Brown-Forman Corporation, Q2 2016, Earnings Call 2015-12-02

Presentation

Operator

Good morning. My name is Selena, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter Fiscal 2016 Conference Call. — ***Operator Instructions*** — I would now like to turn today's conference call over to Mr. Jay Koval. Please go ahead, sir.

Jason Koval

Thanks, Selena, and good morning, everyone. I want to thank you for joining us for Brown-Forman's Second Quarter 2016 Earnings Call. Joining me today are Paul Varga, our President and Chief Executive Officer; Jane Morreau, Executive Vice President and Chief Financial Officer; and Brian Fitzgerald, Chief Accounting Officer.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict.

You should not place undue reliance on any forward-looking statements, and the company undertakes no obligation to update any of these statements whether due to new information, future events or otherwise. This morning, we issued a press release containing our results for the second quarter of fiscal 2016. 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, Form

8-K and Form 10-Q reports filed with the Securities and Exchange Commission.

During this call, we will be discussing certain non-GAAP financial measures. These measures and the reasons management believes they provide useful information to investors regarding the company's financial conditions and results of operation are contained in the press release.

And with that, I'll turn the call over to Jane for her prepared remarks.

Jane Morreau

Thanks, Jay, and thanks for joining us for our second quarter earnings call. I will be covering 2 topics today, which should leave us plenty of time to address Q&A. First, I'll review our results; and second, I'll discuss our outlook for fiscal 2016, which we confirmed earlier today.

So let me start by reviewing our recent results. During the first half of fiscal 2016, we grew underlying net sales by 6%. This underlying sales growth was broad-based geographically, with mid- to high single-digit rates of growth in both the developed and emerging markets. In the United States, underlying net sales grew 7% during the first 6 months of the fiscal year. These results were led by the Jack Daniel's family of brands, which grew underlying net sales by 7%. Jack Daniel's Tennessee Fire contributed almost 3 points of growth in the United States. Our leading portfolio of premium whiskey brands outpaced their competitive set, including aggregate underlying net sales growth of over 30% for the Woodford Reserve family of brands and Old Forester. Our el Jimador and Herradura tequila brands grew well into double digits as the brand building investments we have been making behind both of these leading tequilas are creating important momentum towards achieving our long-term growth strategies. More on those in just a moment.

Before moving on to our non-U.S. markets, I wanted to share some color on our blended value takeaway trends in the United States for Jack Daniel's Tennessee Whiskey. Both Nielsen and NABCA's 3-month trends have slowed as we are now comping against last fall's substantial acceleration and takeaway on the heels of the campaign in fiscal 2015 to reach the 5 million case milestone for Jack Daniel's Tennessee Whiskey. When looking at our takeaway trends on a 2-year basis, which removed short-term comparison issues, Jack Daniel's Tennessee Whiskey has consistently grown value takeaway at a very healthy 9% to 10% rate each month this calendar year when compared to 2013.

In developed markets outside of the United States, the rate of underlying net sales growth improved from the first quarter to the second quarter, resulting in 6% growth during the first half of the fiscal year. Results were up double digits in Germany, France, Belgium and the Czech Republic. Additionally, we experienced solid growth in the United Kingdom, Canada, New Zealand and Spain. Part of the sequential improvement was also due to Australia, which enjoyed more favorable comparisons than in the first quarter, resulting in first half underlying net sales that were roughly flat year-over-year.

Underlying net sales in emerging markets grew 8% year-to-date. Strong double-digit gains in Brazil, Turkey, emerging Africa and the CIS countries were offset by declines in China and in Southeast Asia. Mexico grew underlying net sales mid-single digits fueled by New Mix. Poland also experienced growth albeit driven in part by easy comps to last year. Russia's underlying results improved significantly from the first quarter large declines, resulting in now only a slight reduction in year-to-date underlying net sales.

Non-U.S. markets now account for almost 60% of our total revenue, so I thought it would be worthwhile to share some additional color on takeaway trends for some of the markets outside of the United States where we have good visibility. Three-month consumer takeaway trends for Jack Daniel's Tennessee Whiskey are up mid-single digits in Germany, France and in Australia. The brand is experiencing mid-single-digit growth in Mexico and is growing high teens in Russia. While Poland is down over the most recent 3 months, we are gaining share in whiskey, and Jack Daniel's is up high teens over the last 12 months. Jack Daniel's Tennessee Whiskey is also experiencing a short-term slowdown in the United Kingdom takeaway, driven in part by timing of promotional activities, but 12-month value takeaway is up 10%. So these consumer trends are encouraging as we think about our full year outlook.

Global Travel Retail, which accounted for approximately 4% of our stripped net sales in fiscal 2015, continues to be challenging, driven by the decline in spend from high-income travelers, particularly Russian and European. Travel retail's underlying net sales are down 14% year-to-date, a slight improvement from the first quarter but well below our expectations for the business. We continue to believe that some of the softness in the U.S. travel retail channel is the result of the timing of orders, and in fact, we started to see some of those orders coming through during the month of November. Excluding the results of travel retail, total company underlying net sales growth would have been closer to 7% in the first half of the year.

Moving now to the discussion of our results on a brand basis. The Jack Daniel's family of brands grew underlying net sales by 7% year-to-date. Growth for this family in the second quarter reflected a slight improvement from the 6% growth delivered during the first quarter. In the second quarter, Jack Daniel's Tennessee Whiskey grew global underlying net sales by 4%, while Tennessee Honey, Gentleman Jack and Jack Daniel's RTDs each grew global underlying net sales at a double-digit rate.

Jack Daniel's Tennessee Honey delivered over 30% growth outside the United States, while increased competitive activity in the United States negatively impact U.S. results for Honey. Jack Daniel's Tennessee Fire contributed almost 1.5 points of growth to the company's underlying net sales growth during the first 6 months of this year as we continue to invest behind the U.S. rollout of this brand. Distribution remains well below the parent brand at roughly 2/3 of Tennessee Whiskey's off-premise distribution and only 1/3 in the entree. We've remained encouraged by the early results from testing Tennessee Fire in a few markets outside the U.S. including the Czech Republic, the United Kingdom and Australia. And we believe that our geographic reach should create significant opportunities to develop the brand on a global basis.

