Brown-Forman Corporation, Q3 2020, Earnings Call 2020-03-04

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Brown-Forman Third Quarter Fiscal 2020 Earnings Conference Call. — ***Operator Instructions*** — Please be advised that today's conference is being recorded. — ***Operator Instructions*** —

I would now like to hand the conference over to your speaker today, Leanne Cunningham, Senior Vice President, Shareholder Relations Officer. Thank you. You may begin.

Leanne Cunningham

Thank you, Dorothy, and good morning, everyone. I would like to thank each of you for joining us for today's Brown-Forman's Third Quarter Fiscal 2020 Earnings Call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Jane Morreau, Executive Vice President and Chief Financial 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 released a press release containing our results for the third quarter fiscal 2020 in addition to posting presentation materials that Jane will walk through momentarily. Both the release and the presentation can be found on our website under the section titled Investors, Events & Presentations. In the press release, we have listed a number of risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission.

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

One last note this morning. The state of Kentucky will be conducting a statewide tornado drill at 10:07 this morning. We are not certain if this will create any disruption to our call. If necessarily, we may need to mute the line for a moment, and we apologize in advance for any potential disruption.

With that, I would like to turn the call over to Lawson.

Lawson Whiting

All right. Good. Thank you, Leanne, and good morning, everyone. Before I comment on our year-to-date performance, I do want to take just a short moment to recognize what a special time it is to be part of Brown-Forman as we enter our 150th year. Back in 1870, our founding brand, Old Forester, was first introduced into the U.S. Today, we now have a portfolio of over 40 premium and super-premium brands sold around the globe. Since our founding, the company's been agile and resilient in navigating through many challenges, including things like prohibition, world wars and economic recessions, just to name a few historical events.

Today, we find ourselves amid trade wars resulting in tariffs that are weighing on our industry, geopolitical events that are disrupting many countries around the world and now a virus that is threatening the global economy. While the headwinds feel pretty strong right now, Brown-Forman has continued to grow throughout our history and remains a strong, healthy company, supported by the commitment of our long-term shareholders and, importantly, our dedicated and talented employees around the world.

So now on to the performance of the company. Jane is going to take us through the company's financial results in a moment. But first, I'd like to provide an update on our progress toward our strategic ambitions. As you've heard me discuss on previous calls, we continue to evaluate our performance, both on a geographic and through a portfolio lens. From a geographic perspective, 18 of our 20 largest markets are delivering underlying net sales growth this year, highlighting the strong benefits of our geographic diversification. As a side note, this does not include Travel Retail, which actually is in decline, and we can talk a little bit about later. However, the growth rates of plus 3% underlying net sales year-to-date for the company are below historical norms and they're also below our expectations, but we believe going forward these rates will return to more historical numbers and we will talk about that throughout the rest of this call.

From a portfolio perspective, our premium and our super-premium brands are well positioned to continue to deliver accelerating top line momentum with leading positions in some of the most attractive and fastest-growing spirits categories, such as whiskey and tequila. In particular, the super-premium brands in our portfolio are propelling the company's growth, both in the U.S. and increasingly our international markets, becoming a more powerful growth driver for the company. So to get into a couple of the specific brand performance issues. Look, the Jack Daniel's family of brands underlying net sales is plus 3% year-to-date, essentially in line with the company's growth rate. We've encountered some near-term challenges for Jack Daniel's Tennessee Whiskey, which is the core, the Black Label brand, in some of our international markets. Jane is going to talk more about this in her remarks when we get into the market-by-market analysis. But from a strategic perspective, we believe we still have the right strategy in place to deliver long-term profitable growth, and we are investing behind the opportunities.

Jack Daniel's RTD business is now over 9 million cases globally and continues to deliver solid growth as the increasingly popular RTD format provides Jack Daniel's consumers with convenience in their drinking occasions. We continue also to focus on the versatility of our portfolio through innovation, which has resulted in the creation of Jack Daniel's Tennessee Honey and Fire over the last 9 years. These 2 brands now contribute 2.4 million 9-liter cases at very attractive margins and are connecting new consumers to the Jack Daniel's trademark. With the launch of Jack Daniel's Tennessee Apple, which is off to a strong start in the United States, we are continuing to drive innovation and diversifying the portfolio. And for our international consumers, we're gearing up for the launch of Jack Daniel's Tennessee Apple, and it should begin to appear on retail shelves in the next few months.

In Gentleman Jack, which we don't talk about quite as often, one of our super-premium family members, is now nearly 700,000 cases and continues to deliver strong international growth. We've also made notable progress towards our strategic ambition of increasing the scale of our super-premium portfolio. Woodford Reserve remain the leader in the super-premium bourbon category and has been consistently growing strong double digits since its introduction 20 years ago or more – 22 years ago. Supported by its excellent track record along with innovations such as Double Oaked, Woodford Reserve has eclipsed 1 million 9-liter cases and is one of the largest growth contributors to the company. Looking ahead, we'll be focusing on the international development of this incredible brand with incremental resources being invested in a number of key markets around the world.

