Brown-Forman Corporation, Q2 2017, Earnings Call 2016-12-07

Presentation

Operator

Good morning, my name is Kayla, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter Fiscal 2017 Conference Call. — ***Operator Instructions*** —

Mr. Jay Koval, director of Investor Relations, you may begin, sir.

Jason Koval

Thank you, Kayla, and good morning, everyone. I want to thank you for joining us for Brown-Forman's second quarter 2017 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 second quarter of fiscal 2017. Because of all of the moving parts in our recent results related to disposition activity and foreign exchange moves as well as last quarter's change in how we present sales, we have posted a presentation to our website that details the topics we will cover in our prepared remarks for the second quarter and year-to-date results. Both the release and the presentation can be found on our website under the section titled Investors, Events & Presentations.

In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, Form 8-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures 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 second quarter earnings call. As Jay mentioned, we posted slides to our website this morning that I will reference in my comments to help you walk through our 2 main areas of focus today, including first, our year-to-date results; and second, our full year outlook. After I complete my remarks, I'll turn the call over to Paul for his comments, and then we'll open it up for Q&A.

So let me start off by providing you with a brief summary of our highlights for our performance to date and outlook, which you will see on Slide 3, and then we'll dig into each of these areas in a bit more detail.

First, as expected, our reported results through October continued to be negatively impacted by acquisitions and divestiture activity as well as FX headwinds.

Second, we experienced a modest improvement in both our underlying top line and operating income results in the second quarter, although our top line growth was a bit less than we had expected. We'll walk you through some of the reasons for this in a moment.

Third, we continue to experience operating leverage, driven primarily by a reduction in SG&A expense.

And then finally, we reaffirmed our EPS guidance for the year at $1.71 to $1.81.

Additionally, we lowered our outlook for underlying net sales and underlying operating income by roughly 1 point. We'll walk you through the reasons we believe our revised outlook is consistent with the trends in our business.

So with that, let me start by reviewing our recent results that are shown on Slide 4. Our second quarter underlying net sales growth of 3% accelerated modestly from the first quarter's 2% growth and resulted in first half underlying net sales growth of about 2.5%. Reported results in the first half declined 4% and were pulled down by: 3 points due to the impact of acquired and divested brands; 2 points due to adverse foreign exchange; and 1 point due to lower inventory levels.

In the first half of this fiscal year, our underlying net sales growth was negatively impacted by 3 items: First, the timing of promotional activity in the United Kingdom as well as some customer buying patterns in Germany, which we expect will reverse over the balance of this fiscal year; second, the absence of discontinued agency brands in Mexico and the Czech Republic, which were in our first half results last year and will no longer impact comparisons going forward; and third, the drag caused by lower used barrel sales, which we expect to moderate in the back half of this fiscal year. So without these 3 items, we estimate our normalized underlying net sales growth for the first 6 months of the year was approximately 4%.

So let's break down our net sales in a little bit more detail. Looking at it geographically, you can see on pages – Slide 5 and 6 that the United States was the strongest contributor, delivering over 5% growth during the first 6 months. Second quarter underlying net sales growth in the United States accelerated almost 2 points from the first quarter's rate of growth. Jack Daniel's Family of Brands grew 4% in the United States, driven by 3% depletion growth for Jack Daniel's Tennessee Whiskey and continued growth from Gentleman Jack and Tennessee Honey. Jack Daniel's Fire strength in the on-premise helped the brand return to growth during the quarter after cycling against tough launch comparisons from the first quarter of last year. Our premium bourbon, including Woodford Reserve and Old Forester, are continuing to grow nicely despite its acceleration in volumes that we anticipated after taking some sizable price increases that were further enforced through high-end positioning. And our tequila brand, el Jimador and Herradura, delivered another quarter of sustained double-digit growth in the United States.

Moving now to the emerging markets where second quarter underlying net sales growth of 3% improved 8 percentage points over the first quarter's decrease, resulting in a 1% decline in the first half. Our 2 largest emerging markets, Mexico and Poland, delivered robust results with underlying net sales growth of 18% and 11%, respectively. Mexico's gains were broad-based, with strong growth for New Mix, Herradura and Jack Daniel's. El Jimador grew underlying net sales volume the fourth consecutive year of price increases as we continued to reposition the brand to drive better margins and returns. Poland's growth was driven by strong gains for Jack Daniel's and improved Finlandia results. Russia, Brazil and Turkey declined at double-digit rate through the first half, as did China and Southeast Asia.

Sluggish performance in many emerging markets are symptomatic of challenging economic conditions, not to mention the ripple effects that result from widespread currency devaluation. This includes the direct impact to our reported results in U.S. dollars as well as decline in consumer and trade purchasing power. For example, foreign exchange can create customer issues through decreased ability to hold inventories, margin pressures and increased levels of parallel trade.

In developed markets outside the United States, underlying net sales grew 2% in the first half, but were flat in the quarter. Results in the United Kingdom were negatively impacted by the timing of some promotional activities for some large retailers from October into November and December. Germany's second quarter sales were negatively impacted by customer buying patterns. Year-to-date, underlying net sales growth of 2% would have been roughly 5% excluding these 2 items above and the removal of agency brands in the Czech Republic. Importantly, we expect these items to reverse over the balance of fiscal year.

Finally, Global Travel Retail grew net sales on an underlying basis by 4% in the first half, helped by distribution gains and soft comparisons to last year.

