

Brown-Forman Corporation, AGM 2012

2012-07-26

Presentation

George Brown

I just want to take a chance to talk about a couple things. One of them, of course, is that there's another Board retiree who's not with us here today, and that's Owsley Brown II, now-retired Chairman and CEO. So it's a pleasure to have his family, his direct family is here with us today, so many of them. Christie and her children and I think some of his grandchildren as well. So thank you so much for coming. Owsley, as you all look around the room and see the brands and read our 10-K and our annual report, you'll see in there so much of his work.

He was a modest person. He would often describe himself to people as an improver of things, and I – and he was true to his word. I had some personal experiences in that improvement process. I'll never forget when I worked for him, my first review as to how I was doing. So I had my PPA organized and went into his office. Ms. Crest let me in. And I'll never forget sitting down and looking across at him at his desk, and he had a nice desk. And he looked at me, and behind him was a black and white photo of his grandfather, in a Panama hat, looking at me too. And so I had beads of sweat, the 2 Owsleys giving me my review. And Owsley said, Garvin, you're doing a fine job. You rarely hand in anything that's poorly written anymore, and so he was candid in his desire to improve things as well.

He had a great impact on the company. Just this past June, I was out in Turkey at a meeting and sat with Laszlo Purman from our Budapest office, who now runs Austria as well. And he was one of our early globalization hires. And he was full of chat about Owsley, and how he'd learnt more from Owsley on Owsley's tour of Budapest than he had learnt growing

up in Hungary about Budapest. So he's just had a wonderful impact on our company.

One of the things, of course, that he had to do, along with our Board of Directors, and Dick would have been active in this and Bill Street, of course, as well, who regrets he can't be here today, was work on succession planning. And in any company, succession planning, of course, is a pretty critical task. And so as I reflect – as I wrote in my annual report letter on so much that he did succession planning was a great legacy that he left for us so what did he do? He reached down into the organization and found in Paul, a arguably young CEO, I think he was probably 38 or 37 when he took over the beverage company from Bill Street and that was in 2003.

I was working for Bill and then Paul at that time, and so I had to help organize Bill's retirement lunch, which was a great barbecue over here in the parking lot with the Jack Daniel's experience. And it was fried chicken and hot dogs and RTDs and Coca-Cola and Sprite and all those nice sweet things. In the summer, what happens, of course, you get a bunch of bees in the tent and so we were all at the mustard jars and the ketchup avoiding the bees, and poor Paul was up there giving his incoming speech, bees flying all over the place, and I'll never forget, sort of, watching my new boss forget cue cards, and there he was with a nice bee on his thumb getting stung like I've never seen. And he didn't flinch. And I thought, you know, he might have made a good choice on this one.

So a couple of years later, he went from the beverage company to the corporate responsibilities and then by 2007, Owsley left the building as an active employee, that was 5 years ago, and Paul took on his titles of Chairman and CEO running our business. It's been a great 5 years for Brown-Forman. It hasn't, let's be honest, been a great 5 years out there in the global economy.

The global economy has brought great uncertainty. Paul and his team have brought growth, and I think that if we could all look back in retrospect, boy, did Owsley do a

great job on succession planning. And actually, just a few days ago, it was Paul's 25th anniversary at Brown-Forman. In the United Kingdom, they would call that a silver jubilee, so Paul's had his silver jubilee this past July. Typically, the company – what happens is the employee who's just passed the milestone is somehow embarrassed publicly by receiving that milestone. We didn't want to break tradition for Paul, so if I can ask our longest-standing independent director and chairman of our Compensation Committee, Patrick Bousquet-Chavanne, to come help me on stage for a second, and our longest-standing family Director, Dace Stubbs, to come join me. And I'll ask you 2 to please help hand that plaque, it's a simple thing but it means a lot at our company, to please help me congratulate Paul Varga on 25 years.

Paul Varga

Mission accomplished. That was great. That was great.

George Brown

So thank you very much. And now, I think, we'll continue on with what the legacy that Owsley has left us, and welcome Paul Varga to the stage to help us understand the business.

