Brown-Forman Corporation, Q2 2013, Earnings Call 2012-12-05

Presentation

Operator

Good morning. My name is Tiffany, and I will be your conference operator today. At this time, I would like to welcome everyone to the second quarter fiscal 2013 conference call. — ***Operator Instructions*** — I would now like to turn the conference over to Jay Koval. Please go ahead, sir.

Jason Koval

Thanks, Tiffany, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's 2013 Second Quarter Earnings Call. Joining me today are Paul Varga, our President and Chief Executive Officer; Don Berg, Executive Vice President and Chief Financial Officer; and Jane Morreau, Senior Vice President of Finance.

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 fiscal 2013 second quarter. The release can be found on our website under the section titled Investor Relations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, 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.

And with that, I will turn the call over to Don for his prepared remarks.

Donald Berg

Thanks, Jay, and good morning. On today's second quarter earnings call, I plan on covering 3 topics. I'll start with a review of our first half results, followed by a quick update on the pricing environment. And I'll close with our revised outlook for fiscal 2013.

So let me start with my first topic, a review of first half results. We are pleased to report first half underlying sales growth of 8%. Remember that on our last quarterly call, we estimated that retail buy-ins likely contributed 1 point or 2 to our rate of underlying sales growth of 10% in the first quarter. The second quarter saw the expected reversal of some of these buy-ins, reducing underlying sales growth to 6%.

Putting the 2 quarters together, for the first half, underlying sales came in at 8%, in line with our high-single digit full year outlook. We believe our underlying net sales result outperformed the spirits industry averages in large part due to our skew to premium brands and our portfolio's focus on faster-growing categories such as North American whiskey.

Let's look at the performance of several of our brands. From this point, any references to net sales will refer to constant currency net sales unless specified differently. So starting with Jack Daniel's, the trademark continued to register solid net sales growth, up 9%

through October. To put this in a broader context, we estimate that over the last 5 years, the Jack Family of Brands has grown at an 8% CAGR, which according to IWSR, is the fastest volume growth among the top 10 largest global spirit brands over that time frame.

Accordingly, Jack Daniel's is broadly recognized as one of the most valuable spirits trademarks in the world today and a major value driver for the company. Its global appeal as a premium imported Western spirits brand has helped it progress from a U.S.-centric brand 20 years ago to a global icon today, recognized and sold in almost every country in the world.

Jack Daniel's Black Label has continued on its global growth story, while being the foundation for very successful line extensions further up the pricing ladder, with Gentleman Jack and Jack Daniel's Single Barrel in the super and ultra-premium price categories. And we believe the trademark is early in realizing the potential upside from our innovation agenda.

Jack Daniel's RTDs provide the brand with broader distribution in venues generally restricted to beer, and more recently the introduction of Tennessee Honey created opportunities for us to bring in a new loyal cadre of consumers into the franchise. More broadly, given North American whiskeys' still relatively small 2% share of global distilled spirits, we believe there continues to be a long runway for future growth of the Jack Daniel's trademark.

Looking at our other brands. We are pleased to say that the rest of our brand portfolio has enjoyed a strong acceleration from year-ago trends. For example, in the first half of last year, excluding Jack Daniel's, all other trademarks in our portfolio grew underlying sales by roughly 3%. In the first half of this fiscal year, these brands grew approximately 6%, almost double the prior year's growth rate.

Let me run through some of these brands' individual performances. In the vodka category, Finlandia grew net sales by 9%, driven by one of the largest vodka markets in the world, Russia. While the overall vodka category in Russia isn't growing, premiumization trends have powered double-digit annual sales growth for Finlandia over the last decade. The premium-plus segment is relatively small at approximately 1% of Russian volumes so we believe this trend still has a long way to go.

While we are working hard on the strategy to better penetrate the U.S. vodka business, we believe Russia, in addition to Central and Eastern Europe, remains one of the largest sources of potential growth for our family of vodka brands in the coming years.

Moving on to tequilas. We acquired the Casa Herradura Family of Brands in 2007. El Jimador and Herradura are regarded as 2 of the best 100% agave tequilas in Mexico. The downturn hit the premium-plus tequila category hard, aggravated by an extended period of agave oversupply, which brought new entrants into the market. But we have seen some stabilization in the category, including a return to growth for our brands. In the U.S., an ever-growing Hispanic population should also be a tailwind for our tequila brands.

Through this acquisition, we also acquired the #1 position in RTDs with el Jimador's new mix. While building on that position, we were also able to launch Jack Daniel's RTDs, helping us grow that franchise at an even faster pace. We also believe that tequila has tremendous opportunities for growth outside of the U.S. and Mexico. We are beginning to see consumer demand for markets as far-reaching as Russia, Brazil and Australia. Tequila's share of global TDS is so small, but again, we believe we are well positioned to drive sustainable growth with our premium portfolio of brands. Herradura in particular is positioned to become one of our large brands over time as we believe we are just beginning to tap into its growth potential with year-to-date net sales of 22%.