And as I mentioned a few minutes ago, Old Forester is celebrating its 150th anniversary this year. It continues to present itself as a leader in American whiskey. The brand is steeped in a reputation of quality and innovation with its core expressions and has increasing popularity with its Whiskey Row series. This brand has been registering impressive gains in the bourbon category and is becoming an increasingly meaningful growth driver for the company. Like Brown-Forman, coincidentally, Herradura was also founded in 1870 and is also celebrating its 150th anniversary. Since we purchased the brands over 12 years ago, the super-premium tequila category in the U.S. has shown dramatic growth. To note, Herradura's underlying net sales are up 20% year-to-date and it's grown to over 600,000 cases with nearly half of its volume outside of Mexico. However, the unprecedented cost of externally sourced agave is putting pressure on gross margins.

To help mitigate, we've been able to increase prices and accelerate the growth of ultra, our higher-priced innovation, which is now nearly 20% of the business. We expect cost pressure to continue, however, through fiscal '21 and continuing – but continuing our strong sales trends. Forward-looking, Herradura and el Jimador are well positioned in the fast-growing super-premium and ultra-premium segments. Our Single Malt Scotch portfolio is also performing very well led by GlenDronach, which has been – experienced considerable growth and has a very promising future. In our other emerging brands, things like Slane Irish Whiskey and Coopers bourbon and Fords Gin, while newer in their development, continue to show potential for very meaningful growth. So generally speaking, we feel very confident across the different brands in our portfolio and the many levers of growth that we can pull upon.

Geographically, I'm very pleased with the success of our U.S. business this fiscal year-to-date. U.S. is not only our largest market, but it is leading our growth in our 150th year. In the most valuable global spirits market in the world, Brown-Forman takeaway trends are outpacing TDS, driven largely by our American whiskey and flavored whiskey portfolios as well as our tequila brands. The launch of Jack Daniel's Tennessee Apple has also, as I said, gone very smoothly and is accelerating growth to our overall plan. However, we recognize we need better performance on Jack Daniel's Tennessee Whiskey in the U.S. But it is worth noting that we can outpace TDS with essentially flat to low single-digit performance on our biggest brand. We could not have said that even a few years ago, but our bourbon and tequila brands have gotten big enough that they actually have a meaningful impact on the overall trends in the U.S. business.

Developed international are having a relatively weak fiscal '20 as the U.K., Australia and Japan are weighing on performance. Where we have made investments in our route-to-consumer, places such as France and Spain and Germany, our business is healthy, and we've been able to broaden our portfolio of brands. In the U.K., which is the second largest market in the world for Brown-Forman, we're in the final stages of investing in a highly talented team and we'll soon assume full control over our route-to-consumer, which, we believe, will reaccelerate growth in this market into the next fiscal year, and expectations are that this will be a strong market for us into the future.

Our emerging markets are being led by BRIC this year. All 4 are providing strong underlying net sales growth, largely driven by Jack Daniel's Tennessee Whiskey. Also worth pointing out is Southeast Asia is producing strong underlying double-digit growth. For the first time in a while, Asia really has been delivering solid growth this year. However, these markets are likely to suffer in the near-term as a result of the impacts from coronavirus. I am, however, very encouraged that our brands are – how our brands are resonating with consumers. And looking into the future, I do think that Asia is a part of the world where we are relatively small, but fast growing, which I do think bodes well for the future opportunity we have there.

To the coronavirus situation, just briefly, I do want to pause and take a moment, say the health and safety of our employees is paramount. Like other companies, we've taken steps to limit our employees' risk by limiting travel, canceling certain meetings, providing up-to-date information from the CDC and the World Health Organization and ensuring our flexible work policies are being utilized. There's so many unknowns right now, and it's difficult to quantify the financial impact. Jane will try to walk you through our thinking on this difficult topic.

So in summary, we're expanding the breadth of our premium and super-premium portfolio both geographically and diversifying our revenue base in categories with the strongest momentum. We continue to have confidence in our long-term global growth potential. Currently – although currently our overall growth rate is a bit below historical trends and our expectations, these are largely driven by multiple short-term disruptions coming together in 1 fiscal year. We believe through continuing to execute our long-term growth strategy, focused on portfolio, geography, investments in our people will continue to extend our leadership in premium American whiskey around the world and continue our track record of consistently delivering profitable growth. While the near-term challenges remain, we will weather the storm as we have throughout our 150 years as we relentlessly focus on creating value for our shareholders.

With that, I'll turn the call over to Jane to review more detail in our financial performance that we released this morning.

