Brown-Forman Corporation, Q2 2021, Earnings Call 2020-12-08

Presentation

Operator

Good morning. My name is Sia, and I will be the conference operator today. At this time, I would like to welcome everyone to the second quarter fiscal 2021 earnings conference call. — ***Operator Instructions*** —

At this time, I would like to turn the conference over to Leanne Cunningham.

Leanne Cunningham

Thank you, and good morning, everyone. I would like to thank each of you for joining us for Brown-Forman's second quarter and first half of fiscal 2021 earnings call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Jane Morreau, Executive Vice President and Chief Financial Officer.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict. You should not place undue reliance on any forward-looking statements, and the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise.

This morning, we issued a press release containing our results for the second quarter and first half of fiscal 2021, in addition to posting presentation materials that Lawson and Jane will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations. In the press release, we have listed a number of risk factors you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures, 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.

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

Lawson Whiting

Thank you, Leanne. I don't have to tell anyone on this call that 2020 has been a year that no one could have possibly predicted. And when we started fiscal '21 back on May 1, I did not imagine that I'd be sharing such solid results with you today. Both Brown-Forman and the industry as a whole has been very resilient through what is a very challenging and volatile environment.

But first, let me start by thanking our employees. This has been a year of extreme turmoil in all areas of life, no matter who you are or where you live, and we could not deliver these results without your hard work, dedication and agility. I also want to thank our dedicated long-term shareholders, including all of the Brown family members and our outstanding Board of Directors for your leadership, encouragement and most of all your support.

Before Jane and I get into the business discussion, I want to offer a few thoughts as we're less than a month away from closing out Brown-Forman's 150th anniversary year. I find it interesting that milestones of our company always seem to come about in turbulent and unforeseen times. Our 50th anniversary was back in 1920, the year prohibition began in the United States. Back then, we found a way to continue to sell whiskey through medicinal licenses and permits. Our 75th anniversary coincided with the end of World War II. And our 100th anniversary was in 1970 when Bourbon began its period of decline, and we reinvented ourselves as a consumer goods company and expanded beyond spirits.

And now today, in our 150th year, amidst a global pandemic, we have again found a way to reach more consumers and delivering underlying top line growth fiscal year-to-date. This year has reaffirmed my long-held belief that no matter the circumstances, Brown-Forman will be agile and able to find a way to deliver top-tier results. And in this year full of uncertainties and the unexpected, it's nice to have something that we can rely on, and we do not take that for granted.

So as I turn to our fiscal '21 results, I want to talk a little bit about some of the surprises in our business. As you can imagine, when we started this fiscal year back in May, the headwinds appeared strong. Bars and restaurants had largely closed worldwide since March. Global travel retail had ground to a halt. Vacations and travel and hospitality were getting canceled all over the world. And in actuality, most of these headwinds really haven't changed, but I want to share with you a few positive stories of resilience in our business in spite of these headwinds and continued uncertainty. First is really the overall performance of the spirits industry. I often talk about what a great business premium spirits is with solid growth, nice margins and high returns on capital, and this year is no exception. Since the start of the COVID pandemic, spirits performance, particularly in the United States, has accelerated. Overall consumption is up, even with many restaurants and bars closed. And we continue to take share from both wine and beer. Although that's a trend that has existed in the U.S. for a long time, the gap has gotten wider in spirits favor.

Another surprise has been the exceptional growth we've experienced in our RTD business. As I mentioned last quarter, we have belief in the ready-to-drink category ever since we launched our first Jack Daniel's RTD over 25 years ago. But I'll admit that this year's performance has exceeded our expectations about the format and the category. And this really is not a single brand or single market phenomenon, we've seen strong growth from our Jack Daniel's RTDs in markets like Australia, Germany and the U.K. Our recent launch of the Jack Daniel's spirit-based RTDs in the U.S. is off to a terrific start. We've also seen excellent performance from our malt-based Jack Daniel's country cocktails in the U.S., our tequila-based RTDs, called New Mix, in Mexico, which is now near a record 8 million cases in the last 12 months. And since our last earnings call, we acquired Part Time Rangers, a range of low-calorie, white spirit-based RTDs as a targeted investment that we believe will help us grow in this key category.

A little bit on Part Time Rangers. This brand was found by 2 brothers in New Zealand and offers white spirit-based cocktails in a convenient format. We believe this brand can help diversify our RTD offerings in this region as well as broaden our reach into the fast-growing white spirit RTD segment. This brand has done very well with a new generation of consumers, and we believe it's well positioned to take advantage of recent consumer trends, such as lower calorie, lighter and brighter tasting. Part Time Rangers is also known for its focus on wildlife conservation and sustainability, particularly through its charitable donations, supporting conservation and ecosystem preservation.

While focused on New Zealand and Australia over the next 12 months, we believe this brand has the potential to move into more markets in upcoming years. Although the shutdown of the on-premise certainly gave a boost to the RTD category, the megatrends of convenience and flavors give us confidence that this category will continue to be a growth driver into the future.