Moving now to some additional color on our brands shown on Slide 7. Globally, Jack Daniel's Family of Brands delivered growth of 2%, led by Jack Daniel's Tennessee Whiskey and helped by Tennessee Honey, Tennessee Fire, Gentleman Jack and RTD. The Jack Daniel's 150 campaign is well under way and we expect incremental benefits over the balance of the year, including the Taste of Lynchburg commemorative bottles at 86 and 100 proof that rode into retail stores for the November and December holiday selling season.

Our bourbon brands also continued on their growth trajectory. As consumers searched for high-quality spirits with heritage, we believe our leading bourbon brands will increasingly stand out against the wave of crafted drinks. We have some of the highest quality bourbons available in the market. And we believe the global potential for our bourbons remain largely untapped as we increasingly leverage the significant investments we have made behind the global growth of the Jack Daniel's Family of Brands, including route to consumer.

In our tequilas, the Herradura brand is enjoying the early stages of increasing consumer awareness and trial, driving solid double-digit gains for the trademark in both Mexico and the United States. We believe that the brand is a growing gem in our portfolio and one that will become an increasingly important contributor to our business given its high margins and significant opportunity to grow share. During the second quarter, we launched the brand's first ever global marketing campaign called Luck is Earned, leveraging the brand's name, as Herradura translates into horseshoe. This campaign illustrates the brand's history, heritage and leadership in tequila and brings it all to life through the consumers' stories.

El Jimador had a similarly strong quarter, driving first half net sales growth of 9%. We believe that the brand's health has never been better as we capitalized on our success in building awareness in the on-premise to fuel off-premise sales in the United States and as we repositioned the brand in Mexico at a more premium level.

Finlandia declined 4% during the first 6 months, with mid-single-digit growth in Poland, offset by continued pressure in the premium vodka categories in Russia. Sonoma-Cutrer and Korbel champagne delivered mid-single-digit and low double-digit growth, respectively.

Now, before I move down the income statement, let me spend a moment discussing our used barrel business, which has had a noteworthy impact on our first half results. Over the long term, we have found being vertically integrated benefits our company through quality control, cost efficiencies and supply stability for the new barrels we need to create our premium whiskey. Used barrels are the by-product from the organic growth of the American whiskey business. So as we have grown our whiskey business, we have been emptying more barrels. This has led to a growing revenue stream that peaked around

2% in fiscal 2016. Over the last year, barrel prices have declined more than 10%, which when combined with lower volumes due to softness in demand for blended Scotch, has negatively impacted our year-to-date underlying sales growth rate by nearly a point.

Our reported margin declined 200 basis points in the first half of fiscal 2017, as illustrated on Slide 8. This decline is primarily due to the impact of A&D activity, which negatively impacted first half reported gross margin by 140 basis points and 60 basis points from adverse foreign exchange. We have also experienced some gross margin pressure from higher content costs, due in part to higher wood prices.

Moving on to operating costs shown on Slide 9. Underlying A&P increased 4% as we ramped up spend as we moved into the all-important OND period. First half underlying A&P is up 1%, down 10% reported. We expect our brand investments and activation will drive momentum over the holiday and into calendar 2017.

On the SG&A front, we remain committed to a disciplined approach to controlling our cost. This, coupled with the absence of onetime items from last year, has allowed us to drive down underlying SG&A year-to-date by 3%, or 4% on a reported basis. This decline in SG&A helped fuel the 7% growth in underlying operating income in the first half of this fiscal year against last year's 9% underlying operating income growth comparison over the same period.

Underlying operating income growth improved from 6% in the first quarter to 8% in the second quarter. Year-to-date reported operating income declined 5%, largely due to an absence of divested brands and foreign exchange headwinds, which is illustrated on Slide 4.

In aggregate, we delivered reported earnings per share of $0.50 in the second quarter, up 3% over the prior-year period, and $0.87 during the first 6 months of fiscal 2017, up

1%. Earnings per share was helped by a lower tax rate and lower share count.

So let me now move into my second topic and final topic for this morning: an update on our outlook for fiscal 2017, as shown on Slide 10. So after all the puts and takes over the last 6 months, we estimate that our portfolio delivered top line underlying growth on a normalized basis of approximately 4%. This is against strong 7% growth in the prior-year's first half, equating to almost 10% 2-year stacked growth. Fiscal 2016 underlying net sales comparisons eased in the back half of our fiscal year to 3% to 4%, which implies that we should be well on track to deliver 4% to 5% underlying net sales growth for the full year. For the details, we have provided an appendix in the back of the presentation that presents fiscal 2016 quarterly rates of growth, excluding the impact from A&D and net of excise taxes.

As we look at our revised full year outlook for fiscal 2017, we are encouraged by several other items. First, November depletions in Europe grew double digits, rebuilding – re-bounding nicely from October declines and validating the timing items we called out. In fact, the United Kingdom had its best volumetric month ever for Jack Daniel's Tennessee Whiskey.

Second, consumer takeaway trends for Jack Daniel's Tennessee Whiskey remained solid in most major markets, helped in part by our continued focus behind the JD 150 plan. Value takeaway is up double digits in Germany and Mexico and mid-single digits in France. The United Kingdom's short-term trends have been impacted by the previously mentioned timing and promotional activity. The 12-month value takeaway is up mid-single digits.