Jane Morreau

Thank you, Lawson, and good morning, everyone. Over the next several minutes or so, I plan on walking you through 2 items. First, our third quarter and year-to-date results, which, as Lawson just said a moment ago, are a bit lower than we had expected at this point in the year, driven largely by performance in some of our international markets. I'll discuss that in more detail as I go throughout my presentation this morning. And then, secondly, I'm going to review our full year outlook, which we revised to reflect 2 things: one, a tempered expectations in some of our international markets; and two, the increasingly uncertain global economic outlook, which includes an estimate of the effect the coronavirus may have on our business globally, including our Global Travel Retail business in Asia.

So let's begin with our actual performance. First, our underlying net sales grew 3% in the quarter, slower than we had anticipated, but consistent with the company's first half results. Second, while the impact of retaliatory tariffs, particularly from Europe, will continue to weigh on our margins and profits for the full year, the year-over-year effect began to ease a bit in our quarter 3. In fact, our underlying gross profit grew for the quarter for the first time since the cost of tariffs began affecting us, up 3%, consistent with our top line. The cycling of tariffs also helped to boost our underlying operating income growth in the quarter, up 5%. Consistent with our third quarter performance, our year-to-date underlying net sales grew 3% on top of 5% growth in the same period last year, but again slower than we had anticipated we would be at this point in our fiscal year.

So breaking down our underlying net sales performance by geography, just there's a bit more color on what Lawson just provided. Again, the U.S., our largest market, representing nearly half our sales, continued to lead our growth, growing 6% underlying net sales year-to-date, the market's strongest rate of growth registered in 4 years. This growth was fueled by the launch of Jack Daniel's Tennessee Apple and sustained double-digit underlying net sales growth from our premium bourbon brands, notably Woodford Reserve and Old Forester, and our tequila brands in aggregate. This strong growth, again, as Lawson said, in the world's most valuable spirits market was also supported by improving takeaway trends, which accelerated over the past quarter and are now growing ahead of our – the healthy total distilled spirits mid-single-digit growth for the first time in over 18 months.

In our emerging markets, we also experienced another quarter of sequential improvement in growth, with underlying net sales up 6% year-to-date on top of last year's double-digit gains. The acceleration was less than expected at this point in the year, due in part to route-to-market disruptions in Africa and macroeconomic and geopolitical challenges, which have begun to weigh more heavily on certain markets in the CIS and Latin America. One of our largest emerging markets are – actually our largest emerging market, Mexico, where we grew underlying net sales double digits last year at this time is now growing in the low single digits through the third quarter, reflecting a weakening economy.

If we were to exclude Mexico and the rest of Latin America, CIS and Africa, our emerging markets grew underlying net sales double digits. So despite seeing some pockets of slowdown, strong double-digit underlying net sales growth was delivered across a number of emerging markets, including Turkey, Russia, China and parts of Southeast Asia, led by strong volume growth of Jack Daniel's Tennessee Whiskey. Poland also returned to mid-single-digit underlying growth year-to-date, following a very strong quarter for Jack Daniel's Tennessee Whiskey. And I thought I'd pause for a moment and discuss our performance in Asia.

Over the past nearly 2 years, we've been quite pleased with the momentum and increasing contribution we've been experiencing from this part of the world. Specifically, our business in China has been growing underlying net sales at a double-digit rate since fiscal 2018, led in large part by our growing e-premise business where we have been focusing our investment in this market. Our performance through January had essentially not been affected by the coronavirus. So understandably, we do expect a marked slowdown in our fourth quarter in this market and other parts of Asia and have already experienced this in February. Despite this near-term headwind, we remain optimistic about the long-term growth potential for our portfolio throughout Asia.

Similar to the first half of the year, our developed international markets delivered 2% growth in underlying net sales year-to-date. This growth was led by Germany, Czechia, France, Spain and Korea, reflecting strong growth of Jack Daniel's RTDs, Jack Daniel's Tennessee Honey and our super-premium American whiskey portfolio, Woodford Reserve and Gentleman Jack. In the U.K., our largest market outside the U.S., underlying net sales declined in the first 9 months. You may recall that we are navigating through multiple challenges in this market this year, including: first, the upcoming route-to-consumer change in May; two, changes in our promotional strategy; and three, softness in the cash and carry channel. So all combined, we experienced what we believe is some short-term disruption. We expect the negative trends in this market to ease as we move into next fiscal year.

In addition to some softer than planned results in the U.K., the devastating fires in Australia have also contributed to our developed international markets growing less than expected. Our Global Travel Retail business, which had declined in the first and second quarter of this fiscal year, grew underlying net sales single – grew net sales high single digits in the third quarter, due in part to easy comparisons to the same quarter a year ago. Despite improvement in the trend, Global Travel Retail remains a drag on our top line, with underlying net sales down 3% year-to-date.

