

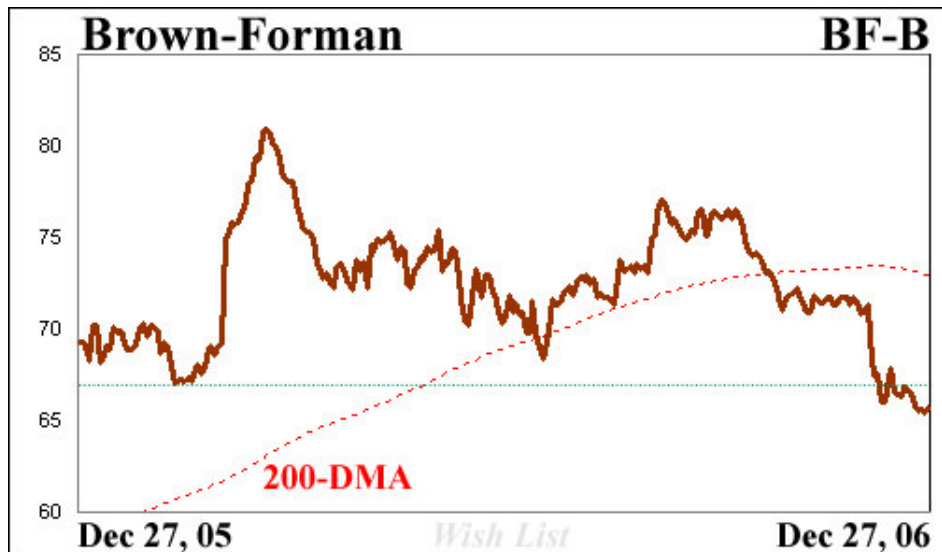
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Brown-Forman Corp. ~ BF-B (NYSE)

Investment Position: Core Holding

Investment Overview

Originally covered in the 2002 Wish List Report, we have not had much to say about Brown-Forman in the last 5-years. However, with the company producing \$1.49 billion in free cash during this time, it is clear that our lack of coverage did not stem from the company's lack of accomplishments. Instead, the buying opportunity we were waiting for never materialized. That is, until now.



For only the second time since we mentioned Brown-Forman the company's stock price is entrenched below its 200-DMA. Meanwhile the growth story of Jack Daniel's, and international expansion story of Brown-Forman's brands remains intact.

When selecting some companies we spend a great deal of time discussing the industry, zeroing in on what we consider to be the most important facets of the business, and/or building an investment platform. Not with Jack Daniel's. Rather, while some of the dynamics of BF's business are worth going over, we nonetheless believe that the financial numbers speak largely for themselves. Accordingly, and to be succinct:

Brown-Forman is a recession resistant stock trading near a 52-week low that has paid a dividend in each of the last 61-years. The kicker is that the company could be receptive to a weakening dollar.

We consider BF-B a core holding and would happily greet a share price fall with a dollar cost averaging regimen.

Company & Strategic Overview

Diverse Attack On The International Scene

Founded in 1870, BF houses a collection of spirits and wines that have withstood the test of time. Most notable is the company's main brand, Jack Daniel's, which - assuming fiscal 2007 ends as expected - has increased 9 liter case sales in each of the last 15-years. Last year, or fiscal 2006, Jack Daniel's logged more than 8.5 million cases sold and sales grew in 90 out of the 120 countries in which the Tennessee Whiskey was served.

| Top brands by cases sold (000's) | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 |
|----------------------------------|-------|-------|-------|-------|-------|-------|
| Jack Daniel's | 8,550 | 7,885 | 7,205 | 6,810 | 6,520 | 6,365 |
| Fetzer | 2,410 | 2,210 | 2,550 | 3,115 | 3,130 | 2,810 |
| Southern Comfort | 2,400 | 2,285 | 2,185 | 2,155 | 2,130 | 2,120 |
| Finlandia | 2,120 | 1,845 | 1,725 | 1,280 | 1,190 | 925 |
| Canadian Mist | 2,035 | 2,115 | 2,150 | 2,315 | 2,375 | 2,375 |
| Bolla | 1,220 | 1,290 | 1,440 | 1,650 | 1,670 | 1,550 |
| Korbel Champagnes | 1,215 | 1,165 | 1,145 | 1,125 | 1,065 | 990 |

While it is easy to point to the 140-year Jack Daniel's brand – not mention the 136-year old Southern Comfort brand – and argue that the company is a one or two trick pony, Brown-Forman has not rested on its super-successful past. Rather, with the additions of global brands like Finlandia Vodka – which is primarily sold overseas - the company has been working diligently to embed itself into international markets. For example, 7% of BF's sales were international 20-years ago, 25% of sales were international 10-years ago, and 41% of sales were international in 2006.

