Brown-Forman Corporation, Q3 2014, Earnings Call 2014-03-05

Presentation

Operator

Good morning. My name is Holly, and I'll be your conference operator today. At this time, we'd like to welcome everyone to the Brown-Forman Corporation Third Quarter Fiscal 2014 Earnings Conference Call. — ***Operator Instructions*** — I'd now like to turn today's conference over to Mr. Jay Koval. Please go ahead, sir.

Jason Koval

Thank you, Holly, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's Third Quarter 2014 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 third quarter of fiscal 2014. 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 operations 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 third quarter earnings call. I plan on covering 3 topics today, which should leave us with plenty of time for Q&A after Paul's brief comments: first, I'll review our year-to-date results; second, I'll share some thoughts on what we believe is driving our top-tier performance; and third, I'll discuss our revised outlook for fiscal 2014.

So let me start with a review of our year-to-date results. We are pleased to report that our underlying net sales grew 8% in the third quarter, slightly above the 7% underlying growth rate registered over the first 9 months of the year. We are encouraged by our ability to deliver strong outperformance in the important O&D period against a backdrop of softer results from many of our competitors.

Let us look at some of our year-to-date growth by geography. Underlying net sales in emerging markets accelerated in the third quarter, lifting our year-to-date growth in these markets from 7% through the second quarter to almost 12% through the third quarter. The majority of our emerging markets enjoyed strong gains, including double-digit growth in China, Brazil, Russia, Thailand, Turkey, India and the former CIS countries. Our results in China have improved significantly through the first 9 months of this fiscal year, driven by our intense focus on diving profitable growth through higher pricing and lower discounting. It is worth mentioning that while our business today in China is relatively small, it has accelerated despite the recent government clampdown on extravagant gift-giving. We believe this is attributable to our portfolio skew to premium rather than luxury price points. Poland also posted double-digit net sales growth year-to-date, reflecting significant volumes at the retail level prior to the January 1 excise tax and price increase. We expect some giveback of Poland's Q3 outperformance in our Q4.

Mexico's underlying net sales declined mid single digits in the first 9 months of the fiscal 2014 due to a few factors, including the giveback after significant trade buy-ins late in fiscal 2013, soft economic conditions and a competitive environment for mainstream tequila and RTDs. The softer results in tequila were somewhat offset by continued demand for the Jack Daniel's family of brands.

In Brown-Forman's non-U.S. developed markets, we delivered 7% year-to-date net sales growth. In Western Europe, underlying net sales increased approximately 10% with strong results in the U.K., Germany and France. On January 1 of this year, we transitioned to our own distribution model in France. We believe that we will be able to translate this investment into long-term growth for our portfolio, our brands, not to mention leverage the cost associated with an owned distribution model as we have done in many markets, such as Germany and Turkey. As expected, the negative impact from this transition and the complete reduction in trade inventory with our previous distributor was $0.06 per share, most of which hit the third quarter.

We continue to be pleased with our performance in Japan since making our distribution change through Asahi a year ago, as net sales grew double digits. We do, however, anticipate a slower rate of growth in Japan in Q4, as well as the balance of calendar 2014, as we lap the 2013 transition to Asahi. Australia's underlying net sales grew low single digits as the continued combination of a fragile economy and what we believe to be excessive excise tax increases have hampered the country's growth.

In the United States, year-to-date underlying net sales grew 4%. As has well been documented, brown spirits are outperforming an increasingly competitive vodka category in both volume and value terms, and price mix has become a significant driver of our sales growth. Off-premise trends remain healthy, although on-premise trends appear to have weakened significantly over the last 12 months to the lowest level in almost 5 years. We believe this decline in the on-premise is driven by a number of factors, including a reduction in traffic count, particularly in casual dining; an overall slowdown in consumer spending as consumer confidence has weakened; and persistently high unemployment among the LDA to age 34 group, to name a few. In that last group, instead of drinking in the on-premise, they are drinking in the off-premise as they balance price and value. And of course, one of the worst winters on record has further dampened on-premise sales over the past couple of months. So while our overall on-premise performance in the U.S. is also down, Jack Daniel's Tennessee Whiskey is outperforming the top 10 value share brands in that channel.

With that, let me now move to a discussion of our brands, beginning with the Jack Daniel's trademark. The Jack Daniel's family registered robust underlying net sales growth, up 10% year-to-date. Growth outside of the United States was strong, driven by global demand for authentic, high-quality, American whiskey brands with clear and distinct consumer positioning. We believe that our low market share outside the United States remains a source of tremendous long-term opportunity as we further grow and develop this brand family. The Jack Daniel's trademark grew well in the United States year-to-date, driven by disciplined innovations such as Tennessee Honey. Tennessee Honey grew net sales over 20% despite increasingly challenging comparisons as we approach the brand's fourth year in the U.S. marketplace. Tennessee Honey is now 1 of just 19 special brands to sell over

1 million cases globally at a price point greater than $25, joining none other than Jack Daniel's Tennessee Whiskey, which holds the #1 position on that rarefied air list of brands. Collectively, Jack Daniel's Single Barrel and Gentleman Jack grew net sales 12% year-to-date. Jack Daniel's RTDs and RTPs also grew well, up 7% globally with solid contribution from Winter Jack, a seasonal ready-to-pour product that was rolled out into a number of new markets this holiday season, including 30 states in the U.S.

Woodford Reserve's family of brands, which includes Double Oaked, advanced net sales 27% year-to-date. There appears to be continued strong interest in super- and ultra-premium whiskey brands in both the on- and off-premise, and we believe Woodford is well positioned for long-term global growth as one of the pioneers in craft distilling. We aspire to develop Woodford into a million-case brand, given the already sizable business we have today and its current growth trend.

