Brown-Forman Corporation, Q4 2014, Earnings Call 2014-06-04

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Brown-Forman Fourth Quarter Fiscal 2014 Year-End Conference Call. — ***Operator Instructions*** — Thank you. I will now turn the call over to Jay Koval, Vice President, Director of Investor Relations. Please go ahead, sir.

Jason Koval

Thank you, Laurie, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's fourth quarter 2014 earnings call. Joining me today are Paul Varga, our President 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 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 of fiscal 2014. The release can be found on our website under the section titled Investor Relations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, Form 8-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures and the reason 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. Thanks, everyone, for joining us today for our fiscal 2014 year end earnings call. I plan on covering 3 topics today, and then I'm going to turn the call over to Paul. First, I'm going to review our excellent 2014 results. And then, I'm going to briefly discuss our fourth quarter results and recent global trends we see entering 2015. And finally, I'm going to share our outlook for fiscal 2015.

So let me start with the review of our 2014 results. Simply put, we had a terrific year thanks to the balanced geographic delivery of growth from our leading portfolio of American whiskey brands, not to mention high-quality investments behind both our brands and our people.

Our underlying net sales grew over 6% in 2014. While this top line growth was slightly below the 7% we had targeted for the full year, we estimate that we outperformed our global competitive set by roughly 5 points, as their rates of growth slowed considerably during the year. We believe that our results have been less impacted due to the balanced approach to investment in both emerging and developed markets, as well as our disciplined management of risk. This approach has helped us draw out growth in both developed markets such as Western Europe while being – while avoiding being overly dependent on some of the emerging markets that experienced meaningful slowdowns this year, such as China.

So let me list – run through some of our geographic results. When we look at our emerging markets business, it performed quite well. In fact, we delivered 9% underlying net sales growth. Notably, we enjoyed sales growth of greater than 20% in markets such as Brazil, the former CIS countries, China, Turkey, emerging Africa, Southeast Asia and Russia.

But our results in emerging markets were not completely immune from the slowdown. In fact, in Mexico, our underlying sales declined 4%, driven in part by the first quarter giveback that resulted from inventory buy-ins at the end of fiscal 2013. In addition, an extremely competitive environment for tequilas also contributed to the decline.

Excluding Mexico's disappointing results, we delivered 7% underlying net sales growth in 2014. In Poland, we delivered 2% underlying net sales growth. We executed 2 price increases on Finlandia in the year, including one on top of a 15% excise tax hike. And we were able to deliver 4% growth in underlying net sales for the brand.

While we believe these are great results for such a mature category, we're closely watching the consumer response to this massive excise tax increase, as we believe this could adversely impact the demand for vodka. And in fact, we are already seeing some signs of softer trends in that market.

Let me move on to Brown-Forman's developed markets outside the U.S., where we delivered 6% underlying net sales growth. The United Kingdom and Germany both grew underlying net sales 8%, and France grew an impressive 18%. The incremental costs for our recent routes and market changes in France will show up predominantly in SG&A going forward. We expect that the benefit from higher sales and gross profit, as we no longer compensate a third party to distribute our products in France, will more than pay for the establishment of our infrastructure in this market in its first full year of operation. France's reported sales fell 12%, reflecting the decrease in shipments and corresponding inventory levels that occurred in the third quarter as we made this transition.

Australia grew underlying sales by 2% despite a weaker economy. We believe that the spirits market in that country has been negatively impacted by the disproportionately high excise taxes on spirits relative to other alcoholic beverages. Canada, our 10th largest market by reported net sales, grew underlying sales 4% and reported sales 2%. Japan grew underlying net sales by 13%, but reported net sales declined 11% as we lapped the large inventory buy-ins associated with the distribution change to Asahi at the beginning of 2013.

Turning to our U.S. business. Our underlying net sales grew over 4%, almost entirely driven by price increases and better portfolio mix. American whiskey continues to gain value share versus TDS after decades of decline, and we believe that the stable dynamics driving this growth remain intact, including consumer interest in authentic brands with heritage, not to mention the early stages of flavor innovation in this country. Off-premise trends remain healthy, but on-premise trends there are still declining.

With that, let me now move the discussion to our brands, where Jack Daniel's led the way. The Jack Daniel's family registered 8% underlying net sales growth, with net sales growth of 10% in markets outside the U.S. and 6% in the U.S. Jack Daniel's Tennessee Whiskey was the backbone of the family's global growth this year, and Tennessee Honey was once again an integral contributor, growing underlying net sales by 36% despite comparisons to the prior year, when the brand's net sales doubled.

Tennessee Honey has officially joined the rarefied air that Jack Daniel's enjoys as 1 of 20 brands over 1 million cases priced at $25 – over $25 per 750. We are extremely proud of the brand's success, driven in no small part through our thoughtful and disciplined approach to innovation, and we fully intend on taking the lessons learned and applying them to future products.

