Brown-Forman Corporation, Q4 2017, Earnings Call 2017-06-07

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 Fourth Quarter Fiscal 2017 Year-end Conference Call. — ***Operator Instructions*** —

I would now like to turn the conference over to Jay Koval, Director of Investor Relations. Please go ahead, sir.

Jason Koval

Thanks, Dorothy, and good morning, everyone. I want to thank you for joining us for Brown-Forman's Fourth Quarter 2017 Earnings Call.

Joining me today are Paul Varga, our Chairman and Chief Executive Officer; Jane Morreau, Executive Vice President and Chief Financial Officer; and Brian Fitzgerald, Chief Accounting 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 fourth quarter fiscal

2017 in addition to posting presentation materials that Jane will walk though momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events & Presentations.

In the press release, we've 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, 8-K and 10-Q reports filed with the Securities and Exchange Commission.

During this call, we'll be discussing certain non-GAAP financial measures. These measures and the reasons management believes they provide useful information to investors regarding the company's financial conditions and results of operations are contained in the press release.

And with that, I'll turn the call over to Jane for her prepared remarks.

Jane Morreau

Thanks, Jay, and thanks for joining us for our fiscal 2017 year-end earnings call.

As a reminder, we have posted slides to our website that I will reference throughout my comments today to help walk you through our 3 main topics, which include: first, a review of our fiscal 2017 results; second, a deep dive into our initiatives to accelerate top line growth over the coming years through reallocating spend and continuing to provide leverage to the bottom line through substantial cost savings; and third, our outlook for fiscal 2018.

Let me start with our overall highlights shown on Slide 3. First, as expected, our full year and fourth quarter reported results were heavily impacted by acquisition and divestiture activity as well as FX headwinds. Now that we have last year's sale of Southern Comfort and Tuaca and given the dollar's recent stabilization, we believe our reported results will more closely approximate our underlying growth as we look ahead to fiscal 2018.

Second, in the fourth quarter, we experienced another modest sequential improvement in our underlying top line growth, which drove second half trends that were almost as twice as strong as the first half. This was helped by the emerging markets, which rebounded nicely off of last year's soft results.

Third, in fiscal 2017, we delivered meaningful operating leverage through SG&A discipline, a theme that should continue over the coming years.

And finally, we shared our outlook for fiscal 2018 in our earnings release earlier this morning. Given the solid top line trends we experienced in the back half of fiscal 2017 and our plans to further accelerate the business, we expect full year underlying net sales growth of 4% to 5% and underlying operating income growth of 6% to 8%. We also anticipate earnings per share in the range of $1.80 to $1.90, given a tax rate of roughly 29% to 30%. I'll come back to our outlook in a few moments.

So let's turn to a review of our fourth quarter and full year net sales results. We grew underlying net sales by nearly 4.5% in the fourth quarter. This represented the third sequential quarter-over-quarter improvement in our top line growth and helped drive 4% growth in the back half of the fiscal year as shown on Slide 4. While the full fiscal year's rate of 3% underlying growth was below initial expectations at this time a year ago, we believe that the trends we experienced in the back half of the year are more indicative of our run rate as we move into fiscal 2018.

For fiscal 2017, our underlying net sales growth was well balanced with each geographic area growing 4%. Growth was solid in the developed world, and we saw marked improvement in the top line rate of growth in emerging markets with second half underlying sales growth of 8% compared to a 1% decline in the first half. Global Travel Retail also rebounded nicely from last year's declines with underlying net sales growth of 7% in the year. These results were helped by distribution gains for Woodford Reserve, improved business with our airline as well as strengthening trends in European and Russian travel.

As illustrated on Slide 5 and 6, reported net sales for the full year declined 3%, pulled down by 3 points of A&D activity, 2 points of adverse foreign exchange as well as 1 point of lower distributor inventory level.

Slide 7 reconciles the full year's reported operating income growth back to underlying as the company's A&D activity in the fourth quarter of last year dramatically impacted reported results.

Slide 8 highlights our top 10 largest markets. It's worth noting that every one of these markets delivered underlying net sales growth for the year. Mexico, France and Japan were standout performers with each country growing underlying net sales growth double digits. Mexico's growth was fueled by our strong distribution capabilities and is skewed towards the fastest-growing categories within spirits, particularly whiskey, premium tequila and RTD.

France continues to benefit from the 2014 route-to-market investment we made that has allowed us to continue to gain share in a mature spirits market, our focus and attention on our portfolio of brands. And Japan's growth was enhanced by a 10% price increase that we implemented this past September. Poland and Russia also enjoyed improving trends with underlying net sales growth of 9% and 7%, respectively, as both markets enjoyed better consumer demand, particularly in the back half of the fiscal year.

In our largest developed markets, we delivered consistently solid results. The United States grew underlying net sales by 4%, the United Kingdom by 5% and Germany by 6%. Germany is not only delivering solid rates of growth, but we believe it is well positioned for future gains, given the improved brand awareness and brand status that we have achieved since building out our distribution in this market. Australia and Canada grew low single digits for the year.

Our other markets, which consists of a mix of small developed and emerging countries, declined 3% in the year as mid-single-digit growth in South Africa, New Zealand and Italy was more than offset by double-digit declines in Turkey, Brazil, China and Thailand. As expected, some of these emerging markets rebounded in the fourth quarter and appeared to be on an improved trajectory as we move into fiscal 2018.

Slide 9 breaks out our brands' full year underlying net sales growth. Jack Daniel's family of brands grew underlying net sales by 3% with gains for Jack Daniel's Tennessee Whiskey, Tennessee Honey, Tennessee Fire, Gentleman Jack and Jack Daniel's RTDs. Woodford Reserve and Old Forester grew underlying net sales by 20% and have maintained solid momentum after taking up prices in fiscal 2017.

Building on the great performance in fiscal 2016 for our tequila brands, el Jimador and Herradura had another record year, while New Mix RTDs reached a new milestone, surpassing 6 million 9-liter cases. Collectively, our tequilas grew underlying net sales by 12% in fiscal 2017. el Jimador continues to grow well in the United States as a high-quality, attractively priced 100% agave tequila and was recently named as an Impact Hot Brand as it surpassed a 0.5 million 9-liter cases in that market. Herradura experienced solid demand in both the United States and Mexico as a smooth-sipping tequila with great heritage and authenticity. And New Mix grew underlying net sales by 17% through a combination of price increases and volume gains.

