Brown-Forman Corporation, Q4 2012, Earnings Call 2012-06-06

Presentation

Operator

Good morning. My name is Tiffany, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fourth Quarter Fiscal 2012 Year End Conference Call. — ***Operator Instructions*** — I would now like to turn the conference over to Don Berg, Executive Vice President and Chief Financial Officer. Please go ahead, sir.

Donald Berg

Thanks, Tiffany, and good morning, everyone. I'd like to start this morning by introducing Jay Koval, our new Director of Investor Relations. Jay joins us from Starwood Hotels and Resorts after leading their Investor Relations efforts since 2006. Prior to Starwood, Jay worked as an analyst on the buy-side at Invesco Funds Group and the sell side of Bank of America Securities. We're excited to have Jay as a part of Brown-Forman's team, and I know he's looking forward to meeting more of you over the coming year. So Jay?

Jason Koval

Thanks, Don, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's Fiscal 2012 Fourth Quarter Earnings Call. Joining me today are Paul Varga, our President and Chief Executive Officer; Don Berg; Jane Morreau, Senior Vice President, Finance.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict.

You should not place undue reliance on any forward-looking statements and the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the fiscal 2012 fourth quarter. The release can be found on our website, under the section titled Investor Relations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, Form 8-K and Form 10-Q reports, filed with the Securities and Exchange Commission. During this call, we will be discussing certain non-GAAP financial measures. These measures, and the reasons management believes they provide useful information to investors regarding the company's financial conditions and results of operations, are contained in the press release. And with that, let me turn the call back over to Don for his prepared remarks.

Donald Berg

Thanks, Jay. On today's fourth quarter earnings call, I'd like to cover 3 main topics, including a review of our full year 2012 results, our preliminary outlook for fiscal '13 and an update on our balance sheet and uses of cash. So let me start with my first topic, a quick review of our results. In fiscal '12, we delivered another year of strong underlying results. Earnings per share of $3.56 were negatively impacted by foreign exchange by approximately $0.11 relative to our expectations a year ago, as the dollar continued to appreciate against most other currencies. Year-over-year EPS comparisons were also negatively impacted by $0.43 per share due to last year's sale of Hopland-based wines. Full year underlying net sales grew 9%, which we believe is about a point ahead of the industry's growth rate and an acceleration from our 4% growth in 2011 and the 1% growth rate in 2010. This underlying sales growth also translated into underlying operating income growth of 9%. Reported gross margins were down 1 point, underlying A&P increased in line with our sales growth, and SG&A growth of 6% provided some leverage to the bottom line.

Our net sales growth was broad-based. Each of our 12 largest markets grew, with these gains powered by volumes. But just as volumes have taken some time to accelerate post-recession to current rates of growth in the high single-digits, we are increasingly confident that the pricing environment has been slowly improving, driven today by improving mix and reduced discounting. I'll talk more about the pricing environment in a minute, when I get to our expectations for 2013, but the takeaway is that we expect price increases to drive better balanced sales growth in fiscal '13.

We estimate the product innovation, drove about 2 points of our 9% net sales growth, including our first full year of results from Jack Daniel's Tennessee Honey, which depleted over 400,000 cases in the year. We have been pleased to see what we believe, is a positive halo effect on Black Label from the launch of Tennessee Honey, proving that a new product can create momentum within the trademarks and actually accelerate the sales growth of the parent brand, rather than cannibalize existing sales.

Jack's family of brands grew global constant currency sales 12% in the year, powered by the return of market share gains in the U.S. and continued strong interest in the brand outside of the United States. RTDs grew sales in line with the parent brand, driven by growth in Mexico, Germany, the U.K. and Australia. Just as RTDs have created new opportunities for us to connect with consumers and new locations through convenience and great flavors, Tennessee Honey has recruited new consumers to the brand, including African-Americans, Latinos and females. While Gentleman Jack and Single Barrel grew well in the United States, depletions jumped over 30% outside of the U.S. and surpassed 0.5 million cases globally. So while the powerful Jack Daniel's trademark is essential to each of these line extensions, we have been diversifying our consumer mix across geographies, race, sex, socio-economic classes and expanding into new locations.

In vodka, Finlandia enjoyed a record year of growth with over 3.1 million cases depleted, driven by strong growth in Eastern Europe and Russia. Our family of tequila showed improving results, with 13% growth for Herradura and 10% growth for New Mix. El Jimador grew 1% despite a competitive environment in Mexico. And in the super-premium category, Sonoma-Cutrer and Woodford Reserve grew depletions double-digits, as consumers increasingly trade up.

Before I move on to my second topic, I wanted to share a few of the country milestones reached in fiscal ’12, demonstrating the breadth of our results across both emerging and developed markets. Brazil and Russia’s combined depletions jumped 95% to almost 600,000 cases. Growth rates in both markets benefited from an easy comparison versus the prior year’s disruption, caused by our route-to-consumer changes we made in the prior year. While we expect these growth rates to moderate on more normal comparisons, the strategic changes in our route-to-consumer platform have tended to have long-lasting impacts on our growth rates. Turkey grew over 25%, on the heels of its recent route-to-consumer changes, and Mexico, where we invested in our route-to-consumer 5 years ago, was up 15%.

We all know that the headlines in Europe remain troubling, as recessionary concerns and talk of additional austerity measures. But Brown-Forman enjoyed another record year, with 9% depletion growth in Europe. The U.K. increased total volumes almost 10% and France jumped over 15%. Belgium, the Netherlands and the Nordic region each surpassed 100,000 cases depleted in the year, averaging growth of 20%. Not surprisingly, countries such as Greece, Italy and Spain were down a few points year-over-year, but as a whole, we grew well in Europe and enjoyed strong market share gains. Given the current economic environment, we expect more subdued rates of growth in fiscal ’13.

