

# **Brown-Forman Corporation, Q4 2018, Earnings Call**

## **2018-06-06**

### **Presentation**

### **Operator**

Good morning. My name is Dorothy, and I will be your conference operator today. At this time, I would like to welcome everyone to the fourth quarter and fiscal year-end 2018 conference call. — ***Operator Instructions*** —

I would now like to turn the call over to Jay Koval, Vice President and Director of Investor Relations. Sir, you may begin.

### **Jason Koval**

Thanks, Dorothy, and good morning, everyone. I want to thank you for joining us for Brown-Forman's Year-End 2018 Earnings Call. Joining me today are Paul Varga, our Chairman and Chief Executive Officer; Jane Morreau, Executive Vice President and Chief Financial Officer; and Brian Fitzgerald, Chief Accounting Officer. Also joining the call today are Garvin Brown IV, Chairman of the Board; and Lawson Whiting, Executive Vice President, Chief Operating Officer and incoming Chief Executive Officer.

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

This morning, we issued a press release containing our results for the fourth quarter of

fiscal 2018, in addition to posting presentation materials that Jane will walk through. Both the release and the presentation can be found on our website under the section titled, Investors, Events and Presentations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, 8-K and 10-Q reports filed with the Securities and Exchange Commission.

During this call, we 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.

As many of you have already seen, we announced that Paul Varga will be retiring at the end of calendar 2018, at which time Lawson Whiting will become Brown-Forman's new CEO.

So let me turn the call over to Garvin to share some of his thoughts on succession planning at Brown-Forman. Garvin?

### **George Brown**

Thanks, Jay. Good morning. I don't normally participate in our earnings calls, but it's not every day that Brown-Forman announces a change in CEO and not every day that you're given an opportunity to comment on the legacy of someone like Paul Varga. So I would like to say – I think – so I think it would be appropriate to say a few words on behalf of our board.

Paul was put in charge of our beverage business in 2003, taking over from Bill Street. In the subsequent 4 years, he gained more responsibility, becoming our full CEO by 2007 with the retirement of our Chairman, Owsley Brown II. He has been leading our beverage

business in one way or another for 15 years. He is the ninth person to have had full CEO responsibilities at Brown-Forman, the third person to do so since 1976.

For those of you who have been around the industry for a while, you will know that when Paul entered the leadership ranks at Brown-Forman, the future of American whiskey was in doubt, even in the United States. He will retire having successfully grown the Jack Daniel's franchise into the most valuable spirits trademark in the world, according to the Interbrand survey of 2017. That's 14 spots ahead of the #2 spirits brand. Thanks to this, since 2003, the company's total shareholder return has grown at an annual rate of 17% and the market cap has grown roughly sixfold. And through a balanced combination of share buybacks, regular dividends and special dividends, Paul also returned \$8 billion to shareholders during this time, an amount that is almost twice the size of the company's market cap in 2003.

And while you won't hear this from Paul, I believe that his ability to galvanize our company behind the Jack Daniel's brand and the values represented by its home place of Lynchburg, Tennessee, is directly responsible for the renaissance of the American whiskey category in this country and around the world and has thus helped bring economic prosperity to countless new American whiskey brands, distilleries, shareholders and employees and the counties in which they live, most certainly, in our home states of Kentucky and Tennessee, but also across the country. It's for this reason, among others, that I believe Paul Varga has been the most successful CEO in our industry's modern era period.

Now since his earliest days as CEO, Paul has worked with the board on his own succession planning in a thoughtful and deliberate process to identify a successor, a leader to Stuart Brown-Forman's next generation of growth. The board agreed that a versatile, values-driven executive, who demonstrates balanced, long-term thinking, inspires high performance and understands our independent culture is the type of individual who will

continue the growth of our business, our brands and our people. And so last week, the board, Paul and I were very pleased to be able to announce Lawson Whiting as the next CEO of Brown-Forman Corporation. Lawson has spent over 2 decades at the company, with leadership experiences in the finance, marketing and commercial functions in the United States and overseas. He has taken on greater responsibilities since 2013 when he returned to the United States from London, where he had successfully led the Western Europe region. Since then, he's been our Chief Brands Officer, which eventually included the role of Chief Strategy Officer. And since last fall, he's been our Chief Operating Officer. He has been integral to our ability to deliver results to date and has helped position this company well to seize the global opportunities that lie ahead. In Lawson, we are confident we have another leader with the strength of character and intellectual rigor to enable Brown-Forman to continue to thrive and endure for generations.

With that, Lawson, I'm going to put the call back into your capable hands. Thank you.

### **Lawson Whiting**

All right. Well, thank you, Garvin. Those are very kind words. It's been over 14 years since I was last on a conference call. So for those of you that have been around for quite a while, you may remember that I held the Investor Relations seat back in the 2001 to 2004 time frame and met many of you that are – I know are on this call. If you've been an investor since – in BF since over that time period, you've been well rewarded because our market cap, if you go back all the way to 2001, is actually up close to 10x or tenfold, plus the \$8 billion in dividends that Garvin described a few minutes ago.

Total shareholder returns have been extraordinary and are a testament to our ability to deliver high-quality growth and do so consistently and efficiently. So Paul has clearly set the bar high in terms of the performance that this great company is capable of achieving. I worked closely with Paul and the rest of our leadership team on setting the strategy that

we are now executing against. We all believe in a long runway for our American whiskey portfolio, and we're fortunate to compete in a very high-performing industry, with spirits taking share within the beverage alcohol sector, and in fact, American whiskey continue to take share within spirits. We're focused on some of the best categories in spirits, and we also happen to own some of the best spirits brands in the world. It's a combination that we believe can generate superior growth over a long period of time.