Finlandia delivered improved full year results as underlying net sales were down only 1% in the year. The macro and competitive environment for premium vodka in Poland and Russia remains challenging. Sonoma-Cutrer grew mid-single digits while Chambord and

Korbel were both up low single digit. Canadian Mist and Early Times declined in the year.

Our used barrel business has been a stubborn top line drag throughout the year, resulting in an 18% decline in our other nonbranded sales. Used barrels were a 50 basis point drag on our full year underlying net sales growth. Given our visibility into the contracts through the end of this calendar year, we anticipate that this business will remain under pressure in fiscal 2018.

Moving down to P&L shown on Slide 10. Reported gross margin declined 190 basis points for the full fiscal year. This decline includes 90 basis points of impact from A&D activity, 70 basis points from foreign exchange and 30 basis points of underlying change.

Slide 11 summarizes our operating performance on both a reported and underlying basis. Focusing on the full year underlying performance, you'll note that our gross profit was up 3% and underlying A&P increased 2%. The big news on operating costs in fiscal 2017 was our increased focus on initiatives that allowed us to better leverage many of the investments that we have been making over the last few years, such as route-to-consumer. Fiscal 2017 SG&A declined 2% on an underlying basis or 3% on a reported basis, helped by 1 point of lower compensation-related expenses. In total, we delivered 7% growth in underlying operating income during the year, down 35% on a reported basis.

Full year diluted earnings per share declined 34%. Now recall that fiscal 2016 included the $485 million gain from the sale of Southern Comfort and Tuaca. Excluding the impact of this sale, full year earnings per share increased 5% as shown on Slide 12.

As I mentioned earlier, our underlying net sales grew over 4% in the fourth quarter, but I also want to point out that our reported revenues were down 5% in the quarter. So in addition to the 5 percentage points of impact from A&D activity and foreign exchange, lower distributor inventory levels pulled 4 points from our reported net sales growth.

This reduction in inventories was larger than anticipated and mainly driven by the United States as well as a reduction in inventories in Spain associated with the summer transition to owned distribution.

Fourth quarter diluted earnings per share came in at $0.37, down 5%, excluding the A&D impact also shown on Slide 12. We estimate that lower U.S. inventory levels and Spain route-to-consumer changes have the effect of reducing our earnings per share in the fourth quarter by roughly $0.03.

Let me now move on to my second topic for today and share some color on the initiatives we are implementing to build on our back half sales growth momentum. This includes reallocating operating costs from the back office to more consumer-facing activities while simultaneously leveraging cost savings to operating income growth.

The 3% underlying top line growth we delivered in fiscal 2017 was below our long-term expectation, but to keep the year in context, over the last decade, our mean and median rates of underlying net sales growth have been 5% and 6%, respectively. In the back half of fiscal 2017, 4% growth was clearly a step in the right direction toward achieving our 2025 aspiration. Given the volatility in the world and the increasingly competitive marketplace for spirit, we are using this opportunity to sharpen our focus to have better efficiency and ensure that we return to historic rates of growth.

Over the short term, these efforts have largely come through the SG&A line as we reduced discretionary spend, such as P/E, meetings, consulting costs as well as reallocated resources that had been dedicated to Southern Comfort to other areas within the company. These cost-containment programs were successful in allowing us to achieve a 2% decline in underlying SG&A in fiscal 2017, 5 points below our underlying net sales growth and translating into leverage of over $30 million.

Over the medium term, we are targeting fiscal 2018 through 2020 cumulative savings of approximately $100 million. We believe these additional P&L savings will boost our productivity by better leveraging our assets in prior investments, such as production facilities, homeplaces, route-to-consumer, supply of whiskey, brands and our people. More importantly, we expect these efforts will create opportunities to invest even more aggressively behind our brands, further accelerating top line growth.

Let me share a few examples that are highlighted on Slide 13. First, the pricing environment remains challenging, so our teams are better utilizing analytics to create an ideal balance of volume growth and price. We're also looking in – to fine-tune the management of our revenues, examining the depth and frequency on our discounting, evaluating the effectiveness of our promotions and negotiating better trade terms for our brand. These efforts should allow us to drive better price/mix and help offset cost inflation.

Second, on our cost of goods, because we are in an aged spirits business, many of our costs over the next few years are already locked and loaded, but we have several projects underway that we expect to help us partially offset the capacity, absorption and higher content costs that will be coming through our P&L the next couple of years. This includes sourcing raw materials, improving production process at the distilleries and cooperages, and refining our packaging without sacrificing the high quality of our products.

Third, on SG&A, we will continue to be cost conscious over the coming years. So while the comparison of fiscal 2018 will be a challenging one given this past year's 2% decline, we have tasked our teams to better prioritize their own efforts to target flattish underlying SG&A, even after incorporating the Spain investments and start-up costs associated with the Old Forester and Slane homeplaces and distilleries that we will make in fiscal 2018.

And finally, at the same time these cost-saving programs are in action, we will be reallocating to and reinvesting significantly in the A&P of our brand portfolio. This includes spending less on traditional market research and more on media as well as we look to maximize the return of dollars reinvested back into the business. We believe this multi-pronged approach positions us well to better – realize better top line growth in an ever-changing global environment while achieving permanent cost savings that translate into strong bottom line performance.

Now let me move on to my third and final topic and put it – pull it all together by sharing our outlook for fiscal 2018 with the key metrics highlighted on Slide 14. Takeaway trends in our major markets remain solid, and we are seeing improved results from many of our historically fast-growing emerging markets shown on Slide 15.

From a portfolio perspective, we expect growth to be led by the Jack Daniel’s family of brands. The brand family will have cleaner comparisons in fiscal 2018 versus lapping the Fire launch this past year and should benefit from the fall introduction of Jack Daniel’s Tennessee Rye into the U.S. marketplace. Our portfolio of bourbon and tequila brands is also poised for additional gains on top of fiscal 2017’s high rate of growth.