Another pleasant surprise is the continued and really accelerated growth of super premium brands. As I've shared before, this has been unlike any other recession that we've experienced. In the U.S., ultra and super premium spirits are gaining share at faster rates than in the pre-COVID time periods. And thanks to the portfolio reshaping efforts over the past decade, we don't really have much below the premium price level anymore. I also want to mention that we believe we are not only playing in the right price segments, we're also in the right categories really at the right time. I've already mentioned RTDs, but our 2 most important categories are really American whiskey and tequila. In the U.S., both of these categories have seen a significant increase in their pre-COVID growth trends. And it's worth highlighting the performance of Woodford Reserve. It has not only sustained its double-digit growth and is growing its market share in the U.S., but also we believe it's ready for a significant push in the international markets.

On a geographic basis, the strength of the developed markets and sequential improvement in recent months of the emerging markets has been impressive. It has certainly been a welcome surprise in this dynamic business environment to see such robust growth from our U.S. business. And as we've progressed through this pandemic, we've seen relatively healthy performance from our large developed markets in much of Western Europe as well as Australia.

I'm also pleased with the improving health in the emerging markets, too, which did improve over this past quarter, particularly highlight Poland and Brazil, as Jane is going to talk about in just a couple of minutes. And lastly, the teams deserve a lot of credit for the delivery of new world-class creative. We signed a deal with our new agency of record, Energy BBDO, almost exactly 1 year ago. And in less than a year, they have created beautiful global 360 campaigns for our American whiskey brands, Old Forrester, Woodford Reserve and Jack Daniel's, all through a global pandemic and all done remotely. If you haven't seen these campaigns yet, we've included them in our slides today, and you can believe that Brown-Forman employees around the world are planning to make it count this holiday season.

So in summary, while we continue to face uncertainty and disruptions to markets and channels throughout the world, I remain confident that the essentials of our business are strong. And then as we approach the end of our 150th anniversary, Brown-Forman will enjoy many more milestones to come.

With that, I'll turn the call over to Jane, who will walk us through our second quarter and first half financial results.

Jane Morreau

Thank you, Lawson, and good morning, everyone. As Lawson said, this year has been full of surprises. Considering all the volatility and uncertainty in the world today, we believe that results we released today are strong.

In the first half, both our underlying net sales and operating income are up relative to last year with an acceleration in our top line growth registered in the quarter. Not surprisingly, many of the items that created noise in our first quarter continued to impact our second quarter, including product innovation launches, notably Jack Daniel's Tennessee Apple; timing-related items, both this year and last year; and of course, COVID-19 resulting impacts that include inventory fluctuations, customer buying pattern changes and geographic channel, size and portfolio mix shifts.

Before I discuss our results in more detail, I would like to take you back a year ago. Specifically, as a reminder, in the second quarter of fiscal 2020, we launched Jack Daniel's Tennessee Apple in the United States and sustained our double-digit underlying net sales growth from our premium bourbon and tequila portfolios, when no one could have envisioned the world as it is today. And of course, COVID-19 has created challenges and uncertainty, but also opportunities. We believe this is evidenced by the continuation of our stronger-than-expected performance this second quarter.

With that as a backdrop, let's now turn our attention to the second quarter and first half performance where familiar trends continue to produce solid results.

Starting with our top line. Compared to the first half of last year, reported net sales were down modestly as a result of the decrease in distributor inventory levels that were built in the United States in April and the negative effect of the stronger U.S. dollar. Adjusting for these factors, our underlying net sales grew 4%. As we look broadly across our geographic clusters, we saw a wide range of top line performance with either strong growth or generally double-digit declines. We experienced top line growth in approximately 85% of our markets through the first half, driven by a number of factors, including our well-positioned portfolio, premiumization trends, our innovation and externally, the impact that government stimulus packages had in a number of markets on the economy.

The markets where we are experiencing significant declines appear to have been impacted by a variety of factors, such as down-trading due to economic conditions; heavy on-premise exposure and for us in markets such as Spain and Czechia; declines in tourism, of course, in Travel Retail, but also in Southeast Asia, as an example; and then the external factor lacking here was the lack of stimulus from the government in many of these markets.

Starting with our U.S. business, which represents approximately half our net sales. We sustained our strong first quarter underlying net sales performance in the quarter despite lapping last year's launch of Jack Daniel's Tennessee Apple as our year-to-date underlying net sales grew 9%. This strong growth reflects many of the same themes we discussed in the first quarter. First, the strength in the off-premise. The channel shift since the pandemic began has remained significant with off-premise volumetric growth more than offsetting the on-premise declines. Our portfolio continues to benefit from being well positioned in growing categories and to meet the needs of our consumers during this environment at home consumption. Most notably, the consumers' desire for convenience, portability and variety as well as ease of mixability is being met by the Jack Daniel's RTDs, Jack Daniel's flavors and our portfolio of tequilas. Of note, Jack Daniel's country cocktails again delivered exceptional performance, more than doubling volume both in the quarter and on a year-to-date basis compared to last year.

