Brown-Forman Corporation, Q1 2015, Earnings Call 2014-08-27

Presentation

Operator

Good morning. My name is Jody, and I will be your conference operator today. At this time, I would like to welcome everyone to the Brown-Forman First Quarter Fiscal 2015 Earnings Conference Call. — ***Operator Instructions*** — Thank you. I would now like to turn today's conference over to Mr. Jay Koval, Director of Investor Relations. Please go ahead, sir.

Jason Koval

Thanks, Jody, and good morning, everyone. I want to thank you for joining us today for Brown-Forman's first quarter 2015 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 first quarter of fiscal 2015. 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 reason management believes they provide useful information to investors regarding the company's financial conditions and results of operations are contained in the press release.

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

Jane Morreau

Thank you, Jay, and thanks, everyone, for joining us for our first quarter earnings call. I have 3 topics I plan on covering today, and that'll leave us plenty of time to address Q&A, after Paul's brief comments. So first, I'm going to review the first quarter results, then I'm going to share some thoughts on flavor innovation on American whiskeys and provide an update on our Jack Daniel's Tennessee Fire test. And then third, I'll discuss our full year outlook.

So let me first start with a review on our first 3 months of the fiscal year. As we discussed in June and as expected, we had a very challenging quarter, in terms of comparisons versus last year. This was largely as a result of trade disruptions from recent pricing decisions. We anticipated these actions would result in significant reductions in both retail and trade, at distributor inventory levels. It caused some variability, also, in some of our buying patterns, when we compare our results versus a year ago. So what I thought I would do here is share with you some more specifics, as it relates to the markets that were most affected by these inventory shifts, that just started both our underlying and reported trends to provide some context, when you look at our underlying trends, which are depletion based and compare on to our consumer takeaway trends, based upon syndicated data, whether it's Nielsen or NABCA. The common theme, though, that you're going to hear, as I talk, is in each of these markets, the consumer takeaway trends are much stronger than our depletion trends, again illustrating the retail trade inventory reductions that happened in the quarter.

So let's just, first, start with the United States. We've discussed this with you in the – in June that we will – had on significant price increases over the last 2 years, as you know, particularly on Jack Daniel's Tennessee Whiskey, where we average somewhere in the 3% to 4% range of pricing per year. That drove large buy-ins at our distributor level and our retail level in the past 2 fiscal years in the first quarter. This year, as we also discussed in June, we reduced the rate of our price increases into the, like, 1% to 2% range, and so what that resulted in as we saw very little buy-in activity in the first quarter, but a subsequent reduction in the inventory levels of both the distributor and the retail.

So we estimate, when we look at the inventory levels at the retail and distributor levels in the United States, they really have dropped significantly in the first quarter of this fiscal year compared to the last 2 fiscal years, and then are flat below the pre-price increases in 2012. So just to further illustrate, I'm going to give you a couple of numbers here. And I want use Jack Daniel's Tennessee Whiskey because, of course, this is our most important brand in the United States, as well as around the world. In our underlying trend, our depletion results for Jack Daniel's Tennessee Whiskey declined 4.5% in the first quarter in the U.S. We compare that to our adjusted blended takeaway trends, trends are up 2.5%. So you can see that the significant difference between the depletion trends, as well as the takeaway trends, indicating a retail reduction in the inventory levels, which is not in our numbers that we report on an underlying basis. Importantly, also is that we've seen the Jack Daniel's Tennessee Whiskey's volumes takeaway trends have been accelerating by about 2 points in the most recent 3 months compared to the trailing 12 months, which, we believe, bodes well for the U.S. business over the balance of the year, when we look at our price and volume balancing that we're doing this year.

So set aside the U.S. and let's go to the developed international markets, which we saw a deceleration in results in the quarter. Net sales were actually down 1%. Now some of that was due to lapping of comparisons to a year ago. Last year's first quarter was a very, very strong and some of our key markets developed international markets. But a lot of it was driven by some strategic decisions we made to reduce our promotional activity. For instance, in the U.K., we moved from a high/low pricing strategy there to an everyday low price, in one of our channels. What that resulted in is a short-term hit to our numbers, as retailers reduced their inventories in that market, but we do believe that's the right action in the long-term, and we'll realize higher pricing as a result.

More similar type of situation happened in Germany, different reasons, but also to do with pricing, but it called some, what we call, variability in the customer buying patterns. So similar to what I just did in the U.S., I'm going to give you a couple examples of what happened in these 2 markets. Again, using Jack Daniel's Tennessee Whiskey, if we look at the U.K, the U.K. depletion trends, again in our underlying sales for the quarter, were down 16%, where the takeaway trends are up much, much stronger, and actually are growing. They were up 5%. In Germany, the depletion trends were down 23%, whereas the takeaway trends, again, were growing, up 4%. So when you look at these 2 markets, there's roughly a 20-point spread between depletion and takeaway trends in these 2 important markets for us.

Moving on to Poland. It had another very challenging quarter, very weak economy there, and it continued give back from the January 1 excess tax increase from a year ago or from earlier – from last fiscal year, where we had buy-ins. So what we've done, because of all the noise and the numbers, is we've made some adjustments. We estimate that adjusting for the reductions in the retail trade inventory levels that distorted our numbers significantly in the quarter. So the ones I just described for the U.S., U.K., Germany and Poland actually resulted in our overall global net underlying sales for the quarter to be about 6%, which is right at the low-end of our underlying sales growth for the fiscal year outlook.

