Brown-Forman Corporation, Q3 2019, Earnings Call 2019-03-06

Presentation

Operator

Good morning. My name is Dorothy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Brown-Forman Third Quarter Fiscal 2019 Conference Call. **— *Operator Instructions* —**

I would now like to turn the call over to Jay Koval, Vice President of Investor Relations. Sir, you may begin.

Jason Koval

Thanks, Dorothy, and good morning, everyone. I want to thank you for joining us for Brown-Forman's Third Quarter 2019 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 2019, 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 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, 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 results of operations are contained in the press release and investor presentation.

So with that, I'll pass the call over to Lawson.

Lawson Whiting

All right. Well, thanks, Jay, and good morning, everyone. Overall, I'm pleased with the third quarter and the year-to-date results that we released this morning. In particular, we're focused on maintaining our top line momentum around the world. Underlying net sales are largely where we expected them to be at the beginning of the fiscal year, growing about 6% after adjusting for the impact for tariffs. As a reminder, we chose to absorb the majority of the tariffs this fiscal year in order to maintain that solid business momentum. And Jane's going to talk a lot more about that in just a few minutes.

As a result, though, we are on track for another year of strong, sustained top line growth. Given recent trends and our expectations for a relatively strong fourth quarter, we reaffirmed our fiscal 2019 outlook of 6% to 7% underlying net sales growth and 4% to 6% operating income growth. Importantly, these estimates have been unchanged since Q1. So as I said, Jane will run through the financials in more detail, but before she does, I'd like to take a few minutes this morning to talk about the ongoing evolution of both our geographic and our brand growth drivers and really how they've changed over the past decade or 2.

For many years, Brown-Forman's growth was powered by Jack Daniel's Tennessee Whiskey in the United States. But over the last decade, we've invested significantly in the international expansion of the company as all of you are very well aware. We broadened the portfolio within the Jack Daniel's family of brands. We've reshaped the rest of the portfolio to get out of weaker businesses and invested in faster-growing premium spirits categories. And we've put significantly more resources to organically accelerate the growth behind 2 of the fastest-growing spirits categories, bourbon and tequila. This increased – increasingly balanced approach has been an integral driver of the company's ability to deliver consistently high rates of growth with limited volatility.

So let me use the U.S. as an example, where we've really been focused on portfolio diversification. We're seeing an increasing share of growth coming from other brands in our portfolio beyond just Jack Daniel's Tennessee Whiskey. For example, Gentleman Jack, Jack Daniel's Single Barrel, Jack Daniel's Tennessee – and Jack Daniel's Tennessee Rye continue to grow nicely and provide margin benefits to the trademark. Jack Daniel's Tennessee Honey now – is now about 750,000 cases in the U.S. and Jack Daniel's Tennessee Fire is roughly 400,000 cases, and both continue to grow.

Additionally, we've been investing in what is now a leading portfolio of bourbon and tequila brands. So Woodford Reserve and the Old Forester trademarks have been registering impressive gains in the bourbon category over the last several years approaching 1 million cases between the 2 brands.

Woodford is on track to be the single largest contributor to growth in the U.S. market this fiscal year. The brand is simply on fire and has a long runway ahead of it.

Old Forester continues to present itself as a leader in American whiskey. The brand has really gained a reputation for quality and innovation with a balance of its core 86 and 100 Proof expressions, the popularity of the Whiskey Row series and the annual release of the acclaimed Birthday Bourbon. The opening of the Old Forester homeplace on Louisville's Main Street and the recent release of good Old Forester Rye contributed to its position as a real leader in the renaissance of American whiskey.

We're also seeing very nice growth in our tequila portfolio in the U.S. with Herradura over 200,000 cases now at a $40 price point. El Jimador was a 160,000-case brand when we purchased the company 12 years ago, and today, it's over 600,000 cases in the United States. These brands are the most material drivers of our U.S. growth, but we're also hard at work on developing the growth drivers for the next decade.

The last summer, we created an emerging brands team in the U.S. to focus on some of our high-end super-premium brands, including BenRiach, GlenDronach Single Malt Scotchs and Slane Irish whiskey. We also put Herradura and Old Forester into this group. And I'm pleased to say that we have accelerated the growth rate on every one of these brands over the past year. The team has really done a fantastic job in making – in growing these brands a bit faster and making them into the brands where we will see a meaningful impact in the future. We believe we've positioned these burgeoning brands to really become the future growth drivers in the highly profitable yet competitive U.S. spirits market.