After integrating our newly acquired Scotch brands into the company during fiscal 2017 and preparing for the recent launch of Slane Irish whiskey, we expect these brands to begin to contribute to top line growth during fiscal 2018 through thoughtful seeding and leveraging our route to consumer.

In total, these items should drive underlying net sales growth of 4% to 5% in 2018. We expect somewhat higher rates of underlying net sales growth in the front half of the year, given more challenging comparisons in the back half. Underlying gross margins will likely be down slightly as price/mix is offset by higher cost. Recently implemented and planned cost savings measures will have a more meaningful impact during the outyears.

Regarding operating investment, we expect to aggressively invest in brand support, activation and media with underlying A&P growth at or slightly above our underlying net sales growth rate. We are targeting flattish underlying SG&A in the year, driving a few points of operating leverage. In the aggregate, we expect underlying operating income growth of 6% to 8%.

Assuming current spot rates, foreign exchange headwinds should continue in the first half of the fiscal year and subside as we move into the back half, netting to minimal additional foreign exchange impact in the year. However, given the volatility in the economic environment, it's worth noting that if foreign currency cash flow exposures collectively move 10% in either direction, EPS for fiscal 2018 would be impacted by roughly $0.06 per share.

We currently forecast our tax rate in the 29% to 30% range, negatively impacting year-over-year EPS growth. After considering the impact of a slightly higher effective tax rate and a modestly unfavorable impact from the combined effects of foreign exchange and route-to-consumer investments in Spain, we anticipate EPS of $1.80 to $1.90.

So in summary, fiscal 2017 was a very busy year at Brown-Forman and one that we would characterize as a year of delivering solid results while taking the appropriate steps to better position the company to return to historic rates of top line growth. While our underlying net sales growth of 3% came in below our long-term aspirations, we began to implement cost-containment efforts to help mitigate the top line malaise, driving another year of high single-digit growth in underlying operating income.

The back half of fiscal 2017 experienced a solid improvement in trends to over 4%. And we will build off this momentum with the assistance of new product innovation in fiscal 2018, including Jack Daniel's Tennessee Rye, new RTDs and Slane Irish whiskey and the seeding of our Single Malt Scotch brand as well as improved contribution from the emerging market.

We will continue to take actions that we anticipate will help drive further top line momentum while increasing the efficiency and effectiveness of our organization. This includes the reallocation of dollars from SG&A to A&P as well as our new partnership with the NBA and refreshed creative across the Jack Daniel's family of brands.

Our team has experienced slowdowns in the past and is confident as ever in our strategy to realize the significant potential of Brown-Forman's brand portfolio and create value for all of our stakeholders. In the meantime, we believe our business remodel remains an excellent one.

In fiscal 2017, we delivered a 33% operating margin and a 19% return on invested capital, both top-tier metrics. And we have been investing in some of the largest capital projects in our history over the last 5 years while returning an average of $850 million to our shareholders in each of those 5 years, equating to a 4% annual yield and helping fuel 13% annual TSR. And over 10 years, our TSR was even better at 14%.

So with that, let me turn the call over to Paul for his comments.

Paul Varga

Thank you, Jane, and good morning, everyone. When we began the year, we knew that FY '17 would be, in some ways, a uniquely challenging year to communicate. Beyond the normal fluctuations associated with foreign exchange and inventories, some of the things we knew that would create that challenge were, first, the sale of our liqueur brands and the resulting gain on that sale, all of which occurred last spring; around the same time, the purchase of our Single Malt brands and their resulting integration throughout fiscal year '17. Both of these items, of course, were implemented with the aim of positioning the company for sustainable growth in the years ahead.

Additionally, we had the reality, which you were well aware of, of cycling against Jack

Daniel's Tennessee Fire's large-scale intro in the United States, particularly in the first half. As part of this, we correctly, in my view, did not introduce another flavored whiskey, instead opting to continue expanding both Jack Daniel's Tennessee Honey and Jack Daniel's Tennessee Fire while readying the system for this year's forthcoming Jack Daniel's Tennessee Rye launch.

And, of course, as you've heard throughout the year, the impact of the used barrel business cyclicality, which, as you know, is not our primary core business but important to understand nonetheless when digesting our earnings. Each of these impacted our reporting and underlying financials in various ways throughout the year and required a little extra attention on our and your part in understanding the overall results.

When the year concluded, we had grown underlying operating income by a very nice 7%. And I believe we continue to position the company for growth in the years ahead. That continued growth expectation is reflected in the guidance that Jane shared with you just now, which forecasts an acceleration in underlying sales growth in the mid-single digits, improved A&P investment, continued cost controls and SG&A efficiency, all of this leading to strong underlying operating income growth similar to FY '17 and our long-term average in the high single-digit range.

So overall, in closing FY '17 and '18, I think everybody here at Brown-Forman feels pretty good about the way we're entering this next fiscal year and actually the next several years and the growth prospects that lie ahead of us.

During our planning cycle, I regularly remind myself of the basic business model we deploy to create value. This model strives, as you know, for superior long-term value created – creation associated with building premium brands. And within the world of premium brands, we are skewed strongly to spirits. And within spirits, premium whiskey has and remains our dominant category. And we have prominent examples in the portfolio of both acquired and organically created brands.

The key metrics on which we focus in assessing the progress of our business are the triad of operating margin, return on invested capital and net sales-led profit growth. And while we view these measures individually, their greatest impact is when they are operating as a powerful combination of metrics.

We view operating margin as the reward for building premium brands to meaningful scale over time. And at our company, there's no better example of that than Jack Daniel's. We believe return on invested capital pairs that strong operating profit with thoughtful capital deployment, and the resulting metric is symbolic of both capital efficiency and the organic nature of our company and brand development.

And lastly, we understand the importance of sustainable growth, growth derived from building ever stronger and larger consumer franchises across the globe. And as was the case in the past year or so, we periodically reshape our portfolio to better position it and the company for this kind of sustainable growth.

When looking at our historical track record on these 3 important metrics, I am struck by the quality and consistency of these metrics at Brown-Forman. In each of the instances I'll cite here, I've looked back over the last 10 fiscal years towards a significant and rather lengthy time period. On operating margin, which, as Jane just said, ended FY '17 at 33%, we averaged an excellent 30% over the last 10 fiscal years with steadily improving margins noted across the decade of performance. Again, this was the reward for building an ever-more-premium portfolio to more meaningful size.