Our other American whiskey brands, including Woodford Reserve and Old Forester, enjoyed fast rates of growth as our authentic American whiskey brands are well positioned to meet the rapidly increasing demand for high-quality premium-priced bourbon. Finlandia vodka's underlying net sales declined 2% year-to-date, driven by declines in Russia where fiscal 2016 got off to a sluggish start, though our results did improve during the second quarter. Poland, our largest volumetric market for the brand, registered slight growth. Southern Comfort family of brands saw underlying net sales decline 7%. While weakness in the United States was the driver of underperformance, the brand has seen positive takeaway trends in markets such as Germany, the United Kingdom and South Africa. Sonoma-Cutrer, Korbel and Chambord each grew underlying net sales by low single digits in the first half of the fiscal year.

Now let me circle back to our tequila brands, which have been delivering accelerating rates of growth over the last year. During the first half of the fiscal year, el Jimador's global underlying net sales grew 8%, Herradura grew 7% and New Mix jumped 31%. New Mix's takeaway trends are showing solid growth year-to-date, and underlying sales were also helped by low trade inventory levels at the beginning of the fiscal year. These aggregate results were well balanced by geography, with 15% underlying net sales growth in the United States and 10% growth in markets outside of the United States. We believe that our tequila brands are early in their development in the United States as consumers are increasingly interested in 100% agave tequilas, particularly ones with the heritage and authenticity of our Casa Herradura family of brands.

I'd like to take a moment and look at Herradura's recent momentum in the United States, an extremely important market for the brand, and to share with you some of the drivers of these strong results. First, let's look at our outperformance, where during the last 12 months, ultra-premium tequila has grown value by roughly 14%. Herradura has been gaining share, with Nielsen takeaway growing 16% over the same period. We believe this growth has been driven by a combination of factors, including the first large-scale media campaign behind the brand since 2007, which helped drive faster velocity and established accounts as well as distribution gains. Thoughtful innovations such as the introduction of Herradura Ultra and ultra-premium priced filter añejo tequila is also helping us better address the high-energy occasions. We believe the runway is long for this brand as brand awareness among our target consumers is only 1/4 of Patrón.

El Jimador has also been growing nicely in the United States, with consumer takeaway on a value basis accelerating from 14% over the last 12 months to 19% over the most recent 3-month period. This is double the premium tequila category's rate of growth as new packaging and more effective on-premise activations are fueling off-premise trends through increasing brand awareness. We are optimistic about both of these brands' growth potential over the coming years, given the brands are early in their development in markets outside of the United States.

Let me now reconcile to reported growth for the first 6 months of our fiscal year. A strengthening U.S. dollar continues to negatively impact our reported results. These FX headwinds dragged down our reported sales by 8 points during the first half of the fiscal year. After a brief pause over this summer, the U.S. dollar resumed its appreciation against other currencies, which will continue to dampen reported earnings growth over the near term.

Our top line grew 6% on an underlying basis, fueled by almost equal contributions of volume growth and price/mix. Underlying gross profit grew in line with sales growth, up 6% as better price/mix was offset by higher costs in the first half. We expect the rate of cost increases particularly related to wood to ease in the back half and help drive modestly better gross margins for the full year.

Underlying A&P spend increased 1% while underlying SG&A grew 3%. So putting this all together, we delivered 9% underlying operating income growth in the first half of fiscal 2015. Foreign exchange headwinds hurt our reported operating income growth by 4 points, and lower inventory levels primarily related to Tennessee Fire pulled another 3 points from our reported operating income. On our other income and expense line, we enjoyed favorable comparisons against last year's losses related to the revaluation of net current assets denominated in foreign currencies. For the first half of our fiscal year, we delivered reported earnings per share of $1.72. Adverse foreign exchange was a $0.07 drag on our EPS, a couple of cents worse than we had anticipated on our first quarter call.

Let me now move to my second and final topic for this morning, an update on our outlook for fiscal 2016. Year-to-date, our top line growth of 6% and operating income growth of 9% are consistent with the results we delivered in fiscal 2015. This growth reflects the strength of our premium portfolio, focused on American whiskey and led by the Jack Daniel's family of brands. Our brands are enjoying broad-based global demand, evidenced by the balanced geographic delivery of our results through the first half of the fiscal year. Additionally, disciplined innovation has allowed us to attract and target new consumers and drinking occasions.

So while we're in the middle of the all-important OND selling season, would drive this proportionate amount of our annual sales, we are encouraged by the balanced geographic growth we have delivered so far in fiscal 2016 and are reconfirming the ranges we shared with you on our last call as we still anticipate full year underlying net sales growth of 6% to 7%. We also expect to deliver 8% to 10% growth in underlying operating income. Somewhat better gross margin expansion in the back half of the fiscal year will likely be partially offset by higher growth in our operating expenses, but we continue to expect solid leverage to the operating income line in fiscal 2016.

Moving now to FX. Assuming current spot rates, we now expect adverse foreign exchange to be approximately $0.05 worse for the full year than we had anticipated on our first quarter call. As a sensitivity, assuming our foreign currency cash flow exposures collectively move 10% in either direction, our EPS over the balance of the year would be impacted by approximately $0.07.

So in summary, the first half of fiscal 2016 keeps us on track to deliver another year of strong growth. Notwithstanding the capital investments we have been making to ensure we are able to supply our growing base of consumers with our high-quality products, our operating cash flow has been strong and growing. This cash flow and balance sheet flexibility has allowed us to return significant capital to shareholders in the form of buybacks and dividends. Over the last 5 years, we have returned $3.6 billion to our shareholders, with almost $900 million alone during the first 6 months of this fiscal year as we aim to consistently deliver top-tier returns for our shareholders over the long term.

So with that, I'm going to turn the call over to Paul for his comments.