In terms of our increasing geographic breadth, 30 years ago, roughly 20% of Jack Daniel's Tennessee Whiskey volumes were from outside the U.S. So it was sort of an 80% U.S., 20% international. Today, it's flipped where over 60% of the volumes are international and only 40% inside the United States. And over the last decade, 80% of its incremental growth has come from markets outside of the U.S., split evenly between developed international and emerging markets. Our developed international markets are performing well, growing comfortably in the mid-single-digit range in line with our historic rates of growth.

Europe and Australia remain solid contributors as we have been steadily investing in our route-to-consumer capabilities in markets that many peers view as mature, including most recently Spain. We're also putting more focused resources on building our super-premium portfolio in Europe. Although much smaller than the emerging brands team in the U.S., the idea is the same: Invest additional resources to focus on super-premium brands that will fuel the next generation of growth. For Europe, that is primarily about American whiskey leadership, led by Gentleman Jack and Woodford Reserve. And while tariffs complicate our near-term American whiskey strategy, we'll continue to invest in momentum against our medium and – medium- to long-term goals in the developed world.

Emerging markets and Travel Retail have been delivering even higher rates of growth as we are in the early stages of building our brands in these major population centers of the world, including outstanding results over the last few years in both Mexico and Brazil. And at approximately 20% of total company revenues, we believe these markets are rich with opportunity for our brand portfolio, and over time, additional route-to-market investments. This is also an area where we under-index relative to our big competitors. So we also really believe that we've got a long runway ahead.

The key takeaway is that we've been expanding the geographic and portfolio drivers of our growth and diversifying our revenue base in categories that we believe have the best long-term global growth potential.

At our Investor Day this past December, we shared with you our strategic framework. If you recall, the framework covered 4 focus areas, including portfolio, geography, investment and people. We believe that through executing against this framework, we'll extend our leadership of premium American whiskey around the world and continue our track record of consistently delivering profitable growth. While tariffs remain a near-term challenge on American whiskey exports, we'll weather the storm as we have so many other challenges over the last 150 years as we look to create value for our shareholders.

Now I'm going to turn the call over to Jane for review of the financials.

Jane Morreau

Okay. Thanks, Lawson, and good morning, everyone. I plan on covering 3 main areas today during my prepared remarks. First, I will review our year-to-date results through the third quarter; second, I'm going to discuss our full year fiscal 2019 outlook, which we affirmed this morning; and third, I will cover our approach to capital allocation. After I complete my prepared remarks, we'll open the call up to Q&A.

As Lawson said, we delivered solid results during the first 9 months of the year despite the substantial burden that tariffs had on our business. Our underlying net sales grew over 5% through the first 3 quarters of the fiscal year. Now the noise around buy-ins and givebacks associated with tariff inventories at the retail level that we discussed on our Q1 and Q2 earnings call is behind us. However, we began to see the cost of tariffs hit not just our cost of sales and gross margins but also our underlying net sales growth in the quarter and year-to-date.

In markets where we own inventory and sell direct, tariff costs flow through our P&L as higher cost of sales. This treatment represents the majority of our tariff costs. However, in certain markets where we sell through a distributor, the effect shows up in our net sales as we lower net prices to compensate for the incremental tariff costs that our partners are incurring. We estimate that these price adjustments reduce our year-to-date underlying net sales growth by approximately 1 percentage point. Thus, our underlying net sales growth of 6% after adjusting for tariffs is largely in line with what we expected at the beginning of the year. A very solid performance against last year's 7% growth in the first 9 months, which were not affected by tariffs.

While I'm on the topic of tariffs. We continue to work with our government affairs partners and industry associations such as DISCUS to resolve the tariff situation. The tariffs remain in place. They will have an estimated annualized cost to our company before taking into account any mitigation actions of roughly $125 million. As we have discussed previously, we have taken actions to mitigate roughly half of the tariff impact we expect in fiscal 2019. As a reminder, incremental tariff costs began to impact our operating results beginning in October 2018. So we anticipate that we will have about 7 months of tariff drag on our results this fiscal year.

Specific to our third quarter, underlying net sales grew 4% and were negatively impacted by about 1 percentage point due to tariff-related pricing actions. Excluding this effect, our underlying net sales grew over 5% for the quarter.

Foreign exchange continued to weigh heavily on the top and bottom line results through the first 9 months of the fiscal year as the U.S. dollar has appreciated against most major currencies over the last year. FX impacted both our reported and – reported net sales and operating income growth by roughly 3 percentage points. When combined with the slight year-to-date increase in distributor inventory levels, we reported net sales grew 3% and reported operating income increased 2%.