And finally, as we analyze the impact from slowing emerging markets growth shown on Slide 12, we believe that trends are improving at the same time that our comparisons are easing, particularly as we move into the fourth quarter.

We expect less reported gross margin erosion on a full year basis than what we have experienced to the first half of this fiscal year, as the easing in margin pressures from A&D activity is anticipated to be offset somewhat by higher content cost. The global pricing environment remains challenging. And while we expect to see modest benefits from price/mix for the fiscal year, they will not be sufficient to fully offset somewhat higher content cost.

On our operating cost, we will continue to invest in our brand portfolio, but we remain conservative until we see a more favorable near-term environment that warrants a more aggressive investment cost structure. We expect underlying SG&A to be roughly flat in the year and plan a modest increase in the back half. Operating leverage will help drive operating income growth of 6% to 8%.

Moving now to FX where assuming current spot rates, we expect adverse foreign exchange to be approximately $0.02 worse for the full year than we had anticipated on our first quarter call, equal to a $0.05 headwind in this year. When considering these expected FX headwinds, the underlying growth in our business and the benefit of a lower share count, our EPS outlook of $1.71 to $1.81 for the full year is unchanged, as we reaffirmed earlier today. As a sensitivity, assuming our foreign currency cash exposures collectively move 10% in either direction, EPS over the balance of the year would be impacted by roughly $0.04.

So in summary, our core brand portfolio continues to deliver healthy, sustained underlying rates of growth, with reported results under pressure from the combined effects of foreign exchange headwinds and our disposal of Southern Comfort and Tuaca last year. We believe that our revised underlying growth rates are both appropriate and achievable, given the business trends we have seen in the first half and what we expect in the second half of fiscal 2017.

Given the macro deterioration and subsequent slowdown in our results in many emerging markets, we have been highly focused on cost discipline, which has largely offset the top line malaise and allowed us to continue delivering high single-digit growth in underlying operating income.

Over the last year, we have made some portfolio enhancements that we believe better position Brown-Forman for the next decade of growth. Our portfolio is skewed to the fastest-growing categories with some of the best brands in the spirits industry. And we are nearing completion of the major capital expansion we began almost 5 years ago to prepare for the next decade of global growth of our underpenetrated brands.

Simply put, we remain bullish on our long-term growth prospects. Our ability to protect and grow our cash flow over time, combined with our balance sheet flexibility, has allowed us to continue to return significant capital to shareholders in the form of buybacks and dividends. So even with our elevated capital investments over the last 5 years, we have returned $4 million to our shareholders since 2012 as we aim to consistently deliver top-tier returns over the long term.

So let me call – turn the call over to Paul for his comments. Paul?

Paul Varga

Thanks, Jane, and good morning, everyone, and thank you for dialing in, as always. As a supplement to Jane's remarks, I believe we had a pretty good first half, particularly in light of a handful of items that worked against our reported earnings. Let me reiterate those briefly.

First and foremost is the absence of sales and profits from the brands we sold late last fiscal year and, to a lesser extent, the loss of agency brands in a couple of countries that negatively impacted the first half. Following this were continued foreign exchange headwinds. A third item was the difficult first half comparison we had against last year's Jack Daniel's Tennessee Fire launch in the United States, and this challenging comp was most prominent in our first quarter this year. Further, the sluggish conditions in several emerging markets continued, though as Jane did note, we did see a nice improvement from Q1 to Q2. And finally, lower sales and profits this year from our used barrel business, and we believe the most significant portion of this impact has already occurred in our first half.

Despite these items, our underlying sales were still up 2.5% in the first half, and underlying operating income was up a solid 7%. And as Jane just shared with you, when we take the step of normalizing our underlying sales, we estimate the first half to be more like 4%.

In the absence of some of these first half headwinds, we are planning for a noteworthy uptick in our second half underlying sales growth. This would position us for full year underlying sales in the 4% to 5% range and underlying operating income growth in the 6% to 8% range, very nice underlying operating – underlying growth against the current backdrop, in my view. And when we account for a little below-the-line help from interest expense, taxes and a reduced share count from our repurchase program, it adds up to us reaffirming today our full year earnings guidance.

Another important aspect of our current fiscal year is the work that we are doing today to position Brown-Forman for growth in 2020 and beyond. Looking back over the last 20 years, we have periodically taken actions or made investments that tempered near-term earnings in favor of sustaining or accelerating the company's growth over the long term. In the early to mid-1990s, 2 good examples of this would be strong our globalization push in the early '90s and the launch of the Woodford Reserve brand in distillery a couple of years later. In the mid-2000s, further examples were the sale of our consumer durables business, followed by the acquisition of Chambord and Casa Herradura. And later in 2011, we chose to sell our popular priced wine business and shift our focus to the introduction of Jack Daniel's Tennessee Honey, a trademark line extension that today is Brown-Forman's second most important brand.

The reason that I referenced these earlier trade-offs is because we believe that we are amidst such a time period yet again. Let me cite a couple of examples from the last year or 2. First, our strong capital investments of late are intended to expand production capacity or improve our brand home places, in some cases both, for Jack Daniel's, Woodford Reserve, Old Forester, Slane Irish whiskey and our cooperage operations. The depreciation costs are just now starting to make their way into our product costs. And we believe this will be a highly acceptable trade-off for the benefit of having sufficient future product supplies and authentic foundations for consumer and trade hospitality in the years ahead.