Over the coming years, we'll continue to invest in our business with an eye towards delivering long-term sustainable growth while maintaining the industry's best operating margins and returns on invested capital. We'll focus on extending our leadership with the premium American whiskey category, led by the Jack Daniel's family. We continue to generate solid growth in both the United States and our international markets, with the emerging markets being particularly strong right now.

Over the past decade or 2, we've been methodically investing in our bourbon and tequila brands to grow them into meaningful contributors to the company, and those investments are now paying off as brands such as Woodford Reserve, Herradura, el Jimador and Old Forester are, in fact, accelerating the growth rate for the entire corporation. Looking ahead, we'll essentially be doing the same thing or we hope to be doing the same thing with Slane, GlenDronach and BenRiach as we look to build them into meaningful contributors.

I look forward to what I hope will be a long and productive tenure, guiding Brown-Forman into its next generation of growth and deliver top-tier returns for all of our stakeholders.

So with that, let me pass the call over to Jane, and she can talk about our fiscal '18 and '19 results.

**Jane Morreau**

Good morning, everyone, and thanks for joining us for our fourth quarter and year-end earnings call for fiscal 2018. Before I run through the highlights for 2018 and our outlook for 2019, let me again, on behalf of the leadership team here at Brown-Forman and our 4,800 employees across the company, say congratulations to Paul and Lawson on the retirement and succession news.

During my comments today, I will reference the slides we posted to our website this morning to help walk you through 2 main areas of focus in more depth than I plan to cover in my prepared remarks this morning. These areas include, first, a review of our full year results; and second, our outlook for fiscal 2019. After I complete my prepared remarks, I'll turn the call over to Paul for his comments, and then we'll open it up to Q&A.

So let's begin with Slide 3, which provides a high-level view of our terrific results this year and our outlook for fiscal 2019. In a nutshell, we delivered strong underlying net sales growth of 6.5%, right in the middle of our outlook and 2 points above the initial outlook we shared with you a year ago. This growth is more than twice the rate from the prior year and in line with our historic rates of growth.

Reported results were even stronger, thanks to favorable foreign exchange and a slight increase in distributor inventory. While growth was largely volume led, we were able to deliver it efficiently with 8% underlying operating income growth. We believe, based on a continuation of the momentum from fiscal 2018, that we are on track for another strong year of results in fiscal 2019.

Now before I dig in deeper to the full year details, Slide 4 highlights our fourth quarter numbers. You will see we maintained our top line momentum with underlying net sales growth of 5% and 6% reported. Results in the developed world, led by the U.S., remained consistently solid, while the emerging markets delivered high rates of growth.

As discussed on the third quarter call, underlying operating income declined 4% due to the timing of operating expenses and higher cost of goods; in addition, the conscious decisions we made such as a onetime special bonus for our employees.

Underlying A&P increased 7% as we invest in — *indiscernible* — brands, and underlying SG&A increased 9%. Reported SG&A jumped 50%, including the creation of a \$70 million charitable foundation, which resulted in a 32% decline in reported operating income in the quarter and pulled down fourth quarter EPS of \$0.23 by \$0.10.

Slides 5 and 6 walk through our full year results, which we believe are more indicative of our run rate as we move into fiscal 2019.

During fiscal 2018, we accelerated our top line underlying growth to over 6%. Our underlying net sales growth for the full year was broad-based and balanced, both geographically and by brand, shown on Slides 7 through 9. Each of our top 10 markets delivered growth, including travel retail. And each geographic cluster, U.S., non-U.S. developed and emerging markets, contributed roughly 2 points to the company's total rate of underlying sales growth.

From a brand perspective, we also enjoyed balanced growth. In fact, from a brand contribution standpoint, shown on Slide 10, Jack Daniel's Tennessee Whiskey, the other brands in the Jack Daniel's family and the combined growth from our bourbon and tequilas each contributed roughly equally to the company's incremental underlying net sales in fiscal 2018.

We are very pleased with how well our brands are resonating with consumers and excited about the future growth potential as we continue to maintain an aggressive investment posture going forward.

Moving down to P&L and shown on Slide 11. Underlying growth margins declined roughly

40 basis points. Its higher costs more than offset the positive price/mix we generated. Our reported gross margins increased 30 basis points for the year.

Our operating expenses, shown on Slide 12, increased as we invested in our brands, with underlying A&P up 6%, in line with our underlying net sales growth. We maintained our focus on efficiency and cost discipline in underlying SG&A, up closer to 1%, excluding special onetime employee bonuses and costs associated with various organizational changes, both of which are included in our fourth quarter.

Reported SG&A jumped 15%, primarily due to the \$70 million of incremental expense associated with the creation of the spending of the new Brown-Forman Charitable Foundation. In the aggregate, our underlying operating income grew a very solid 8% in the year, up 5% on a reported basis, which includes the foundation. Underlying operating income grew roughly 9%, excluding the special onetime employee bonuses and costs associated with various organizational changes.

With a full year effective tax rate of 26.6%, earnings per share came in at \$1.48, an increase of 8% from the prior year. This includes the \$0.10 negative impact on EPS in the fourth quarter related to the foundation as well as the 2 onetime net negative items associated with tax reform of \$0.09 recognized during the third quarter. These items combined for a total of – drag on EPS of \$0.19 for the full year.

Let me now move on to the second topic and share our outlook for fiscal 2019, shown on Slides 13 and 14. A quick headline is that we expect 2019 to look a lot like fiscal 2018, notwithstanding our concerns around the potential for retaliatory tariff on American spirits. On that subject, we have been watching the development very closely as the situation remains fluid, and there is great uncertainty around what retaliatory measures, if any, could be implemented on what, starting when, at what rate or for how long. So while it's premature to comment on the potential impact on our business, we are on top of the

situation and have been taking measures over the last few months to mitigate risks such as increasing our inventory levels in non-U.S. markets where we own our own distribution. As a reminder, roughly half of our revenue is generated in the United States, 1/4 in Europe and another 1/4 in other parts of the world. In the non-U.S. business, we own our distribution in roughly 2/3 of these markets.

