Brown-Forman Corporation, Q3 2023, Earnings Call 2023-03-08

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Third Quarter and Year-to-Date Fiscal '23 Earnings Conference Call. — ***Operator Instructions*** —

Please be advised that today's conference is being recorded. And I would now like to hand the conference over to your speaker today, Ms. Sue Perram, Vice President and Director of Investor Relations. Ms. Perram. Please go ahead.

Susanne Perram

Thank you, and good morning, everyone. I would like to thank each of you for joining us today for Brown-Forman's Third Quarter and year-to-date fiscal 2023 earnings call. Joining me today are Lawson Whiting, President and Chief Executive Officer; and Leanne Cunningham, Executive Vice President and Chief Financial Officer. This morning's conference call contains forward-looking statements based on our current expectations.

Numerous risks and uncertainties may cause actual results to differ materially from those anticipated or projected in these statements. Many of the factors that will determine future results are beyond the company's ability to control or predict. You should not place undue reliance on any forward-looking statements, and except as required by law, the company undertakes no obligation to update any of these statements, whether due to new information, future events or otherwise. This morning, we issued a press release containing our results for the third quarter and 9 months ended January 31, 2023, in addition to posting presentation materials that Lawson and Leanne will walk through momentarily.

Both the release and the presentation can be found on our website under the section titled Investors, Events and Presentations. In the press release, we have listed a number of the risk factors that you should consider in conjunction with our forward-looking statements. Other significant risk factors are described in our Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission. During this call, we will be discussing certain non-GAAP financial measures. These measures, a reconciliation to the most directly comparable GAAP financial measures and the reasons management believes they provide useful information to investors regarding the company's financial condition and results of operations are contained in the press release and investor presentation. With that, I would like to turn the call over to Lawson.

Lawson Whiting

Thank you, Sue, and hello, everyone. I'm proud of the results that we're sharing with you today as we delivered strong organic performance for the first 9 months of fiscal 2023. Before I go into the details of our most recent results, I wanted to take a moment to step back and acknowledge that it has now been 3 full years since March of 2020, which for Brown-Forman and the world was the start of the COVID-19 pandemic. Since that time, we've experienced significant volatility and uncertainty while always remaining focused on the long-term health and growth of our portfolio of brands and our people.

Consider that during this 3-year time period, we added 2 new super premium brands in Gin Mare and Diplomático and we divested others. We just launched a major global initiative with Jack & Coke. We grew by more than 500 employees as we evolved our route-to-consumers in 5 markets, strengthened our integrated marketing communications capabilities and grew our emerging brands teams, among other changes.

And importantly, compared to the first 9 months of fiscal '20, we grew Jack Daniel's Tennessee Whiskey by 1.5 million cases in which we reserved by 500,000 cases even amid severe supply chain constraints. Through it all, we delivered what our investors have come to expect from Brown-Forman, consistent, reliable compounding of growth. If you follow Brown-Forman long enough, you know that we often speak not in quarters or years or even decades, we speak in generations. And I truly believe one of our greatest competitive advantages is this long-term perspective.

It allows us to demonstrate creativity and resilience in the face of constant change to execute on our strategic priorities and invest boldly behind our brands and our people. This focus has allowed us to deliver short-term results that are in line and recently even ahead of our historical growth rates while still investing in our business.

And it is this long-term focus that gives me confidence that as the world and our business begin to normalize, we will continue to deliver against our long-term growth algorithm, producing mid-single-digit organic top line growth and high single-digit organic operating income growth over the next decade. So regardless of how you look at our business through the lens of the last 3 months, the last 3 quarters, the last 3 years or the last 3 decades, I believe you will reach the same conclusion. Brown-Forman's business is strong. We are well positioned in the best categories and price points, and there's nothing better in the market than our talented people around the world.

Now turning the focus back to our year-to-date fiscal '23 net sales results. We delivered high single-digit top line growth on a reported basis and double-digit top line growth on an organic basis as the reported results were impacted by foreign exchange headwinds. Organic net sales growth in the first 9 months was driven by continued strong growth for Jack Daniel's Tennessee Whiskey in our international markets in the Travel Retail channel by Woodford Reserve in the U.S. and a strong performance in RTDs driven by Jack Daniel's RTDs in Australia and Germany, along with New Mix in Mexico. Jack Daniel's Tennessee Whiskey continued to be the largest driver of our top line performance here to date, delivering 12% organic net sales growth, driven by strong consumer demand, higher pricing and the rebuilding of distributor inventories.

Given the size of this brand and the fact that the brand delivered a 20% organic net sales increase in the year-ago period, this growth is particularly impressive. Consumer demand for Woodford Reserve also remained very strong, and we're significantly better positioned to meet this demand to supply constraints mainly related to glass have eased, and we increased our bottling capacity. This resulted in organic net sales growing 35% through the first 9 months of the year. There's been some exciting news in the past couple of months for Woodford Reserve, which I believe will continue to position the brand for future success. In January, we announced that Woodford Reserve entered into an agreement with Churchill Downs to renew Woodford as the presenting sponsor of the Kentucky Derby through 2027.

The extended partnership also includes Old Forester as the official mint julep for the Kentucky Derby, along with Finlandia and Herradura. Woodford Reserve also recently named Elizabeth McCall as Master Distiller, the third in the brand's 26-year history and the first female Master Distiller. She is the second generation of her family to work in the spirits industry following in our mother's footsteps.