While in some cases key acquisitions like Finlandia, Casa Herradura, and Chambord Liqueur are used to broaden the company's global reach, in other instances existing brands are doing the leg-work. For example, Jack – which is the number four premium spirit in the world – has already mapped out a heavy footprint in the UK (890K+ cases annually) and is also trotting swiftly into places like China (135K+ cases). 24 of Jack's Top 25 markets grew in 2006.

With BF's diverse spirits lineup and the ability to successfully acquire and integrate brands, the company has become a mid-sized global leader in premium spirits. And while some on Wall Street have questioned the takeover of Herradura, it should be remembered that one acquisition can make all the difference...In 1956 Brown-Forman purchased the then 90-year old brand Jack Daniel's for \$17 million.

Competition or Cartel?

With a mere \$8 billion market cap BF is tiny compared to giants like Diageo and Pernard Richard. To be sure, for every \$1.46 in net income that Diageo generates Brown-Forman generates \$1.00 *in revenues*. Given the size differential it is somewhat surprising that price isn't more of a factor in the marketplace. Should the regulators begin investigating a global price fixing scheme?

Not at all. Rather, what enables Brown-Forman to compete with larger players is, again, its diverse attack. On the one hand, the company fully understands that brands can be pulled into markets if consumers want them badly enough, and that in this type of dynamic price is not always the determinate factor of brand choice. And on the other hand BF has done well forming alliances with competitors to limit the scale advantage of the larger players. For example, Brown-Forman's 2002 cost-sharing agreement with Bacardi, which was recently renewed through 2012, allows both companies to reduce shipping costs and broaden the reach of their respective brands in the UK, while at the same time setting up a formidable front against the Diageos of the marketplace

First We Take Manhattan. Then We Take....?

Owning the number one whiskey in the world, Brown-Forman has an asset that has a distinct competitive advantage in the American marketplace. Quite frankly, this advantage shows up quarterly in the company's financial statements, and, on an intangible basis, in the image that is evoked when name Jack Daniel's is spoken. You cannot create a brand like Jack overnight, nor can you generate similar returns. Other whiskey producers follow the price of Jack Daniel's in America, which is perhaps the greatest compliment of all.

But with global expansion arrives the risk that key brands will require intensive investment to reach the competitive advantage overseas that is seen in America. Moreover, there is the risk that brands will simply not be accepted overseas. To date Brown-Forman has not encountered this problem, but as the acquisitions continue to pile up and new efforts to gain customers in untested markets proceed, uncertainty could creep into the equation.

The Lone Obstacle

With the above investment platform and business overview built, the moorings that threaten to weaken the story are as follows:

Brown-Forman is an expensive stock that will require extremely high rates of execution in the coming months/years to avoid a further correction in its stock price.

More specifically, Brown-Forman's recent \$876 million acquisition of Casa Herradura – which the company anticipates will be dilutive to earnings through fiscal 2009 – needs to be integrated on schedule and without inflicting lasting damage to the company's industry leading balance sheet. Since the deal has not officially closed, the company has not disclosed many of the financial estimates regarding the business (i.e. what will capex be next year after the Casa Herradura takeover?) The takeover was announced on August 28, 2006 and BF's stock price is down by more than 10% since that point.



Getting To Know Casa Herradura (from BF press release)

Casa Herradura, with approximately 1,100 employees, is the second oldest and third largest (behind Cuervo and Sauza) manufacturer of tequila, based in Guadalajara, Mexico. The company was founded in 1870 by Don Felinciano Romo and is still held privately by the Romo family.

Casa Herradura's tequila brands sell approximately 1.8 million nine-liter cases, with more than 80% of total volume sold in Mexico, with the remainder primarily in the United States.

Casa Herradura owns two primary tequila brands:

Tequila Herradura (pronounced Air a dura), which translates to "Horseshoe" in English; and

El Jimador (pronounced El He mah door), which is the term used to describe one who harvests the agave plant from which tequila is made.