Jack Daniel's Single Barrel and Gentleman Jack together grew underlying net sales 12%

and depleted over 600,000 cases. Growth of 11% in the U.S. was almost as strong as the 13% growth registered outside the U.S. Jack Daniel's RTDs and RTPs also performed well, up 5%.

We continue to innovate beyond Tennessee Honey, including Winter Jack's rollout to the U.S., which helped drive depletions of over 110,000 cases. Sinatra Select depleted over 10,000 cases globally, and we launched No. 27 Gold, a twice-mellowed, twice-barreled expression, which appears to be off to a really good start.

In the fourth quarter, we also announced that we have begun testing Jack Daniel's Tennessee Fire, a new flavored spirit that tastefully blends the Jack Daniel's Tennessee Whiskey with a red-hot cinnamon flavor. This test is only in its second month in 3 states, but we've been encouraged by what we've been hearing, including positive qualitative feedback from our salespeople, distributors and in social media. The phenomenon of flavored whiskeys in the U.S. appears to be in its infancy, but it is already driving some of the most explosive growth that we've seen in the spirits industry in years. So we will evaluate a number of key metrics around the consumer and trade's receptivity to the brand, and we will keep you informed on the progress of this test on future calls. But with a brand as important as Jack Daniel's, you can expect us to be prudent with our approach, yet another example of how we manage the balance of risk and reward.

Woodford Reserve's family of brands grew underlying net sales by 26%, marking the 18th consecutive year of double-digit gains for the family, and we believe we were just cracking the surface of the brand's global potential. Old Forester grew underlying net sales 16% in the year, with accelerating growth in the on-premise as word spreads among bourbon connoisseurs. It's refreshing to see consumers return to authenticity, as Old Forester was not just our founding brand, launched in 1870, but also was the first bottled bourbon. And during the bourbon boom of the 1960s, Old Forester sold over 1 million cases per year.

Herradura and el Jimador grew underlying sales in the U.S. by 12% and 9%, respectively, but global sales suffered from the extremely challenging conditions in Mexico, where our Family of Brands experienced a decline of 8% in underlying net sales.

Fiscal 2014 was not a good year for New Mix, though our sales did stabilize somewhat during the year after the first quarter's large giveback. Southern Comfort's underlying net sales fell 2% in the year. Results outside the U.S. grew 2%, driven by a rebound in the United Kingdom. Results in the U.S. were disappointing, with underlying sales down 6%. We believe these declines are due to the persistent challenges in the liqueurs category, as well as declines in the on-premise.

Moving now to the P&L and record selling reported to underlying net sales. Reported net sales growth of 4% was negatively impacted by 1 point due to reductions in trade inventories and by another point due largely to the weakening of the Aussie dollar, resulting in 6% underlying net sales growth for the year.

In addition to the global – increased global demand for our brands I just discussed, we also benefited from higher prices and better mix, as innovation contributed roughly 2 points to the company's underlying net sales growth for the year. This helped us drive a 100 basis points improvement in gross margin and an 8% underlying growth in gross profit.

Underlying A&P increased 8%, as we continued to invest behind the long-term development and positioning of our brands. A&P is now up 25% over the last 3 years, as we anticipate another year of healthy growth in fiscal 2015.

Underlying SG&A grew 6% in fiscal 2014. And it's important to note that we have been making very purposeful planned strategic investments behind our business that we believe will drive continued outperformance. Some of the examples include investments in emerging market capabilities, as well as investments to drive the global growth of the Jack Daniel's family of brands. But we are also investing in other capabilities such as the recent route-to-market change in France, the world's third largest whiskey market. And we expect to have many opportunities to make similar high-return investments around the world as we reach critical mass in rapidly growing markets, emerging and developed.

Overlying each of these investments is our belief that investing in our people creates a competitive advantage in the marketplace through higher engagement, better loyalty and greater diversity of experiences, leading to what we believe are improved decision-making, innovation and collaboration, which ultimately drives better profit growth. Nowhere is this more evident than in our route-to-consumer investments we've made over the past few years.

Putting it all together, strong top line growth coupled with increases in our operating expenses led to underlying operating income growth of 11% in fiscal 2011, which we estimate to be 9 – fiscal 2014, which we estimate to be 9 points ahead of our global competitive set.

And over the last 3 years, Brown-Forman has delivered 37% growth in underlying operating income, nearly double what we estimate to be the growth rate for the industry over the same period. Our reported diluted earnings per share for the year came in at around $3.06, helped in part by a lower tax rate but negatively impacted by the $0.06 due to the distribution change in France.

Now I'm going to move on to my second topic and briefly discuss our fourth quarter results and recent global industry and economic trends we see as we enter into 2015.

