Brown-Forman Corporation, Q1 2016, Earnings Call 2015-08-26

Presentation

Operator

Good morning. My name is Selema, and I will be your conference operator today. At this time, I would like to welcome everyone to the Brown-Forman First Quarter Fiscal 2016 Earnings Conference Call. — ***Operator Instructions*** — I will now turn today's conference call over to Mr. Jay Koval, Director of Investor Relations. Please go ahead, sir.

Jason Koval

Thanks, Selema, and good morning, everyone. I want to thank you for joining us for Brown-Forman's first quarter 2016 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 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 first quarter of fiscal 2016. The release can be found on our website under the section titled Investor Relations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, Form 8-K and Form 10-Q reports filed with the Securities and Exchange Commission.

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

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

Jane Morreau

Thanks, Jay, and thanks for joining us for our first quarter earnings call. I plan on covering 2 topics today, which should leave plenty of time to address Q&A after Paul's brief comments. First, I'm going to review our first quarter results; and second, I'm going to discuss our latest outlook for 2016.

So let me start by reviewing our results for the first 3 months of fiscal 2016. Our underlying net sales grew roughly 7.5% in the first quarter. As expected, this rate of growth came in above the range that we are forecasting for our full year due to the seasonality we discussed on our last call. Our underlying net sales growth for the quarter were broad-based with the United States being the largest contributor to our growth with underlying net sales up 10%. The company's portfolio of American whiskey brands drove these results with growth across the Jack Daniel's trademark, Woodford Reserve and Old Forester. Additionally, the launch of Jack Daniel's Tennessee Fire also helped results, contributing almost 4 of the 10 points of growth we delivered in the United States. Recall that Tennessee Fire was launched nationwide in the United States during our fourth quarter 2015 with encouraging trade and consumer reactions. While the brand is still in its infancy in 42 states, it continued to track very favorably against the early days of Jack Daniel's Tennessee Honey in the original 8 test markets.

I'd like to point out one key difference between the 2 brands. Tennessee Fire has seen increased acceptance and higher relative sales in the on-premise compared to Honey. We remain optimistic about Tennessee Fire's growth potential and know the brand has expansion opportunities available to it as it is distributed in only 67% of Tennessee's whiskeys off-premise accounts and 30% in the on-premise. While the competitive environment for flavored whiskeys has intensified after the recent entrance of Canadian-flavored whiskey, we still expect Fire to be a great addition to the Jack Daniel's family of brands, augmenting total value growth. As an aside, we are encouraged about the early days of performance for Fire and its test markets internationally, notably, the U.K. and the Czech Republic.

So let's take a look at some of our other brands' performances in the U.S. Our tequila brands, el Jimador and Herradura, grew underlying net sales double digits as we continued to build brand awareness through better on-premise activation and promotion. Southern Comfort and Canadian Mist declined in the United states during the first quarter, while Korbel and Sonoma grew aggregate underlying net sales in the mid-single digits.

Our business in emerging markets continue to grow well with underlying net sales up 11% in the quarter. The majority of our emerging markets enjoyed solid double-digit gains, led by Mexico, Turkey, Brazil, Ukraine and Africa. Poland also returned to growth as we believe we have worked through the inventory issues caused by the effects of the January 2014 excise tax increase. But the competitive market and environment remains challenging there.

Russia's underlying net sales dropped 36%. This was the result of a deteriorating economy and the devaluation of the ruble, both of which have negatively impacted consumer confidence and, ultimately, consumer demand. A challenging comparison with last year's first quarter's underlying growth of 17% also contributed to the decline in the quarter for this market.

Looking at our non-U.S. developed markets, we experienced a 5% increase in underlying net sales growth. This was led by strong double-digit gains in the United Kingdom, France and Germany. Germany was particularly strong as we have successfully resolved trade negotiations with several key accounts. While the U.K. and Germany both enjoyed favorable comparison to last year's Q1, Australia's comparison was more difficult as the market declined double digits, reflecting a weak economy and a challenging excise tax environment for spirits.

Travel retail's underlying net sales declined 18% due to 2 main factors. The first and largest factor was related to what we believe is the timing of orders from a couple of our customers. The second factor was ongoing softness in European travel retail, which has been hard-hit by Russian consumers, who have cut back on travel and are spending less per trip in duty-free. Our underlying net sales growth for the company, excluding some of what we believe to be timing issues in travel retail, would have been over 8% for the quarter.

Moving now to the reconciliation of underlying to reported growth. Our reported net sales declined 2%, negatively impacted by 9 points of foreign exchange. As an example of this foreign exchange headwinds we experienced in the first quarter, the euro was almost 20% lower in the first quarter of 2016 compared to the same quarter last year, and other currencies have devalued even more dramatically against the dollar. Reported sales were further hit by a 1 point reduction in inventory, resulting in approximately 7.5% underlying net sales growth. Our top line growth was driven by strong volume gains and a 2 point improvement in price/mix. A better price/mix helped drive an 80 basis point improvement in gross margins and a 7% increase in underlying gross profit. Our underlying A&P spend increased 3% and SG&A grew 6%. So when we put this all together, we delivered 9.5% underlying operating income growth.

On a reported basis, operating income grew 3% and earnings per share grew 7% to $0.75, held back by approximately 3 points of adverse foreign exchange. This leads me to my second topic, our outlook for fiscal 2016, which we reaffirmed today. Before I dig into that topic, I would like to add that while we are fortunate to have a business model that combines long-term growth with defensive characteristics, we realize that we are not immune to a further deterioration in the global economy. So like all of you, we are anxiously watching the market gyrations over the last 2 weeks, particularly in the emerging market. We believe we are fortunate to be in the early stages of capitalizing on our emerging market potential and are optimistic that, over time, it will become an increasingly important driver of our results. But for now, our emerging market footprint outside of Poland and Mexico is less than 10% of our total revenues. So our exposure is significantly less than the competition. Additionally, this approximate 10% is well diversified, spread over 100-plus countries around the world.