Revenue growth was well balanced across our portfolio. Performance was led by the 4% underlying net sales growth across the Jack Daniel's family of brands. Tariff-related pricing actions reduced the Family of Brands underlying net sales growth by 1 percentage point from over 5. Our premium bourbons including Old Forester and Woodford Reserve grew underlying net sales 24%. And our tequilas, including Herradura, el Jimador and New Mix RTDs, grew underlying net sales in aggregate of 13%.

Now moving down the P&L to our gross margins. Year-to-date gross margins declined 190 basis points year-over-year. The impact absorbing the majority of the tariff costs accounted for roughly 2/3 of this decline while higher input costs for both wood and agave drove the remainder of the decrease.

Gross margin compression was partially offset by the continued tight management of SG&A spend. Underlying SG&A declined 2% due in part to lower personnel costs, including compensation-related expenses.

I want to take a moment and point out that we expect fiscal 2019 will remark the fifth straight year of SG&A leverage we delivered via our efficiency and productivity initiatives. It's important to note that while we leverage prior investments such as in route-to-consumers, we've also increased our SG&A in markets such as France and Spain as well as established the emerging brands groups in the U.S.

Now over the Spain period, we've heightened our focus behind building our brands and consistently reallocated from SG&A to increased investments behind the consumer growing our underlying A&P roughly in line with our sales.

Our underlying A&P investment grew 3% year-to-date as reinvestment in our American whiskey brands, including the first year of our Woodford Reserve, Kentucky Derby sponsorship, Jack Daniel's Tennessee Whiskey and the new Old Forester hone place in distillery. Now pulling it all together, we grew underlying operating income 4%. Higher operating income coupled with a significant reduction in our effective tax rate resulting from last year's Tax Act more than offset higher interest expense and a pension settlement charge and helped power the 12% EPS growth to $1.40 per share through the first 9 months of this year.

Now let me move on to my second topic. And I'll share a little bit more color on our reaffirmed outlook for fiscal 2019. Given our year-to-date results, our improving recent takeaway trends and easing comparisons in our fourth quarter, we remain on track to deliver another year of strong, underlying net sales growth in the range of 6% to 7%. Our trends outside the U.S. remain healthy, and in the U.S., we are seeing encouraging trends in the recent takeaway data that points to further acceleration in our business from the year-to-date underlying net sales growth of 4%. As we discussed on our second quarter call, our brand activation and promotional periods were back-half weighted. Combined with the strong execution by our sales team and distributor partners, we have seen a meaningful acceleration in our U.S. business over the first 9 months from 2% underlying net sales growth in Q1, 3% in Q2 and 5% in the most recent quarter. We expect that this momentum will continue as we move into fiscal ’20.

Looking at our U.S. business over a longer period, our recent mid-single-digit rates of value growth are in line with our average growth rates over the last 5 years. We’re very pleased with our consistency and sustained solid growth in this important market, which is also in line with TDS growth over that same period. As a reminder, top line comparisons for the company softened from 7% underlying net sales growth delivered during the first 9 months of fiscal 2018 to 4.5% in the fourth quarter. And comparisons or even more dramatic on the bottom line, where year-to-date underlying operating income grew 11% during the first 9 months of fiscal 2018 and then declined 4% in the fourth quarter. Also recall, our reported SG&A in the fourth quarter of last year included the $70 million contribution to create a charitable foundation.

We anticipate gross profit will remain under pressure in Q4, primarily due to tariff and cost of sales inflation on wood and agave. As a result, we anticipate our full year gross margins will decline more than 200 basis points in fiscal 2019. Given the expectations for modest SG&A declines for the full fiscal year and solid investment in A&P, we continue to expect our underlying operating income will grow in the 4% to 6% range and earnings per share to increase 11% to 18% to $1.65 to $1.75. This outlook assumes that tariffs remain in effect throughout the remainder of fiscal 2019.

Now let me move on to my third and final topic today. A quick discussion on our capital allocation. As you know, the consistency of our revenue growth and efficiency of our business model allows us to generate strong and growing free cash flow. And over many years, we have followed a systematic approach to allocating this cash. First on our list is appropriate reinvestment back into the business to meet future anticipated demand. Second is growing our cash dividends. And third, in the absence of meaningful M&A opportunities, we look to return excess cash through special dividends and share buybacks.