So back to the outlook. Over the last 12 months, our teams around the world have worked diligently to accelerate our net sales growth, and they had done so with an eye towards building sustained momentum for years to come. We believe that our premium American whiskey portfolio is second to none and very well positioned for additional market share gains. So while it's tough with – to have favorable category tailwinds, we firmly believe that we are in the early stages of building brand awareness and extending our reach globally while also delivering top-tier performance. And as you can see from the announcements over the past few weeks, we continue to fine-tune our organizational structure to ensure that we can execute our long-term strategy effectively and with greater efficiency.

So given that high-level perspective, let me share the numbers. We anticipate another strong year of top line momentum, with underlying net sales growth in the 6% to 7% range. We expect performance will again be led by our American whiskey portfolio, including further developing the Jack Daniel's family of brands around the world. We also anticipate the pricing environment to remain challenging but are building in some very modest price increases for certain brands as well as expectations that we will again experience portfolio mix gains given our fast-growing premium plus brand.

We expect top line comparisons will be slightly more favorable in the back half of the year. Higher costs in wood, agave and freight, along with incremental depreciation expense associated with our multiyear capacity expansion program, will likely result in modest growth margin declines in fiscal 2019, similar to what we experienced in fiscal 2018 on an

underlying basis.

As you know, last year, we announced a 3-year, \$100 million cost savings initiative through fiscal 2020. We are well on track to achieve these savings, including continued leverage of our existing SG&A, minimizing input costs as well as capturing efficiencies up and down the P&L.

Our heightened focus on costs positions us to continue to fund many of the additional investments we have been making in our brand development. And in fiscal 2019, this will include incremental resources focused on new emerging brands. We believe this will help us speed our Slane Irish whiskey and GlenDronach and BenRiach Scotch brands in the United States, making them more meaningful contributors to our growth in future years and to expand our premium plus American whiskey portfolio, notably Woodford Reserve, Gentleman Jack and Jack Daniel's Single Barrel in several key international markets. These investments are in addition to the significant brand investments we expect to continue to make to bring in new loyalists to our leading portfolio of premium brands, not to mention various route-to-market enhancements.

In total, we expect our underlying A&P will grow in line with our underlying net sales growth and underlying SG&A to be essentially flat compared to fiscal 2018.

Slide 15 highlights how we have increasingly been allocating spend from SG&A to A&P since fiscal 2013.

In the aggregate, we anticipate delivering another year of underlying operating income growth in the 7% to 9% range. Regarding phasing on operating income, remember that our first half of fiscal 2018 underlying operating income grew 14%, while the back half was up only 1%. So expect tough bottom line comparisons during the first half to ease in the back half of fiscal 2019.

We expect a full year tax rate of 21%, a few additional cents of interest expense we reflect in the aggregate \$600 million bond issuance from April, slightly lower net inventory levels and a few cents negative impact from foreign exchange based on spot rates to date. In total, we believe this will result in reported earnings per share of \$1.75 to \$1.85, representing growth of 18% to 25% over fiscal 2018 EPS of \$1.48.

As a sensitivity, EPS over the balance of the year will be impacted by roughly \$0.05 if foreign exchange rates move 10% in either direction.

One more housekeeping item. Similar to other companies you follow, we are adopting the new revenue recognition standard in the first quarter of 2019. As a result, there will be some movement from A&P to revenues of around \$20 million to \$25 million. Now these reclassifications will have no impact on our bottom line.

In summary, we are very pleased with the acceleration in our top and bottom line underlying growth performance in fiscal 2018, back in line with our historic growth rate, and believe we are well positioned to deliver similar growth rates in fiscal 2019. We have been generating strong underlying growth in a high-quality industry, steadily gaining value share in important markets such as the United States, Western Europe and many of the emerging markets. We believe we have one of the best portfolios of spirits brands available in the markets, focused on premium American whiskey and tequilas today while saving future brands. And we are achieving this growth efficiently, driving leverage to the bottom line, maintaining our industry-leading operating margin and excellent returns on invested capital.

We have been returning a significant amount of capital to shareholders, averaging roughly \$1 billion a year over the last 3 years. And we are generating top-tier returns for shareholders, up 53% this past year, averaging 17% per year over the last decade.

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

**Paul Varga**

Thanks, Jane, and good morning, everyone. First, let me thank Garvin for his very kind words to kick off today's call. As I hope all of you know, it's been my privilege to work at Brown-Forman and, of course, to have been the company's CEO for this last many years. I consider myself very blessed to have been given this rare opportunity to lead such a wonderful company as Brown-Forman.

Let me also congratulate Lawson on taking Brown-Forman's CEO responsibilities starting in 2019. He's an exemplary choice to lead Brown-Forman, and I know he will excel in the role.

As investors, you would expect that we take our succession planning responsibility very seriously, and indeed, we have. Much like our products, which take years to mature, my succession was thoughtfully considered and I believe skillfully implemented over many years. And today, Lawson as well as his executive leadership team colleagues are the products of that careful planning, and they are well prepared to build further on the company's historical success. So rest assured that the company remains in excellent hands going forward.

And thanks, too, to Jane for her detailed comments, which highlighted our F '18 results and F '19 expectations. I don't have a lot to add to her comments other than just state that the last 12 months or so were indeed memorable as they encompass last spring's widespread acquisition rumors about Brown-Forman, U.S. tax reform announced in December and our resulting actions announced in January, our succession plan announcement last week and most recently, the threat of retaliatory trade tariffs against American whiskey. It seems that there's never a dull moment.

Against this backdrop, however, the company more than doubled its rate of underlying sales growth while sustaining our excellent operating margin and return on invested capital, and this contributed to a superb 53% TSR for the fiscal year. And at fiscal year-end, Brown-Forman's TSR ranked at the very top relative to our competitive benchmarks on a 1-, 5- and 10-year basis. Of particular note is the consistency of the company's 3-, 5- and 10-year TSRs, which finished the fiscal year at 18%, 17% and 17%, respectively.