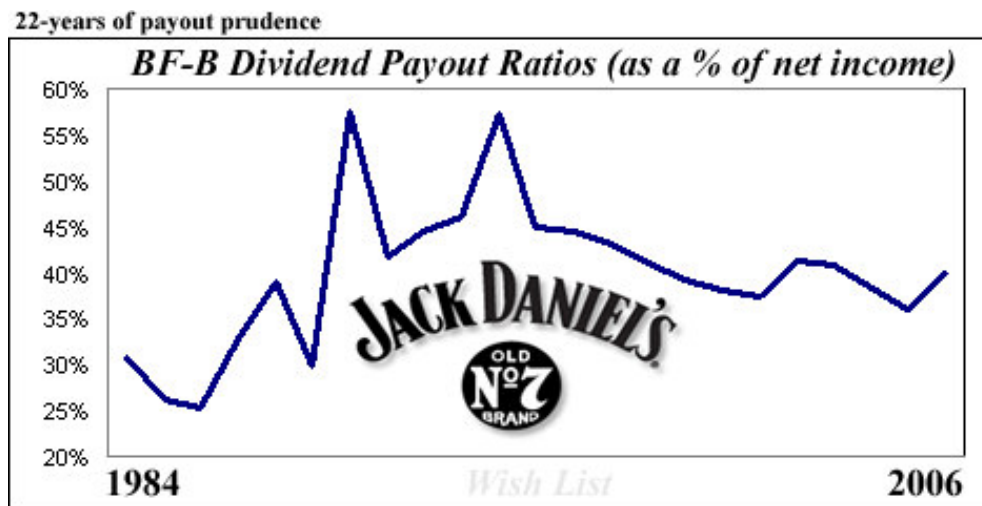
In the U.S., Herradura is positioned as a super-premium brand (approximate price of 750 ml bottle at retail is \$40) and El Jimador is positioned at the premium level (approximate price of 750 ml bottle at retail is \$20).

Valuations and Financials

While we do not consider BF shares to be necessarily ‘cheap’ at current prices, at less than 20-times earnings there is reason to believe that shares are not obscenely valued. After all, in each of the last 10-years Brown-Forman has traded above a P/E multiple of 20 for at least part of the year. Moreover, BF compares well with competitors, as some recent data excavated from S&P aptly demonstrates.

| S&P Statistics As of Dec 22, 06 | | | | 12-Mo. | 30-Day | | | | | |
|------------------------------------|-------|------|--------------|-----------------|-----------------|------|--------------|--------------------|----------|-------------------|
| Peer Group | SYM | \$ | P/E Ratio | Trailing EPS | Price Chg(%) | Beta | Yield (%) | Quality Ranking | ROE % | Pretax Margins |
| Brown-Forman Corp. | BF.B | 65.4 | 19 | 3.36 | -9% | 0.34 | 1.8 | A | 27.5 | 22.9 |
| Constellation Brands | STZ | 28.4 | 21 | 1.34 | 2% | 0.33 | Nil | B+ | 11 | 10.4 |
| Diageo plc | DEO | 78.4 | 16 | 4.79 | 3% | 0.16 | 2.9 | NR | 43.9 | 29.6 |
| MGP Ingredients | MGPI | 21.3 | 21 | 1.01 | -1% | 1.36 | 0.9 | B | 11 | 6.5 |
| Magnotta Winery | MGN.C | 2.11 | 11 | 0.19 | -4% | NA | Nil | NR | 10.8 | 17.9 |
| Vina Concha y Toro | VCO | 30.2 | 35 | 0.86 | -2% | 1.14 | 1 | NR | 11.5 | 11.2 |

As for BF’s 1.8% dividend yield compared to Diageo’s 2.9% yield, it should be noted that this has more to do with the company’s conservative focus. To be sure, if Brown-Forman’s payout ratio was as high as Diageo’s, BF would be yielding a comparative amount. Instead, BF, unlike DEO’s recent historical experiences, does not payout more in dividends than the business is taking in.