In liqueurs, Southern Comfort competes in the highly competitive category that has been under pressure over the last few years. During the summer months, we launched a new consumer engagement plan, including a new and more consistent media mix in the United States to drive and aided awareness. And it appears to be working, with U.S. 3-month volumes for the family now growing faster than TDS, according to recent Nielsen data. There's more work to do here to stabilize global sales, but we are encouraged by recent U.S. results and believe that we are on the right track to return this highly profitable brand to growth mode.

The company's super and ultra-premium brands have been performing well for quite some time. That performance has continued with these brands delivering solid double-digit net sales growth in the first half. Consumers are increasingly looking at our high-end brands as affordable luxuries worth the prices charged. Among these brand performances, Woodford Reserve grew net sales 27% and Sonoma-Cutrer, 18%.

So the key takeaway that I'd like to leave with you is that our efforts have been working to accelerate the sales growth of our portfolio beyond Jack Daniel's, helping drive better, balanced revenue growth for the company as a whole. Our premium brand portfolio is focused on categories that we expect to grow faster than the broader spirits market, so we believe that we are well positioned to continue to outperform the industry. We'll talk more about our market-by-market and brand-by-brand approach to drive long-term growth at our Investor Day next week.

In addition to achieving better balanced top line results by brand, our results were also driven by broad-based geographic strength. Emerging markets, despite some slowdown in parts of Latin America and Asia, contributed over 40% of our incremental underlying sales growth in the first half. These results were fueled by Russia, Brazil, Turkey, Mexico and Poland.

Underlying sales were roughly flat in Western Europe, impacted by the combination of weaker economic conditions in the U.K. and France and the impact from price and excise tax increases taken earlier this year, all partially offset by growth in Germany. Among other developed markets, Australia also grew net sales high-single digits in the first half, and the U.S. delivered underlying net sales growth of 8%, in line with our global rate of growth.

Comparing our underlying to our reported results, year-to-date top line reported growth of 2% was negatively impacted by 3 points due to the strengthening of the dollar and 4 points due to the absence of the agency relationship for the Hopland-based wine business. We estimate that inventory levels in the channel are still running slightly higher than last year, contributing 1 point to reported sales growth as giveback in the second quarter hasn't yet completely offset the first quarter buy-ins.

Underlying gross profit increased 10% year-to-date as reported gross margins increased 2.6 points. Half of that increase was due to the absence of the agency relationship for the lower-margin Hopland-based wines, and the other half coming mostly from improving price mix, with a smaller contribution from lower costs associated with value-added packaging.

Underlying A&P spend increased 6%, below what we expect for the full year as the timing of this year's A&P increases are spread more evenly throughout the year, resulting in more spending weighted to the second half compared to last year. Underlying SG&A increased 10% through October due in part to the timing of various expenses. Operating income grew 12% on both an underlying basis as well as reported, and earnings per share increased 18%. All in all, we are pleased with our results in the first half and our continued industry outperformance.

Let me move on to my second topic, a pricing update. We view price increases as crucial for our brand's premium positioning and as an opportunity to offset inflationary pressures and tax increases. First half sales trends came in close to where we thought they would be. Price mix is up 2 points year-to-date and over 3 points in the second quarter, a significant improvement from the minus 1% impact last year.

In addition to a healthier overall pricing environment for the industry, we believe competitive promotional activity has diminished over the last year. Within this environment, we have significantly reduced the use of value-added paths over the last 6 months, which helped drive some margin expansion through reduced costs.

The combination of lower promotional spend, continued trade-up from premiumization and shelf price increases implemented earlier this year are all helping deliver better price mix and gross margin expansion. It remains to be seen what will transpire over the important holiday selling season, so we will closely watch competitors and monitor retail behavior over the coming weeks. But so far, we are encouraged by the trends we are seeing in the pricing environment, particularly in fast-growing categories such as North American whiskey.

This brings me to my third and final topic, our revised outlook for fiscal 2013. The global environment remains uncertain with macroeconomic concerns in parts of the world such as Western Europe and Asia, as well as in the U.S. with the fiscal cliff unresolved. Foreign exchange remains volatile and the tax environment is a wild card. But despite this backdrop, we believe we are on track to deliver the high-single digit underlying sales growth we shared with you 6 months ago.

At this stage, we expect the momentum of the first half to continue, with the price increases we have taken driving improved price mix and leverage the gross profit line, which is then flowing through to operating income. As a reminder, we do expect our reported gross margin improvement to be much more modest in the second half as we move past the positive impact from Hopland-based wines on December 31.

We are increasing our expectations for growth in underlying operating income by a couple of points to the double-digit level and increasing our EPS range to $2.58 to $2.70 per share. This revised outlook includes approximately $0.02 of anticipated interest expense from incremental debt we expect related to our recently announced $4 per share special dividend. To help you model the potential impact from changes in foreign exchange, a 10% move in the dollar in either direction would impact EPS for the balance of the year by approximately $0.09.