Separately, the shift to at-home consumption convenience and the desire for contactless commerce has propelled our portfolio's explosive growth in the e-commerce channel with continued triple-digit trends compared to pre-COVID levels. And as consumers seek everyday luxury, premiumization continues to favor our super premium portfolio, particularly Woodford Reserve and our craft series expressions of Old Forester as these brand families sustain their double-digit underlying net sales growth. Our developed markets grew underlying net sales in the high single digits for the second quarter and 10% through the first half. Continued growing demand for Jack Daniel's RTDs, most notably in Australia and Germany, benefiting from the consumers' desire for convenience and the launch of Jack Daniel's Tennessee Apple, drove these gains. We remain pleased with the launch of Jack Daniel's Tennessee Apple internationally, where we continue to see the rate of sales equal to or greater than the Honey post-launch rate of sales.

Our emerging markets collectively reversed their first quarter declines, growing underlying net sales low single digits for the second quarter and lifting the underlying net sales to flat year-to-date. Poland and Brazil have been resilient in the first half. And while Mexico declined in the quarter, its underlying net sales have grown year-to-date, driven by the exceptional performance of the new mix RTD business in the first quarter, benefiting from the temporary interruption experience in the country's beer supply chain.

While the New Mix business remains healthy, we continue to see evidence of consumer trade down in the tequila and whiskey categories in Mexico and several other emerging markets. The rest of our emerging markets collectively remain down year-to-date, most notably, Southeast Asia, Russia, India and Latin America.

Finally, our Travel Retail business continued to be the most significantly affected with international airline travel declining almost 90% and nearly all the cruise industry remained shut down. While we saw a slight improvement in the second quarter as our military channel is performing well, our Travel Retail business, excluding this channel, continued to experience net sales declines well over 60% for the first half of the fiscal year.

Turning to our largest brand for a moment, Jack Daniel's Tennessee Whiskey. Overall, through the first half, the brand's volumes remained down, with essentially flat volumes in both the U.S. and our developed international markets and declines in emerging markets, though the rate of declines improved somewhat in the second quarter and declines in the Travel Retail channel. The shift from on-premise to off-premise consumption in our developed markets continues to drag down Jack Daniel's Tennessee Whiskey's underlying net sales year-to-date. However, we believe the brand remains quite healthy and is gaining share in the majority of its top 10 markets.

Now turning to our gross margin. Our gross margin declined 350 basis points through the first half, resulting in our underlying gross profit dropping 1%. Higher input costs related to agave and wood as well as a reduction in fixed cost absorption due to lower Jack Daniel's Tennessee Whiskey volumes represented nearly 2/3 of our gross margin decline.

Channel and portfolio mix shifts essentially drove the remainder of the margin drop.

Moving to brand expense. While our advertising spend was down for the quarter, reflecting the reduction in on-premise activations and the cancellation of various events and sponsorships, we did see the decline slow compared to the first quarter as there are investments, most notably behind our new Jack Daniel's Make It Count campaign began in October. We continue to expect our advertising investment to accelerate over the balance of the fiscal year. Our underlying SG&A investment remained down in the quarter, reflecting tight management of discretionary spending, such as travel and hiring freezes.

And finally, to our fiscal 2021 outlook. As we look ahead, a high level of uncertainty continues to exist, including the impact of the current surge in COVID-19 cases and resulting restrictions as well as the impact this may have on our consumer demand, notably during the critical holiday season that is upon us; and the tapering off of government financial stimulus in a number of countries, barring no changes between now and the end of the calendar year; and the potential effect on the global economy, employment and overall recovery. As a result of this uncertainty and volatility, that we expect to persist over the months to come, we are not providing quantitative guidance for fiscal 2021 at this time.

With that being said, and more qualitatively speaking, as we think about our broad geographic clusters. First, our developed markets. While we expect the volatility and uncertainty to remain high for the foreseeable future as we experienced a second round of lockdowns related to the pandemic and have noted slowdown in our November early results in Europe, we remain optimistic given the resiliency and strength of our performance during COVID to date.

Travel Retail. We do not expect our business to recover this year in this channel and will remain down significantly. We expect many of our emerging markets will remain subdued, though we anticipate to benefit from easy comps when we begin to lap the start of the pandemic in our fourth quarter. Our nonbranded business dominated by the sales of used barrels is expected to continue to be a drag on our top line performance this year as it was in the first half, reflecting the expectation of lower volumes and pricing.

Our gross margin will remain under pressure for the year, driven by the expectation of higher input costs and mix shifts. However, where our gross margin ultimately lands will depend not only on the volumes of our business, but the mix of our business geographically, by portfolio, channel and size.

Regarding operating investments. We believe we are well positioned to invest effectively. We expect our unusually high operating expense leverage in the first half to significantly reverse in the second half, reflecting a notable increase in broad reach media spend, as we are investing more into the important holiday period and the recently launched Jack Daniel's Make It Count campaign. As it relates to our effective tax rate for the full year, we still expect our all-in tax rate to be in the range of 17% to 19%. Our balance sheet and cash flows remained strong, and our capital allocation strategy is unchanged.