So this brings me to my second topic, our outlook for fiscal ’13. While fourth quarter depletions accelerated slightly from the third quarter levels, we believe this is due to some inventory buy-in, in advance of our scheduled price increases this summer. The global economy remains uncertain and hard to predict, and consumer confidence is volatile, but given the strength of our brands and the momentum in our business, we are expecting another strong year of growth in fiscal ’13.

Underlying trends support high single-digit sales growth in 2013, including price increases for most of our portfolio on a market-by-market basis. For Jack Daniel’s, we are anticipating a global average per price increases of 3% to 5%, with slightly lower price hikes for the rest of the portfolio. Consequently, we do expect volume growth to moderate, as we are targeting a return to a more balanced revenue model. But overall, this should result in a healthier mix of growth.

Most of the price increases we had planned should be implemented by the end of this summer, and we are optimistic that our brands will be able to support the first broad-based price increase since before the 2008 recession. We are diligently working on new innovations and line extensions, but we don’t expect a new product introduction in fiscal ’13 of the same magnitude as Tennessee Honey. On Honey, we believe this brand still has a long way to go. Total awareness of the brand today stands at 31% versus 98% for Jack Daniel’s Black Label. Remember, it was launched mainly in the U.S. off-premise accounts, and in only a few sizes, primarily the 750 and the 1 liter.

So we see some great opportunities to further expand in the on-premise, and introduce new sizes in the U.S., as well as selectively expand into some markets outside of the U.S., where flavored spirits have been performing well, such as the U.K., Australia, South Africa, Poland and Korea.

In the United States, consumer takeaway has remained strong after the initial launch. So in summary, we expect Tennessee Honey to show growth in fiscal 2013, even though in the early months, it'll be facing more difficult comparisons with last year's pipeline fill. While our Southern Comfort brand continued to decline in fiscal 2012, we began to see some trends move in the right direction. In fiscal '13, we are looking to stabilize the parent brand through a new communications platform, increase spend on advertising and digital, and the hiring of a new creative agency. Product innovations such as the launch of Cherry and the continued rollout of Lime and Fiery Pepper, along with the new market introductions for these line extensions, will also help drive sales in the coming year.

Moving on to margins, we have talked a lot on prior calls about the other ways we connect with our consumers beyond just straight A&P spend. This has included value-added packs, enhanced packaging and targeted promotions, all of which impacts gross margins. These were particularly useful ways to stay relevant with consumers, when much of the on-premise business moves to the off-premise. While today, we are seeing select opportunities to reinvest directly in the A&P line, and shift some of these dollars from what I'll summarize generally, as push activities, to more pull-type investments, we intend to continue to maintain our flexibility and utilize the entire P&L to invest and grow our brands.

Increasing input prices, such as corn, glass, energy and label – and labor, have pressured our gross margins for several years in a row. But it's our expectation that reported gross margins will begin to expand again in fiscal '13, particularly driven over the near term by the end of the agency relationships with the Hopland-based brands. This arrangement generated $79 million in revenue and $0.04 of profit in fiscal 2012. So reported gross margins will benefit going forward, from the absence of this business. Over time, we would expect some gross margin improvement through price increases, while we continue to invest in our brands and people.

Now, turning to foreign exchange. In fiscal '13, we expect foreign exchange will again be a headwind, as the euro, pound and Aussie dollar have dropped dramatically over the last few weeks. We estimate that at current rates, foreign exchange will negatively impact fiscal 2013 EPS by $0.11 per share. We have incorporated this into our EPS guidance of $3.60 to $4 for fiscal ’13. In terms of sensitivity, we estimate a 10% move in the dollar, in either direction, will impact full – would impact full year EPS by approximately $0.17, a benefit when the dollar weakens, but a drag in reported earnings if the dollar strengthens.

Let me take a minute to talk about some seasonalization patterns for fiscal ’13. As you know, price changes can have an impact on the timing of shipments, particularly when it’s the first broad-based price increase in several years. While we are doing what we can to mitigate this impact, we have already seen buy-ins in advance of our summer price increase. These buy-ins are in line with what we had expected, but it will result in front-loaded volume growth. While it is hard to quantify the impact, we would expect volatility in our reported and our underlying results, whereby first half volumes will run well ahead of our full year expectations, and second half volumes will slow meaningfully, post buy-in. Quarterly fluctuations aside, we are targeting full year underlying sales growth to be up high single-digits, and we’ll update you as the year progresses on the price volume mix.

I’ll now move on to my third and final topic, a brief discussion of our balance sheet and uses of cash. Our balance sheet is in great shape, with net debt of $168 million and the company is firmly in investment-grade territory. Our business generates prodigious cash flow, allowing us to both reinvest in future growth, as well as return cash to shareholders. Given we enjoy an industry-leading ROIC, our business typically requires limited capital reinvestment, averaging roughly 2% of sales over the last decade. We now have some larger one-time investments that will temporarily boost capital spend to over $100 million for each of the next 2 years. This capital plan is related to the wonderful success of the Jack Daniel’s trademark, as we invest in our barrel needs and distilling capacity to meet the anticipated future demand of our consumers around the world. To be clear, we expect that these will be once-in-a-generation investments for the company and not a permanent change in our expected annual rate of reinvestment.

Beyond investing in our future organic growth, we remain disciplined in our approach to acquisitions. Over time, and at the right price, we will look to acquire complementary brands that we think will do well in our hands, given our long-term horizon. To the extent that attractive acquisitions are not available, Brown-Forman has used a combination of dividends and buybacks to return excess cash to shareholders. In fiscal '12, we returned over $400 million through dividends and buybacks. The annualized dividend is $1.40 per share and our share count today is down 5% from just 4 years ago.