Looking over our past 12 months, we've returned an aggregate of $1 billion to our shareholders. At the same time, we've continued to invest behind our business, expanded our production capabilities, leveraged technology for cost savings and revenue growth initiatives, increased whiskey inventories to meet future growth expectations, fully funded our employees pension program and established a charitable foundation for the communities where our employees live and work. This disciplined approach to capital allocation combined with our track record of delivering sustained top line growth in the 6% range have been key drivers of our value creation equation for our shareholders. The consistency of our revenue delivery over the last 10 years can be attributed to Brown-Forman's brand building model and the company's early success at developing our trademarks in new markets around the world. While we have been successfully navigating our near-term results through the challenging world of tariffs, we manage our business for the long term. Strong support from our shareholders, including the Brown family, enable these time horizons, which is essential to a company that derives the majority of its revenue from aged spirits. We believe our portfolio of premium American whiskey brands is second to none and position us well to continue creating value for our shareholders.

And with that, that wraps up our prepared remarks. Dorothy, go ahead and open up the call for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Robert Ottenstein with Evercore.

Eric Serotta

It's Eric Serotta on line for Robert. My main question was on Travel Retail. Looks like there was a fairly dramatic slowdown in the third quarter with bringing your year-to-date up 6% or so. Just wondering if you could give some color behind what drove that? And if you could remind us how your Global Travel Retail business splits up by major regions and what the trends have been there?

Jane Morreau

Sure. You're exactly right. We did see some slowdown in our third quarter. Now, as we've been communicating all year about our Travel Retail business, it started off quite strong in our first quarter, over 20%, as I recall, and has been steadily coming down, and that just simply represents some noise in the business. What I would say noise is buying patterns with a handful of customers and some actions actually we've taken related to a customer that are disrupting the results. And actually, I suspect that noise might continue a bit more into Q4, but pulling back out of all the noise that's happened in this year, the business remains fundamentally healthy. Travel trends continue. The business is strong there for us. We got very solid growing business with our Woodford Reserve and Herradura business, nice innovation going in with Jack Daniel's Bottled-in-Bond and Ryes and our Single Malt. So fundamentally, what I think you're seeing in this year's numbers is nothing but some timing of buying patterns and so forth that I think will continue for the balance of the year, but not to be overread, I think our business in Travel Retail remains solid, probably in the mid-single-digit type growth area.

Eric Serotta

Great. And just as a reminder, how does your business split out geographically within Travel Retail?

Jane Morreau

Yes. It's about 1/3 in Americas, 1/3 in Europe and 1/3 in Asia.

Operator

Your next question comes from the line of Tim Ramey with Pivotal Research.

Timothy Ramey

I was struck by the numbers that you gave on the impact of the tariffs and then the mitigation effects. And I wasn't quite sure how to interpret it. So I think you said tariffs only impacted 7 months of the year. I assume that the major number was on annualized basis rather than just 7 months. And would you argue that you have mitigated roughly 50% on a go-forward basis?

Jane Morreau

Yes. So Tim, the number that I noted in my prepared remarks of $125 million was an annualized cost of tariffs alone, just themselves. So that was before any mitigation. And for this year, the number is somewhere within $70 million to $75 million of which we've mitigated half of that this fiscal year. We're in the process of our planning for next fiscal year, assuming tariffs remain. And so another $45 million to $50 million before any mitigation. We're working on mitigations as it relates to that now. So does that clarify your number?

Timothy Ramey

It does.

Operator

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

Judy Hong

Jane, just one quick clarification. The impact – the 1% impact on – in net sales in the quarter related to the lower pricing to the distributors. I presume that's going to stay in place until the tariff impact has left. Is that the right way to think about that impact?

Jane Morreau

Well, if you – we expect about 1% impact for a year as it relates to that. Now if tariffs stay in place forever, let's hope not, but if they stay in place next year, we've taken the vast majority of the impact to our sales line this year already. So meaning this: When you start cycling against next year, you're not going to see as large of impact on the sales line.

Judy Hong

Okay. Got it. I guess, my broader question is just in terms of your advertising spending. Number one, just as it relates to your guidance, when you say it will grow in line with your sales growth this year, I just want to confirm that's in line with your underlying net sales growth, not your reported net sales growth? I think the language has changed a bit over the course of the year. So I just wanted to confirm that, that's the case. And then, I guess, more broadly, it seems like many of your competitors are actually raising your advertising spending as a percent of sales, particularly in the U.S. market. And I guess, I just wanted to get a sense of your spend level versus your competitors. When you kind of look at your market share performance in the U.S., I think the total sales growth got better, but category also improved, so just in thinking about your spending level with kind of the market share losses, particularly around the Jack brand continuing to see some softness there?