So to summarize, we believe the business is performing well with better, balanced revenue growth across geographies, across brands, and with price mix an increasingly larger contributor. Price increases and favorable mix are driving leverage to the gross profit line and ultimately to operating income. Our balance sheet, coupled with our growing cash flow, provides us with the flexibility to pay the special dividend and at the same time, we retain ample capital capacity to continue to invest significantly in our future growth, including keeping our eyes open for brand acquisitions that we think will be complementary to our existing portfolio.

We have a proven track record as strong stewards of capital and believe our recent dividend announcement reinforces our position as a company focused on delivering superior risk-adjusted returns for all of our shareholders.

So with that, I'd like to turn the call over to Paul for some brief comments before we open up the call to Q&A.

Paul Varga

Thanks, Don. We are pleased, obviously, with the first half results and the overall health and prospects for the company going forward, and I think this is particularly true when we consider some things that Don mentioned about the uncertainty that exists across the globe.

The one thing I would highlight from the first half is the balance of the performance across the company, and I observe this really in the portfolio balance that Don was just discussing, as well as the geographic mix and geographic balance performance that we're seeing, but also in some of the highlights he just provided related to our gross profit delivery. It's such a wonderful combination when you're able to have your volumes up, your prices up and your costs even slightly down a bit.

And I thought I might just give you one example on the effects or the way we have been observing our margin from the Jack Daniel's U.S. business, which of course, Jack Daniel's is our most important brand and the U.S. continues to be our most important country. And about a year ago when we were observing the potential opportunity to raise prices, much – we thought the environment was improving in such a way a year ago versus what we'd seen in the prior 2 or 3 years that we wanted to explore that.

At that time, just using the Nielsen results from early November a year ago, the Jack Daniel's business on a 12-month basis was up just above 1%, and all of that was attributable to volume. And you fast-forward to today and using the Nielsen results from – that I think ended November 10, the Jack Daniel's Tennessee Whiskey business was up 4.2% in the prior 12 months, with 2.5% of that coming from volume and the remainder, of course, coming from pricing and mix, or 1.7 points.

So we're really pleased with that as an example from a pretty clean market, where there haven't been a lot of excise taxes and things like that, as an example of what we'd hoped would be available to a brand like Jack Daniel's back when we started to explore that environment. Actually back at that time, we felt like in some ways that others were out exploring it ahead of us, and we thought there'd be opportunity. In fact, as we look at the last 12 months, we think we've been able to see some of it.

So really pleased with that kind of pricing and volume balancing act as well. So all in all, we're very pleased with our first half and most importantly, we want to thank our employees across the globe for their continuing efforts to help us produce these results. It's enormously important to the company, and we want to make sure we thank them as well.

So with that, we're available to take any questions you might have.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Vivien Azer of Citi.

Vivien Azer

My first question has to do with your outlook for the bourbon category or North American whiskey, specifically in the U.S. Now that we've seen some of the changes in the promotional environment and pricing both from you and your competitors, can you give us a sense of what you think a good run rate is for the category for the back half of the year and then maybe over the next 3?

Paul Varga

Well, I mean, all we can do is maybe direct you to some of what we're observing in the institutional data because that's the most current stuff. You'll get some end-of-year reports for 12 months, and some people will try to forecast that going ahead. I was actually just – I mean, we were looking at it in preparation for today, so I'll give you an example. The U.S. spirits business 12 months ago was running at about a 3.7% run rate, and today, this is all dollars not cases, is running at 3.8%. So about the same, just below 4%. The bourbon category in the United States was running at 6.5% 12 months ago and is running at just below 9% right now in dollars so it's – over the 12 months, it's accelerated. I don't know if that will keep up or not, but it certainly is exciting to have growth rates on a 12-month basis that are more than double the spirits industry. And for those of us who have a concentration in bourbon, I mean, that wasn't the case for a long time in the U.S. distilled spirits market. So we welcome it. I think that there's favorable premiumization going on within bourbon just as there is a little bit in spirits. And we also think there's real price increases that have been getting through not just by our company, I think, but by others as well. So we're pretty bullish about what's going on with bourbon and American whiskey right now.

Vivien Azer

Fair enough. My next question has to do with Southern Comfort. It's certainly encouraging to see continued improvement in the brand in the U.S., but there seems to be a real difference between what you're seeing in the U.S. and the deterioration that presumably you've seen in Europe given the results for the first half for the brand globally. Can you speak to the trends that you're seeing specifically in the U.S. and then what you have in store for Europe to hopefully turn the brand around there?