In the fourth quarter, our underlying net sales grew 3%. But as we mentioned on our third quarter call, we expected the fourth quarter's rate of growth to be negatively impacted by significant timing issues. This included expected giveback in Poland and Germany after the large buy-ins that incurred in both of these markets during the third quarter. It also included the challenging year-over-year comparison with last year's fourth quarter, when we experienced buy-ins in advance of price increases in Mexico, as well as inventory build in Japan early last year. After adjusting for these items, we estimate our underlying net sales growth in the fourth quarter came in more in line with our full year underlying net sales growth for the year.

Looking at economic and industry trends through a geographic lens, the U.S. continued to experience healthy growth, notwithstanding the slow start to the calendar year. The developed markets outside the U.S. showed signs of improvement, driven largely by better conditions in larger developed markets of Europe.

And while some of the emerging markets have slowed, the broader group enjoys the favorable tailwinds of a large and rapidly growing middle class with an enormous appetite for American whiskey. So net-net, we believe that we are entering fiscal 2015 with a favorable backdrop.

So this leads me to my third and final topic, our outlook for 2015, which we are expecting to be another strong year of growth. So most of the trends that have driven our top line growth over the last 3 years we expect to continue in fiscal 2015. This includes global interest in premium American whiskey, which has helped drive share gains over TDS.

In fiscal 2015, we expect price increases outside the U.S. to be comparable to what we achieved in fiscal 2014. In the U.S., we are intentionally moderating our price increases following the cumulative effect of 2 years of robust pricing. Putting this all together, this should result in roughly 2 points of price improvements in fiscal 2015.

With mid-single-digit volume growth expected, we believe we can deliver another strong year of underlying net sales growth in the 6% to 8% range. Looking at gross margins for next year, we expect them to expand at a more modest rate than they did in fiscal 2015, driven by price mix gains that will roughly offset cost inflation, as well as better margins that we expect from France.

In fiscal 2015, underlying A&P is expected to grow slightly faster than sales growth, and underlying SG&A is projected to grow slightly below sales growth. Remember that SG&A in fiscal 2015 will include the full-year impact of our own distribution in France.

On the capital investment side, fiscal 2014 CapEx came in lighter than expected, due largely to a shift of some spending into 2015. We now expect 2015's CapEx to be in the $120 million to $140 million range as we complete these once-in-a-generation investments that we believe will allow us to strengthen our competitive advantages through our barrel-making operations and distilling capacity. Just looking at 2016 CapEx for a moment, we believe that will be another year of stepped-up capital investments before CapEx returns toward historic levels of 2% to 3% of net sales.

So net-net all these strategic investments behind our people, our brands and our production capabilities, we believe we can deliver underlying operating income growth of 9% to 11% and diluted earnings per share of $3.25 to $3.45. This EPS range assumes a full year tax rate of 30% to 31% and includes a negligible impact from foreign exchange. However, sensitivity on foreign exchange, a 10% move in the dollar in either direction, would impact our full year EPS by approximately $0.14 per share.

One more quick comment on fiscal 2015. We do expect some volatility in the seasonality of both our underlying and reported results, particularly in the first quarter, as we lap significant buy-ins in the U.S. from aggressive price increases over the last 2 years. We expect our performance over the balance of the year to strengthen following tough Q1 comps.

So in summary, fiscal 2014 was yet another great year for Brown-Forman, as we drove market-leading growth while simultaneously investing in our long-term strategy. Our free cash flow is impressive, driven by an inherent efficiency that results from a single point of production for much of our focused portfolio.

This cash affords us the ability to invest in the business while driving a strong balance sheet with net debt down $230 million this year. Our balance sheet flexibility, combined with excess cash, allows us to opportunistically look for suitable M&A, as well as explore ways to return this cash to our shareholders over time, as we did this year when we returned $280 million through quarterly dividends and buybacks. Over the last 10 years, we have returned $3.7 billion to shareholders through a combination of growing dividends, share buybacks and special dividends.

Our great results in 2014, not to mention over longer periods of time, are aided by the long-term horizon of our strong, family-controlled shareholder base. And we believe our prospects remain as bright as ever, driven by our premium spirits portfolio, anchored around the fast-growing American whiskey category.

Global demand for whiskey, and Jack Daniel's in particular, is strong and growing. And we believe the long-term opportunities for Brown-Forman are enormous. So with that, I'm going to turn over the call to Paul for his comments.

Paul Varga

Thank you, Jane, and good morning to everybody. I'll just add a few comments to what Jane has done here this morning. In general, I thought we had just another great year overall. And I think our relative TSR performance over 4 horizons, 1, 3, 5 and 10 years, provide what I consider to be perhaps the finest summary statement about the quality of our fiscal year 2014, as well as the many successful years that have preceded it. Across all 4 of these time horizons, Brown-Forman's absolute and relative TSRs are impressive, in my view. Our annual total shareholder return over 10 years was 17%, significantly outperforming our industry competitive set, consumer staples and the S&P 500. In fact, Brown-Forman's at the very top of this benchmark set over the 3-, 5- and 10-year horizons, with only Beam outperforming us on the 1-year as a result of their sale to Suntory.

