Brown-Forman Corporation, Q3 2021, Earnings Call 2021-03-03

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Brown-Forman Corporation Third Quarter Fiscal 2021 Earnings Conference Call. — ***Operator Instructions*** — Please be advised that today's conference is being recorded. — ***Operator Instructions*** —

I would now like to hand the conference to your speaker today, Leanne Cunningham, Shareholder Relations Officer. Please go ahead, ma'am.

Leanne Cunningham

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's Third Quarter Fiscal 2021 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 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 third quarter of fiscal 2021, in addition to posting presentation materials that Lawson and Jane will walk 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 discuss certain non-GAAP financial measures. These measures, a 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 result of operations are contained in the press release and investor presentation.

Before we transition directly to our third quarter fiscal 2021 results, we have 2 very special guests with us today. As you may recall, on January 27 of this year, we announced a change in our Board of Directors Chair. Here to speak about this upcoming transition is George Garvin Brown IV, current Brown-Forman Board Chair; and Campbell Brown, Brown-Forman Board member and incoming Board Chair, both great, great grandsons of the company's founder.

Garvin, I would now like to turn the call over to you.

George Brown

Thank you, Leanne, and good morning. I'm delighted to join you today. In the almost 14 years that I've chaired our Board, this is just the second time speaking on one of these quarterly calls. The first time was when the Board and Paul Varga announced Paul's succession plan in 2018 when we welcomed Lawson Whiting in as our next CEO. Like then, I'm here today to discuss succession planning to elaborate on the exciting news that the Board and I announced on January 27, my intention to retire from the Board this July and the Board's intention to elect Campbell Brown as our next Chair of the Board of Directors, a fellow member of the fifth generation of the Brown family and a 27-year veteran of Brown-Forman Corporation.

Knowing that succession planning is among the most critical work any Board can perform, I thought it would be appropriate to discuss the news as we did for Lawson. The Board's succession planning work is led principally by our Governance and Nominating Committee, chaired by our Lead Independent Director, John D. Cook, Director Emeritus of McKinsey & Company. The Board and I have been working on what we call continuous long-term succession planning since I joined Paul on the Board in 2006 and became Chair in 2007, almost 14 years ago. In the case of my own role, I always felt that having Lawson Whiting firmly in place as our CEO combined with our lead independent director in his role would be a good time to move on Chair succession planning as those 2 individuals lend so much stability to our governance system.

In parallel to this Board work, the company and the Brown family have been building out a system of Brown family shareholder engagement and governance for more than a dozen years, building upon the work that the generation before us started in the 1980s, 1990s and early 2000s. Some of you may have heard me describe these efforts at the investor conferences that we've held over the years in New York. From the Board's point of view, the governance work that the Brown family has done has allowed the Board to interact with and know personally the company's long-term shareholders. As a result, the Board has been able to understand the capacity, capabilities and interests of family members with regards to potential roles in our governance system. This interaction has been critical to enabling the Board to make thorough and informed decisions on long-term succession plans such as this one.

The press release we issued points to Campbell's experience at Brown-Forman. His early years helping the globalization of our business in emerging markets, his breadth of experience running regions and brands in our home market, including relationships built with the U.S. distributor network and his leadership of the renaissance of our founding brand, Old Forester. The press release was more silent, however, on Campbell's experience building our family governance system. Since making his home in Louisville, Kentucky in 2001, Campbell has been a founding member and/or leader in all of our family governance initiatives. Coupled with leadership roles that he has taken on at Louisville in our community, the Board believes that this combination of experiences with the company, family and in the community make Campbell uncommonly well prepared, ready to take on this role. The Board also believes that having this sort of leader ready to partner with our CEO, Lawson Whiting, and the Board on its long-term agenda is, in fact, another example of how being a family-controlled company is a competitive advantage for Brown-Forman in the marketplace.

And so in Campbell, I have no doubt that you'll find a Brown family leader, who will continue to build upon and strengthen the scaffolding of relationships between the company, the public and our long-term family shareholders and industry partners that have made and will continue to make Brown-Forman a high-performing, independent, world-class brand building company headquartered in Louisville, Kentucky, worthy of your consideration as a prospective long-term investment. I do look forward to making some remarks at the annual stockholders' meeting this summer. But for now, I'll hand it over to Campbell.

Campbell Brown

Thank you, Garvin, and good morning. First off, I'd like to thank the Board for the confidence it is placing in me as the next Chair of our Board of Directors. I first worked at Brown-Forman in the summer of 1987, 33 years ago. I was 19 and I was working in our mail room. Since then, I've had the pleasure and honor to work alongside colleagues at the company in a number of roles and regions based at different times in India, the Philippines, Turkey, Maryland and of course, here in Louisville, Kentucky. As Garvin mentioned, in addition to the various operational roles I've been a part of over my 27 years here, I've also enjoyed working with members of my family and other leaders within BF on our evolving governance initiatives, really since they were more formally kicked off for my fifth generation in the year 2000.

And so as you could well imagine, I couldn't be more honored to take on this new responsibility for the company as we prepare to welcome our 151st year of operation. As you would have heard us say before, we believe that beverage alcohol brands and, in particular, aged spirit whiskey brands performed well in the hands of multigenerational stewards. My own time leading the renaissance of our founding brand, Old Forester, I've seen firsthand the success that we can realize when we pull all of the value drivers of our industry together in the right way, with the right people, at the right time.