Paul Varga

Thank you. Well, anything that has silver in front of it, if you think about it, with your hair getting a little silver, yes, it doesn't feel like it's been 25 years, so thank you very much. And in some odd sort of way, last year, we were up here and we talked about Tennessee Honey, if I had really thought about it when I got stung by that bee, maybe 8 or 10 years ago, maybe that had been an inspiration to introduce that thing earlier, because it's been a real success. So – it's my pleasure to give you an update on the business. We typically – we've done this in a number of different ways oftentimes focusing very much on the performance of the company, and I thought I'd do a little bit of that this morning. We've

got very good results. So if you've had a chance to look at the annual report, you would've had a chance to get into them a little deeper than I'll probably get into them here this morning. I'm going to broaden the view to really kind of look at the last 10 years. And then I thought I'd maybe shift gears, if you don't mind, and look ahead a little bit at what we are foreseeing as some of the things we might be doing and trying to accomplish in the next sort of 5 to 10 years.

So if you'll bear with me on this one, it's a bit of a repeat for those of you who've seen the annual report. But I just think it's something that is so informative about – when 2012 – fiscal 2012 ended for the company, it also completed a 10-year run in the world that is very easily broken into 2 pretty distinct 5-year periods. And a measure we've often used. We think it captures a lot of what goes on at the company and the business, its total shareholder return, and so I'll just use the device of looking at 2002 to 2007, which the entire world would have declared were sort of a boom time, good times. And then we're going to compare it to what has, as Garvin referenced, been a more difficult time for the global economy, which we'll call the bad times. And of course, you've got the full 10-year period. And these are better metrics, we think, for our company to really look at even though you can have a whale of a 1-year performance, we'd like to really keep a focus on the 3 and the 5 and the 10 and in some instances, the 20-year performance of the company. So what you'll see is back in 2002 to 2007, Brown-Forman had a wonderful performance during that 5-year period, very much like using the S&P 500 as the benchmark for comparison, that had single-digit growth basically the global or the U.S. Equity Index. And then for Brown-Forman, noticeably above it at 13%. Something you'd be proud of if you could sustain that for a very long time. And then in 2007, we know the world changed, the global economy, the financial crisis, all kinds of things influencing consumer behavior and businesses worldwide. And yet we just finished 2012 and Brown-Forman had a total shareholder return of about 14%, and what really became apparent was, unfortunately, the U.S. Equity Index, during that 5-year period, only advanced a modest 1%

and this assumes that reinvestment of dividends. So a good part of that might have actually been dividends versus equity growth. And so you'll see for the 2 – full 10-year period, the company's performance metrics on a really critical metric, and there are others to support this: underlying operating income, return on invested capital, other things we look at, I thought this may be the best summary of where we are today as we enter the, sort of, summer of 2012. This is what we've just completed and this – many have taken note of the industry and the company as a sector or an individual company that holds up well in both good times and bad times. And so it's one of the reasons that I think a lot of companies are interested in our particular company, are getting a lot more coverage. We're getting a lot more interest in us as an investment vehicle for people.

Now when I think of our position today, and oh, excuse me, here's one additional point on this, just thinking about the 5 years, you'll see how impactful these numbers can be. Because those are percentages, so think about them from a dollar standpoint. If you had invested, we use shot glasses to – only this company, right? I mean, who uses shot glasses to depict ourselves versus the S&P 500. If you had invested \$1,000 just 5 years ago at the beginning of these sort of bad times, here's how Brown-Forman's \$1,000 investment would have fared versus the S&P 500. So you see it in dollar terms and it's just pretty staggering. I mean, it's really a powerful sort of outperformance relative to the U.S. Equity Index.

Now we do stop and think of the end of the fiscal year, how's our position today? As I think about Brown-Forman here in 2012 and consider the health of the company, there's really sort of 3 things I would reference.

