Brown-Forman Corporation, Q4 2019, Earnings Call 2019-06-05

Presentation

Operator

Good morning, and welcome to the Brown-Forman Fourth Quarter and Fiscal Year 2019 Earnings Call. My name is Nicole, and I'll be facilitating the audio portion of today's interactive broadcast. — ***Operator Instructions*** —

At this time, I would like to turn the show over to Jay Koval, VP of Investor Relations. Please go ahead, sir.

Jason Koval

Thanks, Nicole, and good morning, everyone. I want to thank you for joining us for Brown-Forman's year-end earnings call for fiscal 2019. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Jane Morreau, Executive Vice President and Chief Financial Officer.

This morning's conference call contains forward-looking statements based on our current expectations. Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict and 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 fourth quarter fiscal 2019, in addition to posting presentation materials that Lawson and Jane will walk through momentarily.

Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K, 8-K and 10-Q reports filed with the Securities and Exchange Commission.

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

As a reminder, before I turn the call over to Lawson and Jane, in the interest of time and fairness, we ask that you limit your questions to 1 per analyst. You're welcome to rejoin the queue, and we'll take your follow-up questions as time permits.

So with that, Lawson?

Lawson Whiting

Thank you, Jay, and good morning, everyone. We've called this the year of change, challenges and continued consumer momentum for Brown-Forman. We're generally pleased with our top and bottom line results for fiscal 2019, both of which were up 5% on an underlying basis. Importantly, our top line growth rate would've been really – I call, the run rate would have been 6%, excluding the impact from tariffs. So generally call it a good year in maintaining consumer momentum; not a great year given all the headwinds that we're facing to the bottom line, but still a good year for us. We have a lot of reasons too to be optimistic, I think, about fiscal '20 and beyond.

Starting with the U.S. spirits market itself, where the trends are as strong as ever, particularly within the consumer goods world, the U.S. spirits market remains one of the best businesses in CPG. We believe we have one of the best premium spirts portfolios in the world as evidenced really by the strength and consistency of our long-term results. We've averaged 5% to 6% underlying top line growth for most of the last decade, and we expect more of the same in fiscal '20.

So Jane in a few minutes will share more of the detail behind what we believe was balanced delivery of these results in fiscal '19 and then also share some key milestones that we achieved during the year.

So rather than remember fiscal '19 as the year of tariffs, we'll change the headline to be 2019 remembered as the year we continued to invest in momentum across the portfolio and we delivered balanced growth across many geographies and brands. Recently, the IWSR Global Report came out a week or 2 ago, and it was interesting to read as it covered or talked about a lot of the – both attractive and then, call it, unattractive segments within beverage alcohol. Essentially, it said the categories really that you want to be in going forward include whiskey, tequila, gin, in the format of RTDs generally. And we obviously have a big whiskey business, we have a big tequila business, RTDs are increasingly important to the company, and we continue to seek ways to play into the gin category.

So we feel like we're positioned well in the categories that you want to be in and relatively less involved in categories like vodka, liqueurs, rum, wine and even beer where we do not have as much exposure. So it really supports our overall portfolio strategy and all the portfolio reshaping we've done over the past several years as we've gotten out of some of those unattractive categories. For example, obviously, the divestiture of our wine business a few years ago and our liqueur businesses 2 or 3 years ago and then really increasing our exposure to whiskey, both with Irish and Scotches. So we feel pretty good about the portfolio reshaping we've done and the impact that can have going forward.

So some brand highlights from fiscal '19. First, just talk Interbrand, which is the global marketing agency, once again named Jack Daniel's Tennessee Whiskey as the most valuable global spirits trademark in the world. Our teams are very proud of that, and we continue to defend that position strongly. And while we believe the runway is still long for Tennessee Whiskey, we've been thoughtfully diversifying the trademark through innovation and geographic broadening of our revenue base.

Today, the Jack Daniel's family of brands, beyond Tennessee Whiskey, is now over 3.4 million cases and Jack Daniel's RTDs cross 9 million cases. These brands are much earlier in their global development than Tennessee Whiskey, and they tend to be both growth and margin enhancing. Most importantly, they strengthen the Jack Daniel's trademark by allowing us to participate in new drinking occasions and bringing new consumers. So we expect the forthcoming Jack Daniel's Tennessee Apple to be a significant contributor globally in the years ahead.

The Apple Whiskey category has grown to over 2 million cases, nearly all of which is in the United States, and our partners are very excited about the potential for this Jack Daniel's Tennessee Apple in the marketplace. While it's essentially going to be a U.S. only launch in fiscal '20, we are excited about the long-term potential for the brand around the world.

Another highlight of fiscal '19 would be Woodford Reserve. It's interesting. It took us 10 years. We started the brand in 1997, and it took us 10 years to hit the 100,000 case mark. Last year, the brand added 170,000 cases. So globally, the brand family hit 890,000 cases and is well on track to surpass 1 million cases in 2020. Woodford was named spirit brand of the year by MarketWatch, and for anyone who watched this year's Kentucky Derby, we executed some amazing activations for the brand and generated sizable impressions through our excellent sponsorship.

Furthermore, the performance of Woodford Reserve Double Oaked, the launch of malt, special offerings such as our partnership with Woodford – with Baccarat and duty-free this summer, all served to further premiumize the brand and really solidify it as the category leader in the world of super-premium whiskey. And we do believe the best is yet to come with significant run room in the United States and then even greater outside of the United States where it's delivered only 20% of its volume this year.

Tequila is another bright spot in the portfolio with both Herradura and el Jimador delivering double-digit growth rates last year, and we've also introduced a cristalino product down in Mexico called Herradura Ultra, which is approaching 100,000 cases. So that business is very strong and growing very quickly.