I thought I'd pause and just mention a few recent actions in this arena. As you know, our first priority is to invest fully behind our business. Our Board recently approved an investment of $125 million in capital to expand our bourbon making capacity in Kentucky to meet the anticipated future consumer demand of our brands. We also announced a couple of weeks ago an increase in our annual regular dividend, marking the 37th consecutive year of increases and the 76th year of paying quarterly dividends in our 150-year history. We continue to actively evaluate our portfolio, selling the Early Times Canadian Mist and Collingwood brands, and as Lawson mentioned, acquiring the ready-to-drink brand, Part Time Rangers.

In summary, while there have been a number of challenges and headwinds in the first 6 months of our year, we believe our results reflect our agility and resilience to adapt and seize the opportunities in this very volatile and uncertain environment. As the COVID-19 pandemic and its effect on the global economy continues to evolve, we will continue to manage, as we always have, putting our people first and staying focused on the long term.

As Lawson mentioned, in our 150-year history, we have experienced many turbulent and unforeseen events and have emerged from those times stronger and with healthier brands.

And with that, this concludes our prepared remarks. Let's open the line to questions.

Question and Answer

Operator

— ***Operator Instructions*** — The first question will come from Steve Powers with Deutsche Bank.

Stephen Robert Powers

So I guess maybe we could start on the A&P, if I could. I guess I'm curious as to – with the lower spending in the first half, just what that implies about your share of voice year-to-date. And then how you anticipate that share of voice to trend as you ramp the broad reach investments that you called out in the second half?

Lawson Whiting

Yes. Go ahead.

Jane Morreau

I can start off with the phasing of the spend. I mean really what you saw on the – just as a reminder, yes, we were down significantly in the first quarter, and it was really more driven by when the pandemic hit and us taking a pause in our spend so that we can evaluate and reflect where we wanted to spend and the type of spending that we wanted to have take place. And so that continued a bit into the second quarter. Though I will say that it's always more important to step back and peel back the onion, if you will, and understand that we were spending and did increase our spending in places where the momentum was going, so behind U.S. Woodford Reserve and Old Forester, behind our RTDs, behind our flavors. So all the things that you have seen driving our growth in the quarter, we spent behind and have spent behind year-to-date.

What we did though was pull back a bit, as I said, in the first quarter rightfully so for the

COVID environment because of the restrictions on the on-premise channel, which took activities out of that, as well as sponsorship events and things. And we said, let’s take the money there and reallocate it to broad reach media and focus it when the new campaign that Lawson mentioned earlier came out – comes out. And that’s really behind Jack Daniel’s in the Make It Count campaign, and it really just started in the October period, really late October. And so you didn’t see a lot of that, but you’re going to see a heavy concentration when we think about the phasing of it.

We wanted to be there for the holiday, so a lot of spending is focused in the holiday period, where we think we’ll have nice share of voice. And from then on, when you compare our spend relative to the prior year in the fourth quarter where we were down because, again, COVID related.

So I’ll let Lawson pick up on share of voice or anything he wants to add on that.

Lawson Whiting

Yes. The only thing to add to that is that share of voice, at least I think in our general opinion, it’s getting to be less and less relevant as a metric to use because of the explosion in the spending in the world of digital and social media. So while I do think our share of voice will be going up markedly over the next few months, I’d just be a little cautious on using that as a real strong metric because of the different ways that people are spending. And as Jane said, she’s right, we were – I know the teams were very excited to get these new campaigns out there, and there was just a bit of a bias to wait until we had that. And so for the most part, Jack is ready now. Woodford has been out now for a few months. You’re going to see more from Old Forester and more on our tequilas in the very near future. And so you’ll be seeing more of our brands on air starting now.

Stephen Robert Powers

Okay. That’s great. And maybe a follow-up on that question, A&P, and then a different buck of investments, I'm curious about. On the A&P, when I look back, it's hard, I guess, to figure out what the right benchmark is. But a decade ago, A&P was running about mid-teens as a percentage of sales. Clearly, first half, we're down below 10%. I guess when you think about the normal – what normalization looks like as we emerge, what – how should investors be thinking about the right level of spending for your business as it's currently scaled? And then that's, I guess, the follow-up. And the second bucket is just – it didn't come up in your prepared remarks, but obviously, e-commerce has been making great inroads in your – across the market, but in your category specifically. I'm just curious as to how you've pivoted to step up your investments there and whether you think you're keeping pace with the change, you're effectively ahead, just what your level of readiness is for the e-commerce channel as it looks in the future?

Jane Morreau

Let me take the first part of the question and Lawson can build on that. But hoping that we try to target each year, and certainly, at this point in time, we will diverge from that, but we try to target our spending in line with our revenue growth. And so you wouldn't see – I think what you're seeing in the first half is just what I explained earlier in my commentary, which was the timing, the phasing, how COVID hit, how — ***indiscernible*** —, but again – and that's why were so dramatic in the first half relative to our top line growth as being down. But it is something that we, long term, want to spend in line with our sales growth. I hear what you're saying, you're looking back a decade ago. There's lots of puts and takes in the area. You got to look at pull out effects, brands that have come and gone and things of that nature. And we also look at the spending that we do not just in the A&P line item. We've talked about this before. I know on calls, we look at all line items in the P&L. So our packaging costs would show up in cost of goods or gifts that shows up in cost of goods. Our promotional activity, which are a net reduction to our sales price. And then, of course, our people who build the brands. And so we look at it holistically like that as opposed to just one line item. But again, I would say, our ambitions are to, again, spend in line with our growth in revenues on an ongoing sustained basis.