While we experienced some improvement in the quarter and had anticipated further improvement in the fourth quarter, resulting from the phasing of certain customer purchases, we now estimate that as a result of the coronavirus, our Travel Retail business for the full year will be down similar to year-to-date performance. Our used barrel business declined significantly in the third quarter. The decline in this business reflects both a reduction in demand due in part to the U.S. tariff impact on Single Malt Scotch Whiskey; and secondly, softening prices driven by the increased supply of the used barrels in the market. This business and our other nonbranded business, which includes contract bottling and bulk whiskey and bulk wine sales, have negatively affected our underlying net sales year-to-date by about 1 percentage point.

Now looking at our business through a portfolio lens. Consistent with the drivers of our growth for the first half of the year, our premium whiskey brands, Jack Daniel's RTD, Jack Daniel's flavors and tequilas, remain the key contributors. As Lawson mentioned, Woodford Reserve continued its consistent double-digit underlying net sales gains, fueled by strong consumer momentum in the United States and is now over 1 million case super-premium brand globally. With only 20% of its volume outside of the United States, growing at an even faster rate, we believe the brand has a significant run rate for geographic expansion.

Tequila has delivered underlying net sales growth of 10% year-to-date, pulled down modestly by our pricing actions on the Pepe Lopez mix fill brand in the U.S. Our consumer takeaway trends in the U.S. remain very strong. For Herradura specifically, in addition to the strong takeaway trends in the U.S. and increasing volumes in Mexico, higher prices and a favorable product mix in both the U.S. and Mexico helped to deliver the 20% growth in underlying net sales year-to-date. Jack Daniel's RTDs grew underlying net sales mid-single digits on a year-to-date basis, driven by volumetric gains in Germany and the U.S. and introduction and launch in France.

JD flavors continued its broad-based geographic growth, most notably in the U.S., France, Poland, Czechia and Brazil. As it relates to the successful launch of Jack Daniel's Tennessee Apple in the U.S., the brand remained on track to deliver about 1 percentage point of growth for the company this year. Jack Daniel's Tennessee Whiskey underlying net sales were essentially flat as year-to-date growth in emerging markets were offset by declines for the brand in the U.K. and our Travel Retail channel.

Moving down the P&L to gross margins. Year-to-date gross margins declined 220 basis points year-over-year reflecting – resulting in flat underlying gross profit growth through the first 9 months. The reduction in gross margin was driven by the same 2 factors we've highlighted for the last 3 earnings call: first, our input cost reflecting agave and wood inflation; and secondly, tariff related costs. As I mentioned earlier, while the impact of tariff-related costs will continue to impact the full year margin, as we began to cycle prior year periods that were affected by tariffs, the year-over-year effect began to ease in the quarter with 100 basis point compression for the first 9 months compared to 200 basis points through the first half. We continue to invest behind our brands with underlying A&P spending up 3% year-to-date, in line with our top line growth. As we've discussed on previous calls, the effective increase in our spend is much higher given the significant reallocation we took this fiscal year to increase our efficiencies from high touch spend to broad reach media and digital investments, along with our increase in activations and promotion activities.

On the SG&A front, we remain committed to a disciplined approach to our investment, looking for opportunities to continue to gain efficiencies, including productivity initiatives that ultimately results in operating leverage. It is important to note, however, that while we continue to leverage prior investments, we've also increased our SG&A in markets where we see opportunity to heighten our focus on building our brands and accelerating our growth. For example, a key element of this can be seen in our third quarter of this fiscal year as we began to invest in the U.K., opening a new office and creating and forming the team and capabilities that we believe will support building our broader portfolio of brands in our new route to market structure that will begin on May 1. In the aggregate, both our reported and underlying operating income declined modestly year-to-date, driven in part by an approximate 3 percentage point drag related to tariff related costs. An effective tax rate of just over 17%, which includes a couple of discrete items year-to-date, drove 4% growth in diluted earnings per share to $1.45.

Now turning to my final topic this morning, an update on our fiscal 2020 full year outlook. There are really 2 sets of factors weighing on our outlook, which I will describe in turn that has led us to revising our full year underlying net sales growth from 5% to 7% to low single digits. First, tempered expectations from some international markets, reflecting short-term disruptions and macroeconomic and geopolitical headwinds. Specifically, to discuss, the U.K., our largest international market, is experiencing short-term changes and disruptions, including the transition to our own route to market in just a few months. The economy of our largest emerging market, Mexico, continues to weakening. The strengthening U.S. dollar has made our brands more expensive to our customers and consumers in certain other emerging markets, such as Latin America and CIS, further exacerbating the uncertainty and unpredictability of demand. And finally, unplanned destocking in Travel Retail.