So while the majority of our portfolio growth is coming from these American whiskey brands and our tequila brands, we're also planting seeds for tomorrow's growth. Over the last few years, we've launched Slane Irish whiskey. We bought the GlenDronach, BenRiach and Glenglassaugh trademarks in the Single Malt space, all of which are growing at tremendous growth rates right now.

In summary, our portfolio strategy focused on premiumization and disciplined innovation is a clear strength for Brown-Forman. We really believe it will continue to deliver consistent results year in and year out, including positive mix. We really don't have a leaky bucket anymore, which is another benefit to our business. Over the past years, there were a number of years where brands were really leaking on the sales line and provided sort of a headwind for us, and we've largely fixed those or sold them off. So we still – we remain very confident in our portfolio going forward.

I'm frequently asked about the sustainability of the bourbon boom, in general, and the supply outlook and believe me it's something we study closely as our perspective has implications on our long-term corporate strategies, but in short, we believe this bourbon renaissance is just getting started and the historical cycles really would support this viewpoint.

Younger consumers are increasingly focused on brands with provenance and with authenticity, and they're searching for quality over quantity. With our premium spirits portfolio intentionally focused on American Whiskey, we believe we're one of the best positioned companies in the consumer staples universe to continue to deliver sustained compounding growth in sales.

In addition to favorable category trends, another reason I believe in our ability to deliver growth in this both fiscal '20 and over the long-term is that we're still comparatively early in our journey into the world of the – in the international world, particularly in emerging markets. And just one example, 10 years ago, in Brazil, our business was roughly 35,000 cases. Today, it's our 10th largest market in the world, and we sell over 400,000 cases, and there are numerous examples like that around the world.

Moreover, 20% of Jack's volumes come from the emerging market space. And some of you may remember, we've talked about this in past investor calls, 50% of Johnnie Walker's volumes are coming from the emerging markets. And so, as we approach a lot of those emerging markets, we really do believe we have a long runway ahead to keep capturing share from the incumbent Scotch whiskey brands in many of these markets.

We plan for the long-term, enabled by strong Brown family support. So while the short-term discussion might be skewed to topics such as the tariff impact on our margins, we're focused on the opportunities ahead that will help us deliver the best possible shareholder returns through the power of compounding over many years. The spirits business, as I said, is one of the best in the world. We enjoy strong rates of growth, driven by increasing consumer demand. We've successfully delivered high rates of growth – higher rates of growth in the industry over the long-term, thanks to our focused portfolio strategies in the right categories and our ability to build and grow world-class brands.

We fully intend on fueling this momentum with the right balance of investments in our brands, our geographies, our assets and our people, and we believe that this will enable us to deliver great results, including consistent and sustained top line growth, high operating margins and leading returns on invested capital.

So we believe we can back to that high-single-digit operating income growth when we move past these tariff burdens in the middle of fiscal 2020.

The tariff burden is substantial, as you would have heard on our last call. We talked about $125 million on an annualized basis. Roughly 60% of the American Whiskey business into Europe is a Brown-Forman product. So we have a high share of these exports. So we view these tariffs really from the EU as a targeted campaign right at Brown-Forman, an American business headquartered in Kentucky.

Our corporate headquarters, our production assets and the employees who produce our fine whiskeys are all located in the United States, and that isn't going to change. We've invested billions over the years behind capacity expansion and aging inventory stocks, and we've created meaningful jobs and contributing to growth in both Kentucky and Tennessee. It's a tough situation. We continue to actively work with our leaders in both the U.S. and abroad. We seek a quick resolution to these tariffs.

So with that, let me turn the call over to Jane for a more detailed look at both fiscal '19 and the outlook for 2020.

Jane Morreau

Okay. Thanks, Lawson, and good morning, everyone. I plan on covering 3 main areas today during my prepared remarks. First, I'll review our fiscal 2019 results; second, I'll discuss our fiscal 2020 outlook; and third, I'll walk you through the foreign exchange and tariff headwinds we have been facing. After I complete my prepared remarks, we'll open it up to Q&A.

As we reflect on fiscal 2019, we're very pleased with our employees and partners' ability to adapt and manage through a very active year of change and challenges. We continue to invest in the consumer momentum across our business, which resulted in a consistent and solid results you saw this morning as well as the achievement of several milestones, which I will cover later.

As Lawson mentioned, we estimate the price adjustments associated with tariffs reduced our full year operating underlying net sales growth by nearly 1 percentage point. Thus, we believe underlying net sales growth of 6% after adjusting for this tariffs is really impressive rate of growth in the consumer world and in line with our long-term track record of performance.

Adverse foreign exchange was the primary delta between our underlying and reported sales growth of 2%.

Our top line growth was driven by broad-based geographic gains and a balance contribution across our portfolio of brands. Further, the year was marked by a balanced year of capital deployment and a continuation of our industry-leading operating margin and return on invested capital.

Okay. Now let's look at our fiscal 2019 sales results by major geographic cluster. After a soft start to the fiscal year in the United States, underlying net sales accelerated slightly from the first half to the second half. Despite this acceleration, the back half performance in the United States fell below our expectations and was the main driver of the company coming in slightly below our guidance range for underlying net sales growth in the year. Correspondingly, SG&A also came in below our forecast, due primarily to lower compensation-related expenses. Recent blended takeaway trends for total distilled spirits in the U.S. continue to point to a very healthy industry as we move into fiscal 2020. Our estimate of the U.S. markets growth on a value basis is in the 6% to 7% range, while our blended 3-month takeaway trend has improved 2 points from last fall to roughly 6%. We expect our trends to continue to improve in fiscal 2020, particularly projecting of Tennessee Whiskey given the brand activations and promotional activity we began to implement in late April and we will continue to drive and execute this fiscal year.