Now for our fiscal 2016 outlook. First quarter results were largely in line with the trajectory we anticipated for the full year, and as such, we believe we're on track to deliver the 6% to 7% underlying net sales growth we shared with you on our last call. We expect to continue the combination of modest gross margin expansion and better leverage through our operating cost will allow us to deliver the 8% to 10% underlying operating income growth. We are also reaffirming our earnings per share range of $3.40 to $3.60. While currencies remain volatile, the net FX impact is still expected to be a headwind in fiscal 2016 using rates as of late last week. As a sensitivity, a 10% move in the dollar in either direction would impact EPS over the balance of the year by approximately $0.08.

To share a little bit more color on the seasonality of foreign exchange, I thought it would be good to remind everyone that the large appreciation of the U.S. dollar occurred in the fall of last year. So with that, we expect another quarter of significant headwind on our reported revenues, so less so of an impact by the time we get down to operating income due to the absence of a $10 million loss in last year's Q2 resulting from the revaluation of current assets that were reflected in other income and expense. Looking at our full year tax rate, we still expect it to be in the range of 30% to 31%.

In summary, our balanced geographic approach has helped us continue to deliver market-leading rates of growth fueled by robust global demand for American whiskey. Disciplined innovation is helping drive our results, and premiumization trends continue, all of which we believe position Brown-Forman for another record year of top and bottom line growth. And while we are investing significantly to meet future anticipated demand, our business model allows us to return capital to shareholders through growing dividend and our ongoing share buyback program.

So with that, I want to turn the call over to Paul for his quick comments.

Paul Varga

Thank you, Jane, and good morning to everyone. I think I'd like to start by just saying I was pleased with the quarter as it continued our strong underlying results from FY '15. The underlying Q1 results were right in line with our full year guidance for both underlying net sales and operating income, so in my view, we're off to a good start to the year. One noteworthy milestone that occurred during the quarter was Jack Daniel's Tennessee Whiskey surpassing 5 million cases in the United States for the first time in its 149-year history. And to be clear here, I'm referring to the parent brand, Jack Daniel's Black Label, as most know it.

I've been reflecting some on this recent accomplishment, so I thought I'd share a few perspectives with you about it. First, I'll simply note that attaining the 5 million case level in our industry is a rare event in its own right. This is a very high level of consumer acceptance achieved by very few brands. Add to this the fact that Jack Daniel's is priced at the super-premium price level, well above the price of most brands that have achieved the 5 million case level, and the recent milestone is even more rare and impressive in my view. And consider further that the 5 million cases are derived from just one single country for a brand that does more than 12 million cases in more than 160 countries around the world, and it elevates the accomplishment even further. So as I think about all of this and the brand's recent performance further, it's not that difficult to imagine that a different outcome was quite possible. While the trends for American whiskey have been a positive factor in recent years, I can think of at least 5 factors that had the potential to negatively impact Jack Daniel's volumes in the U.S. over these last many years. And yet, this very strong and unique brand forged ahead despite these forces.

The first factor I'll cite is the difficulty that big brands have experienced both inside and outside our industry. As evidence, consider that the largest 10 brands by volume in calendar year 2010 in the United States have not only lost share but cumulatively lost over 1 million cases in the last 4 years with 6 of the top 10 having lower volumes today versus 2010. Jack Daniel's was one of the brands that grew nicely against this very difficult backdrop for more larger, established brands.

A second force was pricing. Despite the consistent price increases by the Jack Daniel's brand in the United States to support its super-premium position and to reinforce its specialness, volumes have still moved forward, and this is not always the case for brands who attempt to advance price.

A third factor has been the intensifying competition in the American whiskey segment as new entrants in craft, premium plus and flavored whiskey have exploded in recent years. While some of this expands interested in the category, at the same time, it is a direct source of competition, particularly for the most proven and established players, such as Jack Daniel's. Additionally, the brand held up extremely well to its own innovation, where there was the possibility of cannibalization. It's not uncommon to observe brand innovations that will significantly cannibalize the parent, but the development of expressions like Gentleman Jack and Jack Daniel’s Tennessee Honey have not held back Jack Daniel’s volumetric progress to-date.

And finally, it’s often believed that older, longstanding brands are mature brands whose best days are behind them. I find it impressive that Jack Daniel’s is in its 149th year in the United States and sits today at its all-time volumetric high point. I cite these factors to illustrate that Jack Daniel’s is not your normal brand. I believe it to be a special brand and often the exception to the rule. As part of our responsibility to be excellent brand stewards, we believe it is important to consistently and persuasively tell the brand story. Some of you on this call had the opportunity to hear parts of that story in June with your visit to the brand’s homeplace in Lynchburg, Tennessee. The brand story is a story of authenticity, a story of quality, a story of the brand’s heritage and history, a story of Americana, and a story of a small-town brand making a splash on a worldwide stage, all conveyed with the down-to-earth personality, genuine hospitality and with an intent to make friends the world over. We are thrilled that many of the attributes that Jack Daniel’s possesses so naturally appear to be in fashion with consumers these days, and we believe this bodes well for the brand, both in the United States and across the world.

So thanks for indulging my recognition of this milestone, and congratulations to everyone at Brown-Forman on the accomplishment, most notably our Jack Daniel’s and U.S. teams. With all of the attention that our globalization and our Jack Daniel’s line extensions have received in recent years, I thought it important to briefly highlight some of the impressive progress we are making with our most important brand and our most important market.

That concludes our remarks this morning, and we’re now happy to take your questions.

Question and Answer

Operator

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

Vivien Azer

My first question has to do with the top line. Clearly, the timing issue in travel retail was a factor in terms of the 7%-plus underlying sales growth. But keeping in mind that you're cycling your easiest comparison of the year, what gives you comfort that you can hit that full year objective, given kind of where you've started the year? And if you could comment on the role of expanded distribution for Fire as part of that, that would be helpful.