Now turning to the second factor weighing on our outlook, the uncertainty and unpredictability, the effect the coronavirus may have on our business globally, including the current, most effective areas, Travel Retail in Asia, most notably China. Included in our outlook is an estimate of some additional deterioration that is likely if this continues to evolve globally. We continue to expect gross margins will be down around 200 basis points for the year, again, split between tariff-related costs and higher input costs. Regarding our operating costs for the full year, despite the volatile and uncertain markets, we continue to build our brands, investing behind them roughly in line with our net sales growth. We're expecting SG&A to now be flat for the year, continuing to provide leverage to operating income.

We've reduced our underlying operating income outlook from a range of 2% to 4% to flat to modestly down, driven by lower top line expectations that I just discussed. We narrowed our earnings per share outlook from $1.75 to $1.85 to $1.75 to $1.80, still benefiting from a lower effective tax rate. So lastly, while our expectations for growth this year are now below our initial range, we continue to believe there is a long runway of opportunities ahead for our brand. Our teams are experienced, as Lawson said, weathering these uncertain times and are focused on accelerating our business back towards our consistent historic rates of growth. However, we are cognizant of the current market dynamics that may limit our near-term improvement.

In the meantime, we believe our business remains very attractive with nice margins resulting from the efficiency and historic consistency in our revenue growth, industry-leading return on invested capital and ample free cash flow. Over many years, we have followed a systematic approach to our capital allocation that has served us well: first, reinvesting back into the business to meet future demand; second, growing our cash dividends; and in the absence of meaningful M&A opportunities we return excess cash to shareholders through special dividends and share repurchases. Currently, we continue to invest behind the business and expanding our production capabilities, increasing whiskey inventories to meet future growth expectations, investing in technology to not only improve our efficiencies throughout all of our functions of the company but also to drive growth-based analytic insights such as our revenue management platform.

We continue to return cash to shareholders as we always have, thoughtfully, disciplined and consistently, including increasing our cash dividend for this calendar year by 5%. While we have been navigating near-term challenges, including tariffs and the increasingly uncertain and volatile world, we continue to manage our business as we always have for the long term. Strong support from our shareholders, as Lawson also said, including the Brown family, enables this long horizon, which is essential to the company's steeped and aged spirits. We believe our portfolio of premium, super-premium whiskey and tequila brands position us well to continue creating value for all of our shareholders.

And with that, this concludes our prepared remarks. Dorothy, please open the call up for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Peter Grom with JPMorgan.

Peter Grom

So maybe this is a bit early, but I would imagine you're starting your planning for next year. And it would be helpful to try and understand how you are thinking about the impacts of the virus and weaker international growth beyond just next quarter. And I guess, what I'm really trying to get at is if top line growth remains below historical levels, input costs are still a headwind and your tax rate moves back into the 20% to 21% range, what are the levers you can pull in order to deliver earnings growth in fiscal '21?

Lawson Whiting

Yes. Look, I mean, I think obviously we're not giving out guidance yet for next fiscal year. But I think as you look at our business in general, we feel pretty confident on the U.S. business these days as it is sort of above TDS, and I would expect that to continue. As I said in my prepared remarks, even with Jack at sort of subdued rates, we're able to grow above the TDS number. So – and believe me, there are a lot of plans and there's a lot of action, a lot of activity going around to try to improve the growth rates on Tennessee Whiskey. And if that happens, we're even, I would call it, more confident in the U.S. market. So that feels pretty good. The developed international side of things is subdued, but it largely – as Jane said, that's largely the U.K. There are other markets that are not kicking on all cylinders these days.

But I think we can get that – we'll get that category of markets, the developed international, back into what its traditional range would be mid to even a little bit better than mid-single-digit growth. But I'll take mid-single digits out of that part of the world. And emerging is the volatile one. It's always been the volatile one. It's been growing at a rate above our company average now for a number of years. It has slowed this year, as we said, largely because of Mexico. Asia is the wild card in this. And I don't know how to tell you to – we're trying to think about what is the growth rate for that part of the world going to be, because right now it's solid. But we're going to be a little more subdued. And I think at the end of the day, we're going to be – we use the word around here agility a lot. You're going to have to be agile next year because while things do have a tough outlook, the comps are going to be a little bit easier next year, and I could see some bounce backs and some other things that make it – that turn it into a pretty good year. So not directly answering your question because we have not provided that guidance yet, but I think we generally feel pretty good on the top line, that things will return to what I call a more normalized growth rate.

Jane Morreau

Just to build on what Lawson said a little bit more on the developed international, he was hitting on the U.K. and as I said in my prepared remarks this morning. What's happened in the U.K., we believe there's really some short-term disruption. So if you get that short-term disruption behind us next year, just having that market back to stability will get us back more to our historic growth in that part of the world. So that will help. As Lawson said, that it is the emerging markets, but we've got a lot of pockets of growth, and we're very excited about a number of those. But as you know, emerging markets always have been volatile in everybody's business. But there are tremendous opportunities long term. I see this all is really the short term right now.