Elizabeth builds on the legacy crafted by Chris Morris, who is taking on a Master Distiller, Emeritus role and has been instrumental in the growth of Woodford over the past 25 years. We're very thankful for Chris and Elizabeth and all they are doing to build a very promising future for Woodford Reserve. RTDs remain the third largest contributor to overall company growth, driven by the consumer trends of convenience and flavor. Jack Daniel's RTDs grew organic net sales 10% and New Mix delivered 41% organic net sales growth.

While on the topic of RTDs, I thought it would be interesting to take a look at one of the oldest and one of the newest brands in our RTD portfolio. First, Jack Daniel's Country Cocktails which we launched in the early 1990s. 2 years ago on this call, we announced that we are partnering with Pabst Brewing Company for the supply, sales and distribution of Jack Daniel's Country Cocktails within the United States. We believe that the partnership would provide tremendous growth potential for the brand with greater access to production and variety pack capabilities, along with Pabst distribution network which would provide more efficient access to new distribution channels.

I'm pleased to say that our beliefs were correct. Based on Nielsen at the beginning of February, Jack Daniel's Country Cocktails was the second fastest-growing flavored malt beverage in the United States, continuing to gain share and grow distribution. Jack Daniel's Country Cocktails is now a top 10 flavored malt beverage brand, and I want to thank both the Brown-Forman and Pabst teams for significantly accelerating the growth of this brand.

I also have immense gratitude for the teams at Brown-Forman and the Coca-Cola Company, who are working on our newest RTD, and that is, of course, Jack Daniel's and Coca-Cola. While we only have a couple of months of data from the distributors since the November launch in Cancun, Mexico, the early results are certainly very positive. They shared that the 9-liter case volume of the Jack Daniel's and Coca-Cola RTD significantly exceeded the volume of the Jack Dan's and cola RTD in the equivalent 2-month period a year ago. They reached the distribution target within days of launch, showing the excitement and enthusiasm from the retailers and the consumer repurchase rate is encouraging. The experiences and learnings from Cancun has helped to set the stage for a successful national launch across Mexico, which began in early February.

These learnings will also be shared with other markets that are launching soon, including the United States, a number of European markets as well as Japan. For these initial markets, cans are now rolling off the production lines and will be on retailer shelves in cold boxes in late March and early April. We're excited not only about the potential growth of this product, but also believe as we always have with RTDs that the Jack Daniel's and Coca-Cola RTD will have a positive impact on the [full strength] family of brands.

RTDs serve as consumer recruitment vehicle, bringing new consumers of legal drinking age into the Jack Daniel's family as well as a marketing vehicle visibly showcasing the trademark and what we often call cans and hands. The Jack Daniel's and Coca-Cola RTD launches will be supported by a new global advertising campaign, jointly funded by Brown-Forman and the Coca-Cola Company, which introduces the product and showcases the incredible attitude of these 2 iconic trademarks coming together in a single can.

We'll continue the product launch in additional European, Asian, African and Latin American markets throughout the calendar year 2023, and I look forward to sharing more in the upcoming quarters. While we're on the topic of product launches, I want to briefly provide an update on Jack Daniel's Bonded. Over the past 5 years, we've been working purposely to premiumize the Jack Daniel's family brands and elevate our whiskey credentials initially laying the foundation with specialty launches such as Jack Daniel's Single Barrel special release heritage barrel and Jack Daniel's 10-year-old Tennessee Whiskey.

Earlier this fiscal year, we introduced the first Jack Daniel's super-premium permanent line extensions in over 25 years with Jack Daniel's Bonded Tennessee whiskey and Jack Daniel's Triple mash whiskey. In just a few months, the new Bonded series received powerful and impactful claim from whiskey critics across the globe, including Jack Daniel's Bonded being named the 2022 Whiskey of the Year by Whiskey Advocate, the most coveted global accolade in the whiskey industry.

Like the Jack Daniel's and Coca-Cola RTDs, these new whiskeys give both long-term friends of Jack Daniel's and new friends, the opportunity to explore and discover within the Jack Daniel's family. While there is excitement and momentum in the whiskey and RTD categories, tequila remains an attractive and fast-growing category within total distilled spirits.

As we shared last quarter, after experiencing significant supply chain disruption to the first 3 months of fiscal ’23, glass supply for Herradura has continued to increase. We’re now better positioned to meet consumer demand and Herradura delivered a 9% increase in organic net sales in the first 9 months of fiscal ’23. We’re also seeing takeaway growth accelerate in the U.S. as distributor inventories are being rebuilt. And organic net sales for el Jimador increased 19%, driven by consumer demand and pricing growth, both in the U.S. and in Mexico.

In November, we launched Herradura Legend, a unique Añejo tequila that has matured and heavily charred, new American White Oak barrels, a process that’s unique in the category and one that leverages our barrel knowledge and expertise. As premiumization continues in the category, Legend is a permanent member of the Herradura portfolio that enables us to participate in the prestige price point segment.

On the topic of pricing, 2 years ago, we introduced our long-term pricing strategy for our portfolio of brands, which aims to increase prices consistently year after year and to grow net sales through a combination of both volume and value. Our organic net sales growth benefited from 3 points of favorable price mix in the first 9 months of fiscal ’23. This was driven by higher prices across much of our portfolio and was led by Jack Daniel’s Tennessee Whiskey. Based on the latest Nielsen data Brown-Forman’s pricing growth of nearly 3% is outpacing total distilled spirits of just over 2%. Our revenue growth management initiatives, which includes identifying pricing opportunities, not just in the U.S., but in every market, are a key part of our comprehensive focus on top line growth.