Now Jane highlighted the 2 biggest reasons for our F '14 outperformance relative to the industry. Those were: one, our strong exposure to, and category leadership of, the premium American whiskey segment, which continues to have excellent momentum; and two, our geographically balanced contributions from both developed and emerging markets alike. I believe that in combination, these 2 descriptors help make Brown-Forman unique today in the global spirits business.

Led by our multi-decade work on the amazing Jack Daniel's trademark, Brown-Forman has and continues to play the lead role in expanding the appeal of premium American whiskey to more than 160 countries worldwide. Globally, consumers have come to appreciate Jack Daniel's and American whiskey for an abundance of attributes that I believe include taste, quality, heritage, premiumness and authenticity.

At the very same time, consumers also enjoy Jack Daniel's' mixability, modern popularity and its accessible, less formal, down-to-earth brand personality. As I've said in the past, I think Jack Daniel's and American whiskey uniquely possess attributes of both scotch and vodka, 2 of the world's largest and most important distilled spirits categories globally. And as you've heard here this morning, our FY '15 investment posture and earnings guidance reflect our belief that this appeal will continue.

And my belief in our growth prospects extends well beyond just the next 12 months, as both Jack Daniel's and American whiskey's share of the global whiskey market, despite their wonderful development over the last decade, remain at relatively low levels. Accordingly, our short-, mid- and long-range plans prioritize the continued development of strong trademarks against the global whiskey opportunity, something we know very well with the Jack Daniel's trademark leading the way. And we will pursue the global whiskey opportunity with some superb assets in hand. These include our whiskey trademarks, like Jack Daniel's, Woodford Reserve, Old Forester, Canadian Mist and Early Times; our distilling and manufacturing operations, which are being expanded as we speak, and these include our unique ownership of barrel-making operations that give us unparalleled control over barrels' supply, cost and innovation; and an expanding influence over our global route to consumer. When paired with our company's collective whiskey knowhow, we feel these high-quality assets and capabilities position Brown-Forman very well to continue its growth and success around the world.

As in the past, I believe our success will require great ideas, like Jack Daniel's Tennessee Honey, consistent investment and the focused efforts of our talented employees worldwide.

This last reference to the focused efforts of our people is another attribute that I believe is somewhat unique to Brown-Forman relative to our competition. As I consider those in the spirits industry today who are working to build their company's global, I don't know of another company who prioritizes the development of a single trademark in their sales and marketing efforts across such a vast global landscape the way we do with Jack Daniel's. And I believe this is a unique advantage for both Jack Daniel's and Brown-Forman. What we may lack in terms of portfolio breadth, scale and size relative to some competition, I believe we more than make up for with intensity and consistency of focus globally. And certainly, the investments we've made over the years in our route to consumer have been one of the key enablers of this.

So let me summarize why I believe Brown-Forman is a truly unique investment opportunity, and I'll apologize in advance for overusing the word unique here to make my point.

We uniquely own Jack Daniel's, the leader of American whiskey and one of the world's largest premium distilled spirits in the world of any kind. This one-of-a-kind brand has the appeal of both scotch and vodka, giving it a vast and somewhat unique global consumer opportunity. We seize that opportunity with a unique set of trademark and manufacturing assets that enable us to efficiently produce 148-year-old brand icons like Jack Daniel's, fast-growing super-premium whiskey brands like Woodford Reserve and successful innovations like Jack Daniel's Tennessee Honey. We take these superb brands to the global marketplace with what I believe is a unique and unmatched level of sales and marketing focus.

And of course, I'll add to that, that we have the unique commitment and support of the Brown family, who has continuously owned and controlled Brown-Forman for more than 140 years and who remain very committed to the company's enduring and independent success. This combination, in my view, helps produce the uniquely attractive financial results that we share with you today and that we are intent on delivering going forward.

Let me close by simply thanking our employees worldwide for another year of really outstanding results. You are indeed unique to Brown-Forman, as is the culture in which we all work, and none of these results are possible without you. So thank you. This concludes our prepared remarks, and we're now happy to take any questions you might have.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of John Faucher of JPMorgan.

John Faucher

I have to say, first off, the top line continues to be great, and they're growing faster than the industry, which is obviously tremendous. I guess I'm a little confused on the top line guidance for next year in 2 ways. So first off, you talked about the category slowing. And if I look at your results on a 1-year or 2-year basis, they're slowing a little bit. There's going to be moderating pricing, and yet it sounds like you're comfortable that you can reaccelerate the top line. So can you walk me through that? And then, I guess, more specifically in Q1, unless my numbers are wrong, I actually have Q1 as your easiest comp of the year. So can you talk a little bit about maybe what we're not seeing in the comp on an underlying basis that makes Q1 such a tough quarter?