Paul Varga

Thank you, Jane, and good morning, everyone. I'll be pretty brief here. FX headwinds aside, I'm pleased with our first half underlying results, particularly the performance of our premium American whiskey portfolio, which, of course, is led by the Jack Daniel's family but was also bolstered by strong performances from both Woodford Reserve and

Old Forester.

Also appreciated in the first half was broad and balanced geographic performance. In my view, this is the major asset for Brown-Forman and a very beneficial attribute of the company for investors. I will say that there is nothing easy about the current business environment, not that we ever expect it to be easy. At a time when the threat and reality of global terrorism is increasing, emerging market economies have softened somewhat and industry competition has intensified, particularly on the innovation front in the United States, I feel our underlying business continues to perform very well and notably very consistently.

I'll make this point related to this consistency by noting that Brown-Forman's FY '15 full year results from last year saw a 6% growth in underlying net sales and a 9% growth in underlying operating income. With today's mid-year results, we have posted a 6% growth in underlying net sales and a 9% growth in underlying operating income. Further, in confirming our full year EPS guidance this morning, we are anticipating that underlying sales and operating growth will roughly continue at these same attractive rates. And if they do, we estimate that Brown-Forman's underlying results will continue to compare quite favorably to our spirits competition.

So while we still have the last half to navigate, and this includes our important holiday season, I'm pleased with where we are at this year's midpoint. I will also note that our earliest read on November's business, which, of course, was not part of this morning's first half results, is quite positive and serves to further strengthen our confidence in our underlying growth outlook.

Before closing, I'd like to note one other item that I believe reflects Brown-Forman's ongoing progress as well as our belief in the continued growth prospects for the company, and that was our announcement to increase the annual dividend by another 8% in calendar year 2016. This marks the 32nd consecutive year that the company has increased its annual dividend, and this, I believe, stands as another testament to the consistency to which I'm referring.

Thank you. Those will conclude our prepared remarks this morning, and we're now happy to take any of your questions.

Question and Answer

Operator

— Operator Instructions — The first question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Mohsenian

First, just wanted to get an update on kind of the positive offset to keep full year EPS guidance the same despite the incremental FX hit. Is there something specific on the positive side giving you confidence there? Is it more related to having a range around earnings and maybe where you land in that range is a bit different? And then second, Paul, was just hoping for some more detail on the competitive pressures you cite in the U.S. around innovation. How big a concern is that going forward as flavored whiskeys proliferate? Obviously, you guys have been very successful with the flavored products so far. But do you worry competitive risk ramps up going forward as some of your competitors catch up to you? And it looks like a number of the Canadian whiskey brands are kind of revitalizing themselves as they move into the flavored products. So how big of a risk is that and how do you manage through that?

Paul Varga

Okay. Thank you. Jane, you want to take the first one, I'll tackle the ***— indiscernible —***

Jane Morreau

Let me take this – yes, I'll take the first. So your question was really around what our full year outlook, and really the biggest change that's happened from what we gave you back in June and what we've reconfirmed in August and what we're saying today is FX. And so excluding FX, I think we're – as we confirmed today, we're on track for this top line 6% to 7% growth and the bottom line 9% to 10% – 8% to 10% growth. So the only change has been FX, and FX is – still fall within the range that we gave you.

Paul Varga

Yes. And to Dara's question related to competition. Let me just – this is something we started to emphasize a bit more at the conclusion of our first quarter when we were discussing results. So let me just maybe build on that a little more. I think this reference to competition. I mean, look, companies always have competition. So it's not like that's new. I think the thing that I would emphasize, and I might break it down particularly as I think your question related to the United States, which is one of the most competitive markets just because of the structure of the system and the ability to innovate within it, which is both, of course, a blessing and a curse, depending upon which end you're on. So when I think about what's been happening in the last sort of 6 months or so in the United States, going back a few years, many of the really global competitors had more – what I'd say more balanced geographic earnings profiles than some of them have enjoyed here more recently. And if you think back 4, 5 years ago, a lot of people were dependent on the emerging markets for growth whereas their developed international markets may not have been growing as robustly. And in the U.S. they could expect maybe industry competitive levels of growth, but the emerging markets were really helping drive them. And obviously, what we've seen from a number of our competition is that's just more difficult these days. So I think a lot of them are turning to a very attractive U.S. market where innovation is possible. It's a very premium market so the ability to influence your margins, and the growth of your company is probably a little more rapid in the United States just because of the structure and profile of the market. And so these are good competitors, and they want to grow. And so as we sort of forecasted back in the first quarter, we expected levels of increased competition just generally to go up. So I think that is an influence on one level. So you got highly motivated competitors who want to grow at rates kind of like Brown-Forman's, right? I think the other thing is just the existence of this flavored whiskey phenomenon that's going on. And so what we've seen is a lot of different strategies people are deploying for trying to be successful in that particular segment. And for us, for example, I'll just heighten the Jack Daniel's Tennessee Honey competition. And I think this will kind of help on Dara's question. Just in the last year what we've seen, whereas the category was really developed along the lines of primarily cinnamon and honey with just a little bit of cherry-flavored whiskey out there. What you see just 12 months later is the development of both an apple-flavored segment, which increases competition but also for Jack Daniel's Tennessee Honey has been more, what I'll call, popular price competition whereas we held sort of the premium position within the Honey segment, now there are new competitors in there that are at lower prices. So I think we've started to see that within particularly cinnamon apple and honey stratification between popular and premium price leadership. And so when we refer to intensifying competition, it's really along those lines. The things we'll continue to do, we talked about this in the first quarter, I think it continues to be our posture is that our great advantage in playing in flavored whiskey, I feel, today, is to be focused on fewer flavors but broader geography and less on lots of flavors and narrow geography. And so of course, a lot of the data that you observe and are interested in, which we are as well because it's become an important piece of the distilled spirits market in the United States, is this U.S. flavored whiskey segment. But I really continue to believe, and it's been our experience on Tennessee Honey that a lot of gold is there to be mined outside the United States. So it doesn't mean we don't have to compete in the United States, and we'll sharpen our sales and marketing efforts there. But I still continue to believe that while there's great runway ahead for the 2 flavors that we've got on the Jack Daniel's franchise and those opportunities exist both in the United States and overseas, we have really continued to have some advantage because of the strength of the Jack Daniel's trademark and our route to consumer around the world in developing beyond just 1 country. So that's the current way we're sort of thinking through this. I don't expect us to do this introduction of multiple flavors at one time or sometimes what people are referring to as sort of the flavor of the month thing. I just really think these – we want to build these as Jack Daniel's brand extension.