This includes significant reallocations within advertising spend to increase broad reach media and digital investments by double digits over the next 12 months.

Our emerging markets were a standout performer with underlying net sales of 11% in the year on top of the 13% growth achieved in fiscal 2018. We delivered broad-based and consistent growth with our 2 largest markets, Mexico and Poland, up 11% and 10%, respectively. Our collective emerging markets outside of these markets also grew 11%, driven by Brazil, one of our top 10 largest markets where our growth trajectory remains impressive with underlying net sales up 25% as we surpassed 400,000 9-liter cases in the year.

Russia results improved as we lapped the rough market changes made in late fiscal 2018 with underlying net sales growth of 17%. China grew strong double digits fueled by doubling of our e-premise business, which now represents over 30% of Jack Daniel's Tennessee Whiskey sales in China. We have established strong technical partnerships with 88 commerce platforms in China that are allowing us to reach more consumers, tell our story and be available where they are shopping. Several other markets are growing well, including Sub-Sahara Africa and Ukraine, which grew underlying net sales double digits, while India and Southeast Asia delivered high single-digit growth.

In our developed markets, business remains solid, up mid-single digit and in line with our historical performance after adjusting for over 1 percentage point drag due to tariffs.

Germany approached 1 million drinks equivalent cases, growing underlying net sales 10% with particular strengths in RTD. Australia at nearly 1 million drinks equivalent cases drove 6% underlying net sales growth, also powered by RTDs.

Growth in the United Kingdom, France and Japan were more subdued, sub-low single digits. Spain's route to consumer investment of nearly 2 years ago fueled strong double-digit gains again in fiscal 2019 with significant share opportunities remaining in this nearly 5 million case whiskey market.

I think it's interesting to observe between great results in our international markets and of various awards we've received, recognizing Brown-Forman as a great place to work in markets such as Poland, France and Spain, to name a few. We believe our performance reflects the great talent and the commitment of our employees in these markets.

Travel Retail delivered another solid year of results, including underlying net sales growth of 6% with the Jack Daniel's Family of Brands over 1 million 9-liter cases, Woodford approaching 100,000 and tequila is over 50,000. And at just 4% of total Travel Retail market share on a value basis, we believe there is plenty of room for our Travel Retail business to grow.

Moving on to the discussion of our balanced delivery of growth across our portfolio of brands and some additional awards and milestones achieved this past year. For starters, the Beverage Information Group named Brown-Forman the U.S. Supplier of the Year, awarding us more brand growth awards than any other supplier. The Jack Daniel's Family of Brands reached 25.8 million 9-liter cases, including 9 million cases of Jack Daniel's RTDs. Roughly 1/4 of the family's volumes are driven by brands other than Jack Daniel's Tennessee Whiskey, and 60% of total volumes are generated in markets outside of the United States.

Jack Daniel's Tennessee Whiskey grew to over 13.4 million cases, including over 8 million cases internationally, making it the single largest expression sold over $25 per bottle. Honey and Fire are nearing 2.5 million cases combined with growth rates fueled by further development of the non-U.S. business, where Jack Daniel's Tennessee Honey's volumes are over 1 million cases. And we are excited about this fall's launch of Jack Daniel's Tennessee Apple in the U.S. marketplace.

Now Lawson spent some time addressing our focus on portfolio development, including premiumization and innovation, particularly related to our leading portfolio of American whiskey. Excluding Jack Daniel's Tennessee Whiskey, in aggregate, we grew underlying net sales by double digits for our premium American whiskey brands, including Gentleman Jack, Jack Daniel's Single Barrel, Woodford Reserve and Old Forester. Combined, almost 2.2 million 9-liter cases were depleted. Gentleman Jack grew underlying net sales high single digits and Jack Daniel's Single Barrel grew at the fastest rate in the last 7 years, driven in part by the Heritage Barrel of Recognition as the third best whiskey in the world by Whisky Magazine.

In addition to a significant contribution from Woodford Reserve as it nears 1 million cases, our founding brand, Old Forester, surged past 250,000 cases, the brand's highest volumetric level since 1994.

Our homeplace investments play an important role in providing consumers with the opportunity to experience our brands and to learn about how they are produced, including last year's opening of the $50 million Old Forester homeplace and distillery. The Old Forester Turf has already ranked as one of the Top 10 best new visitor and tourist attractions by USA TODAY and is well on track to reach 100,000 visitors later this summer.

Another innovation, we now have rye products in the market from Jack Daniel's, Woodford Reserve and Old Forester, which by the way won a gold medal at the San Francisco

World Spirits Competition. Total rye volumes for these 3 brands are over 100,000 cases and rye remains a fast growing category in the U.S.

Tequilas are also fast-growing and important part of our business, depleting 9.2 million cases in fiscal 2019, which includes almost 7 million cases of New Mix RTDs. Our tequila brands, including Herradura and el Jimador and New Mix collectively grew underlying net sales by 12% this year on top of last year's 13% growth, helped by our Cristalino products. The tequila category is growing well, and our brands are well positioned to capitalize on these trends going forward. Unfortunately, consumer demand for 100% agave tequilas is leading to record high agave prices and necessitates that we implement more aggressive price increases over the coming months to maintain a vibrant business, particularly in the lower priced Mexican market.

Moving down the P&L. Our gross margins declined 260 basis points in fiscal 2019. 160 basis of this – points of this decline was due to absorbing the cost of tariffs in the majority of countries, while higher input costs, including wood and agave and other such items such as foreign exchange drove the remainder. Gross margin compression was partially offset by the 5% decline in underlying SG&A in fiscal 2019 due to lower compensation-related expenses and our continued disciplined approach to cost.