Now in order to post such consistent returns, a company needs to have just the right ingredients, along with ample cooperation from the environment in which it operates. Brown-Forman possesses a wide range of attributes to support our long-running success. The 5 that I believe deserves special emphasis today are: one, the company's active portfolio management, which has positioned the company for stronger growth at higher margins; two, the superb brand building carried out by our people each and every day; three, our track record of capital deployment, which is trapped to ideally balance the needs of our business and the needs of our shareholders; four, Brown-Forman's strong governance system, encompassing the Brown family, our Board of Directors and our executive leadership; and very importantly, great people working in a great culture, where their personal growth and efforts enable the company's growth.

On the topic of superb brand building carried out by our people each and every day, I'd like to highlight just a few brand building milestones that our company achieved by the time fiscal year 2018 had come to a close.

Jack Daniel's Tennessee Whiskey surpassed 13 million cases for the first time, and this propelled the Jack Daniel's' family of brands to exceed 17 million cases. Our Jack Daniel's flavored expressions crossed 3 million cases, with the RTDs measured on an equivalent basis, and Gentleman Jack surpassed the 600,000-case milestone. In total, we sold more than 1.5 million cases of American whiskey at super-premium prices and above, led by

the Woodford Reserve trademark, which sailed through 700,000 cases with its 21st consecutive year of double-digit growth. And while still very early in development, Brown-Forman surpassed 100,000 cases of super-premium Rye whiskey across the Jack Daniel's and Woodford Reserve trademarks.

Adding further to the 2018 milestones were the Old Forester family crossing 200,000 cases comfortably and the Herradura trademark exceeding 500,000 cases for the very first time.

As I think across these milestones, some of the common drivers had been innovation, investment, a heightened sense of focus within our route-to-consumer, premiumization within the trademarks, which has made the value of the trademarks even more valuable than their volume metric milestones indicate, and of utmost importance, the quality of the products themselves. With the seemingly endless array of competitive offerings today, it has never been more important to ensure our product formulations meet the taste expectations of their intended audiences. And as I'd like to say, our production colleagues across the globe know how to put it in a bottle.

In closing, let me congratulate my colleagues across the Brown-Forman community on their superb efforts to produce the FY '18 results we've reported this morning as well as thank them for positioning the company for further success in FY '19 and beyond.

That concludes this morning's prepared remarks, and we're now happy to take any questions that you have.

## **Question and Answer**

### **Operator**

— ***Operator Instructions*** — Your first question comes from the line of Brett Cooper with Consumer Edge Research.

### **Brett Cooper**

Congratulations. Paul, if I can ask you what you think the biggest challenge is that you're leaving to Lawson, and if Lawson is willing to answer, some of the biggest opportunities he sees as he takes over and looks forward over the next several years.

### **Paul Varga**

I think the biggest challenge is actually come from some of the opportunities, which, inevitably, they've been, over my time, competitive challenges, having to navigate what inevitably become mid- to long-term competitive threats in the categories where we operate. I think we've seen this here over the last 7 to 8 years. We – I think we've been pretty adept at handling some of those more macro factors that come. I think we've been a fairly adaptive group. And of course, in the current times, people are focusing on things like the possibility of retaliatory trade tariffs. But I think the bigger thing over time is making sure that our brands are presented in a favorable way out in the marketplace relative to the competition.

### **Lawson Whiting**

Yes. I guess if you pin me down and say you have to pick one, I mean, it would be the continued leadership at the premium American whiskey category around the world. And that's a blend of both the continued Jack Daniel's growth, where we continue to grow nicely in the United States but we're seeing tremendous growth outside of the United States still and the emerging markets continue to kick in. And we're still very much under, say, under-indexed or underrepresented in many of the emerging markets around the world. So there's a lot of opportunity there. And the other, we're beginning to push harder on the portfolio development, particularly in places like Europe that are still relatively Jack concentrated, but brands like Woodford Reserve will be the cleanest example. We have very high aspirations for the brand and pretty high confidence that we can make it a meaningful contributor to the company.

## **Operator**

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

## **Judy Hong**

Congratulations to both of you, Paul and Lawson. So I guess my question is just around the comments that Jane had made on the tariffs and completely understand it's still a moving part here. But I guess I just wanted to get your sort of baseline assumptions in terms of what the scenario could look like if you're actually assuming a 20% or 25% tariff on American whiskey in both Mexico and Europe. And you talked about some of the measures that you've taken on building inventory. So I'm just wondering if that was in the fourth quarter numbers or is it too common in 2019 guidance and just thinking about how you factor that into your guidance. And then to the extent that some of these markets are under a little bit more pressure, I guess the one upside potential would be just continuation of the strong growth that you're seeing on emerging markets. So can you call out maybe a few markets where you see the upside potential as you are lapping some of the strong growth that you actually potentially see even an acceleration in some of those markets?

## **Jane Morreau**

Judy, you've asked a lot of questions. You want to talk about tariff?

## **Lawson Whiting**

Yes, let me try the tariff one.

## **Jane Morreau**

— *indiscernible* — our outlook and our results.

## **Paul Varga**

Yes, inventories and...