Just to mention a few other markets in Europe, that are really doing very nicely, both on an underlying net sales basis, as well as the support and takeaway trends, such as France, Belgium and Netherlands, we still are seeing some pressure, economic pressures, if you will, in Italy and Spain. But if you flip over to our emerging markets, they had a very, very nice quarter. It grew quickly. In fact, they accelerated from last fiscal year. They were up 15% in the quarter. We knew, and we had described some of this to you previously, that Mexico's growth was going to be up, because of some favorable comparison against the weak periods last year, where there were large givebacks. But beyond that, the majority of our other countries in the emerging markets really enjoyed strong growth. And I could name a lot of them, but I'm just going to name a few of them. Brazil had very nice growth. Russia, Turkey, Indonesia, just to name a few.

So in some – summary, while I said our underlying trends were up 3% net sales for the quarter, so overall reported, we really believe that the underlying trends themselves, when adjusted for these retail inventory adjustments, were close to the 6%. When I look though, however, at the 3% growth that we had in top line for the quarter, about 2 points of that improvement was driven by price mix. That combined with the reduction in our cost actually helped drive the 50-basis-point improvement you see in our gross margins, as well as our 5% gross profit growth that you saw in the quarter.

Moving on to A&P. You saw a reduction in A&P spend. That's really timing related only, where you saw an 8% increase in SG&A, as we continue to invest behind our people to drive our business, including the route to consumer change we made in France last fiscal year. We discussed this at the end of last quarter call, too. We actually expected our first half of the year SG&A to be higher, and so as the year goes on and we start cycling against these investments, this is a stepped up investment we made in France. In the second half of the year, we expect SG&A rate of growth to go down.

So pulling this all together, our underlying growth in operating income was up 7% for the quarter, 1% on a reported basis. Our EPS grew 5% to $0.70 per share.

So let me now move on to my second topic, and I want to discuss flavored whiskey and its impact on American Whiskey Renaissance, and then I'll update you on the Jack Daniel's Tennessee Fire test. I thought it would help to frame the American Whiskey opportunity that we see by going back in time. So let's go back to the 1970s and look at how many cases of American whiskey were sold at the time. It's about 100 million cases. That's when the consumption of American whiskey actually peaked. Well, fast-forward it today, where there's a 40-year secular decline in the category. It was roughly cut in half, so it's about 50 million cases. If you look at the U.S. population of legal drinking age, at that time, it's grown about 50%. Meaning the per capita consumption of American whiskey has fallen by almost 70% over that period. So we were witnessing an inflection point in the U.S. American whiskey around 2010, where we really saw consumer interest in the category reignited. And so when we look at the work we've been doing over the last 4 years and the growth that has resulted, we think this is the first of many, many years to come of recapturing the lost market share, that I just described to you.

So when we look at what we think is the cause of this renewed demand, of course, there's a multiple factors, but I'm just going to mention a few. One is the rise in craft distilling, which is led by our own Woodford Reserve; the consumer interest in heritage and authenticity; and what appears to be vodka fatigue. But this just – I'm going to focus on another factor, I'm calling a fourth factor today, which is the important as the flavored whiskey.

So in 2013 in the U.S., our flavored whiskeys accounted for about 45% of the American whiskey volume growth. When we're looking at what drove that, most definitely demographics played a major role in that and with the increased interest from women and minorities, based on their changing taste profiles and preferences, as well as convenience. I can speak to this. I have a couple of millennial kids myself, and I know I probably taught them to like things that tasted differently, but millennials definitely have grown up with many different flavor offerings, whether it's cereals or soda or water or juices. So they now expect to have all kinds of choices and taste, and they want great tasting things. And of course, mixability and drinkability have played an important part, too, in the bourbon Renaissance. So of course, it's natural for Brown-Forman, our company, to take these and leverage these sought-after characteristics, through our disciplined approach that we have toward innovation, combined with our great American whiskey brands and innovate. And so that leads me to how we've been innovating and approaching flavored innovation, and we've been doing it in 2 main ways right now. And first is we've been focusing on different taste profiles and expressions of existing brands. So some examples would be Woodford Reserve, Double Oaked force or Single Barrel or Jack Daniel's Sinatra. And what these products had were different taste, built off of grain recipes or barreling technology or aging requirements, but they serve to be what we believe are great extensions of our core brand offerings. And they also were tended to be in the super-premium price points. They definitely have generated positive publicity and also satisfying what is new in this era of consumers' desire for discovery. So you can expect that we'll continue to selectively release these innovative offerings into the future.

So the second way that we've been introducing flavor into our portfolio of brands is through flavor liqueurs into our whiskeys. And of course, we did that with Jack Daniel's

Tennessee Honey. That's selling over 1 million cases. Just after a third full year into the marketplace, we reached that last – this past January, and we think that speaks volumes to the global interest in the brand and really the success of our innovation strategy. So it's allowed us to introduce new consumers to the brand, and as well as offer new drinking occasions. And for a while, we've seen some recent bit of slowdown in growth rates of the brand in the U.S., as it begins its fourth year in the category in the law of large numbers takeover. We really do believe there remain untapped opportunities for the brand in this important market in the U.S., as well as we can continue to expand it outside of the U.S. as we continue to do this year, where the brand grew underlying sales a little over 50%. So you can expect that we'll continue to drive the Tennessee Honey's growth around the world, but we've been testing, as we've discussed with you previously, our second full stream flavored expression, which is Jack Daniel's Tennessee Fire. So the test results from these 3 markets where we entered – where we started to test, have been really, really encouraging, both from a trade perspective, as well as the consumer perspective. We've also seeing nice halo in these 3 markets on the Jack Daniel's trade market sales, for its gain shared, with minimal cannibalization to both whiskey, Tennessee Whiskey, as well as Tennessee Honey.

So now with that, our plan is on rolling now Tennessee Fire to 5 additional states during the fall, and we're readying our plans for possible further geographic expansions. But our goal, with Fire, is really in line with what we've been able to do with Honey, and it's to create a brand extension of Jack Daniel's versus the flavor of a week approach. So we'll, of course, update you on our plans in future calls, as we go through this process.

