing quite well and quite strongly. That seems to be where the biggest competitive threat is these days. On pricing, do you…

Jane Morreau

Yes, I can try. This, definitely, I think you're talking about the U.S. market as well. As Lawson said in his prepared remarks, and I did as well, the overall – the total distilled spirits markets in the U.S. remains quite healthy. We estimate, when we look at our Nielsen, NABCA, other syndicated data, we see it's up 6% to 7%, so really quite nice. Pricing still is fairly muted or we might say stable. It's barely there. So maybe it's teeny – 0.1 improvement. But it's really still fairly muted and stable.

There's a couple of categories that we're seeing pricing in rum, tequila, liqueurs. For us, tequilas is what we've been paying attention to given our large portfolio of tequila brands, and we've taken pricing, and we've seen pricing in the tequila category from other brands now really over the past summer has accelerated some. We see American whiskey still very healthy. When looked at that, it continues to grow faster than TDS. And really pricing for American whiskey is flat now. But still, I wouldn't call the market healthy for pricing, if you will. It has – the American whiskey pricing has improved a little bit, that is again similar to the overall TDS. So hope that answers your question as it relates to the pricing environment in the U.S. If not, I'll…

Lawson Whiting

I do think it's less – I won't say less bad, but the pricing environment has been pretty weak over the last few years, and there are some nuggets of change that make it look like it just gets a little bit better. But as Jane said, it's small incremental benefits. It's not big chunk. But – and I do think we expect that tequila will be probably the category that will see the strongest pricing over the – we've already seen it a little bit and expect that will continue, say, over the next year.

Nik Modi

Yes. That's very helpful. And then just one more quick one on the agave cost pressures. Any visibility on when that could start to improve, I mean, because it's been so volatile over the last few years?

Jane Morreau

Yes. You're right. And just as a reminder, for us, the agave costs really didn't start hitting us in a big way until this fiscal year. That's why you heard that was up so much this year. Because we had so much internally sourced agave before then, which was significantly lower than if we had been buying it on the external market. If you look at the external market, the price has increased by about 5-folds since 2015 from about MXN 5 per kilogram to over MXN 25 per kilogram, but the real rapid increase has been 2016 through 2018. It seems to like it slowed a little bit this calendar year 2019 still going up, hitting unprecedented levels.

So we're hoping that's leveling off, but we still don't see that reversal of that high cost pressures come in until late calendar 2021 or '22, early 2022, that's based upon what we have seen, that's made available to us on the plantings, and when the planting started to increase significantly and can meet and exceed the demand that's out there.

Lawson Whiting

I'll just add a quick comment on it is, the tequila business, the consumer takeaway in the U.S. has been so strong over the last few years. I mean while – we're well in the double digits as are a lot of our competitors. The response so far has been people have been much more aggressive with pricing in Mexico, which is generally a lower margin market, you had to take price down there or a lot of brands would have become unprofitable very quickly.

So we'll see how that – what happens to consumer demand in Mexico and what that may happen to the long-term cost of agave in the United – or well, globally. So there's optimism that it can start to come down, but we have enough visibility into the supply and in the demand forecast that you can see, as Jane said, that sort of late 2021, early 2022, seems like when the lines will start to cross, then you'll start to see some relief.

Operator

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

Vivien Azer

So I wanted to dig in a little bit on A&P and your outlook around that, in particular, given the change in your agency of record. It is certainly, I think, encouraging to see that you guys are investing behind your brands. That generally has been a very good long-term strategy at Brown-Forman, but there is a little bit of a disconnect that seems, right, in terms of, Lawson, what you kind of said as you started your tenure as CEO, you acknowledged it today that the double-digit growth that you had expected kind of sustainably in emerging markets. And how much of a factor was that in terms of changing your agency of record and maybe taking a more global approach to brand building? Obviously, you have innovation and a very large U.S. business that you have to support, but is there any thought that maybe more A&P in emerging markets can kind of get you back to that healthier run rate?