Old Forester grew net sales 13% year-to-date, terrific results from a brand that has been in decline for many years. There is enormous consumer interest in bourbon brands with heritage and authenticity, and Old Forester has both. So we are very excited to see consumers gravitate back towards the first bottled in bond bourbon.

In vodka, Finlandia's family of brands grew underlying net sales by 9% year-to-date, driven by Russia and Poland. A move to more premium products is helping drive strong results in Russia. However, we believe the vodka category in Poland remains challenging, and we would expect full year rates of growth to moderate given the previously mentioned buy-in, in that market.

In tequila, Herradura and El Jimador both grew underlying net sales with growth in the United States offset by declines in Mexico, where the tequila category remains extremely competitive. While agave prices have increased, they have not yet translated into better pricing discipline in that marketplace. New Mix RTDs' net sales declined 10% year-to-date, as last year's fourth quarter trade buy-ins negatively impacted the first quarter results. More normal trading patterns have resumed for New Mix as inventories have rebalanced, but the fourth quarter still faces a challenging comparison to last year's buy-in. Southern Comfort's net sales were down mid single digits. These declines were driven by a combination of worsening on-premise trends in the United States and continued pressure in the broader liquors category.

Let me now move to the P&L and reconcile reported to underlying net sales. Year-to-date reported sales grew of 5% was negatively impacted by 1 point due to reductions in trade inventories and by another 1 point due to the strengthening of the dollar, resulting in 7% underlying net sales growth. This top line growth, driven by improvements in price and mix, helped drive a 70-basis-point improvement in our gross margin and a growth in underlying gross profit of 9%. Year-to-date underlying A&P spend increased 8%, 1 point above our underlying net sales growth, as we continue to find new opportunities to invest behind the long-term growth and positioning of our brands through increased media spend on award-winning creative campaigns as well as next-generation advertising. Year-to-date underlying SG&A grew only 2%, helped by some favorable items as well as timing of expenses. We estimate that the normalized rate of SG&A growth would have been over 4% excluding this favorability. So putting this all together, the solid top line growth, margin expansion due to price and mix and operating expense leverage drove underlying operating income growth of 14% or 9% on a reported basis. Given the previously mentioned timing of SG&A, as well as the impact from buy-ins in both Germany and Poland, we estimate these factors boosted our underlying operating income growth through January by about 2 percentage points. Our reported diluted earnings per share for the first 9 months increased 10% to $2.45.

Now moving on to my second topic, I'll share some thoughts on why we believe we are performing at the top tier of the industry. First, we believe we have a terrific portfolio of brands that are skewed towards an increasingly global category, American whiskey. In fact, we have the leading brand, Jack Daniel's, and this trademark represents roughly half of our global volumes. Second, over the past several years, we have divested of lower-growth and lower-margin brands and businesses, such as Hopland wines, Lenox and Hartmann Luggage. This has resulted in a highly focused premium spirits portfolio. In other words, we lack the large tail of low-end brands that some others in our industry have accumulated. Third, we have maintained a disciplined approach towards innovation that has helped fuel growth, such as the success we have driven with Tennessee Honey. And finally, we believe that part of Brown-Forman's outperformance has been driven by a balanced geographic delivery of top line growth. For example, while some competitors were reducing investments in Europe and doubling down in China, we pursued a strategy of balanced investments across all potential markets, developed and emerging, with an eye towards developing superior risk-adjusted returns. So we have been significantly less impacted by the slowdown in some of the emerging markets and have been able to deliver strong market share gains in parts of the developed world, such as Western Europe.

So we are encouraged by the strength and consistency of our results. While many competitors are increasingly focused on cost cutting, we believe we are in the fortunate position to be able to continue investing in our operations, including but not limited to A&P and SG&A, in an effort to drive long-term sustainable growth.

This leads me to my third and final topic, an update on our full year outlook for fiscal 2014 and, specifically, a walk-through of what we expect for the fourth quarter. We believe we are on track – still on track to deliver the high single-digit underlying net sales growth we shared with you since the beginning of the fiscal year, albeit at the low end of the range. We expect our price increases and improved mix will continue to offset inflation on cost of goods and help drive full year gross margin expansion. A&P has been growing ahead of sales, and we expect this trend to continue in the fourth quarter. SG&A growth, helped by the previously mentioned favorability, is running a few points behind our full year expectation for mid single-digit growth. This implies Q4's SG&A will be up double digits as favorability unwinds and we incur expenses related to several strategic investments and organizational-related changes.

These expenses include such things as the buildout of both our sales force in France and the workforce at our new cooperage, not to mention the establishment of our European regional headquarters in Amsterdam. Because these anticipated expenses are occurring later in the year, we expect Q4's underlying operating income growth to be well below what we have achieved year-to-date but keep us on track to deliver our outlook for strong, low double-digit underlying operating income growth for the full fiscal year. Remember that this outlook is on top of last year's impressive 13% growth in underlying operating income. Low double-digit underlying growth in operating income corresponds to an EPS range of $2.95 to $3.05. This EPS range includes a negative $0.06 impact from France as well as a $0.01 hit due to adverse foreign exchange. We expect a full year tax rate of approximately 31%. And 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 $0.04 per share.

In summary, we are very, very pleased to be reporting such terrific results this morning. This performance is the result of years of investing in our business, and we will continue to invest behind our brands, our people and our production facilities in order to drive the next decade of growth and market outperformance.

So with that, let the turn the call over to Paul for some of his comments.