So in summary, we believe that we have a resilient cash-generative business model with strong growth potential. We have used innovation, global expansion and marketing programs to build and maintain strong connections with our consumers and drive our top line growth through volume gains. But we believe that the current business momentum will allow us to create more value for shareholders through price increases than volume. Pricing will allow us to better balance our top line growth and help drive margin improvements over the long term, after several years of partially absorbing cost increases and excise tax increases. So with that, let me now turn the call over to Paul for his comments.

Paul Varga

Thanks, Don, and good morning to everyone. I just want to say I'm really pleased with the results we've reported this morning, where we saw our underlying sales and operating income both grow at 9% and these growth rates were a nice acceleration over the last fiscal year. I'm also encouraged that these high single-digit growth rates approximate our historical long-term growth rates. As in the recent past, our growth story was an organic growth story, as we derived our incremental business by developing our existing brand trademarks around the world and also, as in past years, the Jack Daniel's trademark led the growth of Brown-Forman.

The Jack Daniel’s Black Label brand had a super year, with underlying net sales advancing by 8% and again this year, the brand’s incremental growth was derived from a diverse group of countries around the world, and this included another stellar performance in emerging markets. Comfortably above 10 million cases globally, Jack Daniel’s Black Label is one of the world’s largest super-premium brands by volume, and this combination of very large volumes, derived from a broad and diverse set of global markets, sold at super-premium prices, makes Jack Daniel’s Black Label a very rare brand indeed. The worldwide appeal of the brand, as well as the depth of emotion and attachment it garners from an ever-larger contingent of global consumers and advocates is truly remarkable. And further, it provides the foundation for a select number of well-positioned and increasingly important trademark line extensions. One of those line extensions, Jack Daniel’s Tennessee Honey, was an important contributor to FY ’12 and this introduction helped propel our company’s market share growth in the United States, the world’s largest and most important distilled spirits market.

FY ’12 was equally impressive in my view, from a qualitative and strategic standpoint, as we continued to position the company for success in the years ahead, via both operating and capital investments. These efforts and investments encompass our route-to-consumer, R&D, packaging, media, IT, production, supply chain, and talent development, to name just a few.

I believe that our strong FY ’12 results, our excellent financial health that Don referenced, and our continuing prospects for growth in FY ’13 and beyond, were key contributors to Brown-Forman’s FY ’12 total shareholder return of 22%, which compared again, quite favorably to the S&P 500’s 5% return. And as Don highlighted earlier, we are planning for a continuation of FY ’12’s high single-digit underlying operating income growth in FY

’13, while delivering it with a different balance in volume and pricing growth than we experienced in fiscal year ’12.

Shifting now to our longer-term performance. Last week, we gathered some of our leadership from around the world to review FY ’12, align around FY ’13, and check in on the progress of our longer-term strategy, which we referred to as BF150. During those few days, we took the opportunity to look closely at the last 5 years, which coincidentally spanned both the difficult global economic recession of 2008 and 2009, as well as the steady recovery that we’ve experienced from 2010 to 2012. We also found it helpful to contrast those 5 years with the 5 years that preceded them, from 2002 to 2007, which was a period of strong global expansion and excellent results for many businesses, to see how Brown-Forman had performed. Essentially, we were testing to see how we had fared in both good times and in bad, if you will.

What we observed was that Brown-Forman’s performance in the first 5 years, from ’02 to ’07, resulted in excellent 5-year TSR of 13%. And this compared favorably to the S&P 500’s 9% TSR over the same period. Of course, things changed in the world in 2008. Interestingly however, Brown-Forman’s 5-year TSR performance that just ended in FY ’12, which spanned the ’07 to ’12 period, was 14%, and that compared very favorably over the same period to the S&P 500’s 1% TSR. So over these last 10 years, broken into 2 5-year segments, one broadly thought of as good times, and the more recent 5 years often described as bad times, Brown-Forman produced a consistent and excellent double-digit growth rate in total shareholder return, outpacing the performance of the S&P 500 over both periods.

Knowing that we compete in an attractive industry that has consistently outpaced both the S&P 500 and consumer staples, we also compared our TSR over the last 10 and 5 years to our spirits competition and noted that Brown-Forman’s total shareholder return was above the industry average for the 10 years and at the very top of the industry on the 5-year. We look at – we look back at these relative multi-year performance metrics so that we can learn from what they tell us. In this case, it is a source of confidence that most of what we've been doing has fortunately been working. The backdrops of the respective 5-year periods that I referenced were quite different and accordingly, we deployed some different initiatives to be successful, such as being cautious with price increases, or by being more aggressive with packaging and line extension innovation, which was aimed at positioning our brands for success in the growing off-premise.

At the same time, we also continued to rely on some of the longer-term investments that have served the company so well, regardless of the environment, such as improving our global distribution footprint and route-to-consumer. Our aim, looking backward or forward, is to produce consistent, excellent long-term returns for shareholders. We strive to do this by building strong and enduring brands, which have multi-generational growth prospects and that yield attractive returns on invested capital over the long term. We found that these types of brands generate cash very efficiently, and we then attempt to put that cash to excellent use by balancing well our reinvestment in the business, with our desire to return some of it to shareholders to enhance long-term returns.

Don referenced the fiscal year '12 uses of cash, but I wanted to provide some insight into how we've done this over the past 10 years, considering that from 2002 to 2012, Brown-Forman generated roughly $4.6 billion in cash, with virtually all of it coming from operations, but only 2% of that coming from a modest increase in net debt. We reinvested 33% of it back into the business, via increases in capital expenditures, working capital and acquisitions, netted by divestitures. Having satisfied the capital needs and opportunities of the business and not discovering any additional acquisitions that fit our criteria for long-term value creation, we returned 38% of the cash to shareholders through regular dividends, special dividends and capital distributions. We used the remaining 29% to buy back Brown-Forman's stock at an average price of just under $40 per share. We believe this balance of cash deployment served the business and shareholders very well over the last decade.