Second, our recent disposition of Southern Comfort and Tuaca, paired with our acquisition of the GlenDronach, BenRiach and Glenglassaugh brands and distilleries once again traded a larger pool of current sales and profitability but with a declining sales trend for a currently smaller business, but one that we believe offers greater long-term growth potential, not unlike, say, the choice we made a decade ago to sell consumer durables and buy Casa Herradura.

This fiscal year's reported results illustrate this trade-off visibly as the absence of Southern Comfort and Tuaca sales and profits are not offset by the profits of the smaller single malt brands, which are also temporarily depressed this year by the onetime costs of integrating them into Brown-Forman. I will also note that our decision not to reduce SG&A commensurate with the lost profitability of the disposed brands equates to a people investment we are making, as many of our frontline sales and marketing employees redirect their attention to the balance of our portfolio. And we believe this will benefit our brand development in the years ahead.

One of the best pieces of evidence I can provide to these type of short-term trade-offs are good decisions long term for Brown-Forman can be found in the example of Woodford Reserve, which celebrated its 20th anniversary as a brand this year. As a result of our strong investments over the years behind the brand's distillery, its home place, its packaging and its lifestyle marketing, Woodford Reserve has grown steadily to become one of the leaders of the exciting and fast-growing super-premium bourbon category. In fact, I believe the brand's development over the last 2 decades made a meaningful contribution to the bourbon category's resurgence as a whole. In my view, Woodford epitomizes the quality, authenticity, flavor, hospitality and down-to-earth personality that today's consumers seeks from their high-end bourbon experience. Having surpassed the recent milestone of 500,000 cases, the brand is poised for excellent growth in the years ahead. And alongside Gentleman Jack and Sonoma-Cutrer, it serves as a superb reference point for other premium brands in Brown-Forman's portfolio that might be new to our company or still in relatively early stages of seizing the large opportunity in front of them.

We aspire for brands like Old Forester, Herradura, GlenDronach, Coopers' Craft and our forthcoming Slane Irish whiskey to follow a similar path as the one Woodford has traveled over these last 20 years, and we are investing behind this aspiration accordingly. And at some point down the road, we will look forward to recalling this current time of investment as another important period for Brown-Forman that helped the company continue its historic combination of high margins, high returns on invested capital and strong and consistent growth.

That concludes our prepared remarks, and we are now happy to take your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question comes from Brett Cooper from Consumer

Edge Research.

Brett Cooper

Track channels and competitor commentary would suggest some slowdown in U.S. whiskeys in the U.S. And actions we've seen over the last few months point to more money flowing into small brown spirits brands from large competitors. How do you think about the segment outlook in the U.S? And then, how do you prepare for what may be heightened competition in the future?

Paul Varga

Brett, we may have just missed the very first part of your question, but I think I got the gist of it. If we don't get it fully, just repeat it, if you will. I think we've recognized the realities of this competitive landscape, I think you're referring to the United States here, for some time. I mean, it's been our experience that the largest companies and brands in the United States across most categories have – obviously, they're typically a higher basis of existing business and volume, but they have been generally losing share of the U.S. market for some time, as a lot of these upstart brands and a lot of the newer brands that are being introduced to the market have grown, in some cases, rapidly from these small bases. We, of course, have had some of those ourselves. Just the brand I just referenced there, Woodford, would be such a nice example. But when you have brand leaders like in our case, like Jack Daniel's, you are absolutely exposed to that. And so I think in our case, for example, of the premium and ultra-premium bourbon business, we have not set an aspiration that Jack Daniel's would need to lead in terms of market share development of that category, just because it is far and away the largest brand and has – I mean, you would expect brands like Woodford Reserve and even our own Gentleman Jack, et cetera, to grow at rates above Jack Daniel's. Now, having said that, we do strive, with the passage of time, to compete at typically the – one of our internal reference points we look at a lot would be the growth of the brand at a net sales level that's consistent with the country's development overall. So look out for the TDS or premium TDS in some instances. So we have a lot of different categorical reference points. But the point you make is particularly prominent in the United States as it relates to just this onslaught of competition that's been introduced to the marketplace for the last 5 years where, as we say, we're well aware of it. I feel pretty good that the brands that have been more established in our portfolio have held up fairly well. Some of it has, of course, from just category momentum. Of course, the fact that bourbon has been growing. We, too, have observed, I think you referenced that maybe some of the more recent 3 and 6 months growth trends look a little softer than they were historically. We observed that as well, but they still remain, from our experience, well above historical. And actually, particularly in comparing them to some other countries around the world, they still seem very attractive.

Operator

Our next question comes from Robert Ottenstein from Evercore.

Robert Ottenstein

I'm wondering if you could talk a little bit about tequila, and there's a couple of questions I have. Number one, just kind of how you see the market for tequila evolving in the U.S.? Is your strategy to kind of stick with it, the current brands you have or do you think you need more? A little bit about pricing power for tequila. We're hearing a little bit about some potential shortages for agave and prices for agave going up. So just wondered if you could kind of discuss those questions broadly on your tequila business, please.