Paul Varga

Thank you, Jane, and good morning, everyone. I really don't have a lot to add to this morning's release and Jane's very nice summary of our Q3 and year-to-date results. Her detailing of the reasons for our performance relative to our broader industry is, I believe, the main storyline today. We worked very hard over the years to put the company in this position, balancing well, I believe, risk and reward along the way. And today, we, of course, welcome what Jane mentioned, the great momentum that exists for whiskey at premium-and-above price points. And above all, we cherish the opportunity to continue developing the Jack Daniel's trademark around the world as our foremost opportunity in premium whiskey.

I mean, just in summary, we're in a great place today, and we very much look forward to what lies ahead. Before we take your questions, let me finish by congratulating our employees on our continued excellent results and on the comprehensive quality of the results that we announced today. They cannot happen without the collective effort that we observe each and every day across our company, so let me simply say, well done, everyone.

That concludes our prepared remarks. And now we're happy to take any questions you might have.

Question and Answer

Operator

— ***Operator Instructions*** — And your first question will come from the line of Nik Modi with RBC Capital Markets.

William Kirk

This is Bill Kirk for Nik Modi. Real quick, you mentioned there'd be some giveback, but have you quantified the 3-2 [ph] magnitude of the Poland buy-in ahead of the excise tax? And is that reflected in the distributor inventory adjustments to calculate underlying net sales and operating income?

Jane Morreau

Nik, in terms of your 2 questions, the giveback, the way I would characterize it is the combination of both Poland and Germany buy-in was about 1 point. And so that's what we would expect to shift from third quarter to the fourth quarter in terms of the OI.

Paul Varga

Yes, its impact on OI.

Jane Morreau

Yes.

Paul Varga

And the impacts are not – just to clarify something to you, it is not something that in the schedule we always provide that reflects inventory adjustments. This is something that is actually in our underlying operating performance. And so we make note of it, of course, when we think there's – it's not sustainable in this case because it was related to buy-ins. So we think the impact of OI will be – was it 2 points specific…

Jane Morreau

It's 1 point for Poland and Germany and about 1 point for the SG&A timing.

Paul Varga

One point for – that's it.

Jane Morreau

And Paul is correct, the inventory – it's not included in our inventory adjustment schedule.

William Kirk

Okay, perfect. And then real quick on Winter Jack. It's branded as a seasonal offering, but given its success and the success of the cider category on a larger basis, are you considering allowing it or something like it to become a more year-round offering?

Paul Varga

We're looking at it. We've only had 2 passes at it so far, with the first one in Germany, and it was very seasonal. I mean, it was as intended. And then in the United States, we expanded it this year after just a couple of initial markets, and really, we're encouraged by what we saw. So we're – like we always do, we're – with any Jack Daniel's line extension, we always err on the side of caution and conservatism. And so we're taking a look at it. But we're aware of the appeal of that flavor profile and those offerings, particularly in the U.S. market these days.

Operator

And your next question will come from the line of Judy Hong with Goldman Sachs.

Judy Hong

Paul, just wanted to get some perspective on the pricing environment in the U.S. I think in the brown spirits, pricing still seems to be pretty healthy here. So just wanted to get your view on that and kind of the opportunity to take further pricing going forward. Also, just in terms of the on-premise, still somewhat soft for the industry as a whole. How does that kind of factor in, in terms of thinking about pricing?

Paul Varga

Well, Judy, I think the first part is, yes, we would agree with you. I mean, I think it is a tale really of maybe 2 categories, if you were thinking brown spirits versus white. It does appear that through the holiday period, particularly, that the combination of trade-up to ultra-premium price points within the category is offering a form of a price increase. But then also, within the trademarks, you can see continued evidence of pricing going up. Less so, of course, particularly in the hotly competitive vodka market and in some of the other categories. So – but we think that potential continues to exist. I mean, you do – as we go into maybe, what is this now, going to be the third year, we continue to look at cumulative impact as well as the individual impact. And remember, too, for our most significant interests in this area, being the Jack Daniel's trademark, it was not just for financial reasons or trying to cover costs and those sorts of things that we took pricing. I mean, very prevalent in our thinking all along has been continuing to price Jack Daniel's at the ultra-premium levels that we believe it should be around the world, particularly as these segments above the Jack Daniel's price point, which we, of course, compete in, but so do others, continue to develop and expand pretty rapidly. So we, of course, just don't want Jack Daniel's to be seen as a mid-priced or popular-priced brand. So there are some strategic reasons for us to continue to explore that. We're, at this – always on this call, when we get questions, we're always amidst our planning and budgeting for next fiscal year. So we'll be taking a look at what the specific details are around pricing going forward. But it certainly is our hope that with the category momentum and some other factors out there, we'll be sensitive to the economies that we encounter around the world. But we like the category momentum, and that should encourage us to continue to take pricing where we can get it. So – and then on the on-premise, I think you had a question about just what does that mean for pricing. Well, I mean, I think Jane mentioned this, you want to be sensitive to it. It's a weak and weaker environment versus the off-premise right now. So you've got to exercise some caution there. And I also would note that one of the reasons we think the on-premise is a little soft is because of the value equation associated with drinking off-premise relative to on-, so – and actually, the gaps can be pretty large there depending upon where you frequent. And I do think that, that is a contributing factor and does influence the way a lot of the companies might be thinking about pricing. It is, during normal times, I think, a bit easier to pass through price increases when the price is by the drink versus the bottle. But that environment has been kind of soft now for a while. And I just haven't seen as aggressive a set of activities around pricing in that area as we have in the off-premise. So we'll take a look at that as well as we go through our planning this year, but I don't have any sort of new news to report on that.