I can assure you that I view the responsibilities that our Board has with the company, the community and our shareholders in much the same way. We understand our responsibilities to you, our public partners, in the same way we do our brands, namely, long-term sustainable growth achieved responsibly over generational time lines. I look forward to meeting you in due time, when we can all get together and convene again. I certainly plan to attend future investor conferences. But for now, I'll hand it over to Lawson to walk us through the Q3 results.

Lawson Whiting

Thank you, Garvin and Campbell, and good morning, everyone. I hope that Garvin and Campbell's remarks are a reminder of our long-term perspective in how we approach our business. I really do want to thank Garvin for being an invaluable partner to me for 20-plus years. I believe we have an outstanding Board of Directors, a very committed set of shareholders that are supportive of the strategic direction of the company. So Garvin, thank you for everything you've done to set this company up for success. And Campbell, I look forward to partnering with you in order to deliver many more years of continued growth.

So with that, I'll talk now a little bit more about our third quarter results. During this past quarter, we closed out Brown-Forman's 150th anniversary year and said goodbye to 2020. And while calendar 2021 has not ended the pandemic and has certainly not reopened all the bars and restaurants and nor has it enabled people to travel freely again, we have found ways to leverage our strengths and to find a way to deliver solid results in this challenging environment. So as I turn to our third quarter and year-to-date fiscal '21 results, I want to share my thoughts on why I believe we're operating from a position of strength.

As you can imagine, many of the favorable trends that I talked about in our calls earlier this fiscal year remain relevant. First, spirits performance continues to be very strong and to take share from both wine and beer. This category also offers attractive growth, healthy margins and high returns on capital, and we remain confident that we're in the right categories. American whiskey and tequila continue to grow and take share in these 2 categories, which also include our RTD business, represent the majority of our sales and profits and are driving our performance. We also remain confident that we're focused in the right priced segments, super-premium brands continue to experience strong growth relative to the lower priced segments, and we believe that super-premium price point will continue to grow very nicely even in the post-pandemic period.

Another area of strength has really been our RTD business. Benefiting from the convenience trend, the RTD category has been exploding in many parts of the world. We continue to see strong growth from our Jack Daniel's spirit based RTDs in markets like Australia and Germany, and while in its first year, we're pleased with the performance of our spirit based RTDs in the U.S. Our tequila based RTD, New Mix, which crossed 8 million cases in Mexico this year, continues to deliver good results. But the strongest performance has come from our Jack Daniel's Country Cocktails here in the U.S., which has more than doubled in size over the past year. We introduced Jack Daniel's Country Cocktails over 25 years ago and the brand has brought many new consumers into the Jack Daniel's family.

And so with that ready-to-drink category booming, we felt the time was right to capitalize on this opportunity. So as we announced back in December, we'll be partnering with Pabst Brewing Company for the supply, sales and distribution of Jack Daniel's Country Cocktails within the U.S. and domestic military. This partnership provides tremendous growth potential for the brand with greater access to can production and variety pack capabilities, which are driving the industry. Furthermore, with Pabst distribution network, Jack Daniel's Country Cocktails will gain much more efficient access to new distribution channels. And with Pabst focused on Jack Daniel's Country Cocktails, our core domestic distributor partners can place even more focus on our premium and super-premium spirits portfolio. Jane will talk more about our brand and geography performance in greater detail here in a minute, but I did want to share a little bit on the performance of the Jack Daniel's family of brands.

Year-to-date, the Jack Daniel's family brand's underlying performance has remained strong. We are benefiting from the convenience trend that I just mentioned, but also from increased interest and mixability. While mixability has been a powerful part of our story for a long time, obviously, with Jack and Coke, our Jack Daniel's flavors portfolio is now providing consumers with ease in making flavorful yet simple cocktails. Jack Daniel's Tennessee Honey crossed 2 million cases in the third quarter, with more than half its volume outside of the United States, and we're encouraged by the initial performance of Tennessee Apple as we continue its global rollout.

With respect to JD TW, which is the core black label, this has been a tough year, but we believe any disruptions really are circumstantial and temporary. One data point that I found interesting was, at least according to IWSR, Jack Daniel's Tennessee Whiskey is the second largest on-premise brand in the entire spirits world by volume. This business has obviously fallen off quite sharply in this environment, but we do see light at the end of the tunnel, and we are all looking forward to the reopening of the bars and restaurants around the world.

Last point, and then I'll hand it over to Jane. I'm cautiously optimistic that the U.K. and EU tariffs on American whiskey will be resolved. But it goes without saying that BF has been hurt and unduly impacted by this trade war with Europe. A couple of points that I think you may find interesting. The latest Eurostat data shows that about 25% of the entirety of the U.K. and EU tariffs leveled against the U.S. have been borne by the American whiskey category. And so based on IWSR, we know we're about 2/3 of the American whiskey category exports to the U.K. and EU. So do the math. We estimate that we alone, so Brown-Forman, Louisville, Kentucky based company has borne roughly 15% of the entire tariff build that's been leveled against the U.S. It's just a terrible situation, and it's imperative that we get it resolved. And get it resolved as soon as possible.

So in summary, while uncertainty and volatility remain, I'm confident that our well-positioned portfolio, the resilience of our people and the agility of the company will enable us to continue moving forward from a position of strength. With that, I'll turn the call over to Jane, who will walk us through our third quarter and year-to-date financial results.