Donald Berg

Sure. I mean in the U.S., and we've talked about this, I think, quite a bit, going back a number of months ago, where we were really looking at a lot of new communications to put out there, how much we were spending behind media, how we were spending it in terms of seasonality. So there's been quite a few changes there with the recent advertising campaign that we think's had a big impact, how we're using social media around that advertising campaign. And it's nice to see that the brand is responding to all of that. Outside the U.S., as we look at our numbers, we think we had a better second quarter than first quarter. We recognize we still have a long way to go. Some of it too is just kind of running up against the environment that you're seeing, particularly in Western Europe. We're probably a little bit behind the United States in terms of where we are in putting some of these plans in place and starting to get them executed. But we're encouraged by what we've seen in the U.S. to believe that we can get the rest of the world on track so that we can get the brand overall back on growth.

Paul Varga

One thing that influences Southern Comfort's international performance quite a bit is it just doesn't have the breadth of geographic distribution that a brand like Jack Daniel's does obviously. So the U.K. market being – it's our second largest market for Southern Comfort, with the excise taxes hurting that market, I think Southern Comfort is probably more uniquely exposed to that in terms of – as a percentage of its business. We have begun to put some of the initiatives and actions that have worked in the United States into play in the U.K. more recently. They just were factually behind in terms on the calendar and relative to the U.S. So we're hopeful that, that will improve it. But we also think that Southern Comfort has to find a number of new ideas, just as we have been able to do in the last 12 months in the United States, everywhere where it competes because it really is in a competitive category with that LDA, that sort of 29-year-old consumer that it targets, and so there's a lot of competition in the United States. And we thought it would be more difficult to get it turned around some ways in that real tough U.S. market, and we are pleased by what we've seen. So I think getting focused on the same stuff in some of its key international markets could have some of the same benefit. But it is behind.

Operator

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

Judy Hong

I wanted to go back to just probing on the pricing commentary. And I just wanted to get your perspective on whether you think that most of the price increases that you've taken have now gone through the value chain and all the way into the consumer level. And if you can help us understand kind of what impact you're seeing as you've taken these price increases at the consumer level. And then just if you look at some of the categories like vodka, obviously, the pricing environment there is still very challenging. So how much attention do you really pay to that particular category? And if there's any risk that the brown spirits do suffer if the vodka category continues to be very competitive from a pricing perspective?

Paul Varga

Maybe we'll both take a stab at the couple of questions I think that were in there. In some ways, our rate at the consumer level is just now beginning to improve because, as you've suggested with your question, it takes a while for all that pricing to get reflected. Always, the most readily available data to us is from the United States, unfortunately. But this pricing was going on all over the world. So if you'll permit us, it will probably take us a few more months to really read the consumer's acceptance of it, reaction to it, and then start to get into new patterns. And the other thing too that's so important to this is the context against which some of these price increases were taken. Where they went up with excise taxes, that of course, is a different environment than, say, in the United States, where they were just individual brand increases versus something that affected the whole industry. But just using the U.S. data, I mean, I'd direct you back to the comment I made in my opening remarks about how pleased we are with what we're seeing so far in Jack Daniel's. I'll give you just sort of one example that even goes to sort of the 3- and 1-month trends in the United States more near-term, where that pricing starts to get reflected, is that the Jack Daniel's sales growth rate outside of the 12 months ago was at the 1% level, and it's pretty steady in the 3.5% to 4% level at the dollars in terms of dollars growth on a 12, 3 and 1 month. So you obviously start to see more contribution from pricing as you get toward the nearer months, but the fact that sales rate holds up at the 4% level and that's a higher level than the 1% we had a year ago, I thought was really encouraging. So that's why we chose to highlight that. It always varies brand by brand. We think that the higher you go up the pricing ladder, perhaps the more ability there is to take some price. So if you're talking about $35 and $40 a bottle of tequilas or bourbons, we think there's – a 2% or 3% price increase is something you can expect to get more readily than something that's priced at $10 a bottle. That's just been our experience. All of the data we look at in the United States today would tell us that the highest growth rates in the industry exist at the premium-plus level, so above even the Jack Daniel's price point. And so all of that we think is encouraging for an improved pricing environment. We're going to – we're not going to get out of control with it. We don't think that's appropriate. But you've got to remember there was a very cautious pricing posture in the industry and in our company from about '08 to '11. So we're encouraged by what we've seen in the last 12 months. And so far, if one of your questions was, are we rolling back all these price increases we've taken, the answer to that is no.

Judy Hong

Okay. And then just in terms of the price elasticity with the vodka category, is that something that you pay attention to or are you – if you think about just the Jack and kind of your brown portfolio, that's really where you want to see the competitive dynamics stay rational?

Paul Varga

This – absolutely, I'm taking your question as a U.S.-only question. Outside the United States, our reference point for Jack Daniel's is probably almost exclusively whiskey and the very premium whiskeys. We'll look at other brands as well that it might interact with, but it's largely a whiskey phenomenon. In the United States, yes, we'll look at it, but mostly up at those premium price points where Jack Daniel's plays. So you're going to look at brands like Absolut and Ketel One and Grey Goose and Cîroc and brands like that and probably a little less so at the pricing dynamics of the Smirnoffs and Svedkas and brands like that. Now that is important for our Finlandia business, but less so for our Jack Daniel's business. But I would say we're not preoccupied with weekly or monthly vodka pricing dynamics as it relates to our price – pricing and thinking as it relates to Jack Daniel's.