Operator

And the next question comes from the line of Bill Marshall with Barclays.

William Marshall

I'm just kind of building – not to belabor the point but just building off of that. On the flavor commentary, we do have examples in other categories, vodka, maybe even craft beer, where the consumer does kind of jump from one flavor to the next, looking for the next thing consistently. And I'm interested in your commentary around focusing on fewer flavors. What is the risk that the consumer just moves away from the flavors that you've emphasized? And is there anything different about the whiskey category that's unlike vodka or beer, or these other categories which have been a little bit more fickle as we look forward in the sustainability of this growth? And then secondly, digging into that even further, how do you view the flavor phenomenon impacting the core Jack Daniel's style? And are you – do you feel you're cannibalizing the core brand? And will consumers come back into that brand if they do move away for some of the flavor expressions?

Paul Varga

All right. Good question. Yes, I mean, I think the data would show that people are showing an interest in flavored variety. I think the key to not being susceptible to dramatic declines in your volume, it goes to, one, the strength of the trademark; two, the quality of the product offering itself and continuing to offer a product that really holds up in the glass, I think, is really critical to this because not all of them will; and then just the way that you sell and market the brand. You just don't want it to be actually feel like sometimes, and it's often a reaction to short-term conditions, studying something maybe perhaps that happened last month or in the last 12 weeks or 6 months. The reality is to really treat these things as brand expressions and continue – I mean, for us, the size of Jack Daniel's Tennessee Honey today, I mean, it is a pretty significant brand on a global scale. I think we've mentioned this from time to time. I mean, there's fewer than 20 brands that we know of that are at its price point and above 1 million cases globally. So we don't treat it as sort of, like what I'd call flavored extension from which we've now got to go replicate it over and over again. I think that can be a self-fulfilling prophecy. On the balancing act of cannibalization versus what I'll call the gateway of introducing someone through say, Tennessee Honey or Jack Daniel's Tennessee Fire to the whiskey category where they might not have been a participant in the past. And we are seeing, I think, really nice evidence of, particularly now with the passage of time, because they've got more data on Honey, it's newer still on Tennessee Fire. But it actually exposes people to the Jack Daniel's brand in such a positive way. And it's a way for them to sort of build their palate toward the appreciation of what I'll call straight whiskey. And so I feel like yes, you can accept modest levels of early cannibalization to the extent it exists. I mean, we've been very comfortable thus far with both of the expressions at the level of cannibalization. You expect a little bit, and frankly, we feel like on Tennessee Fire, just because of the shot nature of that occasion, that it has potential to do a little bit more cannibalization than Jack Daniel's Tennessee Honey did, although both are what I consider to be modest and acceptable levels and more than offset by the potential gateway and marketing value they create. So as people – the way I like to think about it is as people switch flavors, as you say, one of the things that we expect is that they switch flavors from, say, Jack Daniel's Tennessee Fire to Jack Daniel's Black Label. So and I just don't anticipate us getting caught up in a very exhaustive flavor-by-flavor exercise. And so from time to time, compared to other people who are building distribution or getting trial with any number of flavors, we're just going to have to deal with it. And so the way we would be successful is to focus on the flavors we have and try to get them to be as successful in the marketplace that they can, and I continue to think a huge piece of that for us is a global marketplace versus just the U.S. marketplace.

William Marshall

Perfect. And if I could just ask one quick follow-up. It looks like your price/mix accelerated pretty nicely in the second quarter. I assume that's predominantly, if not wholly, on the mix side. I'm curious what the puts and takes were there. If it was an acceleration in some of our premium product selling through or a slowdown and maybe some of the more value products. And how we should think about this for the back half of the year on the price/mix side.

Jane Morreau

Sure, I'll take that. So just talk about the split on the price/mix. It was more mix, as you said, than price. I think it's 1/3, 2/3, if you will, or in that range. And it was driven, as we looked through it, it was driven by definitely higher growth from our premium portfolio of brands, so our Woodford Reserves, our Jack Daniel's family of brands definitely contributed. To a lesser extent, we did have some of our lower-margin products not do as well, Finlandia and Canadian Mist, those that, to a large extent, it was due to the premiumization of our products. As we look forward in terms of the rest of the year, as we were consistent and throughout the year, we're not really expecting much from pricing the whole year, very modest pricing. And so anything that we get will be more mix-related. I think at the beginning of the year, we said it was going to be in a couple of percentage points is the message that we've had. So I would assume that it will stay in the 2% to 3% range for price/mix in totality.

Operator

Our next question comes from Bill Schmitz with Deutsche Bank.

William Schmitz

Just a modeling question to start and then a real question. So do you wish your repurchase target for the year exhibits much higher than we thought or at least modeled for the quarter? And then also CapEx is a lower than we thought given all the initiatives you guys are doing. And then lastly, your comfort level on the leverage ratio, kind of where you think you could sort of take it and still be within your comfort zone. And then any sort of commentary on divestitures or acquisitions because there's obviously been some stuff in the press about some of the brands you may or may not be parting ways with.

Jane Morreau

Okay. Well, you asked a lot of questions. I'm not sure if I — ***indiscernible*** — but I'm going to do the – what was your specific question, would you mind saying on the share repo again? It was…

William Schmitz

Do you have a share repo target for the year? Because it came in much higher in the quarter than we thought, yes.