Jane Morreau

I might just build on what Paul said, just to note a couple of our brands in the on-premise and how they're performing very, very well. And that is Woodford Reserve, which we also talked about in this call, and our vision to get it to 1 million cases, as well as Tennessee Honey. Both of those brands are performing very well in the on-premise.

Paul Varga

Yes, and it picked up in recent months, too, so…

Judy Hong

Got it. Okay. And then just on China, so, Jane, you talked about the acceleration you've seen in that market. If you can quantify just how much China was up in the third quarter and then some of the changes that you've made there. I think you had talked about changing some of the pricing strategy there. But anything to sort of note in terms of what is driving sort of that acceleration in that market, which arguably has been more challenging for some of your competitors?

Jane Morreau

Yes. So China, of course, is a low base for us, and it was up double digits in the quarter. We've done a number of things over the past year as it relates – past couple of years as it relates to that market in terms of how we go to market: our people there, the structure, the pricing, the discounting. It's a whole host of new things that we're doing there. And again, it's a small market for it. We're very, very excited about what we've been seeing in the momentum and we're starting to see, and again, like I said, it's up double digits for the quarter.

Operator

And your next question will come from the line of Ian Shackleton with Nomura.

Ian Shackleton

Yes, Paul, Jane, Jack Daniel's Tennessee Honey, you kept seeing run rate as you had in the first 6 months, the 30%, and I think you have – looks like you expected that to slow down a little bit in the second half. I mean, what's happened here? Is this renewed growth in the U.S. or was it new markets? Why are you managing to keep that growth rate going so strongly?

Paul Varga

I think a balance of all of them, Ian. We – some of the influence to this is staging kind of the win we roll out in markets. If you go all the way back to the beginning, we started in the United States and we could track quite easily where and when we were introducing it and then as we've expanded it more globally, and it's been pretty staged. Not everyone, as was our tradition in the earlier parts of the rollout, introduced in the first 3 to 4 months of the fiscal year, our fiscal year. So actually, we had some introductions occurring here after even the end of October, just so there's some Q3 introductions that contributed to that. And I'd say just the U.S. has continued to hold up well. I mean, it's on slightly lower growth rates off the higher base. But compared to some of the things we would have been concerned about, when you get these products that do very, very well at the intro, you always have a lurking concern about whether they're going to be too trendy and drop off when they start to cycle against their early successes. And this one, we've been very pleased on 2 levels: one, that it's continued to grow off of its expanding base, and I think a big part of that is it's strong in new consumers; and the other one is just the minimal amounts of cannibalization that we would've observed as it relates to Jack Daniel's Black Label. I mean, those are the always critical tests for a new product in its first few years. And then, yes, of course, we continue – we don't have as much experience in the markets outside the United States yet. We've got 1 year or 2 with some of them, and the competitive environment is different out there. But so far, so good. I mean, this brand, I think, during the quarter, passed 1 million cases. Jane referenced it. That's sort of rare space for brands that are $25 and above. So, so far, so good on it. And as we do our plans for F '15, we'll be looking closely at those expectations. And in the summer, when we can report full year, we'll update you guys, perhaps, on it.

Ian Shackleton

I think just on a full – I mean, on the tax rate, Jane, you've given us the 31% for this year. I mean, that's slightly lower probably than we've been thinking. Is that a sustainable level as the business becomes more international? Should we be expecting a slightly lower overall tax rate?

Jane Morreau

Yes, so just for the year, I will say – and for the quarter, we had a couple of discrete items that went through. So it is lower than we would normally expect ongoing. But I would just step back for a moment and think about our tax rate in general. And we're a U.S.-based company. We have a single – our flagship brand that has a single point of production that's in the U.S. as well. And as you know, the U.S. has one of the highest tax – corporate tax rates around. But to your point, as we do get more global, and we've been seeing this over the past several years, we get – our business expands, so 60% of our revenues were outside of the U.S. last year, 40% in the U.S, we do expect the tax rate to come down slowly. With that being said, we're always actively looking for legitimate ways to have a more efficient tax rate, and we're very proactive in that space.

Paul Varga

Yes. I mean, I think your question – the best aid to this, if you really think over the long term, in the next 10 years is the international development of the business, which thank-fully, for us, has been the main story for a long time, and so we'll continue to look for opportunities. We're encouraged by what – with this, what is I think the key focus on this point is how discrete this item was and these items were in the quarter to take the tax rate down.

Operator

Your next question will come from the line of Bill Chappell with SunTrust.

Sarah Miller

This is Sarah Miller on for Bill. I just had a kind of – can you talk about, number one, the promotional industry environment during the holiday season? What was kind of the level of gifting, and if there was any excessive promotional activity or kind of any commentary about what you saw there?

Paul Varga

Well, I mean – and Jane, you can think about it. I mean, we wouldn't have any provocative headlines, I think, in that area. I mean, the holiday period is always competitive. I think one of the things that influences a bit of the discounting and promotional pricing around whiskey these days, particularly in the categories that we pay the most attention to, our supply-demand dynamics that have been sort of well discussed around the world as it relates particularly to Scotch. And I mean, I think I would have observed that the pricing is pretty rational around the world these last couple of years, probably as a result of that. Because, I mean, if their supplies are precious, they don't want to be giving away the product at prices that is just inappropriate. So I think that might have been, in the longer range, is just more general influence for the premium and ultra-premium areas, where we tend to be concentrated. To be quite honest with you, I know in like – categories like vodka and more standard-priced tequilas and things like that, I mean, it's very competitive. I don't know that I'd say that the prices were lower so much as it was just tougher to get prices to go up.

Jane Morreau

Right. Just building on what Paul said, this is more of a U.S.-only comment, and so that's only a smaller portion of our business as we go forward. But according to the syndicated data that I believe you all receive or see, both in Nielsen and NABCA, over the holiday period, the value actually grew, and so meaning – implying that with probably less discounting, could be mix in there as well. But if we look at value growth over that period, it was actually – it picked up a little bit.