## **Lawson Whiting**

Yes, sure. So first of all, you had to check off there – within the guidance that we've given, we are not assuming these tariffs are going to be enacted and hurt the results that we have. We – and the other part of what you said in the fourth quarter, the inventory builds that we've done were primarily really exclusively in own distribution markets where we're able to move the inventory into our warehouses over there, but it's not been reflected in sales or depletions or anything like that. So – but look, it's a tough, tricky situation that we've been watching now for months. And it seems like every day we wake up, and the thing takes a little bit of a twist and turn, including even last night. So it's a dynamic situation. It's one that we're obviously watching closely. It's one where it's very dangerous, I think, to make sort of generalistic statements or broad statements across large quantities of markets because I do think our reaction will be largely market-by-market basis. And what we mean by that, just try to be clear on it, markets where we own our own route to market, which would be most of Europe, most of the big markets in Europe, we have a lot more flexibility and control over the situation. The markets where we use third-party distributors, it's a little bit more difficult. So we're going to have different responses for those different types of markets. Markets that have big retail concentration where we have 1 or 2 customers that may make up a majority of our sales, we're going to have to be careful with those markets, too. So this is going to be a bit surgical, I think, in the way that we respond, but know that we have lived through these sort of dynamics before or the rapid excise tax increases, which have happened periodically. We've had supply shortages. Maybe you get a big FX swing, something like that. All these dynamics that can move pricing around in a pretty quick moment, we've experienced before, and we think we'll fight through it again.

## **Jane Morreau**

Let me just see if I can answer the rest of the questions, I think that Lawson started on the outlook for the year, which does not assume anything as it relates to trade tariffs at

this point, neither does my phasing. So I said that our first quarter might be a bit tougher, our first half of the year to be a bit tough for bottom line because of the strong operating growth we had last year, also said our first – our second half top line would be slightly better. So if something were to happen again, there's a lot of uncertainty around that, those things could change as a result. Now as it relates to, I think, were your questions were in terms of our – maybe our outlook for the year, the 6% to 7%, I think it's pretty as important to pull ourselves back and look at cluster-by-cluster, geographic cluster-by-cluster. So let's start with the United States. Since the beginning of the calendar year, you've seen TDS improve. It's improved over 1 point, so – in terms of its growth rate on a value basis. Our growth this past year was in the 5% range. We continue to believe that, that can be true for next year, our fiscal 2019, along with we are putting investments to accelerate our growth behind our Scotch and Irish. We alluded to that during our call today, so we believe that. And the meaningfulness of Woodford Reserve as an example, and it's growing 20-plus percent, is very significant to us. So we believe those combined, that growth – that U.S. market can have easily mid-single-digit growth going in above TDS. Our developed – nondeveloped international markets have been consistently in the 5% to 6% growth range. Our underlying trends support that. Takeaway trends in our overall major markets also support that. Now emerging markets grew quite nicely this year, and they were up in the 13% range. We think they have stabilized quite a bit, even if they don't grow at that 13% rate, which I think there's plenty of opportunities. That's where a lot of our growth is going to come from over the long period of time, and we've been talking about. So say they grow in the 6% to 7%, we can easily get to the 6% to 7%. Again, pulling back and thinking about innovation, more broadly, too, which will support not only the U.S. but also other markets around the world. We only had a partial year of Rye. Jack Daniel's Tennessee Rye is an example of last year. We'll have a full year of that again this year. And we're making investments, as Lawson alluded to in his comments, overseas to get our Woodford Reserve and some of our super-premium portfolios growing faster

there, too. So all these things combined give me quite confidence in our 6% to 7% range, even if emerging markets would just slow a tad. Hopefully, that answers your question.

## **Operator**

Your next question comes from the line of Steve Powers with Deutsche Bank.

### **Stephen Robert Powers**

I guess – first of all, congrats, Paul and Lawson, for me as well. I wanted to just pick up where we just left off in response to Judy's question. I think your comments, Jane, were helpful. But maybe you can talk a little bit about just where we are coming at a Q4 versus the full year because if I look at your year '18 that you just finished, as you laid out, it was a very strong year. Then I think relative to where you expected to start the year, it came in ahead of those original expectations. So to some extent, the year-over-year comp in '19 is tough. And you did decelerate modestly into the end of fiscal '18. So I guess, in the context of that, maybe building on what you have just said, Jane, in response to Judy, is what gives you the confidence in what I perceive as effectively a reacceleration into '19? That's my main question.

### **Jane Morreau**

Sure. I can do that, and hopefully, they add on here. I would say – we've been talking about the phasing in the tough comps first since December, particularly phasing on the costs, if you recall. So of course, we expected those to start come in, in the third quarter, which we saw, and then we made conscious decision in our fourth quarter to invest more behind the business, do special bonus, things like that, because of the performance of our business and also influenced by the tax reform. And we believe that sets us up well for next year. I'll refer to some of our investments that we're making incrementally next year behind our new brands, our new-to-the-world brands, these new drafts, I should say, our Irish and our Scotch, which we believe will help accelerate those growth rates, plus

the investments we're making in some of our key international markets to accelerate the growth rates of our premium plus portfolio. I would also say again, you might recall that our first half of last year - or first quarter of last year, our nondeveloped markets from a phasing perspective - you've got phasing all over the place, I really wouldn't get caught up in a phasing of any one quarter. I think you need to pull back our underlying trends, our takeaway trends off the port and what we're saying in here. You do get noise in any one given quarter. So last year's first quarter, as an example, our nondeveloped U.S. markets were pretty soft. So I've got confidence in the - and we're not truly accelerating from a fourth quarter, if you will, it's more of a continuation of our full year.

### **Paul Varga**

Yes. I think I'll just add to it. I'd just highlight the - just - we will benefit from Jack Daniel's Tennessee Rye, as Jane said, particularly in the first part, but also think we will build momentum throughout the year because it had a somewhat slower build throughout the year than we might have anticipated, and we feel like we've got it poised for better growth next year. I also think the same thing is true of the high-end single malts. And remember that those, along with the high-end expressions from Woodford Reserve and Herradura and others, do give us beneficial portfolio mix as we go throughout the year. So just keep those things in mind as well, but it should bolster your confidence.