Jane Morreau

Yes, we don't target a share repo for you all. I remind you that we have a $1.25 billion authorized share repurchase that was effective last March 24, I believe, and we've repurchased about $1 billion against that, so we got $250 million, $250 million or so left on that initial approval, if you will. But the way we approach share repurchases are opportunistically, so we're looking at those in investment. And so as when you saw us buy a significant amount in our second quarter where we felt like the market wasn't real understanding in realizing some of the underlying growth that we see in our business and how we see it going forward and it was being masked somewhat by foreign exchange. So but we don't have a target for that for the year, if you will. So it's more of an opportunistic as several factors go into play when we do it, both the price of the stock, what we – our own needs of our business are, so funding to our own business, whole host of things that go into that. So but we do have about $250 million left on it. In terms of the CapEx, you did see it. It's lagging where we thought it was going to be for the year. We expected it to be about $200 million for the year. I think some of it is going to get shifted to next year. So right now, we're expecting somewhere in the $150 million, $160 million range for the year. So it's timing only. So we'll be pushed in to next year. And when we get done with all of our capital expenditures, the major ones behind expanding our distillery, adding the cooperage through mills, adding bottling, we'll have spent well in excess of $300 million on those expenditures. And then you asked a question about…

William Schmitz

The leverage ratio.

Paul Varga

Coverage ratio, which we don't – we're very comfortable at the levels that we're at right now. I mean, as you all would know from following us, we have a pretty conservative posture about that. Historically, some of it's just what opportunities come along, it's not that we're not willing. I will say that in addition to what Jane said there that the attractive borrowing rates, paired with the long-term prospects we feel for the company, combine to motivate us a little bit on the share repurchase activity. Right now, the ability to – if you just think about it for a very, very long-term investment to buy back shares today and to have a view of the company in the way that we do as managers and then just be able to support it with very low price debt today by historical terms is a wonderful combination of factors. And I'll just – to boot, I mean, you're always looking at what your alternative investments might be. And as we scour the world and think about the things we can invest in, investing our own business is right near the top. So and that occurs both through the CapEx that Jane mentioned but also through the share repurchase program. And then, you had also mentioned about rumors in the marketplace. And as we – is our typical posture, we have just been really well served by not commenting on rumors that are out there related to things that we might either be – somebody's prospecting that we might be selling our bang. And we just really appreciate the fact that over the years, the no comment on that has served us well. So we'll continue to hold by that today.

William Schmitz

Yes, I totally respect that. And then just on the more business side of things, I mean, how do you balance market share versus profitability? Because if I look at the U.S. data and admittedly, the data set is pretty limited for us because we really only have the Nielsen data to go on. But it looks like the incumbent brands are losing quite a bit of market share at least year-over-year on the whiskey and bourbon side. And you have pretty substantial share growth from Bulleit and then that all other category, which probably some of your brands are there as well. But it seems like that's accelerating a little bit and I know the margin mix obviously is improving quite a bit with Woodford and some of the other variants. So how do you guys kind of manage that? And how important is that market share data? And then again, I know it's a short period of time so maybe it's just not a broad enough data set.

Paul Varga

It's important to study, I think, over time to make – I think mostly to make sure that the opportunities you see for your company you're not letting others have. Although I will say it's been my experience in this business to be more growth-oriented and not size- or share-oriented. We be typically don't set scale-based or size-based ambitions relative to competitors for our company. And I – because I think that can lead to oftentimes the wrong sets of behaviors. And I mean it's not that it's not useful, we're as competitive as the next person so we like to look at share data. But I think the criticality of growth and enduring growth is what we've continued to focus on. And so I mean, I really don't feel like we lose sleep like, for example, I mean, it's been – it will be a fact with the size of the Jack Daniel's Black Label business in the United States, it will have a very difficult time growing at the growth rate that Woodford Reserve is. I mean, it's just – it's at an earlier stage of development. So what we tend to do when we look at share data is we look at it with and without Jack Daniel's. We look at it in ways that can inform us and illuminate where there might be growth opportunities for us. And I actually – I mean, but we are competitive. I will tell you that we want, like for example, at the price point above Jack Daniel's in the U.S. American whiskey market, we want to be a leader. We want to have our fair share of it. That doesn't mean we would do anything at any cost to be the #1 volumetric player at the ultra-premium level. But I will tell you that we really feel like that's an area that we know well. We have the assets, the production assets, and the know-how to be part of that. So and the same thing is true of flavored whiskey. It'd be rare for you to hear us say something like we need to be #1 in flavored whiskey in the United States. That's – just not compelled by that, and I don't think our company is. We don't like to see other people get consumption that we don't have. But when you have, as our company does today in our largest markets, something like a 6% or 5% market share, and when you have on across the globe less than 1% of the market share, you're going to be really frustrated for a long time if you measure yourself on that basis. So we think we can be an enormously successful company building value for shareholders without having to dominate any particular category or segment.

Operator

And the next question comes from Judy Hong with Goldman Sachs.

Judy Hong

Jane, so on your full year underlying sales guidance, I know you're continuing to stick to the 6% to 7%. You did 6% year-to-date, I guess, last year, you also did 6%. And if I kind of look at the fourth quarter comps being pretty tough and U.S. comps are probably going to be tougher in the next quarter or so. So I'm just wondering, I know it's 100 basis points to get to the high end of it, but are there anything in the back half that you expect some acceleration, whether it's markets or brands that gives you some confidence that actually we could see some acceleration in the back half?

Jane Morreau

Yes. So great questions, and again we're looking at our full-year forecasts and we do see, as Paul already alluded to, getting off to a good start in November. So we are seeing an acceleration from that perspective, and so we're expecting – we had a pretty soft third quarter last year. And so we are expecting soft comps against that or easier comps against that quarter and expect that to be a good quarter for us. You did point out that we did have a nice quarter in the fourth quarter last year with the rollout – the national rollout of Tennessee Fire in the U.S. But we also have some markets in overseas that we've been testing, not that we're rolling them out further, but we've got further tests to do in some of those markets, so there will be some offset there too, so it won't be a one-for-one kind of thing if you're thinking about it's going out and we've got to cover it all. So but our full-year forecast anticipates all this, Judy. And we think the 6% to 7% range is acceptable and reachable, given the environment we're in currently.