In summary, despite the volatility and uncertainty, disruptions and challenges, Brown-Forman continues to deliver against our long-term ambitions. Our long-term focus has allowed us to execute on our strategic priorities and invest in the momentum of our brands. This has produced strong organic results in the first 9 months of the fiscal year as well as over the last 3 years. So in closing, on this International Women's Day, I would like to acknowledge the women of Brown-Forman and thank them along with all of our very talented Brown-Forman employees around the globe for their commitment to our strategic priorities and our company values and their continued focus on delivering sustainable and consistent long-term growth day after day, year after year, generation after generation.

With that, I'll turn the call over to Leanne and she'll provide more details on our year-to-date results as well as our outlook for the remainder of fiscal '23.

Leanne Cunningham

Thank you, Lawson, and good morning, everyone. As Lawson reviewed the top line drivers from a portfolio perspective, for the first 9 months of fiscal 2023, I will provide a few additional details on the top line results as well as other items that drove our business results and our outlook for the fiscal year. First, as Lawson mentioned, for the 9 months of fiscal 2023, organic net sales increased 12% compared to the same period last year.

The growth was driven by a 9% increase in volumes, particularly for New Mix, Jack Daniel's Tennessee Whiskey and Jack Daniel's RTDs. We also gained 3% from price mix, reflecting higher prices across much of our portfolio, led by Jack Daniel's Tennessee Whiskey. From a geographic perspective, for the first 9 months of fiscal 2023, strong results were broad-based with organic net sales growth in each geographic cluster compared to the same period a year ago. Collectively, our emerging international markets continued to deliver very strong double-digit organic net sales growth, increasing 26%. This growth was led by Jack Daniel's Tennessee Whiskey, particularly in [Turkey] and Brazil, driven by improved product availability and supply chain disruption ease as well as increased pricing.

RTDs also contributed to growth with New Mix and Jack Daniel's RTDs growing strong double digits in Mexico, where we are gaining share in a growing category and increasing price. In addition, Jack Daniel's RTDs were launched in Brazil earlier this year and are off to a very strong start. This impressive growth includes the impact of the year-over-year declines in Russia as we suspended our commercial operations almost exactly 1 year ago in March of 2022.

Prior to this suspension, this market represented approximately 2% of our total reported net sales. Our developed international markets collectively delivered strong organic net sales growth, up 13% for the first 9 months. We continue to closely monitor the inflationary impact on consumer confidence and still have not observed signs of down trading. In fact, we have continued to increase price through our revenue growth management strategies as spirits remain an affordable luxury for consumers.

Jack Daniel's Tennessee Whiskey was the largest contributor to growth in these markets, driven by Germany, where Jack is gaining share within the whiskey category; Japan, which is benefiting from strong consumer demand with growth in both the on- and off-trade; Korea, as the consumer is continuing to shift to international whiskey brands. And Belgium, as you'll recall, Belgium transitioned to own distribution at the beginning of calendar 2022, we believe that own distribution transition can fuel share growth, strengthen our portfolio, unlock future potential and enable us to capture more of the value chain.

We are seeing that growth in Belgium as Jack Daniel's Tennessee Whiskey recently became the #1 whiskey brand in Belgium during the holiday season, achieving record market share in the month of December.

Australia and Germany continued to drive the growth of Jack Daniel's RTDs, leading to double-digit organic net sales growth, which represented the next largest contributor to growth. The RTD category is growing in these large important markets, and we are gaining share. Our emerging brands team in Europe continues to drive the growth of brands such as el Jimador, Woodford Reserve, Gentleman Jack and GlenDronach. Each brand delivered double-digit organic net sales growth, reflecting our strategic priority of increasing focus on our premium and super-premium portfolio.

Of course, Diplomático and Gin Mare are just getting started. We believe they will soon be a meaningful contributor to this emerging brands business. The U.S. business is beginning to normalize and delivered 4% organic net sales growth. As we have shared with you in the previous 3 quarters, the seasonality of our fiscal 2023 results have been impacted by the abnormal seasonality of the fiscal 2022 shipments due to supply chain disruptions. In the first half of fiscal 2022, distributor inventories did not increase ahead of the holiday season as is typical, and we experienced stronger shipments in the second half of fiscal 2022 as supply chain challenges began to ease.

As expected in the first half of 2023, distributor inventories continued to return to more normalized levels, which benefited the U.S. net sales growth rate by 7 points, as we are now beginning to lap the increase in shipments related to the rebuilding of our inventory position in the prior-year period, particularly for Jack Daniel's Tennessee Whiskey, we estimate the net change in distributor inventories reduced the net sales growth rate by 1 point for the first 9 months of the fiscal year. Woodford Reserve remained the largest contributor to organic net sales growth, driven by strong consumer demand and an increase in distributor inventories as glass supply and capacity constraints continue to ease.

