Brown-Forman (BF.B)

Updated December 6th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	4.5%	**Volatility Percentile:**	35.3%
Fair Value Price:	$35	**5 Year Growth Estimate:**	8.8%	**Momentum Percentile:**	32.0%
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.7%	**Growth Percentile:**	82.4%
Dividend Yield:	1.4%	**5 Year Price Target**	$53	**Valuation Percentile:**	38.1%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	46.0%

Overview & Current Events

Brown-Forman is an alcoholic beverages company that is based in Louisville. The company was founded in 1870 and has a market capitalization of $22.5 billion. Brown-Forman produces and sells whiskeys, vodka, tequila, champagne and wine. Its brands include Jack Daniel's, Finlandia Vodka, Old Forester and many more.

Brown-Forman reported its second quarter (fiscal 2019) earnings results on December 5. The company reported revenues of $910 million for the second quarter, which represents a minimal decline of 0.4% compared to the prior year's quarter. It is a rare occurrence for Brown-Forman to report a revenue decline, but management has a good explanation for this development: Tariffs that were announced throughout 2018 have resulted in customers purchasing more than usual in fiscal Q1, which is why revenues grew at a relatively strong pace of 6% during that quarter. In turn, demand by customers was lower during fiscal Q2, as inventory levels were still relatively high at the beginning of Q2. Brown-Forman expects that this impact is only temporary and that revenues will grow during coming quarters. Brown-Forman guides for sales growth of 6%-7% during fiscal 2019, which underlines that the revenue decline during Q2 was an outlier. After having earned $0.52 per share during Q2 Brown-Forman expects GAAP earnings-per-share of $1.65 to $1.75 for fiscal 2019, which is in line with previous guidance. Adjusted EPS will likely be around $1.80 in fiscal 2019. Brown-Forman has announced a 5.1% dividend increase, to $0.166 per share per quarter, during November.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.82	$0.95	$0.95	$1.07	$1.22	$1.28	$1.38	$1.37	$1.65	$1.67	***$1.80***	***$2.74***
DPS	$0.31	$0.33	$0.36	$0.39	$0.44	$0.48	$0.52	$0.56	$0.59	$0.63	***$0.67***	***$0.97***
Shares	563	551	544	533	534	534	522	494	480	481	***475***	***460***

Brown-Forman has a strong growth track record. The company was been able to increase its earnings-per-share even during the last financial crisis. During the 2012 to 2017 time frame, Brown-Forman grew its earnings-per-share by an attractive pace of 9% a year. Earnings-per-share were driven by a combination of several factors, including revenue growth, rising margins, and the impact of a declining share count, which increases each share's portion of the company's net earnings.

Underlying sales growth was stronger during H1 than what Brown-Forman reported, due to currency headwinds – the strong dollar results in lower reported sales when sales in other currencies are translated back to USD. Thanks to the fact that Brown-Forman owns strong brands and is active in the super-and ultra-premium alcoholic beverages markets, which see consistent market growth, Brown-Forman should be able to keep its revenues growing going forward. This has been the most important growth factor for Brown-Forman in the past, which bodes well for the future. Brown-Forman's Jack Daniels brand as well as its American super-premium whiskeys continue to grow around the globe, although tariffs are a short-term headwind according to management. International operations were the main growth driver during the last couple of quarters and will likely remain an important factor going forward. Higher overall sales allow for margin increases due to better economics of scale, which makes the company more efficient overall, and which is beneficial for the company's net earnings growth rate. Brown-Forman has recently announced a new $200 million share repurchase program, which should allow for further share count declines over the coming years.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.1	17.9	21.4	24.1	24.7	28.4	28.8	27.6	33.2	32.0	***26.1***	***19.5***
Avg. Yld.	2.4%	1.9%	1.8%	1.5%	1.4%	1.3%	1.3%	1.5%	1.1%	1.1%	***1.4%***	***1.9%***

Shares of Brown-Forman have never traded at an especially cheap valuation, but throughout the last decade the company's multiples rose to an even higher level. Shares became slightly less expensive over the last three years, but they still trade at a premium valuation of 26 times profits. This is a tremendous premium over the long-term median, which is why we forecast substantial multiple contraction going forward. The company makes special dividend payments regularly. When we include its most recent special dividend payment of $1.00 per share, the yield is quite solid at 3.5%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	37.8%	34.7%	37.9%	36.4%	36.1%	37.5%	37.7%	40.9%	35.8%	37.7%	***37.2%***	***35.3%***

