BROWN FORMAN CORP
Form 10-Q
December 04, 2013

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 31, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to _______________

Commission File No. 002-26821

Brown-Forman Corporation
(Exact name of Registrant as specified in its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	61-0143150 (IRS Employer Identification No.)
850 Dixie Highway Louisville, Kentucky (Address of principal executive offices)	40210 (Zip Code)

(502) 585-1100
(Registrant’s telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act

Large accelerated filer þ Accelerated filer o

Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: November 30, 2013

Class A Common Stock ($.15 par value, voting)	84,462,242
Class B Common Stock ($.15 par value, nonvoting)	128,735,471

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

BROWN-FORMAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(Dollars in millions, except per share amounts)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2012	2013	2012	2013
Net sales	$1,014	$1,079	$1,892	$1,975
Excise taxes	237	246	449	455
Cost of sales	252	257	454	467
Gross profit	525	576	989	1,053
Advertising expenses	107	111	199	214
Selling, general, and administrative expenses	159	162	308	318
Other (income) expense, net	(3)	(8)	(2)	(7)
Operating income	262	311	484	528
Interest income	1	1	1	1
Interest expense	5	7	11	13
Income before income taxes	258	305	474	516
Income taxes	85	99	154	167
Net income	$173	$206	$320	$349
Earnings per share:				
Basic	$0.81	$0.97	$1.50	$1.63
Diluted	$0.80	$0.96	$1.49	$1.62
Cash dividends per common share:				
Declared	$—	$—	$0.467	$0.510
Paid	$0.233	$0.255	$0.467	$0.510

See notes to the condensed consolidated financial statements.

BROWN-FORMAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in millions)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2012	2013	2012	2013
Net income	$173	$206	$320	$349
Other comprehensive income (loss), net of tax:				
Currency translation adjustments	12	7	(1)	(5)
Postretirement benefits adjustments	5	14	9	19
Net gain (loss) on cash flow hedges	(9)	(10)	(1)	(4)
Net other comprehensive income (loss)	8	11	7	10
Comprehensive income	$181	$217	$327	$359

See notes to the condensed consolidated financial statements.

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BROWN-FORMAN CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in millions)

	April 30, 2013	October 31, 2013
Assets		
Cash and cash equivalents	$204	$192
Accounts receivable, less allowance for doubtful accounts of $9 and $9 at April 30 and October 31, respectively	548	729
Inventories:		
Barreled whiskey	456	462
Finished goods	177	227
Work in process	137	151
Raw materials and supplies	57	61
Total inventories	827	901
Current deferred tax assets	29	44
Other current assets	213	167
Total current assets	1,821	2,033
Property, plant and equipment, net	450	483
Goodwill	617	620
Other intangible assets	668	671
Deferred tax assets	14	13
Other assets	56	62
Total assets	$3,626	$3,882
Liabilities		
Accounts payable and accrued expenses	$451	$513
Accrued income taxes	10	15
Current deferred tax liabilities	7	7
Short-term borrowings	3	6
Current portion of long-term debt	2	1
Total current liabilities	473	542
Long-term debt	997	997
Deferred tax liabilities	180	199
Accrued pension and other postretirement benefits	280	242
Other liabilities	68	64
Total liabilities	1,998	2,044
Commitments and contingencies		
Stockholders’ Equity		
Common stock:		
Class A, voting (85,000,000 shares authorized; 85,000,000 shares issued)	13	13
Class B, nonvoting (400,000,000 shares authorized; 142,313,000 shares issued)	21	21
Additional paid-in capital	71	80
Retained earnings	2,500	2,729
Accumulated other comprehensive income (loss), net of tax	(211)	(201)
Treasury stock, at cost (13,606,000 and 14,132,000 shares at April 30 and October 31, respectively)	(766)	(804)
Total stockholders’ equity	1,628	1,838
Total liabilities and stockholders’ equity	$3,626	$3,882

See notes to the condensed consolidated financial statements.

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BROWN-FORMAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in millions)

	Six Months Ended October 31,	
	2012	2013
Cash flows from operating activities:		
Net income	$320	$349
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	24	24
Stock-based compensation expense	5	6
Deferred income taxes	42	(6)
Changes in assets and liabilities	(226)	(172)
Cash provided by operating activities	165	201
Cash flows from investing activities:		
Additions to property, plant, and equipment	(39)	(60)
Cash used for investing activities	(39)	(60)
Cash flows from financing activities:		
Net increase in short-term borrowings	4	3
Repayment of long-term debt	(1)	(1)
Net payments related to exercise of stock-based awards	(10)	(6)
Excess tax benefits from stock-based awards	13	9
Acquisition of treasury stock	—	(49)
Dividends paid	(100)	(109)
Cash used for financing activities	(94)	(153)
Effect of exchange rate changes on cash and cash equivalents	(1)	—
Net increase (decrease) in cash and cash equivalents	31	(12)
Cash and cash equivalents, beginning of period	338	204
Cash and cash equivalents, end of period	$369	$192

See notes to the condensed consolidated financial statements.