Lawson Whiting

Yes. That 10% number you quoted from the first half, you can kind of throw that out because we will be building back up, as we've said in here, in the second half of the year pretty strongly.

As far as the e-commerce, I mean, I think we, like a lot of others, see the opportunity here. I mean everybody is seeing that. But we have industry estimates that say that in the next 3, 4, 5 years, you're going to see as much as 10% of global sales going through e-commerce, and it's only at 2% today.

So you're going to see an explosion there, and we're obviously going to be a part of that. But it is small. In the U.S., it's sort of 1% right now, 1%, 1.5%, but we've added a lot of investment there, and we will be adding more over the next, say, 6 to – 6 months or so.

And so we've got a number of ideas and things that we're going to do there, and we're reallocating resources pretty much like you would expect we would to make sure that we're there for that channel. But it's not only a U.S. thing. In fact, it's bigger than in many markets outside of the U.S., I mean, China being the most well known, but U.K., Germany, France, Australia, Brazil, Mexico, it's all – all those markets are seeing exploding e-commerce growth, and we're making sure that we're going to be a part of it.

Operator

The next question will come from Sean King with UBS.

Sean King

I guess I'd like to understand your outlook on tariffs, given the new administration. And within that, in the event that you saw some retaliatory tariff relief, would you pass that on to consumers in the form of pricing or potentially step up investment or even flow through to the bottom line?

Lawson Whiting

Okay. A big – my favorite question. Look, tariffs, which we're now 2.5 years into it, none of us 2.5 years ago thought that we would still be in the situation that we're in now, and we continue to work hard to try to find ways for the entire industry to get out of this mess.

There are, I mean, I think, compared to, say, last quarter when we talked about this, certainly some encouraging signs. Certainly, the new administration seems to be putting people in place in important sort of economic roles or trade-related roles that are more centrist and a little more free trade than what we have seen out of the Trump administration. And so we have to be a little more optimistic there. And we'll see. I mean I do think also really both the U.S. and the EU together want more stability in these international relations. They don't like the chaos either. And so we don't know what the Biden administration is going to do, but we are trying everything that we can do to influence to make sure that these trade disputes get resolved.

And so I hate to – I am more optimistic, I guess. I've been optimistic now for 2.5 years and it still hasn't solved itself. So optimism isn't getting it done. But there are so many people that are getting hurt by these things. And I think the entire industry is looking at this like we need to solve both sides of the Atlantic. It's tough to say at the same time because they're 2 different disputes, but both sides are working to limit it or get it – rid of it altogether. And then there is Brexit, which is only, what, 3 weeks away or something like that. And so I do think the U.S. and U.K. have been making progress there on trying to find free trade agreements. And so that one may pop up sooner than a resolution with the EU. But net-net, getting more positive on the topic.

Jane Morreau

Yes. And an answer to your second part, just to build on what Lawson said, second part of your question, we don't have a crystal ball, as he said. We are optimistic, cautiously optimistic. But if the tariffs would go away, you were asking what would we do? Would we drop it to the bottom line? Would we spend? Would we take pricing – we're evaluating all those things. I think our bias would be certainly to take some and reinvest it back in the business, look at pricing and all the different variables. So this is something we hope we can actually implement here if the tariffs go away.

Lawson Whiting

Yes. Pricing decisions are largely separate from tariffs. It's more of how much are we going to reinvest in the business and how much is going to drop to the bottom line. And it – I think it – a lot of it depends when this actually happens, how do you do the U.K. versus the EU, a lot of things like that. But it will be a balance between the 2.

Operator

The next question will come from Lauren Lieberman with Barclays.

Lauren Lieberman

You both spoke a lot about marketing and the new Jack Daniel campaign in TV, but I was also curious about building brand equity, sort of in the new world, assuming, right, there's a time frame for on-premise to completely come back even post vaccine, and that's been such a core part of the spirits model and especially for establishing some of your new or more premium brands in new markets and new geographies. So just curious how you're thinking about that demand, brand awareness creation model and what it looks like, again, with a more limited on-premise footprint even post pandemic?

Lawson Whiting

Yes. I mean, look, that's a tough question. The – going forward, I do think, first of all, the restaurant business, while slow to come back, it will come back. And we will continue to use that as a nice channel to promote particularly the smaller brands. And that's what was working very, very well, pre-COVID was the brands like Fords and the brands like Slane and even our GlenDronach and our single malt Scotches. So that model really, really was working well. We're having to pivot to spend a little bit more time and attention with those folks in the specialty on-premise channel, which is still huge – specialty off-premise channel, I'm sorry, which is still very, very big. And it's just a matter of focus that seems to be working. You can do that focus on the on-premise, you can do it in the off-premise. But you just need to put time and attention against these smaller brands and that separating those people's responsibilities from building a Jack Daniel's or building a Woodford has worked very, very well in the U.S., and it's something we're going to do outside of the U.S. now, too. I mean we're – it would certainly – it works better when the on-premise is more vibrant. But these folks are able to do both channels at the same time and really build these brands. And I think we've got enough confidence that, that model can work that we are going to continue to focus on it.