Paul Varga

Sure. I mean at this stage, we are very comfortable with the portfolio we have in tequila, as – we sometimes, of course, refer to it as Casa Herradura. But remember, it includes predominantly, I mean in terms of our main focus, 2 trademarks, which is the Herradura tequila brand itself and then El Jimador. And then, of course, I'll just remind everybody, within each of those brands, one of the – this is actually one of the great balancing acts anybody who owns a tequila brand undertakes is that you've got typically 3 expressions under each of those. And they range from – it's really interesting to watch how they get categorized by various followers of the category, our competitors. Because we have a clear product under both the Herradura and El Jimador brand that is both – in both cases, they've experienced very rapid growth particularly in the United States. And then of the – and then aged version is called Añejo, and then in between is Reposado. So they – and they actually have different competitor sets in some ways, we find, that, of course, the clear expressions compete more with maybe the vodka category or clear goods, white goods. And then the aged expressions can actually find as a competitive reference sometimes more the whiskeys and brown goods. So you have to look at those individually. I mean, our – we – I think it's safe to say these last 12 months or so have been perhaps the best experience we've had in the tequila business since we have owned Casa Herradura. It's really come in a couple of different ways now and the brand development on both of the trademarks in the United States, but also, their continued success down in Mexico. I think a really important aspect was the repositioning in terms of price for El Jimador down in that market. As the business, at the low price points that it was at, was not as attractive for an owner like Brown-Forman. So we felt it was important to – even with lower volumes, to have higher prices. And we've been undertaking a program to do that now for several years. The Herradura business itself, partially down there as a result of some innovation with the brand Herradura Ultra, has allowed the brand to compete more effectively in Mexico. And then just its continued momentum in the U.S. market as I think super and ultra-premium tequilas continue to enjoy the same type of momentum that we've seen in super-premium bourbon. So as it relates to a forecasted – any shortfalls in terms of supply, I haven't looked closely at that data in a while, but we don't currently have that impacting our business in any significant way.

Robert Ottenstein

And how's the pricing, your pricing in the U.S. and Mexico?

Paul Varga

I think it's holding steady. I mean, I don't think we've had – I'm trying to think if this year, we've had any significant price increases. I don't believe we have. At various times in the past in the United States, particularly in the more competitive arena where El Jimador competes, we would have encountered, I think, some challenges as it relates to pricing in particularly some key markets where new competition would come in and you'd have to discount a little bit. But largely, el Jimador and Herradura with nice U.S. margins have been growing their sales through – predominantly through volumes.

Operator

Our next question comes from Bill Chapman (sic) [Bill Chappell] from SunTrust.

Stephanie Benjamin

It's actually Stephanie on behalf of Bill. My first question has to do with flavors in the U.S., kind of after the acceleration we've seen over the last year. Do you guys believe that that's kind of bottomed out and kind of your outlook going forward? And then, secondly, maybe if you just could provide a little bit more color on why you expect to see the barrels business improve in the second half, just the drivers behind that?

Paul Varga

Jane, you want to take the barrel question?

Jane Morreau

Sure, I can talk about the barrel question. So just a reminder of what I mentioned in our script, it has hurt our first half results about a point. We knew going into the year that pricing on the barrels were going to be down. And so we were aware of that. We also – what we didn't anticipate was some phasing on the timing of the volume. And so that disproportionately hit our first half of our results. They didn't come in as we planned. What we've done now is we also, just for your information, we do annual negotiations in the falls [ph] of the year where we meet with our customers, and we know – it's an annual negotiation, it begins January 1 through December of next year. So we already know directionally what the numbers will be, if you will, both for volumetrically and pricing-wise. So we've taken that in consideration, and that's where a lot of our comments are coming from. I will say the business itself is very cyclical. It's a very dynamic market. It didn't come through in my script. And the supply-demand dynamics are very, very – I think for the rest of the year, we've got it pretty well honed in. But this is again a cyclical business, and we'll watch it as we go ahead into the future.

Paul Varga

Yes, so I think we have pretty good visibility into the remaining months of this business. And as we get any kind of updated view related to the future years, we'll probably be doing more of that during our typical planning. And we'd provide that kind of update probably with our full year earnings back, I guess, in the spring of 2017. So the other question related to the flavors. And yes, I think you're – your assumption was that are these comps kind of easing. And I think the reality is, yes. We felt like particularly – first and foremost, we feel like Jack Daniel's Tennessee Honey has been on a more regular pattern since its introduction. I mean it's been out there now 5 years plus. The Jack Daniel's Tennessee Fire which had, in the United States, its national launch, at the tail end of FY '15, into the early part of FY '16, it created the most significant comparisons for us in our first quarter of this year. And so we definitely feel that they eased into the second quarter and will actually continue to ease as the year goes on. You're always building some form of distribution for these newer line extensions and products. But particularly for that one, it ramped up its distribution rather quick because there was some real pent-up demand for it. So we've been working against some of that initial distribution in trial in the earliest part of this fiscal year. I also think that the brand's continuing to, in some ways, build distribution in the United States to the on-premise. I mean, it's made its way into more points of distribution in the U.S. on-premise. And actually, its velocity looks pretty good from what we can tell. So I feel relatively good about the U.S. Jack Daniel's flavors we've got. The fact that we are not introducing another one and can focus our attention on these 2, particularly in the absence of Southern Comfort and Tuaca, which were also brands we were tending to in prior years, are nothing but a help in our ability to continue to grow those flavors. So I think we're implementing against – pretty much against the strategy we would have outlined a year ago, which is to really focus on these 2, develop them, in the case of Jack Daniel's Tennessee Fire, start the process and to be very disciplined about building its presence in international markets this year as well. And we think that might give us a little bit of help in the second half of this year, too.