Judy Hong

Okay. And if I could just ask about the Tennessee Honey. In the U.S., obviously, it's been some time that you've launched the brand. So what are kind of the lessons that you've learned? And are you making any changes in terms of how you're approaching expansion of that brand in the U.S., and kind of what you're seeing now sort of on a same-store sales basis on that brand? And then internationally, can you update us on how the expansion is going for that brand and if there are any markets that you've found to be particularly successful and kind of what you're seeing in the international expansion for that brand?

Donald Berg

Judy, I'll take the U.S. piece of it. In the number that we cited, where Tennessee Honey is up 50% through the first half, when you look just at the U.S., the U.S. performance is up about 20%, which is – which continues to do exceptionally well. We've talked quite a bit about some of the different learnings that we've had through this in terms of the lack of cannibalization that we think we've seen on Black Label compared to what you could have been concerned about, and the fact that to a certain degree, we think there's almost been a little bit of a halo effect, where it's just brought more traction in the categories, brought more noise, it's reminded more people about the brand and the brand attributes and what-have-you. We certainly believe, and we've talked about this quite a bit, that it's brought new consumers into the franchise. And people who love the whole idea and the whole franchise around Jack Daniel's but didn't necessarily like the taste of Black Label now have found a way to participate and enjoy and be part of that overall franchise. So that's all been very positive. I know there was some concern, at least on a reported basis, how the numbers might come in, given we're in the second year of the launch and going up against some of the pipeline fill and everything. So we continue to just be really pleased by its performance and are just encouraged by it overall. Paul, I don't know if you want to talk about outside the U.S.?

Paul Varga

Yes, I mean, and that's because it's Jack Daniel's and it was in what I'd call a new territory for the brand in terms of line extension, which is flavored full-strength products. I think it's why we've been necessarily cautious with not going out and trying to introduce a flavor every quarter or something. We're obviously thrilled with what's happened in the last – within the last 2 years on Jack Daniel's Tennessee Honey. We knew we could sell Jack Daniel's Tennessee Whiskey prepackaged in a mixable format through our experience with RTDs, but we didn't do that overnight, either. So we took our time with that and wanted to make sure that when we do introduce it in various places around the world, that it can be as successful as we might hope, and we're taking that exact same approach here with the Tennessee Honey. And it's a sort of a staged rollout, and the frame of reference for Tennessee Honey's introduction into a number of these markets is a bit different in the United States. So we're trying to learn in these – in the first half of this year with these launches what's working and what's not. I mean, I'd say so far with the international launch, things are performing pretty well in line with our expectations, and we're trying to adjust as we go in. One thing that's interesting about these international launches is that there was no surprise to them because we'd already been successful out in the United States market. And so I know that whether it was retail preparation or competitive preparation or reaction, there was – they would have had the benefit of a year's worth of wait and observing what was going on in the U.S. But so far, so good. But I'd still – I've said this before. I think if someone was anticipating that Jack Daniel's would start getting into what you observe sometimes in the flavored vodka arena with our flavored whiskeys, I just don't think we're at that level of aggressiveness with the portfolio expansion into flavor right now. We really want to take our time and make sure we build really good branded businesses with these flavors. And we think there's still a lot of opportunity around the world. But so far, so good.

Judy Hong

Okay. So no whipped creamed Jack any time soon, basically?

Paul Varga

Well, you can go buy whipped cream at the grocery store and put it in there if you like, but you're probably not going to see us — ***indiscernible*** —

Operator

Your next question comes from the line of Bill Chappell of SunTrust.

William Chappell

Can you talk, I guess, first on the gross margin? Trying to understand now that you have kind of a good idea of the grain complex and some of your near-term input costs what the outlook is and how that kind of played into your guidance over the next 6 months.

Donald Berg

In terms of our outlook on input costs?

William Chappell

Well, yes, I mean, with the way you account, certainly, you see it sooner than most. And so just trying to understand how you'd know – expect that to affect the full year in terms of overall commodity pressure.

Donald Berg

I mean, it's certainly incorporated in the guidance that we put out there. I think when you think about commodities, I mean, the biggest commodity that we look at would be corn. And from that standpoint, it's probably gotten a little bit better than where it was as we were looking at the full year in the first quarter. So we've seen some slight improvement there. But when you think about commodity costs as it relates to our business overall, generally when you think about, if you take Jack Daniel's for example, and the cost of what goes into making Jack Daniel's, it's actually the cost of glass and the cost of wood that probably drives more of our cap cost factors than what you would see in kind of the corn costs that go in. So it's a – particularly when you look at the impact of the overall company's operating income, it's relatively small.

William Chappell

Okay. And then when you look at – I think you'd said half of the improvement on gross margin was price mix. Is there any way to dig into that? Was it like 80% mix and 20% price or any way that we should be thinking?