Which brings us to the balance sheet, which can be summed up by the giant ‘A’ under S&P’s quality ranking. Brown-Forman has, by many leaps and countless bounds, the cleanest and most consistent balance sheet in the business. Here it is in all its glory.

| BF-B (in millions \$) | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Cash and cash equivalents | 475 | 295 | 68 | 72 | 116 | 86 | 180 | 171 | 78 | 58 | 54 | 62 | 31 | 75 | 50 |
| Short-term investments | 160 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 18 | 17 |
| Accounts receivable, less... | 328 | 296 | 348 | 325 | 280 | 303 | 294 | 274 | 265 | 263 | 257 | 234 | 241 | 239 | 208 |
| Inventories: | | | | | | | | | | | | | | | |
| Barreled whiskey | 274 | 249 | 218 | 222 | 219 | 219 | 202 | 191 | 187 | 176 | 167 | 163 | 144 | 138 | 144 |
| Finished goods | 100 | 102 | 185 | 203 | 183 | 202 | 169 | 189 | 179 | 172 | 169 | 123 | 123 | 143 | 148 |
| Work in process | 107 | 81 | 111 | 112 | 121 | 113 | 94 | 89 | 88 | 66 | 59 | 59 | 60 | 57 | 29 |
| Raw materials and supplies | 42 | 38 | 43 | 48 | 58 | 49 | 49 | 56 | 48 | 37 | 38 | 37 | 31 | 28 | 31 |
| Total inventories | 523 | 470 | 557 | 585 | 581 | 583 | 514 | 525 | 502 | 451 | 433 | 382 | 358 | 365 | 352 |
| Current portion of deferred taxes | 81 | 70 | 67 | 56 | 31 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Current assets held for sale | 9 | 157 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other current assets | 34 | 27 | 43 | 30 | 24 | 28 | 32 | 29 | 24 | 30 | 24 | 20 | 20 | 23 | 24 |
| Total Current Assets | 1,610 | 1,315 | 1,083 | 1,068 | 1,032 | 1,000 | 1,020 | 999 | 869 | 802 | 768 | 698 | 650 | 720 | 651 |
| Property, plant, and equipment, net | 429 | 418 | 515 | 506 | 434 | 418 | 376 | 348 | 281 | 292 | 281 | 252 | 246 | 257 | 243 |
| Prepaid pension cost | 146 | 130 | 118 | 39 | 108 | 93 | 79 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Trademarks and brand names | 325 | 334 | 247 | 235 | 8 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Goodwill or Intangibles | 195 | 193 | 315 | 311 | 246 | 246 | 253 | 264 | 250 | 254 | 259 | 263 | 276 | 280 | 245 |
| Investment in Affiliates | 0 | 0 | 45 | 41 | 127 | 125 | 17 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Noncurrent assets held for sale | 1 | 218 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other assets | 22 | 41 | 53 | 64 | 61 | 57 | 57 | 124 | 94 | 80 | 73 | 73 | 62 | 54 | 54 |
| Total Assets | 2,728 | 2,649 | 2,376 | 2,264 | 2,016 | 1,939 | 1,802 | 1,735 | 1,494 | 1,428 | 1,381 | 1,286 | 1,234 | 1,311 | 1,194 |
| Current Debt | 569 | 638 | 369 | 548 | 495 | 538 | 513 | 510 | 382 | 399 | 303 | 286 | 281 | 210 | 214 |
| Total Debt | 1,165 | 1,339 | 1,281 | 1,424 | 705 | 752 | 754 | 818 | 677 | 698 | 747 | 740 | 770 | 493 | 459 |
| Shareholders' Equity | 1,563 | 1,310 | 1,095 | 840 | 1,311 | 1,187 | 1,048 | 917 | 817 | 730 | 634 | 546 | 464 | 818 | 735 |
| Equity per diluted Share | 12.76 | 10.75 | 9.01 | 6.22 | 9.57 | 8.66 | 7.64 | 6.67 | 5.92 | 5.29 | 4.59 | 3.96 | 2.95 | 4.95 | 4.67 |
| Tangible Equity | 1,043 | 783 | 533 | 294 | 1,057 | 941 | 795 | 653 | 567 | 476 | 375 | 283 | 188 | 538 | 490 |
| Debt/Equity | 0.75 | 1.02 | 1.17 | 1.70 | 0.54 | 0.63 | 0.72 | 0.89 | 0.83 | 0.96 | 1.18 | 1.36 | 1.66 | 0.60 | 0.62 |
| Working Capital | 1,041 | 677 | 714 | 520 | 537 | 462 | 507 | 489 | 487 | 403 | 465 | 412 | 369 | 510 | 437 |
| Current Ratio | 2.83 | 2.06 | 2.93 | 1.95 | 2.08 | 1.86 | 1.99 | 1.96 | 2.27 | 2.01 | 2.53 | 2.44 | 2.31 | 3.43 | 3.04 |
| Debt/Assets | 0.43 | 0.51 | 0.54 | 0.63 | 0.35 | 0.39 | 0.42 | 0.47 | 0.45 | 0.49 | 0.54 | 0.58 | 0.62 | 0.38 | 0.38 |
| Inventory Turnover | 0.61 | 0.66 | 0.46 | 0.41 | 0.39 | 0.40 | 0.42 | 0.38 | 0.37 | 0.37 | 0.37 | 0.39 | 0.36 | 0.43 | 0.41 |