Judy Hong

Just following up on the November trend. So I know you guys had a pretty weak trend in Poland in the third quarter last year. So is the acceleration driven by Poland or are you seeing broad-based acceleration in November?

Jane Morreau

It's pretty broad based right now.

Paul Varga

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It – yes, it's early now but it looks broad-based. Poland's a top 10 market for us but it's rare that it would drive the entirety of Brown-Forman. So oftentimes, the numbers – I mean, you can get that from sometimes the United States because of the size of it within Brown-Forman. And periodically, you'll get the U.K.'s or the France's and Germany's particularly when they combine. But right now, and again, it's early. We still got a lot to see but we're encouraged by what we've seen broad-based out of November.

Jane Morreau

I would just like to add one more thing to that and I alluded to it during my talk – my script, Travel Retail. And it's still tough sledding there, if you will, but we do know that the U.S. Travel Retail business had some timing issues, and we kept waiting for them to come in, and we started to see them come through in November. And so we would – are expecting the rate of decline in Travel Retail not to be what it is for the full year. Thus, we are expecting acceleration there from what we've had year-to-date, so that'll add to some of the growth. That's why we've been pointing out and pulling out Travel Retail, both in the first quarter and the second quarter to show what it actually has done to our growth rate and it's been fairly significant in both the year-to-date as well as our first and second quarter.

Paul Varga

The other thing I'll mention is I think the Travel Retail piece, I mean, we still have some determinations to make inside the company as it relates to geographic expansion on Jack Daniel's Tennessee Fire, so we'll be getting to those here in the next probably few weeks or so. But the other thing is as the calendar year turns, once we enter into 2016, it marks actually the year where the Jack Daniel's distillery will begin to celebrate its 150th anniversary. So you can imagine that a company like Brown-Forman, it's a great milestone. And I don't know how much impact that would have on this fiscal year, but it's something that we expect to be something that's really nice mobilizing event for the calendar year 2016 period. And you can – I mean, you can imagine us having a lot of fun with that but also consumers getting to have a lot of fun with it as well. So we'll be talking probably a little more specifically about that with passage of time, maybe a little bit more at the end of Q3. But that's another point I'd note.

Judy Hong

Got it, okay. And then Paul, I know obviously, you said you don't want to comment on any of the market speculation about M&A. But if I just kind of look at your portfolio, and it sounds like you're definitely stepping up your focus on the premium tequila with the Herradura brand, and that makes perfect sense. But as you think about your broader portfolio and thinking about some of the declining brands and sort of the lower margin businesses, what are kind of the puts and takes of – from a strategic standpoint, of keeping those brands so that you have scale versus perhaps maybe pruning some of the portfolio so you can focus your portfolio to really be more of a whiskey premium tequila brand portfolio even if there is some potential dilution in earnings?

Paul Varga

Yes, I mean, our – I think our portfolio management generally across time, I mean, I think you could just observe it. I think it's stood the test of time. I mean, we've increasingly become more premium and more whiskey would be the observations if you go all the way back to the consumer durables days and wine. But I think it would be evident that when we even chose to exit wines, we chose to stay in Sonoma-Cutrer. So we find that our – I mean, it's just that we have found the benefit of focusing on fewer trademarks that are excellent businesses that have great growth profiles. And the story of Brown-Forman today is that – a lot of companies will have brands that are smaller in terms of their contribution in the modern day than they might have been 5 or 10 years ago, and we always talk about it – if the company's Old Forester that here it's enjoying remarkable success both on and off-premise. But it's a little brand still in the scale of Brown-Forman and probably endured about a 50-year decline. And so I guess you could call that patience. We waited for it to get small enough that it could be termed craft and retro and all these other things that it's enjoying this renaissance that it is today. So there's an example of staying with brands. And I really do feel when you take Brown-Forman's portfolio overall and compare it to many of our competitors out there, I mean, we just have one of, if not the most focused portfolios in the spirits industry and I do think we benefit from that. So but as, again, going back I think it was in your preface, we just don't comment on things that either are incoming or potentially outgoing. It's just not – just doesn't serve us well, and so we let the rumors be the rumors and we keep focused on our business. I know some of you all – I mean, people have speculated, I will say I'm really encouraged by, there's some recent marketing on the Southern Comfort brand that is literally, I mean, occurring in the last week or so where some viral advertising, I'll call it, associated with Danny McBride has gone out there, and Spotify is noting it as one of the top 10 sort of viral efforts in the United States. It's actually gone global as well. So there's – I think that's evidence that the brand continues to get support and we continue to try to put our best foot forward in a really competitive environment.

Operator

The next question comes from the line of Eric Serotta with Evercore.

Eric Serotta

Not to belabor the competition point too much, but wanted to approach it from a different angle. Paul, last quarter, you made the distinction between increased competition for shelf space at retail and back bar space on premise as opposed to competition, price competition, either at retail or on-premise, saying you had clearly seen a pickup in the former, but the latter was kind of in line with historical trends. Wondering whether you could update us on that particularly, price competition in the off-premise? We've seen some hot price points from particular markets. And then related to that, in response to Dara's question, you mentioned some popularly priced flavored whiskeys. I'm just wondering whether you're seeing more or less or the same discounting of sort of the premium core brands from your competitors. So 2 related questions.