Donald Berg

We generally don't break that out.

William Chappell

Okay. Then just switching really quickly to tequila. You've made, I guess, more favorable comments about the category of it stabilizing than we've heard in a while. I mean, is this we're entering easier comparisons or was there something with the agave market where you're seeing less new entrants or how should we look at that market over the next few quarters?

Paul Varga

Well, I think you're talking about from the supply side, right?

William Chappell

Yes, and just kind of the competitive environment and pricing and what have you.

Paul Varga

Well, I mean, you're immediately going to focus on 2 countries there, which are Mexico and the U.S. And I think it will depend a bit on what price segment you're in. We know that both in the United States and down in Mexico at the sort of standard, even approaching the lower end of the premium price segments, those categories remain really competitive. I mean, there's just a lot of entrants in there, some of them at 100% agave, particularly in the United States. And I mean, I was looking at the sort of more recent category trends in the United States in preparation for this, and the tequila business at the dollar level's been a little sluggish relative to total spirits in the last half a year or so. So we'll see how those competitive dynamics, how much of them are related to supply. Usually, the factor we look for is how many new entrants are coming in, I mean, because a lot of times people start to introduce new brands or new extensions. And if those slow down, you might get an indication as to how people are thinking about their own individual supply demand balancing acts. Against that, where we're positioned, particularly in the United States, is up at the higher end. And as Don talked about in his – I mean, we're pretty small, to be honest with you, as a percentage of total tequila in the United States volumetrically. I mean, that's why we think there's so much potential for us. So off of that small base, I mean, right now particularly on Herradura, we think we've got some real momentum going. It sort of started when we introduced the new bottle and package and started to put a little bit more support behind it. So that's been growing. Last year, we had a very competitive year as one of – a new entrant came in against el Jimador in the United States. And actually, I think the brand's weathered it pretty well and is this year off to a pretty decent start. We're continuing to do fairly well in the U.S. The Mexico el Jimador business is a real competitive sort of volumetric slugfest. But overall – and then the other business that's tequila-based, which we've been pleased with generally over the last few years has been the New Mix business down in Mexico, which is an RTD business. So sometimes looking at the category trends when you have a small market share aren't as indicative as what you're doing as individual brands, and I would say that's kind of the case, particularly in the United States, for Brown-Forman's tequila brands.

Operator

Your next question comes from the line of Ian Shackleton of Nomura.

Ian Shackleton

Paul, I wanted to come back on the Tennessee international rollout. And obviously, it's been very visible in the U.K. in the last few months. It strikes me slightly different approach to the U.S. The U.S., you did the off-trade, then it was on-trade next. It strikes me the U.K. is more of an on-trade focus. I'm just wondering, is the U.K. the sort of typical model for how you take the international rollout? Or is this a slightly different marketplace? Or are you still learning as you go along and every market ends up being slightly different?

Paul Varga

The latter. I mean, the U.K. was actually unique with its almost sort of single and staged rollout at first in the on-premise, and there were some benefits to that. But also it probably slowed our momentum a bit because you're selling it drink-by-drink versus letting people buy it by the bottle. Down in Australia, it was different. And so there's no – we're letting the individual marketplaces help inform us as to how to launch it. But since we've expanded in the U.K., since you brought it up, there's been great excitement about the reception we're getting there. We're really encouraged by the U.K. reception. And you would be aware of how strong the Jack Daniel's brand is so you move cautiously. And sometimes, one of the reasons to go into the on-premise, for example, is to be a bit conservative and make sure that the bar tending tray and the consumers who experience there actually like the product, and then you can go a little more broad. And that wasn't necessarily why we chose it that way. But in retrospect, it helps us to learn a little bit as is always the case when you go to the on-premise first. And then you can reflect some of what you're understanding from that channel and take it to the broader market. But the U.K. market we're pretty excited about for Tennessee Honey at this stage.

Ian Shackleton

And perhaps just a follow-up question. Thinking about distribution, own distribution, I think you have talked about France coming up for renewal, which is currently with Bacardi. Have you made a decision on what's going to happen there yet?

Donald Berg

No, we haven't, and we're continuing to look at it though. I think that contract comes up, I think it's next September, and so we've got some time there. But we're having some conversations with Bacardi, and we're proceeding through our analysis.

Ian Shackleton

That's the most likely, I mean, in terms of the markets where you might be thinking about own distribution, that's probably the most likely next decision, is it, across the piece?

Donald Berg

It would certainly be the largest one.

Paul Varga

Yes, I think it's the largest market. There's a lot of smaller markets sometimes where you think you've got a lot of long-term opportunity and you find a way to change your model. But yes, I think France of the countries there, they'd probably be the biggest.

Operator

Your next question comes from the line of Tim Ramey of D.A. Davidson.

Timothy Ramey

If someone told you that it was a given that the whiskey category would grow 4% in volume for the next 5 years, how would your – and we know you're building barrel warehouses. But would that be a rate of growth that your current plans would be able to handle?