Looking ahead, I believe our Brown-Forman 150 strategy will position the company to continue this track record of growth and returns. As part of that strategy, we have high aspirations for both the Jack Daniel's trademark and the rest of our portfolio. A particular note, we've learned a lot about the global whiskey business, primarily through our experience with Jack Daniel's, and we appreciate it for its global scale, premium nature, attractive margins and generally long runway for growth. Since we aspire to be one of the leading companies in this very attractive global category, we hope to apply our growing whiskey knowledge to other brands, whether it be a full strength Jack Daniel's line extension, such as Gentleman Jack or Tennessee Honey, and RTDs such as Jack & Cola, a totally different whiskey trademark, such as Woodford Reserve, Canadian Mist, Early Times, Old Forester or Collingwood, or a brand which today doesn't exist at Brown-Forman that could be either created or acquired and against which we can apply our brand-building skills, just as we did with Tennessee Honey over the last year. We're very bullish on the global whiskey category and the increasing role that American whiskeys are playing in it. We're also quite bullish on the valuable trademarks we own that play at the premium end of vodka, tequila and liqueurs. We believe they too, continue to offer super growth potential for Brown-Forman. In closing, let me congratulate our employees worldwide on a wonderful set of FY '12 results and thank them for the role they have played in positioning our company for much success in the years ahead. We're now happy to take any questions you might have.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Vivien Azer of Citigroup.

Vivien Azer

The first question has to do with industry growth trends and your expectations for FY '13. Are you expecting that this is going to be another year of market share gains? And if so, kind of order of magnitude?

Paul Varga

Well, for the industry, of course that's going to vary market by market. But as I was referencing in my comments, we've seen such nice momentum for the area where we have the greatest concentration, which is the whiskey, particularly the American whiskey business, and we've talked on several calls about the growing popularity of it and we would anticipate that for example, using the United States as one backdrop that we could look at, we would expect that the bourbon and American whiskey business to continue to grow share of what is a growing U.S. distilled spirits market. So we consider the momentum that exists in a key country like the United States to be at our backs and we don't see any reasons, at this stage, why that would cease.

Vivien Azer

And in Europe, you had mentioned that you expect your growth rates to slow. Do you expect the industry in Europe to be up next year?

Paul Varga

I'm actually – I think some of the numbers we've been seeing out of there, is it's been – they've been soft at the distilled spirits level. You can find pockets of categories that are doing better than others. But I mean, it's been – generally been, I mean, difficult flooding for the industry in many of those countries. That's why I think it's noteworthy how well Brown-Forman has continued to perform in Europe.

Vivien Azer

Absolutely, and to be sure, helped in part by some of the route-to-market changes you guys have done. Are there any new opportunities in terms of tweaking your route-to-market in the next year or 2?

Paul Varga

We are always looking at that, but as it relates to a fundamental shift like the one we made in Germany, for example, a couple of years ago, that has helped Brown-Forman's German business, or one that we announced down in, for example, Turkey back in the beginning of this calendar year, there's nothing that we have to talk about right now, as it relates to fundamental changes in the route-to-market that – we just don't have any information on that at this time.

Donald Berg

It's not to say there couldn't be some, Vivien. I mean, there are a couple of market contracts that are coming out, which is when you typically will start to look at them. But they're more in the back half of the fiscal year than the front half of the fiscal year.

Vivien Azer

Understood. And my last question has to do with the incremental CapEx that you've pointed to over the next 2 years. In terms of the amount of capacity that you're bringing online, what kind of percentage increase are we talking about?

Paul Varga

Percentages, let me think about it. I mean, we've averaged over the last many years, something in the like – the $50 million to $60 million CapEx range. I think, Don your comments were…

Vivien Azer

No, no, in terms of the incremental capacity, a production perspective. You made – you didn't do x number of cases now and 2 years from now, you'll do – you'll be able to do y number of cases?

Paul Varga

I see.

Donald Berg

Yes. It varies. So I mean, if you look at some of the distilling capacity that we're looking at, I mean, we're designing in the way that we can basically continue to expand in phases. And so I think in total, over the host of a number of years, you'd probably be looking at the ability to keep up with Jack Daniel's growth, I think is probably the best way to say it.

Paul Varga

It's very long-term volumetric growth rate. That's why we refer to it as the once-in-a-generational type investment.

Operator

Your next question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Mohsenian

So first, I just wanted to discuss the price increases in fiscal '13. It sounds like you're comfortable that consumers are returning to trade up a bit and your portfolio's brand equity justifies the price increases. But I also just wanted to get some more detail on what you're seeing here from a competitive standpoint and the competitive dynamics, as you look out over the next year here in the marketplace.

Paul Varga

Yes, I think, Dara, that part of it is influenced by wanting to position, particularly several of our brands, I mean, Jack Daniel's being one of them, in a – in the marketplace, at the right premium positions, which we consider to be super-premium position. I think those are things you're conscious of. We are very conscious of that, watching that over the last several years just because of the price sensitivity we were observing around the world. But if you just look at the premiumization trends, whether they're here in the U.S., or some of the consumer interest in the ever-more premium brands in emerging markets, I mean, we just want to make sure that Jack Daniel's against that backdrop, continues to be viewed for, as large and as successful it is, as a very special brand. So these are decisions you make along the way as well. So almost alongside the environment's receptiveness to it or our desire to build our margins, any of those other important considerations as well, there is that aspect of it too, that's influencing us.

Dara Mohsenian

Okay, and do you expect the pricing industry or your portfolio to move up relative to the category over the next year? And then also just over the last few months, can you describe the competitive environment and any changes you've seen in the U.S. and Europe, in particular?