So now that leads me to my third and final topic, and it's I want to update you on our growth outlook for fiscal 2015, which we affirmed – reaffirmed this morning. I know you can tell from my earlier discussion about the first quarter, there's a lot of noise in it. And so we do not believe the first quarter results provide a good read for our full year, and that's why we provided the adjustment for you to give you an idea that we believe that the underlying trends are there to keep us on track to deliver the 6% to 8% net sales growth that we shared with you on our last call.

Now this does assume that there's no further deterioration and what we call the very fragile geographic, geopolitical environment in Russia, where there's uncertainty around the government policies, how local laws may have been interpreted and enforced. Just to put it in context, Russia is an important market for us, but in fiscal 2014, it represented a 2% of Brown-Forman's total net sales. So we have and we continue to expect to take price increases this year, which we believe will drive modest gross margin expansion that we also described to you in June. This, coupled with the gross profit growth, continued leverage in A&P and SG&A, but we will continue to invest in both of these categories. We believe we're on track to deliver the 9% to 11% operating income growth that we discussed in our last call.

So while our outlook for our earnings per share remains unchanged, it's still $3.25 to $3.45, we do see a drag, as a result of foreign exchange, about $0.06, but we also are seeing a slightly lower – or forecasting a slightly lower effective tax rate, somewhere around 29.5% , so we expect that to offset much of the drag from the negative impact of foreign exchange.

So in summary, I know there's a lot of noise in the quarter, and I think that we're – you're going to have quarterly noise, and that's why we like to step back and pull ourselves back and look over long periods of time, and really, to look at the future. And when we look at the global demand for our American whiskey, it remains solid. We talked about innovation, of both with Honey and what we're doing with Fire and that's definitely has helped power our results over the last few years. The premiumization trends continue, and so what we think all that combines together is it positions Brown-Forman for what will be another record year, what we believe will be another record year of both top and bottom line performance. And we look to the future, we know that we've got a strong balance sheet, growing cash flow, and that will allows us to invest in the future growth for our returning cash to our shareholders through dividends and share buybacks, as you saw in the quarter.

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

Paul Varga

Thanks, Jane, and good morning to everyone. I'm just going to add a couple of supplementary comments to Jane's, and I'll be rather brief, given that we're only 90 days into the fiscal year, and we actually did a pretty thorough presentation on the company here a few weeks back at our recent shareholders' meeting.

So all in all, the quarter was pretty much in line with what we had anticipated. And in many ways, it was similar, in my view, to what I recall from the first quarter of last year, when inventory changes and buying patterns distorted the short-term results somewhat. And of course, these – the changes that Jane emphasized in her part are, of course, accentuated by the reality that, of course, we're just talking about a very short period of time here, in 3 months. So I thought most important were Jane's examples, comparing the recent growth rates and consumer takeaway versus depletions for Jack Daniel's, in 3 of our key countries: the U.S., U.K. and Germany. Particularly, I thought it really illustrative of this inventory point that she was making. So it also, not as an important for understanding the results, but it's a source of reassurance to me that results should improve over the balance of the year, as the inventories come back into line, the takeaway actually drives the business versus the inventory shifts. So all in all, the expectation of improving underlying growth rates and both sales and gross profit coupled with the continuing expectations, as we had at the beginning of the year and had last year of decent spending leverage, gives us the comfort to reaffirm, at this stage, the full year earnings forecast that we provided just 12 weeks or so ago.

So that sort of is a nice summary of – that I feel, of what the quarter said to me. A couple of other things. Looking ahead, Jane touched on Russia. It is a bit more of a risk today for us than it was when we did our full year plans. And while no doubt an important market, particularly to the very long-term for Brown-Forman, we do take some comfort from the fact that our emerging market business today is quite well diversified. And as we reported this morning, those markets collectively continue to perform very well, with underlying sales in the quarter up 15%.

And finally, I just want to add a point or 2 here, on Jane's comments, about the flavored whiskey opportunity. As she said, Jack Daniel's Tennessee Honey is off to another great start globally,, and we continue to have high hopes for it. Less visible to everyone has been the fact that alongside it, we've been assessing the potential for this possible entry into the marketplace, which is Jack Daniel's Tennessee Fire, and so far, I'm very encouraged by what I've seen in the 3-state U.S. tests. As expected, this happens with almost any Jack Daniel's product that gets tested and introduced, there was high – there's has been high trade and consumer curiosity, and then therefore, early demand for the product. It correlates well with that. So it is quite high. And we, as I said – we just we get this almost with anything we take out into the marketplace, with Jack Daniel's. But beyond this, we tried to read the test results, and what we're seeing is that they're indicating a very strong acceptance of the product itself, which is always really important when we go out and introduce the product, either on a large scale or into tests or even if it's in simulated tests before an entry. So the product performance in the marketplace itself, we consider very important and that seems to be very well accepted in these test markets. As well an appreciation by many, for Jack Daniel's Tennessee Fire being a more premium, authentic and masculine alternative in this space. So not surprisingly, the Jack Daniel's would bring that kind of relevant imagery to the category. So we will be expanding to a few more states, here in October. And in the meantime, we will read the original 3 states for a couple of months more, while we assess the timing and manner in which we will more substantively expand it geographically. It's just an exciting opportunity for our U.S. business, and we know there will be interest beyond the U.S. as well, which of course, we'll also be evaluating. So we'll keep you appraised in the weeks and months to come on our plans, more specifically for Jack Daniel's Tennessee Fire.

So that's all for our prepared remarks, and we're now happy to take any of your questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question comes from the line of Bill Schmitz from Deutsche Bank.