Jane Morreau

Yes. Just to build on what Lawson said, I think our model for it, as we said, has been in the on-premise. But what I think we are also saying and seeing is that we know that how brands grow is by awareness. And so whether the traditional media, which has been going away for some time in terms of the spend with cord cutters and so forth like that and more towards streaming, video – streaming online, social, things of that nature, these brands can get awareness through those mechanisms too or through those channels. And so again, we want to be reach, we're trying to reach more consumers regardless of what it is, which brands, whether they're small or large. So our brand-building model is really focused on reach and being top of mind, if it's small and however we might do it.

And that's like – I said, I think the smaller brands can play well in the digital space.

Operator

The next question is from Peter Grom with JPMorgan.

Peter Grom

So I was hoping to get a little bit more color on the gross margin performance and fully understand how the company is thinking about that line item moving forward. Jane, I know you mentioned that the pressure is expected to continue and visibility on channel and country mix is limited. But could you maybe help us understand how we should think about raw material inflation in the back half, where I would imagine you have a higher degree of visibility? And then building on that specifically, there seems to be a view from some of your competitors that agave prices have stabilized. Is that something you were also seeing? Or is the expectation that relief there still doesn't come until the end of calendar '21?

Jane Morreau

Sure. Great question. Just – I think maybe I'll start off with just what – where we are year-to-date and then what we're forecasting for the rest of the year or are expecting for the rest of the year and then just pull ourselves back and say what does this look like over the longer term.

So as you heard me, and you saw in our earnings release this morning, we talked about 350 basis points of margin erosion. About 1/3 of that is really due to this channel size portfolio shift mix, and the other 2/3 of it is really due to input costs and fixed cost absorption being less because of volumes.

Now the input cost was driven by 2 components, agave and wood or the cost of making wood. And something I haven't spent a lot of time and time talking about in the past is – reminding all of us here that are wood cost were laid down 4 years ago and they're coming through today. And so the reason why I'm mentioning that is because of some of the things we're working on today, which will help improve our margins longer term. So

I'll come back to that in just a moment. So that's where we are on a year-to-date basis. Hopefully, that first makes sense.

As you said, yes, we said we do still expect margins to be down for the year. We're forecasting by the end of the year that we won't – we will improve from the 350 basis points drag of where we are today, it will improve from there. So I think we've hit our peak, if you will, and so we expect that to improve where we land. As you also pointed out, Peter, it depends upon the mix, the channel mix, the portfolio mix and so forth. But we do expect an improvement in the back half of the year.

Now thinking of our future expectations of margins, in medium to long term, I'll start it off explaining the wood situation because, again, what we're seeing come through the P&L this year is wood that was laid down 4, 5, 6 years ago. And so we've got a number of initiatives that we've been working on and continue to work on and will continue to work on that will help improve our cost situation in these type of areas, like wood, things that are going into the aging of the barrel. They will not show up this year, they will show up down the road.

Agave, you mentioned agave. We really haven't changed our outlook on agave from what we explained in the first quarter. Again, just as a reminder, it's really based upon CRT, the plantings from '15 and '16. We expected things to – the situation, the supply/demand imbalance to improve by the end of next – about a year from now, which is our calendar '22, so this time next year. We have, though because overall tequila on a worldwide basis, by doing great in the U.S. and growing quite rapidly, it is actually forecasted to be down for the year. Mexico's down, parts of – other parts of the world where it's really not that big anyhow, but it's down. So I think IWSR said – came out with a forecast of tequila being down about 4% for the calendar year. I only mentioned that is because we have seen some stabilization in pricing. No change really from our first quarter conversation with you, which is about 26 to 28 peso, so still in that range.

But perhaps the pressure on the prices will come down a bit faster we're hoping than maybe this time next year, but we're not seeing a rapid change. We don't expect it to be all of a sudden drop down to the bottom. But we do expect to start seeing some benefits starting later next fiscal year for sure.

And then finally, as one of the previous callers asked was about tariffs. And we're cautiously optimistic that they will resolve successfully, and that will also take pressure off of our margins. And so over the long term, if I'm thinking – medium to long term, I'm looking at our margins to improve from not only where it is today, but even from there. We have one final variable that we've been working on, which is our pricing. I've talked about this before with this group, I believe, which is our revenue growth management capabilities. We've invested a lot in tools. We've gotten quite sophisticated in our U.S. organization and just recently rolled it out to the rest of our major markets around the world.

So we're building those capabilities. And what that capabilities allow us to do is to look at optimizing our pricing by channel, by customer, whether our promotions are effective or are not effective, where are those opportunities to take pricing, and we're actively doing that and have actually seen nice benefits from it already in the U.S. and expect that will help as we go down the road, too.