Paul Varga

Yes. That's about what we have to say on that…

Jane Morreau

Yes.

Sarah Miller

Okay. And then I know we talked a lot about A&P and SG&A. Do you have any additional color you can add on kind of the gross margin side of what you expect going forward? Is pricing going to boost that in the fourth quarter? Or is that going to be offset by kind of FX moves and that kind of stuff?

Jane Morreau

So you've seen, and as we talked this morning, that our gross margin expanded about 70 basis points year-to-date. And you also probably saw that in the quarter, we didn't get as much. I think we were basically flat on our margins. And so one reason for that was the mix of our sales that we had in the quarter. We talked about the buy-in, in Poland. And it was with – largely with Finlandia, which is – has a lower margin for us in our business. So if I think ahead to our fourth quarter, we still believe, our full year, we will have nice gross margin expansion. Sales will still exceed our cost of goods and inflationary increase. But I would think that would imply that our gross margin in the fourth quarter, because of some of that giveback, should have some improving trends.

Paul Varga

Yes. A nice thing I always look at that could help you with thinking about this longer term, and we'll update this, of course, when we get out to the full year results, is just the supplemental information we provide in the earnings release on Page 11. If you just look at the relationship as you go down the page between net sales gross profit and then down to operating income and look at last year as a full year and our first 9 months to date, I mean, it's evident the sort of operating leverage that the company has been able to accomplish just in these last – what that would be 21 months. And we're always looking at that to see what's the appropriate level of it. But we're pleased that we were able to get some leverage, and it exists between both sales and gross profit and then between gross profit down to the operating income line. And so – and we feel like we're investing well behind the business, too. Jane outlined that as it related to the capital investments, too, that we're making to – which will help us 10 years from now and beyond, but then also the things that we need – feel we need to do over the next sort of 12 to 36 months related to A&P and SG&A. So it's a great story, I think, for the company right now, and we always scrub this pretty hard during our planning process. And then, again, we'll update that with you here in this, I guess, early June.

Operator

The next question will come from the line of Mark Swartzberg with Stifel.

Mark Swartzberg

Yes. I guess a longer-term question on the U.S. and millennials. Could you update us on what kind of behavior you're seeing among millennials in the North American whiskey segment, to what extent it's mixing versus straight consumption? My bias is to think that if it's more mixing, that's favorable for the longer-term outlook for the category. And then what also does your research show about their behavior as they age, behavior in the larger spirits segment? Again, you're obviously making some optimistic and, I think, reasonable assumptions as you look out 4 or 5 years for product coming out of the barrel. So just wanted to get an update on what you're seeing from the millennials that kind of undergirds that optimism?

Paul Varga

Yes. I think that – and maybe a couple of things I'd comment on there. Typically, you'll find early 20s sort of legal drinking age and up, say, to the mid 20s, maybe even into the late 20s, you will see a mix component to it. It's the initial trial stage. And interestingly, at least from my vantage point, is that the mixers actually change with the passage of time, too. I mean, it's just – all of us who grew up in the industry would have these references to Jack and Coke and all the – a lot of the leading brands that would be mixed with sodas, and there's, of course, the traditional ones of tonics and things like that. But I mean, all the new ways in which products are prepared and there's such – and one of the great aspects of this booming bourbon business is the ownership of the account in creating the cocktails they're creating that make it delicious for a consumer to drink bourbon. So some of it's been classic cocktails, but also variations of old classic cocktails that – I mean, I just saw somewhere the other day just a Peach Manhattan for Woodford Reserve, which you'd think – I mean, if you think about it, that sounds odd, but how drinkable? It was just outstanding. And so this whole mixability component of American whiskey is perhaps one of the most important aspects of its long-term growth. I think you were sort of inferring that, that it – the ability to enjoy it in a variety of ways and to, actually, to dilute the product so that it's not exclusively a straight consumption or a shot consumption is a real helpful aspect of what we think has been going on. People do tend to evolve. Even if they stay with the brand, we've noticed from Jack Daniel's over the years that they will evolve the way they consume it. Some will stick with the tried and true way they first experienced it, but other people will evolve toward sometimes more straight consumption or different types of mixers. I think one of the most interesting aspects of what's going on with the millennials and whiskey, and it actually, I think, could be influencing on-premise today, is the social media aspect. And if you think about it, if you're challenged from the standpoint of disposable income but you still want to gather, but you can't afford to go hang out and drink in the bar, you end up creating the bar maybe at home. And social media is a great partnership to that exercise for the consumer. They can mobilize people and be with other people and connect with other people in a way to assemble each other. Sometimes it's called mobbing or hoarding, and I've heard all kinds of interesting terms for the way that millennials and others are gathering. And so that could have a contributing factor to some of the softness that you might see in the on-premise. I mean, I don't have any data to prove that. But just observationally, it seems correct to think that people with access to technology and communications and the ability to bring each other together in different ways than always relying on the bar to do that for them will create new ways to enjoy the products. And of course, that might be part of the reason they're fueling the off-premise consumption relative to the on-. So I think there's a lot of things, some of which we don't quite fully understand and know yet but, of course, we welcome as it relates to our business. But I do think this mixability factor that you were hinting at there is a huge factor in the consumption of American whiskey today.