BROWN-FORMAN CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In these notes, “we,” “us,” and “our” refer to Brown-Forman Corporation.

1. Condensed Consolidated Financial Statements

We prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the U.S. Securities and Exchange Commission for interim financial information. In accordance with those rules and regulations, we condensed or omitted certain information and disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP). We suggest that you read these condensed financial statements together with the financial statements and footnotes included in our annual report on Form 10-K for the fiscal year ended April 30, 2013 (the 2013 Form 10-K).

In our opinion, the accompanying financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of our financial results for the periods covered by this report.

We prepared the accompanying financial statements on a basis that is substantially consistent with the accounting principles applied in our 2013 Form 10-K, although during the first quarter of fiscal 2014 we adopted new guidance for disclosures about offsetting assets and liabilities and for reporting amounts reclassified out of accumulated other comprehensive income. Our adoption of the new guidance had no material impact on our financial statements.

2. Inventories

We use the last-in, first-out (LIFO) method to determine the cost of most of our inventories. If the LIFO method had not been used, inventories at current cost would have been $209 million higher than reported as of April 30, 2013, and $213 million higher than reported as of October 31, 2013. Changes in the LIFO valuation reserve for interim periods are based on a proportionate allocation of the estimated change for the entire fiscal year.

3. Income Taxes

Our consolidated interim effective tax rate is based upon our expected annual operating income, statutory tax rates, and income tax laws in the various jurisdictions in which we operate. Significant or unusual items, including adjustments to accruals for tax uncertainties, are recognized in the quarter in which the related event occurs. The effective tax rate of 32.4% for the six months ended October 31, 2013, is based on an expected tax rate of 31.8% on ordinary income for the full fiscal year, as adjusted for the recognition of net tax expense related to discrete items arising during the period and interest on previously provided tax contingencies. Our expected tax rate includes current fiscal year additions for existing tax contingency items.

We believe there will be no material change in our gross unrecognized tax benefits in the next 12 months.

We file income tax returns in the United States, including several state and local jurisdictions, as well as in several other countries in which we conduct business. The major jurisdictions and their earliest fiscal years that are currently open for tax examinations are 2006 in the United States, 2009 in Ireland and Italy, 2008 in Australia and Poland, 2007 in Finland, 2003 in the U.K., and 2002 in Mexico. The audit of our fiscal 2012 U.S. federal tax return was concluded during the current fiscal year. In addition, we are participating in the Internal Revenue Service’s Compliance Assurance Program for our fiscal 2013 and 2014 tax years.

4. Earnings Per Share

We calculate basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share further includes the dilutive effect of stock-based compensation awards, including stock options, stock-settled stock appreciation rights, restricted stock units, deferred stock units, and shares of restricted stock. We calculate that dilutive effect using the “treasury stock method” (as defined by GAAP).

Some restricted shares have non-forfeitable rights to dividends declared on common stock. As a result, these restricted shares are considered participating securities in the calculation of earnings per share.

The following table presents information concerning basic and diluted earnings per share:

	Three Months Ended October 31,		Six Months Ended October 31,	
(Dollars in millions, except per share amounts)	2012	2013	2012	2013
Net income available to common stockholders	$173	$206	$320	$349
Share data (in thousands):				
Basic average common shares outstanding	213,276	213,587	213,220	213,634
Dilutive effect of stock-based awards	1,615	1,617	1,623	1,614
Diluted average common shares outstanding	214,891	215,204	214,843	215,248
Basic earnings per share	$0.81	$0.97	$1.50	$1.63
Diluted earnings per share	$0.80	$0.96	$1.49	$1.62

We excluded common stock-based awards for approximately 508,000 shares and 410,000 shares from the calculation of diluted earnings per share for the three months ended October 31, 2012 and 2013, respectively. We excluded common stock-based awards for approximately 534,000 shares and 412,000 shares from the calculation of diluted earnings per share for the six months ended October 31, 2012 and 2013, respectively. We excluded those awards because they were not dilutive for those periods under the treasury stock method.

5. Contingencies

We operate in a litigious environment, and we are sued in the normal course of business. Sometimes plaintiffs seek substantial damages. Significant judgment is required in predicting the outcome of these suits and claims, many of which take years to adjudicate. We accrue estimated costs for a contingency when we believe that a loss is probable and we can make a reasonable estimate of the loss, and then adjust the accrual as appropriate to reflect changes in facts and circumstances. We do not believe these loss contingencies, individually or in the aggregate, would have a material adverse effect on our financial position, results of operations, or liquidity. No material accrued loss contingencies are recorded as of October 31, 2013.