Operator

Our next question comes from Laurent Grandet from Credit Suisse.

Laurent Grandet

I've got really 2 questions. The first one is about Coopers' Craft. Could you give us a bit of how it has been received by retailers, and first sales you are expecting from Coopers' Craft? And then more generally, I mean with more competition coming from a multitude of craft bourbon, how does it affect your performance in general? And do craft, I mean, grow the category, or just take share from existing brands? And do you see this evolving with some of your larger competitors investing in that space?

Paul Varga

Okay, I mean, I'll – let me take your second question, which was a broader one about the category. Sure, I think it's maybe doing a little bit of both, the way you pose that question. I do think there's no doubt that the infusion of a lot of new bourbon brands, or, I mean, frankly, you can see it across a bunch of categories. We're starting to see it, of course, in gin. You can see it in tequila. I mean, it's long happened in vodka, of course, as whoever the latest upstart for the recent decade was, took its, in some cases, position from the previous leading brand. But in this case, I think it is contributing. A lot of the entrepreneurs we're seeing, it's contributing to category interest. I think it most certainly then contributes to category trial and some of the volumes. And is that a source of competition? Of course. I mean, there's no way that it can't be when there's more available entrants. And so the way that it makes a company like us think about that is, first and foremost, try to understand what it is about the category and the brands that are coming in that people are finding interesting. And to the extent that our brands also possess, or, in some cases, may even have better attributes along those lines, make sure we're emphasizing them. And so something that's been undertaken at Brown-Forman here these last couple of years is to really emphasize the credentials of our American whiskey brands, and it starts, of course, with Jack Daniel's. And so if you're paying attention to everything from marketing communications to the quality with which we are preparing our home places, to packaging and messaging on packaging, all of that is intended to be contemporary to what people find interesting today about American whiskey and in bourbon. For people who are prone to not wanting an established brand versus something that's new and are just going to try it, I mean, there's not much we can do about being well known or having brand awareness. What we can do though is also offer some brands from Brown-Forman, as is the case with Coopers' Craft that are new to the world and, of course, tell them that story of why Coopers' Craft is, in my view, a perfectly suited entrant into this craft bourbon category today and how authentic the story is behind it as it pays tribute to the barrel making that is unique to Brown-Forman. And so we feel like we're trying to participate in a growing category in a variety of ways. And to date, I'd say we've been net beneficiaries of all this than we have been on the losing end of it. I mean we can cross-reference a bunch of categories, both inside and outside the beverage alcohol business, where that hasn't been the case. And so I think what we can do is put forward our best foot to meet actually the needs of what is creating this consumer interest, which, I think, are some of the elements I mentioned in my prepared remarks, which are things like authenticity and quality and, I mean, making sure the taste and flavor of your products meet their needs, hospitality is incredibly important in this equation. So we're just continuing to strengthen and emphasize those attributes. And so far, Coopers' Craft is doing pretty well. It's in a very limited amount of the U.S. geography only. Our internal reception from our own people, first and foremost, was very strong. And now we're just now getting in out into, which you would – you recognize as a pretty competitive and crowded marketplace. But the fact that it comes from Brown-Forman and given our credibility in this category, gives it a leg up over many of these upstarts that are coming in from entrepreneurs.

Operator

Our next question comes from the line of Vivien Azer from Cowen.

Vivien Azer

So Jane, I had a question about your comment on investment spending. If I heard you right in your prepared remarks, you indicated that you would wait for a more accommodative backdrop before you would lean in there. But I'm having a hard time reconciling that with some of your commentary around the consistent good results in the U.S. and then the inflection that you think you're seeing in emerging markets. So when would be the right time to lean in?

Jane Morreau

Okay. Yes, so what I was referring to, Vivien, is overall, as you saw, we had leverage in the first half of the year largely due to SG&A investments. So first of all, we're referring to the SG&A investment line item as well be very thoughtful on that. We are going to continue to invest where we see that we should, such as the Spain RTC as part of our SG&A investment we'll be doing starting in the last half of the year. So that will continue. The – we are seeing some improving trends, as I noted, in the emerging markets. All emerging markets aren't created equal. So there's certain markets where we're investing and those that we won't. That was what I was referring to, so some of those areas. The U.S., we are investing nicely in. So it varies where – where we will continue to invest is where the consumer is and where they're receptive to it. We would just be more thoughtful. I always remind people to, when we think about the line item of advertising, or when you look at that, we think about our investments well beyond that line item, including the SG&A line, which is the people on the street that builds the brands as well as the cost of our packaging and the value-added packs, which we have several out there right now as it relates to the 2 we were referring to from the Taste of Lynchburg for the JD 150 celebration. So all that comes into play, too, just not focusing strictly on that one line item.

Paul Varga

And that, this reference also is – for us, isn't from necessarily just kind of a 3-month to 3-month. If you think back to a couple of years ago, we would have – I know we would have been in more of an investment mode in, say, Russia where Jack Daniel's and Finlandia were – had great momentum. And then as the Russian economy experienced its difficulties, and consumers' affordability associated with our products tempered somewhat and it's actually really has hit Finlandia over these last couple of years. You might see a net example us allocate resources more towards, say, Jack Daniel's Black Label in the United States where we had a more cooperative category development, a stronger economy, et cetera. So we're regularly reallocating within the mix of investments that we're making. And so I do feel like that part of Jane's comment referred to a slightly longer period of time as well in terms of the way we move A&P, SG&A, and even from time to time investments in things like packaging between brands and regions of the world.