Lawson Whiting

Well, I would – the healthier run rate in emerging markets, I think, as we said, is largely a Mexico issue and then Poland. In Poland, we do expect to get back on track and sort of back to its old ways of very, very healthy growth rates. And it's one of the reasons the back half of the year, we think, will be stronger. We – the reason for appointing BBDO, I mean, after I do find it interesting that Jack Daniel's essentially have the same agency, although it had morphed some variations over the years, but had the same agency for 50 years. And I hate to say it was nothing more than – it was just time to take a fresh look and getting more global agency to help support us. And then the other brands, the tequila brands, Woodford all those, their budgets aren't really big enough to sustain a global partner around the world very easily. It's much better, I think, if we consolidate those together and sort of have a team partnership effort, but there is truth too. It's not only emerging markets. It's the developed international markets, too, where the most focus is on developing those other brands these days, and we will be supporting those with a lot of new and hopefully, better advertising. So it's – we've got a new Chief Brands Officer. We've got a new leader on Jack Daniel's and the combination of that with a new agency, I think, can only bring positive things.

Vivien Azer

That's helpful. If I could just follow-up, since you mentioned Woodford, in particular, internationally, can you just remind us what Woodford's domestic versus international mix is these days?

Jane Morreau

About 80-20.

Lawson Whiting

Yes. 80-20.

Jane Morreau

Volumetrically, yes.

Operator

Your next question comes from the line of Amit Sharma with BMO Capital.

Drew Levine

This is Drew Levine on for Amit. I wanted to jump back to the commentary on the COGS line, again, worse perhaps by 0.1 here or there. Can you just talk about the internal productivity initiatives that you have in place? Or you could push on more to offset these sorts of 0.1 moves here and there? And maybe if you could push harder on that.

And then just a housekeeping item. Obviously the tax rate was a lot lower than expected, and previously, I think we're looking for 20% to 20.5%. So just any update on that would be helpful.

Jane Morreau

Let me start off with the tax rate. So the tax rate was lower in the quarter and then our year-to-date because of a couple of discrete item. And so when we look at our full year, we – which includes these discrete items that happened in the quarter, we expect our rate to be between 18% and 19% for the year, lower than the number you just said. But I would, on an ongoing assumption, assume that our rate from operations, which is included in this 18% to 19% for the rest of the year to assume between 20% and 21%. So that's our tax rate.

As it relates to initiatives for cost, we are – we have a number of initiatives underway. We are looking and have been looking at and quite frankly, the cost would be even higher if we didn't already have some of these initiatives underway, where we are getting – looking at everything from our packaging materials to how we get more efficient in the plant to the gift – cost of gift that shows up in cost of goods and what – if we charge or don't charge or how much we do for that and whether it's paying for ourselves. So there is a number of things that we've already done and continue to do in that space.

We are also looking at technology. We had a big project this year that just is really getting underway at our cooperage operation is significant cost savings. Again, those cost savings because of our aged inventory will not come through for 3 or 4 years from now. But these are utilizing technology and machine learning and robotics and things of that nature. So there's a number of things going on in that space.

Operator

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

Grant O'Brien

This is actually Grant on for Bill. I had a quick one on tariffs, but actually on U.S. tariffs, and I was wondering if you guys have seen any impact or any switching to your brands from the U.S. tariff on scotch imports? Or whether you'd expect any lift to your brands going forward from that?

Lawson Whiting

Well, it's only Single Malt Scotch. It's not blended. So the volume – blended is obviously a much bigger category than single malt. So we haven't seen any impact yet. I mean it hasn't been long enough, but I don't even think it's been a month-or-so or maybe 2 months since the whole thing was announced. And so they saw the same as we did in the prior summer when we moved a lot of inventory across the border to get ahead of that, they did the same thing. And so you're just not seeing the pricing changing yet.

But to be honest, single malt pricing is so much higher than the vast majority of our portfolio that although I'd love to say it's going to have a positive benefit on our brands, I'm not sure I can honestly say that. It's just not a big enough category, and it's so far away from the price points from the majority of our portfolio.

Operator

Your next question comes from the line of Bryan Spillane with Bank of America.

Bryan Spillane

Couple questions. First, I don't know if I missed it, but Jane, did you give us the capital – CapEx outlook for the year?

Jane Morreau

Yes. That's still within the $120 million to $130 million range, it's in that range.

Bryan Spillane

All right. And then, Lawson, I guess, 2 things. One, just Travel Retail, and I guess, it's come up with some of your competitors as well in terms of just the softness there. And I guess I'm still not understanding how much of it is just a change in, I guess, how they're ordering? Or is there some other sort of just underlying softness in Travel Retail, whether it's related to the consumer? Or is it just something more sort of macro that's driving softness in that channel? If you could shed a little bit more light on that.