William Schmitz

Can you just talk about how much of the emerging market growth, excluding Mexico, in your mind you think is distribution gains versus same-store sales? Is there a way to quantify that?

Paul Varga

We know we have a fewer syndicated resources that cover the broad distribution, particularly in Jack Daniel's in those markets, so – but you're always building a little bit of inventory, because we're still at early stages of the development there. But I think we've been in many of those markets now long enough that these double-digit growth rates we're seeing, I feel, are reflective of consumer takeaway versus inventory build, and they're not – all these markets will be very different market by market. But you tend not to see some of the buying patterns, that you will see, with these major customers, that you have in the developed markets, that have the ability to inventory and build 4 to 6 to 8 months' worth of inventory. So I think that we're generally – my feel is that just because of the consistency with which the results have been coming forward over the last many years, that it's indicative of consumer takeaway in those markets, more so than any kind of inventory build.

William Schmitz

Great. And then just a quick follow-up. Did you set a revised time for the broader rollout of Tennessee Fire? Did I miss that in the prepared comments? Was there a timeline when you think you'll have national distribution?

Paul Varga

The only thing we just said was, if you missed it was, we're going to go in October to 5 more states in the United States. And between now and then, we'll be assessing the plans for doing something more substantively in terms of a broader geographic expansion, and we'll keep you posted on it. But we've got some work still to do in observing a little bit of performance in those original 3 states, and we want to keep looking at how best to sell and market the brand, when we go to a broader geographic platform, but all of the signs are really encouraging that we're going to be well accepted with it. It's just getting our ducks in a row.

Operator

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

William Chappell

Paul, Jane, can you maybe just help us understand what was different from your internal expectations in the quarter? Because it sounds like a lot of the pricing and the timing of shipments and – was pretty much what you expected 12 weeks ago. So I'm just trying to understand, if we look at, like, maybe Finlandia or if we look at the growth in the tequila market, what was different from what you were expecting internally?

Jane Morreau

I think the only difference, from my perspective, was not understanding the impact of some of the pricing decisions that we were making in the developed international markets. Now we understand them. But I think that was the main one. We were still somewhat uncertain, as it related to our brand, Finlandia, and what that was going to be – what the price increases, 2 price increases last fiscal year, was going to have on the brand itself in Poland and still are evaluating that, but I think that those were the main 2 things. But by and far, the largest thing that happened was, and it affected our quarter, was the U.S., and we anticipated it.

Paul Varga

Yes, I thought Jane's examples on, particularly the Europe, I don't think any of would have anticipated. You cited a 20-point difference between the depletion trends and the consumer takeaway trends in Germany and the U.K. We would have anticipated some of that, not to that size, and so you hope that'll correct here in the ensuing months, as you start to have trading patterns that match the consumer takeaway, so that would've been a bit bigger than we would've thought. I think the U.S., would be we largely were in line with.

Jane Morreau

— *Indiscernible* — , along with that.

William Chappell

And does that change kind of your longer term outlook on pricing and – or how you would pass through pricing?

Paul Varga

Not at all.

Jane Morreau

No.

Paul Varga

Not at all. I think – I mean, some of it is, we got more aggressive for 2 fiscal years. We had some of the same thing with the building of inventories in the first quarter back, when we did it. Now you're coming back off of it a little bit, in terms of the size of it. So it's an accordingly appropriate adjustment, then and it hits the quarter.

Jane Morreau

And it does work itself out throughout the year, though.

Paul Varga

It does. And – but the one thing you are always monitoring, and it's the reason we're doing a little less pricing this year than we did in the prior 2 fiscal years is you just want to make sure the cumulative impact of the pricing isn't too much, particularly on a franchise like Jack Daniel's, where you have both ultra-premium or super-premium pricing paired with very large volumes, and so that balancing act we're always doing, but I think that's the more important thing than – and we always try to give you transparency to what's happening, as it relates to these shifts in the inventories. But in any event, I think, the more important thing is how the consumer, and in some parts of the trade, too, are reacting to your pricing plans.

William Chappell

And the last one for me, just on further color on Tennessee Fire. I mean, as you said, Paul, you expected pent-up demand to have a good initial response. Is there any more kind of color in terms of – is it cannibalization versus Honey? Or is it incremental? Or anything else you can kind of give us? I know it's still very short.

Paul Varga

Yes, we would anticipate the early reads, like I said, they were so encouraging because it is very limited in terms of what we're seeing, in terms of cannibalization so far relative to both Jack Daniel's Tennessee Whiskey, Black Label and to Tennessee Honey. If anything, it's providing a nice halo. And it – some of it could be expected. The flavor profile that we're testing of this Jack Daniel's Tennessee Fire, is a really different taste than either Jack Daniel's Tennessee Honey or Jack Daniel's Tennessee Whiskey, Black Label. So some of it by design, I think, you would expect to be for different occasions or for different consumer palates and that in fact, is playing out in this test. So that's encouraging. I think it's more wanting – us wanting and we're also very much trying we're trying to do a lot of things at Brown-Forman, but also within the Jack Daniel's trademark, making sure that in the U.S. market and other markets, that we are appropriately focused on building Jack Daniel's, Tennessee Whiskey and Black Label, we continue to be really enthused about the potential for Jack Daniel's Tennessee Honey. And so part of it is to make sure that we don't get distracted by the enthusiasm that's out there, and we manage it well, and we can portfolio sell well and that we're in tune to any potentials that might exist for any cannibalization, even though it's been minimalized so far. So I think – and the other thing is just making sure we know how to market and sell and message these products to ensure the best collective success for the company and the trademark, and that is always a trial-and-error process, making sure you get that messaging right, the weights of spending and investment between channels. And so part of it is, I think, the necessary exercise of using the test, in fact, as a test ground to see what might bring the best results for us.