Jane Morreau

Thank you, Lawson, and good morning, everyone. As Lawson said, we have experienced plenty of challenges this year. But because of our people and our brands, we delivered solid results for the first 9 months of fiscal 2021, with both underlying net sales and operating income up relative to the same period last year.

As expected, in the third quarter, we experienced a slowdown in our top line growth, reflecting the lapping of Jack Daniel's Tennessee Apple launch in the U.S. and the renewed lockdowns and restrictions, particularly across Europe related to COVID-19. Also, as planned, our high operating expense leverage in the first half began to reverse in the third quarter, reflecting a notable increase in our A&P investments behind our brands.

With that as a backdrop, let's begin by reviewing our year-to-date performance. Starting with our top line. Compared to the first 9 months last year, our reported net sales were flat, reflecting a decrease in distributor inventory levels, primarily in the United States that were built in response to the supply chain uncertainty during the early days of the pandemic. Adjusting for this factor, our underlying net sales grew 2%. As we look broadly across our geographic clusters, we experienced underlying net sales growth in each. Developed markets continue to grow, while emerging markets return to growth. However, underlying net sales in the Travel Retail channel remained down significantly.

Starting with our U.S. business, which represents approximately half of our net sales, underlying net sales grew high single digits despite cycling last year's launch of Jack Daniel's Tennessee Apple, which slowed growth approximately 2 points. This strong growth was driven largely by several of our premium whiskey brands, notably the Woodford Reserve family of brands, Old Forester and Gentleman Jack, as well as Jack Daniel's Country Cocktails or Tequilas and Jack Daniel's Tennessee Honey. We continue to experience very strong growth in the off-premise, which is more than offsetting the on-premise volumetric weakness. Additionally, while still a small percentage of our off-premise sales, our portfolio's explosive growth in the e-commerce channel has continued to expand at triple-digit rates.

E-commerce for beverage alcohol was a fast-growing trend pre-COVID and has significantly accelerated during COVID. We believe consumers have become comfortable purchasing products through this channel, which will enable continued strong channel growth in a post-COVID environment. We believe we are well positioned for the shift to e-premise and are continuing to increase our investments and advance our efforts in this channel.

As Lawson mentioned, we believe our portfolio remains well positioned in growing categories and is meeting the consumers' need for at-home consumption convenience, ease of mixability and great-tasting cocktails. And as evidenced by the performance of our super-premium portfolio, premiumization remains a trend as consumers continue to treat themselves to everyday luxuries, such as Woodford Reserve Double Oaked and the Old Forester Craft series.

Our developed international markets experienced a slowdown in net sales trends in Q3, reflecting the restrictions and lockdowns in Europe during the important holiday selling season. Despite these challenges as well as declines throughout the fiscal year in countries that are heavily weighted toward tourism and the on-premise like Czechia and Spain, our developed international markets collectively delivered strong underlying net sales growth, up high single digits year-to-date. The key drivers of this growth have been the strong performance of RTDs, particularly in Australia and Germany and the launch of Jack Daniel's Tennessee Apple.

Based on off-premise takeaway data in the major markets of Australia, the U.K., Germany and France, each are growing double digits and gaining value share relative to TDS. Collectively, our emerging markets underlying net sales returned to growth, growing modestly in the year-to-date period, but the story is mixed. The growth was driven by our new Mix RTD business in Mexico as well as gains in Brazil, Poland and China. We continue to experience a decline in a number of other emerging markets, including parts of Southeast Asia, India and several countries in Latin America. Excluding our New Mix business, Mexico is experiencing considerable decline reflecting evidence of consumer trade down.

Finally, our Travel Retail business remained under pressure. Despite registering slight improvement in the third quarter, driven by our military channel, our Travel Retail business has shown little improvement to date, with underlying net sales declining significantly.

Turning to our largest brand. Underlying net sales for Jack Daniel's Tennessee Whiskey remained down high single digits, consistent with the results through our first half. The brand's performance continues to be impacted by the shift from the on-premise to the off-premise consumption, including considering its overall concentration in the on-premise, the essential halting of travel retail and the trading down experienced in many emerging markets. Importantly, based on the brand's key consumer metrics, we believe Jack Daniel remains healthy and is gaining share in the majority of its top 10 markets.

Now turning to our gross margin, which declined 280 basis points to date and resulted in our underlying gross profit declining 1%. Higher input costs related to agave and wood as well as a reduction in fixed cost absorption due to lower Jack Daniel's Tennessee Whiskey volumes represented nearly 3/4 of our gross margin decline. Channel and portfolio shifts basically drove the remainder of the gross margin drop.

Moving to brand expense. As discussed last quarter, we began to increase our investments, most notably, behind our new Jack Daniel's Make It Count global campaign that launched in October. These investments continued throughout the third quarter. And while A&P is still down year-to-date, our investments grew double digits for the quarter. Our underlying SG&A investment will remain down year-to-date, reflecting the continuation of tight management of discretionary spending, including travel and hiring. In the aggregate, we grew underlying operating income 3% year-to-date and reported even stronger. This, combined with a reduction in our effective tax rate, help power the 12% diluted EPS growth to $1.63 per share through the first 9 months of the fiscal year.

