Brown-Forman (BF.B)

Updated December 6th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$63	**5 Year CAGR Estimate:**	0.3%	**Volatility Percentile:**	7.3%
Fair Value Price:	$40	**5 Year Growth Estimate:**	8.5%	**Momentum Percentile:**	83.3%
% Fair Value:	159%	**5 Year Valuation Multiple Estimate:**	-8.9%	**Growth Percentile:**	86.8%
Dividend Yield:	1.1%	**5 Year Price Target**	$60	**Valuation Percentile:**	6.2%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	7.1%

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 $30 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 second quarter (fiscal 2020) earnings results on December 5. The company announced that it generated revenues of $989 million, which was up 8.7% from the revenues the company produced during the previous year's quarter. Brown-Forman's revenues came in ahead of the analyst consensus by $16 million. Currency rate movements were not as much of a headwind compared to the previous quarter, which is why reported and organic sales growth were more in line with each other during the quarter.

Brown-Forman's earnings-per-share totaled $0.59 during the second quarter, which was easily ahead of the consensus analyst estimate, beating the consensus by $0.07. The quarter's profits were the result of a highly compelling earnings-per-share growth rate of 14% compared to the previous year's quarter. Brown-Forman reiterated its guidance for revenue growth of 5% to 7% during fiscal 2020 on an organic basis. Brown-Forman also forecasts that its operating profits will rise by 3% to 5% during the current year, while earnings-per-share are forecasted at $1.75 to $1.85.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.95	$0.95	$1.07	$1.22	$1.28	$1.38	$1.37	$1.65	$1.67	$1.73	***$1.80***	***$2.71***
DPS	$0.33	$0.36	$0.39	$0.44	$0.48	$0.52	$0.56	$0.59	$0.63	$0.65	***$0.70***	***$1.03***
Shares[1]	551	544	533	534	534	522	494	480	481	480	***478***	***468***

Brown-Forman has a strong growth track record. The company was even able to increase its earnings-per-share during the last financial crisis, which can be explained by the fact that demand for alcohol is not cyclical. During the 2010 to 2019 time frame, Brown-Forman grew its earnings-per-share by a solid pace of 7%. 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 has been solid during the last couple of years. Due to currency headwinds – the strong dollar results in lower reported sales when sales in other currencies are translated back to USD – the reported revenue growth rate was not as strong during some quarters. 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. 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 for currency-adjusted sales during the last couple of quarters and will likely remain an important growth factor going forward. Higher overall sales allow for margin increases due to better economics of scale, which makes the company more efficient overall, and positively impacts its net earnings growth rate. Brown-Forman has bought back shares continuously over the last decade, which adds some additional growth to its earnings-per-share.

[1] In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.9	21.4	24.1	24.7	28.4	28.8	27.6	33.2	32.0	30.6	***35.0***	***22.0***
Avg. Yld.	1.9%	1.8%	1.5%	1.4%	1.3%	1.3%	1.5%	1.1%	1.1%	1.2%	***1.1%***	***1.7%***

Shares of Brown-Forman never were especially cheap, but in recent years, the company's multiple has risen to an even higher level. Shares became even more expensive over the last couple of quarters, which is why they trade at a premium valuation of 35 times net profits currently. This is a huge premium over the long-term median and 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 2.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	34.7%	37.9%	36.4%	36.1%	37.5%	37.7%	40.9%	35.8%	37.7%	37.6%	***38.9%***	***38.0%***