Lawson Whiting

Yes. Judy, let me take a stab at it. I mean, I think if you step back over, I think we've looked at the 5-year, our A&P numbers and our underlying net sales are about the same. And that's a pattern we expect to continue for the foreseeable future. I mean, that's something we're pretty comfortable with. And as I and Jane has referred to it, some of that is being funded as we continue to hold SG&A much tighter so that we can reallocate some of the – what would have been the SG&A costs into more consumer-facing program. So now, year-to-date, underlying is up 3%. We said we'd be roughly in line with sales for the full year, which would mean the fourth quarter is going to be healthy. But we – as far as relative to the competitive set and things that I get, that's obviously been a factor for a long, long time. A lot of that is driven by the efficiency, I mean, I think you know this, the efficiency of the Jack Daniel's brand itself. So when you've got one that is such a big percentage of a company and it's such a big brand in and of itself, you get efficiencies from that. And so we still feel pretty comfortable that, that's a sustainable business model where we sales – that we get enough leverage, now put tariffs aside in that conversation, that we can get some leverage out of SG&A and continue to grow operating income at a rate higher than sales. But obviously, in the middle of this stub period we're in here with tariffs, that's not going to happen.

Jane Morreau

Judy, I thought I might just build on a little bit to what Lawson was referring to is your question on the competitive set. We are – we clearly think of A&P and SG&A together. Think about some of the things we've done as it relates to route-to-consumers that clearly show up in SG&A. We think that's building our portfolio overseas. Think about the emerging brands group that we invested in this year, of course, that's building speed on the streets that are building our brands' on-premise location. And so we look many times at the 2 combined, if you will. The new Old Forester homeplace and distillery is an example, which show up in our SG&A, not in our A&P spend. And so there's probably differences there too when you compare ourselves to the competitors. And so we just want to look at it holistically when we think about how we invest behind our business.

Operator

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

Gerald Pascarelli MR

This is Gerald Pascarelli on for Vivien. So my question is on inventory and pricing outlook. Kind of given where we are in the bourbon cycle, there's been craft bourbon coming online, it's been laid down and aged for 4-plus years now, which should be hitting the market. Can you speak to your view of current industry inventory levels? And whether there is a risk of oversupply that will put pressure on the U.S. – on U.S. pricing going forward?

Lawson Whiting

Yes, I'll take it. At least, I'll start it. First of all, as far as industry supply numbers, I actually, I think, we would look at the big Kentucky bourbon producers as pretty significant increases in supply. I'm actually much less worried about the other 49 states or 48 states and those craft suppliers because in aggregate, it's really not all that significant. Although I must say, recent – the most recent volume numbers that you would see in Nielsen for the bourbon market sort of in that 8% to 9% range. So that's just obviously in the U.S.

Jane Morreau

That's U.S. Broadly, it's more like 6%.

Lawson Whiting

So we feel pretty – I mean, those – that's kind of numbers that are awfully strong and shouldn't be outstripping supply. So the situation seems to be in pretty good shape, I think. We're looking at it obviously to – I do think another part of it is, we, along with some of the other larger competitors, have a very obviously large global distribution network that many of, particularly the craft players, obviously don't have, but many other smaller bourbon producers here even in Kentucky don't have. So we do have that advantage, too, that we can continue to grow. And when we've talked about leadership in American whiskey, we're going to continue to grow and expand our bourbon and our Tennessee Whiskey franchise outside of the U.S.

Operator

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

Amit Sharma

Jane, I got a question – a couple of questions for you. One, it was a very helpful conversation on G&A, SG&A, and then how you see it together, right? And that makes sense. But if you really just look at the SG&A part of it, we did see some flex in the quarter in this year. Can you talk about like where is that flex coming from? And as you look to next year, is there an opportunity to do – continue to do more? And then second, on the gross margin line, obviously, we had 200 basis point contraction this year, but agave shows that prices are still high. I know it's a little bit early for 2020, but as you look through, do you expect that pressure to continue and exceed as well?

Jane Morreau

Okay. Sure. Let me see if I can take this. You're right. There was a bit more flex in the quarter as it related to SG&A. Let me just take a minute to talk about that. Of course, our reported results were impacted by favorable foreign exchange. But even stripping that away, our SG&A expenses were down a couple percentage points in the quarter. There was a piece of it that was onetime in nature that won't be repeating itself, again, as it related to a change in our benefits for segment or for our employee population base. But the other piece of it is that is probably equally important is something that we customarily do at this time of the year. Once we understand our performance through the

OND period as we adjust our performance-based compensation and that occurred in the quarter, that happens every quarter – every third quarter, thereabouts, we go up or down with that. So those were the 2 main things as it relates to the quarter. As it relates to the ongoing ability to look at SG&A, again, we've shared our slide this morning that shows the number of years that we've been leveraging SG&A. I think there is – what we have been doing as part of the D&A here is now almost to look at the productivity initiatives to ask ourselves, are we spending – are these dollars being spent in the right places? Leveraging technology will continue to do that. So I think there is still more opportunities to seize leverage through SG&A as we look ahead.