SG&A levels today are similar to 5 years ago, thanks to our focus on efficiency and productivity. Over this period, these initiatives have allowed us not only to reallocate spend to our brands but to continue to make strategic investments such as establishing the emerging brands team in the U.S. and setting up our owned route-to-market in Spain.

Underlying A&P investment grew over 3% as we invested in our American whiskey brands. In aggregate, we grew underlying operating income 5%, reported operating income increased 9%, thanks to the absence of prior year's $70 million contribution to establish a charitable foundation. Earnings per share jumped 17% in fiscal 2019 to $1.73.

Let's now move on to look at our outlook for fiscal 2020. On the top line, we expect underlying net sales growth of 5% to 7%. Our revenue growth has been one of the most consistent stories in the industry, and we have confidence in delivering results in this range.

For fiscal 2019, underlying net sales, excluding price adjustments related to tariffs, was approximately 6%. We expect a negligible impact from tariff related price decreases in fiscal 2020 versus fiscal 2019, 1 point drag.

Moving to the U.S. Recent increases in media spend and promotional activity are beginning to accelerate the company's blended value takeaway, now growing approximately 6%. We expect Jack Daniel's Tennessee Whiskey volume and underlying net sales growth to accelerate in the U.S. in fiscal 2020 as well as a back half contribution from the launch of Jack Daniel's Tennessee Apple. Fiscal 2020 will be another challenging year for gross margin, which we expect to be down about 20 – 200 basis points, split evenly between the remaining cost of sales, impact related to tariffs and higher input costs.

We assume tariffs remain in place for the full 12 months this fiscal year versus roughly 7 months in fiscal 2019. As a reminder, we chose to absorb the tariff impact in most countries in fiscal 2019 to invest behind the consumer momentum and are currently planning to continue to do this as we enter into fiscal 2020.

Setting aside the tariff impact, higher input costs primarily related to agave as well as ongoing wood inflation are expected to be an even greater drag on gross margin in fiscal 2020. We have less internally-sourced supply of agave this year, meaning we are increasingly purchasing in the open market and facing the historically high agave prices.

Against this backdrop, cost discipline and efficiency improvements remain top priority. We will stay diligent on SG&A and are targeting growth of only low single digits in fiscal

2020.

Underlying A&P investment is expected to grow at a somewhat lower rate than underlying net sales growth, but only slightly lagging. In addition to the incremental investment plan, we have reallocated advertising investments from less efficient areas such as agency fees, sponsorships and local events to significantly increase our investment in broad-reach media and digital and in the range of scalable consumer facing activation. Media investment alone is expected to increase up to 30% in key markets such as the U.S., U.K., Germany, France and Australia.

In addition, we expect to add significant incremental dollar to fund promotional activities, particularly in the U.S. This investment is reflected in our net sales forecast and is additive to our advertising investment.

In summary, we are confident that our media plans and overall spend levels will support our top line growth expectation for fiscal 2020. We also believe we will be able to continue to drive leverage from gross profit to operating income, resulting in underlying operating income growth in the 3% to 5% range and earnings per share of $1.75 to $1.85. This EPS range incorporates a tax rate of 21% in fiscal 2020 versus this past year's 19.8%.

As we lap the full year cost of tariffs and move beyond fiscal 2020, we expect to get back to our historic high single-digit underlying operating income growth fueled by consistent underlying net sales growth.

Now, before I wrap up, I want to discuss our foreign exchange headwinds. Foreign exchange negatively impacted our results this past year by 2 points at the top line and 3 points at the operating income level. Foreign exchange headwinds are not new to us. In fact, they've been present for much of the last decade. I thought it might be helpful to help frame this, given that we are the only U.S.-based publicly listed spirits company, meaning we are hurt by a strong dollar, where our foreign competitors have benefited as their own currencies have devalued against the US dollars. Five years ago, the euro was 24% higher than the rate on April 30 of this year. The British pound and Australian dollar were both over 30% higher for the same period. Many emerging markets, including Russia, Turkey and Brazil have experienced much more significant devaluation.

With over half of our revenue generated outside of the United States and the majority of our production occurring in the United States, we have been disproportionately impacted by the strengthening dollar. To help quantify the impact, we estimate that our current year sales of $3.3 billion would have been nearly $400 million higher if foreign exchange rates have remained at fiscal 2014 levels. This translates into an estimated operating income impact of $160 million or $0.27 of EPS at a 21% tax rate.

In addition to those amounts, we believe the strengthening dollar over the period likely hurt demand in some markets because of reduced purchasing power in dollar terms. On top of adverse foreign exchange, as you know, Brown-Forman has gotten caught in the crosshairs of the world of retaliatory tariffs. The gross annualized impact on tariffs as we've discussed before is roughly $125 million before taking into account any country rescinding or lower tariffs and any mitigation actions we took in fiscal 2019 or will take in fiscal 2020. So we are certainly facing a few short-term challenges.

That said, we believe that the dollar won't stay strong forever, that rational thought will prevail on tariffs given they lead to numerous unintended negative consequences, including higher cost for consumers and agave prices will come down given historic cyclicality. As a result, all of these factors are weighing down our near term results, but we view them as temporal and likely to reverse over time.

In summary, fiscal 2019 was another year of solid and consistent top line performance at Brown-Forman, delivering nearly 6% underlying net sales growth after adjusting for tariffs. But we were disappointed by the mixed results in the United States. We believe we have begun and will continue to take the appropriate actions to accelerate the U.S. business in fiscal 2020 and are optimistic that our recent improving takeaway performance reflects some of those actions already.