Jane Morreau

I can start off with the first thing. Our forecast – our actual numbers, Vivien, came in a bit higher than our range, so it did come in around 7.5%. And as you did note, if you pull away Global Travel Retail, our results would've been over 8%. We had some other tough comps, too. Russia, parts of what we saw in Russia, we don't expect to repeat itself, some of which was they had very tough comps versus last year. Australia, some of which are tough comps versus last year, some of which were just difficult trading environment, things that are going on there. And so if I wrap all those things up, if I were to adjust for all those things, our actual growth rate would have been closer to 10%. And so I think what I'm saying to you is a lot of – those 3 things I mentioned, I think some of – there's bits of it that are timing. The only one I adjusted for you was the Global Travel Retail piece. So we knew we would start out of the gate stronger, so I'm expecting those items I just mentioned to lessen as the year goes on and the timing of those orders as such, and Global Travel Retail to reverse themselves. That help?

Vivien Azer

Very helpful. And if you could comment on the distribution opportunity with Tennessee Fire given the metrics that you offered in the prepared remarks?

Jane Morreau

Yes. So the – just to give you a flavor, I noted a number of 67% of off-premise distribution for Fire as related to Jack Daniel's Tennessee Whiskey. As a point of reference, Honey is 81%, and so we know we've got that opportunity to get there as well in terms of its on-premise. While we've gotten faster in the on-premise, the ratio there of Tennessee Honey to Whiskey and Fire to Whiskey is – got opportunities to, I mentioned 30% of Honey on the on-premise and – excuse me, Fire on the on-premise, and Honey is, I think, 39%. So we know we've got distribution opportunities there, all in the U.S. that I'm talking about right now, too.

Paul Varga

Vivien, I'll add, too. I think, while we're not – we don't try to internally here precisely nail down the quarters as we go along. We try to give enough of a flavor to them. And one thing in retrospect that I think we've learned is that the acceptance at the trade for Tennessee Fire in our last fiscal year's Q4 because we pretty rapidly built distribution, and of course, we can't gauge with precision how much retail inventory there is. We can do a really good job, we think, on the distributor inventory pipeline. But on the retail inventory pipeline, it – now I look back on it, I think we probably built it faster than we did on Honey in its early days for Tennessee Fire. And so back when we were, I guess, perhaps forecasting our fiscal year '16 and the Q1, we would have thought that maybe some of that pipeline was going to be more evenly spaced through the first 6 months, whereas, a lot of it, I think, as we look back on it now, happened pretty quickly for Tennessee Fire. And we suspect that was because of the pent-up demand that was occurring because of the staged rollout. So that could be a factor, too, in the Q1 results. It's kind of a hybrid of both your questions there.

Vivien Azer

That's very helpful. Just one last one from me. As we think about operating leverage for the full year, it seems like that should accelerate, given your full year guidance. So can you talk please, Jane or Paul, about the drivers of that?

Jane Morreau

Yes, sure. I'll take that on. In the quarter, we actually had some cost pressures. So you will notice that our underlying gross profit growth and our underlying net sales growth were both online, both grew 7%, and we are still expecting some modest leverage there. But we had cost pressures from wood. I think I talked about this in the fourth quarter, just given the supply-demand constraints there and the cost of wood, so we expect that to abate over the balance of the year and our costs to come down, our cost of goods to come down more in the inflationary 2% to 3% type of range. So we'll expect to start seeing a bit of leverage through the gross profit. And then in terms of operating expenses, we expect to continue to see leverage there.

Paul Varga

We had some…

Jane Morreau

— *indiscernible* — SG&A for the quarter, there was a handful of things that were onetime in nature, are things that occurred only in the first quarter that will not repeat themselves over the balance of the year. So when we adjust for those things, it was more in the 4%, 4.5% range.

Paul Varga

Yes, we would certainly expect the SG&A to moderate from where it came in the first quarter. We got – we have, as Jane said, see it would be like, for example, had our global meeting that came in the first quarter and not had that last year, so for example. So we do expect that to moderate.

Operator

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

Eric Serotta

This is Eric Serotta in for Robert Ottenstein. A couple questions in terms of your comment about increased competitive activity manifesting itself. Could you give some color as to where you're seeing it in terms of countries and categories and who you're seeing it from? Is it the sort of upstart craft players? Or is it some of the large established players in spirits getting a little bit tougher in terms of either price point or execution?

Paul Varga

I think both. I mean, so when we talk about intensifying competition, it could apply to any number of the reference points that we've – in our prepared remarks, I mean, I'll cite a couple. I mean, there's no doubt that if you look at areas like flavored whiskey, premium plus, American whiskey and I'll just maybe comment on it at the corporate level as lots of corporations are competing against each other out in the marketplace. There's just a large number of new entrants in flavored whiskey in that one example. And just – if you just think about it in a very short amount of time, it's my estimate that in the United States alone, the flavored whiskey segment could be 7 million to 8 million cases, which makes it one of – I mean, it's been only – that happened fast, it makes it very large. And so that is very exciting and a lot of people who are seeking growth want to be a part of it, so you start to see a lot of entries. And so that's what makes it in some ways challenging to forecast your business, to think about – so it's quite – because of the pace of its growth, it makes the management of those brands that are – from Brown-Forman in there a much more dynamic exercise. So that's something we're – we've been adjusting to a bit. I think at the super-premium level of American whiskey, I mean, if you just – it's really the craft items or it's just the regionalization of the category, where there's lots of offerings in each state, many distilleries being built. And all of that has a competitive – collectively, really, a competitive presence in the American whiskey category. Some of it's exciting because it adds new users, but for the established players, it's something you have to pay attention to. So when we refer to intensifying competition, we're referring to that as well, and that can be very much for retail space, too, space on shelf, space on back bars, et cetera. And then the third area, really, is – I mean, the world doesn't just sit around idly and look at how Brown-Forman's performing and then reviewing themselves and not desire to grow at faster rates. And so we feel competitive pressures from companies that are simply striving to do better out in the marketplace, and often in more recent years, these have been some of the larger competitors. And so whether it's through their innovation or through the intensity of their efforts, sometimes it's spending, sometimes it can be discounts. We're just seeing sort of more of an all-out effort from some of our competition on that range. So when we cite intensifying competition, it really spans all 3 of them.