Paul Varga

Yes, I mean, I think, Dara, as always, the answer on whether the premium position will improve. I think in some markets, you have to look at it as to where you're positioned in any point in time. I think, absolutely, our premium position will improve to the extent we go up, either faster or more, than some of our competition. And that, in some cases, will be the intent. We actually also think, that if you just look at this, maybe on a rolling 12 or 24-month basis, as to what the activity is out there in the marketplace as it relates to how much people are discounting, how many front-line FOB increases, where the shifts in the business are in terms of the retail outlets, what sizes are being sold, there are a lot of influences to the – what the consumers experience in terms of what they pay in the marketplace. But it continues to be an off-premise driven market and therefore, you do have much more sensitivity to price, and I just think the environment generally, has improved. And when you have the – when you compare it like this to last year, the last 2 years to the prior year or 2 years, and when you actually also think about the categories that we're competing in, the fact that it has so much momentum should give you encouragement as well. And a lot of that momentum is being generated in prices above some of our brands. So all of that is encouraging, I think. And so it adds up to us feeling better this year than we would have felt a year ago.

Dara Mohsenian

Okay, and then can you highlight if you're seeing any pressure in Western Europe post the quarter in May or June? Your business obviously seems to be doing pretty well, but have you seen any impact on the category itself or even your portfolio? And then on the other hand, it looks like we're off to a very good start in the U.S. this year in the alcohol category, particularly in the on-premise channel with the strong weather. Do you think you're seeing a more sustainable rebound in the U.S. consumer beyond that favorable weather? And your thoughts on the U.S. consumer?

Donald Berg

Dara, I'll start with Europe. I mean, I think most recently in Europe, we have, as Paul kind of alluded to earlier, we have been seeing spirits overall under I think some greater pressure. As far as our business goes, generally if you looked out over it, we have been taking share in most of the European markets. It's gotten a little bit noisy of late because of some of the price increases that we had already started implementing over there, particularly in the U.K. and France. And so, they're – in terms of the buy-ins that we were seeing and working through all those buy-ins, and then starting to see a reaction at the consumer level with new prices and what have you, it's kind of hard to see – penetrate through all of that, to see exactly how the brands are directly reacting with what's going on in the overall spirits market. But generally, what we've been seeing is similar to what we've been seeing more recently in terms of pressure on the spirits business, but more market share improvement for Brown-Forman.

Paul Varga

Yes, and by the way, those European price changes for us were associated with excise taxes. So those are very different consumer responses and retail responses you see there versus ones where we're fundamentally taking price on our own accord, and not associated with excise taxes. And shifting to the U.S., I mean, I can only cite through the syndicated data I have had a chance to look at, which is through about the end of our fiscal year, to be honest, and so – but all the signs that we've been talking about in that data continued on through that period. And I mean, the most encouraging number I saw that was just on a dollar basis is with the spirits business generally, seemed to advance on a dollar basis by about 50% [ph] for the last 12 months. And the – just using the bourbon category as a surrogate for the American whiskey, it was up, just shy of 7%. So I mean, that was a continuation of the momentum. Where we get really mixed reports on your reference to the on-premise, off-premise, we hear a lot of things anecdotally and observe some things that encourage us. Then you look at some of the reports, for example, the NABCA data, or something, for signs of that showing up and some of it is not being as reinforced. We also look at of course, the public company, casual dining reports, and the things they talked about. So we really see a mixed picture on that. And we see most of the growth continuing right now to be pushed along by the off-premise segment.

Operator

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

Judy Hong

First, just in terms of your margin outlook, so it sounds like you're saying high single-digit sales and high single-digit operating profit growth. I'm not sure you're embedding some sort of margin expansion. You've talked about, on the gross margin side, some benefit as you end the agency relationship, but can you just talk about what you're expecting on the commodity side? And then on the marketing line, I think the edge you had talked about, stepping up their spending pretty meaningfully. So just how you're thinking about marketing spending in fiscal 2013?

Donald Berg

So yes, so on the margin side, the wine agency business that we've talked about represents probably around a point improvement that we would anticipate seeing next year. And then with the price increases being ahead, what we would anticipate being cost increases, we should see a little bit of improvement there as well, as the price increases start to take their full effect through the fiscal year. On the spending, we've been historically very consistent about the spending behind our brands. I think you can continue to expect that next year in terms of our spending growth increasing, fairly much in line with what we're seeing in terms of sales growth increases.

Paul Varga

With – and probably A&P being a bit ahead of SG&A investment as it was in the FY '12 results.

Judy Hong

Okay, so that would imply the operating income growth exceeding the sales growth in 2011 – in 2013?

Donald Berg

Right now you have been pretty much – I mean, there's rounding…

Paul Varga

There's rounding. I think they're more in line, I think.

Donald Berg

But when you round it all, they're pretty close in line. But yes, you might see a little bit at the operating income line versus the sales line. But right now, it kind of all rounds to 9.

Paul Varga

And of course, it remains to be seen. I think – an important consideration is what sort of responses we get of course, to the new pricing that we're putting into the marketplace. And then you've got this, what I think is an important consideration for our company, which is the combination of the year 2 phenomenon for Jack Daniel's Tennessee Honey in the United States, recycling against such a successful introduction, potentially offset by the success we may be able to achieve by expanding it in the international markets.

Judy Hong

So can you give us some more color on that? Because clearly, you are going into other markets outside the U.S., and then you've got the on-premise expansion on Honey. Sort of sizing up that opportunity, phasing in terms of the expansion, why not go more aggressive and expanding in more – other markets? How are you thinking about just the phasing of the expansion?