Organic net sales also benefited from higher prices across the portfolio, led by the Jack Daniel's family of brands, though partially offset by lower volumes of Jack Daniel's Tennessee Whiskey as the brand lapped a strong prior year comparison. As you will recall, at this time last year, we shared that due to supply chain constraints, particularly for glass, we prioritize Jack Daniel's Tennessee Whiskey. This prioritization was reflected in the year-ago results as we met the strong consumer demand for the brand, particularly in the on-premise and focused on rebuilding inventory levels across the supply chain.

Korbel California Champagne is benefiting from higher pricing, though that benefit is being more than offset by lower volume. In the U.S., the gap between Nielsen takeaway and our actual results have narrowed considerably as we lap many of the factors that created the disconnect, such as the shift to the on-premise with its reopening along with the brand and market prioritization impacts from the supply-chain challenges.

Overall takeaway trends improved during the quarter as the industry began to normalize with total distilled spirits value growth in the mid-single digits, as we lap the impact of the supply-chain constraints that previously suppressed our performance, particularly for Jack Daniel's Tennessee Whiskey, Gentleman Jack and the Jack Daniel's Tennessee flavors, our takeaway performance is accelerating, and Brown-Forman has closed the gap with total distilled spirits for the first time in 2 years.

We continue to work to rebuild finished goods inventory levels across the 3-tiered system and believe that distributor inventory levels are starting to normalize. We are continuing to rebuild some brands and sizes but shipments and depletions are now largely in balance across our full-strength portfolio.

And finally, the Travel Retail channel continued its strong rebound as travel continued to rebound with the return of international airline travel and the cruise industry. Organic net sales grew 52%, led by higher volumes across much of our portfolio and our business has nearly returned to pre-COVID levels.

Now turning to gross profit. In the first 9 months of fiscal 2023, our reported gross profit increased 5% or 11% on an organic basis. For gross margin, headwinds more than offset our tailwinds, resulting in 170 basis points of contraction compared to the same period last year. Favorable price mix and the removal of the European Union and United Kingdom tariffs on American whiskey were more than offset by higher costs due to the impact of inflation on our input costs and supply-chain disruptions, largely related to global logistics constraints as well as the negative effect of foreign exchange.

Moving on to our operating expenses. Compared to the same prior year 9-month period, organic advertising expenses grew at a significantly higher rate than our top line growth, largely due to the timing of our increased marketing investment for Jack Daniel's Tennessee Whiskey, Woodford Reserve, the launch of Jack Daniel's Bonded and Herradura in the United States.

Organic SG&A investment increased double digits, driven primarily by higher compensation-related expenses and the investment behind our people as we return to in-person events and activities in support of our collaborative culture and relationship-based industry.

Our reported operating expenses were impacted by 2 items: a noncash impairment charge for the Finlandia brand name, largely due to macroeconomic conditions, including rising interest rates and increasing costs and certain post-closing costs and expenses in connection with the acquisition of Diplomático, largely driven by costs related to the termination of existing distribution contracts as we integrate the brands into our distribution partners.

In total, reported operating income decreased 13% and organic operating income grew 9% in the first 9 months of fiscal 2023.

These results, combined with a pension settlement charge resulted in a diluted EPS decrease of 16% to $1.20 per share. Lastly, to our fiscal 2023 outlook, our performance for the first 9 months of fiscal 2023 was strong with high single-digit reported and double-digit organic net sales growth, driven by strong consumer demand, higher pricing and the rebuilding of distributor inventories.

And while there were a number of items in the third quarter that negatively impacted our reported operating income results for the first 9 months of fiscal 2023, we delivered high single-digit organic operating income growth. As trends begin to normalize globally, we remain confident in the broad-based growth of our U.S. and international markets, along with the travel retail channel. While the global macroeconomic and geopolitical environment remains volatile and uncertain, we believe our business will remain resilient, reflecting strong consumer demand, the strength of our portfolio of brands, the continued execution of our pricing strategy and the return of inventory to more normalized levels.

For the full year, the effect of the estimated net change in distributor inventories could range from no impact to a moderate unfavorable impact on our results as we lap the significant inventory rebuilding during the fourth quarter of fiscal 2022.

Our guidance assumes no impact from an estimated net change in distributor inventories for the full year, and we now expect organic net sales growth in the range of 8% to 10%. As it relates to our fiscal 2023 cost, the inflationary environment increased input costs ahead of our expectations and supply chain disruptions, particularly transportation, logistics, and freight, while easing remain challenging. Additionally, we have noted the impact of foreign exchange on our reported results.

While the U.S. dollar has weakened from its peak in September, the U.S. dollar remained strong against many major currencies, most notably against the euro, Turkish lira, Pound Sterling and Polish zloty. As we continue to navigate these challenges and work to limit their impact, we expect the headwinds of inflation, supply chain disruption costs and foreign exchange to impact our full year results.

Partially offsetting these headwinds, we continue to expect pricing and the removal of the EU and U.K. tariffs on American whiskey to remain tailwinds for the full year. Based on these headwinds and tailwinds, we continue to expect full year reported gross margin to be consistent with the first half of fiscal 2023. We are reaffirming our expectations for operating expenses as we believe that investments in our brands and our people will drive strong long-term top and bottom line growth. As a reminder, since the time we were burdened with the EU and U.K. tariffs, we have long been committed to reinvesting a portion of the tariff relief back behind our brands once removed, which we were finally able to act upon in fiscal 2023, driving our brand investment at a rate above our top line growth, and we will also invest in our people to support our business needs in a more normalized environment.