And finally, to our fiscal 2021 outlook. As we look ahead, we continue to believe we are operating from a position of strength. Despite the high level of uncertainty that exists, particularly around the rollout of the COVID-19 vaccine and the eventual easing of restrictions and the government financial stimulus policies in a number of countries and the potential effect on the global economy and consumer spending. As a result of this uncertainty and low visibility of the timing of recovery in various markets and channels, we are not providing quantitative guidance for fiscal 2021.

However, we are optimistic as we look to our fourth quarter, where we begin to cycle the initial impact of COVID-19 and are seeing improving levels of consumer confidence in many markets around the world. Beyond this fiscal year, we expect the challenging operating environment to continue to improve, particularly as the on-premise and countries heavily reliant on tourism began to recover.

From a qualitative perspective, while we expect continued volatility in our developed markets, we remain confident in the resilience and strong growth that these markets have collectively exhibited to remain for the full year. We do not expect certain developed markets like Spain and Czechia, many of our emerging markets, the Travel Retail channel, are our used barrel sales to recover this fiscal year. Our gross margin will remain down for the year, driven by higher input cost and mix shift. Looking beyond this year into the next couple of years, we are expecting margins to improve nicely, driven by a number of productivity related initiatives underway and the benefit of lower agave costs.

Regarding operating investments, advertising and SG&A, we expect to continue to invest behind our brands, resulting in a significant acceleration, most notably in advertising in the fourth quarter as we invest behind areas where the business is showing strong momentum, coupled with cycling against last year's significant decline in spend during the early weeks of COVID-19. Our full year effective tax rate outlook is unchanged at 17% to

19%. Our balance sheet remains strong, and our continued capacity to generate strong operating cash flows is sound. Consistent with our long-held capital allocation philosophy, we continue to invest behind our business fully, pay increasing dividends and look for opportunities to acquire great brands such as Part Time Rangers RTDs.

In summary, while the past year has been like no other, presenting many challenges, we believe our results today are strong and reflective of our ability to leverage our strength in this environment. We are optimistic as we look ahead beyond this fiscal year, where we expect our medium-term growth rates to accelerate toward our long-term aspirations.

With that, this concludes our prepared remarks. Lawson and I will now take your questions. Operator, you may open the line.

Question and Answer

Operator

— ***Operator Instructions*** — And our first question comes from Vivien Azer with Cowen.

Vivien Azer

Since we have Campbell on the line, Campbell, I'd love to pose a question to you. Diversity and inclusion have become very topical in consumer packaged goods. So I'd love to hear your perspective on how you can bring stewardship in that area as your – in your role as Chairman of the Board.

Lawson Whiting

Yes, Campbell is not live on the line or he has stepped away, but I'll take a shot at your answer.

Vivien Azer

Okay.

Lawson Whiting

Yes. I mean the D&I efforts that have been going on at Brown-Forman classily for a decade or longer, really, I think, have served us very well over the last year and obviously been a very, very difficult year on that front. But the fact that we were – I personally feel we were better prepared than many, many others and has helped us. And so looking ahead, something Campbell is very involved in, in the community, I think he referenced that a little bit. And Louisville has been a flash point for many of the challenges that are happening, not only here but across the U.S. So yes, I mean, I think they will remain very important to us. We're certainly not backing down or backing away from any of those efforts. It takes up a lot of time on our management team. We're really trying to do it the right way. And we keep saying, be better, do better. And we'll continue on that front.

Jane Morreau

Yes. I might just add one point to what Lawson said. I think the Board believes in it so much. And I think that's one of the things you were getting to as well, that part of – you'll see this in this year's proxy, that part of the executive leadership's bonus will be tied to D&I and the progress we make in that space, which, of course, is a component of ESG. So I think that's an important signal from our Board to that importance in terms of our incentive pay here at the top of the company, which will, of course, make its way down throughout the organization and it is making is way down through the organization as time goes on.

Vivien Azer

Absolutely. That's really helpful color, both Lawson and Jane. If I could just squeeze in a follow-up, Jane, you noted a longer-term glide path to margin recovery, which you sounded pretty high conviction around. Can you just kind of remind us – I know you won't want to put targets on this. But maybe just from an agave timing perspective when we might start cycling the headwinds there.

Jane Morreau

Sure. Yes. Again, just a reminder, when we were on our second quarter call, we said, and I want to reiterate it, that where we were in our second quarter, the margins which were at 59%, we said that's the bottom. From here on, it's going up from there. And I think you saw some improvement in our third quarter, we were down 150 basis points from last year, so you did see some improvement.

As it relates to your specificity of the question, yes, we do have a number of initiatives underway, as I alluded to, that will improve our margins over the next few years. But as it relates to agave alone, we've been pretty consistent on this response as we look at the CRT plantings back in '15 and '16, we can see the acceleration in plantings that occurred that will then become available in the back half of next year. Maybe a little bit earlier next year, being our fiscal 2022. So later this calendar year. I think it may actually happen a little earlier because we've seen some stability in the agave prices.