Amit Sharma

And gross margin?

Lawson Whiting

From agave…

Jane Morreau

Sorry, the agave. Yes, you're exactly right. The agave prices, from what we can tell from the information that we have available to us, that the agave prices will remain under pressure probably through the next 18 months or even 2 years as we look out there. And so they will continue to have pressure on our margins next year. What we've seen in a market like Mexico is the pricing environment is fairly robust. Most competitors have taken pricing. We have not seen that so much in the U.S. at the premium – super-premium and ultra-premium levels. We have seen it below that level. But there is going to be continued increase just because agave is doing so well. It's on fire in the U.S. It's doing well in Mexico, too. So supply and demand just what was planted several years ago is going to have upward pricing pressures that we would expect over the next couple of years that will impact our margins.

Operator

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

Kevin Grundy

I had a question on the organic sales guidance and your decision to maintain it for the year. So the 6% to 7% that you're still expecting for fiscal '19 implies a pretty sharp acceleration in 4Q. And Jane, I know you talked about some of easing of year-over-year comparisons, and I think some encouragement with what you're seeing from a retail takeaway perspective. But I was hoping you could drill down a little bit on that, number one. Number two, I guess, where you kind of expect to land within the range, the high end would certainly seem to be an extremely strong result in the current environment. And then just more broadly, is there anything that you see that makes you either more encouraged or a bit discouraged in terms of that kind of number looking out to next year something in that 6% to 7% kind of range?

Jane Morreau

Yes. I think you answered a lot of these – the questions yourself. That was a great recap. As we said, we are growing over 5% through our results year-to-date. **— *indiscernible* —** is against last year's tough half over 7% growth. So then we talked about how we were adjusting for tariffs, our growth's really more in the 6% range. Now I think maybe it's helpful to look at a 2-year stack. If you look at our 2-year stack for adjusting for tariffs and so forth, we've been clearly on a 2-year stock basis in the 12% range. So implying that we – as we look ahead, we're expecting a strong quarter as you said, high single digits. We feel good about that, when we see the momentum in the business that is happening in the U.S., you pointed that out. You saw recent takeaway trends to support that. Our emerging markets business remains very strong. We can expect that to continue in our fourth quarter. We know we had some timing-related items that are going to help us in this year's fourth quarter as well. And so when I look at the – what we're expecting, you're exactly right, we are expecting a high single-digit growth in Q4. It still put us squarely in a range of 6% to 7%, but I'd say we'd be at the high end of 7%, probably not. But we're squarely within the range, including with or without tariffs.

Lawson Whiting

Maybe I'll add another point on there too. The – I mean, the pricing environment in the United States has actually improved a bit over – I'll say, over this fiscal year. I mean, 12 months ago, you were seeing price declines, just talk TDS for a second, of a point – 100 basis points, 150 basis points down and that's essentially flat now. So there's been a nice improvement in the pricing environment. As we said last call too, the promotional activities from Brown-Forman is going to be weighted to the back half of the year. So that's helping accelerate our business right now. We also talked about in Q2, the material increase in media spend, which is just rolling out or has been rolling out there over the last month or so. And so that's starting to help things too. That we've – the timing of the year of our spend this year was a little unusual on/off, but it's heavy right now. So you're seeing some of that, and I hope that should be stimulating some volume. And you're also seeing some innovation. So we've got a legacy product out there on Jack Daniel's and Tennessee taste. There's others, not huge but incrementally positive for our sales growth. And another comment, I think, that's just interesting about the industry these days, when you talk about TDS sales growth, and it's sort of in that 6% range itself right now, but the mix to get to 6% has evolved a little bit over last year. Half is volume and half is mix, which is one of – the mix piece of it is what I think is interesting because it's gotten to be so material, I mean, that's the premiumization of the U.S. spirits market. But to have volume growth at 3%, little to no pricing on any individual brand, but 3% mix is a really strong indicator, I think, in the health of the business. And when you break down TDS into the sort of standard, mid, premium and ultra-premium buckets, the really, really strong growth that you're seeing in that ultra- and super-premium buckets, well in the teens or low teens, is quite impressive and that's where a lot of our portfolio is playing these days. So I just think it's interesting to see the premiumization of the U.S. market continues, and if anything, is accelerating.

Operator

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

Grant O'Brien

This is actually Grant on for Bill. Just wondering on the EU market, even though you guys didn't pass through the pricing, I was wondering if you guys have seen any changes in your ordering pattern there, whether that be maybe a pickup as some smaller craft players are not entering the market or a slowdown as kind of the market shifts away from brown spirits at all?