Eric Serotta

Okay. And as a follow-up to that, you had about 2% price/mix on a weighted average globally in the quarter. How does that break down between the U.S. and non-U.S.? I imagine there is some currency-driven pricing in some other countries. What should we expect in terms of price/mix contribution for the U.S. this year?

Jane Morreau

Yes, so just pull back on pricing a bit. I think what we got at the year-end was we were going to lean a little bit more on volume this year and a little less on price. So we would still get a benefit from mix just because of our portfolio and the more premium adds and the faster growth rates we're experiencing on some of our higher-end whiskeys, such as Woodford Reserve so that in and of itself gives you a benefit. Recall that we took a couple of years of pretty aggressive pricing in the U.S., both in '13 and '14. We did some more moderate pricing last year, and we expect to continue to do more moderate pricing this year, so in the low single digits, the 1%, 2% range is what we guided to. I don't have the actual number for the quarter, but the price/mix, it was a bit – it was pretty split as I recall, pretty close to being split between price and mix in terms of contribution.

Paul Varga

And you should always expect the mix factor to be more prominent in the United States just because of the size of the portfolio and the fact that the premium items are doing so much better than our lower-priced items in that particular market. I mean, our portfolio just isn't that – as expansive as in the United States when you go to the international market.

Operator

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

Russell Miller

This is Russ Miller on for Nik. It seems Jack Daniel's Tennessee Whiskey depletion slowed somewhat sequentially during the quarter. Could you provide some context around the slowdown for this brand fiscally? And then I have a follow-up, if you don't mind.

Jane Morreau

Yes, so are you looking at Schedule B? Is that what you're looking at?

Russell Miller

Yes. 3% depletions growth.

Jane Morreau

Yes. So again, there's lots of things going on, lots of moving parts in the quarter. I think I mentioned some of them in my prepared remarks, and I mentioned some when Vivien asked the question. We definitely had moving parts where we were down in Russia because we – and we had customers in travel retail that didn't order. We also had tough comps in Australia. They had a price increase last year in the first quarter – or as of August 1, so there was a large buy-in there. So there's some of that dynamic going on, if you will. On the flip side, there's other moving parts, too, in terms of looking at our developed markets. I think I would just pull back and not get hung up on Tennessee Whiskey in just 1 quarter. I think what I would suggest then is looking at our largest market. Paul spent some time on talking about the milestone we achieved in the U.S. in the quarter of 5 million cases. And when I think about what we were doing in – and takeaway trends a year ago, that brand was actually – I think it was flat to a little bit down. And if you look as the year progressed and it has continued to hold up, the growth rates have been – has improved, and I think it was even stronger in NABCA information I saw yesterday, but it's in more in the 4.5% type of growth range. So I think that knowing that as a backdrop and then looking at the family number, I think you may be referring to 2, realizing that it's hugely impacted by RTDs in Australia. Again, that's a tough market there right now from both an economy perspective as well as just the RTD category. And if you were to just strip Australia out of those numbers, you would see a nice number for the Jack Daniel's family of brands depletion growth, it would have been up 7% for the quarter.

Paul Varga

Yes. So as the Black Label – as we look at the Jack Daniel's Black Label numbers for the next 9 months, we would expect, based on the factors Jane talked about, some of the seasonal stuff that occurred in travel retail, and Russia is a more difficult one to try to anticipate. But we would expect that volumetrically and hopefully from the sales standpoint to be better for the balance of the 9 months in the first quarter.

Russell Miller

Okay, that's very helpful. And then as a follow-up, could you provide perspective on your on-premise business overall and the delta in on-premise versus off-premise growth for the quarter and looking forward?

Paul Varga

Well, that's a country-by-country answer. And of course, sometimes, we don't have the details to provide you. I mean, our business in the United States, the largest and most important country, we've actually been encouraged by our on-premise progress over the last 6 to 12 months where it appears our brands are performing a bit better than they were in – prior 12 months. Some of that, as the fact that Jane mentioned it relates to some help from the introduction of Tennessee Fire into the on-premise, so that's a nice thing. But it really is the skew to the American whiskey that is doing it and the results on brands like Woodford Reserve, Old Forester, Jack Daniel's continues to do well. So I think we would be in the largest market encouraged by some of the more recent trends in the on-premise. And honestly, something we'd look to for both on-premise and off-premise in this country are fuel prices. And so we would knock on wood that the lower fuel prices and as the expectations they would continue to help support some of the recent performance in that channel.

Jane Morreau

I thought I might just build on what Paul said, too, something he talked about at the end of our earnings release and something he talks to us from time to time is, really, we started seeing a change in consumer behavior starting right after – during the recession, and people started not going out as much and people started changing where they had their drinking occasions. And I think we're seeing some of more blur between on-premise and off-premise. And not that on-premise is not important, but people's – where they drink has remained changed, I believe, from when the recession hit.

Paul Varga

Fundamentally.

Jane Morreau

Fundamentally, yes.

Paul Varga

And we do believe that. I mean, if you just look at the behavior of millennials, where they might have spent 3 or 4 hours at a bar for an evening, they may only be spending 1.5 hours, and the first portion of it is in their apartment on the couch with their friends. And so the brand selections that occur in those different environments are really important, and I think that actually is a contributing factor to why the flavored whiskeys are actually doing fairly well because they're convenient to pour and consume and don't require a lot of mixers, et cetera. So I think there's some changing dynamics that may be with us for a while.

Russell Miller

That's very interesting. And then a last question, if you don't mind, is there seems to be a lot of buzz around the industry regarding mezcal. And is that a category you'd be interested in entering through an acquisition or with el Jimador, Herradura. If you could just provide any context around that, that'd be helpful.