Jane Morreau

Yes, let me see if I can start off with the first one, and Paul may jump in to share color, too, and I can – I'll answer the second one, too, but we'll do the first. So let's talk about the top line and why we feel confident that we can achieve the 6% to 8% range of net sales growth that we just provided guidance on for next year. A couple of things. We're actually seeing – in the U.S., I think you may have seen the most recent NABCA information that our trends are actually improving there. So U.S. is one of our largest markets. It's roughly 40% of our sales. And so that – we're seeing improving sales there. We had a drag on our earnings this past year, as we've discussed on several times as it related to Mexico. We are not expecting that again next year. In fact, we're seeing improving trends there. We're expecting that to have the inventory giveback situation that we had this particular year. We're also seeing some pricing abilities going on there, pricing power, if you will, as the agave price – cost of agave has caused suppliers to start increasing their prices in that market. In addition, the third piece that I would point to is France. We knew that when we went to our own distribution model there that it would increase our sales and resulting gross profit. In fact, as I've said in my script this morning, it also flows through to the bottom line, and we'll make profit via that whole operations covering our infrastructure costs. So those 3 things, in addition to the continued growth in emerging markets – when I look at emerging markets, excluding the Mexico that I just referred to from this year, we continue to grow well above our growth rate for the company, and we expect that to continue. We continue to do around at the same pace that we did in the third quarter once we consider the givebacks that we expected and we communicated during our call in the third quarter. So those are the – some of the reasons that I would point to.

Paul Varga

Yes. A way I sometimes summarize it is, if you just take the 12-month and think of this as a 6% underlying net sales growth rate, and then you think that's replicable and then you consider the impact of what we think will be improved years, both in the United States and the full-year impact of France, I actually think those are the 2 most significant contributing factors to our enthusiasm. Jane, you want to talk about, first, Q1?

Jane Morreau

Yes, let me see if I can take you through the Q1 now according to you thinking that it was going to be an easier comp. I think what we have to do is really rewind time a little bit. 2013 was our first year that we took pricing in a number of years. Recall, we weren't taking pricing during the economic downturn. And so in 2013, our first quarter, we took significant pricing globally. And in particular, in the U.S. was very significant. In fact, if you look at our numbers in the first quarter of 2013, our depletion growth was up 17%. You fast forward it to 2014, we took another significant price increase, and our depletions were basically flat with that. What we're doing in 2015, we're still taking pricing around – outside the U.S. We're not taking as much. We are still taking price increases in the U.S., but not as much. So what we're expecting is some giveback from that very first year when we took the price increases up and the retailers bought in. So there'll be a reduction in retailer inventory levels, if you will, and that's what we're expecting to be the tough comps at the top line. I also want to mention one other tough comp that I think is worth mentioning as well is on the SG&A line. And the reason why I think that's worthy of mentioning is, recall some of the investments that we made this year. We've been talking about France on a number of calls now, but for the first 8 months of this coming fiscal year, we'll be – this will be new expenses for us until we start lapping when it came onboard in January. So that, and we have a couple of other investments that we made in the last part of the year, including the cooperage, as well as moving our headquarters in Europe to Amsterdam. And those were all fourth quarter investments, so you're going to see some heavier upfront SG&A spending through the first couple of quarters of the year.

Paul Varga

And one reminder, we have historically, and this is why I think there's such a benefit to doing this, stripped out what I call the shipment-based inventory fluctuations in our quarterly financials as we discussed them with you. And so you'll see these reconciliations between reported and underlying that usually include, particularly during these periods of price increases, adjustments for shipment-based inventory. We don't – it's just too hard for us to estimate what the depletion-based versions are, and I think that's the major source of this U.S. tough comp that we're going to have is just buy-ins. Now remember, we will get back the benefit of not having – and you'd expect to get those perhaps in Q2, where you don't have all the giveback that was associated with those buy-ins before. So it's a very logical sequence. And we're just trying to highlight for you that it could impact our Q1. But as we unfold the remainder of FY '15, we expect it to fall in the range of what we're providing to you today.

Operator

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

Judy Hong

I guess, my question is just some elaboration on your decision to maybe take a little bit more modest pricing in the U.S. Sales have obviously been relatively healthy for you guys.

So just in terms of maybe thinking about portfolio as a whole, is this really for the broad-based portfolio, you're taking a little bit more modest pricing approach? What is sort of driving your decision to do that, and just what you're seeing from a competitive perspective, perhaps, as well?