Beyond the obvious Jack Daniel's Tennessee Whiskey example, noteworthy contributors to this would be brands like Jack Daniel's Tennessee Honey, Jack Daniel's Tennessee Fire, Woodford Reserve, Old Forester, Herradura and Sonoma-Cutrer, so very nice balance across the portfolio.

On return on invested capital, which ended FY ’17 at 19%, we averaged roughly 20% over the last 10 years. And this incorporates the cost of acquisitions and our recent significant capital investments behind production capacity and brand building, investments to ensure the Brown-Forman success story continues.

And on underlying sales, which was 3% in FY ’17, and underlying operating income growth, which was 7% in FY ’17, we enjoyed similar quality and consistency over the 10-year period. Underlying sales growth averaged 5%, and underlying operating income growth averaged 8%. And it’s noteworthy that the upper end of the ranges of guidance we provided today for FY ’18 approximate these long-term rates of underlying growth.

As an even stronger indicator of consistency on this growth metric, consider that we grew underlying sales and underlying operating income in each and every one of the last 10 years. And on the underlying operating income metric, our lowest one year of growth was a very acceptable 4% in a very challenging FY ’09.

Taken together, a business model consistently producing 30%-plus operating margins, 20% ROICs and 8% underlying profit growth will create excellent shareholder value over time. This has been our experience of the last 10 years, and it is our aim and expectation to sustain this excellent model going forward. We continue to be optimistic about the global opportunity for our brands. And as you know, we speak about this opportunity regularly with you and most recently did so at last December’s investor conference. And I’ll refer you to that presentation for a more detailed description of the long runway for growth that we foresee for Brown-Forman.

Now of course, we do not take any of these metrics and resulting company success for granted, and sustaining or even improving on those metrics takes an enormous amount of work and investment by our company. So in closing, let me thank and congratulate all of my colleagues across Brown-Forman for their superb efforts, both in FY ’17 and over the 10-year time period that I’ve referenced here this morning.

That concludes our prepared remarks, and so we’re now available to take questions.

Question and Answer

Operator

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

Vivien Azer

So I wanted to start, please, on – with the A&P commentary. Paul and Jane, I think it’s quite encouraging to hear that it’s going to track with sales, given that A&P on an underlying basis really had been lagging your top line over the last few years. So – but as you think about kind of deploying that incremental investment, 2 parts please, number one, how you’re thinking about brand hierarchies and how you’re going to prioritize around that, and number two, any geographic focus that you’ll call out.

Paul Varga

Sure. I mean, I think the brand hierarchy would not surprise you. I mean, it – I mean, the focus would be along the lines of the Jack Daniel’s family. I think certainly from year to year, you would see an increased emphasis on some of the innovation, the launching of brands like Jack Daniel’s Tennessee Rye, certainly increased investment on the expansion of our single malts into FY ’18, for sure, is a contributing factor. Woodford Reserve has been receiving incremental investment steadily. So I think it would be along the lines of those premium whiskeys and premium brands that we’ve highlighted consistently.

Jane Morreau

And from a geographic basis, we are allocating a bit more to the United States, some of which is what Paul was alluding to as it relates to our innovation. That's where Jack Daniel's Rye is going to be launched initially in the seeding of Slane. And then also we are investing more behind Woodford Reserve. That came through our planning process this year as well as other – the Gentleman Jack, we're actually doubling our media investment there, too. Some really good creative. I did, Vivien, I just wanted to pause for just a moment, and something to – I was looking at recently with the Board of Directors, we looked back at our A&P spending over the last 6 years. And when we looked at it, stripped up Southern Comfort for those last 6 years, we actually spent more than our underlying net sales growth. And 2 of them, we spent at. So I think some of it is infusing those years that we didn't have – we had Southern Comfort in there. It's probably something that we – to share with you all at this point in time.

Paul Varga

Yes, but it definitely distorts the figures.

Jane Morreau

It certainly distorts it, yes.

Vivien Azer

Just following up on the shift in your A&P dollars, can you talk a little bit about the decision to move dollars out of market research into media? I mean, I certainly – the incremental media makes a ton of sense to me. But given how dynamic and competitive the alcohol industry is right now, I'd just love to hear some incremental thoughts on reducing your investments in market research.

Paul Varga

Yes, I wouldn't read too much into that one as – but I think the – those – that is an example I think that Jane cited is really more along the lines of given the competitiveness that exists in markets around the world today with so many new increased competitors, et cetera, and their imminent realities of needing to get your dollars into – whatever those programs are oftentimes described as media or efforts at retail, et cetera. But having what we call sort of working dollars against the consumer, and I think some of what those reallocations that we reference are in some ways long overdue because the world of being able to observe consumer behavior or get consumer feedback has been changing so significantly in the last 5 to 10 years because of everything from social listening to the ability to get directly to your consumer because of the increased access through technology, that – I mean, it's a natural consequence that you could move media dollars to where the consumer actually is today. And so I actually find that particular example to be one that's a pretty natural reallocation. It doesn't mean that you don't need to be in touch with your consumer at all. I wouldn't want that misinterpretation. And frankly, what we know and have access to today is far greater than it would have been 10 years ago. And so we used those examples of just highlighting that what we've communicated inside our company to our employees is the desire to really have FY '18, '19, '20, I mean, really putting forward our best foot as it relates to active investment against the consumer. So we give examples inside like a little less planning and a little more execution or a little less backroom and a little more front line. And these are subtle examples, because you absolutely need all of this in order to run your business successfully. But in this subtle reallocations, we used those types of examples, and we thought we'd share a few of them with you today.

Vivien Azer

Terrific. And just one last housekeeping item. Jane, you called out the inventory destocking in the U.S. Was that just kind of normal course of business housekeeping? Or are you seeing your wholesaler and distributor network start getting a little bit leaner in terms of inventory on hand?

Jane Morreau

I think it was a bit more than we expected and a bit more than we would expect if we look at next year. I think we'll have maybe $0.01 giveback next year, but it was a little bit lower than we expected. Last year, it was slightly higher. So I think it was more – we expect it to be about $0.01 coming back next year.