Peter Grom

Okay, that's helpful. And just a quick follow-up. Just on your Global Travel Retail guidance.

I think you mentioned earlier that you expect full year to be in line with year-to-date which kind of implies minus 3% for Q4. It just strikes me meaningfully better than what we've seen from your peers. So any color on how you arrived at that would be pretty helpful.

Jane Morreau

I'm sorry. So it's better than what our peers, is that what you're saying?

Lawson Whiting

Yes. I mean, I think…

Jane Morreau

Yes. I mean, I think our business is smaller percentage-wise than them. They have more concentration in Asia than we do. And so our concentration of our Travel Retail business is more in Europe. So they probably are being affected a bit more than we are from the Asia part of the world. With that being said, we had – as we've talked about the Travel Retail business before, it's quite lumpy and volatile anyhow from quarter-to-quarter and when people purchase. And so we had the strong growth at the beginning of last year first half and now we're cycling against some softer growth in the second half for Travel Retail. We still do expect some improvement, but that will be offset by this coronavirus on our business and the global – just people less traveling internationally. So we – but that's what I would answer your question in terms of why they're so different than ours, smaller, and it's where they're concentrating.

Operator

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

Lauren Lieberman

I was hoping we could talk a little bit more about the U.K. I mean, of course, you gave us some high-level commentary. But I guess, one, just more color on what's going on with cash and carry. I feel like last quarter, it sounded like it was limited to a few customers and more of maybe a retail than a consumer dynamics. So just curious how that's sort of evolved. And then, secondly, kind of changes in the promotional strategy, impact from the route to market transition. These I think were planned and embedded in guidance, things you've done in other markets previously. So anything you could share on kind of like what's gone wrong or differently. Specifically, again, because this is something you've done very successfully in other markets before with arguably less disruption.

Jane Morreau

Yes. So let me start. I think Lawson will chime in here too. The cash and carry is limited to a couple customer – 1 customer really, and so that business, we talked about last time, so that really hasn't changed from our third quarter what we were referring to what was going on there. We just have a more precise thing, cash and carry this time. The increased promotional strategy, you're right. It was planned. And it's something that we're doing as we get ready to own our own distribution come May. And that's why when we look ahead to this market and the optimism we have going forward versus what we have had this year, we will be in control of a lot of our decisions of working with the grocers and determining the pricing strategies. And right now that doesn't always happen. And so that's important for us as we go forward. Just a reminder why we made this decision to go on our own route-to-consumer in the U.K. This relationship has probably served us quite well. It started in 2002, served both companies quite well, but we had very limited portfolio at that time, I don't know, 10, 12, 15 brands. And now combined, we have over 100 brands. So you can only imagine the lack of attention, focus, prioritization, understanding the consumer and focus on our own portfolio. And so we haven't transitioned yet. That, again, is May 1. But we believe the focus, the prioritization, the understanding the consumers, the more direct contact with our customers, if you will, will allow us to not only accelerate our business there, but get our rest of our portfolio growing quite nicely.

Lawson Whiting

Yes. This one is kind of a different animal this time. This is a cautionary arrangement as opposed to what we used to use typically with more agency-type relationships. And so you're not going to see a big margin and change. You're not going to see – I mean our – this has been one of the most successful markets in the world for Brown-Forman for literally a long time. But I think both companies would admit it's just time. We've – as Jane said, our portfolio has got bigger, the concept has got bigger, and we've moved on. So on the pricing or the promotional question you asked a little bit earlier, I mean, the – look, if we're totally honest, the amount of promotion in the U.K. market got too big. And so we're trying to reduce that a little bit and get some pricing up, and we're working on that slowly. It's not a – I mean you have to do it slowly with the European retail world, but we're paying the price necessarily. We're just seeing short-term disruption with some of our customers as we do a little bit less promoting. We do think in the long run it's the smart thing to do. And we'll both – we're taking our medicine now for what we think can be a great outlook going forward.

Operator

Your next question comes from the line of Vivien Azer with Cowen.

Vivien Azer

Just to follow-up on the top line, please. Jane, you guys were pretty specific about the coronavirus impact on Travel Retail and what you're seeing in February, specifically in Asia Pacific. But as we think about the revision to the full year guidance, are you already – or also baking in some weakness in newer markets where the coronavirus is starting to emerge, particularly developed Europe, like Italy and France?