Based on the above expectations and assuming no full year impact from the estimated net change in distributor inventories, we continue to anticipate high single-digit organic operating income growth.

We continue to expect our fiscal 2023 effective tax rate to be in the range of approximately 22% to 23%, and our capital expenditures are still planned to be in the range of $190 million to $210 million. In summary, we are pleased and proud of the strong results delivered for the first 9 months of fiscal 2023, with double-digit organic net sales growth that was broad-based across our portfolio and geographies.

And as expected, the seasonality of our fiscal 2023 results are being impacted by the abnormal seasonality of the fiscal 2022 shipments related to the supply chain disruptions. As trends are normalizing, we believe our business will remain resilient, reflecting the strength of our portfolio of brands and our talented people. We also believe our long-term perspective enables us to navigate the changes of our world and to deliver sustainable and consistent long-term performance. This concludes our prepared remarks. Please open the line for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Our first question will come from Vivien Azer of Cowen.

Vivien Azer

So I wanted to follow up on the commentary around the Jack and Coke strong start internationally. Is it possible to quantify that at all in terms of the contribution to country-level growth and/or the impact that it had on the broader Jack franchise? And then as a follow-up to that, can we talk a little bit about the expected investment spending for the U.S. launch as well?

Lawson Whiting

Yes, Vivien. A couple of things. One, as I think you know, the launch was really in Cancun over the last few months. It was not even across the entire country of Mexico. And so, the impact on this fiscal year is negligible, even probably within the country of Mexico would be negligible. So – but look, I mean, I think in Leanne's – on some of the comments that she made, it's off to a good start. We're pleased with the distribution. We're pleased with the consumer repurchase rates and everything. So everything is going sort of as planned or even maybe a little bit better than planned, but it's tough to extrapolate or see that impacting fiscal '23. Now fiscal '24, I mean, we haven't given any guidance yet on that, and we'll probably do that after – in the next quarter when we start talking a lot more about fiscal '24.

But I think it is worth pointing out a little bit about how this is going to work just so that you all understand how the model works. And I'll just use a couple of examples. We can use Mexico as probably a good starting point. The Coca-Cola Company has taken the lead and the business model is actually similar to how they work with their bottlers around the world. But instead of 2 players, there's 3 as we are part of that too. So the revenues, the costs, the brand expense, all of that will be reflected on the Coca-Cola Company's P&L, not on Brown-Forman's, we will be selling whiskey – bulk whiskey, almost the equivalent of concentrate in their terms. And so that's the revenue impact on us, but you're not going to see the full P&L impact in a country like Mexico. Turning to the U.S. If you look at the U.S., and it's going to be also similar for Germany and Australia, which are our 2 really big RTD markets, we're going to handle the manufacturing and the distribution.

And so U.S., Australia, Germany, you will see the revenues, the brand expense, the costs all in our P&L. So it's difficult when you try to consolidate the 2 to figure out how is that all total up because it really is going to depend on the balance of sales between all the different markets around the world. But 1 way or the other, we still feel pretty good about it. And we'll talk more about that, as I say, in the next quarter.

Leanne Cunningham

And then from an investment perspective, to answer the second part of your question, this is about, as often mentioned, you jointly being funded between Brown-Forman and the Coca-Cola Company and that joint advertising will also have a halo effect over the entire Jack Daniel's family of brands kind of as we think amplifying the trademark.

Operator

Our next question will come from Andrea Teixeira of JPMorgan.

Drew Levine

This is Drew Levine on for Andrea. So I wanted to ask on the gross margins. It doesn't seem like the cost headwinds really abated much at all. Although I think last quarter, there was a pretty sizable headwind due to mitigation efforts to get the product on shelf in addition to inflation, obviously. So could you talk about where you're seeing continued pressure on that cost line and how you see it evolving over the coming quarters? Because I would think most of those mitigation efforts were in the past, but maybe it doesn't appear. So any color there would be helpful.

Leanne Cunningham

Okay. And I'll take that in 2 parts. So where we are kind of year-to-date and then stepping back from our full year outlook. First, I think it's important that you'll recall our full year guidance, which is consistent in line with our first half of 2023. So it does imply improvement in the fourth quarter. For us, our normal seasonality of the fourth quarter generally has a positive impact on gross margin and we will have a benefit in lapping the foreign exchange impact that we had in the fourth quarter last year. Continue to say we're always fortunate with our premium and super premium portfolio of brands that can handle the pressure that we've been facing over these last quarters. So as you can see on Slide 7, we did contract 170 basis points, ending at 58.4%. That price mix positively impacted gross margin by 200 basis points due to price increases across our portfolio, led largely by Jack Daniel's Tennessee Whiskey.

Then we have the removal, a positive impact of the removal of the European Union and U.K. tariffs on American whiskey, which benefited our gross margin by 170 basis points. Specifically to your point on costs, our cost for the year-to-date was negatively impacted 430 basis points, and it's those 2 key drivers, which is the impact of inflation, which we are still seeing largely on most of our commodities. So some of that is beginning to ease. I'll speak to that in a moment. And then energy and fuel as well as for us in our third quarter, we still have November and December in our third quarter. So we were still experiencing expenses related to – costs related to supply chain disruptions and getting that product to the shelf, though we do see those beginning to ease with our inventories returning to a more normalized level.