Paul Varga

But not a fundamental shift related to tight finances or things like that. I mean, it really just more timing related.

Jane Morreau

Yes, timing-related. Yes, thank you.

Operator

Your next question comes from the line of Nik Modi with RBC Capital Markets

Nik Modi

I was wondering if you can provide maybe some more color commentary on the pricing discussion you were saying about the challenges you're seeing right now. Just if you could be more specific and just give us some examples. And then on a related note, as you think about the $100 million in cost savings, how much of that is pegged to some of the trade spending ROI that you referenced during the conference call?

Paul Varga

Jane, you want to take the second one first, and then I'll address the pricing one?

Jane Morreau

Yes. So let me make sure I understand what you are after on the second – on the $100 million and return on invested capital. Is that what you say?

Nik Modi

No, no, no. I was asking, of the $100 million that you're talking about, how much of that is linked to getting savings out of your trade spending as you referenced during the conference call?

Jane Morreau

Oh, I see what you're saying. Okay, so how much is coming from our better analytics as it relates to depth and breadth of frequency of promotion and things like that? Yes, that's a great question.

Nik Modi

Correct.

Jane Morreau

So just so you know, as we've discussed in the call, these initiatives are something that we have just started in earnest in F '17. So the split and how they may come about will likely change from where we see it today. And so I think, more importantly, in the short term, we have already seen a lot it come from SG&A. And I think you're going to see a bit more in the SG&A as we look into F '18. Then when we look at our cost of goods that I was alluding to, those are the programs that take a bit to get into place and just how our inventory comes through because of the aged products. Those will be over the coming – pursuing years. And then the depth and breadth of – or the effectiveness of our discounting, if you will, the effectiveness of how much spending that we'll have there that will be as we – we're actually in the early stages of that – for that particular aspect will change over time.

Nik Modi

And Jane, if I could just interject real quick, how much of a percentage of sales is trade spend, the gross to net? Can we just get a rough parameter of how big it is?

Jane Morreau

I mean, our discounting dollars are some – are around the $600 million, not all of that is trade spending. Some of it's just the future exit.

Paul Varga

On a base of – a gross base of 4 5.

Jane Morreau

$4 billion, yes.

Paul Varga

So — ***indiscernible*** — a little more than 10%.

Jane Morreau

Yes.

Paul Varga

Oh, and on the pricing question, I mean, look, this is a obviously a regular question that we explore each year, and we've talked about it in the past. I really – this is something I think is really important for this year. And maybe if you think about, there are various times where it's – we feel you're more compelled to take prices up. And I would cite a couple years ago when industry supplies were a little tighter. There weren't as many competitors, particularly the – a lot of these new upstarts in allowed-to-develop markets. There are – have been examples related to currency where we've taken prices up in some of the emerging markets around the world. But I think as a general sense, we are leaning a little bit more on the volumetric quotient this year than pricing as a conscious decision because of what we consider to be the importance of true consumption-based volume development of the brand. I mean, I know you understand there's volume and pricing, obviously. But in our business, I've just have always felt that there are times where, particularly in a social business, where the brands interact into the public domain and people actually observe the consumption, I really do feel like that from time to time, you really want to make sure that your volumetric market share has the support and doesn't have the, in some cases, the challenge of rising prices. And I think one of those times is upon us right now. How long it will last is an open question. I would give the example of last year, Woodford Reserve took some nice pricing in FY '17. And then this year, and it's – will take a little bit of price but not near as much as it took last year. And part of the reason it is, is that's a very competitive super-premium American whiskey and bourbon category. And Woodford Reserve needs to continue to retain its share of consumption in that and particularly with all the increasing competition. You will see us change prices where we feel like positioning is not appropriate. And we, in various countries, will do that from time to time. The one that has been most recently implemented was we really felt like down in Mexico with el Jimador, we had the opportunity for business model reasons but also just to compete in the marketplace where we wanted to compete to fundamentally reposition the brand on price. You'll have some examples like that as well. But I do feel like FY '18, one of the themes is leaning a little more heavily on volume versus price to drive our net sales growth.

Nik Modi

Great. And then if I could just ask one more and just address the elephant in the room because I'm sure most people are wondering. Usually in cases where M&A is being discussed in the media, most companies don't comment on any rumor. But in this case, Brown-Forman came out with an official release. And I just was wondering, Paul, what prompted that? Why take such a strong reaction to what was being said in the press?

Paul Varga

I think there were a couple of things. And there's an art, of course, to saying something without saying anything. And we, of course, do not comment on any specific speculation.

So we held and continue to hold to our – I think the policy that served us well there. But I think because of the noise in the marketplace that I think the way that it was – that some of the trading volumes in our stock, the way it was affecting our stakeholders, our employees, et cetera, and the interesting thing is all we said was something that we've said many, many, many times before just against the backdrop where you had all that noise. And in my view, it was well timed and said enough.

Operator

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

Judy Hong

So I guess I wanted to get a little better understanding of how you're seeing the U.S. market right now. I mean, if I kind of look at the fourth quarter, underlying sales growth, up 1%, I know the market was kind of slower in the beginning part of the year but just seems like it was weaker than what's certainly been trending in the first part of the year. So what do you think has sort of caused that slowdown in the fourth quarter? And then within kind of that 4% to 5% underlying sales growth outlook for fiscal '18, where do you think kind of U.S. stacks up there? And then any kind of color around the rye opportunity and how much incremental growth that you think that, that can provide?