We expect stronger rates of top line growth outside the U.S. than in the U.S., again, in fiscal 2020. While gross margins are expected to remain under pressure in fiscal 2020, our cost containment and efficiency efforts have propelled operating margins above 34%, including the investments we have been making in our business. We, again, ended the fiscal year with a top-tier ROIC of 22%, including another year of record investment behind our business in the form of CapEx and barrel whiskey inventory based on our medium-term growth outlook. Strong and consistent financial results and judicious capital allocation have helped us deliver terrific returns for our shareholders.

Our excellent 10-year TSR was 19% per year. This type of compound growth results in tremendous value creation for shareholders. $100 invested a decade ago would have been worth over $550 at the end of this past fiscal year. And we are hard at working on executing the long-term strategy that we believe will help drive superior shareholder return over the next decade.

And that wraps up our prepared remarks. So Nicole, could you please open up the call to questions?

Question and Answer

Operator

— ***Operator Instructions*** — And the first question comes from the line of Chris Pitcher with Redburn.

Chris Pitcher

You referred to the launch of Apple in the back half of the year. I was wondering if you could talk through what lessons you've learned from Honey and Fire. And how specifically you're looking to position the brand to tap into the 2 million cases that you were – referred to?

Lawson Whiting

Yes. I mean, I think – and Jane, you can weigh into, but over, I'll say, the last 9 years, it's been about 9 years since we launched Honey, we've been very thoughtful and measured with our flavor strategy. But one thing we do know is the flavors do bring in new consumers into the franchise, and that's probably the single most important point and one of the reasons why we continue to believe in them. It's been – since 2011 with Honey and then 2015 with Fire, so those brands have been around now for a while, and they continue to grow. And as I said, they continue to add to our – not only our growth rate but our margin. So these are good healthy businesses for us. I find it interesting, flavored whiskey now – I mean, this is just a U.S. comment, but flavored whiskey is now larger than the flavored vodka category in the United States. So it's a big category, it's a very profitable category. And one that we've seen really minimal cannibalization over a period of time.

So there's a lot of good things going on in the world of flavored whiskeys for us and one we're going to continue on. And I should say, it's only going to be in the United States and it's only the second half of the fiscal year. So it doesn't have a massive impact on next year. But long-term, when we roll it out internationally, we will really be the first big brand that goes with the Apple flavor internationally, and it keeps us pretty optimistic that can be a meaningful business.

Chris Pitcher

And just to be specific, I don't want to pin you to targets, but in terms of the first 12 months of launch, should we expect a sort of Honey-style step-up in terms of volume? And specifically how are you positioning it so not to cannibalize the Honey brand?

Lawson Whiting

Well, we don't have a – we're not going to give kind of a volume forecast. We've said that it can improve our growth rate by what, about 0.5 point next fiscal year. So that – you can sort of back into some sizes there. But no. I mean, I think, the way people consume the Apple will be different than the way they consume the Honey brand. And so, I don't – as I said, we haven't seen significant cannibalization in the past and we really don't have a reason to see it – we don't really think it will be that big going forward. Obviously, there's a lot of Jack Daniel's drinkers right now that have moved into Crown Royal Apple because that brand has been so big over the last few years, and so our hope is that we're going to go get some share back from there too.

Operator

Your next question is from the line of Peter Grom with JPMorgan.

Peter Grom

So Jane, I was hoping you could elaborate more on your underlying SG&A outlook. The performance in '19 was clearly impressive, but on top of cost savings and efficiencies, you've highlighted in the past that some of the OpEx leverage was more onetime in nature as well as due to competition. So can you maybe just touch on where you see the opportunities to cut more? And then also, what would kind of trigger those bonuses or compensation related items that helped '19 to move back into SG&A in '20? And does your guidance reflect those bonuses coming back?

Jane Morreau

A lot of questions there. So I think you're just really asking about our guidance on SG&A going forward. And I will, as we talked about in our – in my script today, just – if I go back to 2013, we've been reallocating from SG&A to brand expenses purposefully for a number of years. And over the last 5 years, our SG&A is flat with what it – today versus what it was 5 years ago due to what you're referring to some of our productivity and efficiency initiatives that we've had going on. But yes, we've been able to continue our strategic investments, whether it's in emerging markets or rest of markets and so forth. And we'll planning – plan to do that. We still have some other projects going on as it relates to SG&A, but we continue to have – when we think about efficiency and productivity initiatives, we think about every line item, every operating expense line item of the P&L, so that starts from discounting and ensuring those are the most effective and efficient they are. So gets into our revenue growth management capability, it gets into our cost of sales, looking at packaging opportunity, looking at ensuring our supply chain is as efficient as it can be. It looks at sourcing opportunities not only in our cost of goods, but in our advertising and SG&A. These are all projects that we continue to have ongoing as we look ahead. And so I guided this morning to a modest growth in SG&A, a low single-digit growth next year in SG&A. We did benefit this year as you noted from some onetime items. And as you know, some of that was compensation-related items that we've got – what we plan for next year is we have a philosophy regarding our compensation, we got to pay for growth or we got to grow to pay for that growth, and so that's all built into our outlook for next year.

Operator

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

Vivien Azer

So I wanted to touch on pricing and promotion. Jane, your call out on stepped up promo in 2020 in the U.S., in particular, it makes a lot of sense given some of the trends that we've been seeing. So I was hoping that you can just comment on how that impacts your expectations for the pricing that you've been seeing in the Brown spirits category in the

U.S., has that been – has it been tempering already? You expect that to continue? And then how that impacts your thoughts around the total company top line algo, volumes, pricing and mix?