We have guaranteed the obligations of a third-party's bank credit facility used in connection with its importation of our products in a foreign market. Our maximum exposure under the guarantee is approximately $47 million should the third-party importer default on its obligation, which we believe is unlikely. As of October 31, 2013, our exposure under the guarantee is approximately $45 million. Both the fair value and carrying amount of the guarantee are insignificant.

6. Pension and Other Postretirement Benefits

The following table shows the components of the pension and other postretirement benefit cost recognized for our U.S. benefit plans during the periods covered by this report. Information about similar international plans is not presented due to immateriality.

	Three Months Ended October 31,		Six Months Ended October 31,	
(Dollars in millions)	2012	2013	2012	2013
Pension Benefits:				
Service cost	$5	$5	$10	$11
Interest cost	9	8	17	15
Expected return on plan assets	(10)	(10)	(20)	(20)
Amortization of net actuarial loss	7	8	14	16
Net cost	$11	$11	$21	$22

Other Postretirement Benefits:

Service cost	$—	$—	$1	$1
Interest cost	1	1	2	2
Net cost	$1	$1	$3	$3

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7. Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. We categorize the fair values of assets and liabilities into three levels based upon the assumptions (inputs) used to determine those values. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – Observable inputs other than those included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data.
- Level 3 – Unobservable inputs that are supported by little or no market activity.

The following table summarizes the assets and liabilities measured at fair value on a recurring basis:

(Dollars in millions)	Level 1	Level 2	Level 3	Total
April 30, 2013:				
Assets:				
Currency derivatives	$—	$5	$—	$5
Liabilities:				
Currency derivatives	—	4	—	4
Short-term borrowings	—	3	—	3
Current portion of long-term debt	—	2	—	2
Long-term debt	—	1,011	—	1,011
October 31, 2013:				
Assets:				
Currency derivatives	—	2	—	2
Liabilities:				
Currency derivatives	—	10	—	10
Short-term borrowings	—	6	—	6
Current portion of long-term debt	—	1	—	1
Long-term debt	—	954	—	954

We determine the fair values of our currency derivatives (forwards and options) using standard valuation models. The significant inputs used in these models are readily available in public markets or can be derived from observable market transactions. Inputs used in these standard valuation models include the applicable exchange rate, forward rates and discount rates for the currency derivatives. The standard valuation model for foreign currency options also uses implied volatility as an additional input. The discount rates are based on the historical U.S. Treasury rates, and the implied volatility specific to individual foreign currency options is based on quoted rates from financial institutions.

The fair value of short-term borrowings approximates the carrying amount. We determine the fair value of long-term debt primarily based on the prices at which similar debt has recently traded in the market and also considering the overall market conditions on the date of valuation.

We measure some assets and liabilities at fair value on a nonrecurring basis. That is, we do not measure them at fair value on an ongoing basis, but we do adjust them to fair value in some circumstances (for example, when we determine that an asset is impaired). No material nonrecurring fair value measurements were required during the periods presented in these financial statements.

8. Fair Value of Financial Instruments

The fair value of cash, cash equivalents, and short-term borrowings approximate the carrying amounts due to the short maturities of these instruments. We determine the fair value of derivative financial instruments and long-term debt as discussed in Note 7.

Below is a comparison of the fair values and carrying amounts of these instruments:

	April 30, 2013		October 31, 2013	
(Dollars in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	$204	$204	$192	$192
Currency derivatives	5	5	2	2
Liabilities:				
Currency derivatives	4	4	10	10
Short-term borrowings	3	3	6	6
Current portion of long-term debt	2	2	1	1
Long-term debt	997	1,011	997	954

9. Derivative Financial Instruments

Our multinational business exposes us to global market risks, including the effect of fluctuations in currency exchange rates, commodity prices, and interest rates. We use derivatives to help manage financial exposures that occur in the normal course of business. We formally document the purpose of each derivative contract, which includes linking the contract to the financial exposure it is designed to mitigate. We do not hold or issue derivatives for trading purposes.

We use currency derivative contracts to limit our exposure to the currency exchange risk that we cannot mitigate internally by using netting strategies. We designate most of these contracts as cash flow hedges of forecasted transactions (expected to occur within three years). We record all changes in the fair value of cash flow hedges (except any ineffective portion) in accumulated other comprehensive income (AOCI) until the underlying hedged transaction occurs, at which time we reclassify that amount into earnings. We assess the effectiveness of these hedges based on changes in forward exchange rates. The ineffective portion of the changes in fair value of our hedges (recognized immediately in earnings) during the periods presented in this report was not material.