Lawson Whiting

Yes. I mean I think it is a little bit of both. I mean first of all, for Brown-Forman, I don't know about the rest of the industry, as we said, we had really double – very, very strong double-digit growth last year. So the comps have been very, very difficult, but there has been some weakness in terms of global passenger counts and things like that. There's some odd things going on in China. There's other places where Global Travel Retail, I do think, as an industry, has taken a couple of – I think couple of points down in terms of its growth rates. I'm not sure if it's a short-term or a long-term thing, I don't really believe it is a long-term thing. But I do think the sort of global weakness in the economy is having an impact on passengers, and that's the most important channel within Global Travel Retail.

Bryan Spillane

All right. That's helpful. And then if I could just sneak one last one in related to Apple. I guess based on the comments you made on the prepared remarks, it sounds like it's at least initially gotten off to a start that might suggest it could be as big as Honey or Fire? So did I hear that correctly? I'm just trying to get an understanding of like how big you think this could be.

Lawson Whiting

I mean you heard it correctly.

Jane Morreau

Very early days.

Lawson Whiting

It's only been out for what, 6 or 8 weeks or whatever it is. So – but I – as I think we've said before, the brands want to taste really, really good. Two, it is priced a little bit under the market leader in the United States as opposed to our last effort with Fire, which was priced above the market leader. So that gives us a little bit of an advantage in terms of maybe in the on-premise and sustainability there. And yes, I just think it's a flavor, too, that when you leave the United States, Apple is a very – it's a common flavor. Consumers really love it. And there really is no market leader in terms of Apple outside of the United States. It's really only inside the United States where you got established. So that's a world that's pretty wide open to us. It does make us optimistic that it can be something big.

Operator

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

Robert Ottenstein

Lawson, I'm wondering if you'd step back a little bit? And can you give us your updated views on the spirits market, and particularly kind of brown spirits, whiskey, where that's sourcing the growth in your view? What your marketing people are saying? Is it beer? Is it wine? Is it vodka? And how that – maybe that may be different on and off-premise? And is it a question of development of consumer taste? Or maybe, as you said before, there hasn't been a lot of pricing, is it kind of a pricing issue? Just love to get your big picture thoughts.

Lawson Whiting

Yes. So I would – I mean, break it up between the U.S. and the rest of world for a second. So look, American whiskey, which has been growing at a high single-digit rate now for a number of years in a row, and those trends really have pretty much continued. Now where – it's interesting. Everybody has been talking about the health, the trends in health and all these seltzer brands that are – have absolutely boomed in the last few years and what's it going to do to your brands or your business. And I just cite TDS, it's as strong as ever. In fact, it's up a little bit. So I don't necessarily think that we're sourcing or that seltzer phenomenon has really had much of an impact on spirits yet. There's people that would say that it's impacting vodka a bit, but whiskey is farther away from that, I believe. And so I think we at least have some insulation against some of that phenomenon.

So the U.S. business is largely – I think the U.S. American whiskey business is largely the same reasons it's been before. Consumers want that sort of full taste. They like the people behind the brands. They like the stories behind the brands. It just fits into sort of American culture these days. Outside of United States, I mean, demand – it's been thrown around with the tariff situation a little bit. So it's been volatile, but we still look at the enormous runway for our brands, particularly that becomes a conversation around sourcing from scotch for the most part. We've said a few times around here that scotch had a 100-year head start on us. But if you go and you look at where the British colonized the world 100 years ago and really planted scotch as the core drink, we continue to go after that consumer and have been doing that well for 20 years.

So yes, I mean, I think we still feel pretty good about that, and we still feel pretty good about the emerging markets opportunity, where we are – we're way behind scotch in those markets. And we – particularly, as we said today, places like China, places like India and Asia, in general, we're so under-indexed relative to other categories that we're going after that in a bigger and bigger way and allocating more resources that way. So yes, I mean, the American whiskey categories is very healthy, and feels like it's going to stay that way.

Robert Ottenstein

Yes. And just in terms of the U.S., do you see most of the sourcing from beer or from wine or from vodka?

Lawson Whiting

Well, it's – spirits have been taking from beer and wine for 20 years. And beer had its troubles over the last few years. And certainly, we've been a benefactor to that. Vodka has been a funny category because it's had one brand that has been an explosive brand for a decade now, maybe even longer than that. And certainly, they're taking share from the rest of the vodka brands, and we're probably benefiting a little bit from taking share from the other vodka brands, too.