Paul Varga

Yes, I think it's probably a combination of a couple of factors from that vantage point. And Jane, you add to this. I think we outpaced the market with Jack Daniel's. And so we don't just manage the brand for its immediate financial success. And so one of the things we're always trying to monitor and evaluate is how the consumer response is. And it's my view that the consumption of these brands is really important to their brand equity, not just the purchasing of them and the consumer's willingness to pay what we will hope to be higher prices. But their enjoyment of the brands with – particularly with other people is one of the contributing factors, I think, to brand equity in this business. And so, I mean, I've always been a fan of closely monitoring the balance of volumetric contributions alongside the pricing ones. And I just feel like we leaned so heavily in the United States over the last 2 years on the pricing. I felt back 24 or 30 months ago that, that was the right thing to do, to reinforce premiumness and some of the things that we were seeing that we thought Jack Daniel's, particularly in the United States, might have needed to reinforce because of the developing American whiskey segment above it in terms of price. But you go through that process, you look at it. I don't regret the pricing that we've taken over the last 24 months. I just think it's a good year to be more moderate and let the consumer and the trades settle in to these pricing levels of Jack Daniel's as we go along. So I mean, it's really more based on just a balancing act of brand equity development and – while recognizing that volume contributions and pricing contributions are different as it affects our P&L.

Judy Hong

Okay. And then just staying on the U.S., you talked about the year starting off a little bit slowly, and you've seen some improvement recently. Can you just maybe talk about what you think has sort of driven the year to start off slowly, and then what's driving the recent improvement? And then just in terms of what you're seeing in on-premise in particular, as you called out that, that channel has been particularly soft, do you see any signs of that channel perhaps improving?

Jane Morreau

I can talk a little bit about the latter one. Of course, I think the most recent information from the restaurant traffic count that – this came out in the last couple of days, is showing some improving trends in the on-promise. In terms of our sales, as we look through our results through our most recent NABCA information, we actually did see some improving trends, still declining, but some improving trends. I do think that, as we talked on the last call, there's several things impacting the on-premise from economic trends: the consumer confidence; the young millennials in terms of their unemployment is the highest among all sectors of the population, and so there's been a move for them to consume maybe not on-premise, but in the off-premise; and then, of course, the long and unusually cold winter that we had that didn't really end until, I guess, March, end of March. So we think all those things have improvement. So we're optimistic that we're seeing some improvement in the trends of what we saw yesterday from the restaurant and then our most recent trends, but they're still down because of all these other factors.

Paul Varga

Yes, and I mean, I'll just add, I think that we talked about it on the last call, I think there's always the quarterly or weekly references to everything from traffic counts to weather. I think the more interesting thing we're trying to consider is, and particularly for the U.S. market, but is whether or not there is a just fundamental change between on and off that is either consumer related to particularly the young adults of today or there's just an inherent price sensitivity and advantage to drinking in the off-premise that has been accentuated. And so those are, I think, critical things for us to think about, and our people in the United States are thinking about how they support the on- and off-premise knowing that both of the channels are vital to this business. But on the margins, the off-premise continues to do better than the on-premise. And I think I really do feel like the off-premise numbers just leaned more heavily in these last 2 years as an industry, and it reinforces the comments I made just a minute ago, on pricing versus volumetric growth. Still healthy growth for the industry and doing well within beverage alcohol, but you do have to know that people, particularly when there's difficult or more difficult economic times, that they will be more hesitant as prices are going up for the industry. So I think people – I noticed that in the first year when we went up in the United States, we did not outpace the competition as much as the cumulative impact of years 1 and 2 with our second year of price increases as I think many in the industry, particularly in non-brown spirits, were moderating their pricing. And so that's something you pay attention to. And I think that can have an impact on on-premise trends, off-premise trends, too, in the split between pricing and volume. And then I think you had another question, and I just would refer back to our earlier answer, which was why are we starting the year soft? I mean, we really just think that it is the seasonal effect of cycling against pre-price increase buy-ins in the United States that won't exist in Q1 as strongly. And we'll have to lap that quarter, and that could put some pressure on the volumetric results in that Q1. I mean, that's the basic answer to that.

Operator

Your next question comes from the line of Mark Swartzberg of Stifel.

Mark Swartzberg

A couple of questions, also kind of trying to probe more on the topic of growth and sustainability. One of them is Russia, Turkey, obviously doing very well. Could you comment on how you think those particular markets are evolving? And then kind of more on the developed side of your business, Australia, U.K. and Mexico, obviously different trends there. But as you try to handicap how the future might compare to the recent trends you've seen in those 3 markets, that would be great.

Paul Varga

Well, I mean, I just – I'll let – and maybe first do one on those markets as maybe a grouping. Jane referred to this in her comments that what really differentiated our FY '14, if you study it historically, was the emerging market performance relative to our competition. We've been outperforming a lot of our competitors in the developed, particularly developed international markets, while also because – or largely because of our success with Tennessee Honey and Woodford Reserve and brands like that, also growing share in the US. So the thing that really stood out to us in FY '14 was the differential performance in emerging markets, even though we saw some difficulties that Jane highlighted in places like Mexico and Poland. I think, going forward, I mean, we're not anticipating – we don't know what our competition will do in terms of their forecasted growth, but we certainly anticipate the emerging markets continuing to be strong. So I would reference Turkey and Russia – I mean, certainly, in Eastern Europe, everyone's got a more cautious attitude as it relates to what's happening over there and just the economic world and the impact of what's going on over there. But it hasn't yet changed our posture as it relates to building our brands or making investments, et cetera. So we're continuing to expect nice growth, and I'd say leading growth for our company from the emerging markets, as they've been producing for us in the last many years. The U.K., I think, was one of the markets that had a great year. And it's one of the nice benefits that the U.K. had a nice year when the Australian distilled spirits market was more difficult for everybody, and we were – we grew a little bit down there, but not as much as we had in some prior years. And so that geographic balance we've got there that we've referenced a couple of times today was really a big help. So having the U.K. and Germany and France have good years if Australia or Mexico or Poland has a little more of a soft one, it – we can recover as a company.