But more importantly, one thing we've not talked about before as it relates to agave, and while we're confident that we'll start seeing benefits in our F '22 beyond the market price, is that a few years ago, we changed our strategy of how much we were going to cultivate ourselves, how much we were going to own, how much we were going to be exposed to on the market. And so we have, starting next year, a higher mix of our business that we'll be cultivating from the agave plants coming through our own business, which is much less than what you could buy in the market. And so we'll start seeing that benefit next year. We believe we'll continue to see benefits from the exposure both to the external market and to our own internal mix of our products next year, following a year and a little bit more the following year after that. I hope that answers your question.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan Spillane

Just a couple of questions. First – or just a quick one first, Jane, I don't know if I caught this, but capital spending. Did you give a CapEx outlook for fiscal – for the full year?

Jane Morreau

Yes. I don't think we mentioned that, but it's going to be somewhere in the $70 million type of range for this year.

Bryan Spillane

Okay. And then I guess, more just kind of thinking about modeling out into the future and not even specifically to '22, but just medium term. How should we think about – the U.S. and developed international year-to-date are both grown a couple of hundred basis points faster than what the run rate was for the last few years. So they're actually, in this period, growing faster and obviously, the developing markets and Travel Retail growing slower.

I guess my question is, we're kind of thinking about getting back to Brown-Forman's medium-term and long-term growth rate, are the developed international and U.S. markets, would you expect them to accelerate off of this? So has there been some structural change with regard to like the growth of ready-to-drink, market share gains? Could those markets specifically grow faster than they had pre-COVID? Or are we really looking at those kind of reverting, back maybe to the mean and getting the kind of the growth back in emerging and Travel Retail? Just trying to understand kind of the moving parts within that. And again, not necessarily thinking about it for '21, but just over the medium term, just how we should think about those pieces?

Lawson Whiting

Yes, Bryan, let me take a – I'll take a stab at it. If you back up pre-COVID times, the U.S. business was growing sort of around TDS, and we – that's been a goal for us for a long time, and that's sort of in that 4%, 5% range. Developed international, maybe 1 point or 2 higher than that. And then our emerging markets, which, like everyone has said, been more volatile, but had been several points above that in the prior few years.

Come fiscal '21, as we said, with the U.S. business has picked up. The market is we – essentially, we did a bit of a study on which markets – you can see which markets are growing really nicely this year. And you've had your Australias and Germanys and even the U.S. and some of these really big markets that have done really, really well, influenced somewhat by what Jane said in her earlier comments. The stimulus – the markets that had fiscal stimulus from their governments have done remarkably well, and it's been a big benefit to that. And those that didn't, so Southeast Asia and the Indias and Africas. And generally, a lot of the emerging markets didn't, and they fell off quite a bit.

Now looking into the future a little bit, does the algorithm change a little bit? I think our portfolio is well positioned, and I think it's important that, say, the Woodfords of the world and Herraduras of the word, brands like that, that are in very hot categories, have just simply gotten bigger. And so that will have a more impactful impact on our results going forward. So that helps a little bit, I do think.

And then the RTD business has been on fire now. It's not going to stay at the rates that it is right now. Country Cocktails has doubled. So that's going to slow down a little bit. But I think it will be picked up by the emerging markets, which we expect, I mean, the comps in the next couple – at least in the next year, are going to be easy. So we expect some better growth out of there. So I do think there'll be a bit of a reversion to the mean. But longer term, I think we've got our portfolio well positioned to do maybe 1 point or 2 better than we've done historically. We'll see.

Operator

And our next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira

And congrats on the succession announcement. I appreciate the commentary on the import tariffs. And I know it's a topic that you like to discuss. So could you update us on the thoughts that you – that how it would flow from the commentary that you gave last quarter into the bottom line or part will be reinvested back on advertisement and promotions as the industry recovers in Europe?

And then as a follow-up on the agave cost, and I appreciate the commentary. So your main competitor increased prices, particularly the U.S., right? Are you planning to follow them in pricing here? Or the integration of the agave plantation that you discussed and the stabilization of costs would offset that? Appreciate both.

Jane Morreau

Yes. Just a quick response on the agave. We've increased our prices really significant on all 3 of our brands in the U.S., Pepe Lopez, which is our value price brand, but the 2 main brands that are – that came from our acquisition back in 2007, Herradura and el Jimador were up double digits on pricing. And we did that earlier this year. And so that's already in our numbers. And I think that it was, actually, according to one of the Nielsen reports I read recently, we were at the top of the list in terms of pricing there.

As it relates to tariff, I'm going to turn it over to Lawson to answer that question.

Lawson Whiting

Yes. I mean you mentioned I'd like to talk about tariffs, but I hate talking about tariff like – because they have become such a big problem for us. But look, I mean, I think we're encouraged over the last few months of some of the conversations that have happened, particularly some comments coming out of the European trade people. And we need to get the U.S. trade representative in her seat, which I think is expected to happen sometime in the next few weeks to really get meaningful conversations happening again. But it does feel like there's a little bit of break in the ice between the 2 sides. And we are working as hard as we can to try to affect that and to make them go away.

Now in terms of what happens when they actually go away, we really have not made that decision yet. And we'll see. I mean I think you would – as you probably expect to be kind of a typical Brown-Forman thing, we will be reinvesting a pretty nice chunk of that back into the business. But some of it would fall to the bottom line, too. But as I say, we haven't put a specific number out there yet. And I think that's a bit of TBD.

Operator

Our next question comes from Lauren Lieberman with Barclays.