Lawson Whiting

Just a follow-up comment on the tequila category, just because it's – I mean it's been fascinating to watch. We've said, and you can read a lot of different CPG categories, whatever trends were happening pre-COVID just accelerated over the last 8 or 9 months. I don't think there's any category where that may be more apparent than tequila. — ***indiscernible*** — has seen a bit of it, too, in the U.S. Yes, in the U.S. And the super premium and ultra-premium brands are on fire.

I mean they're just growing at rates that are through the roof. And we all say it's – people like to make a margarita at home, but I don't think that many people are buying $60 and $70 bottles of tequilas and making margaritas with it. I mean that's over ice, with the lime, drinking it as a cocktail. And if you look at the Nielsen trends or the NAFTA trends or anything else, I mean vodka, which is a much larger category, for every dollar that tequila is growing, vodka is losing, and the 2 of them almost offset each other. But it's just been a dramatic change in the U.S. spirits business in terms of categories between those 2. And it's – as I say, it's been interesting to watch and quite honestly, is a good thing for us because we're very small in the vodka world and much bigger in the tequila world, cost aside.

Jane Morreau

And Peter, if you're interested in a recipe, our CEO here, Lawson, gave us one yesterday for margaritas that I'm trying tonight after this earnings release is over.

Peter Grom

No. I appreciate that. If I just – I do have one quick follow-up, Jane, just based on some of those wood initiatives you mentioned. I guess when can we expect those to begin to show up in the P&L? And I guess, you'd have a – given the aging process here, right, I mean when or how much longer do you expect wood to be inflationary given what you laid down 4 years ago?

Jane Morreau

Yes. So I think what we've laid down in the barrel is already in the barrel. So I think you're talking about 4 years down the road before we start seeing some real benefits. We're doing some things today that could come through, or bits of it can come through a LIFO – on a LIFO basis. Won't get too technical here, but we'll get a little bit of that coming through in current – in next year, let's say.

Operator

The next question will come from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog

I wanted to touch on the divergence that you're seeing between your volumes and price/mix. Definitely understand there are several major drivers here, both from a product mix and a channel mix standpoint. But I guess it would be helpful if you could provide a little bit more color on the drivers of this. And then second, can you give us a sense as to when we might expect this divergence to narrow? I guess I'm wondering how big of a risk do you guys see that pricing ultimately reverts to lower levels over the long term?

Jane Morreau

Yes. I assume what you're referring to is that our volumes were up 15% year-to-date, and that's really driven by our RTD business, where we've seen explosive growth. Our Jack Daniel's RTDs are up 36%, and our rest of – and our New Mix business, which is 100% in Mexico, is up quite nicely as well, benefiting from a first quarter beer disruption in that market.

And so something that we'd like to do is try to equalize it on an equivalent basis. And so when you equivalize the drinks on a volumetric basis, both full strength whiskeys and full strength tequilas, you're about at a 1% volumetric growth. Our mix, again, is really, again, driven by the portfolio shift, meaning the acceleration in the RTDs and the new mix. We talked about this in our first quarter earnings call that something we've read about from time to time is this margin erosion from RTDs. But quite frankly, it's pretty small in the grand scheme of the margin erosion that we've seen. And we want to be there for the consumer, which we are, as you can tell by these volumetric trends. We're meeting the convenience needs, the tasty, flavorful cocktails and so forth like that. So we have and we'll continue to believe that the small amount of margin erosion resulting from the RT (sic) [RTD] business is a good thing in this environment, particularly.

Lawson Whiting

Yes. We've been having an internal debate, quite honestly, on how sustainable are these growth rates in the RTD world, and are they just COVID driven because so many people are home, or are they something bigger than that?

And I do think – we call them megatrends, but I mean, convenience and flavor fits very well on those. And so you're not going to be seeing the triple-digit growth rates that we've seen in some places, but we feel pretty good that it's going to stay. The other big one that Jane mentioned in her prepared remarks, but it's the on and off thing, I mean that's obviously very big, too, probably bigger than most folks realize as that liter size in the U.S. would be the example versus [1 75] which is much more profitable. And so that will reverse and be a benefit to the gross margin at some point, too. So there's just a lot going on in terms of mix that all add up, but there are lots and lots of small things. Did we answer your questions?

Bonnie Herzog

Yes. That was helpful. But I mean, if I may just circle back on the pricing lever. And I don't know how comfortable you guys are around talking about that, but love to hear your views over the long term.

Lawson Whiting

I mean I think we talked about tequila pricing, and that's inching up. It's not growing by leaps and bounds, but there's certainly momentum to take the price up in that. Even our own brands, if you go SKU for SKU as the comparison or apples-to-apples, there is some small amount of pricing going up now largely from reduced discounting in the off-premise. But I don't sense in the industry or even in our own sentiments that when this is over, we're going to get more aggressive on pricing. I don't think anybody really wants that. And so I would expect similar to what – we haven't had much pricing. It's been very, very low single digit, but that's a fair assumption, I think, going forward to long term.

Operator

The next question is from Kevin Grundy with Jefferies.