And then I've already mentioned FX. It will be a headwind for the full year. It negatively impacted us year-to-date at 120 basis points, but we do see a bit of a benefit as we go into the fourth quarter. For our full year, one of the things we are seeing as it relates to the impact of inflation. When we plan this year, we planned it at a – for inflation to be higher than our average. And in reality, we know it's been well above that, really on our commodities and our energy and fuel. Three notable areas that we do see easing beginning to come, which is in the space of natural gas, specifically in the U.S., it is beginning to decrease significantly in Q4. And even as we look into our Q3 and even as we see into the early parts of Q4, it continues to step down.

It's still above the prior year level, but it is beginning to ease. Then I'll also note that with glass prices, though they continue to increase in conjunction with the commodities and the inflation on the commodities takes to build the glass, the significant decline in the U.S. natural gas prices will help moderate the expected increases as we enter F '24. And then lastly, as it relates to freight, we've been talking about freight, transportation, logistics, that from an equipment perspective, it will remain imbalanced and stress, but the cost of fuel has been one of the largest drivers of the transportation costs. And now with the cost of oil that has been volatile, we do see that diesel prices are now below their peak as well. So those are 3 early indicators, kind of some of the easing of the inflation that we have seen, that really is still yet ahead of us to come.

Operator

Our next question will come from Nadine Sarwat of Bernstein.

Nadine Sarwat

I want to stick to that gross margin point. So far, we've been talking about what you're seeing at the moment and going into this last quarter. Could you help us understand any of your expectations for gross margins on the medium term? I appreciate you might not want to give explicit guidance, but to the extent that you could give us the puts and takes about where you think you can be trending, including calling out maybe where agave prices are, that would be very helpful.

And then lastly, on your impairment, just a follow-up on the Finlandia brand. One of the reasons you called out were higher interest rates. I presume that would impact your entire portfolio when going through that exercise. So could you just give us a little bit more color about your expectations for this brand, in particular, how that's changed and the role you see it play in your portfolio going forward?

Leanne Cunningham

Okay. I will start on a bit more color on the midterm for cost. You're correct, and we're always excited this time of year to begin thinking about and talking about the next fiscal year, but next quarter is when we'll provide significantly more detail on that. I can say and with the commentary that we have is with our distributor and retailer inventories returning to a more normalized level, a significant portion of the cost that we have incurred related to the expedited shipments of our finished goods into the market, we believe that's going to significantly ease as we move forward. That's probably the best thing that I can say for that today.

To your comment on agave. Agave, we continue to be – we've talked about there is strong demand for the category, but we do see greater supply coming on. We are beyond our peak, but we have kind of stabilized around the MXN 28 to MXN 30 per kilo. And for us specifically, our demand has been very strong. So the balance between our internal and external sourcing is for us kind of one of the headwinds we had faced in this year. But again, we do see that supply coming on, and we'll talk more about that in the next quarter as what we think for the next fiscal year.

Lawson Whiting

And then on Finlandia, Nadine. So yes, that – look, a sizable impairment charge is not something that's fun, but obviously, I think you all know it's noncash. What happened was, it's a combination of things. It's the rising interest rates, meant the impairment testing, I mean, that quickly catches on the impairment testing front, and that's what – that's the major reason that we had to take a second impairment charge on Finlandia.

It's also feeling the pressure from higher cost – its input costs are higher. And then obviously, Russia and then not only Russia, but the countries that touch it all around there are all very, very weak. And so – it's just been a tough situation. As you all know, it is a regional brand for us. It's not really even sold in much of the world at this point in time anymore.

It's a very – it is an important brand in certain countries, particularly in Eastern Europe. So the suspension of the business in Russia was the biggest single factor that made it so difficult, but we're going to continue trying to improve the performance of the brand and continue to fight through what is a very difficult situation.

Operator

Our next question will come from Stephen Powers of Deutsche Bank.

Stephen Robert Powers

I just wanted to go back and maybe round out the gross margin conversation and the cost conversation. I think behind the commentary you gave around your cost pressures year-to-date and where you see things going was very helpful. But I guess, I'm left with the question of just trying to untie how much of what you've experienced and are experiencing is just a byproduct of general cost pressures kind of industry-wide, which I'm sure is the big part [of their] versus how much of what you've incurred maybe specific to Brown-Forman just based on the way your supply chain is configured and the reality is there or procurement timing, contracting realities. I'm just trying to understand how much maybe kind of more unique to you versus the industry. And if there are things that are more unique to you, just as there's any learnings there as you think about the medium to longer term about how you could maybe insulate yourself from some of that volatility, again, to the extent there is a company-specific element there.

Leanne Cunningham

Well, a few things have happened. And when you think about kind of the impact of inflation and supply chain disruption, generally speaking, 2/3, 1/3 – with the 2/3 being inflation, for us, I mean, I think we've experienced fairly globally the same from inflation. I mean our mix of commodities may be a bit different than other people's commodities, whether we're sourcing domestically in the United States or internationally, and our mix may be a bit different from others.

For us, I think we continue to have the opportunity where we have talked about for the last few quarters, and we have taken on some costs as it relates to risk mitigation to our supply chain that you have heard us talk about.

As we went through supply chain challenges related to glass, we were intentional about diversifying our supplier base that always comes at a bit of a cost. But again, we thought – we think and continue to think it will position us well for the future. Again, for the 1/3 related to the supply chain challenges, I've already talked to that. I think that we are moving beyond that as we return our inventories to more normal.