We do not designate some of our currency derivatives as hedges because we use them to at least partially offset the immediate earnings impact of changes in foreign exchange rates on existing assets or liabilities. We immediately recognize the change in fair value of these contracts in earnings.

We had outstanding currency derivatives, related primarily to our euro, British pound, and Australian dollar exposures, with total notional amounts totaling $686 million at April 30, 2013 and $583 million at October 31, 2013.

Prior to July 31, 2012, we utilized exchange-traded futures and options contracts to mitigate our exposure to corn price volatility. Because we did not designate these contracts as hedges for accounting purposes, we immediately recognized changes in their fair value in earnings. Effective July 31, 2012, we instead use forward purchase contracts with suppliers to protect against corn price volatility. We expect to physically take delivery of the corn underlying each contract and use it for production over a reasonable period of time. Accordingly, we account for these contracts as normal purchases rather than derivative instruments.

From time to time, we manage our interest rate risk with swap contracts. However, no such swaps were outstanding at April 30, 2013 or October 31, 2013.

The following tables present the amounts affecting our consolidated statements of operations for the periods covered by this report:

		Three Months Ended October 31,	
(Dollars in millions)	Classification	2012	2013
Currency derivatives designated as cash flow hedge:			
Net gain (loss) recognized in AOCI	n/a	$(14)	$(15)
Derivatives not designated as hedging instruments:			
Currency derivatives – net gain (loss) recognized in income	Net sales	(1)	(5)
Currency derivatives – net gain (loss) recognized in income	Other income	2	—

		Six Months Ended October 31,	
(Dollars in millions)	Classification	2012	2013
Currency derivatives designated as cash flow hedge:			
Net gain (loss) recognized in AOCI	n/a	$(1)	$(5)
Net gain (loss) reclassified from AOCI into income	Net sales	1	1
Interest rate swaps designated as fair value hedges:			
Net gain (loss) recognized in income	Interest expense	1	—
Derivatives not designated as hedging instruments:			
Currency derivatives – net gain (loss) recognized in income	Net sales	(1)	(1)
Currency derivatives – net gain (loss) recognized in income	Other income	(2)	2
Commodity derivatives – net gain (loss) recognized in income	Cost of sales	4	—

We expect to reclassify $4 million of deferred net losses recorded in AOCI as of October 31, 2013, to earnings during the next 12 months. This reclassification would offset the anticipated earnings impact of the underlying hedged exposures. The actual amounts that we ultimately reclassify to earnings will depend on the exchange rates in effect when the underlying hedged transactions occur. The maximum term of our outstanding derivative contracts was 24 months at April 30, 2013 and 22 months at October 31, 2013.

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The following table presents the fair values of our derivative instruments as of April 30, 2013 and October 31, 2013.

(Dollars in millions)	Classification	Fair value of derivatives in a gain position	Fair value of derivatives in a loss position
April 30, 2013:			
Designated as cash flow hedges:			
Currency derivatives	Other current assets	$6	$(3)
Currency derivatives	Other assets	2	—
Currency derivatives	Accrued expenses	2	(4)
Currency derivatives	Other liabilities	—	(1)
Not designated as hedges:			
Currency derivatives	Accrued expenses	—	(1)
October 31, 2013:			
Designated as cash flow hedges:			
Currency derivatives	Other current assets	3	(2)
Currency derivatives	Other assets	1	(1)
Currency derivatives	Accrued expenses	2	(10)
Currency derivatives	Other liabilities	—	(2)
Not designated as hedges:			
Currency derivatives	Other current assets	1	—

The fair values reflected in the above table are presented on a gross basis. However, as discussed further below, the fair values of those instruments that are subject to net settlement agreements are presented on a net basis in the accompanying consolidated balance sheets.

Credit risk. We are exposed to credit-related losses if the counterparties to our derivative contracts default. This credit risk is limited to the fair value of the contracts. To manage this risk, we contract only with major financial institutions that have earned investment-grade credit ratings and with whom we have standard International Swaps and Derivatives Association (ISDA) agreements that allow for net settlement of the derivative contracts. Also, we have established counterparty credit guidelines that are regularly monitored and that provide for reports to senior management according to prescribed guidelines, and we monetize contracts when we believe it is warranted. Because of these safeguards, we believe the risk of loss from counterparty default to be immaterial.

Some of our derivative instruments require us to maintain a specific level of creditworthiness, which we have maintained. If our creditworthiness were to fall below that level, then the counterparties to our derivative instruments could request immediate payment or collateralization for derivative instruments in net liability positions. The aggregate fair value of all derivatives with creditworthiness requirements that were in a net liability position was $2 million at April 30, 2013 and $9 million at October 31, 2013.