Mark Swartzberg

That's great. And well, as an aside, not that she's drinking age yet, but our 15-year-old was telling my wife and I last night how passé Facebook is, which we're active on. So I'm sure you're much more active than Facebook. But kind of second follow-up is, product coming out of the barrel 4 or 5 years from now, this mixability seems to be a very good reason for optimism in terms of the growth you're planning out there. What do you see that is giving you confidence that as these millennials, of course, aging, we're getting near that point where they're not going to be the contributor to the LDA growth that they've been. What are you seeing that says, okay, they're going to be staying in North American whiskey versus shifting? Is it again this mixability thing?

Paul Varga

I think mixability relative to, say, even other whiskeys that we see – I mean, we think even within whiskey, mixability's a – I do think – and look, we're all – we would all be speculating about how long-running the contributing factor of, say, authenticity is. I mean, many of us at the company are regularly talking right now, even in public forums, I just did one here locally a few weeks ago, where you are challenged to think about why is urban and American whiskey doing what it's doing right now, and how sustainable is it and how might you think about it. I think, at the core of it, it's tied up in all kinds of factors related not only to mixability, but also very much – and I think American whiskey, particularly, hits the sweet spot that's sort of the best attributes of what Scotch provides in terms of premiumness and authenticity and all these other things and all of the great attributes that vodka provides. And I just – I mean, those are the 2 world's largest categories. And so here's – American whiskey sits poised to benefit from being at the intersection of the favorable attributes of the 2 of them. Also, I think, don't underestimate things like the hospitality and the realness and the ability to promote and do public relations because you actually have a real place where people can go and visit and meet the manufacturing, the people who make it. They can understand more about the product and deepen their knowledge. And just as a reference point, that's far less a tradition in, say, vodka, whereas it just deepens the sense of commitment and emotion and also the value equation that consumers will then associate with it. So it's kind of bourbon's time right now. We've been waiting for it, to be quite honest with you, for a long time and are happy to have it. But I – could I forecast 10 years out or even – but it's – we know that these forecasts are required because we have to make the product so far in advance. I do say, one of the things that's a nice self-regulating mechanism, it's really interesting, because you're level-headed – all of us, I hope, are level-headed as we plan 5 and 7 and 10 years out into the future, you do this. You can't have the explosive growth because you won't have the product that creates the trendiness that makes the business go away. So I mean, it's almost like a self-regulating mechanism in whiskey that is you sit there while you could – maybe could be growing at, I don't know, 9 and you can only grow at 7 or something, you're frustrated. But maybe that 7 goes for a lot longer because you didn't get the 9. And in such a way that I think for years, I think, bourbon manufacturers have had to think about this business.

Mark Swartzberg

That's great. Very helpful. We'll try to self-regulate with our numbers as well.

Paul Varga

All right.

Operator

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

Bryan Spillane

A couple of – just a couple of housekeeping questions, and then I've got a, I guess, a little bit longer one or larger one for Paul. Jane, just – have you given CapEx assumption for the full year?

Jane Morreau

We have a CapEx – well, I should revise it. I think, before, we had given a $140 million to $160 million range. I think it's going to be more in the $120 million to $140 million range. That money will end up being what we were projecting this year to be spent, being a little bit less, is actually just going to be shifted into next year.

Bryan Spillane

Okay. So just a timing thing in terms of projects?

Jane Morreau

It's a timing issue. Absolutely. It's just the timing.

Bryan Spillane

Okay. And then the – just the impact of the French – the distributor inventory changes in France in the fourth quarter, have you talked at all about just kind of quantifying how we should think about that in the fourth quarter if there's an effect at all?

Jane Morreau

Yes. Brian, all the hit from the distributor inventory and from the changeover happened through year-to-date January, so we don't expect any more at this point in time.

Bryan Spillane

Okay. So fourth quarter is clear of that?

Jane Morreau

It should be clean…

Paul Varga

On the inventory.

Jane Morreau

I mean, on the…

Paul Varga

Not on the SG&A.

Jane Morreau

And not on SG&A. That's fair, Paul.

Bryan Spillane

Okay. And then just on the kind of the lumpiness in the way that SG&A has come in, so it's going to be higher in the fourth quarter. So is that, again, just a timing thing, first? And then, second, is SG&A, I guess, going to come in for the full year higher or lower or in-line than where you were originally planning?

Jane Morreau

So I'll do this. I mean, let me think about this SG&A thing. First of all, it is lumpy, and we're around 2% underlying right now. I think we've done a really good job thus far balancing the investment in our business with containing cost. But as I said in my script, we're projecting, if we take out all the benefits that we've had and timing through the first 9 months, we're running probably a little bit over 4% on what we call a normalized basis. So when you look at the fourth quarter, it is going to be up double digits. We do not expect that going forward to next year. It's highly unusual. Some of the things that I mentioned, let's talk about, first of all, the cooperage as an example. That's – we're very excited. We're going to have our new cooperage open in Decatur, Alabama for full production here in a matter of weeks. And those costs that are going to hit the fourth quarter are onetime in nature, so they won't be repeatable. I've mentioned the European office, the regional office. That's part this year, part next year kind of thing. The France is an ongoing thing. This is the first quarter we will have full expense in it. And we will continue to have it all of next year, of course, and beyond. But comparability for the first 8 months next year will be difficult because we didn't have it in the previous year. So it's a combination of things like that. And so I would not expect, though, what you're seeing in the fourth quarter to be sustainable. We will have – our numbers are coming pretty close to what we planned for the year, which I think was your last question.

Bryan Spillane

Yes, okay. That's helpful. And then, I guess, Paul, just this one last question. I guess, since Beam was taken out, there's been some speculation and we've certainly fielded a lot of questions about just how Brown-Forman stands in terms of the industry consolidating, would the company be a takeout target. And so I guess, not asking you to answer that directly, but more I just kind of reflected back on the Investor Day in 2012 and the presentation that Garvin Brown had made, where he really laid out the – how the board thinks about the stock, how the family thinks about it, the ownership in the stock. So can you just talk a little bit about whether anything in that regard has changed and just, overall, how you think Brown-Forman is affected? Or is it not affected at all in terms of some of the consolidation you've seen in the industry?