Paul Varga

Well, I mean, first is that just the appreciation we have for any line extension we do on Jack Daniel's. Even though it's been very successful in the United States and it's the dynamics, particularly the flavored whiskey and flavored brown spirit expansion that was occurring in the United States' distilled spirit market, against which Jack Daniel's Honey entered, was a very important consideration for us. And then, when you begin to take it outside the United States, you want to see what other sources of growth exist for Tennessee

Honey's introduction. And with Jack Daniel's, we just always tend to go a bit slower. I think very appropriately so, because you want to learn market by market, what might work and where a new entrant like Tennessee Honey might actually source its volume. You want to pay great attention to the potential for cannibalization. I think by paying great attention to it in the United States, we actually struck a beautiful balance of the way we've entered the market and what we've been able to accomplish there, and we just want to do that everywhere we take it as we assess its potential. So I think there's a number of factors to consider. Actually, the number of markets we're going into around the world have – had been asking for Tennessee Honey for a while. So we know that there's a demand or call at least from our people, and from a lot of their customers, to try Jack Daniel's Tennessee Honey. So we're going to call this maybe a phased rollout, based on the learning we get, not first and foremost from the U.S. but also in the new markets we're entering.

Judy Hong

Okay, and then just lastly on Finlandia, you've seen the brand improving in terms of the trend in the last 2 or 3 quarters. I'm just wondering how you're thinking about that brand at this point, both internationally and then your effort to really expand the brand in the U.S. as well.

Donald Berg

So a lot of Finlandia's growth has been driven throughout the Central and Eastern European markets, in particularly Russia. Poland is its largest market. It, as a market overall, has continued to be a difficult market, generally. But Finlandia has been performing particularly well there. So we – from everything we've seen, we would anticipate seeing continued nice growth there. Russia is the one that was probably the big story this last year, and it was going against some pretty soft comps because it did suffer a little bit in the transition in our distribution change a year ago. But it's got some very nice momentum there. And we're very excited about what the possibilities are there. I think in the United States, our approach has really been more broadly based than just looking at Finlandia. There was quite a bit of innovation that was brought out, last year and the last couple of years, with the Little Black Dress vodka and with the Chambord Vodka, and we're continuing to work with Finlandia both in terms of its quality positioning but also through some of the flavor profiles there that we're developing. And so I would say that in the U.S., we're really looking at a more broader-based vodka category approach, than just kind of looking at specifically through the lens of just Finlandia.

Paul Varga

Judy, I would add, we do have an enormous amount of innovation going on around Finlandia and the vodka category right now. It's just a – it's a pretty exciting time at the company. Within Finlandia, at site, we've launched a ready-to-drink format in Mexico in the past 12 months, Finlandia Frost, which we've – are pretty encouraged by its year one results. We've just launched, in the first part of this calendar year in Poland, a new flavor extension. That's a spiced vodka, which we have some hopes for. Globally, we've rolled out what we consider to be an improved package for Finlandia that has made its way into distribution, solely around the world, which we think can contribute positively to some of the sales trends, and even the very super-premium entry into a select number of markets with the brand, Finlandia platinum. So there's a number of different things we've been doing to round out the overall Finlandia brand approach, and then Don mentioned a number of these other ones, which also include a really little brand that we bought in the past year, Maximus, which we've restaged for launch here in – relaunch in FY '13 over in Poland that we hope will give us a boost in that country as well.

Operator

Your next question comes from the line of Lauren Torres of HSBC.

Lauren Torres

I think you did mention that you expect to see your price increases to cover your cost increases. Just trying to get some clarity on what you are seeing with respect to whether it be ingredient, packaging or fuel cost, if you have relatively good visibility that with the pricing actions you have in place, that you could offset all of these increases, particularly if they get stronger or they start to increase more as the year progresses?

Donald Berg

Yes, I think right now, our view on a lot of the input costs, are they'll continue to increase, but our expectation is just that they would increase in a lesser rate than what we saw throughout fiscal 2012. And then as we look at those expectations compared to our planned price increases, that the price increases would more than cover what we're expecting in terms of the inflationary effects on the input cost.

Lauren Torres

And any threat to this year with respect to excise tax? Because I know you've faced some of that over the last few years. Is there anything within the next year that's of concern on the excise tax side?

Donald Berg

Well, I mean, you're always concerned on the excise tax side. In the U.S., if you want to start there, anytime anyone starts thinking about any kind of broad-based tax reform or the need for additional revenues, for the most part, it hasn't been brought up as part of that dialogue. But you're always vigilant about watching it and doing what you can to ensure that all of the great work that the industry has been doing from a responsibility standpoint, the people recognize it, and that an excise tax increase in the U.S. is really a tax on the overall hospitality industry. And I think those messages have really been quite effective up to now, in really kind of keeping excise tax increases in the U.S. at bay.

But as governments get hungry, you can never just be quite sure. Outside the U.S., and we've seen a number of markets over the last several years where excise taxes have come in to play, most recently in the U.K. and France. Australia automatically takes excise tax increases along the lines of inflation twice a year. We'll continue to see that. And so, it's out there. But I think as we sit here looking out today, we don't see anything that would be particularly new or different from just kind of the general level or atmosphere that we've been seeing over the last couple of years.

Lauren Torres

Okay, and if I could just lastly ask, again on the pricing side, and I guess as a follow-up to comments you made to a previous question, have you seen, with respect to your competitors' start, I mean, is this something that we need to wait closer to the head of the summer to see most of the bigger players take these increases? Or you have good confidence now going into the summer that it's going to be an industry-wide effort on the pricing side?

Donald Berg

Yes, I think, kind of coming back to a little bit of what we talked about before. I mean, if you think about in the U.S., and again looking at some of the syndicated data, you have seen some improvement in the price mix. I think earlier in this calendar year, we were thinking that some of the pricing improvement we were seeing, we're really more less promotional and what have you, as opposed to at the shelf. Anecdotally, we're starting to hear some things at the shelf. But my guess is we're going to be seeing more of it later into the summer than what you're currently seeing right now.