Jane Morreau

Yes. So let me start and I'm sure Paul will chime in here. First of all, Judy, as you can imagine, we don't focus heavily on any given quarter. And so there was some noise within the quarter. I think it's better to pull ourselves back and look more at the syndicated data and look at the – our Brown-Forman value growth in the U.S. And it's been running in the 3.5% to 4% range on a blended basis, on a value-growth basis. And I think some more recent Nielsen trends also show some improvement there. So that's something to keep in mind because you're going to have noise in any given quarter results. So I do acknowledge and we all acknowledge that the U.S. market and the competitive nature is very intense, and we had things in slowdown in TDF and our own trends, again, just noting again that the syndicated – more recent syndicated data is showing some improvement, which is encouraging. Now as we look ahead to fiscal ’18, there’s – I would like to think about this in a couple of buckets. I’ll talk about innovation, and then we’ll talk about our core business that we have today, from tequilas to premium bourbon to the Jack family. So as we looked further to ’18, a lot of the innovation, I said earlier, was going to be focused in the U.S. So rye will be coming through in the U.S. That’s where we’re primarily – primary launch is. We’re going to be introducing Slane this summer in the U.S. We are going to further see the [free] Scotch – Single Malt Scotch brands in the U.S as well. So we’re going to get a lift from that innovation, if you will, from these brands. On top of that, our tequila brands continue to perform very well. In syndicated growth rates there, we’re doing very well. Our cost book el Jimador and Herradura, we expect another solid strong year from them. We look at our premium bourbon, that’d be Woodford and Old Forester, and we expect – again, they had another year of solid growth, as I said, 20% increase in net sales. We’re actually expecting an acceleration – a bit of acceleration next year, and let me tell you why. On the Woodford front, we are spending incremental dollars behind that, and we think we’ve got some good programs there. We have a new package on our Double Oaked that’s beautiful if you haven’t seen it. It’s coming out. We think that’ll do very well. In the Old Forester front, we also have a lot of tools in our toolkit ready to go there. We’ve got new package. There’s a movie coming out this fall that it’ll be – Old Forester will be – you’ll see it in there. A new product called Statesman is coming out, so there’s a lot of exciting things. So that’s why it gives us confidence that we’ll have an acceleration in our growth rates there. Now let’s talk about Jack Daniel’s Tennessee Whiskey, if you will. I think the way I would think about Jack Daniel’s Tennessee Whiskey and really the Jack Daniel’s Tennessee Family of Brands too is that we’re going to do a couple things. We’re going to not only increase our visibility of the brand, and I’ll talk about that in a moment, but also the accessibility. And the visibility strength is, we have a – we've alluded to in our comments earlier about the NBA contract. So with that, of course, the finals are going on now. The WNBA will have theirs soon. So there's a lot of activity with that. So we'll have increased media spend that's going on. So the visibility, the NBA is a very exciting opportunity for us, just the number of consumers that drink Jack Daniel's and don't, and we think there's opportunity to recruit new ones there. And the accessibility of area, there's several tools that we have in place. We're going to do various things around holidays we're excited about. And so there's many things along those fronts that we have. And then across all of the Jack family, we've got a refresh creative that I think is really great. If you haven't seen the Gentleman Jack ad, it's a lot of fun. So there's a lot of new things coming from Jack in the various areas that I've just mentioned that we're focusing on. Paul is over there getting ready to say some things, too, so I'm going to pause for a moment and let you chime in on other aspects…

Paul Varga

Yes, the other part — ***indiscernible*** — I think the last part of your question was about just discuss the rye opportunity in a little more detail. So I just thought I'd, I mean, just add a few points on that. I mean, one thing you'll hear us regularly, and we said it several times today about this leveraging existing assets. And one thing you have to remember, of course, that you'll notice that we've – it's so easy to forget, is that you would've had to have made these products so many years ago to have the assets called supply today. And we are entering a period just now and really the last year looking back and into this year and in the next couple of years where we're going to have really ample rye supply. And this category is not a huge category across the United States right now. And one of the challenges is that can people get their hands on high-quality rye. Maybe this one might have escaped you in the past, but Woodford Reserve introduced a rye a while back. Jack Daniel's Single Barrel at the very super-premium end has arrived. Both those are doing very well in the marketplace, are getting nice critical acclaim, and now here comes Jack Daniel's Tennessee Whiskey rye at a premium price point to regular Black Label. And the thing that gives me so [awe] in this example really utilizing the assets that we have of ample supply now. And I take heart from the fact that, in previous instances, at least in my career, where Jack Daniel's entered the super-premium whiskey category with Gentleman Jack, when Jack Daniel's has entered the RTD segment so successfully and here more recently as you all will have all observed its entry into the flavored whiskey business, Jack Daniel's has an impact. And consumers really enjoy drinking products from the Jack Daniel's distillery that are unique like this. And so we've got high hopes for the Jack Daniel's Rye brand. I mean, we don't know, and one of the hard questions on this as you look out over the next few years is how big could it be internationally. But we had those exact-same questions when we were sitting and thinking about the super-premium American whiskey business, which is relatively undeveloped above Jack Daniel's price point years ago. The – when we thought about American whiskey-based RTDs, there weren't many of them out there in many of these markets. The flavored whiskey, same questions. So in some ways, it is an open question, but it will be something we certainly explore over the next few years to see what the possibilities are there. But it's – I actually feel like kind of back to Jane's comments, I mean, the U.S. really does have – it is really teed up and prime for an excellent year. Now having said that, it is an incredibly competitive and wide-open marketplace where a lot of competition, a lot of investment available to those competitors, and we have to execute extremely well. But I really do feel like we've lined up our – the United States for an excellent year, and now let's just go see what happens.

Jane Morreau

I thought I might build on one more thing that Paul said, just it's given perspective, I think you were trying to get to some volumetric things, and I will say when we did rye and when we did Fire and we did Honey, they were 400,000, 500,000 cases in their year 1. And what we – this is much smaller than that.

Paul Varga

But supply constraint.

Jane Morreau

Exactly. Supply constraints. But again, as he mentioned, it's going to be premium priced to Jack, proof – higher proof as well. So...

Paul Varga

Yes. And I will say one of the interesting things we'll be see – interesting to see how it plays out in the trade. But we have waited to enter this market because we wanted to make our own rye whiskey. And it strikes me that all of the rye whiskey that particularly presented by the premium leaders in that category today, the products they're selling for the most part are not made by them from their own distilleries. And so that I really do believe there's a credibility factor related to Jack Daniel's producing its own ryes, Woodford Reserves similarly. And so it would be interesting to see how this plays out over the next couple of years.

Judy Hong

Got it. That's very helpful. If I could just follow up on the cost-savings program. I mean, I guess I don't recall in recent years where you came out with actually like a multiyear $100 million type of program. So I was just curious, sort of, what was the kind of the premise in terms of coming up with sort of a hard target number. Perhaps it's maybe in response to some of the rising competitive pressure and the need to kind of find resources to invest in the marketplace. Or if you're looking at benchmarking against the – some of your peers and sort of finding opportunities and kind of is there more to go after 3-year period.

