



# Brown-Forman (BF.B)

Updated March 11<sup>th</sup>, 2019 by Jonathan Weber

## Key Metrics

|                             |      |                                            |       |                                 |       |
|-----------------------------|------|--------------------------------------------|-------|---------------------------------|-------|
| <b>Current Price:</b>       | \$50 | <b>5 Year CAGR Estimate:</b>               | 4.5%  | <b>Volatility Percentile:</b>   | 76.9% |
| <b>Fair Value Price:</b>    | \$37 | <b>5 Year Growth Estimate:</b>             | 8.8%  | <b>Momentum Percentile:</b>     | 33.6% |
| <b>% Fair Value:</b>        | 134% | <b>5 Year Valuation Multiple Estimate:</b> | -5.6% | <b>Growth Percentile:</b>       | 86.6% |
| <b>Dividend Yield:</b>      | 1.3% | <b>5 Year Price Target</b>                 | \$57  | <b>Valuation Percentile:</b>    | 9.3%  |
| <b>Dividend Risk Score:</b> | A    | <b>Retirement Suitability Score:</b>       | C     | <b>Total Return Percentile:</b> | 15.0% |

## Overview & Current Events

Brown-Forman is an alcoholic beverage company that is based in Louisville. The company was founded in 1870 and has a market capitalization of \$23.8 billion. Brown-Forman produces and sells whiskey, vodka, tequila, champagne and wine. Its brands include Jack Daniel's, Finlandia Vodka, and Old Forester among others.

Brown-Forman reported its third quarter (fiscal 2019) earnings results on March 6. The company announced that it generated revenues of \$904 million, which was 3% more than the revenues it produced during the previous year's third quarter. Brown-Forman's revenues came in below the analyst consensus, though. Brown-Forman's management points out that the underlying net sales growth rate was higher than that at 5% year over year, but adverse currency rate movement impacted Brown-Forman's reported revenue growth rate negatively.

Brown-Forman was able to grow its operating income by 4% during the first three quarters of fiscal 2019, while its earnings-per-share were up by an even better 12% year over year. Earnings-per-share totaled \$0.47 during the third quarter, but investors should keep in mind that earnings-per-share growth was positively impacted by tax law changes; one should thus not assume that the current earnings-per-share growth rate will be sustained. Brown-Forman's management guides for earnings-per-share of \$1.65 to \$1.75 during fiscal 2019, which represents a slight increase versus the earnings-per-share that Brown-Forman has generated during the previous year.

## Growth on a Per-Share Basis

| Year          | 2009   | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019          | 2024          |
|---------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>    | \$0.82 | \$0.95 | \$0.95 | \$1.07 | \$1.22 | \$1.28 | \$1.38 | \$1.37 | \$1.65 | \$1.67 | <b>\$1.70</b> | <b>\$2.59</b> |
| <b>DPS</b>    | \$0.31 | \$0.33 | \$0.36 | \$0.39 | \$0.44 | \$0.48 | \$0.52 | \$0.56 | \$0.59 | \$0.63 | <b>\$0.67</b> | <b>\$0.97</b> |
| <b>Shares</b> | 563    | 551    | 544    | 533    | 534    | 534    | 522    | 494    | 480    | 481    | <b>475</b>    | <b>460</b>    |

Brown-Forman has a strong growth track record; the company was able to increase its earnings-per-share during the last financial crisis. Demand for alcohol is not cyclical. During the 2012 to 2018 time frame, Brown-Forman grew its earnings-per-share by an attractive pace of 8% 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.

Underlying sales growth was stronger during Q1-Q3 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 is also beneficial for the company's net earnings growth rate. Brown-Forman has bought back a considerable number of shares throughout the last decade, which has been a tailwind for its earnings-per-share growth rate.

*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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## 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 | 29.4 | 22.0 |
| Avg. Yld. | 2.4% | 1.9% | 1.8% | 1.5% | 1.4% | 1.3% | 1.3% | 1.5% | 1.1% | 1.1% | 1.3% | 1.6% |

Shares of Brown-Forman never were especially cheap, but in recent years, the company's multiples rose to an even higher level. Shares became slightly less expensive since the valuation peaked in 2017, but they still trade at a premium valuation of close to 28 times profits. This is a premium over the long-term median and over our fair value estimate of a 22 times earnings multiple. The company makes special dividend payments regularly, when we include its most recent special dividend payment of \$1.00 per share, its dividend yield is quite solid at 3.3%.

## 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% | 39.4% | 37.5% |

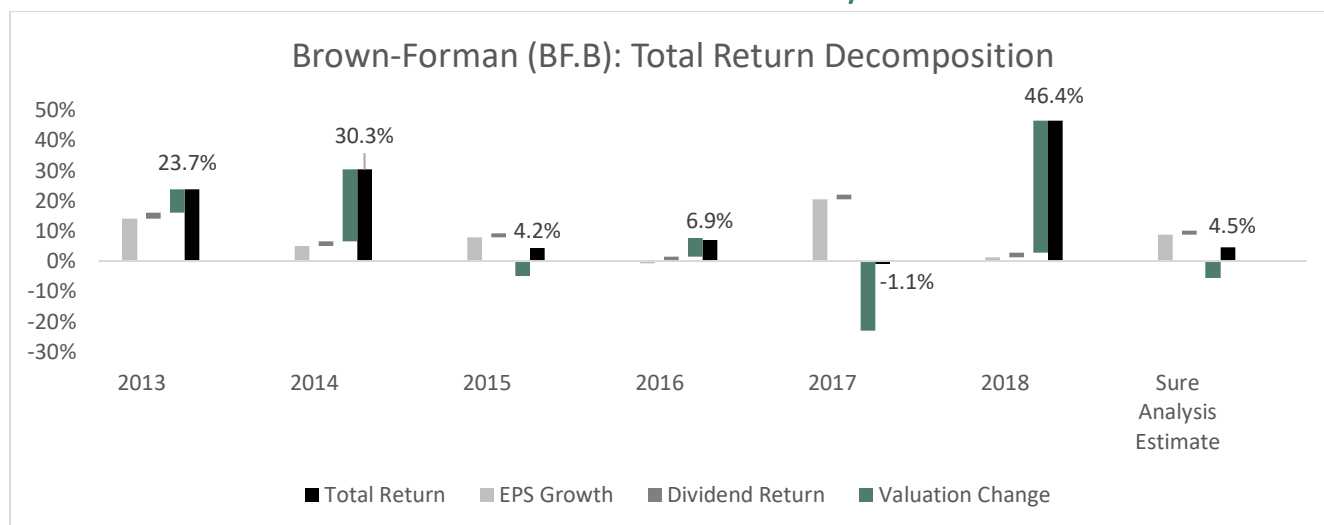
Brown-Forman's dividend payout ratio has been extremely stable over the last decade, the company paid out between 35% and 40% of its net profits during almost every year in that time frame. The reliable dividend growth track record and the low payout ratio mean that Brown-Forman's dividend looks highly sustainable for the foreseeable future.

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 a high-quality company that has achieved compelling earnings and dividend growth in the past. It is active in an attractive, non-cyclical industry. Unfortunately shares trade at a quite high valuation right now, which is why we only forecast mid-single digits total returns. We rate Brown-Forman a hold due mainly to the stock's 25% premium to our fair value estimate.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 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                 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| 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             | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 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.

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