One, first, is, the company is growing. We are – we have longed – it's been our ambition to be a continuous growth company – a company that might grow on an enduring basis. And a couple of the highlights that I would note from the last fiscal year are that

we concluded with a 9% sales growth rate – underlying sales growth rate, and also 9%, we finished the year with a 9% underlying operating income growth rate. Those approximate – those were accelerations over the prior year, which were more in the mid-single digits. And then also very helpful, I think, for you to know as shareholders is this high single-digit growth rate in underlying operating income is a return to a level that we have experienced historically. So as you think about the difficult times in '07 and '08 and '09 where we sat and talked about eking out sort of low single digit or mid single-digit growth rates, we've returned to a level that more closely approximates our long-term historical rates. So that's something that is exciting to us. And the another attribute of this growth that's going on with the company right now, you might see it on some of these collateral materials around the campus today and some of the statistics, really 2 additional points: one, the growth of the company last year was very broad geographically, with maybe one exception, maybe – being China. All of our, sort of, lead and top almost highly prioritized markets grew during the fiscal year. And across the portfolio, while it was Jack Daniel's trademark led, we had nice growth that we were able to experience on Finlandia with the reserve, Herradura had, maybe, it's best year, Sonoma-Cutrer, and even though it didn't grow, we saw improved performance with Southern Comfort, which is something we've been working very hard on. So I think that the combination of broad geographic and portfolio growth will continue to be one of our ambitions because we think by pursuing a multitude of both portfolio and geographic alternatives out in the world, that we have the longest runway for growth.

In addition to our growth, I mean, here again we're using mint juleps to talk about our financial strength. Which I – if you think about it, this was another – a lot of people will get these sorts of growth results, and maybe not have quite as strong, for example, a balance sheet or they'll put the company at greater risk than maybe Brown-Forman might. And we stand at the end of fiscal year 2012 in a wonderful position. We've been able to say that here for – particularly during '08 and '09, and '10 that was very helpful, But I think

that particular period, to be able to talk about our financial strength, the health of our balance sheet. We continue to be at the very top of the industry, and our return on invested capital, which is really important metric we look at for the efficiency with which we produce our profitability. So the company is a growing company that's in very good financial condition. And as we look ahead, I think, the most important thing is to think, "What are the alternatives and initiatives and ideas that company might have to actually continue this?" And what are some of the things we're thinking in about, and we call that Brown-Forman 150. It's a strategy that we crafted 2 years ago to set us on a course out to 2020, which will be our 150th anniversary, and the idea was to see how we might change the company, continue to grow it over the next decade. A lot of companies were looking at 10-year strategies at the end of the decade of course, particularly with the economy being the way it was. And fundamental to any strategy is trying to identify what specific opportunities that there are out there in the world you'd like to pursue. So I thought I just talk about maybe just 4 of them.

There are a lot of things we're going to look at. But the first one is we really think we have a reason to be very successful in whiskey. We already are a leader in American whiskey around the world. And we think it is, in our opinion, the most attractive global category. So we're are pleased that we have a position in it and while we've long had a position as a leader in American whiskey, we think all different sorts of whiskeys that are out there, scotch, Irish, there's a bunch of local whiskeys that could be very interesting to Brown-Forman over the next decade. In addition to whiskey, in the most recent say, 10 or 15 years we've had a better position in vodka, and it's really been helpful to our giving – us the a foundation in our Eastern European business. So we continue and then we think this, just behind whiskey is a very attractive global category. It's a bit more regional than the whiskey category but still growing in its global scope and very attractive as well.

We also, as you know, a few years ago bought into the area of the Casa Herradura busi-

ness, so we're very bullish about tequila. But today it's a little more limited in terms of where it's concentrated in the U.S. and Mexico but very interestingly, starting just like we saw with American whiskeys 15 or 20 years ago to start to show some very, sort of, low level development in countries outside Mexico and the United States.

And then finally, our liqueur brands, which we think not – none of these are as global as, let's say, Jack Daniel's is, so they tend to have a regional skew to them but there's other brands that we might also – one example I'd give, that we own today, Sonoma-Cutrer, which is very relevant, really, to our U.S. business, not a particularly global brand today, but plays an important role to our U.S. business.