Jane Morreau

I can take a little bit of that and let Paul jump in. I don't think – I would say just, in general, when we look at acquisitions, we're not necessarily looking at categories. We're looking at businesses and we're looking for brands, and we're looking for good businesses and good brands. So what I mean by a good business is, is it attractive. Does it have attractive economics? So are the margins well, the returns well? Are they capital intensive? Hopefully not. Are they growing? Are they sustainable? Can they be globalized? And so we look less at the category, if you will, versus the brand and looking for a good business. I would start off with that. Given our portfolio we have now, we've spent the last decade really tweaking it. More than tweaking it, I should say, because we sold off our consumer durables business. We got – sold off our low-value wine business. We brought in some brands in the portfolio, too, mainly the tequila brands. And so we've had what I call now a pure play spirits portfolio skewed to the premium end. And so that would be something else that we would obviously look for, and it's obviously more skewed to American whiskey, which happens to be the place to be right today.

Paul Varga

Yes, I think you'll find us being fairly focused relative to our competition on particular trademarks. And probably my most direct response to the interests that's out there in mezcal is that our response would be to focus ever more on Herradura. I mean, I think that we have so much work still to do to build awareness, distribution, velocity. Telling the story of Herradura remains very important to us. We think it can be a very significant piece of business for us in due course. It's actually showing nice traction of late. We think that interest in mezcal might interest as well in the tequila category because of the flavor profiles. But to your point, I think it would be shortsighted on our part not to pay attention to emerging categories and see how they might impose competitive tension or distraction for our brands in the marketplace. And these have come up from time to time whether they're mezcal or the cachaças or the Japanese whiskeys are showing some – in this country, some interest. So I think it is worth always having a little bit in your peripheral vision these categories so you can see what you can learn from them. From what I can see so far from mezcal, it makes me want to work even harder on Herradura.

Operator

The next question comes from line of Bill Schmitz of Deutsche Bank.

William Schmitz

— indiscernible — be short or long-term benefit from what's going on with Diageo in the U.S. on the investigation?

Jane Morreau

You want me – I'll start off with that?

Paul Varga

Sure.

Jane Morreau

You probably have read as much as we have read on that, and so we only know what we've read. Only thing I can really talk about is ourselves and how we address our own business. And something that we've always done probably for 2 decades now is measure ourselves on a depletion basis, not a shipment basis. And with that being said, we also, not only do all of our management reporting here on that basis, but we also hold all of our sales force and employees accountable on a depletion basis. So that they're incentivized, if you will, on that same basis. And when – of course, when you're in the business that we're in, which is the whiskey business, the whiskey-making business, something we've been in the whole time we've been around, it's very important to – it's really some art and science to it, but we've had many learnings over the many years, if you will, to be careful of how much you lay down when you lay down what you lay down. And so it's not like the white spirits, if you will. So we pay a lot of attention to what the inventory levels are both at distributor level. And we try – well, we have information on consumer takeaway, which would be the best information, obviously, if we had that, to see what's going on in the retail level to see when things were – to get out of whack. So that's something that we constantly are looking at and are constantly aware of.

Paul Varga

Yes, I'll just add that the idea that – I mean, I referenced this a little bit with the point I made earlier about corporate competition. I mean, I think that the effect of that amongst many other factors, perhaps for Diageo, who you cited, is they're probably a more motivated competitor as a result of really a couple things. One, is desire to continue to be a better company and grow. So if they're doing that, of course, for a company like Brown-Forman, everybody else in the industry creates competition. I think the test would be whether or not it's any more significant than what we've experienced historically because we always find that there's some competitors who are out in the marketplace make – whether they manage their business by shipments or are really trying to preoccupy the retailers by getting them to spend more of their dollars on Diageo brands or somebody else's brand. That can – that's always been a competitive force. And people who manage their business at retail differently than we might, I can't say that it's any different today than it – I've seen over my career in many countries around the world people who will do things because, what I call competitive distraction. I think the net of – a more important factor are companies who are striving to grow at rates that are higher than they currently are experiencing. And when you attempt to do that, whether it's through investments or innovation or some of these others, you just get sometimes a more formidable competitor in the marketplace. I don't know if that's any more difficult than we encounter all the time. And so my advice to our own people is to keep our heads down, do the right things that are right, both short, mid- and long term for our company and our brands and adjust where you see there's something new, particularly on the innovation front. I think that's a more compelling competitive force sometimes than the heavy discounting or stealing the retailers' dollars through loading or something like that. So in any event, I – for us, we pay attention to it, but we're not going to be preoccupied with it.

William Schmitz

Okay, that's very helpful. And then I just had a question on the guidance. I think you said something like compass on your sales are emerging markets ex Poland and Mexico. So why do you feel that you've got a necessity of sort of comping [ph] on the guidance based on global economic environment? It seems like, by and large, most of the developed markets, which are the bulk of your business, are still – I mean, they're not great, but they're not any more volatile than they have been in the last, I guess, 2 or 3 quarters. Is that fair?

Paul Varga

Yes, I think you make a good point. I think it's more the uncertainty around where – what might go – what might occur going forward as a result of just the skittishness that we've seen over the last, I mean, literally week to 10 days. More impactful for our business are countries that undertake aggressive excise taxation as some policy of the country to raise revenues or whatever that, that can directly impact us. You're absolutely correct that there's always macroeconomic forces that are working both for and against you. But we were reacting a little bit more, I think, to just the recency of some of these market selloffs. I mean, I'm not – at this stage, we'll see what happens. I'm not obsessed with what's going on out there. I mean, and a lot of it is because our geographic diversification at the company has really been a big help for us. I mean, the country we've been talking about here just a little bit today, Australia, which has been kind of difficult economy. It's been a difficult distilled spirits environment and been not the leading performer for Brown-Forman more recently. But I'll cite that awhile back, while countries were having difficulty, whether it was in Europe or maybe the United States was not performing the way it is today, Australia was leading Brown-Forman in some ways because of the growth of our RTDs and our main-line whiskeys down there. So I always try to reflect on how this geographic diversification and not putting all of our eggs in one basket can help us. And it's the times like these that I'm particularly appreciative of it.

Operator

The next question comes from line of Ian Shackleton with Nomura.

Ian Shackleton

Paul and Jane, can I go back to what you said on FX and, well, I guess, with what's happening in markets in the last couple of weeks? The FX headwinds have become a little bit more severe. And basically, your EPS guidance range intact, is it a comment that the FX really hasn't moved that materially? Or is it the fact that despite there's more negative FX, you've got other positives running the other way, which allows you to keep that guidance?