Mark Swartzberg

And that's great, Paul. In terms of kind of trying to sustain that strength you've seen in the U.K., and potentially even having a pickup in Australia, is that – are those difficult exercises, or is that kind of more kind of, given the trends you're seeing and the plans you have, something you think reasonable?

Paul Varga

I mean, we wouldn't be sharing it with you if we didn't think they were reasonable. I mean, maybe a way to think about it is a couple of the things that has been leading the growth for the company have been just the worldwide performance of both the Jack Daniel's Tennessee Whiskey brand, as well as the global rollout of Jack Daniel's Tennessee Honey. And I would say that our prospects, even though we might deliver, like the example we've been citing today in the United States, the Jack Daniel's results to a different balance of pricing and volume, our hopes and expectations as it relates to Jack Daniel's Tennessee Whiskey, and I'm encouraged that, even I guess out here in year 4 for Jack Daniel's Tennessee Honey, our organization is similarly optimistic about its continued growth. And then we've got other things that Jane mentioned that we're either testing or rolling out, mostly in the world of Jack Daniel's innovation, that could be encouraging for us, too. So I think all said, I'm really comfortable with the 6% to 8% underlying sales forecast that Jane provided.

Jane Morreau

Yes. No, I'd just add on to what Paul said. I mean, in addition to the U.K., we've got a lot of – the rest of our portfolio, beyond Jack Daniel's, is doing very well, and they're very early in their stages of development. So we're doing very well. It had a great year for Chambord and Tuaca, many of our other brands, Woodford Reserve, Old Forester just getting introduced. So we're very optimistic there. Australia is a tough market, and we know that it was this year. The economy is tough, the excise taxes that they take twice a year, and we continue to worry about that in terms of the accessibility and affordability of our brands to the consumers. And it is the one that we continue to expect some toughness in the next year.

Paul Varga

The one thing I would cite to that I continue to think is unique, I mentioned some of these in my comments is, relative to – our skew to American whiskey, and within American whiskey, to Jack Daniel's, in this regard is a real advantage as it relates to the question you asked. There are not a lot of brands – I can only count a couple on – it'd be less than 5 that have the geographic breadth of Jack Daniel's, not only in performance today, but opportunity. And I think that is something that encourages us. I mean, we can't forecast what's going to happen in every single market, but the ability to continue to develop Jack Daniel's across 160 countries or more, and in a large number of them, we're at very early stage of development, is one of the things that gives us the encouragement here.

Mark Swartzberg

That's great. And if I could, I had 2 follow-ups, one on what you just said, Paul and Jane, and then just on gross margin outlook. But what you just said seems to help you kind of manage the complexity that any company facing the growth and the different rates of growth around the world that you're facing. But nonetheless, it seems that complexity is nonetheless going up for your business: the geographic trends, the emphasis on different flavors, the SKU count. Can you just speak to how you think, as a CEO and as a team, you organizationally are getting better at managing complexity? And then as I said, I had a gross margin question.