Jane Morreau

Yes. Thank you, Vivien. I'm glad you asked the question. Let me just pause for a minute, as we want to be super clear here with what we have in our forecast. So again, if you looked at what we did, we took our overall forecast down, as you saw. We reduced our underlying forecast with 2 factors. First, it was the tempering of the growth and contribution from some of our international markets, again reflecting some short-term disruptions as well these macroeconomic and geopolitical challenges. So when we look at our base business, what we would estimate now that our base business is doing is probably growing in the 3.5% to 4.5% range. It is, therefore, a couple of points less than what our expectations were just 3 months ago. But the second factor that we built into our forecast – and this is what you're asking specifically about, Vivien, led to our reduction in our top line outlook. And again not surprising is this unpredictability and uncertainty surrounding the coronavirus and what it may have on our business globally.

So we've estimated at this point, there's about 1 point drag, including those markets that are currently affected. So to your point directly from the Asian markets, including China and other parts of Asia, Travel Retail and we have in – Italy in there. So collectively, that's about 8% of our business. And as I said earlier, yes, we've already seen areas – many of these areas already affected in our February results. But that being said, we also have, in that 1%, some additional downside impact. And we don't know, none of us knows, that's going to be enough, too much. We're learning daily as this situation, and so we're really only looking at our fourth quarter. We haven't tried estimating downstream, secondary effects on anything beyond the demand we see and then an expectation for perhaps it's spreading to some other markets. We don't know about the economy and the consumer confidence and sentiment and how they may linger into our first quarter and summer months. So we'll obviously come back in June with more guidance on that for next year. So Vivien, I know I went into a little bit more detail, but I thought it was important to just to phrase it for you or put it in perspective in terms of where we are and that why we did reduce our guidance into the 2 buckets.

Operator

Your next question comes from the line of Kevin Grundy with Jefferies.

Kevin Grundy

Two very quick ones for me. Just clarification on the guidance and just to kind of see where you are for fiscal 4Q. So the guidance is now low single digits for the year. My thinking is you're probably toward the higher end of low single digits, and that is closer to 3% as opposed to 1%, with the 3% for the year implying something sort of similar for 4Q, particularly given the strength of the U.S. But if you could just confirm that, that would be helpful, just to kind of see where you are with that. And then for Lawson, just an update on the U.S. pricing environment. As we look at the Nielsen data, the price/mix remains negative and has been that way, although, albeit moderating somewhat. Could you just give us a little bit of an update there in terms of what you're seeing in the competitive environment? And then your expectations going forward from a pricing perspective to help drive some gross margin improvement.

Jane Morreau

Yes. Kevin, just as I just mentioned a moment ago, our base business guidance would be in the probably in the 3.5% to 4.5% range, and we've got about 1 point drag from the coronavirus. So whether it's going to be worse or not than that, we don't know. So that's how we got to our low single-digit growth.

Lawson Whiting

And I can take a shot at the pricing thing. So look, I mean, as we've talked about now on numerous calls, the pricing environment has been challenging in the U.S. for a number of years now. Really for the last – I'll say last decade, it's been low single digit. Some of that – I mean, as most companies do, we take a hard look at how our competitors are doing and where we are relative to that and try to pick our spots, and we've done that.

In the last year, we had gotten above and the competitors were going down, and that hurt our volumes a bit. And so at the beginning of this fiscal year, we got a little more aggressive, and our volumes have reacted. Our volume growth this year is as good as it's been – I don't know how many years. It's a number of years. So I think if we – that's a good thing, and that means consumers are still taking the product away, and we feel pretty good about that. But it's cost us on the value line, and we want to get that back in balance again. So the idea for next year is certainly to have it more in balance, and that's something that we're working on very hard. And actually I think you'll start to see some of the results of that even in the fourth quarter, which will improve our mix. When you were commenting about the mix, was that a Jack Daniel's question or the full portfolio?

Kevin Grundy

That was a Black Label question that I'm saying, because I mean, overall, the higher growth of the more premium products is driving more favorable price/mix overall. But I was specifically just looking at Black Label, where the trend there from a price/mix perspective remains negative.

Lawson Whiting

Yes. That will start to improve here in Q4.

Operator

Your next question comes from the line of Sean King with UBS.

Sean King

I have a question just drilling in a little bit on the Travel Retail. Is it safe to assume that, that business is, I guess, a lower gross margin but a higher operating margin than, I guess, the base business? And I guess, if at all, is that something to keep in mind?

Jane Morreau

Yes. I'm sorry if I make sure that I understand your question. Do we earn less, higher or lower margin on the…

Sean King

Yes. I'm just wondering if like the margins from a – from what I've heard in the past is that it's a higher gross margin business for Travel Retail, but it's actually a lower operating margin – or sorry, a lower gross margin, but a higher operating margin. Is that a fair assumption for the Travel Retail portion of the business?