Paul Varga

That's a – I mean, you outlined it, I thought, very well there. I think it's really the latter 2 points you made, that wanting to remain competitive, finding opportunity. Over the years, we've been less overt, I agree with you, at times. We definitely did some of this, I forget how we actually phrased it back in the '09, '10, maybe even into '11 period a little bit. We certainly were talking about this one concept that we regularly explore. I mean, if you just think about Brown-Forman's, what exists between our gross sales and our net income. I mean, there is in the range of $3.8 billion of available resources there. Everything from discounts to cost to investments you make, to taxes. And I really do think it's smart from time to time for companies to regularly be looking at those resources and seeing if just – even if you don't change the aggregate amount, even if just subtle shifts or – and sometimes important shifts can make an impact on the sales growth rate and make their way down to the bottom line more efficiently. And I remember there was a little period back in that time when we really were working packaging an RTDs. And so the investment actually showed up in some interesting ways. I mean, it showed up in your cost of sales and not in your A&P line. And we've had a few examples of that this year. Jane referenced like the Woodford Reserve repackaging, the Old Forester. So there are examples of it. But nonetheless, the way you actually stated the last 2 elements of that, which were to remain competitive and make sure you're putting your resources forward to maximum impact, is the real reason.

Operator

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

Robert Ottenstein

Two questions. The first one, Paul, I understand how you want to invest more behind the brands. My question is more about brand positioning. And the thought is, one of your major European competitors recently had a Capital Markets Day and talked about how the consumer is redefining status, redefining premium. There's a democratization of status. People are going from being self-centered to be more generous, a whole range of things like that in that – what counted as status in the past isn't necessarily that today.

And given Brown-Forman's focus on the premium segment, do you agree with that, that status and premium is being defined today differently than it was 20 years ago? And how do you see yourself evolving along those lines?

Paul Varga

That's a really interesting question. Yes, of course. I think we could look to the world and see examples of how luxury is suddenly being redefined, or I mean, one of the – and some of the comments you were referring to there actually are – it's a sweet spot I feel of why bourbon and American whiskey are doing so well. We've talked about that at times. I mean, I'd be glad – it'd be fun to go back and read our Annual Report letters from last year, where we took that topic on quite directly related to why, why is American whiskey and why are they growing in the way that they are? And of course, one of the questions that arises with us, I'm sure you all think about it, is all this rise of, say, authenticity and people seeking authentic products and all this. And, of course, I just referenced one of the great ironies. While they're seeking authenticity, underneath some of these products, actually, is not very authentic products. And so it is a great irony. And so against this backdrop, I'll give you the one example here over the last 18 months that would be emblematic of what you're talking about at our company. We have always had the asset of Lynchburg, Tennessee, and not only our wonderful products and the manufacturing operations, the quality that comes. I mean, it's an underestimated piece that the whiskey-making credentials and high quality of Jack Daniel's whiskey and liquid. And over the years, as you flex your marketing muscle in certain ways or – and make investments in certain areas of the P&L or behind elements of the marketing mix, most notably digital, things like that, we would take steps and move away a little bit from our home place. And what you would have seen in – I mean, you have to be watching it relatively close in compared to prior years, but our creative output is grounded far more today in what makes Jack Daniel's so real, so authentic and so valuable. And it's the story of the brand as grounded from where it began, where its heartbeat is today. And so if you even look at the first creative effort from Gentleman Jack that even references Lynchburg, Tennessee, really is out right now. The Jack Daniel's Tennessee Honey creative takes us back there. So there's an example of how we are attempting to – and these are subtle things, I'll admit. But put forward the best effort against the backdrop we see right now, which – I mean, there's just no reason for Jack Daniel's, because of its large size, to not be viewed as inherently one of the most authentic brands that ever existed. So we want to make sure we reinforce that with – more and more with our marketing.

Robert Ottenstein

And is – are you seeing the benefits of that in the brand equity among millennials?

Paul Varga

Absolutely. I mean, it's a regular chance – a challenge, as you know. I mean, one of the hard bits of this is to the extent that they are using the word authenticity to describe that they really just want what – sometimes you hear is the word discovery, something that is totally unknown or new. It's very hard and say the American marketplace for Jack Daniel's to be seen as brand new and unheard of. I mean, it's virtually impossible. But you can utilize the assets you have to emphasize the point that you think might be most important and relevant to millennials. And I think there are a fair amount of millennials who, as they discover products and categories and particularly in these whiskey categories like rye and American whiskey bourbon, that they'll be interested in more information about the brand. They won't just look at them for the name on the label or the latest tagline. And so from our vantage point, I think it comes down to telling the story as prominently and compellingly as we can so that they can learn more about it. And I do think it is a much more difficult exercise today with the array of competitive products out there. But in some ways, they will help position us as authentic as well by their own existence and behavior.

Robert Ottenstein

Terrific. And then my follow-up question is on kind of the global route to market, if you could kind of give us an update of where you are. You're always kind of, every other year, going into another country more independently. Maybe kind of where things stand with Spain and any other areas that you're thinking of in terms of significant route-to-market enhancement?