Lauren Lieberman

Great. I wanted to just follow-up on the conversation on tequila and maybe the relative pricing that you took will help answer the question. But my understanding is that some of the other large established brands in the U.S. had really, really strong growth year-to-date, look – comparable period kind of last 9 months, which would make it look like Herradura might actually be not keeping up and not gaining share or it's the weakness – relative weakness in tequilas really coming out – ex New Mixes, coming out of Mexico. So I was just kind of hoping for more clarity on what's going on with the tequila business. It should be, I think as you've been discussing, a huge opportunity for growth in the U.S. and also in a lot of developed markets across the world.

Lawson Whiting

Let me take a stab at the beginning, and then I think Jane's got some thoughts, too. But let me step back for a second, explain our tequila business relative to some of our competitors. The first big thing, especially if you're looking at our earnings release, and you're looking at the revenue number in the exhibit, and it's pretty underwhelming. A lot of that is because we have a very big business in Mexico itself. The competitive brands that you're looking at for the most part, do not. They don't even exist in Mexico. So we have been dragged down. I mean our global number has been dragged down by the Mexican market, where, as I say, we're large, not only in the tequilas, but even Jack Daniel's has a pretty substantial business down there, and it's been very weak. It's one of the emerging markets that has struggled.

So – but our U.S. business, turning to that for a second. I mean Herradura is our ultra-premium brand that competes with the large competitors who had admittedly fantastic results and what we have seen, too. Two things on that. Herradura, one, has a very heavy on-premise presence. Somewhere 40-plus-percent of its business is in the on-premise, and that has been tough, which would also be a drag on the overall number. But our Nielsen numbers, I just saw recently, the ones that came out, I think, over the last few days, we're growing at plus 64% in Nielsen. So that's – while that would lag some of the bigger competitors, not by a lot. So I feel really good about Herradura and its positioning. It's got a long runway to go. It's still not – I mean it doesn't even have distribution in large chunks of the United States. And so we will continue to invest behind that, and we will continue to push pretty hard. I think that is one of the brands that we really see as sort of one of the gems of the future.

Jane Morreau

Just building on what Lawson said and supporting what he said. Our Mexico business is a fairly sizable business. And unfortunately, this year is tough. We've seen a lot of trading down in that market, particularly on the Herradura brand, the ultra brand that was moving so fast and growing so rapidly before now. And then shifted so much that if you were to split our numbers a part that you saw on the table, the Mexico business is down 30-ish percent on a strip net sales basis. If you look at our U.S. business, it's up almost 20% on a strip net sales basis. So that's why you're also seeing, as Lawson said, the underwhelming numbers. And it's gotten such that now our U.S. business is going to

– is surpassing the size of the Mexico business, which will bode well for the future as you get this type of growth and we see these growth coming on.

Herradura itself, as Lawson gave you throughout the numbers from the latest Nielsen, relative to the price point that Herradura plays in, it is gaining share. That price point category is going around 40-ish percent, so it is. Where you see the real acceleration in the tequila growth is above that price point, more the ultra price point. And so we're going to be playing some things there, too. We've got a wonderful brand that we've launched recently from Herradura, it's called Herradura Legend, it's very ultra, ultra-premium. But we think it's got lots of legs. And people are, again, indulging in these everyday luxuries. And Ultra is a product that we introduced in Mexico a few years ago, fairly introduced it in the U.S. And again, these are higher price points. That's where you see the real accelerated growth. And we've got a new campaign that we're launching in April. And we're really excited about that from Energy BBDO. So there are some things that we're looking at as we go ahead to continue to accelerate it. But both of our brands are doing well in the U.S. in the price points they play in.

Operator

Our next question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog

Actually, I wanted to ask about the ad spend. Jane, you just touched on this. But as I look at it in the quarter, it was up a bit more than I was expecting and really a pretty big jump as a percentage of sales. So I guess I'm wondering if that was maybe a pull forward from your Q4? Or should we assume similar spending levels for the remainder of this fiscal year? And then maybe as we look forward, how should we think about your ad spending levels and the anticipated impact on your top line, especially in the context of what you mentioned earlier, Lawson, about your long-term growth expectations? I guess I'm trying to get a sense of your confidence level that you're spending the right levels in terms of ad spend to drive top line and possibly accelerate it.

Jane Morreau

Bonnie, let me start off. I'm sure Lawson is going to build in here as well. But just the – we knew this year was going to be a crazy-looking year on phasing. And just to remind you, it actually started last year in the fourth quarter, in the last 6 weeks of the fiscal year. So when COVID hit in the middle of March through all of April, when we cut – shutdown – on-premise were shut down and then sponsorships, all those things went away. We knew early on, we saw our first quarter was an unusual quarter. We really didn't start spending until the second quarter, and that was purposeful, not only because of the consumer and its readiness to hear what we were saying, but also because we had a new agency partner, Energy BBDO, in which we launched our Make It Count campaign toward the end of October.

So what you're seeing in the third quarter, we had – we've been talking about all year long. So some of this is situational and circumstantial relative to what was going on in COVID, some of it is because we planned it this way. But as you look to the balance of the year, I think I said this in our remarks, we look to the fourth quarter, we're going to continue to see an acceleration in the rate of growth. So our year-over-year rate of growth, because of the decline last year, plus just the way we spent this year, is going to be up even more on a percentage basis than it was in the third quarter.