Jane Morreau

Ian, actually, if you were to look at the rates earlier this week, which actually went in our favor, it would have – that's what we ran our analysis as — ***indiscernible*** — the rates still hadn't changed much from when we gave guidance at year-end. So we really haven't seen much movement at all as it related to forecasting for the year, which is a few cents of headwind across FX.

Paul Varga

With it being very focused on the first half of the year.

Jane Morreau

It's very focused on the first half of the year…

Ian Shackleton

Understood. And just a follow-up. I mean, with what's happening in – I'll just stick in the emerging markets and elsewhere, with currencies weakening and probably expectation of valuation coming down, do you think it'll start to open the door to be a bit more aggressive on M&A in the spirits space?

Paul Varga

Yes, I think there's certainly unique opportunities that the currency can create. I would totally agree with you there. I think the trick still becomes whether or not what you might pursuing is really on 2 fronts of our 4 As, whether they're available and, in fact, attractive. And so as far as I'm concerned, that hasn't changed that much. The things that we would find more most attractive are pretty strongly unavailable. And so we're not going to be preoccupied with it. It's one of the reasons we've become so focused on innovation with sort of the example of entering Irish and trying to do with that initiative, some things, perhaps, similar to our experience on Woodford Reserve over the last 20 years. So I think the industry continues to be an attractive place. It can change, and it has for some of our competitors. And whether or not that creates some impetus for M&A or some opportunities for us remains to be seen.

Ian Shackleton

Just finally, I mean, is there any update on the Ireland thing. It was quite a long-term project, but is there any update on how that's progressing?

Paul Varga

Yes, I think there's – at the end of September, we're doing a groundbreaking over there. And so from our original sort of 12-month plan, I think we're on track, which as you know, is sort of exciting around here. We're getting some product and initial packaging and brand identity work done so that we can do something concurrent while we're building out the distillery and then starting the distilling of the product and the aging of it. So it'll be a concurrent process, very much the way it was at the company for Woodford Reserve back 20 years ago.

Jane Morreau

I think we're targeting the spring of 2017.

Paul Varga

'17, so maybe a year from the end of next – our fiscal year, we might be entering the market.

Operator

Your next question comes from the line of Judy Hong.

Paul Varga

She may be on mute. Judy?

Operator

Your next question comes from the line of Bryan Spillane.

Bryan Spillane

I guess, the question – just one question, I guess. It's a little bit of a follow-up to Bill Schmitz's question. If you look at what's happened in the currency markets, the commodity markets, the equity markets in the last couple of weeks, markets are essentially trying to suggest that there's been some change, right. That either growth has slowed in some of the emerging markets, China especially, but also maybe even you're beginning to hear a little bit of concern that maybe there's a risk that you even see a slowdown in the U.S. So I guess, my question is as you're doing your planning going forward now from maybe where you were when you set your plans at the beginning of the year, is there anything at all that you're seeing that suggests that there's been any kind of change as the year has gone on? Just trying to get a sense for whether or not there's been any signals, any indications, anything that you're seeing as you look into your markets, into your plans that suggest maybe the market's shifted a little bit?

Paul Varga

It's a good question. We're going to – actually, I think next week, I'm looking at our distillery production plans, which is always a point in time in our process to review and reflect on whether your plans have changed because, I mean, obviously unfortunately, I have to look out many years, which means you're going to be inaccurate. But here's the way I'd say it. I would say that in the – 3 large sort of pieces of business we sometimes dissect our business into, in the United States, generally, I think it's a continuation of what we would have felt and seen. I think the only factor which is – it could be macroeconomic indirectly, has been some of the intensifying competition, I think, would be the point I'd make. But otherwise, we're continuing to – I mean, we really like the growth rates that we're experiencing and the performance of the company relative to the industry in the United States, and we're sort of sticking with those plans. I mean, there's always an uncertainty around innovation like Tennessee Fire and where it'll settle out and all that, but we're putting forth our best effort on that. And so that would be one bucket. Another bucket would be how do I feel today versus maybe a year ago or so on – or even 6 months ago. I know your question was about versus 3 weeks ago – about the developed markets, but I actually feel better about what's happening for our company this sort of summer and going into the fall in Europe than I did previously, as we've seen the U.K. continue to do well. Germany, France, which has continued to be just a great market for us and coming off of a year that was in our financials, had a lot of transitional things going on because of the start of the company. Emerging markets, Russia, you couldn't feel better about. Now part of that is because we, to protect our margins, took a pretty large-sized price increase that was related to currency, which is rare for us to take currency directly related to currency price increases. And I think we'll have a pretty uneven month-to-month business in Russia, some because we'll be trying to figure out what's going on in that economy, how our business is being affected by it and as people sort of acclimate to our new price level over there. In the same vein, some of the other emerging markets are doing very, very well. And again, the diversification we have across many emerging markets is a help in that. We're paying particular attention to Australia. It's an important country for us, and it's having some difficulties. And I think, as Jane said, I mean, we're just trying to understand better what's going on in our travel retail. We think there's some seasonal impact, as she explained there, but that has been a very consistent and strong performer for the company for the last many years. So we'll be paying more attention to it. But on balance, when you put it all together, I mean, here's the way I'd say it: our first quarter underlying sales and operating income basically mirrored what our forecasts are for the full year and are also a continuation of basic results we had last year. So I don't see anything right now. And I mean, we could change our minds if we have a global financial crisis or something like that. And I think that was the point Jane was trying to make. Nobody really knows where this is headed. We're trying to stick to our own very focused plans around our business until we see something else there.

Bryan Spillane

And just one follow-up, and I think you might have addressed this in an earlier question. But just when you talk about intensifying competition in the U.S., you're talking about just a lot of new products hitting the market, not price competition or discounting?

Paul Varga

Yes, I think that's the dominant piece. You always have pricing competitiveness, but I don't see that, that is in some level of intensity. I just think that because of what's happening with American whiskey and flavored whiskey and our positions in both of those, so prominently, you take note when there's lot of new entrants. So it's mostly on the innovation front.