Jane Morreau

Okay. There's a lot there too. I'm glad you pointed out and brought up the promotional incremental spend that we're going to do in the U.S. And we started doing a little bit in the fourth quarter, really in late April. And if you recall from our third quarter call, we actually had expected some of the promotional activity and some of our shift in spend more to broad-reach media to actually take hold in the fourth quarter and accelerate our U.S. growth faster than – and it just hasn't come about yet. So we're very encouraged about our most recent – and I don't – you all know me, I don't typically focus on short-term trends, but because we were able to get these programs in late in the year in April, we went on new creative and broad-reach media, started last week of April. I think it's relevant to look at what's working now. The latest drop of Nielsen trends shows for Tennessee Whiskey, in particular, an increase in the volume. You will see some increase in promotional activity too as you're pointing out.

As we look into the rest of 2020, we expect to continue to have some increased promotional activity, smart about it, in terms of when and how we do it, we'll be very smart about that, as you know we will be. So as we look at the plan for next year, when I talked about the 5% to 7% growth at the top line on an underlying basis, it will be another year of more volume-driven plan than a price-driven plan. We do have some pricing expected largely with tequilas, which we can talk about later. But other than that, it's going to be largely be a volume-driven plan with some benefits continuing from mix because as – we're expecting next year's volume growth from our premium plus business to continue to outpace and provide mix benefits.

Lawson Whiting

The only – I'll put just a couple of other points around it. I mean, in calendar 2018, so not – yes, in calendar 2018, we did take prices up on Jack Daniel's. And we were up during the O&D period and unfortunately the competition went down at the same time, and we got hurt. And that's part of the reason why the U.S. had a tough year last year. And we really did, I'll call it a call to action on the U.S. teams over the last, say, few months all the way through the 3 tiers to really rally behind the Jack Daniel's Tennessee Whiskey brand. And as Jane mentioned, there's significant increases in media, we've got all kinds of new creative out there, and we're going to be a little bit more aggressive on the pricing front. As we say, some of the short-term reactions are pretty good, but it's one of the reasons why I do think we will have a good year in fiscal '20 because we've let out a little rope to the teams to be able to be more aggressive and hopefully we'll see the results from that.

Operator

Your next question comes from the line of Amit Sharma with BMO Capital.

Drew Levine

This is Drew Levine on for Amit. I wanted to ask about the Mexico tariffs that are supposed to go in place next week. I know tequila is around 8% of the portfolio now. Can you just provide some context on how much of that is in the U.S. if potential tariffs are contemplated within your guidance? And then kind of combined with pricing actions on tequila, if you think you might need to take even more and how that could impact volume for the category?

Jane Morreau

Yes. That's all great questions. And in our guidance, we do not have any increases, decreases built in there. So no rescinding of tariffs from Canada or Mexico that they have already said nor a reduction in Turkey's tariffs, 140%, nor Mexico is going the other way.

With that being said, as you saw, this is a staged impact so it would go up on a monthly basis. And then if we look at the rescinding versus this non – versus this new, it's not material to our overall picture next year. Our tequila sales in the U.S., so this would be new on imports of tequila into U.S., this tax that you're referring to is only 3% of our total revenues, so pretty small in the grand scheme of things. When we look at pricing itself, just as a reminder, I've alluded to this in my script too, we are taking pricing next year in Mexico – or this year in Mexico in fiscal 2020, We took pretty aggressive pricing last year with 10% pricing. We're taking double-digit pricing again this year.

Some of that simply is because the market there is more accepting this right now, given that the Mexican market in general has lower margins. And so given that pressure from agave, other players are also taking it and we are too. As it relates to the U.S., we already have some selected price increases planned. We are starting to see a little bit of pricing in the U.S. in syndicated data on tequilas, and we will keep mindful of that and of course the situation you alluded to, we'll be very mindful of and very on top of and we'll adjust as we need to.

Lawson Whiting

Yes. I mean, there are so many moving parts in the world of tequila these days. It's kind of fascinating that the general consumer demand has been fantastic. The demand for innovation as we mentioned in the Cristalinos at very high price points, sort of ultra-premium price points; and the demand for that is fascinating too, but all that demand has created so much pressure on the supply. And Jane walked through all that, but it's dramatic, a business that we would have that would see the raw input costs going up by very large multiples. I mean, from low single-digit pesos per kilogram to sort of mid-20s, even high 20s. There's very few – I mean, I can't think of very many businesses that see a 5, 6, 7x increase in your raw costs.

So the pricing environment has to give a little bit. We have to think that. It hasn't really moved much yet in the United States as it has in Mexico because they started from a lower base, but we do expect to that the category will see some pretty meaningful increases in the near-term future. And if tariffs enter the conversation then, I don't know. I don't know where – how significant and how long that those and what that impact will be. We're just going to have to be a little more agile on our own pricing strategies and see how that plays out.

Operator

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

Judy Hong

First, Jane, I don't know if I missed this, but did you give a gross margin guidance for fiscal '20? And how tariff versus the input costs kind of break out in terms of your gross margin guidance? And then just more broadly speaking, just going back to your U.S. business, I think certainly makes sense to spend a bit more money on the promotional side of the question. I guess also – and I'm still curious to hear kind of your thoughts on your total ad spending going down as a percent of sales this year in light of, again, when you hear your competitors raising their ad spending 200 basis points over the last 2 years, why not sort of take the year to do both, so increase promo and ad spending as a percent of your sales more aggressively?

Jane Morreau

Let me answer your first question, and I'll start on the second, Lawson, you can jump in. I did provide guidance on fiscal 2020 as it related to gross margins. I said we expect another 200 basis points decline in our gross margin next year, about half of it was due to tariffs. The other half is due to input costs, partly agave related, which we've been talking about this morning. As it relates to the U.S. business, you're right, we just talked about the incremental promotional activity. I think it's also important to understand what all we're doing in the U.S. as it relates to our spend level.