### **Lawson Whiting**

Yes. A couple of other things specific to the U.S. As Jane mentioned, TDS has improved by about 1 point, and Tennessee Whiskey has gone along with that. And I have some sympathy for you all that are using the different syndicated data sources because I know they're pulling in different directions and a little bit hard to follow these days. But we still think our consumer takeaway on Tennessee Whiskey around 3%, but then you add the other - the Honey and Fire and Gentleman Jack and Rye and you have the rest of it in there, and that - we feel pretty confident that, that business is going to stay up in those

kind of growth rates, and that pulls the whole family up into a mid-single-digit grower. So the other factor I think I'd add into it, the pricing environment, modestly better. I mean, it's not great, but we are planning price increases for next year, even slight, but at least that's better than some of the more aggressive discounting that's happened, I'll say, over the last couple of years. So we'll have to be careful and dynamic in the way that we do that, and it depends on what the competitive reaction is going to be. But we see it as a positive year from a price increase, not – from a price perspective, not from a drag.

### **Stephen Robert Powers**

Great. If I could just follow up real quick on that last point. The pricing increases that you see, is that more in the tequila, bourbon side? Or is that more broad-based? And then lastly, if there's any way you could just maybe further dimension the planned investments and the projected ramp in Irish whiskey and single malts that you expect as '19 progresses into the future, I guess.

### **Lawson Whiting**

Admittedly, my comments were more on whiskey, and tequila would certainly – probably even more so in tequila than any other category. But bourbon category and – the whiskey category in the U.S. has been tough. It's not been a great pricing environment for a couple of years. And we do see that improving right now, and the data would show that over, I'll say, the first half of this calendar year where we see an improvement. What was the other?

### **Paul Varga**

That's Slane and single malts, the posture for investment ramp-up going forward.

### **Lawson Whiting**

Yes, I mean, they are small, particularly Slane is off a very small base. And we are investing quite heavily in that right now. We're not – the brand is not even national across the

United States yet. So that will be accomplished by the end of fiscal '19. And so we're pretty aggressive with these things. But to be honest, there is not an unlimited supply of whiskey in these brands either, and so we tend to – we think we're doing it in a right way. It's a heavy-on premise rollout in the United States and really very, very limited volumes in Europe. Europe is really prioritizing the rollout in Woodford right now, so we're going to have Slane focused on the U.S. The single malts are bigger. Obviously, those are in place right now. And it did take us a little while to get our – to get them integrated into our system, but I think we feel good about it now that it's – it took longer than it probably should have, but it's in there now and it is rolling and we are putting incremental resources, both SG&A and brand expense behind these and hope to see a lot better result.

### **Paul Varga**

Can I add one thing to that? Because I think it would be helpful if I go back to maybe around our midyear results when we were, in my view, growing at rates. Frankly, we didn't need to, at the bottom line, we were – I mean, we came out of the gates and had some favorable comps, and we're very efficient on the SG&A front. And then as tax reform came through, I think we signaled this to you all, I mean, we really felt like – the back half of FY '18, we could take some actions and make some significant investments that would really help us with the continuation and, in this case, acceleration of the company's results in FY '19. And of course, now that you all know, I mean, I really was thinking through this that it would be great to have that momentum continuing on with the consideration of leadership changes, et cetera. And we really would like to have those investments in place and to have gotten those out there sooner versus later. And I would highlight, right, it's in our forecast, the expectation of, again, strong A&P investment and flattish SG&A expectations for the year. And while still investing behind, for example, people to support the single malt business and the Slane rollouts and things like that, that is a really important piece that we are going to be investing behind people to go develop the initial

distribution awareness to these brands. And in our financials next year, it won't be that visible because of the way that we made investments and set up – took actions to set up FY '19.

### **Operator**

Your next question comes from the line of Peter Grom with JPMorgan.

### **Peter Grom**

Paul, Lawson, congratulations. I was hoping to get an update on the tequila category. First, from a top line perspective, how do you see this category evolving in the coming years? And how should we think about Brown-Forman's involvement in the category longer term? And second, I know you mentioned some inflation in agave prices. Can you just give us an update on what you are specifically seeing and what your expectations are for fiscal '19?

### **Paul Varga**

Well, I mean, I think our – I see as what I would consider – and it will be on Lawson's team going forward, I've seen it right now for FY '19, a strong continuation of what we've been doing with our tequila business, which has been, I mean, focused almost on, I call it, 3 different aspects, which are the Herradura trademark, the el Jimador trademark and, actually, very valuable RTD business that's associated with the el Jimador trademark. And then we grouped it sort of on their development in Mexico, development in the United States and then increasingly, it's very interesting to see the development of these brands outside Mexico and the United States. And so – and across the board, these last couple of years, we've seen the market react to the investments we've been making, I mean, very significantly to innovation. I mean, I would call out the Herradura Ultra work that we've done down in Mexico. And I think that business continues. We've done great repackaging over the years. I think that business continues to be locked and loaded for

continued success, in my view. And I think we're going to be in an enviable position as it relates to this agave pricing because of the investments we made to store tequila in tanks over the years because in the prior cycle, when there was – had been an excess, we were taking it in. So – and the way that we source and produce, I think, also is a slight advantage in this market. It gives us more flexibility to watch the pricing. But I do – I mean, we will, of course, react if the marketplace – the key marketplaces take very strong increases or don't at all. I mean, we're going to have to play those just as we said on – early on the call on a market-by-market-basis. But I continue to expect the tequila business for Brown-Forman to keep rolling.

### **Operator**

Your next question comes from the line of Lauren Lieberman with Barclays.

### **Lauren Lieberman**

So I was just curious if you could talk a little bit about some of the organization changes that were announced a couple of days before the CEO transition was shared externally. So it sounds like there's an element here where there's going to be simple reorganization. There's probably some work at a level down maybe that it will be contributing to some of the cost savings and the ability to drive leverage on SG&A and reallocate resources. But – so I would love to know, I guess, about that. And then also, from an operational standpoint, what these changes do that enabled you to get maybe faster, closer to consumers, sort of the day-to-day positives on execution that you're targeting with some of the reorg work that's been announced.