Jane Morreau

Vivien, I thought I might just pick up one more comment or connect another dot for you where we were talking about improving trends, which we saw in several emerging markets in our Q2 and saw a little bit more, more recently in our November results. What I – as I looked over the balance of the second half of the year, some of that improvement is not necessarily that it's growing like it used to, if you will. It's really going against soft comps from a year ago. So some of that improvement we expect as we look out is some of that as opposed to just overall growth rates that we were experiencing in Russia's and the places like that Paul was referring to a moment ago. So some of that, it's all the dynamics that go into just the comparison numbers.

Paul Varga

But I would anticipate, particularly thinking about it from your all's perspective, as you try to evaluate where we would be placing those incremental investments over the next 5 to 10 years, I clearly see the emerging markets as one of those arenas where we will be making incremental investments. Just because we're so still at a very early stage of development, particularly with Jack Daniel's, and many of them now talking of places like Africa and the Middle East, many of the emerging markets where we still have – we might have a nice presence today and we built it but it's still on a relatively small scale versus the opportunity that's there. And those investments could come in the form of – oftentimes it comes in the form of route-to-consumer investments because we've found that that can have a very direct impact on the brand development. Some of these markets don't permit, in the same way that we're used to here, traditional advertising in some ways. We have sometimes referred to them as dark markets, et cetera. But I still, on balance, see us continuing to invest in these emerging markets over the next decade.

Operator

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

Judy Hong

So first, just speaking of emerging markets, I know it's not a big market for you. But just in India, just wanted to see if you're seeing any kind of an impact from the demonetization that happened and sort of what your expectation is.

Paul Varga

Not yet. I'd say it's too early, but it – yes, I would add it to the list of the types of structural things that occur in these emerging markets that you worry about. But to date, we don't have any estimate of the impact.

Judy Hong

Okay. And then obviously, there's been a lot of chatter around potential for new tax policies, tariffs and trade policies with the new administration. So I know you have some export business and import business. So just trying to get a sense of, broadly speaking, what the potential impact from some of these policies might be. And then more specifically, can you give us the percent sales of your export business? And then how much of your business is imported into the U.S.?

Jane Morreau

I mean, we – let me – there was a lot of questions there on that one. So just broadly speaking, being a U.S.-based company and comparing our company's – our tax rate to our competitors, we have the highest tax rate. So if the tax rate, corporate tax rate were to go down, we'd be a beneficiary of it, and quite nicely a beneficiary of it from just a lower corporate tax rate, multimillion, several million dollars, if you will. So that would benefit us, for sure, if we look at just that in isolation. The – there's a lot of moving parts to it. I still think net-net from the proposal we've seen, that we would be a net beneficiary to it.

Paul Varga

Yes, and on the taxes and tariffs, I mean, obviously, we're a single point producer for our largest brand out of Lynchburg, Tennessee. So it's important that we have – and we're so globally diversified today. So for us – and we're paying equal attention to all this stuff, I mean, because any changes in them can impact your business. But we are obviously very strong proponents of an open global trading environment. We've navigated it pretty well even where there have been very high tariffs that tend to be protectionist in some of these countries. But nonetheless, I mean, so you monitor it to see where there might be specific pluses and minuses associated with Brown-Forman's business. But I mean generally speaking, I think the one that just got the most headlines is the one that you first referenced to and that Jane answered, is that given the high tax rate for U.S.-based corporations, we would be a beneficiary if there was a significant tax reform.

Judy Hong

And just specifically, do you have a sense of some of the export volume as a percent of your business?

Jane Morreau

Our – just our U.S. business versus – we put in our annual report, our U.S. business was roughly less than half.

Paul Varga

45-ish, or something like that.

Jane Morreau

And more than half is outside the U.S.

Paul Varga

55%, yes.

Jane Morreau

That doesn't mean that's where your taxes are, by the way, but yes, but we do quote that.

Judy Hong

Got it, okay. And then just one clarification, Jane. Just in terms of the underlying sales guidance, so it's pretty clear that you've had a lot of discrete items and the comparison issues in the first half that's caused a little bit of softness in the first half. And clearly, you're expecting improvement in the second half, which makes sense. But the full year still came down from 4% to 6% to 4% to 5%. So were there any one specific market or any kind of region that you're a little bit more concerned about? Or is this just first half kind of came in at the low end, and even with the improvement, you think it's more 4% to 5% as opposed to 4% to 6%?

Paul Varga

Yes.

Jane Morreau

Yes. I mean, I think it's more that as we looked at – while we've expecting the emerging markets to continue to improve in the back half of the year, when we looked at what it meant for the full year, an improvement that we were looking at overall, I think that's the biggest number drag that we would have put our – pulled our overall forecast down on, it would have been due to that, those markets. The U.S. stays very nice, continues to grow solidly. In the developed markets, with the timing issue that we referred to, I think are nice and growing in the mid-single digits as we referred to. So it was more the emerging markets. We had anticipated the barrels largely. And so it was really a more of emerging markets, though improving, still not quite to what we had thought.