Paul Varga

Well, I mean, I'll just start. I mean, gosh, I'm trying to think, Bryan, you might go back further than almost anybody on this call with this conversation. I expect you and I have at some point in this conversation. And actually, I give you that reference solely because I think the story and message has been so consistent over that period of time. And look, and how well served has the company and Brown-Forman been by their continuing commitment to the business. So I mean, I think – I don't know that I can actually say it any better than Garvin did in New York, what was that, about 15 months ago or so. It was a little over a year ago, I think. And so no, I don't think there's any change in our point of view. I mean, we have – I mean, I just gave a speech that – where we used the initials of the company to reemphasize our highest ambition, and that phrase is building forever. And I know Jane was there. There was others. I mean, we continue to have regular strategy conversations. And one of the more recent ones I had, probably, I don't know, 3 or 4 weeks ago, we were heavily focused on 2035. I'll just tell you that as a point. So I mean, we were – and we were spending a lot of time on what the business might look like and how the world might unfold in front of us. And so if that gives you any insight as to whether or not we're lessening in our commitment or perspective about that, I think that's probably one good example as to how we field that. And I'll tell you, I think it's really interesting to – I mean, of course, you correctly reflected on all the attention, which is, of course, observing what people are writing or speculating about. But for us, it's not – I mean, it's really not speculating. I mean, we know what we're trying to do, and we welcome the momentum that exists right now in the industry. And we think, also, we're just so well positioned, as you would have observed over the years, to own Jack Daniel's and to be able to take it around the world with what we consider to be still relatively modest shares in the markets and against the categories that we measure ourselves. So we think there's just so much runway still for the company. And so in any event, I mean, I don't really feel like there's any update to that point of view, other than things have been strengthening here at the company.

Operator

Your next question will come from the line of Robert Ottenstein with ISI Group.

Robert Ottenstein

Paul, in the past you've talked about the on-premise as a leading indicator for the business as a whole and that it would – changes in the on-premise could potentially drive your mix of marketing from push to pull and that it was really something to focus on. Do you think – obviously, some of the on-premise weakness is the weather, some of it is the economy. Maybe you can talk about the mix there, number one. Number two, refresh us on the percentage of your business in the U.S. that's on-premise and off-. And then, perhaps most importantly, do you think that the changing patterns of consumptions of millennials, for perhaps a variety of reasons, to drink more at home anyhow, perhaps invalidates the importance of on-premise changes as a leading indicator for the rest of the business?

Paul Varga

Okay, good questions. I think in the past, when I've spoken about the on-premise, I always felt this was just philosophical. But if you could succeed as a brand in the on-premise, it was just the – it was the ultimate test to have a consumer go in and call, usually in a noisy place, pay more than they would if they were drinking at home and, at the decision point, know how to drink it and, oftentimes, as is the case, like the brand so much you're willing to buy one for another person. I mean, these were great tests, I always felt, of brand appeal and the connection between a brand and a consumer. And so it's less of a shopping experience, is the way to think about it. It's just so instantaneous. And so brand strength, I always felt, was measured there. I think your point is, I sort of was referring to some of this in response to an earlier question, is it's probably time to think about a new — ***indiscernible*** — for many of these markets around the world, what the implications are for the on-premise. I would not go so far to say that the on-premise doesn't remain probably perhaps the greatest brand-building environment for distilled spirits and a great differentiator of our industry relative to most packaged goods. I think your question and some of the things we would have been thinking about are good reminders of how does things evolve based on whether it's millennials and new consumers and the way they interact with each other, what does technology impart upon the channel, going back and thinking about pricing. I mean, there was a great question earlier about that. I think all those things are put in the mix, and we haven't done a proper strategic consideration of that. And let's be honest, I mean, it changes market by market by market. You probably should do one for maybe U.S. and maybe more developed Western international markets, would be one cut. Some of these markets around the world, particularly the emerging markets where things are sold by the bottle and food is often consumed, that's a totally different consumption occasion. And so you want to break it into its component parts. But I think it's a fair question for all of us to be asking ourselves, is are we at the beginning of something where the – it's evolving in the way that the consumer behavior is such that it might influence the business. And I wouldn't have a definitive answer to it, but I think it's a fair question to be asking of us and the entire industry.

Robert Ottenstein

And can – so can you remind us, just in the U.S., what your mix in terms of volume is, on-premise and off-? And then what I'm kind of hearing from you is that the on-premise weakness that you referred to, maybe it's a source of caution, but it's not a big source of concern as you do your budgeting for next year?