Again, one thing that might be a bit different from us is just percent of inventory we have of our business as an aged product that might be a little bit different than others, but we can probably dissect that at different day, but – what was the last part of your question?

Stephen Robert Powers

No, actually, I was okay on agave. I think there might have been a question earlier on just sort of what you're seeing on agave, if you've got any comments there.

Operator

Our next question will come from Filippo Falorni of Citibank.

Filippo Falorni

I was wondering if you can talk about the consumer trends that you're seeing across the world, particularly in terms of premiumization, whether you're seeing any slowdown. In your prepared remarks, you sound still optimistic about the premiumization trends. But on the margin, are you seeing any change in consumer behavior? And if you can comment on this topic for your key markets, looking about the U.S., Europe and some of your emerging markets.

Lawson Whiting

Yes, I'll talk a little bit about – I mean the consumer demand, I mean, look, it has still remained very, very strong, as you can see just in our top line figures. I think if you – there's the question around premiumization, which has been happening for 20 years, has been happening in our industry. If we go down to the U.S. market and look about premiumization, it really – premiumization trends spiked a lot during COVID.

They are returning to a little bit more of a normalcy. But if you look at TDS in the United States and you take a look at the breakdown by price point, you'll still see, I'll say, super-premium, ultra-premium growing at a higher rate than say a plain premium, but premium or something down in the standard category. So the story is still true that consumers are premiumizing their purchases and spirits, and that trend has – is still strong.

But if not – the differential between the 2 is not as strong as it was, I'll say, a couple of years ago. So I hope I explained that right. So you're still seeing the premium trends. It's just the delta between super premium and ultra and then the other price points [down low] has come down a little bit. I think a positive take out of all this, though, is our pricing strategy over the last couple of years, so we're through – essentially through 2 years of this, of low single-digit, but consistent regular pricing seems to be working pretty well.

We think we've got a nice balance between where consumers are willing to take the price increases, where retailers are willing to take the price increases and – we think it's the smart thing to do over the long term. And so we're going to continue that trend as much as we can. And so far, we have not seen an elasticity that would really make us, say, you know what, I'm not sure that's the right thing to do. We continue to [pull] forward, and I think we're getting a better balance between volume and pricing, which is something we very much want.

Filippo Falorni

Got it. Anything in particular you're seeing in Europe and emerging markets? Maybe if you can comment on those divisions?

Lawson Whiting

I mean not really. But I would caution, it's difficult to take our trends and extrapolate them to a broad read around the consumers around the world. And that has everything to do with the shipment comparisons that we're dealing with. So if we're only looking at our brands, the shipment comparison, the timing of glass availability, last year, and how we compare against this year sort of dominates our trends more so than what we would say is a read across the consumer moving around. So I know that doesn't really answer your question, but we're just sort of in a unique situation given the volatility that we've seen with glass.

Operator

Our next question will come from Kevin Grundy of Jefferies.

Kevin Grundy

I thought it'd be useful and we spent a little bit of time on U.S. business, so down 10% year-over-year in the quarter, understanding the dynamics around inventory is difficult year-over-year comp. Just a few questions here. Just comment, if you wouldn't mind, how the

U.S. business came in relative to your own expectations, understanding you certainly run the business longer term, I think we can appreciate that. But from a quarterly perspective, how it came in.

Leanne, you also made comments about normalization of inventory levels. I'm assuming that, that commentary sort of holds for U.S. as well. But if you could just confirm that. And then lastly, just from a consumer demand perspective, maybe just touch on retail takeaway and depletions in the quarter, specifically for the U.S. and then expectations here as we look out in the intermediate term. So that would be helpful.

Lawson Whiting

All right. Kevin, I'll start it, and then Leanne, you can add on if you want to. Look, it is – the U.S. market is beginning to normalize. I think we've said that a couple of times, but it's normalizing on a higher base for sure compared to where we were a few years ago. But if you look at TDS right now, it's trending back to the mid-single-digit range, which was where it was for many of the years pre-COVID.

So now we delivered 4% in the first 9 months of the year. That was essentially expected. I mean we were plus 11% through the first half. And so we knew a slowdown was coming, and it did – it fare that way out. It essentially came in relatively close to where we thought. And there is another big factor in this Q3 number for the U.S. And that's – if you go back to last year, just looking at Jack Daniel's Tennessee Whiskey in the third quarter of fiscal '22, we were plus 35. So that is a huge number to compare against.

And that's because that's – this – we're back to the same glass availability topic, where the glass became available in the third quarter. We prioritized Jack over the rest of our portfolio as the on-premise was also opening, and it just was a massive quarter.

And so that comparison had a big impact. If you step back and look at Nielsen or NABCA, you can get a much more sort of normalized rate of growth these days. And that would tell us the U.S. market for us is in that 6% range. I think TDS is 5% to 6%, somewhere right around there. And the NABCA numbers are actually even a little bit higher than that. And so we feel pretty good that maybe if it has returned to normal, but normal is still pretty good for the U.S. market.

And certainly, we're seeing stronger rates of growth outside of the United States. So I think it's also worth pointing out, at least within our own performance, we're doing a little bit better than TDS, which is something that's a goal that we always have out there. And to be ahead of both Nielsen and NABCA with it – honestly, it's been a while since we were above it. Once again, a lot of that because of the glass, but it's nice for our teams to know that they're back ahead of TDS.