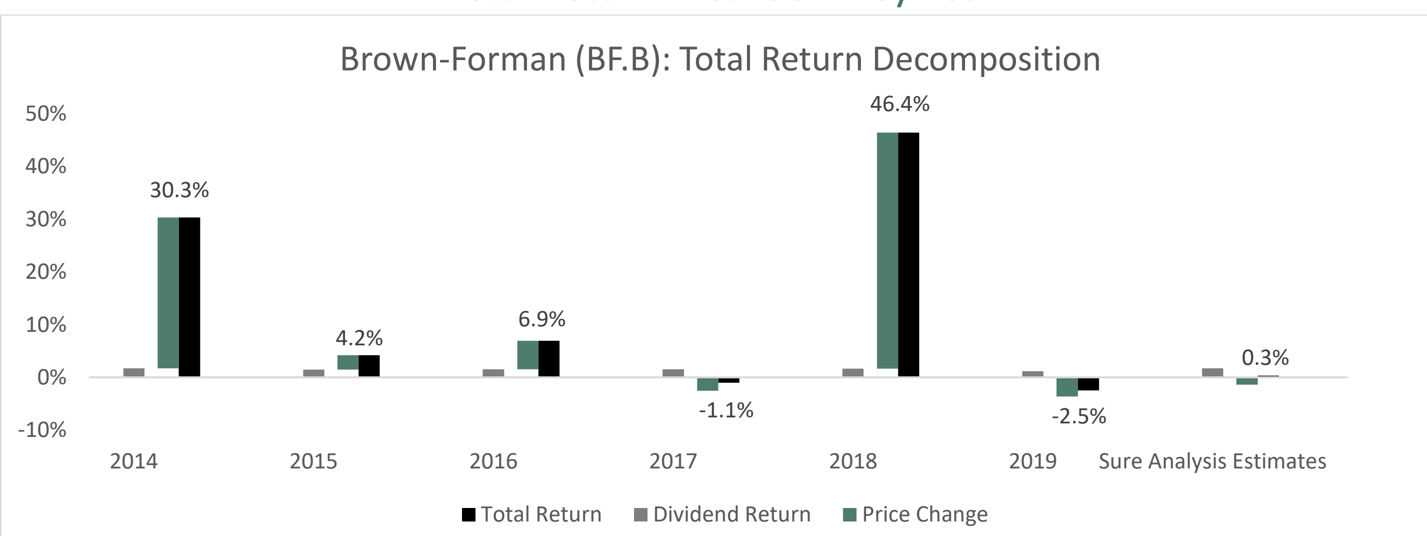
Brown-Forman's dividend payout ratio has been extremely stable over the last decade, as the company paid out between 35% and 40% of its net profits during almost every year in that time frame. The reliable dividend growth track record and the low payout ratio mean that Brown-Forman's dividend looks highly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

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 it 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 active in an attractive, non-cyclical industry. Brown-Forman also is a high-quality company that has achieved compelling earnings and dividend growth rates for long periods of time in the past. Unfortunately, shares trade at a very high valuation right now, which is why we do not forecast attractive total returns over the coming five years. We rate Brown-Forman a sell given the high valuation and the company's weak total return prospects.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2469	2586	2723	2849	2991	3134	3089	2994	3248	3324
Gross Profit	1611	1724	1795	1955	2078	2183	2144	2021	2202	2166
Gross Margin	65.2%	66.7%	65.9%	68.6%	69.5%	69.7%	69.4%	67.5%	67.8%	65.2%
SG&A Exp.	889	940	1005	1058	1122	1134	1105	1050	1179	1059
D&A Exp.	59	56	49	51	50	51	56	58	64	72
Operating Profit	710	855	788	898	971	1027	1048	989	1039	1122
Operating Margin	28.8%	33.1%	28.9%	31.5%	32.5%	32.8%	33.9%	33.0%	32.0%	33.8%
Net Profit	449	572	513	591	659	684	1067	669	717	835
Net Margin	18.2%	22.1%	18.8%	20.7%	22.0%	21.8%	34.5%	22.3%	22.1%	25.1%
Free Cash Flow	508	484	448	440	520	483	414	541	525	679
Income Tax	233	257	247	274	288	318	422	264	260	207

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3383	3712	3477	3626	4103	4188	4183	4625	4976	5139
Cash & Equivalents	232	567	338	204	437	370	263	182	239	307
Accounts Receivable	418	496	475	548	569	583	559	557	639	609
Inventories	651	647	712	827	882	953	1054	1270	1379	1520
Goodwill & Int. Ass.	1335	1295	1285	1285	1297	1218	1185	1394	1433	1398
Total Liabilities	1488	1652	1408	1998	2071	2283	2621	3255	3660	3492
Accounts Payable	97	126	120	133	134	123	121	137	154	150
Long-Term Debt	699	759	510	1002	1005	1183	1501	2149	2556	2440
Shareholder's Equity	1895	2060	2069	1628	2032	1905	1562	1370	1316	1647
D/E Ratio	0.37	0.37	0.25	0.62	0.49	0.62	0.96	1.57	1.94	1.48

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	13.1%	16.1%	14.3%	16.6%	17.1%	16.5%	25.5%	15.2%	14.9%	16.5%
Return on Equity	24.2%	28.9%	24.8%	32.0%	36.0%	34.7%	61.6%	45.6%	53.4%	56.4%
ROIC	16.6%	21.1%	19.0%	22.7%	23.3%	22.3%	34.7%	20.3%	19.4%	21.0%
Shares Out.	551	544	533	534	534	522	494	480	481	480
Revenue/Share	4.43	4.71	5.04	5.30	5.56	5.88	6.05	6.13	6.71	6.90
FCF/Share	0.91	0.88	0.83	0.82	0.97	0.91	0.81	1.11	1.08	1.41

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