Operator

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

Mark Swartzberg

Also in the U.S., Paul, I know we're only a month since Donald Trump was elected President. But it's qualitative stuff that I've heard, seems like the restaurant environment's improving. We've had some stocks in the restaurant space react favorably. The possibility if I'm an operator that I don't have to raise wages to a minimum wage level, that's higher where minimum wage has been. It just seems that the restaurant environment is improving a month in or – so I'm just tried to get a sense are you hearing those qualitatives as you interface with restaurant operators? Again, it's a month in, but what are you hearing qualitatively about the prospect for foot traffic and spend levels per ticket, so to speak, in restaurants?

Paul Varga

Yes, I would agree. We hear them, but it would just be too early for us to see anything that would make that. I mean, so in essence, it makes it more a hypothesis than a reality. I think some of the more, I'd say systemic things that relate to particularly our business, which is not the food part, of course, as much as it is the drink part of the restaurant business, I think I haven't heard anything that makes me change that, which is this aspect of going back now several, several years where consumers started to subtly shift their consumption occasions toward the off-premise more. And there seems to be more a millennial thing, the ability particularly to use social media to gather people effectively starting your own small bar on an evening if you want because it's so efficient to do so and the impact that this then has on suppliers and brands as you try to navigate the marketplace where the off-premise is growing faster than the on-premise. And so what are those dynamics? I actually think it'll be really interesting to see how, particularly one of the more recent developments that came out of this year's election cycle, which was continued momentum on the legalization of marijuana, that being an interesting development. Of course, it's something we've been monitoring. But what it – just this would be, again, an anecdotal thing, the fact that that tends to be more of an off-premise consumption occasion, actually and to the extent that there's cross-category usage between marijuana and beverage alcohol, what does that do in terms of its impact on a brand or a supplier's approach to the business. I mean, it'd be – I think that development will, if anything, add even greater momentum to the off-premise sales versus the on-premise sales. So these are all things that are kind of speculative, quite honestly. They're hypotheses that we are observing out there. We are monitoring them. I do think our organization has done a nice job on trying to cater to the off-premise occasion a bit more, whether it's through special packs, items such as – like the development of flavored whiskey category I think hits a sweet spot as it relates to convenience in terms of consumption. I think as it relates to price and volume trade-offs, I think certainly the off-premise environment is a more price-sensitive channel than the on-premise one. And so there's a number of attributes of the channels that you have to pay attention to as you see subtle. These have not been wholesale and dramatic shifts; they're much more subtle but if you study them over maybe 3 or 5 or 7 years, they become more important than they do in any 1 quarter. So that's about all we have observed as it relates to the questions you were asking. We'll be paying close attention to it, though of course, as the months unfold and the realities of what's prognosticated actually come into play.

Mark Swartzberg

Very helpful. And if I could, I don't know that you gave us this number, but can you give us a sense of the depletion rate in the U.S. between on and off, either in the quarter or the first half, just some directional numbers?

Paul Varga

Oh, I couldn't do it for the whole portfolio. I mean, it's. . .

Jane Morreau

How about we can get back to you?

Paul Varga

Yes, of course, it varies by brand and – but more, I will just say for the United States' distilled spirits market, my guess is historically, it's been somewhere like 75% to 80% volumetrically off-premise and…

Mark Swartzberg

Oh I'm looking a rates of – I'm asking for rates of growth.

Paul Varga

Oh rates of growth?

Mark Swartzberg

Yes. So comparative rates of growth, yes.

Paul Varga

Let's see. Again, it would vary by brand, I think. For example, like I think we've noted this in the last 2 quarters, like the Tennessee Fire brand has – is growing quite a bit faster in the on-premise than as the off-premise right now. Yes, but I would expect generally if the industry's trends applied to each of the brands' trends, if you just carried them over, that the off-premise would be growing slightly faster than the on-premise, for most of brands.

Operator

Our final question comes from Bryan Spillane from Bank of America Securities.

Bryan Spillane

Jane, just a quick one on the guidance. Does the EPS range assume more share repurchases beyond what you've done so far or is it sort of just inclusive of what's happened so far year-to-date?

Jane Morreau

It's just inclusive of what's happened year-to-date.

Bryan Spillane

Okay. And then, Paul, you made a comment about the D&A. Depreciation starting to sort of ramp up as more of the new capacity comes on. And I think it's up a couple of million dollars in the quarter. Can you give us some sense of just how much larger that'll be or timing and magnitude, just how big that could be going forward?

Paul Varga

At this stage, we'll probably, Bryan, do more of that as we get into F '18 forecasting. I mean, we're starting to see a little bit of it. It's just now starting to make its way in. The more significant impact are higher wood cost, frankly, as it goes into your contents. And so that's the more significant item, but it's just also trying to signal to you guys that eventually these investments we've been making do make their way in through depreciation. And, of course, they are spread over years, but we'll give you all good visibility to that as time goes on.

Jason Koval

Thanks, Bryan, and thank you, Paul and Jane. Thanks to all of you for joining us today for our second quarter earnings call. And as Bryan just mentioned, we will be hosting our 2016 Investor Day in New York next week on December 14. So be sure to RSVP if you haven't already. And, in the meantime, please feel free to reach out to us if you have any additional questions. We hope you have a good week.

Paul Varga

Thank you all.

Jane Morreau

Thanks.

Operator

This is the end of today's call. You may now disconnect. Have a great day.