Paul Varga

Yes, I mean, certainly, doing business that widely brings in all kinds of necessities to do it well, everything from encountering regulatory threats or these things that we call dark markets, where they put restrictions on marketing communications, you're always developing new capabilities and skills associated with it. I mean, I do think we bring to the world these assets that I've referred to, but I mean, I'd be foolish not to think that we're not going to be a much smarter organization about all this in 5 years' or 8 years' time. I mean, we have to continue to learn new things in some of these markets and then actually make sure we act on what we learn. I mean, I think we're pretty good at it. I mean, we certainly know how to do the Jack Daniel's and American whiskey part, we feel. We've been at it now for, on an active basis, 20 years to 30 years globalizing Jack. And we were – I think we're correctly and continue to be pretty conservative about how quickly to extend it. We've been encouraged by the sort of results we've had with line extensions or new brands that come from Jack Daniel's. Those do add complexity, I agree with you. So one of the things you can do to make sure you do it well is to test, and that's why we do this testing. And I mean real market tests in addition to the just observing social media or going and doing stage-testing. So those – and I think those are the things that are helpful to us. The experience of our people. We have a lot of people. I mean, one of the things I'm proud of as relates to the 10-year results of the company, the average tenure of the people at our company is above 10 years. So the average employee of Brown-Forman sort of owns these results, and that's really encouraging. I mean, they had all the good and bad of all those times and still were able to produce just really exceptional results. So I think the experience and knowhow of people who have been doing this for a while all over the world is a big help. So those are some of the things that I think that contribute. But I mean, I'll give you one – let me just give you one reference to something that, in this area, we'll be considering. Jane mentioned Jack Daniel's Tennessee Fire, for example, and we'll be really thoughtful about how to enter with a possible other entrant, on a broader scale than the test, into that market. And so when you go to think about that – I mean, you asked how I think about it. Here's an example of that. I mean, on the one hand, I'll be thinking about the development of the Jack Daniel's trademark in the company and what's best for it over a 5- and 10-year period to make sure we're doing all the right things. And – but at the same time, I'm sitting and looking at a category that, in the United States alone, if you just – just our recent estimates of what's happening with flavored whiskey as a segment in the United States, the latest numbers have it significantly larger than the – I'll just cite the Irish whiskey category or the cognac category. And if the more recent 3-month trends related to flavored whiskey as a general segment reflect that continued growth, I mean, it'll be larger than Scotch pretty soon. And so you're sitting in your wing, you don't want to be too slow or too fast on either one of those, and so we've put in place market tests and then metrics we're going to evaluate to ensure that we do all the right things. And those include everything from cannibalization to impact on the parent brand to any number of other both quantitative and qualitative measures. So does that help as an example?

Mark Swartzberg

Absolutely, very much so, and the whole response are very helpful. Last one, just the guide on the gross margin, I can't tell if there's something really incrementally not going to be as powerful this fiscal year as last fiscal year or if it's just conservatism on your part. Can you just talk a little bit about how things might break for or against you in terms of input costs and mix relative to the gross margin guide?

Jane Morreau

Yes. So as I talked about in my script that we are expecting to continue to expand our gross margins. So you will see gross margin improvement this next year, just a little bit more moderate than what we saw this year, the 100 basis points that we delivered this past year. Recall what we said earlier: we're taking a little bit more moderate price increase in the U.S., so that in and of itself will make the gross margin not quite expand as far as it did this past year. We're still expecting favorable mix to happen, so – via organic growth, and so we're still expecting that. So if I were to think about the gross margin, I think of it in 2 parts, really: Improvement due to France; again, we used to pay a margin to our distributor to distribute our products there. We're not paying that anymore, so that'll drop down to your gross profit. And then we are expecting some price increases, as we talked globally, but just not as much as we had this last year. And that will more than offset the cost of inflation on COGS, but not as much as it did this past year. And that's the 2 pieces.

Mark Swartzberg

And mix from – either from a geographic or from a product standpoint, any thoughts on how that might play out, your plans versus what we saw last year?

Jane Morreau

Yes, that's actually in my organic side of the equation, if you will. That's price/mix, so I expect it to be more balanced, if you will.

Mark Swartzberg

Great. And the 2 you gave us on price, was that inclusive of mix, or that's purely the rate, plus mix would be on top of that?

Jane Morreau

That would – mix would be on top of that.

Operator

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

Stephanie Benjamin

This is Stephanie in for Bill. I just have a quick question, kind of going off the last on just gross margin. Could you actually break out the portion of this quarter's gross margin expansion and what was due to the distribution transition in France? And then kind of, do you expect that same kind of magnitude to continue into kind of all the way to 3Q '15? And then just I have a quick question on the Jack Daniel's Fire rollout and just kind of the timing on that.

Jane Morreau

I'll tell you what, we'll get back to you on the margin for France. I don't have that specifically into Q4. We do expect it to – again, as I just spoke to the margin expansion for next year, it will help us there have some margin expansion. And then…

Paul Varga

The other question was on Tennessee Fire. I mean, it's just – we just literally have gone into test here in the last, I mean, I think, 12 weeks or so, 10 weeks or something. And so we're going to at least start to see first – we haven't seen any quantitative data. So I think we're going to need to see a little bit of that. And I mean, I suspect we'll be commenting to you all on each – sort of a quarterly update about how things are going and what our expectations are, but there's no – we have no preset timing as to when the test is over. We're really just going to put – we think it's really smart to put it into a real market test and observe it and then digest the results and make decisions based on that. So we'll keep you posted.

Operator

Ladies and gentlemen, we have reached the allotted time for questions and answers. I will now return the call to Jay Koval for any additional or closing remarks.

Jason Koval

Well, thank you, Laurie, and thanks to all of you for joining us today for our fourth quarter earnings call. Please feel free to reach out to us if you have any additional questions, and have a great week.

Paul Varga

Thank you.

Jane Morreau

Thanks.

Operator

Thank you for participating in the Brown-Forman Fourth Quarter Fiscal 2014 Year-End Conference Call. You may now disconnect.

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