Paul Varga

Yes. I think – I mean, I think it's fair for us to comment on it. Certainly, there's 2 forms that we're seeing, just to go back and be clear. There are 2 forms of the competitive effort. One is level of entries into the marketplace. There was something in the internal report we were looking at here just this week where, and this is a pretty interesting statistic, in the United States, in the U.S. alone, whiskey market above the $20 price point, so $20 price point above, over the last 4 years, more than 500 new entrants. So there's that – that would be, now where are you going to put all those? I mean, there's shelf space, back bar. And of course, I mean, that those are, in many instances, highly regional. So you're not – those aren't going to be full-blown national brands immediately unless they're large trademark line extensions, which have the capacity to do that. But in addition to that, I mean, I don't know, I almost feel like every year for the last 10, around October, November, December, we start to observe increased price competition. And I mean, it differs from brand to brand or company to company, it feels like every year, but I don't know that this year is any more competitive than 2014 was or 2013. I always feel like both anecdotally and when you study the data after the fact, some brands chose to go deep on their 175 or to put RRCs [ph] or coupons out there. I mean, just it all depends on the motivation of those particular competitors. So we have seen some spread difference in the U.S. market between say, Jack Daniel's and Jim Beam. We've seen – and that would be an example for this year. But in prior years, we've seen other brands go deep on discounting. And all of it is just a reminder of the balancing act. I actually think one of the things that will be interesting to see over the – this is not a comment about 2015, but as I look out at 2016, ’17 and ’18, some of this will be dependent upon the stocks available. If these rates of growth for the category continue and these entrants continue to go in and – we never a have quite good enough feel for how much supply is actually out there. And so if demand outstrips supply out there, I think you’ll start to see pricing go up, not down, with sort of rational competitors. So we don’t have any indication of that now, but I mean, this growth rates have been running pretty solid for a while now in the industry. And I think that can be an influence to the pricing and the pricing competitiveness out there.

Eric Serotta

Great. And just as a follow-up, Jane. Wondering whether you can give us any more color or an update in terms of the COGS inflation. I think last quarter, you were talking about 2% to 3% per – for the year. I believe last quarter, you talked about some moderation in wood that would happen in the second quarter. It now looks like that’s more pushed to the second half. Just wondering whether I’m remembering that correctly or if you could give us an update there as to what happened.

Jane Morreau

Yes, sure. So I still think we still would expect COGS somewhere in the 3% range for the year. But in terms of what I’ve said – I don’t know if I referred to the second quarter or not but let’s just focus on the wood as we go forward. We are expecting a moderation in the rate of increase to occur over the back half of the year. That’s one of the big drivers of the increase of the COGS growing a little bit faster than it has historically for us. And the reason why it’s going to moderate is because last year at this time, the cost of logs, the cost of saves, the cost of headings, if you will, all components that go into making a barrel took a pretty significant increase. And it’s continued to increase, but the rate of increase over the balance of year is expected to moderate.

Paul Varga

Yes. So going a little bit back to that earlier question, any price/mix benefit that we would have been seeing through the year is being offset somewhat by some of those higher wood costs. As we start to cycle them, we'll get more benefit from our price/mix in that second half because we're cycling a higher base. So that is a positive for the company in that second half.

Operator

Our next question comes from Nik Modi of RBC Capital.

Nik Modi

Paul, I was wondering if you can help confirm something we recently picked up in the trade regarding Bacardi putting its distribution out to RFP, breaking the alliance with Remy and Brown-Forman, and if that is true, what would be the implications if the distribution alliance actually broke up? Would that benefit you or would that hurt you? Any thoughts on that would be helpful.

Paul Varga

Well, it'd be premature to even assess that. I mean, we are aware that there are some RFPs out there if Bacardi has initiated, but as far as we know, we're continuing to partner with them in the same ways that we have historically in the United States. And just remember, there's part of that partnership we do altogether and the respective companies go and do their individual brand building work and then within each company, people building their own individual brands. So I mean, I think no matter what happens, and I always feel this way about the U.S. environment, whether it's wholesale consolidation, supplier consolidation, people changing distributor alignments, et cetera. I really have a high level of confidence in Brown-Forman's ability to navigate the U.S. system. I really do. We do that. We really don't have a one single way of doing it in the United States. There's some literally 50 different ways you can go-to-market in the United States. And so I just like the flexibility, along with the stability that comes from Brown-Forman's historical approach to the U.S. distribution system. And so we really do – have always – there's still a lot of markets where we go to the marketplace with Bacardi, not only in the United States but outside of the United States us well. So where that's appropriate, we'll continue to do it.

Operator

Our next question is from Tim Ramey with Pivotal Research Group.

Timothy Ramey

Just to recapitulate something you said a few minutes ago, but I think it bears kind thinking a little bit more about. Consumer behavior in alcoholic beverages has always shown a tendency to more complex flavors and more crafted favors, if you will, light beer drinkers go to beer drinkers, become craft beer drinkers and so on. And so I mean, I think it really is the right way to think about it to think that the best thing about Tennessee Fire is Jack Daniel's Black Label. The best thing about Jack Daniel's Black Label is Woodford Reserve or Gentleman Jack. Am I thinking about that right over a kind of 10-year outlook?

Paul Varga

I mean, yes, I think that's one aspect of it, Tim. I think there's a phenomenon that's really interesting in the, call it spirits category relative to – we often get compared to beer or wine. So one observation along the lines of what you're thinking is just first to ground you. Remember that the core offering of distilled spirits more often than not, it's consumed in its final format in a varied or flavored or mixed way. So it's even more natural in my view for flavored spirits to exist In some forms, it's providing convenience. In other forms, it's providing a little more prepared form of what they ultimately enjoy anyway. So and that's not true. I mean, beer is not an ingredient in a broader base beverage, for example. So I think that’s one thing to think about, which I think bodes well for the longer run. The 2 factors that I think will make flavored whiskey have a longer life versus shorter are that it’s inherently the way the core whiskey category gets consumed anyway. And two is that they are aged products that have a moderating and regulating mechanism to the boom bust phenomenon that can happen. I think those are 2 contributing factors that, they don’t guarantee that some brands won’t go away or there won’t be some bubble or something like that. But for our business, it’s why we believe that they can be very strong enduring brands. Then the other piece is what you’re talking about, which is the – and I’m just going to give you an anecdotal one because I saw it over the last – saw these last night. I mean, I’ll give you an example, my wife, who literally does not drink whiskey and never has. And with the introduction of Tennessee Honey and Jack Daniel’s Tennessee Fire, I mean, literally, I mean, she said, "Well, that really tastes good, for example, on the rocks." And literally over the Thanksgiving holiday, she was stealing my Gentleman Jack on the rocks. I mean, so here is an example of somebody who’s developed a palate over a period of time, so that – somebody who never would have been interested in the category. And I think is an example of what you’re referring to. Now whether or not she’ll trade up to Woodford Reserve or Double Oaked, I don’t know. But in any event, I think there’s real foundation to the premise that you suggested there.