Operator

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

Ian Shackleton

Yes. A question around tax. You gotten into a little rate this year. I wonder if that is reflecting a more sustainable lower base. Anyway, I think some of the moves you made in Europe maybe helping with tax situation. Just interested to know how we should think about that going forward.

Jane Morreau

Yes. So tax, as you know, for us, I think we have the highest tax rate of all of our competitors. It's been something that we've been very, very focused on and looking for smart ways to reduce our tax rate. And of course, one of the biggest ways is to continue to grow your business outside the U.S., like we have been, and we've been growing at a fast clip outside the U.S. So that definitely has provided a reduction in our tax rate, and it's continue to do so. So if you look over the, I guess, the next several years at a period of time, I think that you could expect our tax rate to be somewhere around 30 – in the 30% range.

Ian Shackleton

Great. And Paul, just a follow-up. Australia is a market you were quite cautious about last year. It sounds like that's doing quite a bit better, with the growth now. Has that changed for the better?

Paul Varga

I think it's a little combination of both. I think within the quarter, there's maybe easier comps down there versus what we had a year ago, but I know that the team there is a little more – it's a very competitive market, I'll say that, as it relates to what's happening at the trade level. And so – and of course, the innovation remains really important down there, particularly, as it relates to the RTD business. And that team is, I think, in a better position today, as they think about the marketplace, but it – I will say the one thing about that marketplace, mid- to long-term, is the pressure from those excise taxes that have hit all distilled spirits have, in my view, have been significant and disproportionate to spirits and have been one of the influencing conditions to slow the lackluster growth in the marketplace. And I actually think getting some relief on that, through government lobbying, et cetera, is a really important thing for the industry, if it intends to have any kind of consumption growth down that market.

Ian Shackleton

And is there any sign of success, because I know it's an kind of issue, being campaigning on for a while there, Paul.

Paul Varga

Yes, it's a long slog. As you know, I mean, you're going to hear – I mean, you would've heard it from a number of the competitive companies in this industry and Poland, Jane highlighted here. I mean, it is, as we look around and you think about the topical issues, that you don't want these excise taxes to become so rhythmic in the way that they have from year-to-year, particularly within countries. And you occasionally have things like a U.S. consideration of the legalization of marijuana becomes a big threat. You'd try to assess and look at and think about long-term. These excise taxes though, particularly with governmental departments needing revenue and us perceived as an easy target, as regressive as sometimes these taxes are, have really, I think, been more present in our business over the last 5 years than any of us would have anticipated. And they do have – you just look to Poland right now, they do have an impact on the affordability, and so it requires both lobbying and it requires innovation for the suppliers and owners to go and innovate around it, so that they can bring products to the market that may not be as high proof, is the other way to do it, because a lot of it is based on proof.

Operator

Your next question comes from the line of Mark Swartzberg from Stifel, Nicolaus.

Mark Swartzberg

Yes, Paul, Jane. I guess, a few questions. Firstly, as we think about your outlook for the year, your plus 3% start, and your adjustments to plus 6%, given the takeaway dynamics being better than the shipping dynamics, it still implies you're looking for an acceleration over the balance of the year, given your 6% to 8% view. So I know this is a mechanical question, but when you think about what's going to drive the acceleration, is it Tennessee Fire? Is it a particular country? I'm just trying to square that circle.

Jane Morreau

Yes. I think that's a great question and something that we've been studying, as you can imagine. So as we look at it, I think the main driver of it will be the United States, as where we're looking for the growth to come from. It's not Tennessee Fire. Tennessee Fire is all we have in the numbers. We do not have a national rollout in the numbers. So it is the U.S. And as you recall, the discussion that we had in June, in terms of our – that rebalancing of price and volume, if you will, this acceleration after the first quarter, even though I've made this adjustment, we're still expecting improving trends, which we have seen and I alluded to that, too, in my comments, in terms of the takeaway trends for the Jack Daniel's Tennessee Whiskey brand itself. So it's the U.S. largely, is one of them. We've got to see some continued growth improvement, though, in the Western Europe markets that I discussed, and we have reason to believe that, that will happen, based upon some of the plans they have in place.

Paul Varga

I think the other thing I'd add that just helps, particularly when you're discussing it during Q1, is that as tough as our expected comps within the fiscal year, we're going to be for us in Q1, we would anticipate, at least based on history and barring any new news, that our Q4 comps would've been on the easier side, relative to what we had sort of facing us in Q1. So there is a counterbalancing things, but nonetheless as we go along, in order to accomplish these, the forces out as you indicate, things do have to accelerate. We expect some of it to come back through inventory of course, but we also feel like you do need an acceleration as you go through the year. And there's other – and remember, some of these buy-ins, they'll be particular periods, in particular countries, where will be up against other buy-ins. The Polish tax increase was – is one such example later in the year, but we'll try to keep you all current on where those inventory shifts are occurring and when they're not and how Brown-Forman is either benefiting or being hurt by them. And – but nonetheless, I mean, it, part of it, is we really only do have 90 days. We think we have a decent feel for the inventory impact on us, and we feel comfortable affirming the guidance today, based on what we know.

Mark Swartzberg

Fair enough. And if I could follow purely on the U.S. for a moment, if you will, ignoring the inventory dynamic. When you look at the takeaway, you're actually seeing and look at it on a total North American whiskey basis, how would you characterize those rates of growth versus say, earlier this year or a year ago levels? Are they in fact, accelerating? I heard your prepared remarks, I wasn't quite clear if, indeed takeaway for your brown products, if you will is, in fact, accelerating. And then kind of relating to that, vodka fatigue, in some ways, is a good thing for you guys, but we're seeing promotional activity there pickup. So could you just speak about how that's affecting, again, the Brown component of your portfolio, from a takeaway perspective, here in the U.S.?