Leanne Cunningham

And then I'll just add 2 things. If you – all the way back to when we originally planned this fiscal year, you'll recall that we planned for the beginning of normalization with an outlook, a top line organic outlook at mid-single digits, which aligns with our long-term algorithm. That included us cycling the largest impact of the pandemic and also the absence of our Russia business. So as we've gone through, again, all of the prioritization and the strong shipments; in our first half, we had a 5-point benefit year-over-year due to that effort.

Now that we're beginning to lap that very strong comparison of our rebuilding the inventory against the prior year and our markets around the world are beginning to normalize, we have a benefit of 2 points. So I think that's worth noting. And then the other thing, I would say, is in the prepared remarks, we talked about the U.S. business inventory being back in line and at a normal level.

At the enterprise level, we continue to make significant progress. We continue to see a net increase in distributor inventories. At the same time, it's still having the strong consumer demand. But we still believe, as we said last quarter that by the end of this fiscal year, we would kind of be back at, from the enterprise perspective, a more pretty much normal historical levels of inventory.

Operator

Our next question will come from Brett Cooper of Consumer Edge Research.

Brett Cooper

Question for you on distribution or route-to-market. In the U.S., one of your competitors move to beer distributors, United States. Outside the U.S., we're seeing distillers testing alternative routes-to-market whether that be through the Coke bottling network or selling through brewers. And with your business building a relationship with the beer distributors in the U.S., Coke network outside of the U.S., I was wondering if you could speak to or assess your route-to-market potential for changes, and if there's an opportunity to supplement your current efforts?

Lawson Whiting

Well, I'll speak to a little bit at least about the U.S. changes throughout the market. I mean – we are using [Rye] out in California for our launching a Jack and Coke, so that's something that is quite a bit different. But we're still very much in partnership with Breakthru and RNDC for the most – as our largest 2 partners in the U.S. And that business, as you can see through the numbers, it remains pretty strong.

We also made the change 2 years ago with past – I think, it was what it was. That was all about getting with a distributor partner that was able to reach all these points of retailers that are able to sell malt products which is Jack Daniel's Country Cocktails and that has been an enormous benefit to that brand. And so I think our – we are testing different models in the United States. When you leave the U.S., it's very different. That story has all been about us sort of forward integrating and being responsible for our own route-to-market.

And we've – and we say, 5 markets in the last 2 years, something like that. So we continue to be pretty agile and try to mix it up and try different changes or different models and different partnerships. And I think overall, that's had a pretty healthy impact on our business, really not even over the last year, but over the last decade or so, it's been a pretty meaningful impact.

Operator

Our next question will come from Lauren Lieberman of Barclays.

Lauren Lieberman

I wanted to ask a sort of backward-looking question, but [in forming] the forward. And just that in hindsight, it maybe seems like you had greater supply chain issues or glass constraints than some of your peers in the industry. And I just say that based on – as you've talked through reasons for the gap between your performance in TDS previously and that now kind of catching up. So just looking backwards to look forward, are there changes you're making in terms of supply chain, relationships with suppliers, et cetera, or the way that you manage inventory in-house thoughts and with distributors to make sure that you're not in that position again.

Leanne Cunningham

Well, we can start with – in comparison to TDS, again, we've talked many times, and again, around how we were impacted and then how we prioritize our brands of how – based of the opportunities that were available at the time. So with the glass supply capacity that we had, we wanted to prioritize Jack Daniel's Tennessee Whiskey with the reopening of the on-premise. Quickly thereafter, we prioritize Woodford Reserve to have that brand available. And so as we went through that prioritization, it – as Lawson has said many times, it's made it very, very hard to compare our results and our takeaway trends compared to TDS.

Now what we have done is, again, you've heard me talk about, we have done a few things on the supply chain side of our business. We have invested in new technologies to give us greater visibility. And we are implementing new processes. I think, Lauren, when we were together, we talked about actually new processes related to forecasting and planning demand. And then from a cost perspective, we've also incurred some costs to diversify our supply chain, specifically around glass supply. But then we've also brought in new tools and learned new ways of expediting our products to market when and where that's needed.

Lawson Whiting

Yes. I mean I think we've said this on some prior calls, too, but we were nearly 100% with 1 partner for glass supply. And when you talk about Jack Daniel's and Woodford, you're looking at a U.S. supplier of glass for the world. And when that 1 supplier began to really struggle, it impacted us greatly, and we didn't have anywhere else to turn. And so – it has taken – it's been about a year since we, in earnest, found some other partners. And so we are diversifying. We're still heavily reliant on that 1 supplier. But we're trying to diversify a bit. So once again, so we don't get caught in this again, although I must say, we were with that same supplier for 100 years and not had any problems before that. So it was very much a COVID-driven crazy volatile world that caused a lot of these problems.

Operator

Thank you. This is all the time we have allotted for questions. I will now turn the conference back to Sue Perram for closing remarks.

Susanne Perram

Well, thank you. And thank you, Lawson and Leanne, and thank you to everyone for joining us today for Brown-Forman's Third Quarter and year-to-date fiscal 2023 earnings call. If you have any additional questions, please contact us. On this International Women's Day, we hope you will join us in celebrating the women of Brown-Forman and women all around the world. With that, this concludes our call.

Operator

This does conclude today's conference call. Thank you all for participating. You may now disconnect and have a pleasant day.