Offsetting. As noted above, our derivative contracts are governed by ISDA agreements that allow for net settlement of derivative contracts with the same counterparty. It is our policy to present the fair values of current derivatives (i.e., those with a remaining term of 12 months or less) with the same counterparty on a net basis in the balance sheet. Similarly, we present the fair values of noncurrent derivatives with the same counterparty on a net basis. Current derivatives are not netted with noncurrent derivatives in the balance sheet. The following table summarizes the gross and net amounts of our derivative contracts.

(Dollars in millions)	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in Balance Sheet	Net Amounts Presented in Balance Sheet	Gross Amounts Not Offset in Balance Sheet	Net Amounts
April 30, 2013:					
Derivative assets	$10	$(5)	$5	$(2)	$3
Derivative liabilities	(9)	5	(4)	2	(2)
October 31, 2013:					
Derivative assets	7	(5)	2	(1)	1
Derivative liabilities	(15)	5	(10)	1	(9)

No cash collateral was received or pledged related to our derivative contracts as of April 30, 2013 and October 31, 2013.

10. Accumulated Other Comprehensive Income

The following table summarizes the changes in accumulated other comprehensive income (AOCI), net of tax, during the three months ended October 31, 2013:

(Dollars in millions)	Currency Translation Adjustments	Net Gain on Cash Flow Hedges	Postretirement Benefits Adjustments	Total
Balance at July 31, 2013	$(2)	$6	$(216)	$(212)
Other comprehensive income (loss) before reclassifications[1]	7	(10)	9	6
Amounts reclassified from AOCI	—	—	5	5
Net other comprehensive income (loss)	7	(10)	14	11
Balance at October 31, 2013	$5	$(4)	$(202)	$(201)

[1] Net of tax benefit (cost) of $(2), $5, and $(5) related to currency translation adjustments, cash flow hedges, and postretirement benefits adjustments, respectively.

The following table summarizes the changes in AOCI, net of tax, during the six months ended October 31, 2013:

(Dollars in millions)	Currency Translation Adjustments	Net Gain on Cash Flow Hedges	Postretirement Benefits Adjustments	Total
Balance at April 30, 2013	$10	$—	$(221)	$(211)
Other comprehensive income (loss) before reclassifications[1]	(5)	(3)	9	1
Amounts reclassified from AOCI	—	(1)	10	9
Net other comprehensive income (loss)	(5)	(4)	19	10
Balance at October 31, 2013	$5	$(4)	$(202)	$(201)

[1] Net of tax benefit (cost) of $(2), $2, and $(5) related to currency translation adjustments, cash flow hedges, and postretirement benefits adjustments, respectively.

The following table presents further information about amounts reclassified from AOCI during the three months ended October 31, 2013:

	Amount Reclassified from AOCI		Classification in Consolidated Statement of Operations
Amounts related to postretirement benefit plans:			
Net actuarial gain (loss)	(8	)[1]	
	3		Tax benefit (expense)
Total reclassifications	$(5	)	Net of tax

[1] Amount is included in the net periodic benefit cost of pension and other postretirement benefits (as shown in Note 6).

The following table presents further information about amounts reclassified from AOCI during the six months ended October 31, 2013:

	Amount Reclassified from AOCI		Classification in Consolidated Statement of Operations
Net gain (loss) on cash flow hedges:			
Currency derivatives	$1		Net sales
	—		Tax benefit (expense)
	1		Net of tax
Amounts related to postretirement benefit plans:			
Net actuarial gain (loss)	(16	)[1]	
	6		Tax benefit (expense)
	(10	)	Net of tax
Total reclassifications	$(9	)	Net of tax

[1] Amount is included in the net periodic benefit cost of pension and other postretirement benefits (as shown in Note 6).

11. Subsequent Event

As announced on November 21, 2013, our Board of Directors increased our quarterly cash dividend on Class A and Class B common stock from $0.255 per share to $0.29 per share. Stockholders of record on December 4, 2013, will receive the cash dividend on December 27, 2013.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with both our unaudited condensed consolidated financial statements and related notes included in Item 1 of this Quarterly Report and our 2013 Form 10-K. Note that the results of operations for the six months ended October 31, 2013, do not necessarily indicate what our operating results for the full fiscal year will be. In this Item, "we," "us," and "our" refer to Brown-Forman Corporation.