Jane Morreau

I can – I don't know if you've get Nielsen data. I can read you some numbers, just to give you a feel for North American whiskey and their trends, both on a 3-month basis, as well as a 12-month basis. So the trends have accelerated. They are improving. So on a volume basis or a value basis, but let's look at volume basis. It's up nearly 8% on a 3-month basis, and it's about the same as it was a year ago. So I guess, it's not stellar, but it's still much stronger than the TDS category, which has, I guess, slowed slightly in the 3 months period. I think some of that is due to the vodka category, if I look at the vodka trends, which continue to slow down.

Paul Varga

And with for us, within it, I think I'll highlight one little difference that we might observe and Jane's touched on it within the quarter, which because this is now your focused here only on the United States is that, and this is a continuation of last year's results, where Woodford Reserve within our portfolio, continues to really do well and performing very much above the performance of North American whiskey generally. One of the brands, one of our oldest brands, our oldest brand, Old Forester, has been accelerating and its performance over the last 18 months to 2 years. So those would be real highlights. Of course, Tennessee Honey, as a flavored expression, has done very, very well, but those rates, as Jane mentioned, have been coming down some, off the higher basis. The Jack Daniel's Tennessee Whiskey volumetrics are going up, but associated with it – just because we've been taking less price, you'll see less price. The price/mix will come down subtly on that. And then brands that have been performing below North American whiskey, and it depends on how broadly you define it within our category in the United States, would be our Canadian Mist, Early Times, and then even if you went so far as to include a brand that straddles it, which would be a Southern Comfort, has been a brand that we, from time-to-time, refer to, even though it's liqueur, as a flavored whiskey. It would be below, performing below, and – but that's consistent with some prior year reports as well. So I mean, I think the big changes that people might note in the first quarter are slightly different delivery of the sales dollar growth on Jack Daniel's, with volumes accelerating here more recently, and Tennessee Honey coming down on some of those higher growth rates to more moderated levels of growth. And remember, that's reporting only retail business primarily. The one encouraging thing about the U.S. market, that we're starting to hear and see some data for, is the improvements in the on-premise trends, and we certainly can note that for our Jack Daniel's Tennessee Honey brand, as versus its first couple of years, it has really picked up its momentum in the on-premise relative to the off-premise.

Mark Swartzberg

That's great. So the on is – so we've heard the same. Okay, so you are seeing the on. Final one is just can you speak more to whether you think this dynamic with vodka is actually good or bad for your brown spirits?

Paul Varga

Well, I mean, I think, certainly for the brown spirits it's, I mean, if people shift out of white goods and go brown, net-net, that's great for Brown performance, particularly its American business. But…

Ian Shackleton

What I'm referring to is promotional activity picking up specifically.

Paul Varga

Yes. I mean, I actually, I think promotional activity picking up. And I would say, not just the United States, I'd say globally, and I wouldn't consign it just to vodka either. I just think when you have softness in emerging markets when you – for some of our competitors, when you have some of the corporate growth rates that we observed with some of our competition, particularly the underlying sales growth rate, you anticipate that they will fight and compete for that sales dollar more aggressively. And that goes across categories in my view and can be observed on strong trademarks that might exist in everything from rum to gin to cognac to vodka. So we anticipate and observe, this varies market-by-market, that people are – will continue to be competitive, and that sometimes will take the form of promotional pricing. I wouldn't say that it's at a level that I would find out of control or something that I would raise, is any different than what I might have observed 3 or 6 months ago. I think the other things that we continue to watch out for what are the new innovations the competition are bringing, because it's new forms of competitive activity in the marketplace. And so it's a reminder to corporations, like Brown-Forman that are doing well, that they, too, need to be innovating and continuing to bring products to the market, that can meet the needs of the consumer and the trade. So the 2 things we'll keep a close eye on are what level of promotional pricing are out there and the level of competitive introductions and new products.

Operator

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

Bryan Spillane

Jane, I wanted to just go back through, to make sure I understood a few of the components that you outlined, in terms of just breaking down the first quarter. The underlying growth, to the bridge, I guess, from 3% underlying sales growth to a sort of adjusted 6% is really just the change or the effect of distributor inventories or, I'm sorry, retailer towards coming down it. Is that right?

Jane Morreau

That's correct, because the distributor inventories are already reflected in our numbers, yes.

Bryan Spillane

Okay. And then the just rough weighting, just how much of that gap, if you will, between 3% and 6% was, I guess, the U.S. versus what you saw in the U.K. and Germany? Can you just – I'm just trying to get a rough idea of the proportions, in terms of how much they might have contributed.

Jane Morreau

It was about 1/2 [ph], 2/3, 1/3, U.S. versus Europe.

Bryan Spillane

Okay. And then if I'm looking at operating income, and I know you guys measure yourselves – one of the measurements that use for management is depletion-based adjusted operating income. And I guess, if you were kind of looking at that measure, I'm just trying to get a sense for what the profit implication was in the quarter for that, the change in depletions, because of the inventory adjustment. I'm just trying to get understanding of how much of a profit hit it might have been.

Paul Varga

Pretty good, I'd say.

Jane Morreau

It would have been…

Paul Varga

Yes, because you get to flow the 3 points all the way down to the OLN [ph].

Jane Morreau

Yes — ***indiscernible*** —

Paul Varga

Yes.

Jane Morreau

Yes. So…

Paul Varga

It'll be more impactful to 3%. Wouldn't it?

Jane Morreau

Yes.

Bryan Spillane

So fair to say, right, I mean, that the retail inventory…

Jane Morreau

Double digits, when you get down to it.