So these are the areas where we intend to focus. And, of course, we have the great benefit when we go out to pursue this, of owning one of the world's great brands. And that brand is Jack Daniel's. And yet a lot of strategy and a lot of work that goes on in Brown-Forman almost always starts with, what are we going to do first with Jack Daniel's? Because it is a very unique brand, I mean, it's so easy to take it for granted when you've owned it for a long time, as our company has. But I'll just ask you to consider, there's no brand that I know of that has – that is – what I would declare, there's all kinds of adjectives people use for the price point that Jack Daniel's is at. But as a single expression, Jack Daniel's Black Label now, at above 10 million cases, I think, is the largest alcohol superpremium brand and expression of any kind in the world. There are families of brands that span multitude of price points including standard, but we can't think of any singular brand that is that high a volume that is in this price category. There may be brands that have higher sales dollars, and that is – we sometimes refer to it as rarified air. It's just a rare combination to have brands that sell a lot everywhere, but are also very premium priced, and that is the economic engine of Brown-Forman.

So when you own this and you've become as big as Jack Daniel's is, it presents a very

unique challenge to us. The things we've really sweat and study and think about are, how do you take a brand that is inherently mainstream today? It's so popular and well-known and keep it special. And so what I thought I'd do versus using words, I thought I might use a few of our advertisements to show you just 4 different ways we do this today. One will depict a bit of our Lynchburg origins and quirkiness. Another one will depict a Belgian ad where we try to communicate the Jack Daniel's stance and the category unto itself. A third one is a responsibility message demonstrating some of our, just basically, brand and company core values, as brought to you by one of our promotional efforts. It's actually a sponsorship we have in the United States, with the brand – with a band named Zac Brown Band and then the fourth one is how Jack Daniel's says happy holidays so I'll just let you enjoy these.

[Presentation]

Paul Varga

Those are examples. Thank you. Hats off to the people who work on the Jack Daniel's brand each and every day to produce that kind of work. And all a little bit different in some way in trying to touch different audiences at different times, in different ways. And I hope you get, sort of, a feel of how you might keep a big brand special. One way I've always liked to think of it as the brand became bigger was that you almost have to treat it and hope that it's the sort of small-town hero who made it big, as Jack has, but it always retain those small town values that they learned in the place where they grew up. And so we try to take that out to the world and it's working. I mean, it works very, very well. And it – I thought I'd share with you a unique space that I think that Jack Daniel's is beginning to occupy in the world, but also very much could continue to operate a place where it could operate in the world. And a nice way we sometimes talk about it is that it's an intersection between 2 of the world's most attractive categories. And the first one that I would reference is the scotch category. As I said, whiskey we view as the most attractive

category and this particular business is very large, far larger than the American whiskey or bourbon business that all of us would have known growing up. And in it are a lot of qualities that you might associate with brands like Jack Daniel's, traditional values, sold often times on heritage and history, oftentimes, the selling propositions deal with the quality and craftsmanship of the product. Always we know, particularly when drank straight or neat, they're an acquired taste, they take some time to learn and develop the taste and palate for it. A very broad price spectrum. You'll see that within the same trademark, it's a wonderful attribute of this category. You can have something at a popular price, a premium, an ultra-premium, a superpremium, it's amazing. And that gives you the ability to sell different products to different consumers, and actually to have actually price premiumization potential, over time. And as I've said, it's global in nature.

The other category I'd reference that is so interesting that it's kind of different but it's also emerging as one of the world's great categories, is vodka. And the way you might think of vodka, too, in the modern era is that it's some more modern, has more stylish components to it when you think about the packaging and advertising. Very different, it's viewed because people – the neutrality and the taste of vodka oftentimes lends itself to a variety of drinks and an inherent mixability, which is great for a category because it means you can extend it to so many different drinking occasions. As such, what we've seen over the last 20 years that a number of the leading trademarks, including our own Finlandia, have flavors in the bottle prepared so infused flavors oftentimes with the vodka, you'll see citrus and all kinds of new ones too, trust me.