If you're thinking ahead to how you would – how you should expect us to spend, it's going to be choppy next year because you're going to get the flip of that, but let's just talk big picture. If I'm thinking about that, our aspirations have been – always come in every year like that, but to grow somewhere in line with our rate of growth. I don't know if you have…

Lawson Whiting

Yes, the rate of sales growth. Yes. Another thing, within the mix of spend, I think is interesting, too, because there have been some massive swings there. And I'll back up for a second, go back like 2 or 3 years, probably 2 years ago. Well before COVID even came around, we were making changes to our resource allocation models to significantly up weight media and just general consumer touch spends and downplay some of the events, places that were lower touch, even on-premise, things like that. And so that had begun – that mix of spend change had begun before COVID hit. Then it hits everyone, including Brown-Forman. The entire industry drops their on-premise spend, drops their event spending, drops lots of that kind of stuff and starts going back at media again.

So in a way, it has accelerated our path to get there. But in another way, which I hadn't processed, if I'm honest, until a few months ago because we were looking at share of voice and share of different ways of spending, and basically, everybody is doing that. And so the media spend has increased significantly in our industry, but it's still the right thing to do. And I think longer term, we like the rebalance of how we're spending the money. And I think that will – we're going to hold on to that for the – at least the medium to longer-term future.

Jane Morreau

Just to build further on what Lawson said, too. It's not just your traditional media. If we look at what we've spent this year, we spent a lot more in digital. We're up 100% year-to-date in digital media spend. And that is cognizant of where the consumer is and whether they're watching, whatever they're getting our – or mobile device they have in their hand and how they are getting information. So I don't think that you'll see a lot of change in that. We've got to meet the consumer where they are, going forward.

Bonnie Herzog

Okay. That all makes sense and really helpful. And if I may just ask a second question because I really wanted to ask also about the productivity initiatives you mentioned. And I might have missed this, but have you guys quantified what the savings could be? I guess I'm really trying to understand how meaningful these initiatives could be and maybe hoping to get, I guess, some sense from you of examples or opportunities that you see. I think you touched on the agave, but is there – are there any other buckets that we should be mindful of in the next few years?

Jane Morreau

Yes. That's – agave is a great one of our examples of where we changed our sourcing strategy on that. So that absolutely will benefit us. Another example of an initiative we've undertaken is really looking at our – how we source. How many vendors you need to source your gift or your POS or things like that. So more strategic sourcing and getting synergies there. So there's some low-hanging fruit in that area. We're always looking at and as part of our global production's mindset, but we're always looking at how to improve our operations. And so there's a handful of initiatives there. I didn't quantify those. We haven't quantified it, but I can tell you that we – again, just supporting where we said that, that 59%, half 59% in our second quarter was the bottom. You're going to expect to see nice improvements over the coming, say, 2 to 3 years. I would set aside tariffs and that would just add to this benefit. But you could see a couple of hundred, 300 basis points over that period of time through 2025 I think.

Operator

Our next question comes from Steve Powers with Deutsche Bank.

Stephen Robert Powers

Jane, I think you covered agave pretty well, but could you also remind us on how to think about the progression of wood costs and their likely impact on gross margins over the next several quarters?

And then Lawson, you've mentioned this a bit too already, but I guess, can you elaborate a bit further around just your outlook and expectations with respect to ready-to-drink cocktails? And maybe specifically update us on how you anticipate mix impacts flowing through the P&L, assuming that category is set to continue to grow, especially in the context of developments like the Pabst relationship that you highlighted at the open?

Jane Morreau

Let me start with wood.

Lawson Whiting

Yes.

Jane Morreau

Yes. So we have started to see, and we are taking a reduction, I guess, if you will, in the cost of acquiring wood so you're going to start to see, we are – effective in our first – or January 1 this year, there's the cost of wood for us is going down. That will not make its way through our P&L. I think I've talked about this previously because of our long aging process that we had. So think about our Jack Daniel's products, our Old Forester product, Woodford Reserve, 3 – 4, 5 years, depending on what it is down the road before you actually see those lower costs coming through.

You'll start to probably start seeing some mix differences coming through on our balance sheet. Hopefully, as the year come on, where you'll start to see that cost offsetting some of the volumetric trends, which if you look at our balance sheet over the last several years, you'll have seen barrel whiskey go up quite a bit, but that's been a combination of this cost, this wood cost, that's coming through our P&L now that we've been talking about last year and this year. So you really aren't going to start seeing that savings, I wouldn't say until after 2025, probably 2026, 2027.

Lawson Whiting

Yes. And the RTD question, I mean, I think obviously, it has been much covered. The business has exploded in the United States over the last year and in a number of other countries, too. It's always been a consumer recruitment vehicle, and that's the way we thought about it, I would say, even for a couple of decades as we built that brand and sort of the can in the hand and all that. It has now grown into much more than that and to be certainly a profit driver. The Country Cocktails partnership, we call it that, with Pabst now, we do expect to continue to keep that growth rate going for lots of reasons. The most obvious one being they have touch points in many channels, including convenience that we just weren't getting with the spirit wholesalers for the most part. And so the number of distribution points will go up substantially. And so we think we can keep that run going.