So we are increasing our media spend, I referred to this in my conversation more broadly in – because it applies to so many markets but in the U.S. alone, we're increasing our media spend by over 30%. We have [ought] reduced our low reach activities, so sponsorship fees and local events. We've also increased our working dollars. So we have a fair amount of what we call nonworking dollars, couple of percentage points of our total growth, and we've reallocated them to more working dollars for the consumer-facing activations. We got new creative as we just referred to also. And so what we're saying about our spend is it is going to be much more meaningful and much more effective in the U.S. as we enter into fiscal 2020. We believe it is adequate. Something we have been very firm about and have talked about many, many times, our spending is not limited to the advertising line, in fact. Look at our SG&A line, it happens to be larger, and we believe people build brands. And that's something that is an intangible asset for us, it creates value. And so that – so we have people on the street working for us building our brand. That, coupled with our advertising investment, there's packaging and cost of goods and then we refer to the incremental promotional activities.

So we don't look at that alone. And in fact, if I added all those pieces together, meaning the incremental spend that I'm spending behind advertising, the increase in promotional activity, the reallocation of nonworking dollars, we are at or above our net sales growth in the U.S. in terms of advertising.

Lawson Whiting

Yes. I mean, I think, if you go back, if you look at it over the last 5 years, just comparing CAGR of underlying sales to brand expense, they're about in line over the year – over a 5-year window. So we've got it close right now. I mean, I do think we continue to –

as Jane said in her remarks, we have been holding tight on SG&A and trying to – we've been reallocating these investments back towards brand expense. We came up a little bit lighter than sales this year. But as Jane said, we've been playing with the mix and reallocating amongst the mix, and we feel comfortable that we've got an appropriate level out there right now.

As we say, 30% increases in media year-over-year is a big increase. I can't remember ever having an increase that big before. So you're going to see the Jack Daniel's trademark in front of consumers eyeballs a whole lot more this year – this coming year than we did last year.

Jason Koval

And Judy, maybe just to tag on, we've been going after efficiency in SG&A for a few years now, and we're really going after A&P hard this year. So those nonworking dollars are really a function of renegotiating and consolidating agency fees and reallocating to consumer facing. So what Jane was implying is that you're really getting a few extra points of A&P growth that's hidden through that reallocation.

Operator

Your next question comes from the line of Robert Ottenstein with Evercore ISI.

Robert Ottenstein

I'm wondering, Lawson, if you can kind of give us your assessment of your results in tequila. I mean, you've got a fabulous brand, tremendous heritage, it's a great liquid. The market is doing very well, but some brands, I think, Don Julio was up about 25%. When you benchmark your results versus a brand like that, and I see them as fairly similar brands, are you investing enough? Is there enough focus? Do you have supply issues? Or it's just not as a strategic imperative? I'm just trying to get a sense because it would strike me that this would be a time in which you'd really kind of put a foot on the gas for tequila and really expand that business significantly.

Lawson Whiting

Well, I mean, it's a tough time to really put down the gas on the business because of the rapid increases in agave costs. So…

Jane Morreau

We don't have supply out there.

Lawson Whiting

I mean, there isn't that much supply and that which is there is very expensive. And so we've been more about reallocating a little bit and, I'll call, allocating within Mexico itself and trying to find channels and brands that are going to deliver the highest margin. So there's a lot of that going on. I mean, el Jimador itself has gone from, when we bought it, it was about 150,000 cases to 650,000 cases. So we've added almost 0.5 million cases on the brand since we bought it. And Herradura continues to grow at a nice clip. You can highlight there are few brands out there that are growing at stellar growth rates. And we're not there, and we're trying to raise the bar and get there, but I still consider, I'll call it, double-digit sales growth on both of them in fiscal '19 is pretty good achievement. So the business is certainly in a healthier position today than it was even 5 years ago.

Jane Morreau

One thing we did, just as a reminder, Robert, was that we put the Herradura brand, which is our high-end brand in our emerging brands group in the U.S. And so, it's got dedicated people focusing on that along with a handful of other brands, and we have seen an acceleration in that growth this year. So that's in the form of people, feet on the street making calls at bars, making sure that our distribution of the brand gets that much broader. We know we've had lots of opportunities from a distribution perspective and increasing awareness on the brands. So that is one thing that you're – it's hitting. I guess, if you are looking at the A&P line, it's coming through the people and they're focused on it.

Robert Ottenstein

And what about premiumization of the brand? I mean, you do a fabulous job with Woodford and – on the whiskey side. Do you see the opportunity to premiumize Herradura maybe a little bit more and use that to deal with the agave shortage?

Lawson Whiting

Yes. I mean, we are going to be premiumizing – there's 2 ways of premiumizing. Obviously, we're taking prices up, as we said, in Mexico aggressively, and we'll see how the U.S. market trends over the next few months and quarters. But I do – as I said, I do expect it to continue to trend up. It's also – I mentioned the Cristalino Herradura Ultra. We're premiumizing within the mix that we have. That brand sells at a higher price point than the core SKUs within Herradura, as an example, both in Mexico and the U.S. And it's growing very, very nicely, so you get a little bit of benefit there too.

Robert Ottenstein

What about acquisitions on the tequila side? Would that make any sense?

Jane Morreau

I think we've got a wonderful line of tequilas, from the value price all the way up to the ultra-premium, if you will, because of the brands that Lawson was just talking about, which is Ultra. So we start off with Pepe, we've got el Jimador, we've got Antiguo, we've got Herradura, we have got the ladder covered. Now do we have innovation going on? As Lawson said, we'll continue to innovate within it. Got – bring consumers in with RTD, New Mix, which is over 7 – nearly 7 million cases now and growing. And so that we think we've got a pretty wholesome portfolio and of tequilas that can take advantage of the growth that's out there.

Operator

The next question comes from the line of Tim Ramey with Pivotal Research.