Bryan Spillane

The retail inventory adjustments, that effect in this quarter was one of the things that was probably a little – order of magnitude was a little bit more than what you were expecting. So when we kind of look at it from an operating profit and earnings per share basis, there was actually a more meaningful sort of unexpected drag in the quarter, just because of that dynamic. Is that fair?

Jane Morreau

I would – I don't want to over exaggerate it. I think we anticipated the U.S., we anticipated some in Europe, but just not quite to the extreme, so it wouldn't take that whole amount, if you will. So – but in theory, it was a little bit.

Paul Varga

Yes. And we would have fine tuned in terms of our own even – just as we don't go and provide quarterly guidance on our earnings. I mean, I think it was a simultaneous qualitative and quantitative exercise that informed our expectations, and so we just weren't that obsessed with trying to forecast it, in advance, how much of the inventory…

Jane Morreau

The exact number.

Paul Varga

Might impact the overall bottom line earnings. We tried to give ourselves some sense of how it might hit the top line, but nonetheless, I think your point's relevant. It did, of course, have an impact on the underlying operating income growth rate.

Bryan Spillane

Okay. And it was – it is approaching this quarter trying to – the first quarter trying to model that was sort of like one of my kid's math word problems. I mean, there was just so many different components. And so – and I guess, and not trying to get you into a 2Q discussion, but I guess if you could, just in terms of some of the big puts and takes that we might need to consider as we're modeling 2Q, do you have any color you could give us in terms of inventory adjustments or any of those types of things, that just from a big picture at least, with that we may need to think about?

Paul Varga

I mean, nothing that we would get. I mean, I think an expectation of improvement. The only other thing that we know that is a difference from prior years that we anticipate being a help in the marketplace, particularly competitively during an important season, as we anticipate there being more gift and value-added cycles then at a greater level. Some of that, I guess, could hit, Jane, Q2 just some of the shipments and a bit more in Q3. So it might be split between Q2 and Q3, but otherwise, I mean, it's the classic culprits of inventory shift, FX. I mean, the things you're trying to read in order to get down to a really good underlying number.

Jane Morreau

Yes. I mean, I would just pick up – take off where Paul left off. I would think about – I think Q2 and Q3 were probably more normal. I think Q4 will be a bit easier. And I think component pieces of the P&L, like, and I talked about SG&A a little bit, it will continue to be high, definitely for the second quarter. And it will start to come down somewhat in the third quarter, but really come down in the fourth quarter. You'll see spend more normalized, A&P spend, which was abnormal obviously, for the quarter here timing-related only, but I think that's in the…

Paul Varga

And nothing on anything from Tennessee Fire, as Jane mentioned, in Q2. I mean, if anything had an impact, it'd be second half at the earliest, I think, as it relates to significant impact. And of course, we'll just keep you posted on that, as we have plans that we're ready to talk about.

Bryan Spillane

Okay. And just I've got 2 other just short follow-ups. One, just if there's been any change in the expectation for the capital spending range for the year? And then the second , just I guess following up on Mark Swartzberg's question about acceleration. I just want to make sure I heard – so there's acceleration that we should see, just in terms of like shipments should accelerate because of some of this inventory noise and that type of thing. But is there an expectation that end takeaway should also accelerate meaningful, I did meaningfully. I guess, that was – wasn't clear to me whether the acceleration kind of referred to just what you'll be shipping versus expecting some meaningful acceleration in takeaway.

Paul Varga

I don't – I mean, I don't know that we've got to that level where we feel like it has to jump up considerably, certainly versus Q1's reported results. But at the consumer takeaway level, I mean, I think if there's one thing that could have an impact, there are certain market-by-market examples we could give of this. But the one thing that you would anticipate having a positive impact is less pressure in the marketplace on consumer prices, because we're important not getting as much benefit from taking price increases. So I think that, as with the passage of each month and as the price has established themselves, you're always thinking about that, from a competitive reference point. So it will depend a bit on what our competition's doing as well, but I think versus prior years, if anything, that would be a potential contributor to acceleration versus deceleration. The fact that we're taking less price.

Bryan Spillane

Okay. And then, Jane, just CapEx, any change in the CapEx guidance?

Jane Morreau

No, it's unchanged. Still $120 million to $140 million range is what we provided, yes.

Operator

Your last question comes from the line of Robert Ottenstein from ISI Group.

Robert Ottenstein

I was wondering if you could help us ring fence the potential downside in Russia, how to think about the situation there. I know you said about 10% – 2% of sales. But if things got really bad, kind of worst-case scenario, how much potential income statement impact could there be?

Jane Morreau

I think it's just really too early to quantify the potential impact. It's really a fluid situation. So…

Paul Varga

Yes. I mean, I just – we're obviously, working more right now to, frankly, in some ways understand it, attempt to mitigate and communicate, in as direct a way as we can cooperate, with what we can consider to be the authorities who have, in a very limited way from what we understand thus far, with reflecting 1 region and with 3 stores, just literally open up those lines of communication to try to administratively cooperate with them. And I mean, that's sort of where we are, I think, and really it's just premature to go and start doing any significant risk assessments at this stage, I think. We want to get more information before we even undertake that exercise.

Robert Ottenstein

Okay. No, I could certainly, certainly appreciate that. Perhaps something easier to speak on. Could you just kind of give us a little bit of an assessment of how the new French infrastructure is working out?