Donald Berg

As far as any hypotheticals go, I think the best that we can tell you is as we've laid our plans out for the future, we've got the whiskey that we need available to us in order to make those plans come to fruition. And as in any time that you've got aged product that's sitting in warehouses, trying to find that whole balance between volume and price always becomes an important factor. And as we weigh all these factors together at this stage, we feel very comfortable about where we are.

Paul Varga

The thing we would have – this is what we did a year ago was if you were to give us that hypothetical, given that there was a constant level of expected sales, I'd say – I'll use your 4%. The one thing that occurred to us a year ago was that we think we benefit very long term and so do our brands if it's not all coming from volume. That was one of the most important, I think, subtle changes we made in the last year was to ensure that we were getting, particularly if the environments permit it, which we thought they were getting better, was to get a little bit of pricing in there, and that's why we're highlighting it here today and why we went after it. We just think there's a multitude of benefits from sales growth coming in a balanced way. And so you want the volume growth, of course, too. You need both of them. But we have had a 36-month period, where it was either dominantly or almost exclusively being driven by volume. And we just felt like we could do a better job at that.

Timothy Ramey

And just switching gears. We talked about the Southern Comfort Whatever's Comfortable campaign, and you mentioned the LDA to 29. How does that – I mean, those are some disturbing images, as a person that relates perhaps more to the protagonist than I should. How does that brand test with, say, that LDA to 29-aged category?

Paul Varga

Tim, you'll excuse me, you've put an image in my head. I may not be able to answer your question. Let me just – I'll give you a little background on it. Actually, the reaction we are getting has been wonderful, actually. I mean, it's just – it's really been surprising because you see the advertising. And it's not just from LDA to 29. I mean, you're getting – there's almost a mindset and a way that people approach communications that it can't be polarizing. Of course, it can be. But it's largely been well received. And you can almost look at our Nielsen result and start to see on the parent brand Southern Comfort improvement from the time when we started to run that particular advertising execution. Now there's a lot of other factors that contribute to it as well, but you try to point everything in a particular direction. But it was – that one we think has had a pretty immediate impact. It's not always that way. And we actually – given the world we're in today with social media, we actually think there's tremendous benefit from the social commentary just along the lines of what you just did. The people are discussing the communications in social media. Whether they load the ad or not is something that Southern Comfort had not been a part of. It had not been part of consumer communication with one another. And the social media piece is really important to executions like that. And it actually – I don't know if you know the history, but it was actually launched with a 90-second like almost a small film, something you wouldn't do on a network television ad. But it was a 90-second video that got the thing started a few weeks before we did the network media event. So it was, I think, a really good launch by the team and so far so good.

Operator

Your next question comes from the line of Kaumil Gajrawala of UBS.

Kaumil Gajrawala

If I can maybe ask 2 macro questions first. And then the first being is if you can maybe talk about what you've seen in terms of any changes in the on-trade versus off-trade over the course of the first half of your year. And then the same thing on if you're seeing anything incrementally change on travel retail?

Donald Berg

On the on-trade and off-trade, I assume that you're thinking mostly about the U.S. on that?

Kaumil Gajrawala

U.S. would be the most helpful, but if there's anything material outside of the U.S., I would be interested to hear about it.

Donald Berg

Yes, I mean, the best data that we have on that is really coming through the NABCA stage. And if you look at those trends, particularly over the course of the last 6 months, the on-premise has continued to improve and is certainly back in growth mode. We don't see it yet as growing at a faster rate than the off-premise, but it's certainly a much healthier climate environment today than what we would have seen in the worst of the downturn. So that's all very helpful and very encouraging. Outside the U.S., U.K. continues to struggle quite a bit. But a lot of that is I think more environmental and economically driven than anything else. It tends to be, probably in terms of size, one of our – if not the most important market outside the U.S. that's heavily skewed kind of towards that – towards the on-premise trade.

Paul Varga

I mean, one thing we've learned going all the way back sort of to '08 and anywhere where the global – where you observe the economy of a country or the globe or a region softening, that there is a tendency for patterns of consumption to shift from the higher-priced on-premise environment to the lower-priced off-premise environment. And so that's something, I mean, we haven't studied those correlations here of late, but I mean that's just a – that was a general learning we had. We'd have to see if it's continuing to hold up in these more recent times. Travel retail has been a really helpful part of Brown-Forman's growth story here in the last few years. We know that we were pretty significantly underdeveloped in that channel going back a half a dozen years or so. So it's been drilling very nicely for us, not only Jack Daniel's I mean, beyond Jack Daniel's as well. We think our super-premium brands continue to have a great opportunity there. So mentioning sort of the Woodfords and the Herraduras and Chambords of the world. I think those are helpful to think about that channel as being particularly conducive to super-premium brand building. I haven't looked at any of the published statistics of late related to how travel retail's doing as an industry. I'd have to look at that before I could give you a better answer.