Timothy Ramey

Jane, in the context of interest expense, you mentioned agave having an impact on that. I'm wondering if you're doing perhaps long-term contracts like grower contracts we would see in the U.S. for grapes, if that concept applies in Mexico or if that's one of the reasons why that particular factor would be impacting interest expense other than just inventory.

Jane Morreau

Yes. I don't – I'm not sure, I don't – okay. Let me just tell you what's impacted our interest expense this year. We took out new bond offerings at the end of last year, if you recall. I think that is what is impacting our interest expense more than anything. You're referring to working capital, but that's not what's driving it. That's this new debt that we incurred last year.

Timothy Ramey

Okay. Maybe I misheard you on the reference to agave there.

Jane Morreau

Yes, I did a…

Lawson Whiting

Yes. I don't think there's a connection between interest expense and agave.

Operator

Your next question is from Sean King with UBS.

Sean King

Is it a – the question I have is, is it safe to assume that the underlying fiscal '20 sales 5%

to 7% and operating income of 3% to 5% growth include the 5 months of existing tariffs and you are comping the 7 months of fiscal ’19 tariffs? You were able to hold your fiscal ’19 guidance at the higher range at the back half of last year. Are like mitigation efforts getting more difficult or are there sort of other factors going forward?

Jane Morreau

Yes. It’s largely driven by the higher input cost pressures that you’re seeing, but you have captured everything correctly in terms of the 7 months and the 5 months, but it’s really the higher input costs more than anything that are depressing our gross margins next year more than they did this year. So that’s what you’re seeing. A bit more investment behind the SG&A won’t be as beneficial as it was this year either. There will be, but not as much.

Operator

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

William Chappell

Lawson, just a question on Apple. I mean, you talked about [those] in the call that flavors are now as big as vodka, yet this will only be your third launch and that’s not even coming out until calendar 2020 and that you’ve also lost a lot of share to other brands by not having an Apple out there. So can you give us some more color on why it’s taken so long? I mean, I don’t think with Apple or Honey, there’s – it’s a change in aging or anything like that. I think it’s a pretty quick process. So I’m just trying to understand why has it taken so long? Why is it still taking so long to get Apple out? Will you change the pace of kind of getting more flavors out so you don’t lose share? And then, you alluded in your prepared remarks about opportunities in gin. If you don’t mind touching on that, that would be great.

Lawson Whiting

Well, yes. So on the flavor conversation, I mean, it's funny, you say haven't you gone faster. Internally, it's always a debate as to what the pacing ought to be on these things, but we are not – what we don't want to do is be on that sort of the treadmill of introducing one flavor a year or whatever it might be. We believe that these things are really individual brands that the way we've done it has been the right way to do it. As I said, Honey continues to grow and Fire continues to grow. So there's – I don't say, there's not a need, but I mean, we haven't felt like we had to go out and do another flavor. It's just a matter of capturing what is now pretty big business opportunity for us and one that we think can be big. And as we said, there's really no competitor outside of the United States in the Apple favor. So we feel pretty good and pretty confident at the way that's going to go.

As to the gin category, it's just – it's a category we've been looking at for several years now. We continue to try to figure out how we're going to play that and news will be coming out at some point – we hope the news will be coming out at some point on how we may want to talk about it, but it's a category that continues to grow very nicely, and we continue to be on the sidelines. So it's something our groups are looking at.

Operator

And our final question for today will come from the line of Nik Modi with RBC.

Russell Miller

This is Russ Miller for Nik. Given the first quarter 2020 underlying sales growth comp, this is especially tough relative to the balance of the year, just wondering if you could provide any additional guidance on Q1? And as a follow-up, wondering if you could comment on on-premise sales growth trends relative to the rest of business and what are your expectations are for on-premise looking forward?

Jane Morreau

I'll talk about phasing a bit. Glad you brought that up. Just to remind everyone that last year's first quarter top line was particularly strong. That's because it benefited from the buy-ins in Europe largely from the tariffs or tariffs related buy-ins. In the second quarter, it was a pretty soft quarter because there was so much giveback. So if you think about the first half of the year, I think that's probably a better way to look at last year's first half. So we're going to definitely have noise in the first half of this year going up against that tough comp top line at a global level. So I'd like to think about it as a first half, second half, if you will. So I think our first half sales growth will be in the range that we just talked about, more in our underlying growth rate that we referred to today in the 6% range. And our back half of the year will benefit from the contributions somewhat from Apple. And when I think about the bottom line, the first half will be a tough comparison because of the pressures really first half from the tariff and input costs. You won't have the tariffs when we get to the second half. So you're going to see lower operating income growth, very low operating income growth because of that in the first half. Second half you'll see that accelerate. So I hope that gives you a little bit of color there.

Russell Miller

So just to confirm, if you don't mind, that was helpful, but Q1, could that growth in fact be as high as 6% off the tough comp?

Jane Morreau

Going up against a 9% growth, I don't expect that it will be. So strong last year's first – yes, first quarter.

Russell Miller

And lastly, any color on on-premise that you could share?

Jane Morreau

On-premise business in the U.S. remains - I think they're fairly…

Lawson Whiting

Continues to grow, but it's a low single-digit growth. So it's a little bit – if you're just looking at Nielsen trends, for an example, overall market trends are going to be, I think, we said, 1 point lower than that, something like that. But it's growing. It's not in decline, but it's just not as fast as the off-premise.

Jane Morreau

Like it used to be years ago.

Jason Koval

Thanks, Russ. Thank you, Lawson and Jane, and thanks to all of you for joining us today for Brown-Forman's year-end earnings call. And please feel free to reach out to us if you have any additional questions, and have a great summer.

Operator

This does conclude today's conference call. We thank you for your participation and ask that you please disconnect your line.