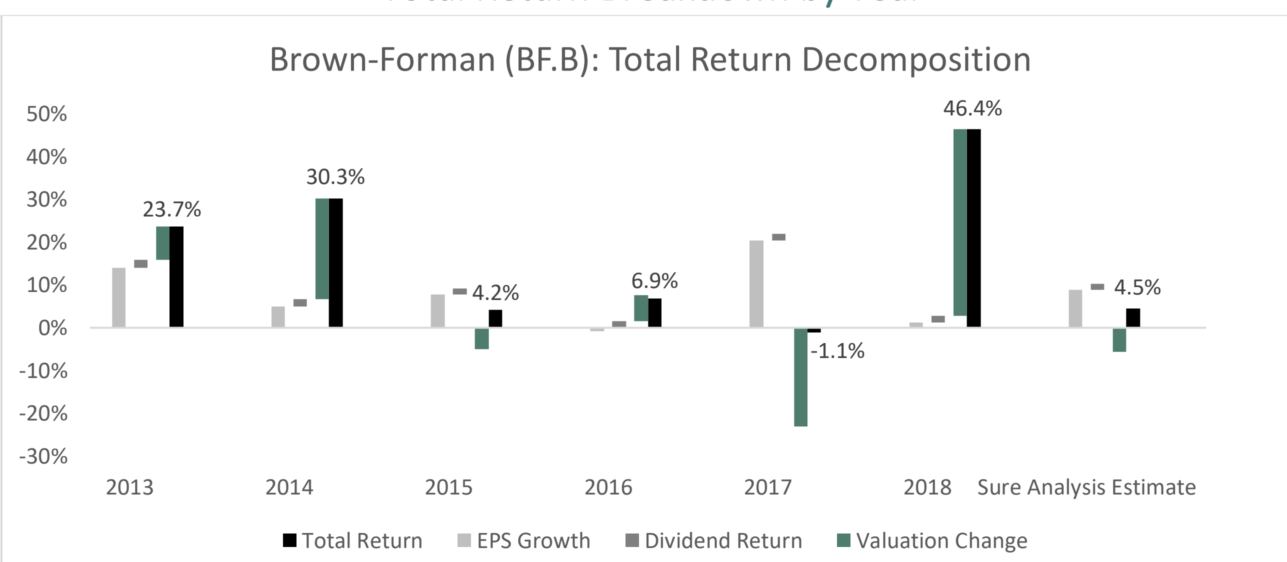
Brown-Forman has leveraged up over the last decade, financing close to three quarters of its assets with debt. The company is in no way overleveraged, though, as the interest coverage ratio (~12) remains at a solid level. Brown-Forman has taken advantage of the very low interest rates over the last couple of years, which is an opportune move.

Brown-Forman's strong brands and the tendency of customers to stick with the brands they like is a tremendous competitive advantage. This, along with the fact that Brown-Forman is one of the largest players in its industry, which allows for better economics of scale and a wider geographic reach, makes Brown-Forman highly competitive. During the last financial crisis Brown-Forman remained highly profitable and actually increased its earnings, which is unsurprising as demand for alcohol tends to be quite consistent. Brown-Forman should be able to weather future recessions well.

Final Thoughts & Recommendation

Brown-Forman is one of the largest alcoholic beverages companies, and it owns strong and renowned brands. Tariffs are a short-term headwind, but Brown-Forman continues to expect solid revenue growth during the current fiscal year. We like this high-quality company, but due to the very high valuation shares are a sell at the current level.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	2481	2469	2586	2723	2849	2991	3134	3089	2994	3248
Gross Profit	1577	1611	1724	1795	1955	2078	2183	2144	2021	2202
Gross Margin	63.6%	65.2%	66.7%	65.9%	68.6%	69.5%	69.7%	69.4%	67.5%	67.8%
SG&A Exp.	931	889	940	1005	1058	1122	1134	1105	1050	1179
D&A Exp.	55	59	56	49	51	50	51	56	58	64
Operating Profit	641	710	855	788	898	971	1027	1048	989	1039
Operating Margin	25.8%	28.8%	33.1%	28.9%	31.5%	32.5%	32.8%	33.9%	33.0%	32.0%
Net Profit	435	449	572	513	591	659	684	1067	669	717
Net Margin	17.5%	18.2%	22.1%	18.8%	20.7%	22.0%	21.8%	34.5%	22.3%	22.1%
Free Cash Flow	437	508	484	448	440	520	483	414	524	504
Income Tax	195	233	257	247	274	288	318	422	264	260

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	3475	3383	3712	3477	3626	4103	4188	4183	4625	4976
Cash & Equivalents	340	232	567	338	204	437	370	263	182	239
Accounts Receivable	367	418	496	475	548	569	583	559	557	639
Inventories	652	651	647	712	827	882	953	1054	1270	1379
Goodwill & Int. Ass.	1361	1335	1295	1285	1285	1297	1218	1185	1394	1433
Total Liabilities	1659	1488	1652	1408	1998	2071	2283	2621	3255	3660
Accounts Payable	326	97	126	120	133	134	123	121	137	154
Long-Term Debt	999	699	759	510	1002	1005	1183	1501	2149	2556
Shareholder's Equity	1816	1895	2060	2069	1628	2032	1905	1562	1370	1316
D/E Ratio	0.55	0.37	0.37	0.25	0.62	0.49	0.62	0.96	1.57	1.94

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	12.6%	13.1%	16.1%	14.3%	16.6%	17.1%	16.5%	25.5%	15.2%	14.9%
Return on Equity	24.6%	24.2%	28.9%	24.8%	32.0%	36.0%	34.7%	61.6%	45.6%	53.4%
ROIC	15.7%	16.6%	21.1%	19.0%	22.7%	23.3%	22.3%	34.7%	20.3%	19.4%
Shares Out.	563	551	544	533	534	534	522	494	480	481
Revenue/Share	4.37	4.43	4.71	5.04	5.30	5.56	5.88	6.05	6.13	6.71
FCF/Share	0.77	0.91	0.88	0.83	0.82	0.97	0.91	0.81	1.07	1.04

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.