### **Lawson Whiting**

Sure. Well, I can take that. So the one thing, just to clarify a little bit, these – the reorganizational changes really aren't about cost savings. They are more about getting closer to the market. But there is a sort of a – particularly, you can do it on a brand lens or

on a market lens, but generally speaking, one of the things we're trying to do is position ourselves for faster growth, both in the emerging markets while maintaining what we have in the United States. And so we are putting people closer to those markets. I also don't want to have the same – as an example, if you are managing a very large market, say, in Western Europe and then also having responsibility for developing some tiny markets in Eastern Europe or in Africa or India or wherever it might be, that, to me, is a bad combination. And so we've been focused on making sure that we have people that are managing the big businesses that we have today and continue to plow forward with those and then having people that don't have to worry quite so much about current day profit growth but are better seeding us for the long run than we want to have. So that's part of it. The other part of it is getting – we do – as I mentioned before, like American whiskey leadership in Europe and broader portfolio development beyond just the Jack Daniel's family, we're putting incremental resources down to better focus on those. So the same people that have to develop Jack Daniel's Tennessee Whiskey are not focused on seeding Woodford in France, as an example, or something like that. So it's a bit of – it's a bit more of a focused organization maybe than it was before, which, in some cases, actually ends up costing a little more money, but we think, ultimately, we'll navigate that within the cost parameters that Jane talked about earlier. And hopefully, this will work and we'll get some faster growth.

### **Lauren Lieberman**

And does some of that tie in with markets where you've now made the change to own your route to market? I mean, does that – are they 2 pieces of a puzzle where you sort of get an accelerated impact where you own your route to market versus those where you're still working with a distributor? Or can you still really pursue that big brand versus small brand or big market versus small market strategy regardless of route to market?

### **Lawson Whiting**

Well, I think you can do it regardless of market. But the own distribution markets tend to be the big ones that are over there, and most of Western Europe's large markets is where we have our own distribution. And it is where we can react the fastest. And so that is – those will probably be the first in line in terms of portfolio development over there. It's a little bit harder when using third parties. So we probably have the highest confidence that we can get some of these other brands, like a Woodford, going in those direct markets.

### **Paul Varga**

Yes. Let me add to that. Since Lawson came into this COO role really last fall, I could just sense, and he's been active in this ever since, which is to really get the rest of Brown-Forman's portfolio in some of these markets. So even within a developed market, really enabling broader portfolio development would be, I mean, one of the themes I think you'll see from him. And I think it's an exceptional push for the company because it can provide all kinds of benefits and leverage the prior – we've been using this for the last couple of years, let's leverage our prior investments, whether it's in our manufacturing operations, in our route to consumer, et cetera. And Lawson, I think, has really jumped on that as it relates to broader portfolio development. So with our ambitions to go – continue to lead across premium American whiskey, you can imagine that in the future years, that putting aside innovation for a minute but just to push alone behind Woodford Reserve, Gentleman Jack, even Old Forester, could be major contributors to Brown-Forman's portfolio development.

### **Lauren Lieberman**

Absolutely. And then if I may add one question also, maybe better for Jane. I feel like it's been maybe a year since you'd started talking a bit externally about the things you've been doing in finance to become more efficient in pricing and promotional activity. Can you talk a little about kind of progress in that front and how you're sort of going to build

on that in the new fiscal year?

**Jane Morreau**

Yes. I think what you're talking about is our revenue management, which I think Lawson was also referring to. And we continue to do this on a market – look at this on a market-by-market basis. Some of the modest increases that we're going to see in prices this coming year in fiscal 2019 are a result of utilizing these tools and testing different things and testing and learning in different markets. And so some of the modest increases that we anticipate are a result of that – those things. So we continue to move forward. We continue to apply it further on a – after more and more markets, and I think you will continue to see us get tenths and – 0.2 – 0.3 points on revenue, which are meaningful to us over time given our revenue numbers and given the difficult market that we're in as it relates to pricing. So good work continues there.

**Operator**

Your next question comes from the line of Tim Ramey with Pivotal Research Group.

**Timothy Ramey**

Paul, it's really been amazing and a pleasure to watch your leadership with the corporation. And Lawson, I may be one of only one or two people on the call that are – was around for your Investor Relations days. So Jay, stay focused and work hard. There's a path to the CEO role out there.

**Lawson Whiting**

Thank you, Tim.

**Paul Varga**

Thanks, Tim.

**Timothy Ramey**

I know there were a lot of demands on cash in the fourth quarter with the foundation and so on. But can you talk about how you're positioned for share repurchase in fiscal '19 and how you feel your degrees of freedom are there?

**Jane Morreau**

Yes, I mean, I think – and these guys can fill in too. I think they're talking really about our capital deployment or capital structure priorities going forward. And again, I would pull back up, Tim, and not look at something like just a share repurchase. You know we've always done them on opportunistic level. Instead, look back and pull ourselves up and talk about where we're investing. And we've been investing quite heavily behind the business, whether it's been laying down whiskey, all the capacity expansion we've been doing, home places that are coming through fruition. Matter of fact, we're getting ready to open our Old Forester distillery here in a couple of weeks. We're excited about that. And so we've been doing a lot of those type of things. We always want to maintain flexibility in our capital and make sure that we can pay regular and growing dividends. And so as it relates to share repurchases, we've just done \$1, as you know, special dividend. So as it relates to return and other forms of cash to shareholders, those are things that we look at every year, annually, but I think our recipe that we've experienced or you've seen us deliver over the last decade won't change. You might see some lumpiness from year-to-year, but again, this all goes into play whether with share repurchases, which, again, are opportunistic that we look at. So...