Basis of Presentation and Use of Non-GAAP Measures:

When discussing volume we refer to "depletions," a term that is commonly used in the beverage alcohol industry. We define "depletions" as either (a) our shipments directly to retailers or wholesalers, or (b) shipments from our third-party distributor customers to retailers and wholesalers. Because we generally record revenues when we ship our products to our customers, our reported sales for a period do not necessarily reflect actual consumer purchases during that period. We believe that our depletions measure volume in a way that more closely reflects consumer demand than our shipments do.

"Constant currency" change is a non-GAAP measure that represents the percentage change in financial results reported in accordance with U.S. GAAP but with the cost or benefit of foreign exchange movements removed. We use this measure to understand changes in our business on a constant U.S. dollar basis, as fluctuations in exchange rates can distort the underlying change both positively and negatively. To neutralize the effect of foreign exchange fluctuations when comparing across periods, we translate current-year results at prior-year rates.

"Underlying" change is a non-GAAP measure that represents constant-currency change further adjusted for items that we believe do not reflect the underlying performance of our business. To calculate underlying change for the quarter and the six month period ended October 31, 2013, we adjust constant-currency change for estimated net changes in trade inventories, a measure which is defined below.

"Estimated net change in trade inventories" refers to the estimated financial impact of changes in distributor inventories for our brands. We calculate this impact using depletion information provided to us by our distributors to estimate the effect of distributor inventory changes on changes in our key measures. We believe that separately identifying the impact of this item presents a more accurate picture of consumer demand for our brands.

Important Information on Forward-Looking Statements:
This report contains statements, estimates, and projections that are "forward-looking statements" as defined under U.S. federal securities laws. Words such as “aim,” “anticipate,” “aspire,” “believe,” “continue,” “could,” “envision,” “estimate,” “ex
“expectation,” “intend,” “may,” “plan,” “potential,” “project,” “pursue,” “see,” “seek,” “should,” “will,” and similar words ide
forward-looking statements, which speak only as of the date we make them. Except as required by law, we do not intend to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. By their nature, forward-looking statements involve risks, uncertainties and other factors (many beyond our control) that could cause our actual results to differ materially from our historical experience or from our current expectations or projections. These risks and uncertainties include those described in Part I, Item 1A. Risk Factors of our 2013 Form 10-K and those described from time to time in our future reports filed with the Securities and Exchange Commission, including:

- Unfavorable global or regional economic conditions, and related low consumer confidence, high unemployment, weak credit or capital markets, sovereign debt defaults, sequestrations, austerity measures, higher interest rates, political instability, higher inflation, deflation, lower returns on pension assets, or lower discount rates for pension obligations
- Risks associated with being a U.S.-based company with global operations, including political or civil unrest; local labor policies and conditions; protectionist trade policies; compliance with local trade practices and other regulations, including anti-corruption laws; terrorism; and health pandemics
- Fluctuations in foreign currency exchange rates
- Changes in laws, regulations or policies - especially those that affect the production, importation, marketing, sale or consumption of our beverage alcohol products
- Tax rate changes (including excise, sales, VAT, tariffs, duties, corporate, individual income, dividends, capital gains) or changes in related reserves, changes in tax rules (e.g., LIFO, foreign income deferral, U.S. manufacturing and other deductions) or accounting standards, and the unpredictability and suddenness with which they can occur
- Dependence upon the continued growth of the Jack Daniel’s family of brands
- Changes in consumer preferences, consumption or purchase patterns - particularly away from brown spirits, our premium products, or spirits generally, and our ability to anticipate and react to them; decline in the social acceptability of beverage alcohol products in significant markets; bar, restaurant, travel or other on-premise declines
- Production facility, aging warehouse or supply chain disruption; imprecision in supply/demand forecasting
- Higher costs, lower quality or unavailability of energy, input materials or finished goods
- Route-to-consumer changes that affect the timing of our sales, temporarily disrupt the marketing or sale of our products, or result in implementation-related or higher fixed costs
- Inventory fluctuations in our products by distributors, wholesalers, or retailers
- Competitors’ consolidation or other competitive activities, such as pricing actions (including price reductions, promotions, discounting, couponing or free goods), marketing, category expansion, product introductions, entry or expansion in our geographic markets or distribution networks
- Risks associated with acquisitions, dispositions, business partnerships or investments - such as acquisition integration, or termination difficulties or costs, or impairment in recorded value
- Insufficient protection of our intellectual property rights
- Product counterfeiting, tampering, or recall, or product quality issues
- Significant legal disputes and proceedings; government investigations (particularly of industry or company business, trade or marketing practices)
- Failure or breach of key information technology systems
- Negative publicity related to our company, brands, marketing, personnel, operations, business performance or prospects
- Business disruption, decline or costs related to organizational changes, reductions in workforce or other cost-cutting measures, or our failure to attract or retain key executive or employee talent

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Results of Operations

Fiscal 2014 Year-to-Date Highlights
For the six months ended October 31, 2013, net sales increased 4% to $1,975 million (7% on an underlying basis), operating income increased 9% to $528 million (13% on an underlying basis) and diluted earnings per share increased 9% to $1.62 compared to $1.49 in the same period last year.