Operator

Your next question comes from the line of Mark Swartzberg.

Mark Swartzberg

Kind of looking at it from a different angle, Paul. When I first read this press release, I looked at the 3% depletion number for the JD family, and I was concerned. But when I see the plus 7 for the total portfolio and the plus 4 from last year, it seems like el Jimador is a part of that. It seems like one can make the case that these are in-demand statistics that your portfolio's actually getting stronger on a total underlying rate of growth basis. So it's a bit of a softball, I realize, but is that a reasonable way to look at it. And then I do want to address some of the questions I have about the slowdown in JD.

Paul Varga

There certainly was an element of our what I'll call rest of portfolio outside of the Jack Daniel's brand having a very good quarter. If you look at the – and I say rest of portfolio, I know you're referring to Schedule B. I'm talking about everything other than Jack Daniel's. And the tequilas had a really good quarter. That might be one of the contributing factors. Woodford Reserve gets larger, and the larger it gets, the more it grows at 26%, the more it makes contributions. It's not specifically called out here, but even contributions from brands like Old Forester, Sonoma-Cutrer, et cetera. Yes, it was a good quarter for the non-Jack Daniel's brands, but I also don't want to take away from the fact that we expect the Jack Daniel's family, and particularly Jack Daniel's Tennessee Whiskey, over the balance of the year to post better numbers than the 3% that was in there. So – but I think it's a fair comment. I mean, it was a good quarter, and there were some – as all these brands have, when you just look at 90 days at the beginning of the year, you have all kinds of things that are influencing sort of a quarterly number. So I wouldn't expect our – for example, our tequilas, to continue to run at those rates for the full year. But nonetheless, we do think they're performing better than they were in the recent past.

Mark Swartzberg

Right, and you did have a comparatively easy compare. But – and then to your point about JD, I want to make sure I'm hearing you accurately. So you think this plus 3 in the quarter from a depletion perspective accelerates as we move through the year, and that necessitates that the Black Label certainly accelerates, but perhaps, too, Honey accelerates? Can you just tell me what the planning assumption is? And I presume that's supported by August trends.

Jane Morreau

One of the big things is the – what's driving that 3% decline that you're referring to on the family are slowdowns due to the decline in the RTD, RTPs.

Paul Varga

But you're in there, not at equivalent cases, but at their volumetric cases.

Jane Morreau

So we don't expect that to be the number – we'll still have tough comparisons coming from Australia. But it's not only about Australia, it's

the number 7%.

Paul Varga

But you look at it, I think, we've already commented on Tennessee Whiskey. On Tennessee Honey, we at least hope and plan that it will grow double digit. I mean, I posted whether they hear [ph] 14% underlying, 18% for the quarter. I mean, I think it's off of a very large base that is – and the growth rates have moderated in the United States somewhat. But also internationally, I mean, if I look at countries like Czech Republic and Brazil and others, Tennessee Honey continues to do very, very well. So it's – and it's always a challenge when you have new excitement for a brand like Jack Daniel's Tennessee Fire to make sure everybody's also continued to focus on Tennessee Honey. I'll also add that it hadn't been a premier focus of the Jack Daniel's Tennessee Fire launch this year, but we thought it important to do a few international market tests, even if they're channel specific or within a country, even regionally specific. Some of the early results we're hearing back from particularly the U.K. and Czech Republic are quite encouraging as it relates to acceptance on the Jack Daniel's Tennessee Fire business out in those markets. As you'll recall, we did some of this with Tennessee Honey years ago. When we launched, we started in the United States, but then began to test interest in the international markets. We used to have far more ability to control some of this, but with social media and the way that word travels today, an introduction, for example, in the United States by Jack Daniel's is instantly known amongst a lot of the devotees to the brand all over the world. So it becomes a little bit harder for us to manage some of that, but right now, I would say, even though it's more qualitative and anecdotal to these tests, I feel like the acceptance for Tennessee Fire in the international markets is perhaps a little better than what we might have anticipated. So there's a lot of factors that could influence the family's continuing performance over the balance of the 9 months. And I'll remind you that the seasonality for our company really picks up in the next 6 months over the fall and in through the holiday period. And so those will be more important to the full year than just even this first quarter.

Mark Swartzberg

That's great. And if I could ask 2 quick ones on JD. Did you give us the U.S. rate of growth just for the Black Label? If not, could you give us that? And then are you saying RTDs that, negative 4, you think, moderates? Or do we have several quarters of that continuing?

Jane Morreau

I think it will moderate. I think we may still see tough declines there, but I don't think it'll be what we saw in the first quarter because it's going up against the price increase that we took a year ago, where it had a buy-in. We did not talk about Jack Daniel's. What I referred to was NABCA's information yesterday that showed volumetric growth on Jack Daniel's Black Label being label up 4.5%.

Paul Varga

Yes, there was an – a directive of some of this…

Jane Morreau

That was a 3-month…

Paul Varga

Publicly available data. Here's just the trend line that I've noted once we were sort of prepping for this is that using just the NABCA data, not the Nielsen data, for the United States, that a year ago, the 12-month trend for Jack Daniel's approximated minus 1. To-date, the 12-month trend is plus 4. And a 3-month trend is plus 4, and a 1-month trend was plus 6. So as you see, it's just traveling along, it's – there's been some strengthening. And so it's very much in line with what Jane was directionally saying about the improvement in the parent brand's performance over the last 12 months.

Operator

And your final question comes from the line of John Faucher.

John Faucher

Wanted to go back to one of the earlier questions, which was about the growth in the flavored whiskey category. And one of the questions we get from investors a lot is how do you guys avoid sort of the peak and then the falloff in flavored whiskeys that we saw in flavored vodkas from a number of years ago? And I understand the supply constraints can be different on whiskey, but can you talk about the differences you're seeing in either the development or the management of the flavored whiskey category, so that you avoid the sort of boom/bust type cycle like maybe we saw in flavored vodkas?