Unfortunately, thanks to the acquisition of a 136-year old Mexican brand, Brown-Forman's balance sheet may be in for a period of pain. Specifically, the company is going to be padding its balance sheet with some debt to help cover the bulk of the acquisition costs.

Turning to cash flows, the company is steady and strong in an almost too good to be true way. As we await and/or try to coax the company to ship us pre-1984 documents, how many major slip-ups have there been in the annual cash flows? The answer is none.

| BFB (in millions \$) | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|--------------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Cash From Operations | 344 | 396 | 304 | 243 | 249 | 232 | 241 | 213 | 220 | 176 | 171 | 197 | 221 | 193 | 156 |
| Additions to PP&E | 52 | 45 | 39 | 119 | 71 | 96 | 78 | 46 | 44 | 55 | 59 | 51 | 27 | 34 | 52 |
| Computer software expenditures | 0 | 3 | 2 | 8 | 8 | 3 | | | | | | | | | |
| Proceeds from sale of PP&E | 7 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 3 | 3 | 10 | 2 | 2 | 3 |
| Dividends Paid | 128 | 111 | 97 | 99 | 94 | 87 | 83 | 79 | 76 | 73 | 71 | 67 | 74 | 72 | 65 |
| Free Cash Flow (CFO-Capex) | 292 | 348 | 263 | 116 | 170 | 133 | 163 | 167 | 176 | 121 | 112 | 146 | 194 | 159 | 104 |
| Payout ratio (compared to FCF) | 44% | 32% | 37% | 85% | 55% | 65% | 51% | 47% | 43% | 60% | 63% | 46% | 38% | 45% | 63% |

Conclusion and Investment Opinion

Casa Herradura. That is the question.

Unfortunately the investor is not yet armed with all the facts, except to say that it is unlikely Brown-Forman's management team has suddenly – after years of conservative and successful tenure – decided to start flushing money down the toilet.

We believe that the company will succeed over the long-term and that many on Wall Street have impatiently ran out of the stock because of the uncertainty that comes with a takeover that is dilutive to earnings. And while we are weary of valuations, we are not concerned should BF shares decline. We simply believe that, like Heinz last year, starting a position in BFB today makes sense. Moreover, we strongly believe that the investment horizon in Brown-Forman should be measured in decades rather than years.

In short, we are by no means calling for a bottom in the stock. But we are calling these types of numbers attractive.

| BF-B (company data) | 35 Year CAGR since 1971 | 25 Year CAGR since 1981 | 15 Year CAGR since 1991 | 10 Year CAGR since 1996 | 5 Year CAGR since 2001 | 3 Year CAGR since 2003 |
|------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|---------------------------|---------------------------|
| Gross Profit | 9% | 7% | 7% | 8% | 9% | 13% |
| Advertising | 10 | 7 | 8 | 8 | 8 | 12 |
| SG&A | 8 | 8 | 7 | 8 | 8 | 12 |
| Operating Income | 8 | 6 | 7 | 8 | 12 | 18 |
| EPS | 12 | 10 | 10 | 11 | 16 | 25 |

What is also attractive is that over the last three years the company's compound annual EPS growth rate has been **double** what it would have been if it had not been for the falling U.S. dollar. To reiterate, the kicker is that the company could be receptive to a weakening dollar.

| BF-B | Actual 3 Year CAGR | Excluding Currency impact 3 Year CAGR |
|------------------|-----------------------|---|
| Operating Income | 18% | 12% |
| EPS | 25% | 11% |

Sincerely,

Brady Willett
Todd Alway

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