The following table highlights the worldwide results of our most significant brands for the six months ended October 31, 2013, compared to the same period last year. We discuss results of the brands most affecting our performance below the table. Our commentary relates to the six months ended October 31 unless otherwise indicated. Changes in net sales are presented on a reported, constant currency, and underlying basis.

	% Change vs. Six Months Ended October 31 Last Year							
	Volume		Net Sales[1]					
	Nine-Liter Cases		Reported		Constant Currency		Underlying	
Jack Daniel's Family	4	%	7	%	8	%	10	%
Jack Daniel's Family of Whiskey Brands	7	%	8	%	9	%	11	%
Jack Daniel's RTDs/RTP[2]	—	%	2	%	7	%	4	%
New Mix RTDs[3]	(20	%)	(14	%)	(16	%)	(16	%)
Finlandia	2	%	(1	%)	(2	%)	1	%
Southern Comfort Family	(4	%)	(6	%)	(5	%)	(4	%)
Canadian Mist Family	1	%	(1	%)	(1	%)	1	%
Korbel Champagnes	4	%	3	%	3	%	8	%
El Jimador	(3	%)	(3	%)	(3	%)	2	%
Super-Premium Other[4]	4	%	6	%	6	%	8	%

[1] Please see the Basis of Presentation and Use of Non-GAAP Measures for additional information on our use of "constant currency" and "underlying," including the reasons why we think this information is useful to readers.
[2] Jack Daniel's RTD and RTP products include all RTD line extensions of Jack Daniel's, such as Jack Daniel's & Cola, Jack Daniel's & Diet Cola, Jack & Ginger, Jack Daniel's Country Cocktails, Gentleman Jack & Cola, and the seasonal Jack Daniel's Winter Jack RTP.
[3] New Mix is an RTD brand produced and co-branded with el Jimador tequila..
[4] Includes Chambord liqueur and flavored vodka, Herradura, Sonoma-Cutrer, Tuaca, and Woodford Reserve.

- Jack Daniel's family of brands volume and net sales grew. The most important factors leading to the increase in net sales on both a reported and an underlying basis were:

a. higher pricing in many markets for several brands within the Jack Daniel's family, most notably in the United States for Jack Daniel's Tennessee Whiskey;
b. higher demand leading to volume growth for Jack Daniel's Tennessee Whiskey in many European markets including the United Kingdom, Russia, France and Turkey;
c. volume growth of Jack Daniel's Tennessee Honey in the United States and in several international expansion markets; and
d. higher demand for Gentleman Jack in the United States and Australia.

Partially offsetting the increase in net sales on both a reported and an underlying basis were:
a. lower demand in Australia for Jack Daniel's Tennessee Honey, which compared to high sales related to its launch in the same period last year;
b. lower demand for Jack Daniel's Winter Jack RTP in Germany; and
c. lower demand for Jack Daniel's Tennessee Whiskey in Spain.

- Both volume and net sales of New Mix RTDs declined. The decreases were driven primarily by higher customer inventory levels at the beginning of the fiscal year. Customer inventories were much higher because of buy-ins at the end of fiscal 2013 ahead of price increases that took effect late in the fourth quarter of fiscal 2013. During the second quarter of fiscal 2014, customer inventories were reduced and normal trading resumed.

- Finlandia volume and underlying net sales increased, while net sales on a reported basis declined. Underlying net sales grew in Russia, in the travel retail channel, and broadly across many markets in Central and Eastern Europe. The gains were partially offset by underlying net sales declines in in a few markets, including Poland, our most significant market for Finlandia, and the United States. In Poland, underlying net sales were negatively affected by customer buy-ins at the end of fiscal 2013 ahead of a price increase implemented at the beginning of the first quarter of 2014.

- Southern Comfort family of brands volume and net sales declined, driven largely by volume losses in the United States and Australia partially offset by volume increases in Germany, the United Kingdom and South Africa. The year-to-date decline was driven by lower consumer demand for Southern Comfort in the U.S. on-premise channel, which weakened compared to the same period last year. In addition, Southern Comfort family sales in the United States in the same period last year included the launch of a flavored line extension, which increased the difficulty of the same period comparison.