Paul Varga

I also would add that this stuff is always very dependent on some combination of – I think you asked your question along the lines of, is it industry-wide, or will we see all the companies. It literally – it's just worth always remembering this. It happens brand by brand and then actually in some categories, they have better opportunity to increase prices than other categories. Some countries, because of the skew of there – I always feel like it's influenced greatly by the skew of the business toward either the on or the off-premise. All of those have an influence on the degree to which people are willing to take price and the receptiveness that the market has to it. But I mean, I would say that worldwide, the whiskey category broadly, would have more pricing opportunity these days as we view it in the vodka category. It's just a generalization. I mean, it's just something I observed. And markets that have a very strong skew of the business to the on-premise have less price sensitivity generally, than those that have enormous off-premise businesses. So you're going to want to look at it market by market, category by category. It really helps when you have a brand like we do, like Jack Daniel's that has the consumer and retail strength that it does, to be able to act almost in some regards as a leader, as it relates to pricing.

Operator

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

Timothy Ramey

Would you just remind me of the TTB regulation? For you to label something Tennessee Whiskey, has it got to be 100% Tennessee Whiskey? Or is there some allowance for blend within it?

Paul Varga

No, there's a genuine standard of identity associated with Tennessee Whiskey that is actually – was very smart on Mr. Jack Daniel's part years ago to make it – the thing that it hinges on is the charcoal mellowing process that is associated very much with the Tennessee Whiskey making, in that Tennessee Whiskey method. So, yes, there's a very definitive standard of identity for Tennessee Whiskey.

Timothy Ramey

Okay, and it's 100% standard effective?

Paul Varga

Yes.

Timothy Ramey

So, I mean, that does really speak to you heat tabs and barrel warehouses. I suppose you can't just go out into the market and fire a blend. And it's for only a year or 18 months into this phenomenon on whiskey but clearly, the supply chain wasn't built to handle the rates of growth it would have enjoyed. You're going to moderate that a little bit by taking pricing. But just from a big picture standpoint, could you give us some thoughts on where you think we are in terms of that big picture supply-demand balance? What's in the warehouses and what can come to market versus where the demand goes?

Paul Varga

Sure, you had a handful of observations in there. I think the – as it relates to the last one, of course we watch all of these closely. But our current plans estimate that supplies will be adequate to meet our forecast for demand. In this year, of course, in almost every year, Tim, the demand forecast is always the uncertain variable in that equation. Things we'll be paying particular attention to in FY '13 will be things we've already mentioned, the marketplace's reaction to our price increases, but also just this – the reception to the global expansion of Tennessee Honey. Both of those will naturally influence the aggregate forecasted demand for Jack Daniel's. But the things we announced this morning in Don's commentary about expanding generally so we can meet the long-term hopes and expectations we've got for the Jack Daniel's brand, I think are very encouraging, as it relates to just the continuing growth runway we see for Jack and reinforced even more so by the fact that, that of the stuff I talked about, which is how well the company and the brand held up during the difficult times in the last 5 years and the responsiveness of the line extension activity. One thing we – I mean, I think is a really unique potential advantage of American whiskies is that when you think about the 2 axes, one being price and one being flavor, that I really do observe around the world that these American whiskies span and have the ability to extend themselves up and down a price spectrum so you can get premiumization, for example, through super-premium and ultra-premium line extensions. Additionally, and unlike some other whiskeys, is – what we've observed is that than on the RTD's side and on the flavored whiskey side, in many ways, the American whiskey taste profile lends itself very well to mixability [ph]. So in my view, it opens up all kinds of expansion possibilities. If you just look back over our last 5 years of performance, at various times we've been referencing the wonderful growth that Gentleman Jack could be in this past year, the contributions from Tennessee Honey, for a few years in there referencing Australia and the global expansion of our RTDs, it's been a pretty comprehensive trademark performance. And all the while, Jack Daniel's Black Label continuing to march on. So all of that is really the encouraging point that we're making about the excitement around the American whiskey and us owning the leading brand trademark in it. So I think it adds up to why would you expand? To accommodate more of them.

Operator

Your next question comes from Ian Shackleton of Nomura.

Ian Shackleton

So my first question was that you set quite a wide EPS range and I know you often do this at the beginning of the year. But it is a wide range. And it gives us quite a precise guidance of the sales and EBIT. And I guess the question really around that is are you building quite a cushion there for the FX moves? Because frankly, if you're going to meet your sales and the EBIT guidance, you got to be at the top end of your current range and not the bottom end, it strikes me, currency being where it is at the moment.

Donald Berg

Yes, Ian, we have this discussion at the beginning of every fiscal year in terms of how broadly we have to set that range and we went more broadly, kind of in the 2009 time-frame, just because of all the uncertainty that we saw at the marketplace. And I think as we sat here this year looking out at fiscal 2013, with everything that was going on in the eurozone and decide, the importance of that area to our business and then seeing more recently what has been going on in terms of increased volatility in currencies, and not just the euro, but also with the pound and the Aussie dollar, we just felt that it was prudent for us, at this point in time at the beginning of our fiscal year, to continue to take a little bit more of a cautious approach to the guidance. Plus, along the lines with some of the things we talked about earlier in terms of – after going for a number of years with no price increases, coming out with the price increases, and not really being entirely sure how all that's going to be received in the marketplace, so you have all of that. Then you also, coming into kind of the second year of Honey and the importance of that had to our business last year and while overall, we anticipate that full year, we'll see growth on that brand, it's a little bit uncharted territory at this juncture.

Ian Shackleton

Okay, just coming back on the pricing comments you've made before, I mean, are there certain categories where you accept it's going to be difficult for you to move price, and I guess we think about the vodka category in the U.S.? Or Are you more optimistically able to move really across the board now?