And also – and prepared, almost, to compete for the beer occasion, Smirnoff probably pioneered this a few years ago with a Smirnoff Ice project, and there's just a lot more interest in mixability and prepared serving of these drinks. And they're a little bit more regional. And so you sit and you look at this, and what we have found is that while Jack Daniel's has a lot of this, of course, that with the passage of time and the way that we've

been building it, that it actually is becoming the merger of those 2.

The Jack Daniel's Tennessee Whiskey, as we know it, had more of those scotch problems, but as it has emerged, we've seen that the globe enjoys consuming it mixed, they think of it as a modern and contemporary brand. They actually, with the introduction, for example, of Tennessee Honey, you start to see how Brown-Forman has introduced a variety of different expressions of Jack Daniel's that both fit the scotch recipe of higher expressions like Gentlemen Jack and Jack Daniel's Double Gold Medal, Single Barrel here are very high-priced, and connoisseur's brand that's been doing very well. But you also see in there Tennessee Honey and Jack & Cola, an RTD, or even in Germany this past year, just very nice success of a product that was sold only in Germany, that's around the holidays, for Jack Daniel's Winter Style Drinking Occasion that sold very well.

So we're tapping into both the flavor aspects but also the premiums that exist in both of the categories. And I think that gives us better growth runway in either of the categories themselves. So that's sort of a unique thing we've been observing. And of course, this exists too beyond Jack Daniel's at Brown-Forman. You'll see that old trademarks of the company like Old Forester or Early Times, Canadian Mist are finding new life with flavored expressions. We just introduced here in the last few weeks a cinnamon-based Early Times, which tastes delicious. I mean, it's incredible tasting. And so it gives new life to a trademark that has otherwise been seeing sort of steady and modest decline. And then also the premiumization, you'll see that I would contend that Woodford Reserve, one of our, kind of, great success stories in the last 15, 20 years, even with a new introduction in OO, which has been a marvelous success this past year. A product that's in test for us, it's sort of a renovation of Canadian Mist, is Collingwood, which is a new expression that's in test that's doing great, we actually have some high hopes for what it might do down the road. So you'll see that this American whiskey category offers all kinds of potential for Brown-Forman, a lot of growth potential, we think.

And the other thing is it's just one of those little shot glasses that I showed you, it's just the whiskey one. And you also have the tequila and the vodka. So I show this to you so you can see a bit of the opportunity that's ahead of us. Now none of this happens magically, it does require investment and you may have seen some of the releases we've had over the last few weeks or so. We are very much now investing in our assets in order to sustain this growth. We are undertaking an expansion of the Jack Daniel's distillery in Lynchburg. We are expanding our cooperage down into Alabama – Northern Alabama. Sonoma-Cutrer is expanding right now. And we continue a modernization and investment program down in Amatitan, where our Herradura and El Jimador and Antiguo brands are made.

So a number of investments, more than we have been making in the prior 4, 5 years, we've seen our capital reinvestment in the business go up. But we think for a very good reason we're going to need the product to fulfill, we hope, the demand that we're going to create. So beyond the assets, we're very much investing in the marketplace. And you see here this was just a listing of 12 or 13 of our critical countries. And I won't go through all of them but you just need to know that Brown-Forman today in 2012 is becoming a very global company. And you see the geographic spread here on this particular picture but I would just note, just in the last 12 to 24 months, we've made pretty significant investments to start our own companies, our own sales and marketing, and in some instances, back room in Germany, Brazil down here, Canada is not listed on the page, Turkey during the last 12 months, all of these are emblematic of Brown-Forman taking its business proposition, largely behind Jack Daniel's, but not just behind Jack Daniel's, out to the world. So it's been a steady and consistent investment. And to be able to do some of this during the difficult times, we think is a very strategic thing, because a lot of people could say, "Now is not the time to do that." We've actually – we considered to do – made up some ground in these last 3 or 4 years by making these investments at a time where maybe others might not have.