Paul Varga

Well, I don't know that the boom/bust on flavored – flavored vodka's boom was 20 years, and it bust has been more recently. But the initial entries into flavored vodka back at the early days of Absolut and Stoli, to some extent Finlandia was back around then in the United States, goes back quite some time. So – and it became a prominent part of the category growing to what I recall being something like 20% or something of the total category. I think flavored vodka today, if you're just independently review it as a category, would be huge. And so if you – of course, that took some time as well. What can we do? I can't speak as an industry. I can only speak to what we can do as a corporation and how we responsibly develop the category and the brands. And the way that I feel about it is to treat the entrants in there even though they – in these cases might be line extensions as bona fide brands. And when you do that, it takes you into a consideration of how are you managing, so in this case, to get truly new consumption to the category. And so kind what I'm – I've kind of reference this in my comments that were prepared, that the success we've had, and I'll just use the United States in this example, of being able to attract new consumers through both Jack Daniel's Tennessee Honey and from what we're seeing in the early days of Jack Daniel's Tennessee Fire, to not only the Whiskey category, but to the Jack Daniel's brand without cannibalizing Jack Daniel's Tennessee Whiskey. I find that it's – and we're looking at it from a bunch of different angles. It's very different than, say, in the soda business of diet sodas versus mainline sodas or light beer versus mainline beer, where they're – with the passage of time, was considerable cannibalization as one went up and the other went down. And so far, because these are occupying quite different drinking occasions, we think if you build the brands in, I think, a constructive way and have that in mind, you will have a more prolonged existence as an expression of, in this case, the Jack Daniel's trademark. So that's what we can do. I can tell you, we're not going to be introducing a brand every 3 months in order to chase numbers or something like that. It's just not – it would be irresponsible to the Jack Daniel's trademark. I think there's a statistic we've been using that Tennessee Honey by itself, when you consider brands that average retail around the world for $25 and above is something like the 17, there are 18, they're something like that largest brand because it occupies, I think, at year-end it was about 1.4 million cases. And that is a very significant amount of business. And so I don't want to really treat it as some line extension of Jack Daniel's. You really have to think about how it can continue to be a prominent brand in the global marketplace. I think the other thing that's sort – we have had some unique experience with here is that there's a lot of, of course, national focus on this emerging 7 million, 8 million case and growing flavored whiskey market in the United States. When you leave the United States, Tennessee Honey has played a very prominent role. It's not the lead role in developing the flavored whiskey category outside the United States. And so we think there – that's why we continue to test and read it very closely so that we can expand the world that it's possible for flavored whiskey from just over 300 million people to perhaps 7 billion people. We can – and so we really are taking a very long-term – even though it's a really dynamic category, where there's a lot of competition, a lot of change and a lot of new entrants that will make a bunch of noise, I think we intend to continue to build it along the lines of the way we've treated Jack Daniel's Tennessee Honey with a very long-term view and trying to create incremental value for Brown-Forman. So does that help you?

John Faucher

It does. And then one follow-up, and I apologize for sort of pressing on this. Can you walk us through – I know you talked about some of the impact of FX on the bottom line versus the top line for the year. Can you talk a little bit about what drove the positive leverage this quarter? Was it sort of recycling some of the changes last year? And then can you give us an idea on the full year, just the difference that you're thinking now, you talked about this on the last quarter, the difference that you're seeing in terms of impact on revenue versus impact on EBIT and EPS?

Jane Morreau

So John, just to clarify, are you talking about FX only? Is that what you're talking about.

John Faucher

Yes, FX only. And a little bit of the view in terms of the impact – transactional impact on the gross margin versus offsets that you're seeing below the gross margin line.

Jane Morreau

Yes. So I think if you refer to the table that we have in our appendix, you'll see the impact on our reported results from FX of 9% on net revenues, and then you'll see the gross profit. You see all the pieces as you go down. And as you said, it gets less as you go down, obviously, because we have expenses offsetting our revenue line item, that the one big thing that you're not seeing on there is something that – it was in our other income and expense, which is also what I was referring to. We expect to not happen again in Q2 or Q3 and a little bit in Q4. But was mainly Q2 and Q3, but we had about a $5 million number or so in the first quarter of this year and other income expense that was not repeatable. It's not – it was onetime in nature, if you will. And so that – what you'll see if you take all the numbers from the schedule at the end and then consider that $5 million going the other way or the absence of last year's hurt because of that, okay. Does that answer the first part of your question?

John Faucher

Yes, it does.

Jane Morreau

Okay. Now repeat your second part again for me?

John Faucher

Well, just sort of, again, sort of mapping out that gap [ph] and how we – the rough order of magnitude of the GAAP [ph] revenue versus EBIT and EPS over the balance of the year?

Jane Morreau

Yes, so again if you think about headwinds, we said we're going to have a few cents of headwinds by the time we get to the end of the year. We had $0.03 or so in the quarter, so maybe a couple more cents. What you're going to see – what I was trying to point out is in this next quarter, because if the rates stay essentially where they were as of last week, we had another pretty good hit versus last year's second quarter at the top line, or you'll see another pretty good sized hit on a transactional basis, if you will, for our revenue line. So I was pointing that out. But I think it'll be much less time you get to the bottom line for the second quarter. You won't see a whole lot more coming through, but I wanted to make sure that you understood that your revenues for the first half of the year are going to be challenged because of the FX comparison. And then set aside the essence of the other income and expense item. I don't know if that helps.

John Faucher

Okay. So it's just that the only thing we really need to worry about from a comp standpoint is simply that Q2 comparison?

Jane Morreau

Well, yes. Think about it as we go into the third and fourth quarters, if the rates were – if the euro was somewhere around $1.11, $1.12, that's somewhere what – where it got to in the third and fourth quarter. So it's not changed there, yes, as an example.

Jason Koval

Thank you, Paul and Jane, and thanks to all of you for joining us today for Brown-Forman's first quarter earnings call. And please feel free to reach out to us if you have any additional questions. Have a great week.

Paul Varga

Thanks, everyone.

Operator

Thank you. This will conclude today's conference call. You may now disconnect your line.