Paul Varga

As I'd said, it's more market by market. I mean, like for example, we find that in a place like Poland right now, where the – where we have a great position in the vodka market, but it's still very competitive. And so our confidence to move – I'll just use this as an example, on Jack Daniel's for example, in the United States relative to Finlandia in Poland, we would have higher comps and it's just because of the competitive dynamics. So it isn't a wholesale comment that every brand and every market should have almost a blind constant to move. And so we try not to make blanket statements like that and decisions along those lines. We really want our people studying it closely and making the right judgments. And at times, we make those incorrectly too, of course. I mean, you might hope that the market can bear some of it. We've actually, in the past few years, had these tests where we've watched where we've taken the opportunity to either hold price or do some promotional pricing that hasn't stimulated the response we wanted. And then as accordingly, you study that, adjust and you don't do it anymore. Or you try something different. And so I think the pricing volume equation at Brown-Forman is probably no different than a lot of other companies who are trying to figure this out as you go along and you look at a lot of factors. But there's just no doubt that for the largest bulk of our business, which is in – and behind Jack Daniel's and our whiskey business, that our confidence is better today in a handful of markets, for sure, and in many markets, just based on the momentums we've seen building over the last 24 months.

Ian Shackleton

And just one final question, that the release with the – to the dispute settlement, what are thinking up to as to which market that is hit. Can you give a little bit more clarity on that? And my view is, does this just really affect anything going forward, this is really just updating the historic numbers for more like-for-like basis, is that correct?

Donald Berg

Yes. I mean, it was just a one-off issue related to a customs item. And it wasn't in fiscal – it's really a comparison issue. It was in fiscal 2011, not fiscal 2012.

Ian Shackleton

Okay, so there's no impact when we think about FY '13 going forward, is there?

Donald Berg

Yes, right. No.

Operator

Your next question comes from Thomas Russo of Gardner Russo & Gardner.

Thomas Russo

For Don. Don, when you talked about the ForEx impact, to what extent are you modeling in any sort of pressure on retail price and local markets, as the value of your products in markets where the currency weakens is higher by virtue of just the currency loan? Or is it mainly the translation effect that you bring back when you say there's a $0.17 per share impact? Is it mainly translations? Or are you actually building in some question about affordability?

Donald Berg

No, it's all translation.

Thomas Russo

Okay, and then Don, when you talk about the gross margin and you made the observation that you invested when the consumer went off-premise in packaging and then sort of the promotional stuff that has shelf impact and that burdened gross margin, to what extent does the improvement in gross margin that you forecast, a bit reflect the shift back from packaging towards the A&P in terms of your product investment?

Donald Berg

Yes, it's in there a little bit. But in there is also – you're seeing it showing up there in the A&P line. And that's mostly around the value-added packaging side of it, that where we're reducing value added packaging next year. To the extent that we saw additional increases in our cost of goods as a result of improved packaging, which can tend to have increased model cost and what have you, those are pretty much – continue to be built in the cost of goods line. And for the most part, for most of those package changes now, there – you pretty much have a good year-over-year comparison.

Paul Varga

If you say so, yes.

Thomas Russo

Okay, good. And then Paul, to what extent has age started to play a role in your premiumization, and how are you positioned in the Tennessee market for offering increasing ages to consumers who seem willing to follow that variable up in price as much as they seem to will in the scotch whiskey category?

Paul Varga

Maybe a little bit but it hasn't really been – Tom, as I think – you may have heard from us before, that the American whiskey-making traditions, I mean, just because of climate and a number of the factoring in the new barrel versus the used barrel, I mean, they just really haven't been an age-denominated business proposition. For most of the bourbons or American whiskeys, there are a lot, of course, as you cite, out in, particularly in the international markets, where the age stratification can be important. We found other ways to do it. I mean, I found there's actually – because they're one of our largest global whiskey competitors, they've chosen to do it more by color. We've always done it in a variety of different ways. And so, we try actually in our trade story and our conversations with people, it's an ongoing education for us to talk about how we bottled to, what we call maturities. So we want the appropriate maturity in the bottle and not necessarily some definitive age. And so we try and we use those techniques to market our American whiskey brands relative to – in most instances, it's Scotch that are the brands that are using the age statements. But a lot of them, a lot of non-American whiskeys will use it. But I mean, we found, over the passage of time, as you can see from Jack Daniel's, which isn't an age-denominated product, it's not driven by that, that you can be wildly successful if you focus on the right things.

Donald Berg

Yes, Paul, actually I've talked a little bit about Woodford Reserve's Double Oaked. It's a creative way of premiumizing. I mean, I don't know if you've seen it yet, Tom, or not. It's a line extension off of Woodford Reserve, where basically we take a fully mature whiskey and then put it back into a new barrel, again for a few months of additional aging. And it just gives us some really interesting character and smoothness, and it's still very early in its initial launch. But the kind of anecdotal things that you hear, it's really quite encouraging in terms of the consumer response that we're hearing. It's just one example of how you can be creative with – in the bourbon category.

Paul Varga

Yes, the other emerging trend I would observe amongst particularly a number of the Scotch competition out there, is less of a reliance on definitive age statements. If you look at particularly some channels like travel, retail, this could be influenced in a bit by supply limitations in some regard. But you're just seeing a lot more branding and marketing on some of the SKUs and expressions that had very price points that really aren't marketed on the basis of an age statement. So we're even seeing a lot of the brands in categories that traditionally have used it – back off of it a little bit.

Operator

There are no further questions at this time. Presenters, do you have any closing remarks?

Jason Koval

Thank you, Tiffany. That concludes our fourth quarter earnings call. Thank you for joining us today and if you have any additional questions, please feel free to reach out to us.

Paul Varga

Thank you, all.

Donald Berg

Thank you.

Operator

This concludes today's conference call. You may now disconnect.