Timothy Ramey

Yes. At the end of the day, the ultra-premium is kind of where everybody is going. They might get stuck along the way, but they might end up going there.

Paul Varga

Tim, the other thing, it’s a really affordable luxury. I mean, you can get, on a liter of, say, Woodford Reserve, you’re getting – there’s 20 standard drinks in a liter of Woodford Reserve. And for the money compared to where you might put your entertainment dollar, particularly if you’re entertaining people at home, it’s a real value.

Timothy Ramey

Just a quick question on barrel making. I mean, you do all that in-house, I believe. And so other than just the raw material costs, as you expand barrel-making activity, should we think about that sort of diluting COGS from higher depreciation and so on? Or should we think about that as a benefit to COGS from greater efficiencies? How would we think about that?

Jane Morreau

Yes, I mean, we're definitely building our new – all of our new facilities with a couple things in mind. One, to make them as efficient and effective as possible; and two, make them scalable, so we're not necessarily building it to be double what we need today, we're building it and scaling it as we go. So I think the answer is sort of in the middle, there will definitely be some incremental depreciation as time goes on from some of the investments we're making, but we're also being very thoughtful in terms of how much we're investing now to minimize overproducing – over constructing and over making something that we don't need at this point.

Paul Varga

Yes, a couple things I think in addition to what Jane's saying there is, just remember from a traditional economies of scale thing. I mean, barrel making, you don't run this down the line in the way that you get that ramped up with — ***indiscernible*** — I mean, these are made by people, human beings. I mean, so that's one of the tricks of the barrel making operation. The – I mean, we do get some benefit I think on a little bit, probably on freight because we're down closer. The new cooperage is a little closer to Jack, which is the primary customer. I mean, a lot of it would depend too on how you account for which, the used barrel sales a little bit. And do you count that as efficiency or do you count that as a sale. And of course, we've been benefiting from the used barrel sales these last couple of years because the market's been so buoyant. So a lot of it depends on how you account for that aspect of it. I will say the other piece that relates to that is it really was in part a, I'll call it a risk mitigation move by the company to ensure we had 2 cooperages spaced in different locations, et cetera. So Tim, as we we've learned that long ago with warehouses and other aspects of the businesses, but it was really was – bought some insurance for us as well because our business is so attractive, we would not want to be – have any limitations as it relates to getting wood.

Timothy Ramey

Yes, I would just say anecdotally in wine, used barrel prices are up 100% because there's so much demand from craft distillers and craft beer makers who want to put the beer in oak, so.

Paul Varga

You bet.

Jane Morreau

That's one of the reasons why the cost just of our own wood that we were procuring went up because some of the wood was going to the beer and – the craft beer.

Paul Varga

A lot of competition for people.

Jane Morreau

A lot of competition, yes.

Paul Varga

They want to use coopers.

Operator

And the final question comes from line of Bill Chappell with SunTrust.

William Chappell

Just a couple things just on the cost front I just wanted to clarify. You had said wood prices would get better in the back half. I mean, is that a sort of a longer-term trend as we move into kind of '17? Or is that just very small changes on year-over-year?

Jane Morreau

Bill, that's actually what I was referring to is a year-over-year comparison. So the rate of change that we have experienced in the first half of the year versus – is abating over the rest of the year. It's not that the costs themselves are coming down at this point because of supply-demand, the demand for it is still outstripping the supply.

Paul Varga

They're just comping the higher pace. They're just – in the second half. They started to go up in the second half of last year, so they won't – you won't have that negative impact as you did in the first half.

William Chappell

Okay. And then I kind of missed the commentary. You had said also SG&A would kind of accelerate faster in the back half. Is there something behind that in terms of like marketing advertising? Or is that just kind of the normal flow?

Jane Morreau

I was referring to operating expenses. So if you look at our first – operating expenses in the first half of the year, they were up modestly and lot of it's due to easy comps, if you will, versus last year. We had pretty high spending in the first half of last year. So we're flipping it in the second half so you have tougher comps, if you will. So that's all.

William Chappell

Okay. And then last one just in all the competition, all the talk about price competition.

Does this impact your kind of use of the goal of trying to raise price a couple percentage points every year as we look to kind of the June price increase?

Paul Varga

Well, I don't know that we've ever had that programmatic an approach to it. I mean, I think we do like to try to advance prices, but we kind of do it – I can recall now, we did some June and July pricing 3 years ago, yes, I think, yes, where we thought that was the right timing to do it. And not all markets did it then but a large number of them did. Sometimes, they're associated with input costs, other times they're associated more with price positioning, just the desire to continue to price the brands at the premium level around the world. So I mean, we'll probably be taking, here in the next, I don't know, 90 days, start to look at where our expectations would be for FY '17 as it relates to pricing, but we haven't – don't have any early thoughts on that. We will continue to get – I mean, as you sell – I'll just use the example, as you sell more Woodford Reserve and sort of less Canadian Mist, you'll continue to get mix though. That'll continue to roll.

William Chappell

Sure. But in terms of what you're saying, the current price competition in the U.S. doesn't alter your plans at this point?

Paul Varga

I mean, you've got to look at it. I mean, the reality is, is that a lot of the competition I'm talking about is above the Jack Daniel's price point. So as it relates to Jack Daniel's, I mean, we're as motivated to make sure we're not seen as too lower-priced related to a lot of these new entrants because pricing in addition to being an economic tool is also a marketing tool in this business. So I just feel like we'll be weighing that as well as we do what the price spread is between us and say Jim Beam. I mean, we'll be looking at both factors.

Jason Koval

Thank you, Paul and Jane, and thanks to all of you for joining us today for our second quarter earnings call. And please feel free to reach out to us if you have any additional question. Thanks, and have a great week.

Paul Varga

Thank you all.

Jane Morreau

Thanks.

Operator

Thank you. This will conclude today's conference call. You may now disconnect your line.