Jane Morreau

No. Our growth, as we said, I think Lawson may have mentioned, or it was definitely in our earnings release this morning, our business in Europe has been pretty steady. It's been in the mid-single-digit 5% range for some – a number of period times. So we really haven't seen a big change there because of the tariffs, whether it's impacting craft players or ourselves, it's been fairly consistent and pretty healthy steady business that we're seeing in that part of the world.

Lawson Whiting

And I'm not sure if I got the point right, you had said people moving away from brown spirits. I mean, that's true in the U.K, clearly with gin doing what it is doing, but it's – that's not true for many other markets in Europe where quite honestly, bourbon – well, American whiskeys continue to take share from a lot of our white spirits categories. It's different country by country obviously, but I wouldn't want that to – I wouldn't want you to walk away thinking that white spirits are growing faster than brown spirits in – or at least American whiskey in many of those countries.

Operator

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

Bryan Spillane

Jane, just wanted to follow up on some earlier question related to gross margin. Just wanted to clear a couple of things up, if you could. Just the $125 million, I guess, gross sort of hit to gross profits. That all fits in cost to goods sold, right? And also, the mitigation, the $70 million, $75 million mitigation, that's all captured above the gross profit line?

Jane Morreau

Yes. So let me just take you back, again. The $125 million is an annualized number. We only have about $70 million, $75 million of that happening this year. Roughly, a little more than 2/3 is hitting the cost of sales line this year and 1/3 hitting our sales line this year. So – but it's all hitting above gross profit.

Bryan Spillane

All above gross profit, okay.

Jane Morreau

All above gross profit. And the split I just mentioned, 1/3, 2/3 roughly.

Bryan Spillane

Okay. And then as we sort of – if nothing changes, then you're really just like one more quarter of that next year, right, where you just trying kind of think about how gross margins could evolve, it just would seem like fourth quarter and first quarter, nothing changes, you'd still have it, and then it should begin to sort of moderate after that. Is that the way to think about it?

Jane Morreau

It will moderate. We still have a little bit more coming through because this – think of those roughly 7 months, we've protected ourselves largely this year because of some of the mitigations we did. Recall that we talked about earlier, we shipped in or rebuilt inventories in advance of tariffs. So that protected us to roughly September or October time period. So until you anniversary that, we'll still have some impact in Q2.

Bryan Spillane

Okay. All right. And then, beyond tariffs, the other pieces, agave, wood, the other things that have sort of been pressuring on cost of goods sold haven't really changed much, meaning they're not – if we're thinking about '19 to '20, it's not as if they've inflated more, right? You're sort of absorbing those – that rate of inflation now.

Jane Morreau

Yes. The F '19 numbers that we discussed to you at the – when I had talked back in June in terms of their margin impact because of those, that has not changed. We're in the early planning stages of our F '20 process, which we'll be able to share more color with you in June as it relates to cost. Clearly, the cost of agave continues to increase, though. I will say that much.

Operator

Your next question comes from the line of Brett Cooper with Consumer Edge Research.

Brett Cooper

A question on innovation. It's been a small driver of your growth recently, certainly less than your peers. I was wondering if you could offer your view on how innovation will come into the business going forward, I guess, relative to the past? And if the focus on seizing smaller brands for the future impacts innovation efforts, and then I guess sub question of that is, certainly seeing more efforts on ready-to-drink cocktails in the U.S. So wondering what your view is on the opportunity of those offerings given your brands?

Lawson Whiting

You want me to take? Look, I mean, your comment that our innovation is not as robust as our competitors, that I'm surprised to hear that because I don't normally think about it quite that way. But I guess, it's certainly true that we haven't rolled out a large Jack Daniel's one in a number of years. That's largely because the current line extensions that we have, primarily Honey and including Fire too, continue to grow. So we feel pretty good that those have – I mean, they're very large brands now and driving some very nice profitable growth. The world of line extension is in the bourbon brands that we have primarily, but it would also include some tequila too are very strong and meaningful actually. So Woodford has got a bunch, Old Forester has a bunch and even Herradura with its ultra line extension has been very, very successful. So we feel pretty good about that. I mean, I guess, that's – your comment about, should the Slane and GlenDronachs and those small brands cause you to pause? I think that's what you're trying to imply that we had – I think it's fair to say we had a lot of – those brands got off to a slower start immediately after we bought them. And so we did put a lot of focus and attention to say, look, we want to get these things going. And so we may have hit the pause button on some of our smaller brands so that we didn't get too much clutter in the innovation pipeline, but now those brands are growing really nicely. And so you'll gradually see Brown-Forman turn up the innovation dial again and continue to make that an important part going forward. So your third…

Jason Koval

RTDs.