Kevin Grundy

Congrats on the continued progress in the quarter. A couple of questions for me, if I may, one on the outlook, and then just a follow-up for Jane on cash and capital deployment. So the first one probably for Lawson, just sort of understanding that we have to get through some volatility here in the winter months. But the broad question, how has your planning changed internally, if at all, as you think about a post-vaccine environment over the next 12 months? And then maybe more immediate term with respect to the guidance, talk about the factors you'd like to see before reinstituting guidance. So you mentioned some of the challenges in November. We understand that there's going to be some volatility. The flip side is, you're also seeing growth in 85% of your markets. I think collectively, the industry across total beverage alcohol has a little bit better sense of what changes in mobility may mean with respect to channel implications and consumer and demand. So maybe just comment on that, and then I'll follow-up on the cash and capital deployment.

Lawson Whiting

That's a doozie. Okay. So the – look, I do – in terms of how we think about planning for the future and things like that, I wouldn't – I mean, I know the brand expense variation between the first half and the second half seems very, very COVID driven, and it certainly was in Q1. But we're not really changing our mentality here over the medium or long term. As Jane said, having brand expense grow in line with sales is a pretty fair way to think about it. And so – and even though we – as I said, the first half hasn't been that way, that is the sort of the near term, medium and long-term direction that we look at.

As far as different – the one thing in the planning world that we'll see how the next 12 months go is what does the recession look like? I feel – I think we feel pretty good about United States and sort of the bigger markets in Europe. But boy, some of the emerging markets of the world, I think, are still – they're going to be slower coming out of this. And so how do we reallocate resources to make sure we're keeping the U.S. vibrant, the U.K., Germanys of the world without walking away from the emerging markets, but we're certainly not going to be investing at the same levels in some of those that continue to struggle in a recessionary environment. And I – not that I'm an economist, but if you – certainly the economists that are out there are predicting a pretty rough return for places like India and Africa and pieces of South America, places like that. Global travel retail is another one that is likely to be in a pretty subdued trends now for years.

Kevin Grundy

Got it. That's all fair. Jane, did you want to make a comment as well?

Jane Morreau

Yes. I mean I could add just a couple of things on to what Lawson said. I guess this re-allocation has been something we've been focusing on for a while in terms of – to be more effective in our spend. And so the COVID environment has really accelerated that. So I don't know that we'll go back to plowing a bunch of a more expensive spend in on-premise. Yes, we'll have people there, but I don't know – because you said post-COVID, and again, it's a crystal ball. So I wish I had to actually **—** ***indiscernible*** **—** consumer behaviors and what they may look like after that.

But I think our focus will still continue to be on reaching as many consumers as we can in our messaging and continue with new creative and with new advertising agency.

But I thought I'd might take one point, so I want to make sure – I haven't really talked about this. I alluded to it in the script that, of course, the shutdowns in Europe and lockdowns in Europe happened in late October. So it really didn't affect our results. I mentioned in my script that we did see a slowdown in November.

Q3 is going to be our toughest quarter, and it was going to be. Anyhow, it's going to be our toughest quarter, both the top line and then the deleveraging because we are spending during this O&D during this spending period. And then we just swing back with the fourth quarter as we go against easy comps at the top line and then the less spending there. So that's I know a little tactical, but I wanted to make sure that I explained that somewhere in this conversation.

Kevin Grundy

We appreciate the color. Quick follow-up, and then I'll pass it on. Cash is growing on the balance sheet. You don't have any debt coming due. How are you thinking about return of capital above and beyond the normal dividend? The stock is still near all-time highs. The company does have a history of paying special dividends periodically. Is the thinking you're going to sort of remain prudent here as long as the guidance is off the table? Or do you return to share buybacks and potentially consider a special dividend given where the balance sheet is and then where the cash balance is? Then I'll pass it on.

Jane Morreau

Yes. So I mean, what we were doing in the net cash position, it is up a bit this year versus last year. It's really all the uncertainty, and we did it purposefully. We do have the proceeds from the sale of Canadian Mist, Early Times in there. We are not planning – as we always do, as I mentioned earlier, we want to fund our business. First and foremost, nothing has changed. We mentioned today a $125 million investment. We're going to – that just was approved by our Board of Directors to spend to expand our bourbon making capacity in Kentucky. So that is something that we're doing.

Our dividend just went up, but we do not have any plans for this fiscal year. So there's too much uncertainty and volatility. We've got lots of things coming up, who knows. While we're cautiously optimistic the tariffs will go away, if tariffs goes the other way in June, we – having the cash on hand is pretty important to us, and we just really don't know what's happening. So again, that was purposeful what you're seeing on our balance sheet and really the mix of how we're doing this between our short-term debt and cash. And so that's been planned for this fiscal year.

Operator

Ladies and gentlemen, we've reached the end of the allotted time for the Q&A session. Are there any closing comments from management?

Steve Cassin

We would just like to thank you, Sia, and thank you, Lawson and Jane and to all of you for joining us today for Brown-Forman's second quarter and first half of fiscal 2021 earnings call. If you have any additional questions, please contact us. And with that, we'd like to wish you all a safe and wonderful holiday season. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference call. You may now disconnect.