- Our Super-Premium Other brands grew both volume and net sales. Volume and net sales growth rates accelerated during the second quarter, driven by higher growth rates for Woodford Reserve, Sonoma-Cutrer and Herradura. In the six months ended October 31, 2013, Woodford Reserve grew volume 26% compared to the same period last year and delivered similarly strong double-digit net sales growth on both a reported and an underlying basis. Sonoma-Cutrer wines and Herradura both grew volume and net sales while Tuaca and Chambord both registered volume and net sales declines in the six months ended October 31, 2013.

On a geographic basis, reported and underlying net sales grew in several markets including the United States, the United Kingdom, Russia, Turkey and France. Underlying net sales increased in Australia, but declined on a reported basis driven by a weaker Australian Dollar. Reported and underlying net sales gains were partially offset by declines in Mexico, Poland and Spain.

Growth of used barrels sales, mostly to customers outside the United States, was also a driver of net sales growth.

Second Quarter Fiscal 2014 Compared to Second Quarter Fiscal 2013

A summary of our operating performance (dollars expressed in millions, except per share amounts) is presented below.

	Three Months Ended October 31,			
	2012	2013	Change	
Net sales	$1,014	$1,079	6	%
Excise taxes	237	246	4	%
Cost of sales	252	257	2	%
Gross profit	525	576	10	%
Advertising expenses	107	111	4	%
Selling, general, and administrative expenses	159	162	2	%
Other expense (income), net	(3)	(8)		
Operating income	262	311	19	%
Interest expense, net	4	6		
Income before income taxes	258	305	18	%
Income taxes	85	99		
Net income	173	206	19	%
Gross margin	51.7 %	53.4 %		
Operating margin	25.9 %	28.8 %		
Effective tax rate	32.8 %	32.4 %		
Earnings per share:				
Basic	$0.81	$0.97	19	%
Diluted	0.80	0.96	19	%

In the second quarter of fiscal 2014, reported net sales were $1,079 million, an increase of $65 million or 6%, while underlying net sales grew 8% compared to the same period last year. Reported net sales growth was reduced by unfavorable foreign exchange movement and a decrease in estimated net trade inventories. Of the 8% increase in underlying net sales, we estimate that about three percentage points were attributable to better price/mix across our brands and geographies. The primary factors contributing to growth in underlying net sales were:

a. volume gains on Jack Daniel's Tennessee Whiskey in the United Kingdom, Australia, France and Russia;
b. higher pricing on Jack Daniel's Tennessee Whiskey in the United States;
c. double-digit volume gains on Jack Daniel's Tennessee Honey in the United States and the United Kingdom, plus volume gains from new introductions of the brand in Germany and Mexico; and
d. volume growth of our super-premium whiskey brands, most notably Woodford Reserve and Gentleman Jack, as these brands continue to grow in response to our higher investments.

Net sales for the Southern Comfort family of brands declined in the United States and its key international markets during the second quarter of fiscal 2014 as the brand faced reduced consumer demand, strong competition from flavored spirits, and a declining on-premise channel in the United States.

On a geographic basis, growth was broad-based in the second quarter, led by the United Kingdom, the United States, Australia, Russia, the travel retail channel, France and Brazil. A few markets, including Germany and Poland, registered net sales declines in the second quarter.

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The following table shows the major factors influencing the change in net sales for the second quarter of fiscal 2014:

	Change vs. Prior Period
· Underlying change in net sales	8%
· Foreign exchange	(1%)
· Estimated net change in trade inventories	(1%)
Reported change in net sales	6%

Cost of sales was $257 million in the second quarter of fiscal 2014, an increase of $5 million, or 2%, while underlying cost of sales grew 4% compared to the same period last year. A decrease in estimated net trade inventories reduced reported cost of sales in the second quarter compared to the same period last year. Higher volume for certain brands, a shift in portfolio mix to higher cost per unit products, and higher value-added package expense contributed to cost increases. Input costs were essentially flat.

The following table highlights the major changes in cost of sales for the second quarter of fiscal 2014:

	Change vs. Prior Period
· Underlying change in cost of sales	4%
· Foreign exchange	—%
· Estimated net change in trade inventories	(2%)
Reported change in cost of sales	2%

Gross profit was $576 million in the second quarter of fiscal 2014, an increase of $51 million, or 10%, compared to the same period last year, while underlying gross profit growth was approximately the same. The same factors that drove underlying net sales growth during the second quarter also drove underlying gross profit growth, while higher costs partially offset the underlying gross profit gains. Higher pricing, particularly for Jack Daniel's Tennessee Whiskey in the United States and Finlandia Vodka in Poland, and a favorable portfolio mix were the drivers of the increase in gross margin of 1.7 percentage points to 53.4% for the quarter compared to the same period last year.

The following table shows the major factors influencing the change in gross profit for the second quarter of fiscal 2014:

	Change vs. Prior Period