Paul Varga

Sure. I mean, Spain, obviously, is the latest example. And the one of the reasons we're so excited there is we've long thought that was a possibility because of the size and potential we think for Jack Daniel's trademark and other trademarks again set huge whiskey business there. And, of course, even the Spanish market had been so difficult for a lot of consumer products. So now we felt was the time as we started to see a little bit of a recovery. And it just seemed for us to be the right time to make that investment. We actually just launched it I think last week to real great enthusiasm and excitement, kicking it off internally for our own people. And so – but there will always be, Robert, I mean, I think examples. If you – I mean, like even in an owned place like Brazil from time to time, we think about how do we add investment to more geographically expand within that large country. So oftentimes when we go in and say we're taking a step forward in terms of forwardly integrating with route to market, it doesn't mean we're full scale in every aspect of the country all at once. So there'll be examples like that. I continue to think that the U.S. market is evolving right in front of us as it relates to route to market, of course there's that 3-tier network and the evolving wholesale community and all kinds of changes that are regularly occurring there. But all of the things that you have to stay alert to, the emergence of the direct-to-consumer aspect that's going on, and so all of the – and each state, of course, is regularly considering changes to its route to market in terms of availability of our core products in expanded ways. So I think in order to service that, we have to regularly tweak it. But one of the reasons we're seeing more SG&A efficiency today than, say, for those of you who followed us 10 years ago, is because that was a period where we were making those initial investments in developed markets to build out what we at the time might have referred to as distribution independence or route to consumer. And once you've done that in a number of places, and we've – even along the lines of the last 10 years, there were periods where we paused. But I do feel like now you make the use of those investments by – we're hitting this example, a perfect example would be utilizing Jack Daniel's presence in a lot of these developed markets, not only for the benefit of focus for Jack Daniel's, but to sell more Woodford Reserve, Old Forester, GlenDronach, et cetera. And so you should expect us to pursue more revenue synergies within the existing RTC assets we have.

Robert Ottenstein

And I guess you had closed – you had finished France a year ago. And I think – is that roughly right? And you had obviously very strong growth in France, 10% underlying growth. I mean, can you see that direct relationship between those investments and the growth, and maybe half of that growth came from the enhanced route to market?

Paul Varga

Yes, in the first year that it occurs, you have it distorted because you pick up some margin, but you pick up costs, et cetera. But after the first year, it really is down to the efforts of that investment – related to that investment. It's about focusing on your brands. And so yes, I would say that a good – I mean – and by the way, we've been, I think, in France 3 years now.

Jane Morreau

— indiscernible — '14.

Paul Varga

Yes, so it's 3 years. So the first year was distortion in the metrics because of the change.

But then in years 2 and 3, that's been attributable to continued focus on those. And actually in that particular country, it's just now that we're starting to show some excitement behind brands like Woodford Reserve.

Operator

Your next question comes from the line of Laurent Grandet with Credit Suisse.

Laurent Grandet

You mentioned, I mean, an improved contribution from innovation next year. You just highlighted Jack Daniel's Rye would be a big part of it. But could you please elaborate especially, I mean, how we could think about BenRiach, Slane, Coopers' Craft? Basically, I'd like to better understand in the U.S. specifically, would that be a regional launch, national launch? When and how big we should think about it? And if you can share a bit more about the premium price you are thinking for Jack Daniel's Rye, that would be great.

Paul Varga

Well, I'll answer the last question first. We see Jack Daniel's Tennessee Rye operating at a modest premium to Jack Daniel's Tennessee Whiskey and in the sort of sweet space that we're in the U.S. rye segment a lot of the volume is. So just around or below $30 a bottle, USD 7.50 is the way to think about that. And so – and we think – and look, there's a lot of activity in that particular price point, obviously, between $20 and $30, but even between $25 and $30 in the U.S. across a lot of categories. And so we think that is right. And then within a rye whiskey ladder at Brown-Forman, you will then have present examples from both Jack Daniel's Woodford Reserve and Jack Daniel's Single Barrel going straight up a rye ladder of price – premium pricing. So…

Jane Morreau

Yes, on your Slane aspect of the question, recall that we are building our own distillery in homeplace, which we hope to open – have opened this summer. And as a result, the whiskey that we have, whiskey we bought from third party, which we didn't turn – in turn finished ourselves. So we've just launched in travel retail in Ireland in April. And we are going to be very selective in our future launches of this because of this limitation on liquids. We have a number of states that we're going to in the U.S. It'll be on-premise-focused. And the same thing in the U.K., on-premise focused further out in Ireland. The price point on that's going to be I think EUR 30 is what is what is target to be in Europe.

Paul Varga

Yes. And one thing about the Slane product, I mean, one thing that's still been so nice for us just for the last year is, particularly in these last, say, 3 months has been some of the nice critical acclaim that our premium whiskeys are receiving across, I mean, really Woodford Reserve in certain aspects, but all – very much the single malts. I mean, the product is clearly in the bottle there. And so that is a huge asset as we go out and expand distribution and introduce the brand names to people. It's already – each of those 3 brands are getting very nice reception in a number of the competitions that exist as people go and evaluate and rate the high-end single malts. And then similarly with Slane. It tastes – one of the things that's making Irish whiskey so attractive to consumers increasingly around the world today is its drinkability. It's light. It's excellent-tasting category. But one of the attributes we're bringing, as Jane said, when we finish this, we're bringing a little bit of our Kentucky bourbon influence to that and the way we're finishing it. And so people are actually taking note of the fact that it's still very much in the Irish family but has elements of – and influences from some of the more robust bourbon flavors. So, so far so good on the reception to that.

Laurence Whyatt

And if you – I can really follow-up just on the U.S., I mean, clearly, Judy pointed out, there was deceleration over the year in 2017. So increased competition, more crafts rates coming in. So how you planning to maintain share space and also introduce new innovation in that context? Because I believe it's either more expensive or more challenging for you guys, I mean, to gain space.

Paul Varga

Yes, I – well, certainly more competition means more competition for everything, consumer palates then retail shelf space and backbars. I mean, this is where we have to depend on the strength of our distribution network and our experience there. I mean, if there's a single call we hear from a lot of the craft brands, and remember, we have some of them. I mean, Coopers' is in our view a craft brand, Woodford Reserve in my view was the original – one of the original brands that began this movement toward more boutique bourbons. And – but one of the challenges they all have is they have difficulty getting into distribution. I mean, many of these are starting in small neighborhoods, et cetera. And as they build out, one of the challenges they have is finding access to the marketplace. And that is certainly something that Brown-Forman would not share. I mean, we have quite an investment and quite a history of having a dedicated effort against our portfolio and great partners in the U.S. who prioritize the development of Brown-Forman's brands. So we periodically even get calls from people who will want to have us represent their brands and the like. So I do feel like, on that particular front, we will be more than competitive and hold our own.

Jason Koval

Thanks, Laurent. And thank you, Paul and Jane, and to all of you for joining us today for Brown-Formans' year-end earnings call. And please feel free to reach out to us if you have any additional questions. Have a good week.

Paul Varga

Thanks, everyone.

Operator

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