Jane Morreau

It's definitely a higher operating margin because of the – there's not the brand spend in there. So it's really more the products themselves and the packaging that you see in some of the people – the experience that are there, some more of that, definitely more…

Lawson Whiting

Yes. If I look at the business – the gross margin of the business. I mean we sell a lot of Single Malt Scotch, for instance, into that channel, and that's going to be a higher-margin business. But – and Woodford Reserve has actually had a really nice run in the Global Travel Retail business, too. But now we also most often focus on the airport side of things, but you also got to keep in mind the Global Travel Retail sector is a lot broader than just airport business. There's a lot of borders to our business in Europe and in China.

Jane Morreau

Military goes in there.

Lawson Whiting

So military. I mean so you've got a real big mix, which I think, as Jane said earlier, the Global Travel Retail, while it's hurting our growth rates right now because it's in decline, it's not big enough to really consider moving our corporate, say, gross margin or operating margin around. It – I wouldn't try to overthink that piece of it in terms of is that going to be a help or hindrance to our overall company gross margins.

Operator

Your next question comes from the line of Bryan Spillane with Bank of America.

Bryan Spillane

Two quick ones for me. First, I think you touched, Jane – in the prepared remarks touched a little bit on agave inflation, and that sounds like it's going to stay inflationary for next year. Can you give us just an update on where we stand now on barrel costs and wood? Has anything loosened up in that market? And then I have a follow-up.

Jane Morreau

Yes, sure. I'll talk about – we did talk about tequila, the agave cost a bit. And just as a reminder on that, we've been consistently saying that we expect agave cost to continue to increase through calendar year – most of calendar '21. So in other words, we won't start seeing any easing to the back half of calendar '21, early calendar '22, so just as a reminder. I mean, we've got that information based upon what is publicly available from the CRT. So we can see when planting started to accelerate and we kind of know what the demand is. And so we can see, by the way, tons of plantings more recently. So we know 6 or 7 years from now we'll have – there probably will be lots of pressure on pricing at that point in time. But in the near term, again, it's going to be late calendar '21, early calendar '22 before we see cost pressures. But now with that being said, Bryan, it's important to note that what we're seeing in the market, where we had seen like a fivefold increase from 2015 in the price of the agave, it really – and it rapidly increased during 2016 through mid last year we have seen some slowing. It's still growing, but not at the – and still at unprecedented dollar – I guess peso cost, if you will, but it's just not growing just rapidly. So that perhaps is a bit of a good news there, if you will. As it relates to the cost of wood, we have seen some moderation in that. But again, you're not going to start to see that come through our P&L because of our aged products 4 years from now. And coupled with that, we have capital investments that we've made. So all of that's got to factor in. That will come through our P&L for 4 years because of our aged products.

Lawson Whiting

But still, the rate of growth of our – the cost of our whiskey products, really of Jack Daniel's, will moderate considerably next year relative to where we've been the last couple of years. So we'll – it makes…

Bryan Spillane

So more think about we're at higher cost levels at this point, but the rate of inflation should start to moderate versus what it's been the last year or 2?

Jane Morreau

Yes. Combined – the 2 combined, yes, if you put the agave and barrels together, yes.

Bryan Spillane

And then, Lawson, if you could just give some color now that Apple has been in the market for a while. And I guess, what I'm interested in is, how it's – how you think the Jack Daniel's Tennessee Black Label is impacted by having all of these sort of line extensions? Do you think that it's diluting the – kind of the core? Are there things you may need to do to strengthen or reinforce the positioning of Black Label in order to make sure that it stands out from all of these other brand extensions?

Lawson Whiting

Yes. So I mean, it's a good – the cannibalization question is one – it's different – first of all, we look at it about 16 different ways trying to figure out how – what is actually happening out there. Because, to be honest, we were a little more concerned about the cannibalization of Honey and Fire necessarily than we were on Black Label. But when we've done the work, and it's the same thing that we've said sort of on prior – when this has come up in prior conversations around Fire and Honey, there's been almost no cannibalization, to be honest, I think it probably surprises a little bit, but it just hasn't been there. There's – it really has been successful in bringing in new consumers in different occasions, and it just feels – it feels like it is showing through the analysis that we do that it's tiny. I mean, it's almost – truly on what we've done so far year-to-date on the impact on Black Label, it's imperceptible, I mean, literally a few thousand cases kind of thing, but it's not the reason that the Tennessee Whiskey brand in the U.S. has slowed down like you'd asked. Another piece of it, I guess, on a volumetric basis, Black Label is up nearly 3% at the same time that we've released Apple. So I think that also gives us some confidence that just the cannibalization is not there.

Operator

There are no further questions at this time. Are there any closing remarks?

Leanne Cunningham

We'd just would like to say thank you to Lawson and Jane and those that have joined us today for Brown-Forman's Third Quarter Fiscal 2020 Earnings Call. If you have any additional questions, please feel free to contact us. And thank you.

Operator

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