Paul Varga

Great, so far. It went live in the beginning of the calendar year, and so you have a normal sort of transition issues in both the marketplace and that the people themselves encounter, being a new company, but it was very well planned. And I think we put investment in up front, so that it could launch in the way that it has effectively done. And I would say that just more qualitatively, the vibe that you pick up when being around the people, who are undertaking the Brown-Forman France today, is really encouraging. And of course, Jack Daniel's has been a very leading performer in that marketplace now for some time we – and actually we continue to have very high hopes for it. So for this year, you'll probably hear more about the margin as it makes its way in, as well some of the costs, but the margin impact is significant for us this year, as it makes its way into the first full year. And then from there on, going out, I mean, it really becomes about implementing in the marketplace, innovating, doing the right – Jack Daniel's Tennessee Honey is entering that market, which I think is very – it's off to a great start. And so all of that becomes the important exercise, and we'll keep you posted. I know there's a lot of interest on what might happen in France and Europe more broadly. But as a counter to the sort of these trading patterns, that we talked about in the U.K. and Germany, I'm glad you brought it up, because France continues to do very well for Brown-Forman.

Robert Ottenstein

Can you give us any sense of the volume acceleration that you're seeing now?

Paul Varga

No. And actually it wasn't planned, I think, as the some massive acceleration to help either pay for it or to recoup it. It was really more – that probably more captured in the margin than it is in any volume acceleration, and I know one of the things that group is doing now that they've got their own company is looking to what possibilities might exist for some forms of acceleration or innovation in that marketplace, now that we have more direct influence over the marketplace, and so those tend to come in the forms of 3- and 5-year plans.

Robert Ottenstein

Terrific. And then my last question, I was very interested to hear your comments on flavors, and I know you guys plan long-term. Any – I mean, just – so we have an idea of kind of how to ballpark these things. 10 years out, I mean, do you imagine – I mean, how many flavors do you think that the Jack Daniel's brand could carry long-term?

Paul Varga

In, as expressed, as your example of a flavor being kind of the Tennessee Honey or Tennessee Fire?

Robert Ottenstein

Exactly. I mean, obviously, and I don't think anybody expects anything like vodka. We talk about 2 or 3, a dozen. I mean, just kind of set of round numbers, how should we think about what you see the long-term potential for different types of flavors?

Paul Varga

I don't. I mean, I don't see it. I mean, it's hard, of course, to crystal ball. It's really difficult. I mean, at this point, I'd find it hard to think a number that you, just using a number like

10, that, at least, for my limited visibility, looking into the future, I – something about that does make me feel real good. The 2, and I'd say, that we've, which is one with still studying and looking at the second window, at a preliminary stage, feels about right for us right now. I think what you want to do though is – with Jack Daniel's, and there's been times where Jack Daniel's may lead the consumer marketplace, it's harder for a big trademark like this. You want to be innovative and all of that, but we also are simultaneously quite protective. And so if the consumer marketplace evolved to the point where actually to be competitive, it required the trademark to do more than a couple, that would create a different opportunity than I would say exists today. I mean, we've seen, right now, in terms of flavor, it's really been, in any kind of scale, really just 2 flavors for whiskey. I mean, it doesn't mean that there won't be broad acceptance of other forms because there's no way, 6 or 7 years ago, I would've forecasted 2 pretty significant, very scaled volumetric markets associated with honey-flavored whiskey and cinnamon-flavored whiskey. I just – we wouldn't have been able to anticipate it. So some of that you'll – we'll have to see where the consumer marketplace evolves to. But our current plans wouldn't forecast a rapid expansion of flavors. We – I'll give you another example, Jane referenced this, of a different type of flavor that would – we might forecast is, and we've been slowly releasing this into very limited distribution in the United States, the last couple of years, has been the possibilities of going into rye whiskey, which has been a very hot category in the United States, of late. And we've been making rye whiskey and then releasing limited amounts of it, in its various stages of aging, to whet the appetite of the marketplace. So that's a different flavored whiskey, it's not necessarily what I'll call the liqueur type of flavored whiskey that you're referring to. So I think that kind of innovation could be important as well. And then the other extremely attractive potentially area of innovation around the Jack Daniel's trademark, beyond flavors and RTDs, is really the higher rungs of the ultra-premium ladder, which the Jack Daniel's Gold No. 27 and Jack Daniel's Sinatra would represent the latest, very limited distribution and very limited offerings associated with those. But really important, not only in the marketing, but if in fact, we get those to any sort of size, they could become important to particular markets or, too, because they're very efficient in their production of profit. So the ultra-premium and alongside, the flavored and I continue to think that, at least to-date, has been a unique opportunity for trademarks like Jack Daniel's that exist in American whiskey. We haven't seen that potential to go both upward on the pricing ladder and across on flavor in many other categories.

Robert Ottenstein

No, that's very helpful. So I take it from your comments that you don't see Maple as having a lot of potential?

Paul Varga

There's none of it big. I know there's a couple of expressions of Maple in the market, and they've kind of gone up and down a little bit. So nothing has really been developed there. Of course, that is a very natural flavor in a lot of whiskeys anyway. So I don't know how different as a taste that is for attracting new consumers. I mean, one of the tests we've considered, when we look at these, is does it bring new people who otherwise appreciate, either that you may, let's say, appreciate the trademark, but don't like all the offerings provided by the trademark, but might enjoy it in a different format. So the ability of it to bring in new consumers, it was my – it's my been my just very distant observation that, particularly with the example of Maple, that there were high levels of cannibalization in some instances, at least that was at least anecdotally or qualitatively what I was observing. I can't – I don't have any facts behind that, but it would make sense because it's a much more slight variation on the whiskey than something more where the flavor itself is quite different, as it is with the Honey and the cinnamon.

Jason Koval

Thanks, Paul, and thanks to, all, of you for joining us for Brown-Forman's first quarter earnings call. Please feel free to reach out to us if you have any additional questions, and have a great Labor Day weekend.

Operator

Thank you. That concludes today's Brown-Forman's First Quarter Fiscal 2015 Earnings Conference Call. You may now disconnect.