Paul Varga

I will say it's a source of caution and it's an area of focus, which is not that different to, say, concern. We're trying to evaluate what the best posture is. I know, in more recent months and as we've talked and predicted, and maybe I'll just use the U.S. as an example, I mean, our gang there wants to spend more time and energy and dollars against the on-promise because we're so prominent with Southern Comfort and Jack Daniel's and Tennessee Honey and Woodford. And it is a – it is not as easy to go and as efficient from a personnel standpoint to cover the many, many, many outlets that exist in on-premise as it is, say, going to a big chain or something. So you have to be thoughtful about how you do it. But no, it's an area of, I mean, concern, I would say. I mean, there's a lot of conversation going on at our company about what's going on with the on-premise and how do we support it, what can we do. I mean, the greatest thing you can do is have the consumers just blissfully walking into the accounts asking for your brands. That's the greatest event. And – but short of that, there's always a bit of a push component and a need to promote in the on-premise. And so our teams are looking at the best ways to do that. We'll continue to think about it, though. I think these questions you all have raised today about the on-premise are fair. They're fair, and we are continuing to think about it. I don't think, what I've seen so far in our own data, that it's cause for some significant, what I would call in many cases, overreactions or a rash move and reallocation of resources between the 2. I think we'll be more thoughtful about it. And then on your question about how – what percentage of our business, of course it varies by brand. But just to give you a really developed, well – a brand in the United States generally might, even if it has very strong call, is going to be more like a 25% to 35% on-premise, and the other part off-premise. I mean, and that would be for the big brands. I mean, you can get these really hot on-premise shop brands, and they'll be 80% on-premise. But for Jack, I don't have the data in front of me, but it's something more like a 20% to 25%. And I think Southern Comfort might be in about that range, something like that, because the business continues, from a distilled spirits basis overall, to be more skewed to the off-premise.

Operator

Your next question will come from the line of Nic Cavallo with Deutsche Bank.

Nicholas Cavallo

Just one quick one on share repurchase, I guess. Looks like you guys didn't buy back stock in the quarter. Is that just being more opportunistic around the stock price? Are there maybe more compelling M&A opportunities out there that you're looking at? Just trying to get a sense of sort of what your appetite might be for share repurchase at these levels versus other uses of cash.

Paul Varga

Jane, do you want to take it?

Jane Morreau

Yes, Nic, that's a good question. I just thought I would take us up a level, first of all, and just remind everybody how we look at our capital allocation decisions, and we always look at them over a long-term horizon, generally 10 years. And we really think that has served the company well, served the shareholders very well because it allowed us to be very flexible in our approach, because we're always looking for the opportunity to – how best to create long-term value for our shareholders. So as you know, what we do is we first go through our list. Our first priority is to always find opportunities to invest behind the organic growth of the business, and we're doing that just now. As you know, we're investing behind a new distillery at Jack Daniel's, the first such major investment since pre-Prohibition. We've got the cooperage that's going to get ready to be opened here soon in Decatur, Alabama. And we're investing heavily behind our Woodford Reserve facility to meet the ambitions that we just talked about in this earnings release of over 1 million cases. We continue to build barrel warehouses so that we have places to put our barrels in to age with the whiskey that we're putting into it, which leads, obviously, to working capital investments that we need to do. So all of those are investments that we do first and foremost. And then we move on our lists, and we want to make sure that we're growing our dividends. And we generally look at growing our dividends in line with our earnings. Once we get past that, we then do look at opportunistic acquisitions, buying back stock and paying special dividends based on our excess cash. And so we do have a share repurchase, and share repurchases are part of our program, as I just said, a part of the equation that we look at. And we have a $250 million share repurchase that will expire this September. We've acquired roughly $50 million so far. I think it's important to note that we've never ever been programmatic, if you will, in our buybacks. So we're not trying to get to a debt-to-EBITDA ratio with these things. And so our buybacks are always subject to what's going on around us in the market and opportunistic purchases and when we can take advantage of it when we pull back and so forth. So we're always constantly reevaluating the best ways to return cash to our shareholders. And we don't – we do it over a long period of time, not measured by quarters. And that's what I would say.

Operator

Our next question will come from the line of John Faucher with JP Morgan.

John Faucher

I realize it's still early days, both in France and then looking at the consolidation of the European operations, but can you talk a little bit about sort of the lessons learned as you've brought more distribution in-house over the past couple of years in Europe and how we should think about that as you look at the balance of your business on a global basis? And what are the key takeaways so far as you've really sort of changed your business model in Europe, and what that implies for the rest of the world?

Paul Varga

Thank you for the question. I was over, it was, I guess, maybe 6 weeks ago, for the launch of the French company. So I'll just use that as the example. A bunch of us went over to sort of help get things kicked off. And I mean, it's unbelievable, the amount of excitement. And this was, of course, a unique case. I mean, I don't know – we got regular questions and observations while we were there about how no one really knew of any other people starting French companies or investing. And the observation sometimes is broader about investing in this way in Europe right now. And so we were sort of against the grain with – as we were before with Germany, to be quite honest. And so I mean, the primary benefit of this is focus, is the way you might think about it. And when you go from being sold amongst many brands to, in this case for France particularly, where it really is almost to start – it's starting out, is very much a Jack Daniel's business. Now one of the reasons to do it is so that it can become more than just a Jack Daniel's business as we develop in a very attractive whiskey market. So what happens is, is that you end up having this large group of people who are, I mean, enormously dedicated and incredibly passionate about going out and building something. And that's an intangible you can't measure, you can't put it on the income statement, but that's it. I mean, that to me is the differentiating factor between having an agency relationship and having an owned. And now there are all kinds of unique circumstances as we go up and down the P&L and can describe the cost, and each case is a little bit different. But if you want to know the common theme, whether it was Australia or Turkey or Germany or France, in this case, any of the ones that we've done historically, it's really about getting the people focused on Brown-Forman's work, and in many instances, particularly in the international markets, that's been the Jack Daniel's trademark. And so it's really the word "focus" and dedicated effort and enthusiasm that comes from having your own people do the work on your behalf.

Operator

And we've reached the end of the allotted time for questions and answers. I'll turn the conference back over to management for closing remarks.

Jason Koval

Thank you, Holly, and thanks to all of you for joining us today for our third quarter earnings call. Please feel free to reach out to us if you have any additional questions. Have a great week.

Paul Varga

Thanks, everyone.

Jane Morreau

Thank you.

Operator

Thank you for your participation in today's conference call. You may now disconnect.