When you invest in a market, you fundamentally are investing in people. And the way that I think about this investment we make in people, I do think we think differently about this. There's a phrase that is often used for people. I'm sure you all – some of you will know what it is. Have you heard of the phrase, SG&A? It stands for selling, general and administrative. What a nice way to refer to people.

At the company – I actually would offer an alternative set of words, maybe strategic growth assets is another way to think about SG&A. And what happens when you invest in these people, you actually illuminate what the stuff I've been talking about. Because without the human beings out there, with their ideas and their energy and their ability to adapt in the spot, these are just words on slides or words on paper. They are – these are strategies, they're helpful and they guide you but it doesn't really happen, it doesn't happen until it's activated by these people. And I was just going to refer to, maybe, half a dozen instances over the last – just few weeks, we had our global and regional meetings here in Louisville, where we had a chance to interact with a number of our folks and this executive leadership team that's in front of you here at the front of the room. We meet quite often, I think they're exemplary of what I'm talking about. We just – we had a very interesting tour this week. Jill and I are down at Louisville production operations where we got a chance to see what was going on there. Their French team and our leadership team, last week, to talk about their business. We've been having regular conversations because of our expansion and other reasons to talk about our supply and demand planning, always something that's important at Brown-Forman. Numerous creative reviews, Chris and others have been taking us through it. And at almost every single instance, I see about 3 or 4 or 5 of the same qualities. In every instance I see commitment from the people, everybody cares about the company in an amazing way. I mean it's just – you can disagree with each other but everybody cares about it. The other thing that's usually present is a common view that it's the company that matters before you as the individual. There's this greater good feel that exists in the company, and it's almost in every

conversation. I mean, seldom do I experience a conversation that is about you or them, it's usually about what's best for the company. Another kind of thing, and we actually get sometimes knocked for this, is a very deep thoughtfulness that I see in the company. It slows us down sometimes, but we're very pensive. We're very thoughtful about what's going to happen right, what might go wrong, we manage risk and reward. And I think it's a very specific attribute of Brown-Forman that I'm actually really proud of. And then finally, you'll see in many of these examples, even if it's a tough problem to solve, the one we've been trying to tackle for the last 4 or 5 years is renewing the growth of Southern Comfort. You see optimism. You actually see people who believe, and even if it's not going to work that time, they're going to come back. And actually I think these are wonderful qualities in any company. But I think it particularly works well for a company that aims to be everlasting, a company that wants to be around as long as it exists today. So if you try to think about companies that want to be around for another 50 years or another 100 years, you want qualities like optimism, like thoughtfulness. You want people thinking about the company first, and you want a commitment. And I tried to think about where did this all come from. I mean, we didn't just go sprinkle dust all over the place. And I think the common thread, it is my favorite picture, I think I've seen in years, which is the picture of Owsley Brown here, and – this was not taken at work, first, although it could have been, it could have been. And he was a painter. He's an artist, but he was an artist down here, too. And I think a lot, Garvin referred to it, a lot of what makes the place go is because of things that he and others did. And Garvin and I in particular wanted to, today, pay tribute to him. And one of the ways we thought we'd do that is to dedicate this 2012 annual meeting to his memory. We thought it would be important to do something symbolic like that to mark the fact that we didn't get a chance to talk to him at this 2012 annual meeting. So the thing I'd ask you as we conclude is when you go out and, we'll conclude here and go to a brand fair, when you have the opportunity to leave here, you're going to see buildings that have been preserved and they're beautiful. You're going to see

landscaping that's incredible. You're going to walk over and you're going to see probably his greatest inspiration, which is this incredible spark of innovation that now exists at the company. You're going to see packages and new formulations and line extensions. You're going to see it all, and when you look at it, also look at the people. They're smiling and enthusiastic and caring about what they're working on, and when you do that, know you're looking at Brown-Forman in 2012 and you're also looking and enjoying the legacy of Owsley Brown II. Thank you very much.

Copyright © 2012, S&P Global Market Intelligence. All rights reserved