Lawson Whiting

Oh, RTDs in the U.S. Well, Jack Daniel's Country Cocktails play squarely in the middle of that. It has been a dramatic turnaround in that business over the last few years and how successful it has been. And so that is our large play right now. In that business, we continue to look at other potential things to do in that RTD world in the United States. Obviously, it's a huge business for us in many countries around the world, both on New Mix and on Jack Daniel's & Cola and the different variants there. I think, as you know, it's tougher to put a spirit-based – to put real spirits into a U.S. RTD and make much money out of it. And nobody is – really nobody is making material money at that side of things. And so you got to do it a different way. But we continue to look at that. I would say we will – we believe in the RTD business on a global basis. I mean, it's something that we've developed into – as I said, a very large piece of business for us, and we want to make sure that we can play it in the United States, too.

Operator

— ***Operator Instructions*** — Your next question comes from the line of Robert Ottenstein with Evercore.

Eric Serotta

It's Eric, again. When the tariffs first started going in September/October last year, you were pretty vocal about taking a deliberate and balanced approach of absorbing some of the tariffs in some of your largest markets. I'm wondering now that we're a good 6 months into it as you start to plan for next year, how are you thinking about that balance in some of your key markets in the EU? And have you taken any mitigation actions in any of those markets to date?

Lawson Whiting

Well, you want me to take it?

Jane Morreau

Lawton, go ahead.

Lawson Whiting

I mean, we – yes, we have been a bit surgical, I think, would be the word, in the way that we've approached the pricing and – while the pricing decisions that we've had to make, and if we're really talking mostly about Europe, it's obviously been a tough pricing environment for a long, long time over there. We continue to push it in some third-party markets. We pushed it in some relatively smaller markets. We've been less aggressive in some of the very large grocery-dominated markets over there for reasons that are pretty obvious, I think. I mean, they're very difficult places to take pricing right now. And we've made a conscious decision to what – we've been calling it investing in momentum, and it's something – once you lose momentum, it's very hard to get back. And so when it came to really getting country by country trying to decide what the right decision might be in a lot of cases in those big ones, we decided the right decision was to wait. It's not wait forever, but it is wait from now, and so we – until these things hopefully get resolved.

Jane Morreau

And so I think we'll continue to do some of the surgical approach that Lawson was mentioning. We're continuing to balance – be very balanced in where we are taking it. We're looking for as many opportunities as we can. Still hoping that the situation will resolve itself. But as he mentioned, it is – we are in a unique position as the export of American whiskey when we're competing against other players that don't have the same issue. So we want to continue to make it affordable to our consumers as well, balancing the margins that we're seeing and how long we think this might last. We're in the early stages of our planning process for next year. So we'll talk in more detail in June to you about pricing as it relates to that for next year.

Operator

Your next question comes from the line of Sean King with UBS.

Sean King

Yes. Tariffs aside and knowing that tequila and international are becoming an increasingly important part of the long-term growth algorithm, is there any sort of, I guess, long-term margin implications that we should be thinking about as sort of the mix shifts away from the core?

Lawson Whiting

Well, look, I mean, historically, our margins internationally were pretty close to what they are in the United States. Some of the more recent FX moves over the last year have made the U.S. sort of on a per case basis or whatever, a bit more profitable, but it's not – they're not hugely different. Some markets are. But for the most part, our international business has pretty high – pretty high margins, too. So no, you shouldn't expect that, that will change the overall company mix all that much.

Jane Morreau

And think about some of the brands we're also selling at the higher end. So I think what Lawson was referring to, if you were thinking that we were only a one-trick pony, Jack Daniel's, and we're not anymore, we've got Woodford Reserve and it's much higher price than Jack. We're looking to expand that around the world. And so its margins will be more. We've got the Jack – the Herradura, which is also higher than the Jack. And we've got – and which is growing quite nicely in the U.S. and really in Mexico and starting to gain footing around the world. And we acquired the Scotch brands, which are very, very nice margins, and we've got high hopes for those. So if you think about the mix of our portfolio too, that's going to help our business quite a bit, too. So if everything stayed the same as it was 20 years ago in Lawson's conversation that might have it, but it's not, as I look ahead given the mix of our business and how we're taking that.

Operator

There are no further questions at this time. I will now turn the call back over to you, Mr.

Jay Koval.

Jason Koval

Thank you, Dorothy, and thank you, Lawson and Jane, and to all of you for joining us today for our third quarter earnings call. And please feel free to reach out to us if you have any additional questions. Take care.

Operator

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