Kaumil Gajrawala

Got it, got it. And the renaissance of North American whiskeys and the addition of flavors and now we've got some craft distilleries out, it looks like shelf space at retail has expanded for the category. Where would you say the shelf space is coming from? And the way the retailers look at it, does it put pressure on your other – in the brands that you have in other categories or does it – does the entire category grow and they don't ask for the incremental shelf space back from you from somewhere else in the store?

Paul Varga

Yes, I'm sure it's a mixture, but I'd be best off to ask some of our retail sales people in the United States to get a better answer. I mean, just off the top of my head, the thing that I would anticipate to continue to occur is a shift generally from lower-priced spirits, whether they're bourbons or vodkas or anything, toward higher-priced because of the just significant growth that's going on at the premium-plus. So there may be a trend that's as much related to the price position as it is the category. And if that's the case, then you'd look at – excuse me, the categories that have more premium development, like the bourbons and tequilas and categories like that, that actually are up at $30 and $35 and $40 a bottle. And it's just in the – I mean, the best interest of the retailer if they can move their products from that space at a higher margin relative to something at a lower margin. I think they're going to just generally probably displace lower-margin products with higher-margin products is what I'm guessing.

Kaumil Gajrawala

Okay, guys. So it's not a story where Jack Daniel's success could potentially put pressure on Southern Comfort or anything like that?

Paul Varga

I don't think so. I mean, we've actually – I'd have to go look at it statistically through a survey. But because we've been expanding the Southern Comfort line through flavor extension, and we've actually repackaged the various aspects of, I mean, like our Southern Comfort 100 Proof and other things along the way, those are helpful tools to being able to keep your shelf presence and even expand it. Brands that aren't innovating and brands that don't – aren't having size expansion and things like that are probably going to be a little susceptible to those that are if retailers are prone to wanting to give some of those innovative products a chance.

Operator

Your next question comes from the line of Tom Mullarkey of Morningstar.

Thomas Mullarkey

I have a question about how you plan to fund the $4 special dividend. Any details you have on your future borrowings other than the $0.02 incremental interest expense this year? And then also going forward, do you plan to eventually pay down the incremental leverage or will you carry that added debt on your balance sheet?

Donald Berg

Yes, so the current plan is that we would fund it with a combination of cash and debt. We've got an $800 million revolver that's available to us, and then we'll look at what other opportunities there might be out there within the overall debt market. So we'll be able to talk more about that on the next quarter because we are continuing to look at it. But generally, it's going to be between cash and debt. How long we go out and how we keep it, we're still looking at all of that.

Operator

Your next question comes from the line of Ann Gurkin of Davenport.

Ann Gurkin

Just wanted to ask you about how you're positioning your business to capture growth in Brazil and to maybe adjust for the change in the culture of consumers moving up the scale, looking for more premium products. I was just curious how you're positioning your business.

Paul Varga

Well, I mean, I think the biggest thing we did was a couple of years ago, we, after a number of different distribution ventures down there, made the leap to put our own personnel in-country to take more responsibility for our own local brand-building and selling. And that was probably the biggest thing, and it came with some investment a couple of years ago. The primary focus down there for us is at the more premium level because it's behind Jack Daniel's. And I think we may have commented on this before, but it's an excellent whiskey market, where we know that some of our competition in whiskey – global whiskey – have very sizable businesses, so we think there's real opportunity there. And at the sales line so far, thinking about the size of our business just 2 years ago versus today, we've been pretty happy with the progress. So I think the biggest thing we would have done there –

and when you put people down there, of course, you put more resources behind them, and so there's been probably a combination of an SG&A and A&P incremental effort down in the Brazil market that so far is doing a nice job on the top line. I wouldn't say that we went into expecting that within 2 years it would be a bonanza at the bottom line. You try to develop these and re-invest behind the business with the hopes that you can build something pretty significant over a period of time.

Ann Gurkin

Okay. And then related to tequila, do you think tequila as a category has growth potential outside of Mexico and the U.S.?

Paul Varga

It's already showing it, yes. It's a pretty small base, of course, and we talked about this a couple of times but yes, there's some nascent interest. And because it tends to be up at the premium level, that's one of the limiting factors where we play is up at the more premium level. But yes, we're pretty excited by it. It's been one of the surprises if I go back to the acquisition of Herradura a bit, that el Jimador and Herradura, we would hope that there'd have been some potential out there for it, and I think our experience so far is there might be a little bit more than we originally thought.

Operator

That was our final question. I would now like to turn the conference back over to the presenters for any closing remarks.

Jason Koval

Thank you, Tiffany. And thanks for joining us today for our second quarter earnings call. We look forward to seeing many of you next Wednesday at our Investor Day in New York. I just wanted to point out because NASDAQ requires an attendee list in advance, we encourage you to RSVP this week if you haven't already. In the meantime, feel free to reach out to us if you have any additional questions. Goodbye.

Operator

Thank you. This concludes today's conference call. You may now disconnect.

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