**Paul Varga**

I'll also add, just to – one of the things that any retiring CEO would want to do for an incoming CEO is to ensure that they have sufficient financial flexibility to act on any opportunities, whether they be share repurchases or appropriate acquisitions or any of the other alternative that Jane just mentioned. And I just continue to think that Brown-Forman remains in excellent financial health as it relates to not only the strength of the balance

sheet and the performance of the company, et cetera, but also just the financial flexibility.

**Timothy Ramey**

And just – if I may follow up, I saw that – was it – is the King of Tennessee news on that. You had mentioned that.

**Paul Varga**

The King of Kentucky.

**Timothy Ramey**

I'm sorry, the King of Kentucky. I stand corrected. Any thoughts on that? Will it be meaningful at all in 2019?

**Paul Varga**

It will be very small in terms of the types of stuff we're talking about today, although very interesting in terms of the way it's getting publicity and the reaction that's occurring. I mean, it is a very high-priced and very limited offering. So – but it actually – the thing I like about it, it continues to showcase something I mentioned in my prepared remarks, which are the exceptional liquids that our distillers put in a bottle, which we sometimes forget about those things when you read about why bourbon is doing so well or why Brown-Forman is doing so well. And I just continue to believe that this product quality component with – particularly with all this competition out there, some of which are not controlling their own methods of production, I think it becomes a vital component in the brand-building model, and so King of Kentucky is yet another example, and builds on some of the other expressions that have been out there very successfully, from Jack Daniel's and Old Forester and Woodford Reserve, test markets on Coopers, others around the company. And so we're smiling very proud around Brown-Forman even though it's a very small introduction.

## **Operator**

Your last question comes from the line of Amit Sharma with BMO Capital Markets.

### **Amit Sharma**

Jane, a quick clarification for you and then one for Lawson. You talked about moving some \$24 million, \$25 million from A&P to revenue. I mean, do you model for '19 that growth, in line with sales, so it should be off of a lower base or a higher base? That's one. And then, Lawson, clearly, you've been part of the strategy over the last several years, and you talked about broader portfolio in international market as one focus from you. What else can we expect as you look through the next 2 years, 3 years in terms of bigger initiatives as you take helm at the CEO position?

### **Jane Morreau**

I'll take the – what I can – I referred to in my call, I didn't mean to confuse people. It's a housekeeping item. We have to adopt the revenue recognition standard, May 1, our fiscal 2019. And what that is going to cause is simply some movement of expenses that used to be in account at A&P up to discounts, thus lowering your A&P and lowering your net revenue. So it's more of a comparability. We'll provide insights into that as we go throughout the year. A lot of companies are doing – some of our competitors have been very significant in that movement, and we wanted to give you insights to that. But we will specifically lay it out as we go throughout the year. It's about \$20 million, \$25 million. It's a reclass only, it has no bottom line impact.

### **Lawson Whiting**

And as far as what else can we do here, I mean, I think it's important to note, and we've already said it a bit today, but don't expect what I would call transformational change at Brown-Forman with the track record that we delivered and the way that we think we've set ourselves up for the next – we call it the next generation of growth. It's a pretty good

business story. And so we're not trying to transform the company, we're just trying to do more of it. And we think this leadership of American whiskey is a very strong platform that we can grow from and we can continue to drive a lot more growth. I mean, I – I'm sensing through your question you're wondering what the world of acquisitions are like around Brown-Forman and the industry over the next few years, and that's pretty tough. I don't – I mean, we obviously – we look, but there haven't been many transactions that we would say create a lot of shareholder value in the last few years. So it's largely an organic growth strategy that's going to continue to be about portfolio development in the developed markets of the world and continue to drive Jack Daniel's in a much bigger way in the emerging markets.

### **Amit Sharma**

And just one on that. It's just not acquisition, Lawson, but also coming of the — *indiscernible* — brands. You've been on that path. Should we see a faster progress on those if you look within your portfolio?

### **Lawson Whiting**

Yes. I mean, well, look, we are constantly asking ourselves the questions. But at the end of the day, we don't have a lot of brands. I mean, the brands that are left on the portfolio that would even make a list like that are very much relatively small. They're not going to be meaningful to the – really, to the financial outlook for the company. But we'll continue to evaluate, but...

### **Jane Morreau**

We'll continue to evaluate.

### **Lawson Whiting**

But I wouldn't expect much dramatic...

### **Paul Varga**

With the scale of Brown-Forman, just to give you a retrospective, what Lenox, the popular priced wines, and Southern Comfort represented at Brown-Forman during those times, they were much more significant than what, like as Lawson said, any brands that would even make a list today. What they would represent as a percentage of Brown-Forman, it's just much smaller. So the portfolio reshaping, we call it, I know I've heard Lawson say this, we've done such work on this that for the next couple of years, I mean, we really feel we're poised to go build these things and to mobilize our organization to realize the potential that we think is there. And so I mean, I personally feel like we've set the place up to run real well right now. And Lawson is the person to take that forward. I really do because I think he'll bring a bunch of new ideas to how we do it and, in some cases, where we do it. But I agree with – here is something that's very important for a CEO succession at a company like Brown-Forman. You have to remember that Lawson would have been sitting beside me and others over these last 4 and 6 and 7 years, making the whiskey and planting the agave that we will now be able to sell. And even if someone particularly wanted to do something on transformational, on an organic basis, they would run into potential issues and the fact that the product would have already had to been made. And so one of the great benefits of managing this transition well is that Lawson has actually helped drive the forecast over the last several years alongside me and others that will materialize as wonderful products in the end that our people will take out to the marketplace.

### **Jason Koval**

Well, thank you, Amit, for that question, and thanks to Paul, Lawson, Garvin and Jane today as well as all of you for joining for our year-end earnings call. And please feel free to reach out to us if you have any additional questions. And have a great week. Take care.

### **Operator**

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

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