Jane Morreau

Just to build on what Lawson said, I do think not only all the things that he said about the authenticity, people behind at the home places and so forth. Our – Leanne today had given us – today is the National Repeal Day for prohibition. And I do think that American whiskey, which has great mixability and to take it a step further, it's the cocktail culture, the modern cocktail culture, so again, that was lost during prohibition or actually created during prohibition. And so here we are. Happy Prohibition Day for us, and I do think the mixability that consumers like with cocktails today is a piece of it as well.

Lawson Whiting

Happy Repeal Day will only be happy for me if they repeal tariffs.

Jane Morreau

That's fair.

Operator

Your next question comes from the line of Kevin Grundy with Jefferies.

Kevin Grundy

Two questions for me. I wanted to pick up on Tennessee Apple and then I had a longer-term question on the operating income growth. So the first one, to follow-up on Bryan's question, and I know it's really early days still with Tennessee Apple, but you're clearly feeling a little bit better, tweaked up the guidance a bit. Can you talk a little bit about retail takeaway? Maybe touch on where the brand is sourcing share at this point? Where you're getting the incremental shelf space? Touch on cannibalization a little bit, and maybe margin implications for the product.

Jane Morreau

Yes. I mean, I can take it. We've only seen 4 weeks of takeaway data. That's all we've got, and that's what we're referring to is this comparison to the early days of both Fire and Honey, and that's comparing favorably to that. So it's very, very early, where it's sourcing from, it's too early to tell you that. In terms of cannibalization, and we get this question each time we've introduced a product from Jack Daniel's, both Honey and Fire, and we saw minimum of any cannibalization. What we've seen instead is we bring in new consumers into the franchise, the taste profile, the lighter taste, particularly this one with Apple in it, we believe we're going to be sourcing that even more new consumers to it.

So it's very early to really get into any more speculation in terms of where it is stealing from or where it might be. I think people are just trying it now.

Kevin Grundy

Okay. Fair enough. The follow-up is on longer-term operating income growth for the company. So I think the comment was before you expect to return to high single-digit growth beyond fiscal '20 as the income from tariffs fades. But I guess kind of stepping back here a little bit and understanding some of the issues with Travel Retail and emerging market slowing, it looks like it'll probably be the lower end of that range seemingly this year as comps get more difficult. So – and then the conversation has been sort of constrained U.S. pricing for a long time, not enough to offset input cost inflation. So what's the level of confidence, if – the top line looks like it's something closer to 5 then to 7 and inability to take pricing in the U.S. to offset input cost inflation, what's the level of confidence that high single-digit operating income growth is a number you can hit even over the intermediate term, let alone sort of medium or longer term?

Lawson Whiting

Let me take this.

Jane Morreau

You could start on…

Lawson Whiting

Yes. I mean look, we've had – the conditions that you just talked about right there, for the most part, have been in place for the last 10 years. I mean there hasn't been U.S. pricing in quite a long time. What's different compared to 10 years ago is we've got a much broader portfolio that's growing, you saw and you could see in the earnings release, how many brands we have growing into the double digits. And so as those get bigger, that's obviously dropping more and more money to the bottom line and becoming a bigger percentage of our mix. And then – so it is more of a volume-led story than a pricing-led story. But I do think the shape of the P&L after we get through this sort of very difficult margin compression time will return to something that looks more like what we have delivered for the last 20 years or something like that.

So I would – I mean look, the story hasn't changed all that much. I don't think, even though the tariffs, I mean, a lot of the cost problems that we have are not – they're not permanent. Well, hopefully, not permanent, within the context of tariffs. And as those start to fall off, you'll start to see more gross margin expansion, and then you'll – hopefully, as I say, the P&L will return to the shape of old.

Jane Morreau

Again, I'm very confident in our top line. Really, I think you're seeing the lower end, but I'm at the lower end just with timing issues without incremental contribution from Apple as an example and some other things that we're doing in the back half of the year. I'm more confident than that. And I do see – when you see these things, it's all short-term in nature anyhow. We still believe in the long-term viability of the emerging markets and Travel Retail, too.

Operator

And there are no further questions at this time. I will turn the call back over to our speakers for closing remarks.

Leanne Cunningham

I would just like to say thank you to Lawson and Jane, and thanks to you all for joining us today for Brown-Forman's Second Quarter and First Half Fiscal 2020 Earnings Call. If you have any additional questions, please feel free to contact us. With that, we'd like to close with wishing you all a wonderful holiday season.

Operator

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