But the RTD business is much more – much, much larger outside of the U.S. than it is inside the U.S., it's like 3.5x the size in the international markets than it is in the U.S. And that, that's a lot of Germany. For instance, Germany business is well over 1 million cases now and very, very profitable and doing very, very well. Australia has been the largest RTD market in the world – well, one of the largest in the world for quite some time, and that business is really strong. So yes, I think that's here to stay. I do think it's been boosted by COVID. I mean – but the macro trends of convenience and flavor fit very well into the RTD business. And so this is something that's here to stay, and we'll just have to – it's hard to see what the growth rates are going to be when you get beyond COVID, but we certainly expect them to still be strong.

And you asked a question about margin? Yes.

Stephen Robert Powers

Yes, I did.

Lawson Whiting

I forget the exact…

Jane Morreau

Yes. I mean the margin for us this year has been very immaterial, I would say, a couple tenths of a point as it relates to the RTD business. Some of that was outsized in the first quarter because of our New Mix business, which benefited from the beer shutdowns. And I think we said this on the first quarter call and second quarter call too as well that we are fine with that right now, a tenth or 2, particularly in this environment, we want to be where the consumer is.

We also noted, it's something we've talked about many, many times in the past and fretted over, but if you actually put this on a drink equivalent basis, it's actually more – a better margin than our full strength. And so there's different ways to look at it. So right now, it's all about meeting the consumer needs, the convenience, providing them with great-tasting cocktail. I think the opportunity exists going forward, but I don't see it as a big margin drag. It hasn't been year-to-date really either.

Operator

Our next question comes from Chris Pitcher with Redburn.

Chris Pitcher

A couple of questions, please. Firstly, on your international route to market. Could you talk a bit about the rest of developed, those countries which don't make the cut to be reported separately because they're obviously – have been a big drag on growth? Can you give us an update on what's going on in Japan and Canada and whether you expect to see a recovery in those markets?

And then secondly, on sort of innovation and digital investments. It looks like the sort of the innovation cycle is accelerating, particularly with all the new categories that are appearing. I mean how are you invested in terms of digital in terms of spotting these trends early? And is your supply chain becoming more agile to respond quicker than perhaps the old sort of 3 to 5-year cycle that you were running on, particularly when it comes to, say, like Jack Daniel's flavors and so forth?

Lawson Whiting

You want me to take the – so the other developed markets that you were referring to, I think you said Japan and Canada. And yes, they – well, I don't know about Japan specifically, but I mean, a lot of the other developed markets have been weaker. Those are what we call partner markets. But they tend to be – there's lots of them, and they're relatively small. And a lot of those, as you move sort of east in Europe would capture a lot of those markets. And that business has been relatively weak. As I mentioned, those are the markets that don't have the big fiscal stimulus, and they have been more challenging. And so yes, I mean, without getting into any specific markets, I mean, there's literally probably more than 10, less than 20 in there that make up those numbers. So I mean it's a whole bunch of them.

Jane Morreau

Yes. I would say we actually are seeing growth in the 2 he noted, both Japan and Canada. I think it's being pulled down, as you and I know, by places that are heavily on-premise, like Spain.

Lawson Whiting

Yes. Southern Europe in general is weak.

Jane Morreau

Italy, so high tourism places, Czechia, some of those type of markets. And so that's what we're talking about. We do expect the easing next year. That's why we're more optimistic about those markets when we look ahead. They're going to come back, and they're going to be going against nothing. So they're going to be very positive for us as we look ahead. So that's on your rest of developed question.

Lawson Whiting

No, I didn't – the innovation question. Can you say that again? I missed what the question was, I guess.

Chris Pitcher

The alcohol category is – you're getting category shifts moving a lot quicker. We've had the rise of hard seltzer. You're talking about the ready-to-serve cocktails a suddenly increase in their importance. The gap between Honey and Fire, Fire and Apple is shortening. Do you get the sense that you're having to innovate quicker as an organization? But historically, you've tended to do big, well-considered innovation. Are you having to become faster? And do you have the systems and digital backbone to stop these consumer trends early and respond in innovation faster than you did, say, 12 months ago?

Lawson Whiting

Yes. I mean look, it is very true. Innovation is – I mean that's across all CPG, I think just becoming increasingly important now. With respect to RTDs and the reference a little bit to seltzer there. The RTD category, for as long as we've been in it, has been heavily reliant on innovation. Australia would be the best example of that. And every year, they come up with something new, and different pack sizes, and proofs, flavors and mix, all the rest of it. And so we've been doing that for quite a long time, and that will continue. So the RTD space in terms of do we have the know-how, do we have the supply chain, do we have the abilities to sort of forecast where the consumer is going in that space, I would rate us high on that.

As far as you referenced Fire and Apple and Honey, that pace is not changing. I mean we’ve been – we’ve done 3 in 10 years and really just obviously started Apple a year ago or a little more. So that pace will not change. So I would not expect us to do another big Jack Daniel’s flavor in the near future, at least. We want to be very measured on that. They’re big campaigns, they’re big launches. They take a couple of years to execute. And so I don’t expect that – I would not expect that the pace on that will be any different than it’s been.

Operator

Thank you. This concludes the question-and-answer session. I would now like to turn the call back over to Leanne Cunningham for closing remarks.

Leanne Cunningham

Thank you. Thank you, Garvin, Campbell, Lawson and Jane, and to all of you for joining us today for Brown-Forman’s Third Quarter Fiscal 2021 Earnings Call. If you have any additional questions, please contact us. With that, this concludes our call. Thank you.

Operator

Ladies and gentlemen, this concludes today’s conference call. Thank you for participating. You may now disconnect.